Ratings Review
March 17, 2023

EMEA Benchmarking – Ratings More Volatile in a More Difficult Operating Environment

Prudent risk management is crucial to achieving long-term objectives

Principal Takeaways:

- AM Best's ratings of (re)insurers in Europe, the Middle East and Africa (EMEA) have been more sensitive to market events in 2022 than in previous years
- Heightened geopolitical tensions (partly as a consequence of the Russia-Ukraine conflict), the rise in global inflation, and recessionary pressures have contributed to a difficult insurance and capital market environment
- Increased claims from catastrophe losses have also contributed to the challenging operating environment

This report evaluates the composition of AM Best ratings in EMEA, and details the rating actions that took place from year-end 2021 to year-end 2022.

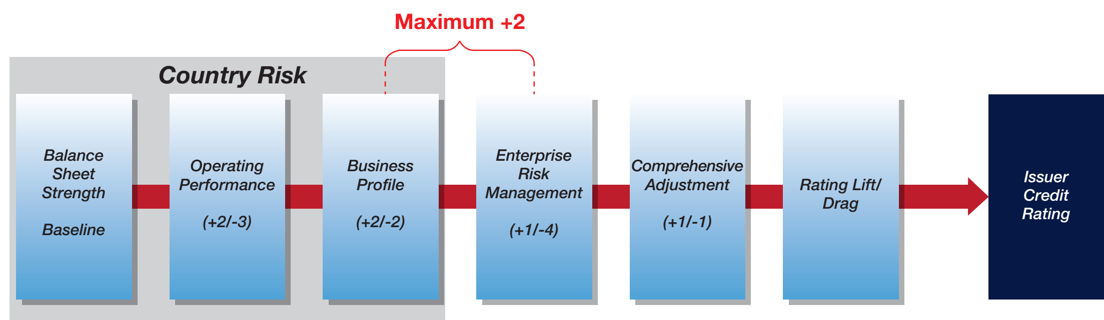
It considers AM Best's broad geographical rating coverage across most rated insurance and reinsurance groups in Western Europe (mainly France, Germany, Italy, Spain and the United Kingdom), the Middle East (predominately Bahrain, Jordan, Qatar and the United Arab Emirates [UAE]), Africa (notably in Egypt, Kenya and Nigeria), and Eastern Europe.

The analysis excludes ratings of subsidiaries that have group and reinsurance affiliation 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.

An AM Best Issuer Credit Rating (ICR) is an independent opinion of an entity's ability to

Exhibit 1
AM Best's Rating Process



Source: Best's Credit Rating Methodology

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meet its ongoing financial obligations. Full details of the rating process can be found in "Best's Credit Rating Methodology". The first step in the development of a rating recommendation is an evaluation of balance sheet strength. The steps described in the balance sheet strength section of the methodology result in a baseline assessment, which is represented on AM Best's ICR scale (e.g., "bbb+"). Other key rating factors—operating performance, business profile, and enterprise risk management (ERM)—are evaluated based on quantitative and qualitative information compiled by the analytical team (see **Exhibit 1**).

Ratings Distribution

The distribution of AM Best's ICRs for EMEA rating units as at December 31, 2022 is shown in **Exhibit 2**. Over the previous 12 months there were nine new rating assignments in the region and 13 rating withdrawals. The ICR distribution varies from "aa" to "ccc".

In mature markets, issuer credit ratings cluster around the "a" and "a-" categories. At the higher end of the spectrum, the operating entities of three market leading insurance groups—Aviva plc (UK), HDI V.a.G. (Germany) and Covéa Coopérations (France)—were upgraded and moved into the "aa-" category.

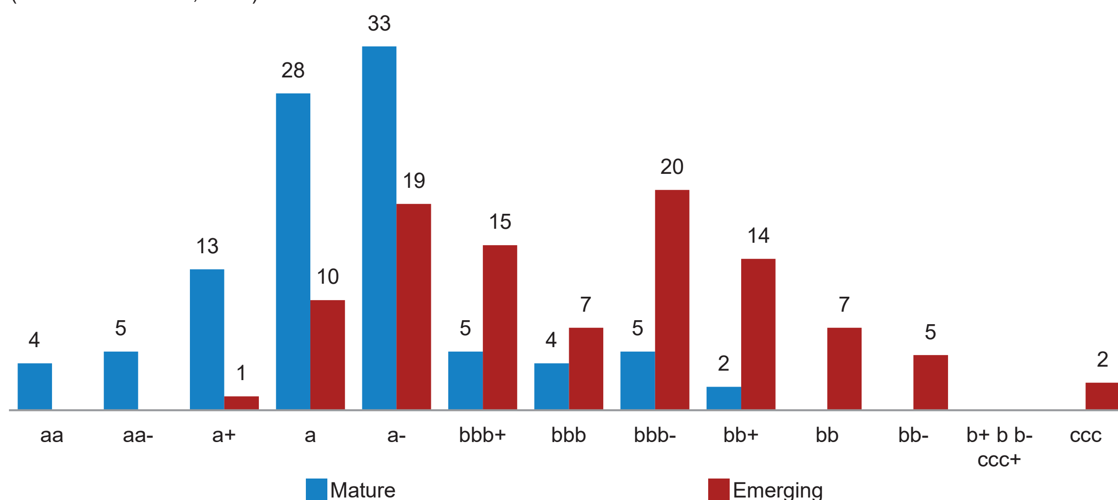
For emerging markets, in which country risk plays an important role in determining the overall rating assessment, the ratings distribution is diverse with peaks at "a-" for companies operating in the AM Best-designated Country Risk Tier 3 (CRT-3), and at "bbb+" mainly for those operating in higher risk countries (see the section "AM Best's Country Risk Tiers" for further discussion). Moving towards the lower end of the rating scale, most (re)insurance groups are domiciled in CRT-4 and CRT-5 countries (which are characterised by heightened levels of economic, political and financial system risks).

The number of emerging market ratings at the higher end (the "a" range) of the scale increased over the past year due to the upgrade of two existing rated companies—Dubai National Insurance & Reinsurance PSC (United Arab Emirates) and National Life and General Insurance Company (Oman)—from "bbb+" to "a-".

Exhibit 2

EMEA – Distribution of AM Best's Issuer Credit Ratings (ICR)

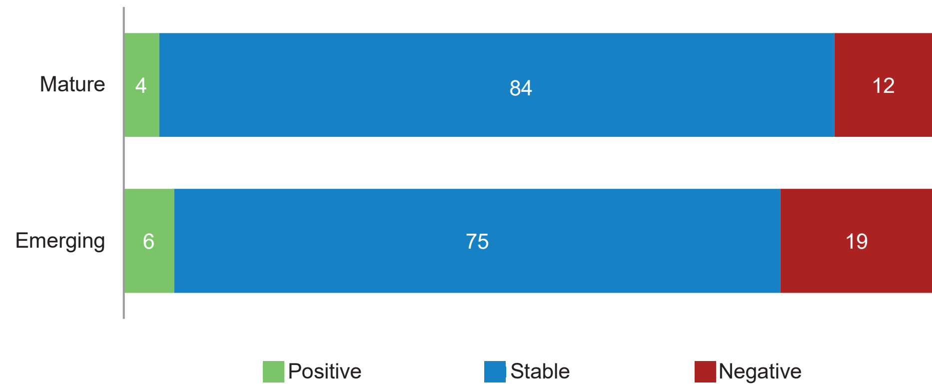
(% at December 31, 2022)



A full listing of AM Best ICR rating categories can be found on our website.
Source: AM Best data and research

The vast majority of rating units (80%) have stable outlooks (2021: 80%). With mature markets showing a higher proportion of stable outlooks (84%) than emerging markets (75%) (see **Exhibit 3**). Positive outlooks were assigned to about 5% of credit ratings (2021: 7%).

