Ratings Review
September 23, 2024

Asia-Pacific Benchmarking: Positive Signs While Navigating Climate and Geopolitical Uncertainty

Favorable rating changes were driven by improvements to balance sheet strength and operating performance

Principal Takeaways

- Issuer credit rating upgrades exceeded downgrades for Asia-Pacific (re)insurers in 2023.
- More than 80% of APAC rating units have a Best's Capital Adequacy Ratio assessment of Strongest.
- Asia experienced a number of natural disasters in 2023, leading to significant insurance claims payouts, underscoring the importance of catastrophe risk management and re)insurance coverage.

This report evaluates companies in the Asia-Pacific (APAC) region that are rated by AM Best and details the rating actions that took place in 2023. It considers AM Best's broad geographical rating coverage across most rated (re)insurance groups in Asia and Oceania. The types of companies rated, operating in both mature and emerging markets, are diverse and include reinsurers, insurers, mutuals, captives, credit and health insurers, takaful operators, and protection and indemnity (P&I) clubs. Australia, Hong Kong, Japan, Macau, New Zealand, Singapore, South Korea, and Taiwan are the mature markets in APAC.

Ratings Distribution More Dispersed in Emerging Markets

An AM Best Issuer Credit Rating (ICR) is an independent opinion of an entity's ability to meet its ongoing financial obligations. As of December 31, 2023, more than 75% of AM Best's ICRs for APAC rating units were a- or higher, with mature markets skewing more favourably than emerging markets (**Exhibit 1**).

During the year, 10 new ratings were assigned and 10 were withdrawn. In mature markets, issuer credit ratings were clustered in the "a" and "a-" categories, while in emerging markets, where country risk often plays an important role in determining the overall rating assessment, the ICRs ranged more widely, from "a" to "bbb". Almost 20% of the ICRs in APAC were for companies in emerging markets, with ratings of "a-" or higher. Most (re)insurance groups at the lower end of the rating scale are domiciled in countries characterised by elevated levels of economic, political, and financial system risks.

The majority of favourable ICR changes were driven by improvements to balance sheet strength (**Exhibit 2**). For one company whose rating was upgraded, all four building blocks changed as a result of its becoming a member of the lead rating unit. Pressure owing to weakened balance sheets generally drove downgrades in 2023.

The outlooks for the vast majority of rating units (87%) were Stable as of year-end 2023, with a larger proportion of Stable outlooks for mature markets (91%) than emerging markets (82%)

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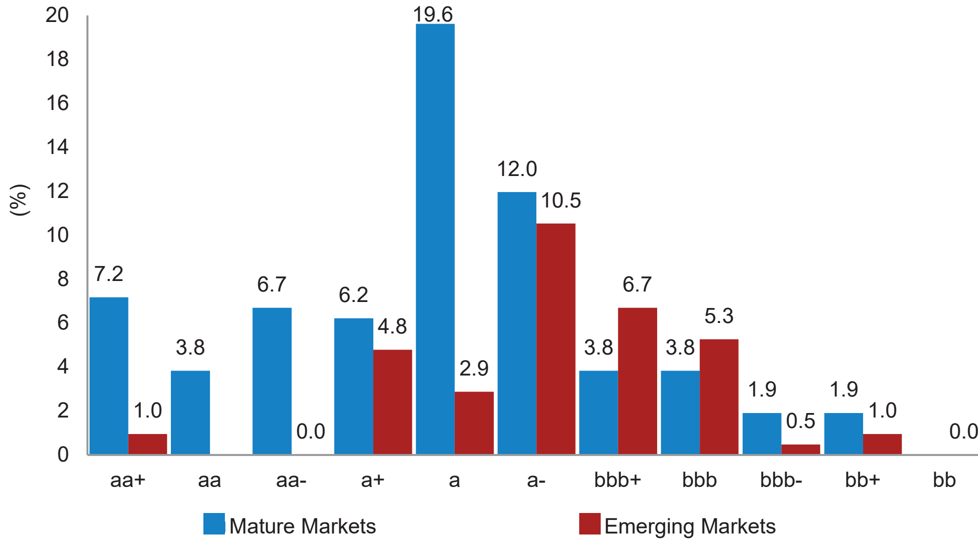
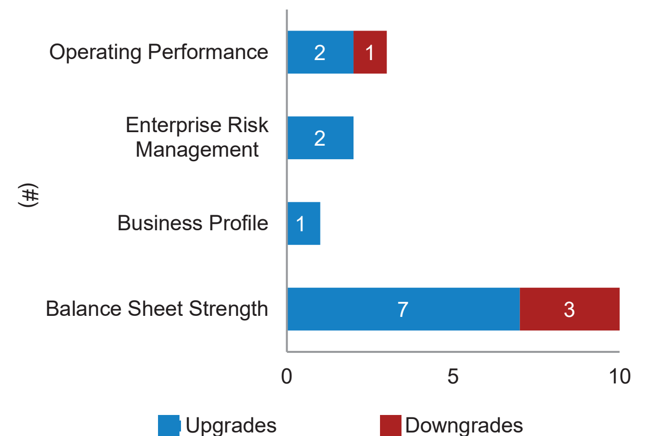
Exhibit 1
APAC – AM Best's Issuer Credit Ratings



