

White Paper: The Quality Difference

How AM Best Adds Value to Insurance Data and Information

Insurance industry financial data is used to analyze companies, develop business strategies, compare competitors and understand the insurance industry.

Data about insurance organizations can be found in many places:

- In published regulatory filings containing statutory data;
- In insurers' annual reports;
- On insurers' websites and in their business offices;
- Through state and national regulatory offices and websites; and
- Through data vendors and organizations that distribute insurance information.

Financial data taken directly from insurer statements can be used to analyze and compare insurance companies, or to monitor conditions and trends for the entire insurance industry.

But "as-reported" data has its limitations. Used in isolation, this raw data may fall short in several respects:

- The data may contain undetected errors, omissions or inconsistencies;
- Simple aggregation of individual company data to a "group" or "pool" level may overstate the results due to "double counting";
- Performance trends may not reflect changes in group composition over time; and
- Variations in company organization and structure that impact performance standards are not apparent from data alone.

To be more useful, insurance data can be subjected to additional steps that add quality and value through:

- Additional cross-checking and inspection to identify and repair causes of cross-check failures such as errors, omissions or inconsistencies;
- Consolidation of individual company data to a "group" level without overstating the results due to "double counting";
- "As-Is" restructuring of "group" data to clarify changes over a period of time; and
- Characterizing and categorizing companies by means of attributes.

Think of this as being similar to the transformation of iron into stainless steel through controlled processes and metallurgy. AM Best transforms raw, as-reported data into a better resource for analysis. This conversion takes knowledge, experience and skill.

The Quality Advantage of Value-Added Data

As-filed, as-reported data can be useful in:

- Obtaining selected financial details about one insurance company at one point in time;
- Verifying insurance company top management information; and
- Determining whether a company has filed required regulatory information.

Beyond these limited uses, however, using as-reported data may be risky. How can we make up for its shortcomings and even add value to it?

1 Each company is given a distinct and consistent identity: Every company in the AM Best database is assigned a unique AM Best company number. That number stays with the data and survives whether a company is spun off or sold, becomes inactive, merges or moves to another domicile. It makes it possible to track results across multiple generations of ownership, regardless of a company's status or where it's now located.

Without a frame of reference, comparisons among insurance companies have little value. That frame of

reference is provided by AM Best's proprietary system of assigning additional composite numbers reflecting industry groups and totals. These numbers gather results from companies with similar characteristics so that they can be compared and their results can be consolidated and aggregated.

Bottom Line: Unique AM Best-assigned numbers allow users to track companies across a variety of changes, and to compare companies with peers and industry statistics.

2 Consolidated results: Analyzing insurance financial information is complicated by variations or differences in ownership arrangements. Insurance organizations may be owned in several ways:

- as a stand-alone single company;
- as a unit of a holding company;
- by an organization that operates as an insurance group; or
- partly owned by another insurance or non-insurance organization.

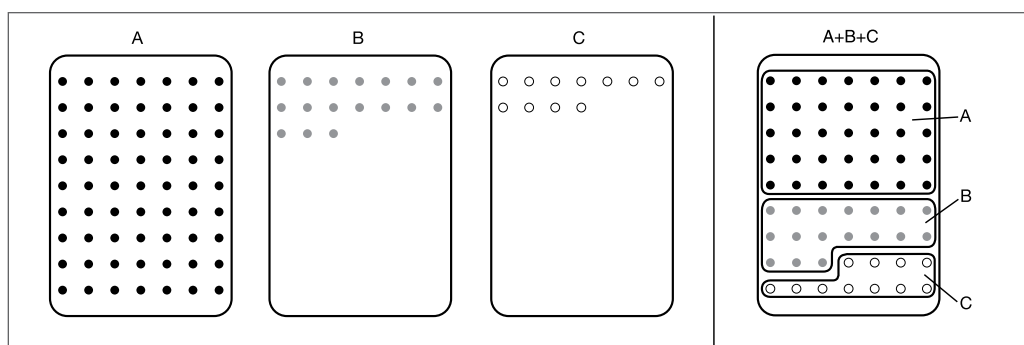
Regardless of the actual ownership, many insurance companies operate as a "group" or "pool," with centralized management and common financial arrangements with other companies. In the process of rating companies, AM Best must look at both the ownership structure, which deals with relationships, and the operating structure, which deals with the performance of the company.

Every insurance company must file its own regulatory information in the US state or territory in which it is domiciled. That means that units of a multi-unit organization may file the same information, some of which applies to the entire group, in multiple domiciles. Taken as stand-alone documents, each filing may be technically correct. Adding the contents of those documents together produces an "aggregated" result, but the aggregated total can exceed the true sum of all the parts. Some of the financial data can be double-counted because a company may include assets or other financial elements also reported by a subsidiary.