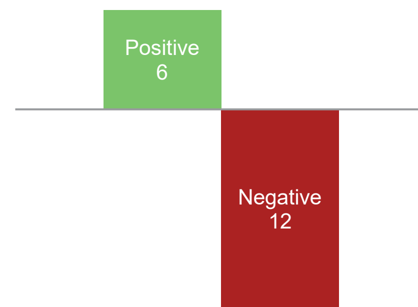
Exhibit 3
EMEA – Best's Issuer Credit Rating Outlook Split, 2022
(%)



Source: AM Best data and research

The reduction in Positive outlooks from 2021 can largely be attributed to the upgrade of a number of (re)insurers and subsequent revision of their outlooks to Stable. In addition, AM Best no longer includes in its analysis three Russia-domiciled (re)insurers that had Positive outlooks in 2021. AM Best has withdrawn these ratings for commercial reasons that include, but are not limited to, the sanctions imposed by the European Union that ban the provision of ratings to legal persons, entities or bodies established in Russia.

Exhibit 4
EMEA – AM Best Rating Outlook Changes from Stable, 2022
(Number of outlook changes)



Source: AM Best data and research

The remaining 15% of rating units had Negative outlooks as at December 31, 2022 (2021: 13%). A total of 12 outlooks were revised from Stable to Negative in 2022, with elevated country risk pressures for some (re)insurers, or pressure arising from weakened balance sheets generally driving the negative action (see **Exhibit 4**).

In addition to the greater number of Negative outlooks in 2022, there were 14 downgrades (2021: seven); of which, nine were emerging market companies, and for the most part were driven by a weakening balance sheet strength or ERM building block assessment (see **Exhibit 5**).

The global economy faced significant headwinds in 2022, which exacerbated existing issues in certain vulnerable emerging markets. This was most notably observed in Lebanon, Tunisia, Turkey, and Ghana, which endured particularly adverse economic crises over the course of the year. Six of the 14 downgraded rating units were in part negatively impacted by exposure to at least one of those countries.

There were seven upgrades in 2022, five of them tied to mature market companies. The upgrades were spread across building blocks. However, it was notable that prudent risk management practices underpinned the resilience of balance sheet strength and operating performance during the challenging equity market and economic conditions seen during 2022.

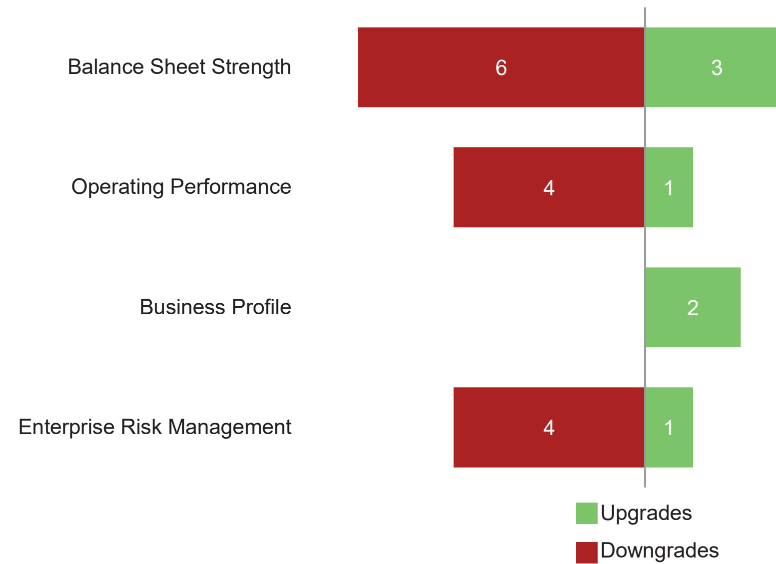
AM Best's Country Risk Tiers

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 Country Risk Tier 1 (CRT-1), denoting a stable environment with the least amount of risk, to Country Risk Tier 5 (CRT-5) for countries that pose the most risk and, therefore, the greatest challenge to a (re)insurer's financial stability, strength and performance.

Exhibit 5
EMEA – AM Best Rating Upgrades and Downgrades by Building Block, 2022
(Number of upgrades and downgrades)



Source: AM Best data and research

AM Best closely monitors economic, political, and financial system risks in countries assigned a CRT assessment. In addition, AM Best 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 determing 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 a company operating in CRT-3 to 5 countries, there are (re)insurers with higher ratings than the sovereign rating; these have demonstrated that they can absorb and mitigate risks arising from their operating environment—a key consideration when evaluating the impact of country risk in the assessment.

Country risk is an important component of the rating assessment for EMEA (re)insurers, particularly given that approximately half of the rating units operate in CRT-3 to 5 countries. Country risk is considered in three of the building block components: balance sheet strength, operating performance, and business profile. Under balance sheet strength, the baseline assessment is determined by analysing an array of balance sheet factors and applying a transition table (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+".

Exhibit 6

AM Best – Overall Balance Sheet Strength Assessment

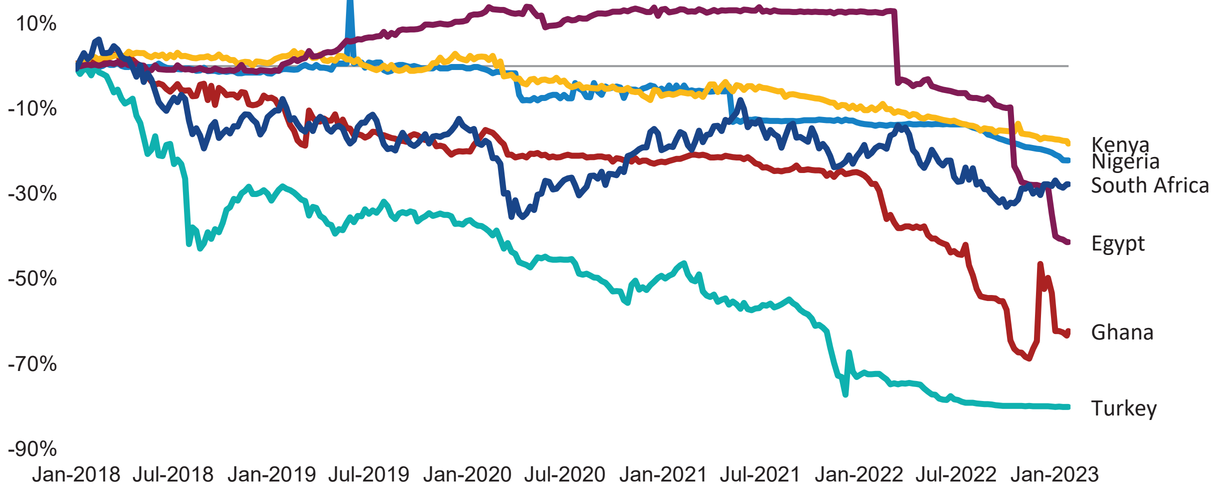
Overall Balance Sheet Strength Assessment		Country Risk Tier				
Combined Balance Sheet Assessment (Rating Unit/ Holding Company)		CRT-1	CRT-2	CRT-3	CRT-4	CRT-5
	Strongest	a+/a	a+/a	a/a-	a-/bbb+	bbb+/bbb
	Very Strong	a/a-	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-
	Strong	a-/bbb+	a-/bbb+	bbb+/bbb/bbb-	bbb/bbb-/bb+	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 Feb 2023

(% using 1 Jan 2018 as the base reference rate)



Source: Yahoo Finance

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 external shocks, such as the COVID-19 pandemic and the Russia-Ukraine conflict.