*Mature markets are Australia, HK, Japan, Macau, NZ, Singapore, S. Korea & Taiwan
Source: AM Best data and research

(**Exhibit 3**). Positive outlooks were assigned to just 8% of all ICRs, up slightly from 2022. The remaining 4% of rating units had Negative outlooks or negative implications, down from 2022. The outlooks for 13 companies were revised to Stable from Negative; 10 were revised to Positive from Stable; and one jumped to Positive from Negative (**Exhibit 4**). Additionally, the outlooks for four companies were revised downward from Positive to Stable. Mature markets accounted for more than 75% of all outlook revisions, with New Zealand and Singapore accounting for most of the changes.

Exhibit 2
APAC – Upgrades & Downgrades by Building Block, 2023



Source: AM Best data and research

Upgrades Exceeded Downgrades

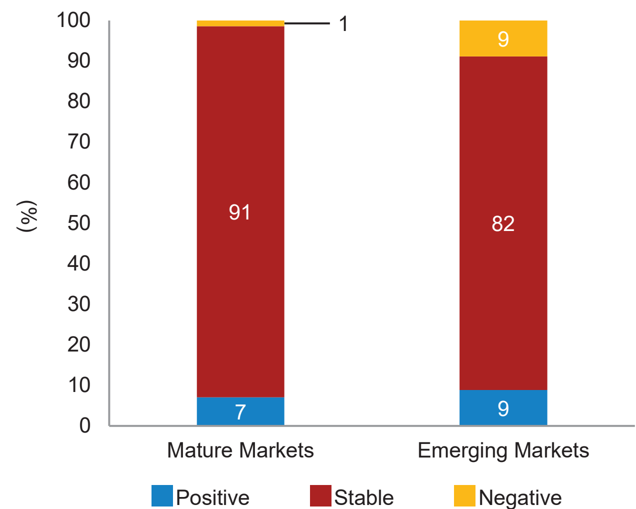
In 2023, eight ICRs were upgraded: three in New Zealand, two in Singapore, and one each in Hong Kong, South Korea, and Vietnam. Improved balance sheet strength and favourable operating performance drove the upward moves. Four ICRs were downgraded, as in 2022, one each in New Zealand, the Philippines, Singapore, and Thailand (**Exhibit 5**). A range of factors, such as falling Best's Capital Adequacy Ratio (BCAR) scores or weakening operating results, were among the drivers.

AM Best's Country Risk Tiers

AM Best defines country risk as the risk that country-specific factors could adversely affect a (re) insurer's ability to meet its financial obligations. Country risk is evaluated and factored into all of AM Best's ratings. As part of the evaluation of country risk, AM Best identifies the factors in a country that could directly or indirectly affect a (re)insurance company operating in that country and conducts stress tests to determine how well a company can absorb the key risks in its operating environment and how its balance sheet can withstand these stresses.