It's as if a company manufacturing widgets took an inventory of all facilities at various times and did not adjust the results to account for amounts from individual warehouse and distribution centers that were also reported in the headquarters figures.

To correct this problem, AM Best data analysts developed their own "consolidation" process. They begin with a portion of the financial statement called Schedule Y, which charts a company's relationship to other companies in group or pooling arrangements. Then they review supplemental documents from the companies and the analysts' own interactions with the companies to identify multiple reporting of the data and to accurately allocate elements that are reported by multiple individual units. Additional information is obtained from the Supplemental Rating Questionnaire, which is sent to each company by AM Best. Financials of the parent are always checked against member units.

The consolidation process defines "eliminations" that must be made to the total to remove the extra contributions due to interownership. AM Best eliminations include the carry-at value of the subsidiary that is reported in the parent company's balance sheet. Beyond the balance sheet, we also create intercompany ownership eliminations for items that impact the statement of income such as dividends to stockholders, net investment income, capital and surplus paid in, unrealized capital gains and, occasionally, realized capital gains.



▲ Exhibit 2 Consolidation of data eliminates multiple filing data and "double-counting."

Through the consolidation process, double-counting is eliminated and results are adjusted to show real-world results. While aggregation describes the simple addition of all the parts, consolidation adds the parts, but also subtracts the double-counting to get a true total.

The consolidation process can even be used for analytical purposes to create other “what-if” group structures to ascertain what the resulting “group” structure’s financial performance would look like. This powerful technique is sometimes used to analyze a potential merger or divestiture of companies into/from groups.

We combine hundreds of property/casualty, life, health, and life & health groups on a consolidated basis.

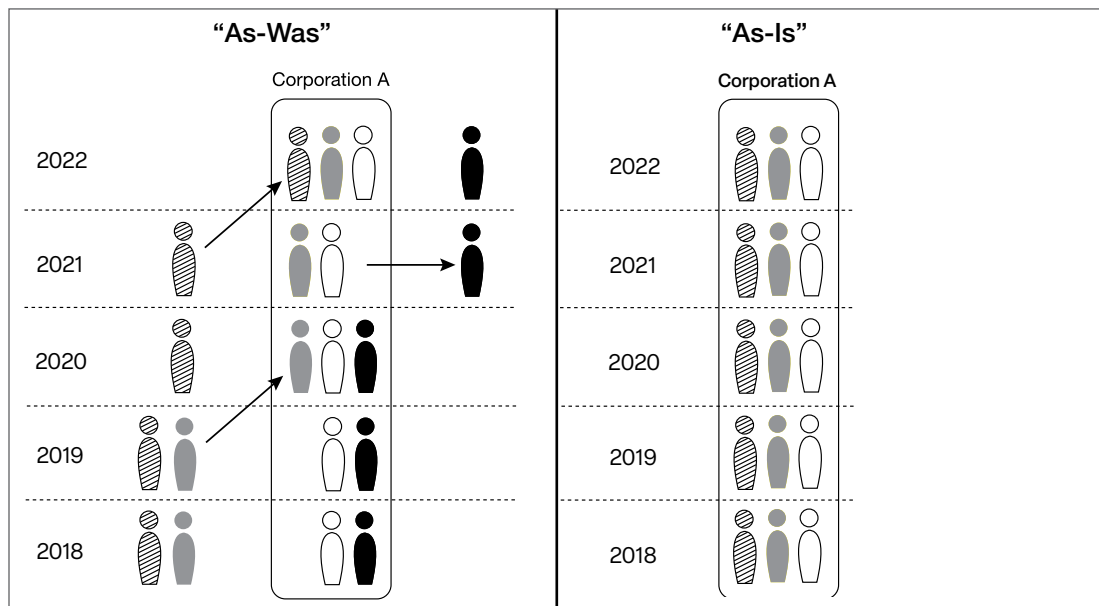
Bottom Line: Analyzing multi-company insurance organizations based on source data alone, without the benefits of expert consolidation, can unknowingly lead to overstatement of the figures.

3 Information can be more meaningful when stated in current terms: Projecting how an insurance entity will perform over time often involves looking at that entity’s past results and seeing how the results are trending. But in the case of an insurance group, results from five years ago, or two years ago, or even the previous year may have little bearing on how that group may be expected to perform in the future.

Why? Because the composition of an insurance group can change dramatically over time. Comparing multi-year results of an insurance group that one year has a dozen members, the previous year had 10 members and two years prior had nine will not produce meaningful insight. It’s comparable to trying to predict how a sports team will perform in a given year based on past performance when the players on the team have changed to the point that the team that was fielded five years ago in essence no longer exists.

To adjust for this, AM Best data analysts bring each year’s results up to date to reflect current ownership and business structure. It’s called “As-Is” information.