Soaring commodity prices as a result of supply-chain disruptions and price shocks have resulted in increased inflation and financial instability across many emerging markets, particularly for those reliant on the import of fuel and other commodities. As global economic conditions remain fragile in 2023, reduced demand may hamper growth and reduce government revenue, adding to the list of existing challenges faced by countries.

In response to the inflationary pressures spurred by the global financial downturn, many central banks have raised interest rates, thus increasing borrowing costs. Compounding

this has been the rapid devaluation of several emerging market currencies (see **Exhibit 7**), which has increased the repayment burden of foreign currency denominated debt. These issues have contributed to large capital outflows amid a "flight to security", leaving emerging market countries with restricted access to external funding, which will make refinancing debt increasingly more difficult.

In particular, multiple African countries are facing a high and growing debt servicing burden (see **Exhibit 8**), which has in some cases led to sovereign default. This is not solely an issue within Africa, with emerging markets around the world encountering similar issues.

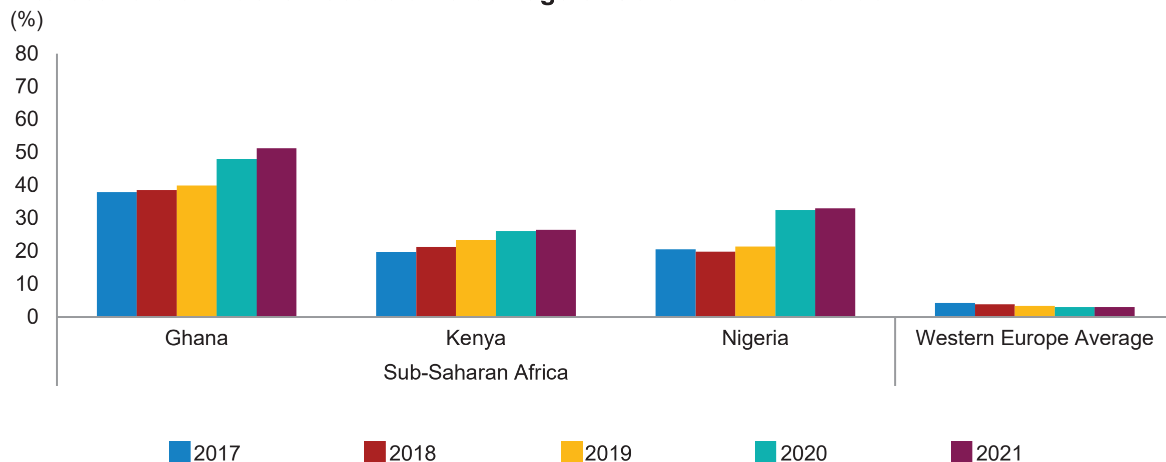
Four countries—all located in sub-Saharan Africa—formally applied for debt treatment under the G20 common framework[1] between 2021 and the end of January 2023. Moreover, according to the International Monetary Fund's (IMF) Debt Sustainability Analysis for low-income countries[2], 15% of countries were classified as "in debt distress", with a further 39% at a "high risk of debt distress", up from 10% and 33%, respectively, in 2018.

During 2023, AM Best expects the global debt burden to continue to increase, as countries balance the trade-off between tightening monetary policy to tackle high levels of inflation, with rising levels of recessionary risk. With average indebtedness and the cost of servicing debt rising, it is likely that a growing number of more vulnerable countries will be forced to consider debt re-structuring or outright default.

Balance Sheet Strength – Baseline Assessment

The distribution of AM Best's assessment of balance sheet strength for EMEA-rated entities is illustrated in **Exhibit 9**. The balance sheet strength assessments of (re)insurers operating in both mature and emerging markets are generally concentrated within the Very Strong category. This partly reflects robust capital buffers, typically in excess of their internal target levels. Companies in emerging countries have a greater presence further down the assessment scale; indicating the influence of country risk on the assessment.

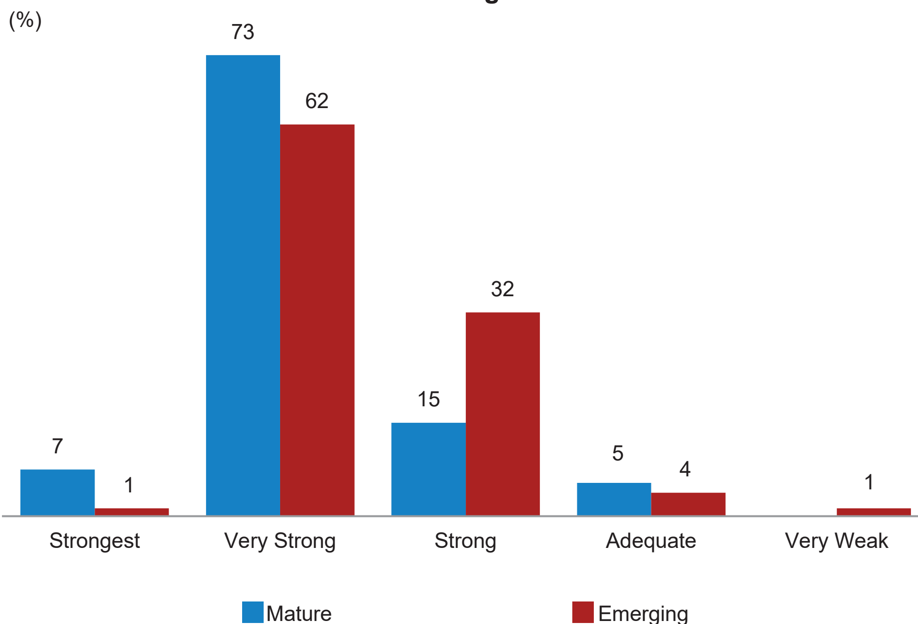
Exhibit 8
Interest Paid on Public Debt as a Percentage of Government Revenue



Source: International Monetary Fund

[1]Common Framework for debt treatment launched in November 2020, an initiative endorsed by the G20 countries to support low-income countries with unsustainable debt.
[2]IMF Debt Sustainability Analysis of Low-income Countries eligible for Poverty Reduction and Growth Trust as of November 30, 2022 (total of 69 countries in November 2022 aggregate, and 72 countries in August 2018).

Exhibit 9
EMEA – AM Best Balance Sheet Strength Assessments
(%)



A full listing of AM Best Balance Sheet Strength Assessment categories can be found on our website.
Source: AM Best data and research

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

AM Best uses a proprietary capital adequacy model—Best's Capital Adequacy Ratio (BCAR)—to measure risk-adjusted capitalisation across several confidence levels. Risk-adjusted capitalisation is assessed as Strongest when the standard 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%. AM Best also assesses stressed BCAR scores to provide insight into a company's balance sheet strength shortly after it experiences a catastrophic event.

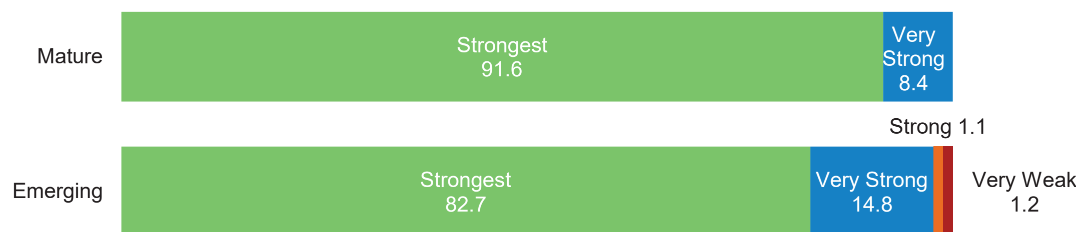
Analysis shows more than 85% of EMEA rating units are within the Strongest assessment of risk-adjusted capitalisation. The mean BCAR for the universe of rated EMEA entities is in the 40% to 50% range. The stressed BCAR assessments of most rated companies are equal to the respective standard BCAR assessments, or fall within one level.

