BEST'S SPECIAL REPORT

Our Insight, Your Advantage™

Ratings Review
March 19, 2024

EMEA Benchmarking – Early Signs Insurance Market is Stabilising Amid Uncertain Geopolitical Environment

The abrupt interest rate rises during 2022 and the first half of 2023 tested the resilience of most companies' balance sheets.

Principal Takeaways:

- AM Best's ratings of (re)insurers in Europe, the Middle East and Africa (EMEA) have begun to stabilise following tough market conditions in 2022
- Despite the uncertain global geopolitical environment, there has been a general stabilisation of macroeconomic conditions which is easing the pressure on the insurance and capital markets
- A combination of strong rate increases and a generally benign year of severe catastrophic weather events led to a recovery in the results of the global reinsurance market

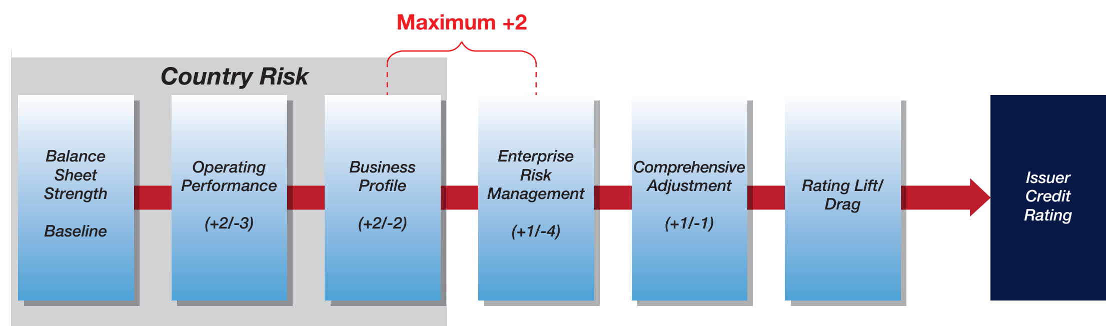
This report evaluates the composition of AM Best ratings in EMEA, and details the rating actions that took place between year-end 2022 and year-end 2023. It considers AM Best's broad geographical rating coverage across most rated (re)insurance groups in Europe, the Middle East and Africa.

The analysis in this report excludes ratings of subsidiaries that have group and reinsurance affiliated codes and branches of (re)insurance groups. As classified by AM Best the analysis is performed on a rating unit basis. The types of companies rated, operating in both mature and emerging markets, are diverse. They include reinsurers, insurers, mutuals, captives, credit and health insurers, takaful operators and protection and indemnity (P&I) clubs.

Ratings Distribution

An AM Best Issuer Credit Rating (ICR) is an independent opinion of an entity's ability to meet its ongoing financial obligations[1]

Exhibit 1
AM Best's Rating Process



Source: Best's Credit Rating Methodology

[1]Full details of the rating process can be found in "Best's Credit Rating Methodology"

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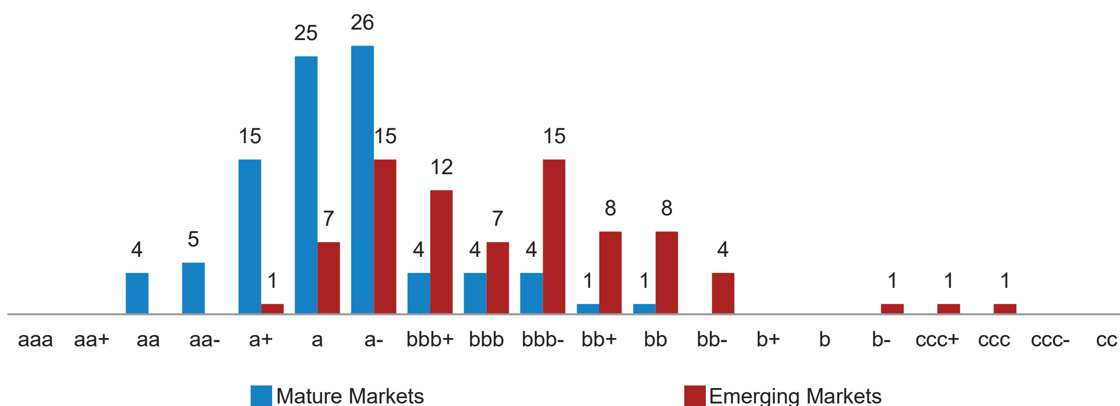
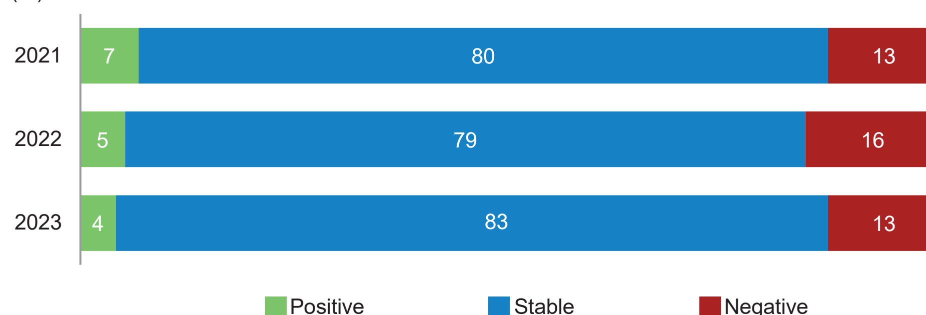
Exhibit 2
EMEA – Distribution of AM Best's Issuer Credit Ratings (ICR)
(As at December 31, 2023)



Source: AM Best data and research

Exhibit 3
EMEA – Best's Issuer Credit Rating Outlook Split, 2021-23
(%)



Source: AM Best data and research

The distribution of AM Best's ICRs for EMEA rating units as at December 31, 2023, is shown in **Exhibit 2**. Over the previous 12 months there were 10 new rating assignments in the region and 14 rating withdrawals. The ICR range remains unchanged against 2022, varying from "aa" to "ccc". In mature markets, issuer credit ratings cluster around the "a" and "a-" categories. For emerging markets, in which country risk often plays an important role in determining the overall rating assessment, the ratings distribution is more evenly spread, ranging from "a+" to "ccc". Moving towards the lower end of the rating scale, most (re)insurance groups are domiciled in higher risk countries, which are characterised by elevated levels of economic, political and financial system risks.

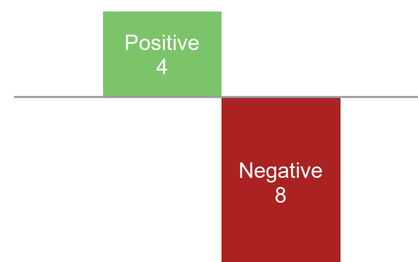
The vast majority of rating units (83%) had stable outlooks (2022: 79%) (see **Exhibit 3**) at year-end 2023, with mature markets showing a higher proportion of stable outlooks (87%) than emerging markets (79%).

This variation is in line with expectations considering the particularly adverse economic conditions observed in certain emerging markets over 2022 and 2023, notably in Lebanon, Tunisia, Türkiye, and Ghana.