In this global and diversified environment, insurance companies commence or shut down operations, change names, sell off products/entities and merge with other insurance groups. Analyzing and comparing these changing companies can be daunting and complex. There are two ways to look at the data resulting from these changes:



▲ Exhibit 3a “As-Is” data reflects a company’s current structure projected backward in time.

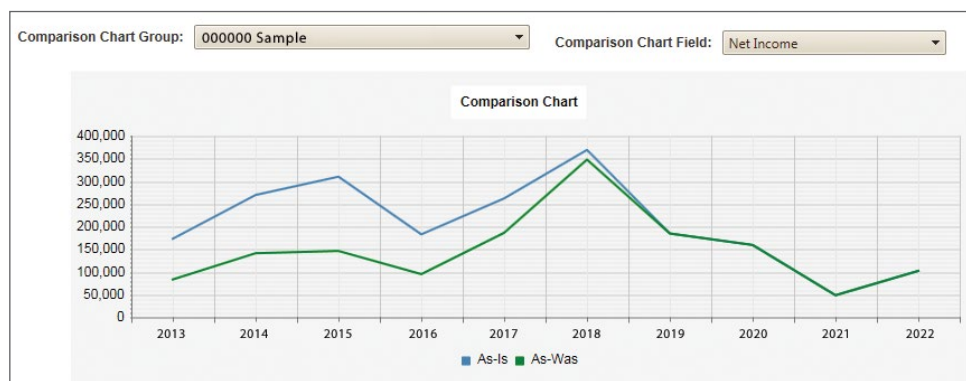
- I. “As-Is” analysis involves consolidating back-year data using the current year’s organizational structure. AM Best analysts study the structure of each insurance organization, and then update the results based on the current ownership. Therefore, prior-year data from units acquired, sold, closed or opened is

incorporated or deleted from the results as if the current structure had existed over the past 11 years. This is the standard presentation AM Best uses for data, as it can provide a more meaningful perspective on a group's performance over the period of evaluation.

- II. "As-Was" analysis displays the data and organizational structures as originally filed at the end of each of the past 11 years. This data format provides a true picture of how each company/group existed at the end of each year. We offer "As-Was" data with select financial database products, so customers can perform historical research.

Comparing these two data sets side-by-side for consolidated data records provides the ability to analyze the financial performance of the group based on the current structure ("As-Is") versus the actual results using the "As-Was" structure. See the sample Key Trending chart below.

Bottom Line: Using "As-Is" consolidated data can provide a more meaningful perspective on a group's performance over the period of the evaluation (from five to 11 years, depending on the kind of data).



▲ Exhibit 3b The Key Trending Report Comparison Chart shows "As-Is" versus "As-Was" data for Net Income.

4 Attributes can be used to characterize and categorize companies: The insurance business is not a one-size-fits-all industry. There are many differences in the way companies are structured, how they are owned and operated, and how they sell their products. Comparing two or more companies without taking these differences into account is like comparing apples to oranges.

AM Best has established several attributes that characterize and categorize companies in meaningful ways beyond simple property/casualty or life/health distinctions. Some of these attributes are used to create industry totals for companies that belong to a subset of the population based on the values of these attributes. Attributes can also be used to screen the industry to collect companies that have the same attribute values. Among these attributes are:

- Marketing Type;
- Organization Type;
- Business Type;
- State or Province, Country of Domicile;
- Lead Company Indicator;
- Aggregation Code; and
- Business Status.

Bottom Line: The attributes AM Best assigns characterize companies and make it easier to work with the data. Without these attributes, differences in the ways companies operate may render comparative analysis unreliable.

5 Cross-checking: Insurance companies file their financial data by means of a set of forms developed by the National Association of Insurance Commissioners (NAIC), typically called the "convention statement" or "statement blank." This statutory statement may consist of hundreds of pages with thousands of individual data fields and includes scores of separate exhibits and schedules, each detailing specific areas of insurer operations.

Insurers can file financial information using several methods, including:

- electronically;
- printed on prescribed forms; or even
- by completing forms manually.

Most insurers file their data via software that automatically catches most errors and inconsistencies. *BestESP*[®], AM Best's electronic statement preparation application, for example, includes hundreds of AM Best-designed cross-checks in addition to those required by the NAIC.

While all software packages must implement the required cross-checks, they still differ in other cross-checking features. Even within a company or group of companies, all exhibits may not be completed by the same person or team; even financial professionals may disagree on how to categorize or report certain financial information. As a result, it is possible to file inconsistent information.