The vast majority of the population with strongest BCARs have a comfortable buffer. In 2021, improved earnings generation and prudent capital management resulted in modest improvements in average BCAR scores. However, unrealised losses on fixed income instruments and volatility in capital markets in 2022 are expected to more than reverse those improvements.

AM Best notes that some companies with exceptionally robust BCAR scores frequently have a limited market profile or are in a start-up phase. They are typically subject to greater volatility in capitalisation given their limited size and reduced ability to absorb large losses. Most companies in both mature and emerging markets have Strongest BCAR assessments. However, companies operating in mature markets have significantly different drivers for capital requirements compared with emerging market companies.

Unsurprisingly, general insurers operating in mature markets have mostly low-risk asset profiles, with the vast majority of the risk being borne out of underwriting. This has partly supported the balance sheet resilience of most carriers operating in mature markets during heightened capital

Exhibit 10
EMEA – Distribution of AM Best BCAR Assessments
(%)



A full listing of AM Best BCAR assessment categories can be found on our website.

market volatility and the increase in interest rates globally during 2022. Those companies have also benefited from strong liquidity profiles and good asset liability management.

Conversely, for emerging market companies, investment risk tends to be the main driver of capital consumption. This is explained by the higher investment risk profile of emerging market companies, as they invest in less mature financial markets with higher levels of credit risk.

Given the heightened volatility and uncertainty in emerging markets, capital charges for investments in higher risk countries are greater within BCAR. In addition, many emerging market companies tend to have narrower levels of asset allocation, which incur concentration and illiquidity charges in AM Best's capital model. Despite the elevated asset risk charges observed in emerging markets, more than 80% of rating units have BCAR scores at the Strongest level (see **Exhibit 10)**. It is common for emerging market companies to have low levels of net underwriting leverage, which results in lower underwriting risk capital requirements compared with mature market ratings.

AM Best notes that most reinsurers have Strongest BCAR assessments, reflected by the significant capital buffers that reinsurers hold, which allows them to absorb large shock losses (see **Exhibit 12**). Most of the reinsurers have robust risk management capabilities and tools at their disposal in order to manage potential earnings and capital volatility in line with their risk appetites. On the other hand, most primary insurers tend to have more moderate risk underwriting profiles that reflect lower levels of volatility and tend not to hold large excess capital buffers.

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 the BCAR is important to the analysis, there are also a number of other components that come into play.

The relationship between BCAR and balance sheet strength assessments for mature and emerging markets is illustrated in **Exhibit 13**. As noted above, over 85% of EMEA rating units have BCAR scores within the Strongest category. However, only 7% of the mature market population had balance sheet assessment at the Strongest level at year-end 2022—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 companies have a balance sheet strength assessment of Very Strong (72% in mature markets and 61% in emerging markets). Very few companies have balance sheet strength assessments below the Strong category.

When examining the emerging markets' population, the assessment is generally lower. 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 mitigating factors. Just over 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 one-fifth. The BCAR assessments are the primary driver of this difference.

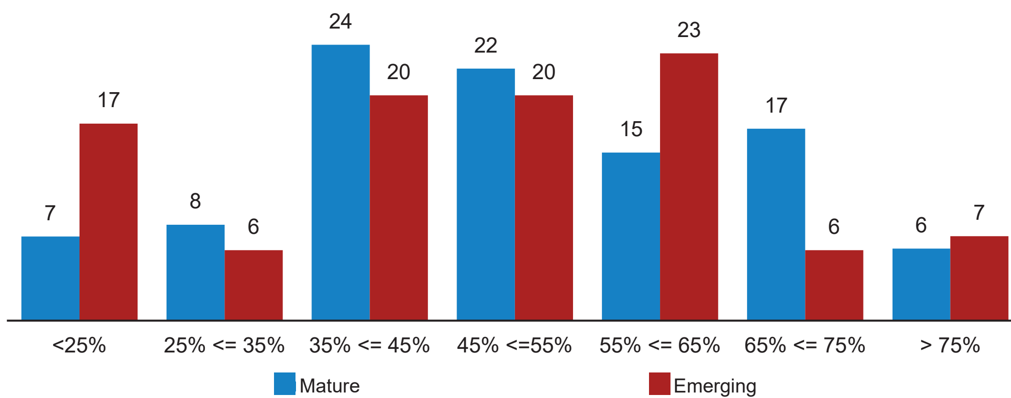
Over the course of the surveillance period, balance sheet strength was the building block that saw the most downgrades, the majority of which were driven by a rapid decline in BCAR and related to emerging market companies.

Beyond BCAR – Other Drivers of Balance Sheet Strength

Mature Markets

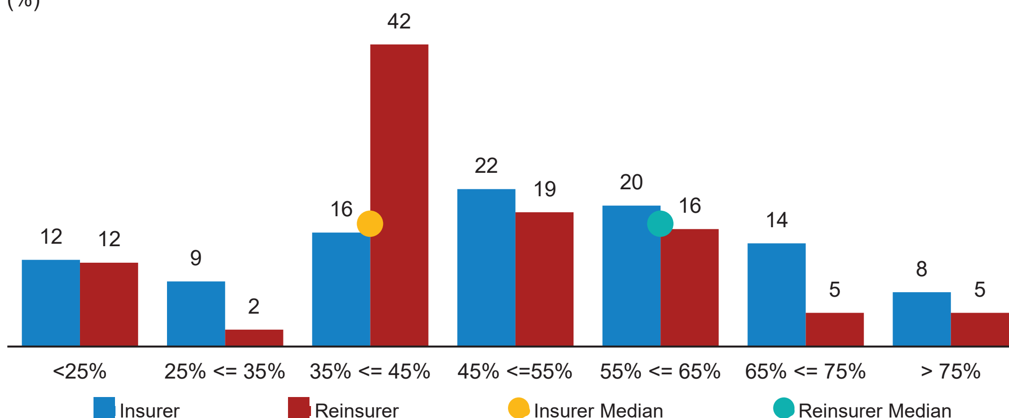
For mature markets, balance sheet strength assessments are heavily skewed towards to the Strongest and Very Strong categories, which in part is a consequence of the strong regulatory regimes adopted

Exhibit 11
EMEA – Distribution of AM Best BCAR Scores @99.6% VaR
(%)



Source: AM Best data and research

Exhibit 12
EMEA – Distribution of AM Best BCAR Scores @99.6% VaR
(%)



Source: AM Best data and research

Exhibit 13
EMEA – BCAR vs Balance Sheet Strength, 2022
(%)

Mature Markets

BCAR Assessment	Balance Sheet Strength					
	Strongest	Very Strong	Strong	Adequate	Weak	Very Weak
Strongest	7.4	69.5	10.5	4.2	0	0
Very Strong	0	3.2	4.2	1.1	0	0
Strong	0	0	0	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	1.2	60.5	19.8	1	0	0
Very Strong	0	1.2	11.1	2.5	0	0
Strong	0	0	1.2	0	0	0
Adequate	0	0	0	0	0	0
Weak	0	0	0	0	0	0
Very Weak	0	0	0	0	0	1.2

Source: AM Best data and research

within these countries, supported by prudent capital management strategies from most market participants. The majority of companies seem to benefit from sound financial flexibility, prudent reserving and strong liquidity profiles.

Financial flexibility has in part been underpinned by access to the capital/debt markets, with mature market insurers striving to retain moderate leverage ratios. Access to debt markets is generally viewed as a positive for financial flexibility.

