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Ratings Review
April 12, 2022

EMEA Benchmarking: Ratings Show Stability Despite Heightened Volatility and Uncertainty

Prudent risk management is crucial to achieving long-term objectives

Ratings of AM Best-rated (re)insurers in Europe, the Middle East and Africa (EMEA) have shown stability over the past year. COVID-19, heightened geopolitical tensions, and inflation risk, as well as catastrophe losses and climate risk have contributed to a challenging economic environment.

Nevertheless, the vast majority of (re)insurers have shown resilience, with balance sheets able to withstand shocks. AM Best considers that robust balance sheets are a strength for rated (re)insurance groups and there have been a number of positive rating actions in the EMEA region over recent years.

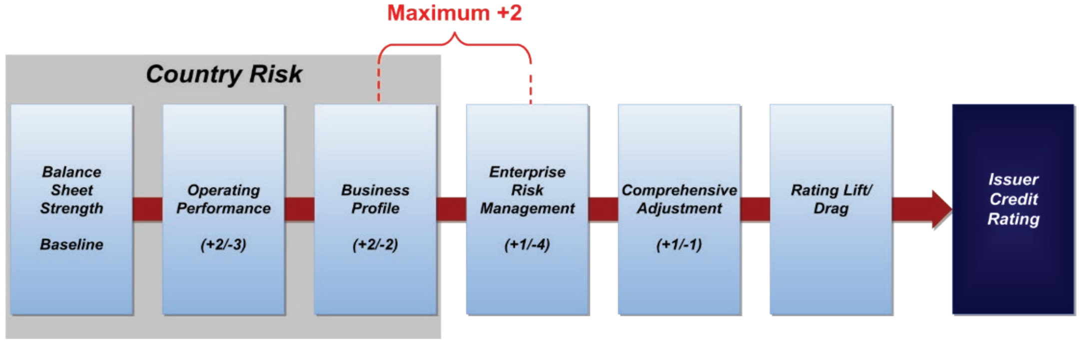
Certain lines of business, including motor, showed improving performance, as government-mandated restrictions reduced the claims burden during the COVID-19 pandemic. However, uncertainty and inflation risk will remain a challenge over the coming months as geopolitical tensions continue. These could put negative pressure on insurers' ratings if they unable to successfully navigate the operating environment.

This report evaluates the distribution of rating actions over the period from year-end 2020 to year-end 2021.

Since the end of that period AM Best has taken a number of negative rating actions related to the Russian-Ukraine conflict. The conflict is expected to contribute to prolonged and heightened financial market volatility, as well as having adverse effects on the global economy. However, AM Best believes that the majority of rated (re)insurers will be able weather the geopolitical storm due to their relatively strong balance sheet resilience.

This report considers AM Best's broad geographical rating coverage across most rated insurance and reinsurance groups across Europe (mainly France, Germany, Italy, Spain and

Exhibit 1
AM Best's Rating Process



Source: Best's Credit Rating Methodology

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2022-053

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 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.

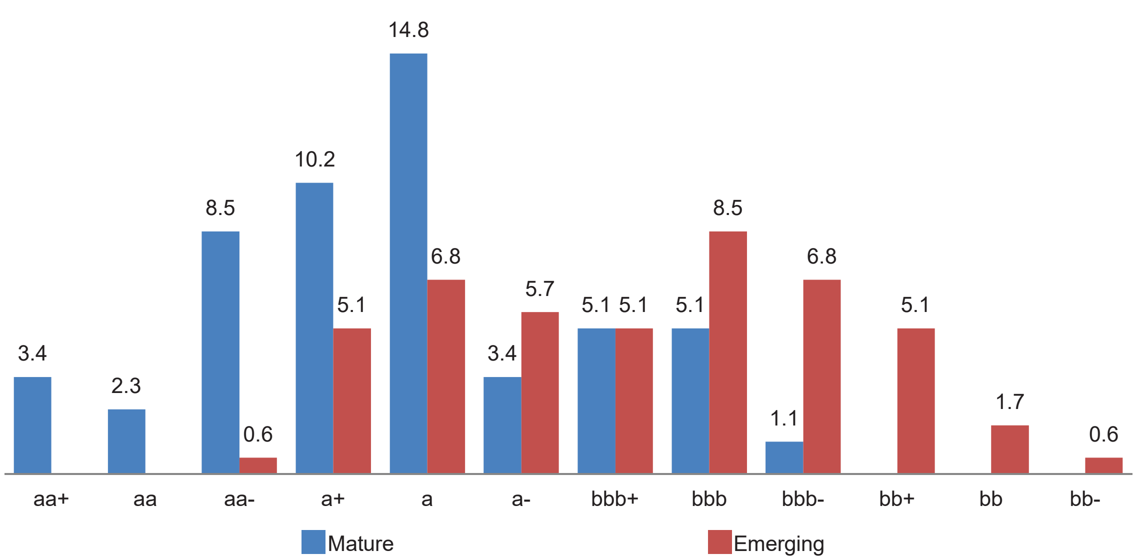
An AM Best Issuer Credit Rating (ICR) is an independent opinion of an entity's ability to meet its ongoing financial obligations. Full details of the rating process can be found in "*Best's Credit Rating Methodology*". The first step in the development of a rating recommendation is an evaluation of balance 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.