Positive outlooks were assigned to just 4% of credit ratings (2022: 5%). The reduction in positive outlooks from 2022 can largely be attributed to the upgrade of five (re)insurers and the subsequent revision of their outlooks back to stable.

The remaining 13% of rating units had negative outlooks or negative implications as at December 31, 2023 (2022: 16%). The reduction in negative outlooks from 2022 is explained by the revision of 10 outlooks from negative to stable, four of which followed a rating downgrade. There were also three companies with a negative outlook that opted to withdraw their rating. A total of eight outlooks were revised from stable to negative in 2023 (see **Exhibit 4**), fewer than the prior year total of 12, with pressure arising from weakened balance sheets generally driving the negative actions.

Exhibit 4
EMEA – AM Best Rating Outlook Changes from Stable, 2023
(Count of outlook changes)

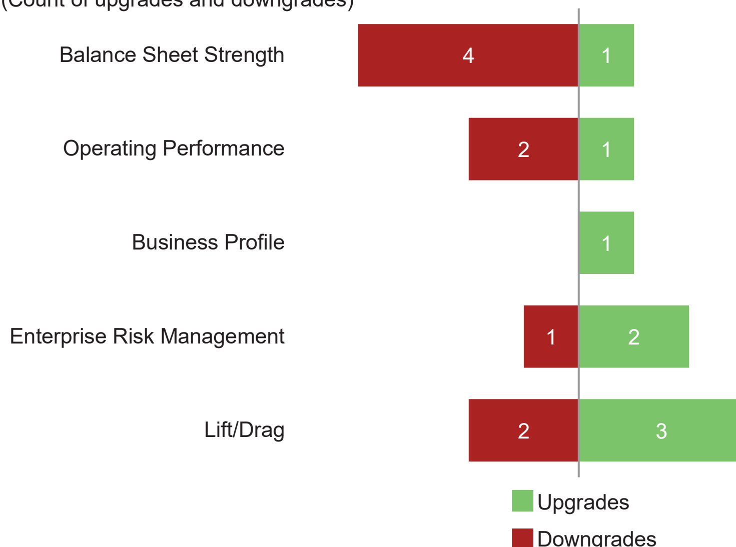


Source: AM Best data and research

In addition to the reduced count of negative outlook changes in 2023, there were only nine rating downgrades (compared with 14 recorded in 2022). Downgrades were spread across most of the building blocks, with the exception of the business profile assessment (see **Exhibit 5**). There was no observable theme that led to the rating downgrades. A range of factors, such as deteriorating country risk considerations, falling Best's Capital Adequacy Ratio (BCAR) scores, weakening operating results, or a decline in the credit quality of the ultimate parent, were among the drivers.

There were eight upgrades in 2023 (2022: seven), five of which were tied to mature market companies. The upgrades were spread across all the building blocks. However, it was notable that prudent risk management practices underpinned the resilience of balance sheet strength and operating performance during the volatile global interest rate environment in 2022 and the first half of 2023.

Exhibit 5
EMEA – AM Best Rating Upgrades and Downgrades by Building Block, 2023
(Count of upgrades and downgrades)



Source: AM Best data and research

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 AM Best ratings.

As part of evaluating country risk, AM Best identifies the various factors within a country that may directly or indirectly affect a (re)insurance company.

Countries are placed into one of five tiers, ranging from CRT-1, denoting 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.

AM Best closely monitors economic, political, and financial system risks in countries assigned a CRT assessment. In addition, AM Best also undertakes stress tests to assess how a company can absorb the key risks in its operating environment and how its balance sheet can withstand these stresses.

Emerging markets generally have higher levels of volatility and uncertainty, and particularly challenging macro-economic environments; hence, stress tests play a particularly important role in those ratings.

It is important to note that 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 the overall rating assessment, particularly for companies operating in CRT-3 to 5 countries, there are (re)insurers with AM Best ratings that are higher than their domicile's sovereign debt rating; these have demonstrated that they can absorb and mitigate risks arising from their operating environment—a key consideration when evaluating country risk in the assessment.

Approximately half of the rating units operate in CRT-3 to 5 countries, hence country risk is an important component of the rating assessment for EMEA (re)insurers. Country risk is considered in three of the building block components: balance sheet strength, operating performance, and business profile (see **Exhibit 1**). Under balance sheet strength, the baseline assessment is determined by analysing an array of balance sheet factors and the appropriate CRT, and applying a baseline rating assessment (see **Exhibit 6**).

Although there is no difference in the table between CRT-1 and 2, other factors play an important role in determining the baseline assessment. The effect of country risk is material for a company subject to a CRT-5 assessment having a Strongest balance sheet strength assessment, starting at a maximum baseline assessment of "bbb+". The country risk assessment can be adjusted upwards or downwards depending on the operating environment and risk profile of the company.

In general over the last five years, countries designated CRT-4 and CRT-5 have experienced heightened levels of economic, political and financial system risks. In recent years, these risks have been exacerbated by shocks, such as the COVID-19 pandemic, the Russia-Ukraine war, and more recently the Israel-Hamas conflict.

Exhibit 6

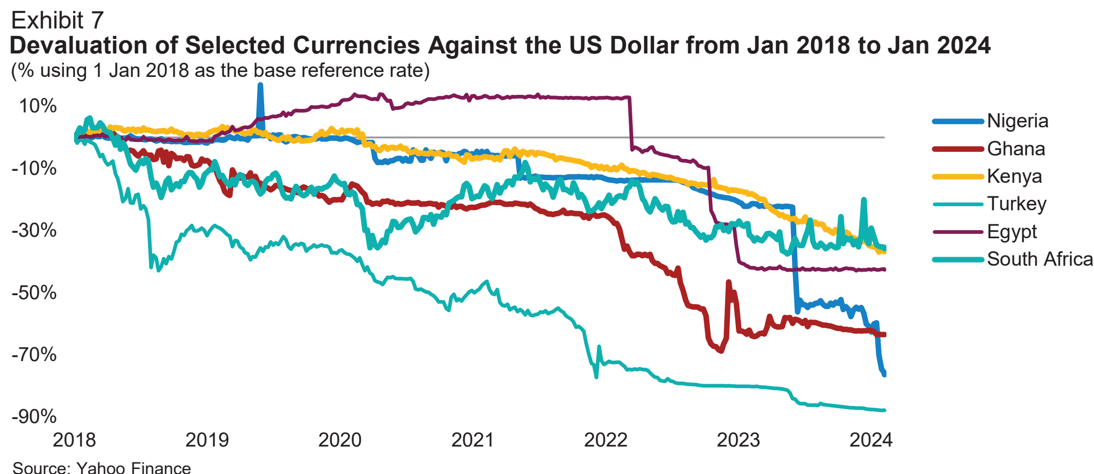
AM Best – Overall Balance Sheet Strength Assessment