Countries are placed into one of five tiers, ranging from CRT-1, for countries with a stable environment with the least amount of risk, to CRT-5, for countries that pose the most risk and therefore the greatest challenge to a (re)insurer's financial stability, strength, and performance. Emerging markets generally have higher levels of volatility and uncertainty, as well as challenging macro-economic environments; hence, stress tests play a particularly important role in those ratings. Approximately 37% of the rated units operate in CRT-3 to CRT-5 countries, which makes country risk an important component of the rating assessment for APAC (re)insurers.

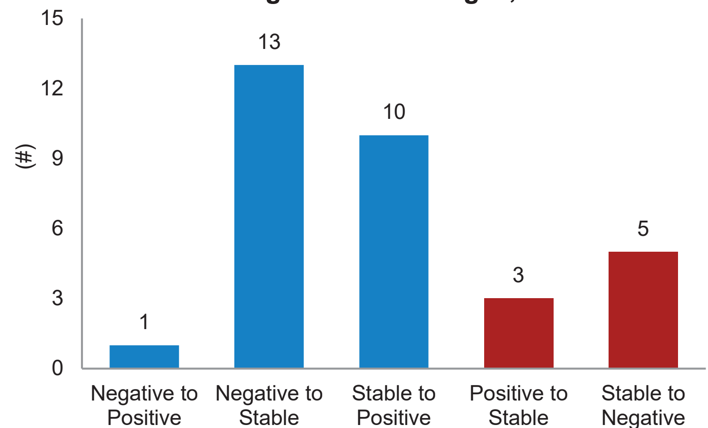
Exhibit 3
APAC – Issuer Credit Rating Outlooks by Market, 2023



Source: AM Best data and research

AM Best's determination of country risk is not directly comparable to a sovereign debt rating, which entails an evaluation of the ability and willingness of a government to service its debt obligations. Although country risk has a bearing on companies' overall ratings, particularly for those operating in CRT-3 to CRT-5 countries, there are (re)insurers with AM Best ratings that are higher than their domicile's sovereign debt rating. These (re) insurers have demonstrated that they can absorb and mitigate risks arising from their operating environment.

Exhibit 4
APAC – Best's Rating Outlook Changes, 2023



Source: AM Best data and research

Balance Sheet Strength – Generally Very Strong

The balance sheet strength assessments of (re)insurers operating in both mature and emerging markets are generally concentrated in the Very Strong category, 49% and 54%, respectively (**Exhibit 6**). This generally reflects strong capital measures. The vast majority of the remaining assessments of companies in emerging countries is Strong (46%), while mature market balance sheet strength assessments are more varied.

Risk-Adjusted Capitalisation – BCAR Scores

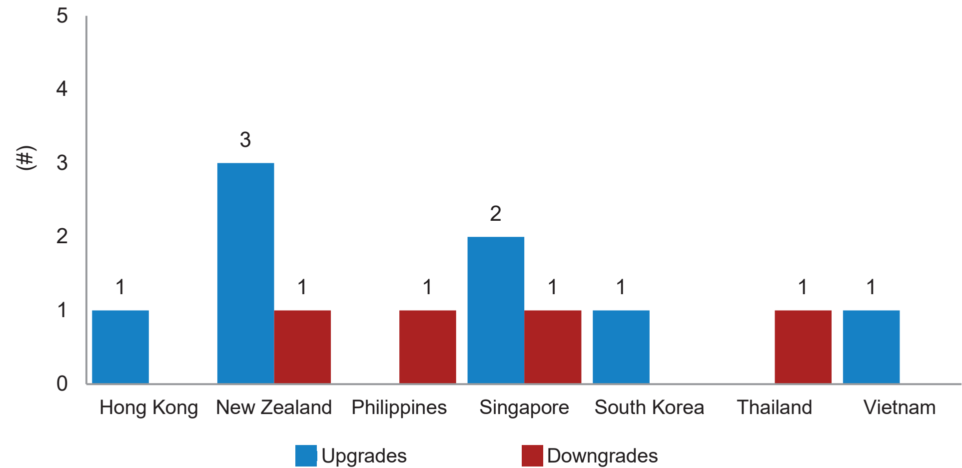
AM Best uses BCAR to measure risk-adjusted capitalisation across several confidence levels. More than 85% of rating units in both mature and emerging markets have a BCAR assessment of Strongest. The mean and median BCAR for the rated APAC universe is in the 45% to 55% range, indicating capital cushion within the Strongest assessment. The BCAR measured at the VaR (Value at Risk) 99.6 of mature markets' lowest and highest quartiles (bottom and top 25%) is less favourable than that of the emerging markets (**Exhibit** 7).