Ratings Distribution

Exhibit 2 illustrates the ICR rating distribution by percentage for EMEA rating units as at December 31, 2021. Over the previous 12 months there were 27 new rating assignments in the EMEA region and seven rating withdrawals. The ICR distribution in the EMEA region varies from "aa+" to "bb-".

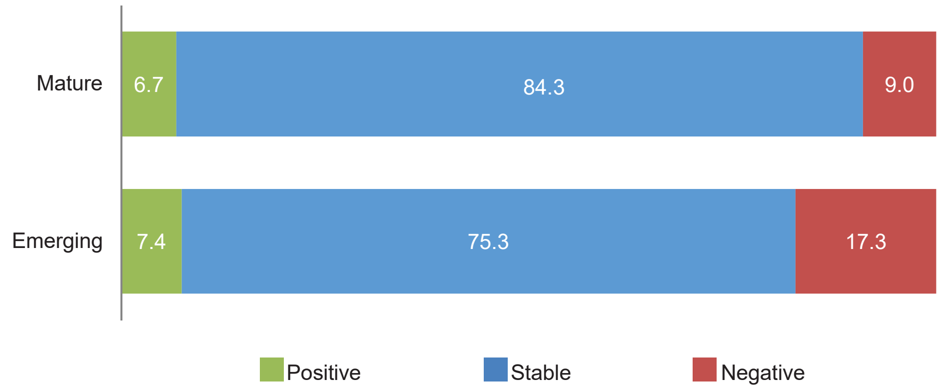
In mature markets, issuer credit ratings cluster around the "a+" and "a" categories. For emerging markets, in which country risk plays an important role in determining the overall rating assessment, ratings centre around the "bbb" level. Moving towards the lower end of the rating

Exhibit 2
AM Best – Distribution of Issuer Credit Ratings (ICR)
(% at December 31, 2021)



Source: AM Best data and research

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



Source: AM Best data and research

scale, most (re)insurance groups are domiciled in AM Best designated Country Risk Tier (CRT) 4 and 5 countries.

The number of emerging market ratings at the higher end (the "a" category) of the scale has increased over the past year due to new rating assignments. These include, Orient UNB Takaful PJSC (a+/stable) – a group affiliation to its parent company Orient Insurance PSC (a+/stable), Abu Dhabi National Insurance Company (a/stable) and AXA Insurance Gulf (a/stable) – recently acquired by Gulf Insurance Group (a/stable).

The vast majority of rating units (80%) have stable outlooks (2020: 82%), with approximately 13% having negative outlooks or negative implications as at December 31, 2021 (2020: 11%). Elevated country risks pressures for some (re)insurers, or pressure arising from weakened balance sheets and/or operating performance trends generally drives the negative rating pressure. With an equal split between emerging and mature markets, 7% of rated companies had a positive outlook (2020: 7%). In mature markets a number of highly rated carriers showed improvements in balance sheet strength. In the emerging markets positive outlook revisions largely resulted from positive developments in operating performance and continued improvements in balance sheet strength. The majority of emerging market carriers that benefited from a positive outlook revision in 2021 were domiciled in Russia. However, following the outbreak of the Russia-Ukraine conflict, those companies were downgraded and put under review with negative implications before being withdrawn, subject to sanctions imposed by the European Union.

During the course of 2021, emerging market ratings have generally trended negatively. There were seven downgrades over the period, all of which were emerging market companies, and for the most part centered around the balance sheet strength and ERM building blocks (see **Exhibit 4**).

The global insurance markets were faced with significant headwinds that exacerbated already challenging operating environments. This was most notably observed in Lebanon, which continues to endure extreme economic and political pressures.

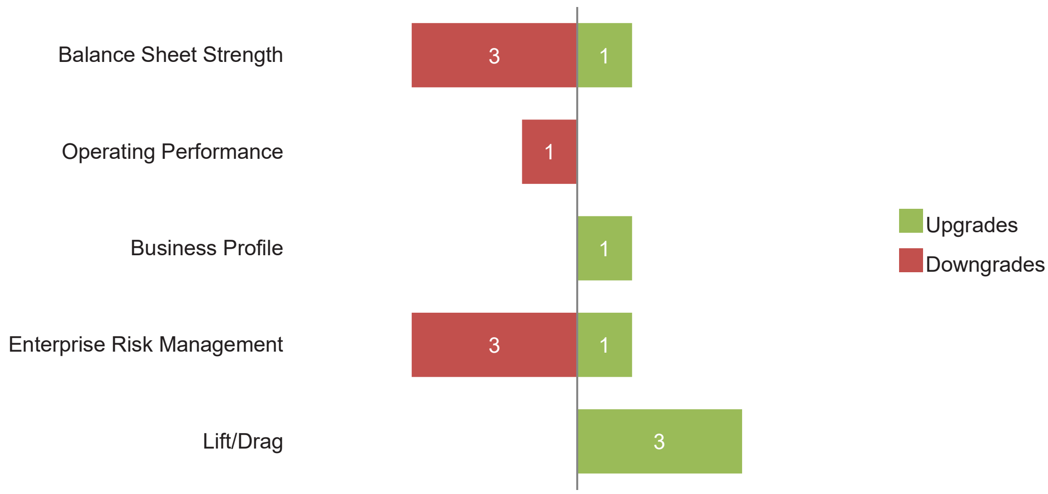
On the other hand, there were six upgrades during the course of 2021, five of them tied to mature market companies. The rationale for upgrades related to balance sheet strength, business profile and ERM building blocks, as well as lift received from parent companies. Most upgrades recognised an improved business environment through 2021, at the company or at the group level.