Overall Balance Sheet Strength Assessment

Combined Balance Sheet Assessment (Rating Unit/ Holding Company)	Country Risk Tier				
	CRT-1	CRT-2	CRT-3	CRT-4	CRT-5
Strongest	a+/a	a+/a	a/a-	a-/bbb+	bbb+/bbb
Very Strong	a/a-	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-
Strong	a-/bbb+	a-/bbb+	bbb+/bbb/bbb-	bbb/bbb-/bb+	bbb-/bb+/bb
Adequate	bbb+/bbb/bbb-	bbb+/bbb/bbb-	bbb-/bb+/bb	bb+/bb/bb-	bb/bb-/b+
Weak	bb+/bb/bb-	bb+/bb/bb-	bb-/b+/b	b+/b/b-	b/b-/ccc+
Very Weak	b+ and below	b+ and below	b- and below	ccc+ and below	ccc and below

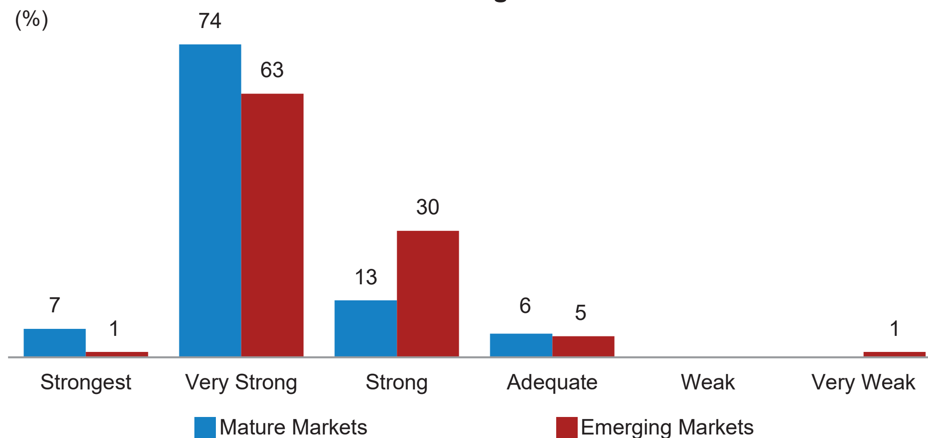
Source: Best's Credit Rating Methodology

Exhibit 7
Devaluation of Selected Currencies Against the US Dollar from Jan 2018 to Jan 2024
(% using 1 Jan 2018 as the base reference rate)



Source: Yahoo Finance

Exhibit 8
EMEA – AM Best Balance Sheet Strength Assessments – 2023
(%)



Source: AM Best data and research

Despite those shocks, over the course of 2023 commodity prices as well as the level of global inflation began to ease, a marked improvement against the tough conditions that characterised 2022. In response to the cooling levels of inflation, many Central Banks paused their rate hardening cycle in mid-2023, and it is widely expected that interest rates will gradually reduce over 2024.

Declining global interest rates over the course of 2024 would over time ease the burden of borrowing costs on national governments, which in 2022 and 2023 reached distressing levels, particularly in certain emerging market countries. For example, four countries—all located in sub-Saharan Africa—formally applied for debt treatment under the G20 common framework between 2021 and 2023, with Ghana being the most recent example. Moreover, around half of Africa's countries are currently facing difficulties in fulfilling their debt repayments with eight regarded to be in debt distress.

Compounding the elevated cost of borrowing has been the rapid devaluation of many emerging market currencies (see **Exhibit** 7), which increases the repayment burden of foreign currency denominated debt. While some of the currencies depicted in **Exhibit 7** have stabilised since the latter half of 2023, many remain devalued at record lows against the US dollar.

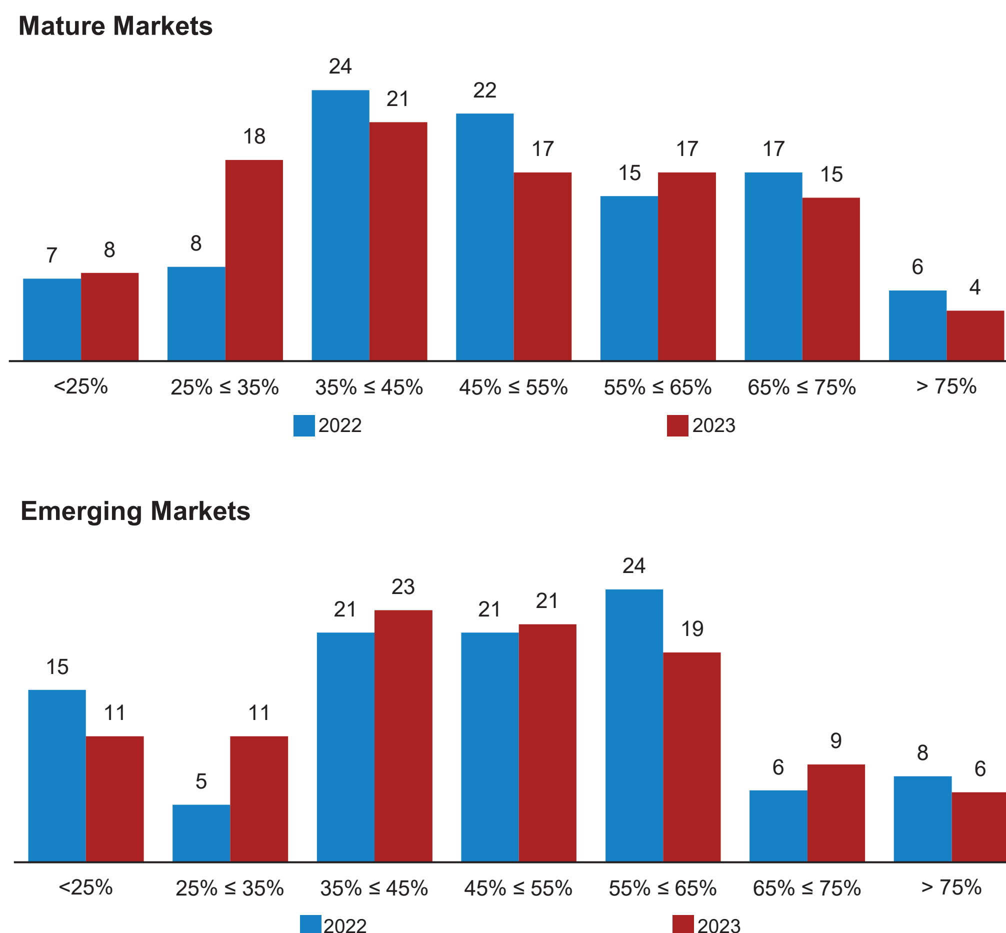
Balance Sheet Strength – Baseline Assessment

The distribution of AM Best's assessment of balance sheet strength for EMEA-rated entities is illustrated in **Exhibit 8**. The balance sheet strength assessments of (re)insurers operating in both mature and emerging markets are generally concentrated within the Very Strong category. This reflects generally robust capital buffers. Companies in emerging countries have a greater presence further down the assessment scale—namely in the Strong category—indicating the possible influence of country risk on the assessment.