Beyond BCAR – Other Drivers of Balance Sheet Strength

While BCAR is important to the rating analysis, a number of other factors are also taken into consideration. In mature markets, the balance sheet strength assessment is Very Strong for

most insurers, which is partly a consequence of the countries' strong regulatory regimes. Mature markets often have well-established regulatory frameworks and stringent regulatory requirements. Insurers are typically subject to comprehensive supervision and capital adequacy standards, as they must maintain sufficient capital to meet obligations.

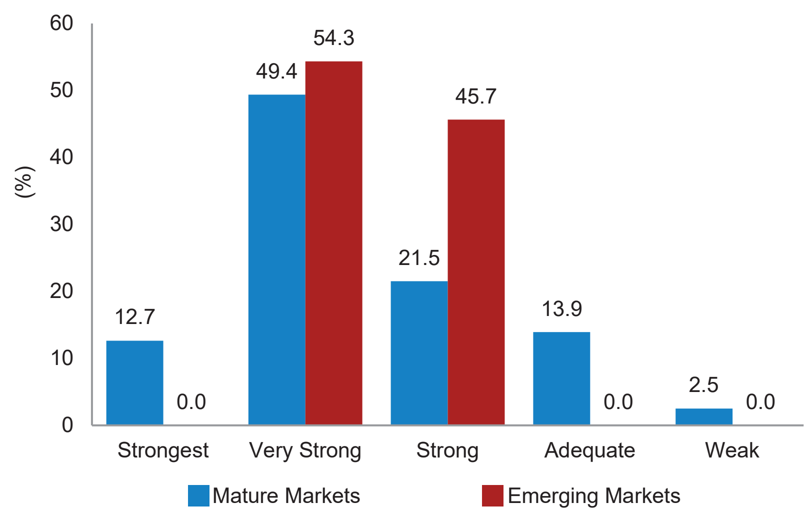
Exhibit 5
APAC – Upgrades & Downgrades Per Country, 2023



Source: AM Best data and research

In addition, mature markets generally have more stable economic conditions, including lower levels of economic volatility and political risk than emerging markets. This stability lessens the need for insurers to hold excess capital to mitigate macroeconomic uncertainty. Insurers may also face fewer underwriting risks, which may be due to better-established risk management practices, more accurate actuarial modelling, and a deeper understanding of market dynamics. However, emerging markets typically have simpler insurance products, resulting in lower probability of adverse claims development. Many catastrophe-prone emerging markets have low insurance penetration.