Because AM Best requires data to be consistent and of the best quality in order to determine a Best's Credit Rating, AM Best analysts have developed and utilized hundreds of automated cross-checking calculations and manual "spot-checks." These tests subject thousands of fields to consistency testing. Each year, AM Best data analysts discover inconsistencies, errors and omissions, such as:

- incorrect classifications;
- data elements that don't agree with data on another exhibit;
- data that fails the required filing cross-checks in statement preparation software;
- missing data elements;
- missing exhibits, and more.

Simple errors or omissions might be rectified directly by AM Best's data analysts. More significant errors and inconsistencies are reported to the source company, and updated information is requested.

Our data comes from a wide range of sources, and we have resources dedicated to obtaining and improving the data. In many cases, value-added data is received, cross-checked and made available to customers within 48 hours of filing (timing varies based on factors including country of domicile, date of filing, filing method, etc.).

Bottom Line: Users who rely on data from source filings or from vendors who do not stringently cross-check may not benefit from AM Best's improvements to the as-filed data.

It All Begins at the Source

AM Best has a long history of collecting and analyzing insurer financial data. We continually maintain and expand our extensive database, which includes data for close to 100% of all premium volume reported by insurance companies. Our expertise in this area has kept pace with developments in filing requirements and technology:

- AM Best helped develop many of the processes and specifications now incorporated into national filing standards; our data team has participated in the national standards-development process.
- AM Best was one of the pioneers of electronic statement filing—in fact, the scope of our guidelines related to the cross-checking calculations in *BestESP*, AM Best's statement filing application, is more comprehensive than regulatory guideline requirements.
- AM Best was one of the first organizations to begin helping insurers to file their statements online.

For many decades AM Best staffers have collected physical statements and entered them by hand into our database. To a small degree that process continues today. That's because some insurers are not required to file, and health insurers in some jurisdictions are not covered by national filing standards. Each year AM Best's staff must key in, and sometimes interpret, these non-electronic filings and verify filing documents and supplemental information not collected in the electronic filing process.

Bottom Line: Relying on AM Best, a provider that has many decades of experience in processing and cross-checking data for its own stringent requirements, assures that you will have the highest-quality data prepared with a focus on consistency and accuracy.

Putting This Knowledge to Use

The business benefits of this rigorous data-cleansing, consolidation, restructuring and categorizing process are a strong element in the Best's Credit Rating process and are available in all of AM Best's publications and information products. This information is reflected in products and services such as:

- *Best's Insurance Reports*®
- *Best's Aggregates & Averages*
- *Best's Financial Suite*, including data products that consolidate the various schedules and exhibits
- *Best's Credit Reports*
- *Best's Financial Reports*
- *Best's Alert Service*
- Customized data studies including information available in "As-Was" format—in other words, as it was originally filed

We make the data behind Best's Credit Ratings available to customers of many key products, providing a more complete understanding of the rating process.

We Have a Vested Interest in the Quality of This Information

Unlike nearly every other data provider, we live each day with the business benefits of our data-improvement process. This high-quality insurance information is the basis for:

- The analysis that creates our *Best's Credit Reports* and Best's Credit Ratings
- The financial exhibits in our publications, including *Best's Insurance Reports* and *Best's Aggregates & Averages*
- The *Best's Rankings* and *Best's Special Reports* we publish online throughout the year
- The exhibits and information included in our news products, including *Best's Review*® and *Best's News & Research Service*

Bottom Line: Providing data that is improved through our value-adding techniques is crucial to fulfilling our mission and vision. Our mission is to provide timely, accurate, comprehensive and insightful information to anyone interested in the creditworthiness of insurance companies and insurance-linked securities. Our vision is to be the world's most recognized, accepted and respected full-service credit rating agency, news publisher and data analytics provider specializing in the insurance industry.

AM Best offers industry composites of aggregated results:**Property/Casualty Composite Listings**

Accident & Health	Private Passenger Non-Standard	Total US P/C Industry
Commercial Automobile	Auto	Total US P/C Agency
Commercial Casualty	Private Passenger Standard	Total US P/C Direct
Commercial Property	Automobile	Total US P/C Lloyd's
Credit	Private Passenger Standard	Total US P/C Mutual
Fidelity & Surety	Automobile & Homeowners	Total US P/C Reciprocal
Financial Guaranty	Reinsurance	Total US P/C Risk Retention Groups
Medical Professional Liability	Surplus Lines	Total US P/C State Fund
Mortgage Guaranty	Warranty	Total US P/C Stock
Personal Property	Workers' Compensation	

Life Composite Listings

Credit Life and Accident & Health	Individual Life	Total US L/H Mutual Companies
Group Accident & Health	Multiple Lines	Total US L/H Non-Profit Companies
Group Annuity	Reinsurers	Total US L/H Stock Companies
Group Life	Total US L/H Industry	
Individual Accident & Health	Total US L/H Fraternal Companies	
Individual Annuity	Total US L/H - Excl. Fraternal	

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