Risk-Adjusted Capitalisation – Best's Capital Adequacy Ratio (BCAR) Assessment

AM Best uses its proprietary capital adequacy model—BCAR—to measure risk-adjusted capitalisation across several confidence levels. Risk-adjusted capitalisation is assessed as Strongest when the BCAR score is above 25% at the 99.6% value at risk (VaR) confidence level, and Very Strong when the BCAR score is between 10% and 25%[2]. When assessing BCAR scores, AM Best typically uses the latest available year-end audited set of financial statements. For most companies analysed in calendar year 2023, this would involve a calculation of BCAR with year-end 2022 as the base year.

Exhibit 9
EMEA – Distribution of AM Best BCAR Scores, 2022-23 Years of Analysis
(%)



Source: AM Best data and research

[2] Full details can be found in "Best's Credit Rating Methodology"

Analysis shows more than 90% of EMEA rating units are within the Strongest assessment of risk-adjusted capitalisation, exceeding the 25% threshold. The mean BCAR for the universe of rated EMEA entities is in the 45% to 55% range.

Companies operating in mature markets have significantly different drivers of capital requirements compared with emerging market companies.

At the reporting year-end 2021, greater earnings generation and prudent capital management resulted in modest improvements in average BCAR scores. Conversely, at reporting year-end 2022 there was a clear decline in average BCAR scores, particularly in the cohort of companies in mature markets (see **Exhibit 9**).

The rapid rise in global interest rates in 2022 resulted in severe unrealised losses on fixed income instruments. This particularly negatively impacted the developed market cohort for a number of reasons: i) developed market companies typically have a greater weighting of their investment portfolios held in fixed income, while emerging market companies tend to favour cash, equities and real estate more heavily; and ii) due to the presence of a considerably larger life insurance segment, developed market companies on average have greater underwriting leverage, and therefore have a larger investable asset base, resulting in a larger capital impact from unrealised losses.

Balance Sheet Strength Versus BCAR Assessment

There is a common misconception that the BCAR assessment is equivalent to a company's overall balance sheet assessment. This is not the case; while BCAR is important to the analysis, there are also a number of other components that come into play.

Exhibit 10

EMEA – BCAR vs Balance Sheet Strength, 2023

(%)

Mature Markets

BCAR Assessment	Balance Sheet Strength: Strongest	Very Strong	Strong	Adequate	Weak	Very Weak
Strongest	7	73	7	3	0	0
Very Strong	0	1	4	2	0	0
Strong	0	0	2	0	0	0
Adequate	0	0	0	0	0	0
Weak	0	0	0	0	0	0
Very Weak	0	0	0	0	0	0

Emerging Markets

BCAR Assessment	Balance Sheet Strength: Strongest	Very Strong	Strong	Adequate	Weak	Very Weak
Strongest	1	61	23	4	0	0
Very Strong	0	1	5	0	0	0
Strong	0	0	3	0	0	0
Adequate	0	0	0	1	0	0
Weak	0	0	0	0	0	0
Very Weak	0	0	0	0	0	1

Source: AM Best data and research

The relationship between BCAR and balance sheet strength assessments for mature and emerging markets is illustrated in **Exhibit 10**. As noted previously, over 90% of EMEA rating units have BCAR scores within the Strongest category. However, only 4% of EMEA rated companies have a balance sheet assessment in the Strongest category—showing that although BCAR is very important to AM Best's analysis, it is not the only consideration when looking at balance sheet strength.

The vast majority of EMEA rated companies have a balance sheet strength assessment of Very Strong (69%). Very few companies have balance sheet strength assessments below the Strong category, as this is often—although not always—associated with (re)insurers that receive weak credit ratings and have therefore decided not to make their ratings public.

When examining the emerging markets' population, the balance sheet strength assessment is not quite as robust. A mere 1% (a single rating unit) of emerging market companies were at the Strongest level, and this is partly due to several country-risk factors. More than one-third of emerging market rating units have balance sheet strength assessments of Strong or lower, comparing unfavourably with the mature market population where the figure is less than 20%. Country risk considerations as well as other quantitative and qualitative factors result in this difference.

As highlighted earlier in this report, over the course of the surveillance period, balance sheet strength was the building block that saw the most downgrades, the majority of which were driven by a rapid decline in BCAR.

Beyond BCAR – Other Drivers of Balance Sheet Strength

Mature Markets

In mature markets, the balance sheet strength assessment is robust for most players, which in part is a consequence of the strong regulatory regimes adopted within these countries, supported by prudent capital management strategies from most market participants. Moreover, the majority of companies benefit from sound financial flexibility and strong liquidity profiles given the depth of capital markets in developed countries.

Access to capital/debt markets is generally viewed as a positive for financial flexibility. This, nevertheless, may be mitigated by some players showing financial leverage that is already deemed high, particularly compared to peers rated at the same level.

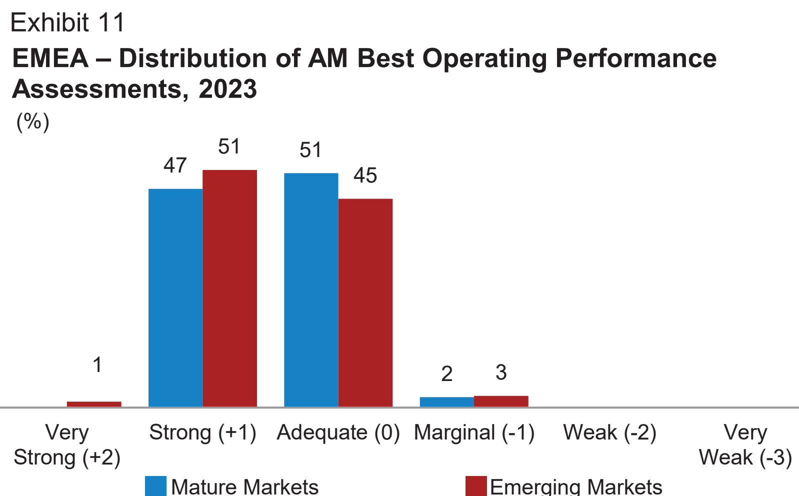
In light of the relatively low cost of capital pre-2022, and the aforementioned general erosion of capital in 2022 thanks to unrealised losses, financial leverage in mature markets has increased. This particularly presents a significant re-financing risk for companies with debt issuances that are coming up to maturity at a time of investor uncertainty and higher interest rates.

Emerging Markets

While the risk-adjusted capitalisation of emerging market players is generally robust, other balance sheet components often play an important role in reducing the balance sheet strength assessment. In particular, very high levels of reinsurance dependence is often a negative factor. While in most cases this risk is partly mitigated by the use of reinsurers of sound credit quality, there remains significant counter-party credit risk in the event of large losses. This is often amplified by the concentration among a single (or few) counterparties which exacerbates the potential impact that a reinsurance dispute could have on a (re)insurer's balance sheet.

Other offsetting factors include inadequate asset liability matching (ALM); particularly for companies operating in CRT-4 and CRT-5 domiciles where long-duration fixed income securities are sometimes scarce. Most companies are restricted—by regulation or in practice—to invest only in their domestic financial markets, which are often in the early stages of development.