In light of the relatively low cost of debt in recent years, levels of financial leverage have generally increased. In addition, the nominal leverage ratio was further elevated by reported declines in capital and surplus levels (driven by unrealised losses) in 2022. High financial leverage ratios can be a risk if financial market volatility and investor uncertainty were to make it difficult to issue new debt instruments if needed.

A more intense focus on reserve adequacy is also underpinning balance sheet strength (this has been a weaker balance sheet factor for some carriers in the past). This change in focus is taking place against a backdrop of increasing inflation and robust underwriting discipline in most markets.

The investment portfolios of non-life market participants tend to be very conservative. However, some mature market players show a degree of concentration in local markets or to a particular asset class, which could lower the quality of the overall investment portfolio. Rising rising interest rates during 2022 affected fixed income assets directly and consequently put pressure on many insurers' balance sheets. However, the vast majority of mature market players benefit from robust asset liability management and strong liquidity profiles relative to their underwriting risk profile,

with appropriate stress testing performed on their balance sheets. This is expected to allow them to absorb potential shock losses and hold fixed income assets to maturity.

The higher interest rate environment has prompted mature non-life players to reduce their exposure to the high-risk assets they had acquired in response to the low interest rate environment. Some have started increasing holdings in fixed income assets as interest rates have risen. Life insurers are typically subject to greater asset risk, with their fortunes more closely correlated to the economy, but mitigated through prudent asset liability management.

The main negative factors in the balance sheet strength assessment relate to high levels of reinsurance dependence. This has proven in some instances to be a challenge for primary insurers, as this has exposed especially those carriers to changes in reinsurance market conditions, dispute risk and credit risk.

Emerging Markets

While the risk-adjusted capitalisation of emerging market players is generally assessed as Strongest to Very Strong, other balance sheet components can weigh on an insurer's overall balance sheet strength. 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 can be 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. Often companies are only able to invest in their domestic financial markets, which are often in the early stages of development.

Given the generally smaller size of economies in emerging markets, there are 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.

Even when liquidity in the domestic market is good, a negative impact may arise from stress tests relating to large losses, or write-downs for many companies.

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.

Operating Performance

Operating performance assessments for EMEA companies centre mainly around the Adequate to Strong categories (see **Exhibit 14**), with a relatively similar distribution between both mature and emerging markets. At present, there is only one company with an assessment of Very Strong.

The vast majority of Strong assessments are for companies that are market leaders, or (re)insurers with stable profiles that benefit mostly from diversified earnings sources and have consistently generated strong risk-adjusted returns for a long period, with a solid profit-generating pattern expected to continue.

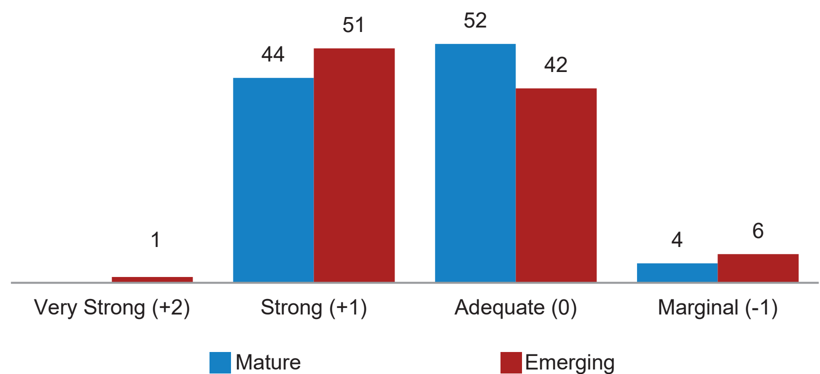
Exhibits 15, 16 and 17 illustrate several five-year average performance ratios for mature and emerging markets. The underwriting performance and return on equity (ROE) for both segments show a trend—as expected—of improving profitability as there is a move from the Weak to the Very Strong category.

The drivers of underwriting results tend to differ slightly between mature and emerging markets.

Exhibit 14

EMEA – AM Best Operating Performance Assessments

(%)



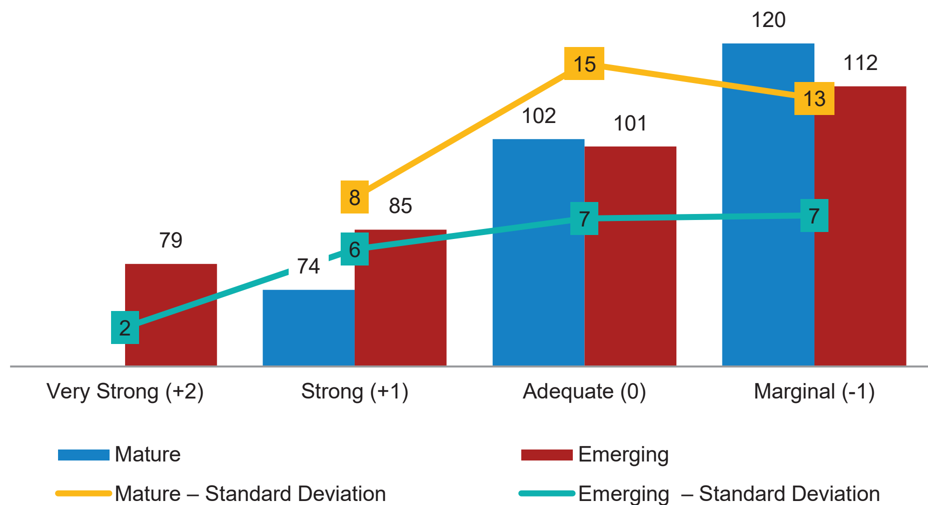
A full listing of AM Best Operating Performance Assessment categories can be found on our website.
Source: AM Best data and research

The mature market players have generally shown relatively good underwriting discipline, underpinned by stable performance ratios (excluding the impact of captive insurers that tend to have high volatility in underwriting performance). However, increased claims inflation and higher interest rates are expected to lead to pressure on technical margins, especially in highly competitive mature markets. This could lead to higher underwriting volatility and somewhat weaker underwriting performance.

Exhibit 15

EMEA – Five-Year (2017-2021) Average Combined Ratio

(%)



A full listing of AM Best categories can be found on our website
Source: AM Best data and research

One of the features of emerging markets is insurers' extensive reliance on profit commissions from their reinsurers.

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

This incumbent 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 appetite for these risks from the reinsurance market, with less support to local market participants, could have major ramifications for the profits of 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.

While this business model remains viable for the time being, the recent trend in hardening of global reinsurance rates and terms and conditions will likely test the profit margins of cedents.

Those with combined ratios of around 100% are likely to be considered Adequate. For companies that have a higher assessment, average combined ratios in most cases are well below the 100% level and the stability of their performance is generally better as indicated by the lower standard deviation for better performing companies.

The combined ratio's average standard deviation for developed market companies tends to be above that of emerging market companies (see **Exhibit 15**). This can be explained by the presence of insurance captives in the sample. These are generally located in developed markets and tend to show an increased volatility in terms of combined ratio. While the standard deviation appears higher for these companies, captive insurance companies generally produce more favourable combined ratios in benign years, and benefit from a certain level of financial flexibility emanating from their parent.

When considering return on equity (ROE) for the whole population (see **Exhibit 17**), 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 -7% for companies assessed as Marginal and increase to 14% 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.

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 imply. In certain territories, inflation and interest rates may be particularly high (this can often be the case in CRT-4 and CRT-5 domiciles), which implies that affected companies operate in volatile environments and are largely dependent on investment income to bolster earnings.

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 2022, companies can experience a material spike in claims, wiping out many years of profits. This emphasises that the 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.