Exhibit 6
APAC – Balance Sheet Strength Assessments, 2023



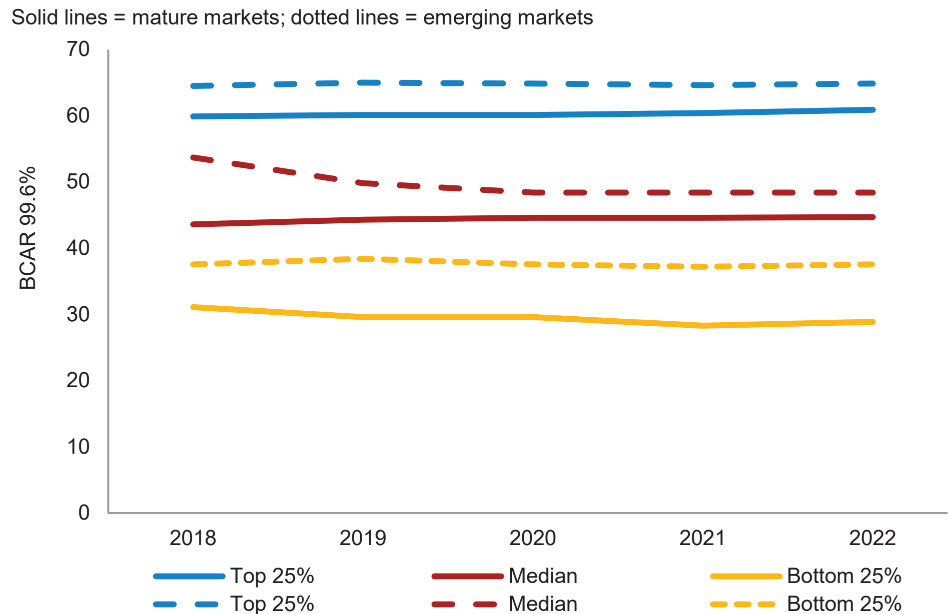
Source: AM Best data and research

Access to the capital and debt markets provides financial flexibility, which enables insurers to maintain adequate capital without relying solely on retained earnings or other internal sources of funding. Furthermore, mature markets often have higher levels of insurance penetration, which can provide insurers with more diversified revenue sources that can enhance their risk profiles. Niche players, despite their small size, have a defensible competitive business profile that also leads to more favourable underwriting performance.

Emerging markets may have strict regulatory requirements, leading insurance companies to maintain higher capital reserves to comply with regulatory standards and mitigate risk associated with regulatory changes. However, these markets may have rigid and simplistic regulatory capital requirements which may or may not appropriately match the risks the companies face. They are also

vulnerable to greater perceived risks such as currency volatility and political instability. Emerging markets offer significant growth opportunities for insurers in countries with expanding middle-class populations and growing urbanisation.

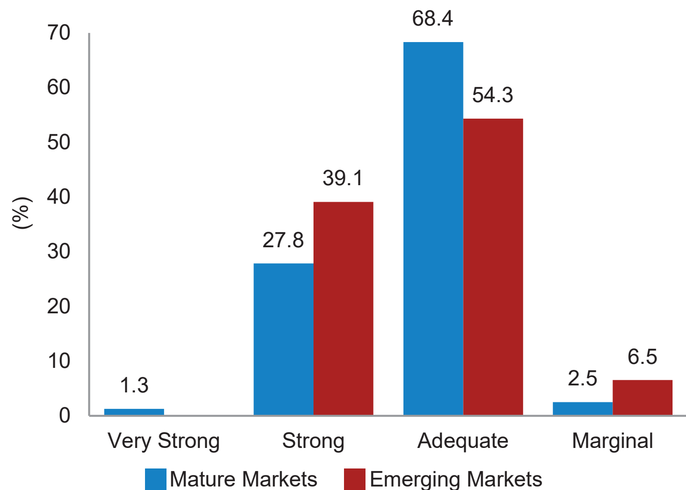
Exhibit 7
APAC – Mature & Emerging Markets – BCAR VaR 99.6 by Quartile
Solid lines = mature markets; dotted lines = emerging markets



Source: AM Best data and research

However, competition can be intense, with local and international insurers vying for market share. Insurers may bolster their capital levels to support business expansion and capitalise on growth opportunities. Furthermore, emerging markets may also present unique underwriting and currency risks, such less developed infrastructure, fluctuating currency exchange rates, and limited insurance literacy, all of which lead to financial instability.