Exhibit 11
EMEA – Distribution of AM Best Operating Performance Assessments, 2023



Source: AM Best data and research

Given the generally smaller size of economies in emerging markets, there is a limited number of banks and issuers for (re)insurers to invest in. This typically results in much more concentrated investment portfolios, often to the local sovereign or government-owned institutions, exposing (re)insurers to greater levels of concentration risk. Such concentration significantly increases the sensitivity of (re)insurers' balance sheet to default events.

In addition, the financial flexibility of emerging market companies is often weaker than mature market counterparts. Most emerging market companies do not issue hybrid debt and are reliant on their main shareholder(s) or private banks for financing—the latter of which is often on more onerous terms with much shorter maturities. Consequently, it is often the case that bank debt is used as a short-term solution to a longer-term problem, which is a negative consideration in the balance sheet strength assessment.

Operating Performance

Operating performance assessments for EMEA companies centre mainly around the Adequate and Strong categories (see **Exhibit 11**), with a relatively similar distribution between both mature and emerging markets. At present, there is only one company with an assessment of Very Strong.

Many of the companies assessed to have strong operating performance are companies that are market leaders, or large multinational (re)insurers with stable profiles that benefit mostly from diversified earnings sources and economies of scale.

Exhibits 12 and 13 illustrate several five-year (2018-2022) average performance ratios split by the mature and emerging market cohorts. The underwriting performance and return on equity (ROE) for both segments show a trend—as expected—of improving profitability as there is a move from the Weak to the Very Strong category.

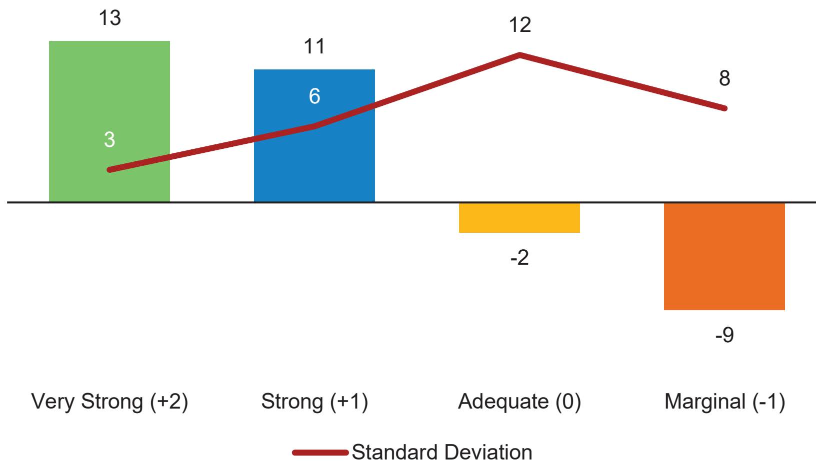
Companies with combined ratios of around 100% are likely to be considered Adequate. For companies that are given a higher assessment (Strong or Very Strong), average combined ratios in most cases are well below the 100% level and the stability of their performance is generally better as indicated by a lower standard deviation.

When assessing operating performance, companies' profiles and exposures can differ vastly. For example, a catastrophe underwriter may have had exceptionally good results over a longer period of time with very low standard deviation. However, following a catastrophe such as Hurricane Ian in

Exhibit 12
EMEA – Five-Year (2018-2022) Average Combined Ratio Standard Deviation
(%)

Not shown in exhibit – Weak and Very Weak (No entries) Source: AM Best data and research.

Exhibit 13
EMEA – Five-Year (2018-2022) Average Inflation-Adjusted Return on Equity



Not shown in exhibit – Weak and Very Weak (No entries) Source: AM Best data and research

2022, companies exposed to the event experienced a material spike in claims, wiping out potentially many years of profits.

This emphasises that a longer track record of the company also needs to be evaluated, and the prospective view of market conditions needs to be considered in the assessment.

When considering return on equity (ROE) for the whole population (see **Exhibit 13**), the Strong category produces, on average, double-digit real returns with lower standard deviations. This illustrates the fact that more stable and highly performing companies benefit from higher operating performance assessments.

Average ROEs (adjusted for inflation) in EMEA ratings are -9% for companies assessed as Marginal and increase to 11% for those assessed as Strong. For companies that fail to make real returns, often with combined ratios running at levels in excess of 100% in both emerging and mature markets, the assessment tends to be Marginal or lower.

Mature Markets

The drivers of underwriting results tend to differ slightly between mature and emerging markets. Within the mature-market cohort of companies, there is a more diverse set of company types.

For example, there is a large group of captives whose profiles are typically comprised of a smaller number of very large risks. For those companies, the combined ratio tends to be very low in benign loss years, and well over 100% in loss-affected years. Due to this greater inherent potential for volatility, it is common to see a more conservative operating performance assessment, even when combined ratios sometimes average well below 80%. Many of the companies that reside in the upper left corner of **Exhibit 12**—such as those with a higher standard deviation but low average combined ratio—are captives.

Other company types which tend to skew average ratios in the mature market are start-ups, whose results tend to be unfavourable in the early years of operations, but then improve drastically, which results in an elevated standard deviation. For those companies, AM Best places greater emphasis on the business plans, track record of the management team, and market conditions when assessing operating performance. Consequently, many of the companies that are in the upper right corner of **Exhibit 12** with an Adequate assessment are start-ups.

Emerging Markets

Operating performance metrics of emerging market companies need to be considered with caution. When taking into account returns in real terms, the performance may not be as good as the nominal figures seem to imply. In certain territories, inflation and interest rates may be particularly high–recent examples would be companies operating in Türkiye and Nigeria. This implies that affected companies operate in volatile environments and are largely dependent on investment income to bolster earnings.

One particularly prevalent feature of emerging markets–typically those in the Middle East–is insurers' extensive reliance on profit commissions from their reinsurers. Generally, the largest and most competitive market segments are motor and medical. These are high-retention mandatory lines of business, whose profitability is marginal at best.

These commissions are often generated from reinsurance cessions on high-value general insurance classes such as property, engineering and oil and gas. Insurers writing this business often benefit from negative acquisition costs (greater inward commissions from reinsurers over the direct commissions involved in sourcing the business) to bolster overall underwriting profits.

This model has served companies very well for many years. However, the reliance on a single source of income is of some concern. Any change to the reinsurance market that results in less support to local market participants can have major ramifications for the domestic market, with profits potentially wiped out overnight. Moreover, most insurers will be unable to accommodate high-value risks due to a lack of technical know-how and small capital bases.

Calendar Year 2023 - Strong Recovery in Reinsurance Results

The year 2023 proved to be a strong one for the reinsurance market, with much of the capital losses experienced in 2022 recouped. The January 2023 reinsurance renewals were broadly considered to be "disorderly", which really confirmed the presence of a hard reinsurance market.

Reinsurers were able to achieve significant increases to attachment points, especially on property programmes, which along with higher rates, significantly improved underwriting margins.