AM Best factors into its assessments the earnings profile from both investment and underwriting activities and the level of volatility over various time periods. Further investigation into the track record of earnings and prospective market conditions is also important, as well as analysis of the sources of income, and performance relative to peers.

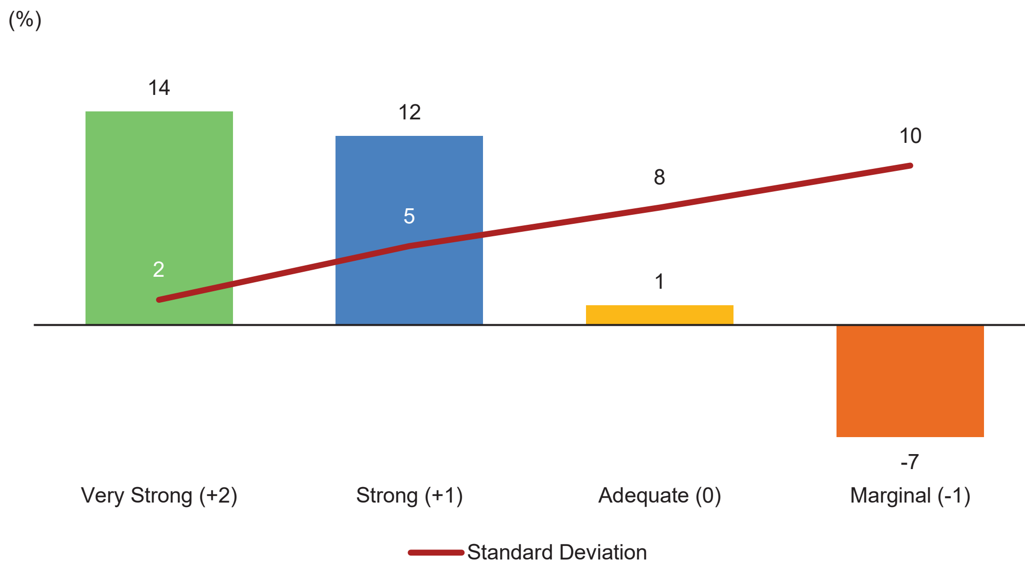
AM Best considers prospective earnings generation, absolute earnings, gross versus net profitability, performance relative to peers, and potential market and economic conditions (such as inflation, changes in interest rates or geopolitical developments) as part of its operating performance analysis.

Exhibit 16
EMEA – Five-Year (2017-2021) Average Combined Ratio Standard Deviation
(%)

A full listing of AM Best categories can be found on our website.
Source: AM Best data and research.

Exhibit 17
EMEA – Five-Year (2016-2020) Average Inflation-Adjusted Return on Equity

(%)



A full listing of AM Best categories can be found on our website.
Source: AM Best data and research

Business Profile

Most assessments of business profile for (re)insurance companies fall within the Neutral and Limited categories (see **Exhibit 18**). Just 5% of the total EMEA population receives a Very Favorable assessment. These companies are global insurance or reinsurance groups that have well-diversified operations (both by geography and product line), they can rely on robust income streams and excellent distribution capabilities with multiple sources of revenues. They are also market leaders

that can dictate pricing and terms, are sophisticated in terms of their underwriting and data quality, and also tend to be at the forefront of innovation (see **Exhibit 19**).

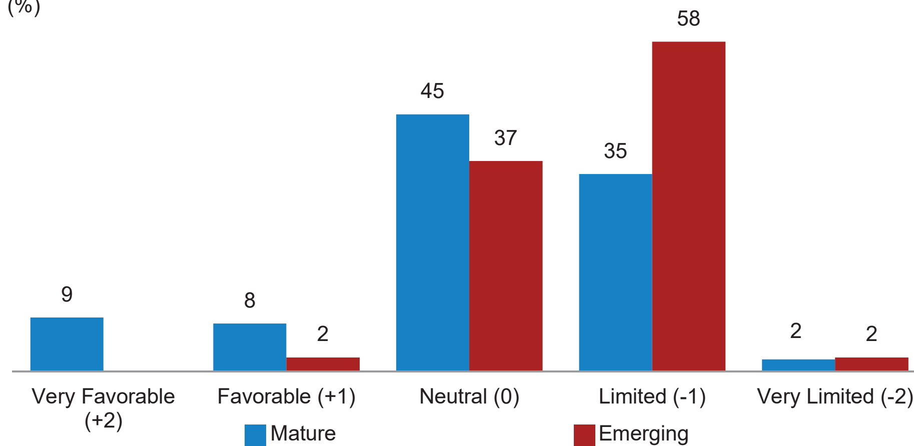
For those companies that are assessed in the Favorable category, there may still be certain elements of their business profile that are lacking, such as diversification, or key business segments that are underperforming.

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 to their non-insurance parent company (often only insuring a limited number of lines of business). In addition, captives potentially have less control over their premium distribution channels 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 access to business.

Exhibit 18

EMEA – AM Best Business Profile Assessments

(%)



Source: AM Best data and research

Exhibit 19

EMEA – AM Best Key Business Profile Characteristics

Very Favorable (+2)	Favorable (+1)	Neutral (0)	Limited (-1)
• Superior global franchise • Excellent product & geographical diversification • Excellent access to business through multiple channels • Market leaders in key segments • Pricing sophistication • Core markets/products performing well • Significant innovation	• Leading position in a single market or niche segment • Good product & geographical diversification • Strong access to markets through key distribution channels • Extensive in-house expertise • Good data and pricing sophistication • Core lines performing well	• Strong market profile in a small market • Limited size on global scale • Narrow profile on net basis • Some dependence on third parties • High degree of competition • Moderate economic/ political/regulatory risk	• SME and monoline insurers • Limited product & geographical diversification • Very limited profile on global scale • Narrow profile on net basis • High dependence on third parties • High degree of competition • High economic/ political/regulatory risk • Limited innovation

A full listing of AM Best Business Profile Assessment categories can be found on our website.

Source: AM Best data and research

Analysis shows a clear link between a company's Business Profile assessment and its innovation assessment. Unsurprisingly, companies with higher assessed business profiles, generally tend to score higher on their innovation assessment. An interesting point is that innovation is not limited to market leaders and that companies across a range of sizes use innovation to leverage their expertise in different aspects of their operating model.

Emerging market players may hold excellent positions in their respective domestic markets, with good control and leadership positions, but their overall size and level of diversification may be limited. Furthermore, such companies generally have narrower profiles and are subject to greater levels of competition as their markets have largely opened up to non-local players. On a global scale, they can be relatively small. 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 includes three components—the risk framework evaluation, the risk profile evaluation and the overall assessment. As **Exhibit 20** 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 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 medium-to-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 companies tend to have Appropriate, Marginal or Weak risk management assessments, in part a consequence of the early stages of insurance and regulatory development of these markets, as well as generally elevated risks prevalent in those operating environments.

AM Best's ERM risk framework evaluation component focuses on five core areas: risk appetite and tolerance, stress testing and non-modelled risks, risk identification and reporting, risk management and controls, and governance and risk culture (see **Exhibit 21**).