Exhibit 8
APAC – Operating Performance Assessments, 2023



Source: AM Best data and research

Operating Performance – Adequate or Strong

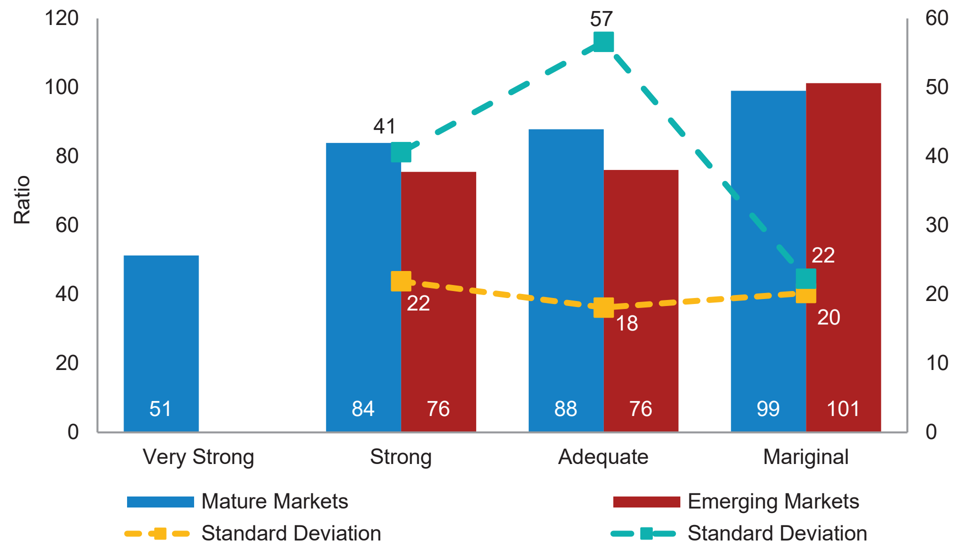
The operating performance assessments for APAC companies are concentrated in the Adequate and Strong categories (**Exhibit 8**), with a somewhat similar distribution for both mature and emerging markets. At present, only one company in Singapore has an operating performance assessment of Very Strong. A majority of insurers in both mature (68%) and emerging (54%) markets have an Adequate operating performance assessment.

Many of the companies with Strong operating performance assessments, whether in mature or emerging markets, are market leaders or large multinational (re)insurers with stable profiles that benefit mostly from diversified earnings sources and economies of scale.

When assessing operating performance, companies' profiles and exposures can immensely differ. For example, a number of major disasters of 2022 fell across the development spectrum, from floods in Australia, Bangladesh, India, and Thailand, to drought in China, typhoons in the Philippines, heat waves in India and Japan, and earthquakes in Fiji and Indonesia. Floods were the deadliest, accounting for 74% of disaster events in the region. Companies with an operating performance of

Strong have slightly lower five-year average combined ratios than companies assessed as Adequate (**Exhibit 9**).

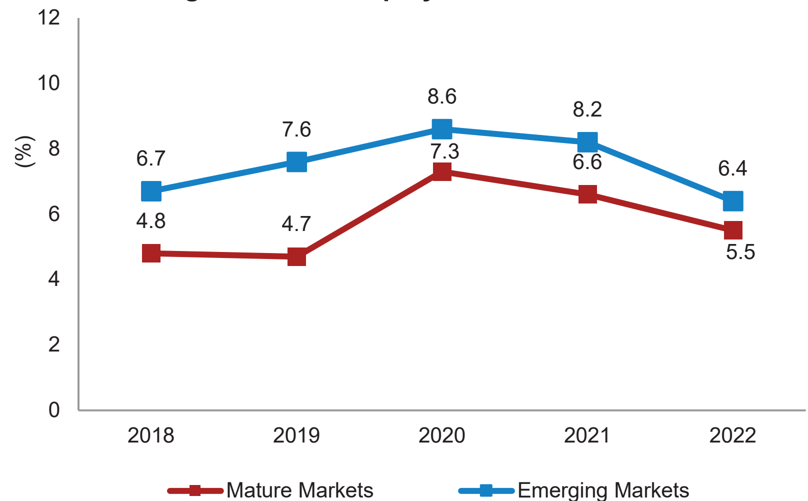
Exhibit 9
APAC – Five-Year (2018-2022) Average Combined Ratio