Despite 2023 being another year with over USD 100 billion of global insured catastrophe losses, reinsurers were generally able to avoid losses stemming from many of the associated events as there were few large catastrophes in geographies with high insurance penetration. The increase in attachment points meant that many losses were not falling on the reinsurance market. Additionally, higher interest rates on fixed income and an equity market recovery bolstered overall performance,resulting in estimated average ROE's for the market in the low-to-mid-20% range for the year[3].

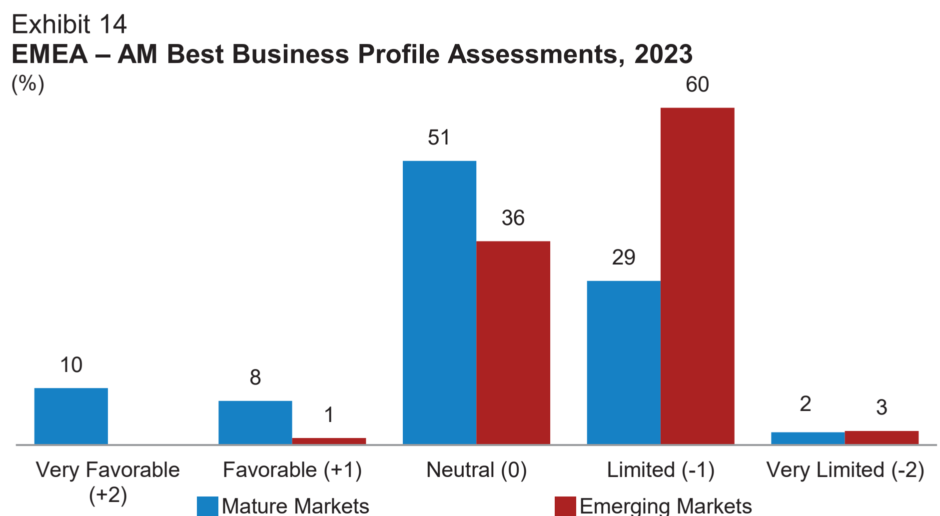
Even with much more orderly renewals in January 2024, participants have not indicated any softening in market conditions.

Business Profile

Most assessments of business profile for (re)insurance companies fall within the Neutral to Limited categories (see **Exhibit 14**). Just 5% of the total EMEA population receive a Very Favorable assessment—these companies are global (re)insurance groups, that have well-diversified operations both by geography and product line. They can rely on robust income streams and their profiles are supplemented by excellent distribution capabilities with multiple sources of revenues. These companies are market leaders that can dictate pricing and terms.
For companies that are assessed in the lower categories, there may be certain elements of their business profile that are lacking, such as diversification, or key business segments that are not performing as well as others.

AM Best notes that insurance captives generally tend to be assessed as Neutral or Limited as they often show little diversification because of the role they play. In addition, captives potentially have less control over their premium distribution than traditional insurers. While certain captives may suffer from a lack of diversification, for example, where they are not able to diversify through access to third-party premium, captives generally are of strategic importance to their parent and tend to secure good and reliable access to premiums.

Exhibit 14
EMEA – AM Best Business Profile Assessments, 2023



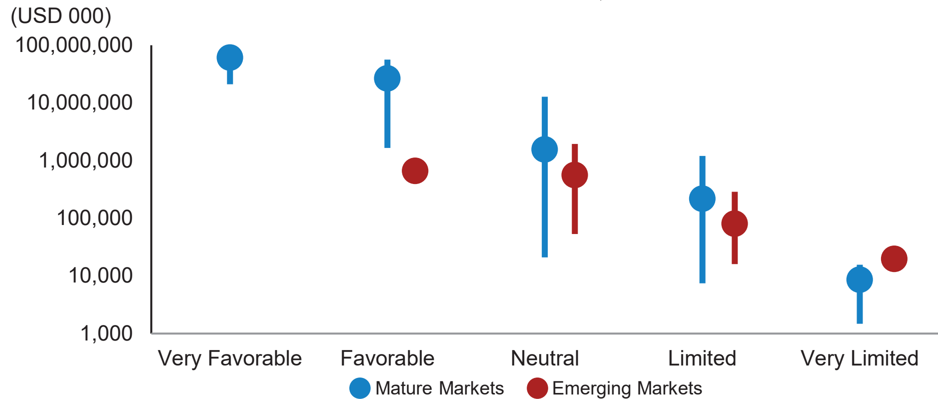
Source: AM Best data and research

Analysis shows a positive

[3] See AM Best Commentary "*AM Best report "Strong Recovery in Total Reinsurance Capital*", 8 January, 2024

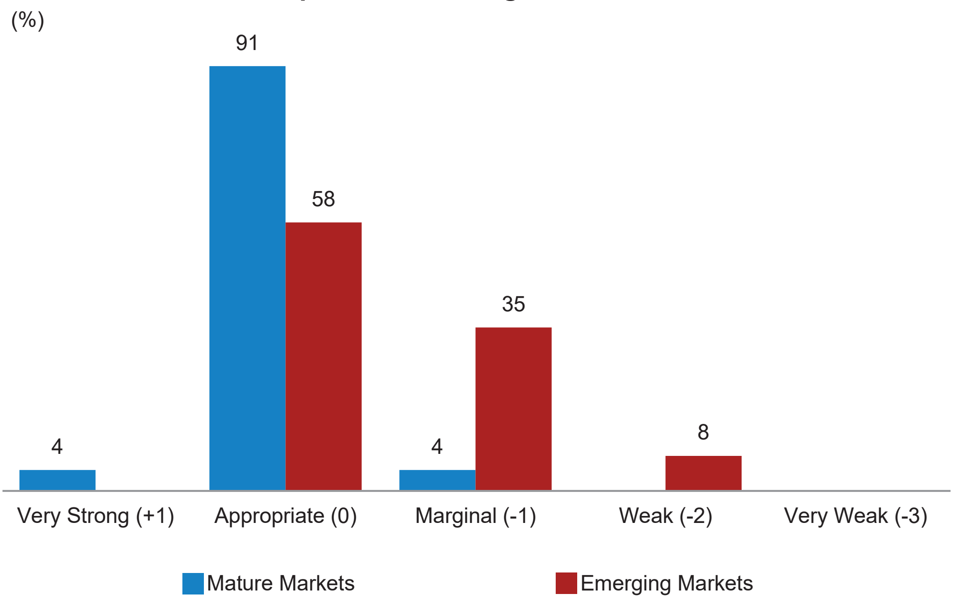
correlation between a (re)insurers Business Profile assessment and its scale (see **Exhibit 15**). While AM Best does not detail any size specific thresholds associated with the Business Profile assessment, unsurprisingly, larger companies tend to demonstrate certain key attributes which are important to the assessment. For example, larger (re) insurance groups often have diverse profiles both by line of business and geography, as well as a much more dominant market share.