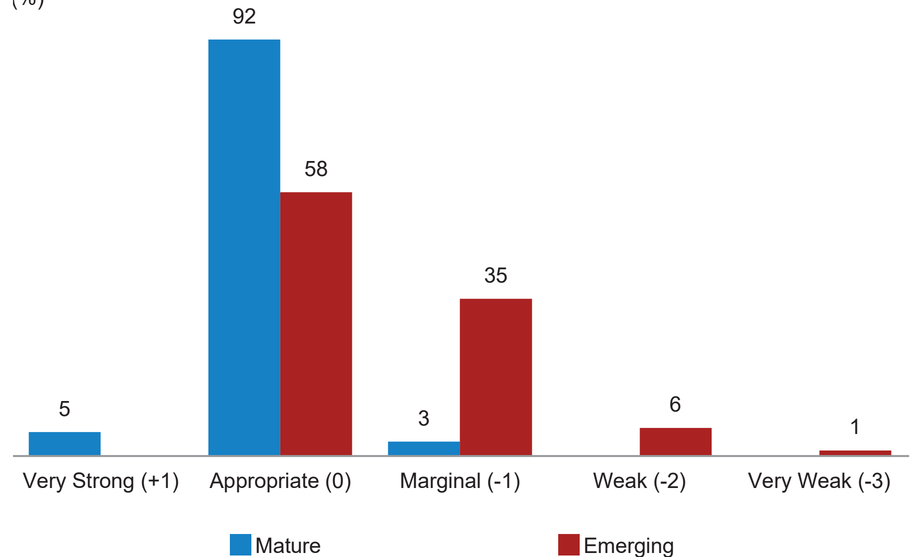
For mature markets, approximately 15% of companies are deemed to have a framework assessment of Embedded. The majority of companies fall within the Developed stage.

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 tolerance levels, 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 are deemed reactive rather than proactive

AM Best notes that especially larger and complex insurers may be impacted by occasional shortcomings in governance or weakness of control processes in individual silos when market conditions are challenging, despite 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 through external acquisitions might especially be 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.

For mature markets, a higher proportion of weaknesses are found in stress testing and non-modelled risks, and under risk management and controls.

Exhibit 20
EMEA – AM Best Enterprise Risk Management Assessments
(%)



A full listing of AM Best Enterprise Risk Management Assessment categories can be found on our website.
Source: AM Best data and research

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

Despite emerging market companies falling short across all categories, the main areas of concern relate to stress testing (including investment portfolio stress tests), and governance and risk culture. At times, 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.

In the future, AM Best expects companies operating in emerging markets to demonstrate improvements in ERM, though it should be noted that the benchmarks of each assessment level are also likely to constantly rise. In order for companies to maintain their current assessments, they will need to be proactive in the development of their risk management practices.

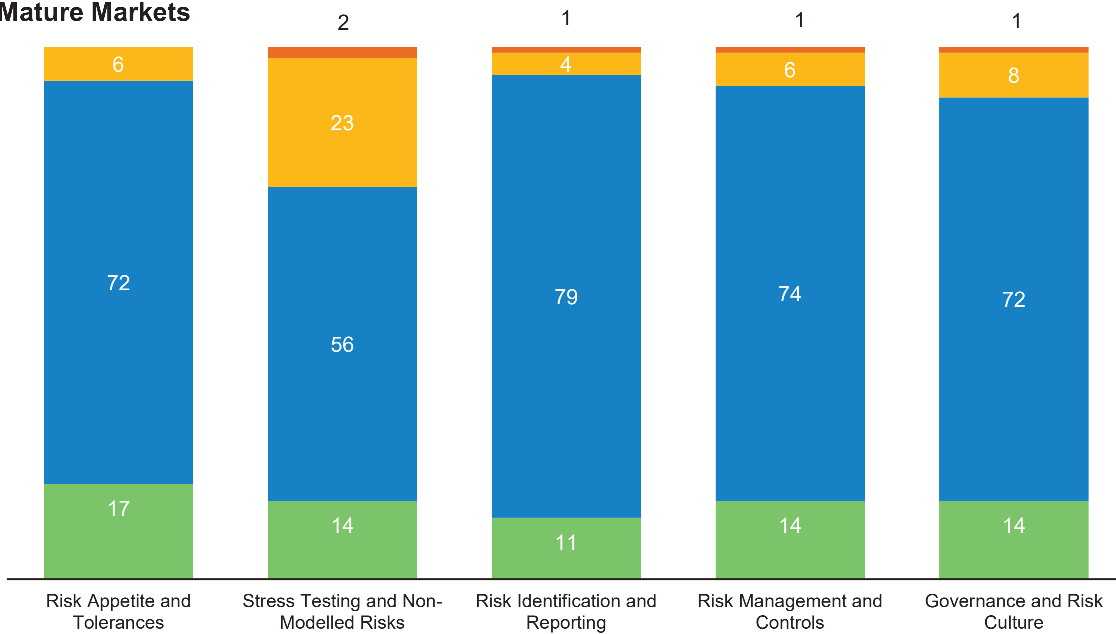
AM Best's ERM risk evaluation consists of eight components and assesses a company's risk management capability relative to its risk profile. AM Best examines risks related to product and underwriting, reserving, concentration, reinsurance, liquidity and capital management, investments, legislative/regulatory/judicial/economic,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

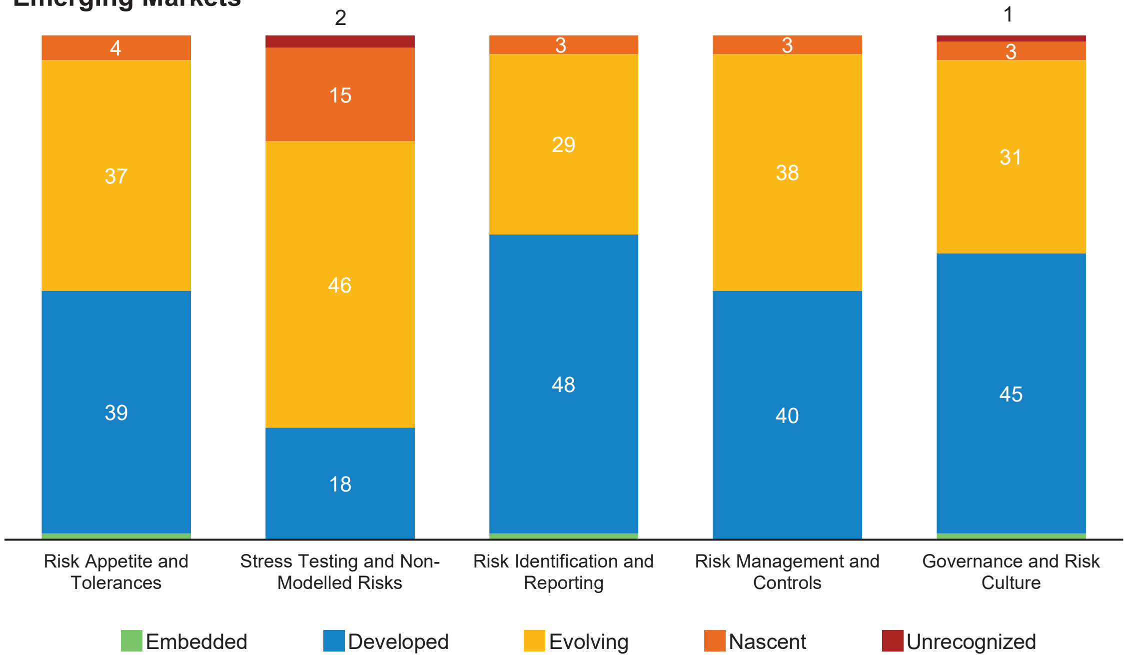
More diverse and complex companies are viewed to have higher risk profiles. Such companies might include global insurance and reinsurance groups, and enterprises that have substantial catastrophe exposures, long-tailed business, or high embedded life guarantees. These companies will need more robust tools and mechanisms in place to manage their exposures and need a sufficient framework in place to support these risks.

Exhibit 22 highlights the most important features for the ERM assessment. AM Best views global insurance and reinsurance groups as the most risky, in part due to their sheer size and scale. Nevertheless, these companies tend to have the strongest risk management capabilities and tools at their disposal, and to have demonstrated their effectiveness over time.