Source: AM Best data and research

Driven by the hazard characteristics and the underlying diverse socio-economic vulnerabilities and exposure, the major disasters in 2022 were complex with intense cascading impacts. For example, earthquakes such as the Band See in Indonesia, with a 5.6 magnitude, are relatively severe. The fundamental reason was the critical vulnerability of communities at risk and direct exposures of economic and social assets near the epicenters. The average yearly return on equity (ROE) in mature markets tends to be significantly lower than in emerging markets. Many mature markets experienced a significant increase in claims payouts, leading to negative underwriting results and consequently, driving down ROE (**Exhibit 10**). Insurers in emerging markets also saw a notable decline in the average ROE, after consistently posting higher ROEs than insurers in mature markets in recent years.

Exhibit 10
APAC – Average Return on Equity



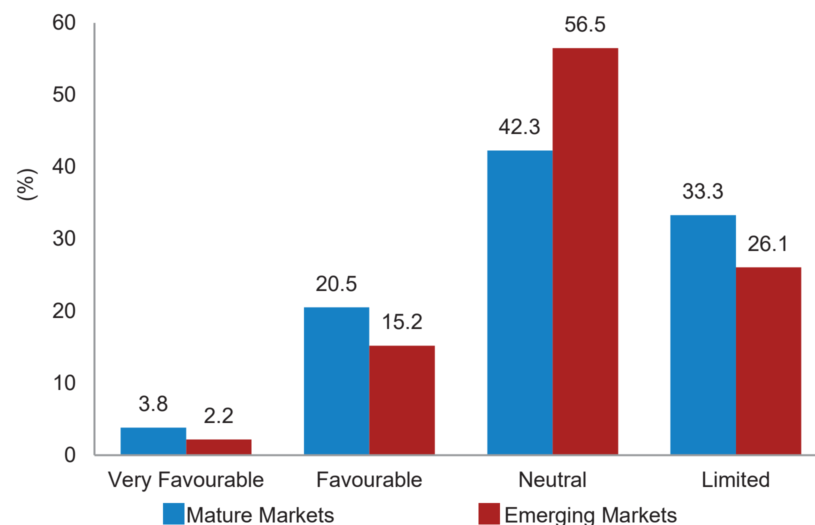
Note: ROE outliers and non-CS duplicates removed.
Source: AM Best data and research

The operating performance metrics of emerging market companies need to be considered carefully. Their performance may not be as good as the nominal figures may suggest, as emerging markets often have faster-growing economies and expanding middle-class populations. This leads to rising demand for insurance products, which can translate into higher premium growth rates and greater profitability, resulting in higher ROE. They are also more competitive, with lower market penetration rates than mature markets, which allow insurance companies to command higher premiums and achieve better underwriting margins. This may also reflect higher inflation in emerging markets, meaning that the real ROE is not better for emerging markets when adjusted for inflation. However, emerging markets may have less stringent regulatory environments than mature markets.

Operating Performance Drives Asian Reinsurer Strategies

AM Best's Asia-Pacific reinsurance composite achieved strong non-life revenue growth and favourable earnings in 2023, supported by a more stable investment environment and benign catastrophe activity. With business profiles characterised by a more traditional property line focus, as well as a relatively large book of proportional treaties, underwriting performance has benefited less directly from rate hardening and the high interest rate environment, and more from operating performance stability over the years.

Exhibit 11
APAC – Business Profile Assessments, 2023



Source: AM Best data and research

Underwriting strategies for 2024 are diverse and depend on the reinsurers' ability to secure retro capacity, as well as their ability to manage the underwriting cycle the past two years. Large Asian reinsurers have adjusted their catastrophe capacity offerings in their home markets to minimise their catastrophe exposures, while others have deployed a mature market growth strategy to capture the benefits of material rate increases. In addition, geographic expansion and diversification of their lines of business from traditional property treaties such as building liability, life and health, and specialty books, will allow reinsurers to better manage the reinsurance cycle.