Exhibit 15
EMEA – Business Profile Assessment vs GWP, Year-end 2022
(USD 000)



The marker represents the mean in the sample. The vertical lines represent the range.
Source: AM Best data and research

Exhibit 16
EMEA – AM Best Enterprise Risk Management Assessments, 2023
(%)



Source: AM Best data and research

On the other hand, it is important to highlight that scale does not necessarily correlate with every component that AM Best considers when assessing the Business Profile.

When analysing **Exhibit 15**, the data supports this assertion, whereby the vertical lines–which denote the largest and smallest company in each keyword–overlap substantially across each of the categories. This would imply that other considerations that are not so correlated with size–such as management quality, product risk, and regulatory, event, market and country risks–have played a role in the final outcome.

Emerging market players may hold excellent positions in their respective 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, they are more likely to have a greater dependence on third parties to manage their business and to be subject to high levels of regulatory risk.

Enterprise Risk Management

AM Best's ERM assessment is comprised of two main components—the risk framework evaluation and the risk profile evaluation. As **Exhibit 16** shows, most companies within mature markets have an Appropriate assessment, reflecting the sound ERM practices and robust regulatory regimes under which they tend to operate.
Overall, less than 3% of the rated population has a Very Strong ERM assessment.

In order to achieve the highest assessment, companies need to demonstrate that their risk management approach has been effectively utilised over the long term and is adding value to the organisation. A company needs to demonstrate that ERM is effective and embedded across its organisation.

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

Risk Framework Evaluation

AM Best's ERM risk framework evaluation focuses on five key areas: risk appetite and tolerances, stress testing & non-modelled risks, risk identification and reporting, risk management and controls, and governance and risk culture (see **Exhibit 17).**

In mature markets, approximately 11% of companies are deemed to have an assessment of Embedded across all of the risk framework evaluation components.

Most mature market companies have fairly robust risk management frameworks in place. However, the framework may not be fully embedded within the organisation and may fall short or show some weaknesses in approach.

Examples include breaching risk appetite tolerances, limited use of stress testing, or some shortcomings in risk controls and governance. Effective action can be taken by the company's management, but such instances can be deemed reactive rather than proactive.

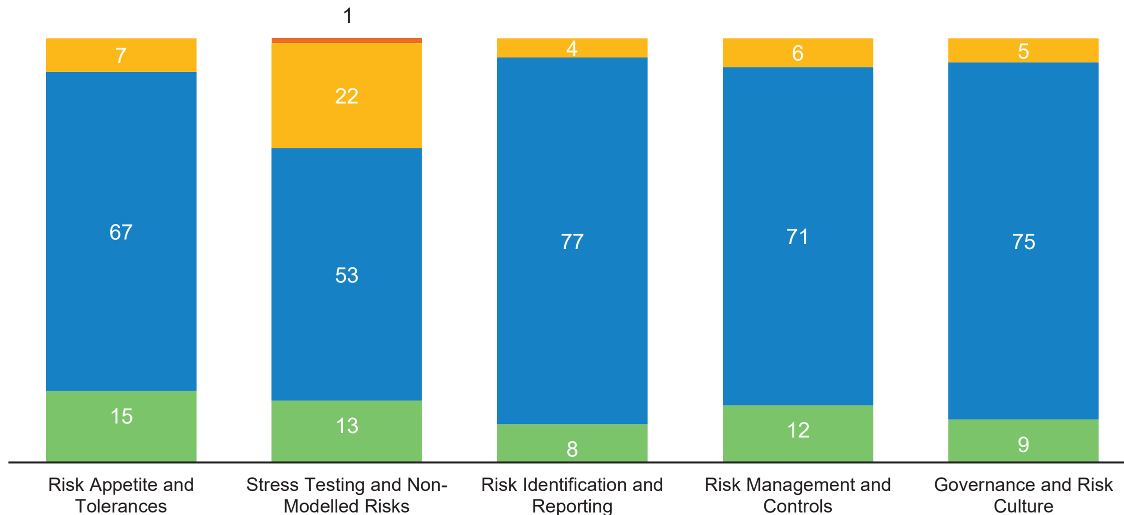
AM Best notes that especially larger and complex insurers may experience occasional shortcomings in governance or weakness of control processes in individual silos during challenging market environments. This can be despite the insurer having a conservative and prudent approach to risk management, strong risk capabilities relative to its profile and an embedded risk framework.

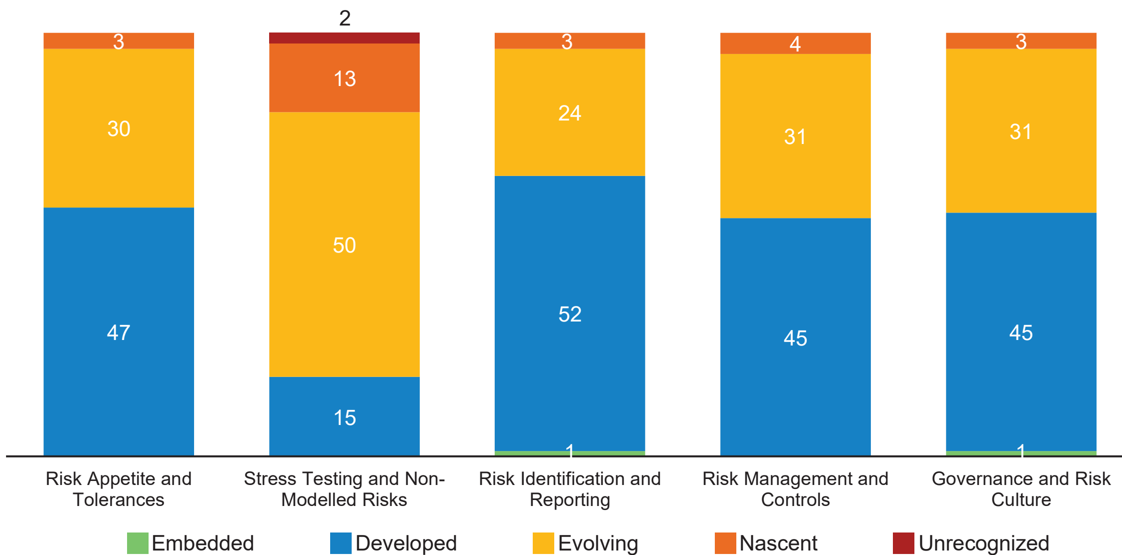
A complex entity that is growing inorganically might be especially prone to risk control shortcomings as it generally takes some time to fully establish a certain level of risk culture that interlinks to good governance and risk management controls.

Across the whole EMEA rated population, a higher proportion of weaknesses are often found in stress testing and non-modelled risks. (Re)insurers that do not adequately stress test their organisation run the risk of over-exposing their company to a given risk. Such companies often have a long-term history of capital and performance volatility.

For emerging markets, no companies are viewed to have an Embedded risk management framework, which is largely reflective of the earlier stage of development in many of those markets, the small size of companies and desire to maintain silo risk practices. Most assessments are in the Evolving category, with a few companies in the Developed category.

Exhibit 17
EMEA – AM Best Risk Framework Assessments, 2023
(%)





Source: AM Best data and research

At times, emerging market companies have demonstrated good risk management structures on paper, but the utilisation of such models generally remains weak and untested or is highly reliant on third parties.