Most complex global insurance and reinsurance groups have in many cases a risk capability of Very Strong. However, the broadest category is Appropriate, which reflects the diversity of companies under consideration. These range from complex groups, with a relatively sophisticated ERM approach, to small and conservative single market participants or monoline players with a lower risk profile and excellent control over their risks.

Exhibit 21
EMEA – AM Best Risk Framework Assessments
(%)

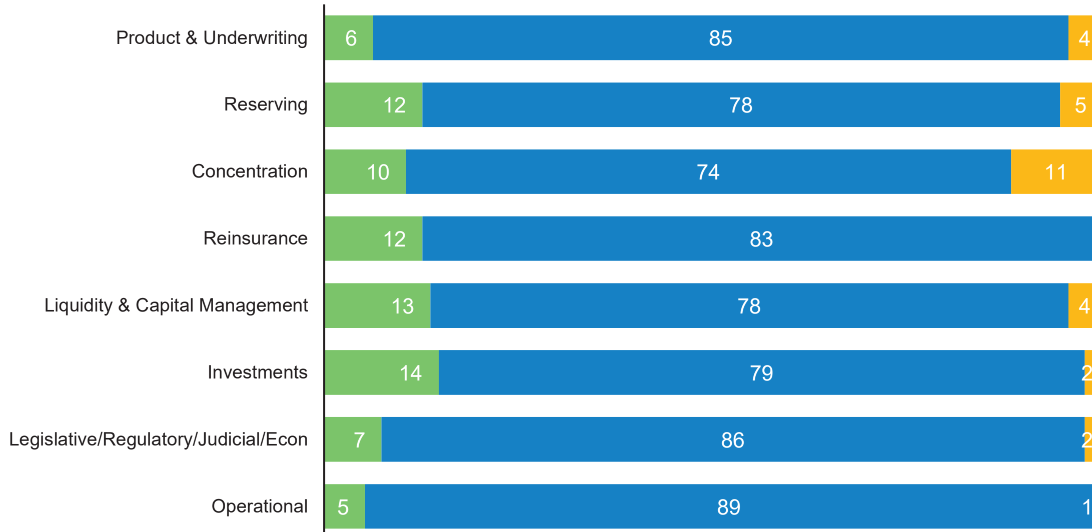


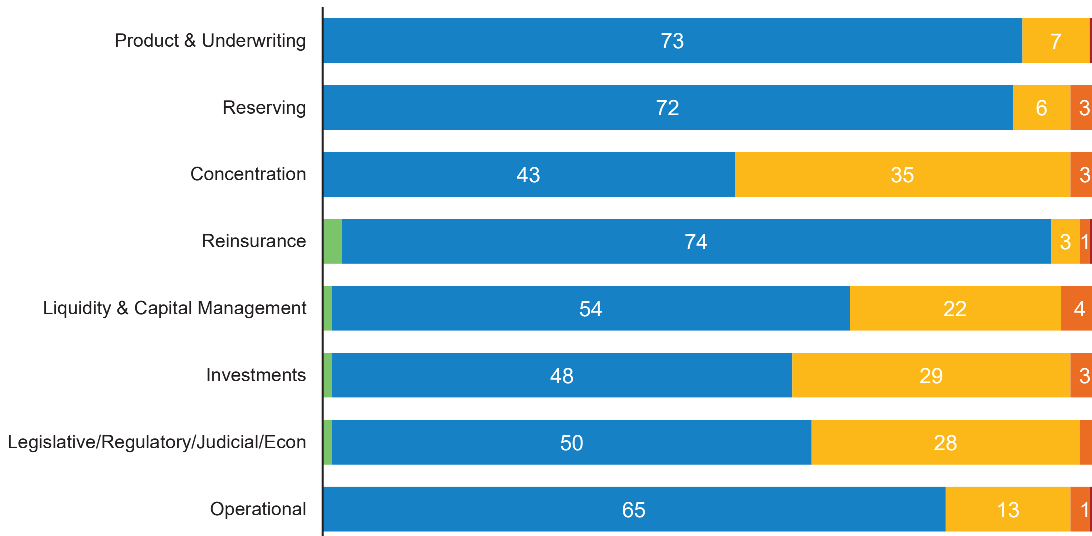


A full listing of AM Best Risk Framework Evaluation assessment categories can be found on our website.

In any case, AM Best expects companies to improve their ERM approach constantly, as markets and regulations develop. A company's failure to keep pace 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 relative to their defined risk appetite.

Exhibit 22
EMEA – AM Best Risk Capabilities
(%)

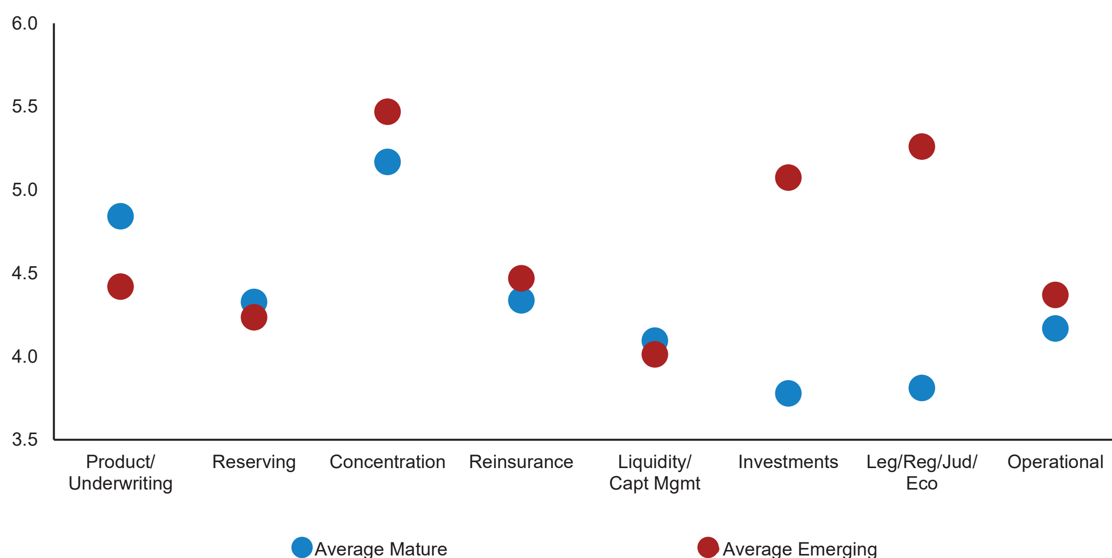




A full listing of AM Best Risk capability categories can be found on our website.
Source: AM Best data and research

Exhibit 23 illustrates the risk profile for the EMEA region. For mature market carriers the greatest risk is mainly concentration followed by product and underwriting risks, with the latter reflecting the assumption of complex and long tail risks. For emerging market companies, the greatest risks tend to be concentration, investment, and legal, regulatory, judicial and economic risks. This reflects the risk profile of many (re)insurers being concentrated to a single market, product or counterparty, and the higher asset risk associated with those markets. Also, a number of insurers have shown deficiencies in managing capital and holding sufficient liquidity for their operation.

Exhibit 23
EMEA – AM Best Average Risk Profiles
(1: Low Risk to 9: High Risk)



Full details of AM Best's Average Risk Profile categories can be found on our website.
Source: AM Best data and research

Prudent Risk Management Remains Crucial

Rating disclosures under the updated BCRM methodology 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 have eroded steadily in recent years, but BCAR assessments still largely remain within the Strongest category. The abrupt interest rate changes during 2022 and the negative impact on fixed interest valuations has 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 remained a concern and add significant volatility to operating performance and capital adequacy. The adoption of prudent risk management

practices is critical, 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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