Business Profiles – Neutral to Limited

Most of the business profile assessments of (re)insurance companies fall in the Neutral to Limited categories (**Exhibit 11**). More than 50% of all emerging market players had a business profile assessment of Neutral, versus 42% of all mature market companies, followed by 33% with Limited. Only 3% of the APAC entities received a Very Favourable assessment—three in mature markets (Singapore, Japan, and South Korea) and one in an emerging market (China). These companies are global (re)insurance groups, which have diversified operations by both geography and product line. For companies assessed in the lower categories, certain elements of their business profile may be lacking, such as diversification, or key business segments may not be performing as well as others.

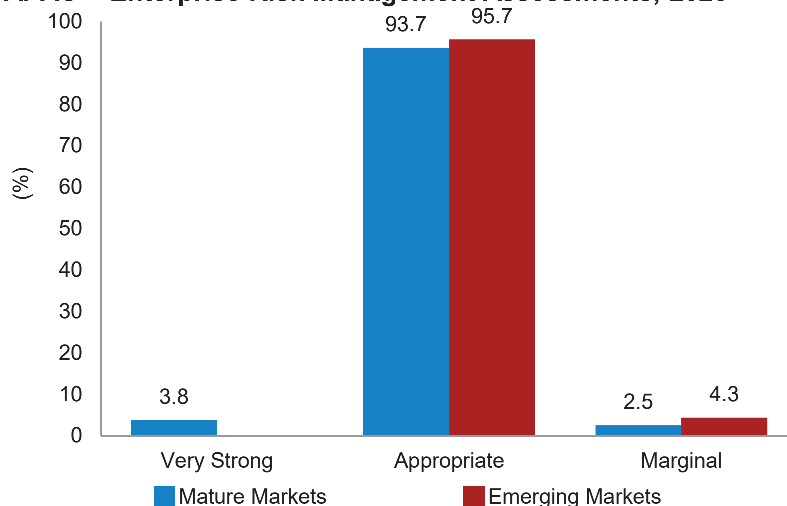
Emerging market players may hold excellent positions in their domestic markets, with good control and leadership positions, but the overall size and level of diversification tend to be more limited. Furthermore, such companies generally have narrower profiles and are subject to greater levels of competition as their markets are opening up. On a global scale, they can be relatively small with limited diversification. Further, they are more likely to depend more on third parties to manage their business and to be subject to high levels of regulatory risk.

Prudent Risk Management Remains Crucial

AM Best's ERM assessment is composed of two main components—the risk framework evaluation and the risk profile evaluation. The majority of companies in mature markets had an ERM assessment

of Appropriate, reflecting the sound ERM practices and robust regulatory regimes under which they operate. In emerging markets, more than 95% of the entities also had an Appropriate ERM assessment (**Exhibit 12**). Overall, only 2% of the rated population had a Very Strong ERM assessment (one company each in Singapore, Japan, and South Korea).

Exhibit 12
APAC – Enterprise Risk Management Assessments, 2023



Source: AM Best data and research

To achieve the highest assessment, companies need to demonstrate that their risk management approach has been effective over the long term and adds value to the organisation.

Emerging market ERM assessments range from the Appropriate to Weak categories, partly a consequence of the early stages of insurance and regulatory development in many of those markets, as well as generally elevated risks in those operating environments.

Rating disclosures under Best's Credit Rating Methodology (BCRM) allow for more straightforward and detailed benchmarking. Although this report highlights the main characteristics and differences among (re)insurers in the APAC region, one should bear in mind that any generalisation always carries the risk of oversimplification, masking wide differences at the company level.

This analysis highlights some common themes as weaknesses, the most important of which is risk governance, with some (re)insurers, especially in emerging markets, adopting basic or minimum requirements to run their businesses. Some companies have only recently adopted more practical and sophisticated approaches to managing their operations.

In part, regulatory developments, which serve to strengthen the market, revealed some deficiencies. Although the market is likely to endure some short-term turmoil for long-term stability, the impact of regulatory changes remains a challenge for a number of insurers with less developed risk governance frameworks. Having prudent risk management practices is therefore considered more critical than ever, to ensure that companies manage risks effectively and in a controlled manner, especially in times of heightened economic uncertainty and market volatility.

Published by AM Best

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