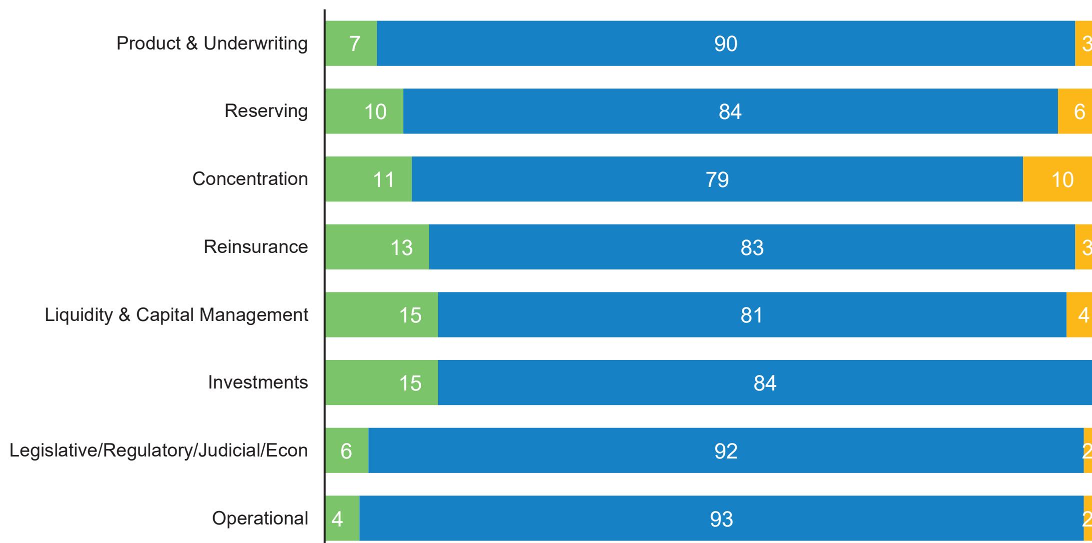
Risk Profile Evaluation

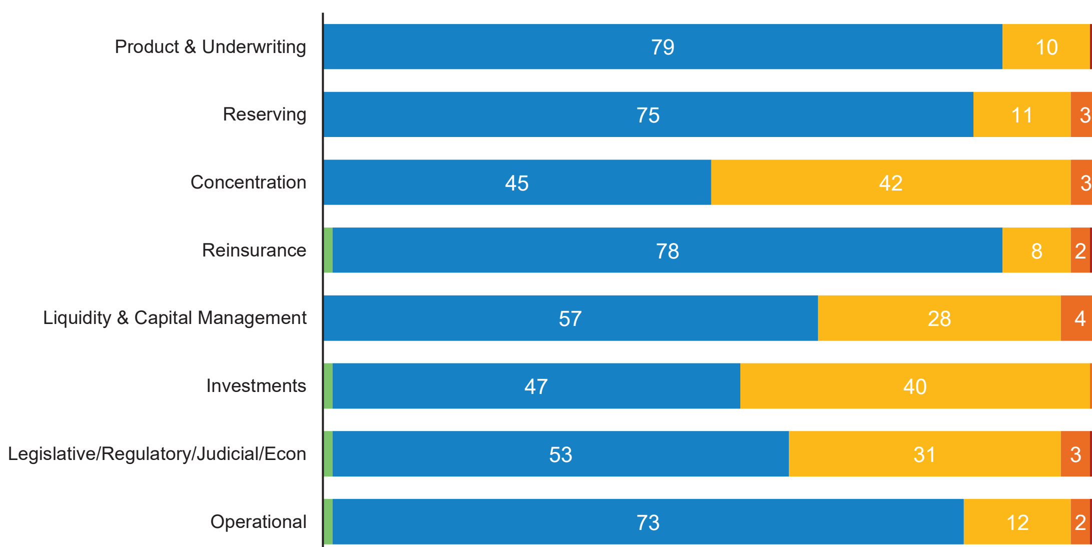
AM Best's ERM risk profile evaluation consists of eight components and assesses a company's risk management capability relative to its risk profile. AM Best examines risks related to product and underwriting, reserving, concentration, reinsurance, liquidity and capital management, investments, legislative/regulatory/judicial/economic, and operational.

More diverse and complex companies are viewed to have higher risk profiles. Such companies might include global (re)insurance groups, and enterprises that have substantial catastrophe exposures, long-tailed business, or high embedded life guarantees. Nevertheless, these companies tend to have the strongest risk management capabilities and tools at their disposal and have demonstrated their effectiveness over time. For this group, their capability is viewed generally as Very Strong.

AM Best expects companies to improve their ERM approach constantly, as markets and regulations develop; the benchmarks at each assessment level are likely to rise. A company's failure to keep pace

Exhibit 18
EMEA – AM Best Risk Capabilities, 2023
(%)





Source: AM Best data and research

with the changing landscape and evolving risks and challenges may, over time, exert pressure on its assessment. The litmus test for most companies are volatile market environments and emerging risks that test the adequacy of a company's risk capabilities relatively to their defined risk appetite.

Exhibit 18 illustrates the risk framework evaluation for the EMEA region. For mature market carriers, concentration risk is consistently the lowest scoring sub-component.

For emerging market companies, several categories are considered to be deficient, including: concentration, investment, and legal/regulatory/judicial/economic risks. This reflects the risk profile of many emerging market (re)insurers being concentrated in a single market, product or counterparty, and the higher asset risk associated with those markets.

Prudent Risk Management Remains Crucial

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 EMEA region, one should bear in mind that any generalisation always carries the risk of oversimplification, masking wide divergences at the individual level.

Additional challenges may also arise when trying to attribute separate rating impacts to specific factors that seem to be acting simultaneously, such as positive operating performance that an analyst may view as a direct result of both a strong business profile and ERM.

This analysis highlights some common themes as weaknesses, the most important of which is risk governance, with some (re)insurers, more so in emerging markets, adopting basic or minimum requirements to run their businesses. Some companies have only recently taken the initiative to adopt more prudent and sophisticated approaches to managing their operations. This has been highlighted by their significant adjustments with regard to re-stated financial statements, asset write-downs, reserve strengthening, and incidents of fraud.

In part, regulatory developments, which serve to strengthen the market, highlighted certain deficiencies. While the market is likely to endure some short-term pain for prolonged long-term stability, the impact of regulatory changes remains a challenge for a number of insurers with less developed risk governance frameworks.

The buffers that many companies had in their risk-adjusted capitalisation were eroded in 2022, but BCAR assessments still largely remain within the Strongest category. The abrupt interest rate rises during 2022 and the first half of 2023 tested the resilience of most companies' balance sheets. Asset concentrations in high-risk investments, for example from (re)insurers seeking higher yields in a context of the prior low interest rates, or with exposure to riskier less liquid investments, have partly remained a concern and add significant volatility to operating performance and capital adequacy.

The adoption of prudent risk management practices is therefore considered to be 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.

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