AM Best's Country Risk Tiers

AM Best defines country risk as the risk that country-specific factors could adversely affect an 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 an insurance company.

Exhibit 4

EMEA Upgrades and Downgrades by Building Block, December 2020 to December 2021



Source: AM Best data and research

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 an insurer's financial stability, strength and performance.

AM Best closely monitors economic, political, and financial system risk 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 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 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 taken into account 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 5**).

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

Exhibit 5

AM Best – Balance Sheet Strength – The Baseline 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

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.

CRT-1 remains the most stable tier with low financial system risk. This tier includes France, Germany, Switzerland and the UK. Some large European economies, which have experienced significant stress in recent years, can be found in CRT-2 (namely Poland, Italy, Ireland and Spain). CRT-3 covers a wide range of countries, from emerging markets such as Qatar and the UAE, as well as European countries including Malta and Portugal.

There have been only a few countries with material changes in their CRT assessment in recent years (see **Exhibit 6**). Bahrain and Oman fell to CRT-4, mainly stemming from greater fiscal strain following low oil prices at the time. Tunisia moved to CRT-5 due to very high economic risk in 2020. In 2022, Russia moved down to CRT-5 in the light of sanctions imposed during its conflict with Ukraine.

Exhibit 6

EMEA – Country Risk Tier Movements

(as at March 2022)

Country	Country Risk Tier (CRT)	Economic Risk	Political Risk	Financial System Risk	Movement
Bahrain	4	High	Moderate	High	Moved to CRT-4 in 2015
Oman	4	High	Moderate	High	Moved to CRT-4 in 2018
Egypt	5	High	High	Very High	Moved to CRT-5 in 2011
Tunisia	5	Very High	High	High	Moved to CRT-5 in 2020
Russia	5	Very High	Very High	Very High	Moved to CRT-5 in 2022

Sources: BESTLINK

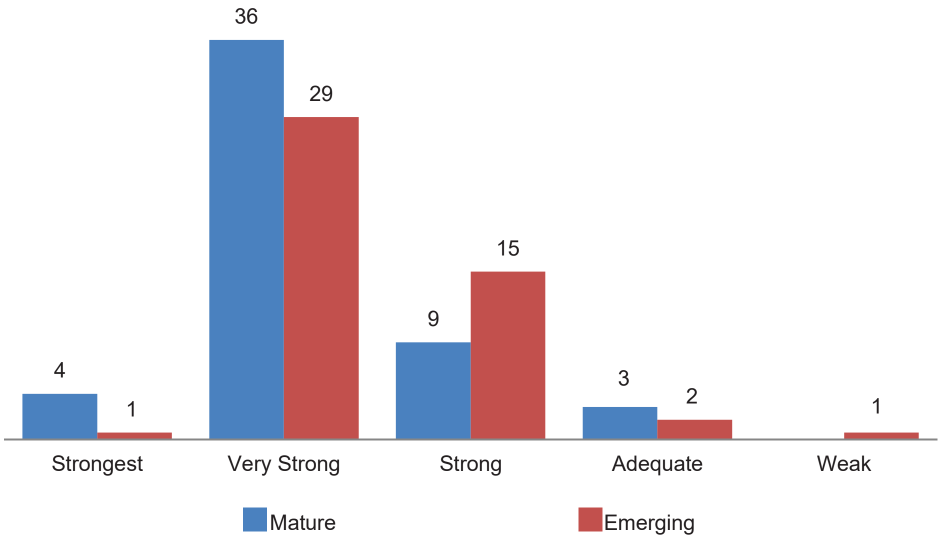
Best's Financial Suite - Global , AM Best data and research

In general, since 2019, there has been increasing risk for many countries (particularly in light of the economic volatility caused by the COVID-19 pandemic) which has resulted in greater uncertainty in the financial markets, increased geopolitical tensions, and higher levels of financial system risk in both mature and emerging markets.

Balance Sheet Strength: Baseline Assessment

The distribution of AM Best's assessment of balance sheet strength for EMEA-rated entities is illustrated in **Exhibit 7**. 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 economies have a greater presence further down the assessment scale; indicating the influence of country risk on the assessment. There are no companies in scope at present that have their balance sheet assessed as Very Weak.

Exhibit 7
EMEA Ratings – Balance Sheet Strength Assessments
(%)



Source: AM Best data and research

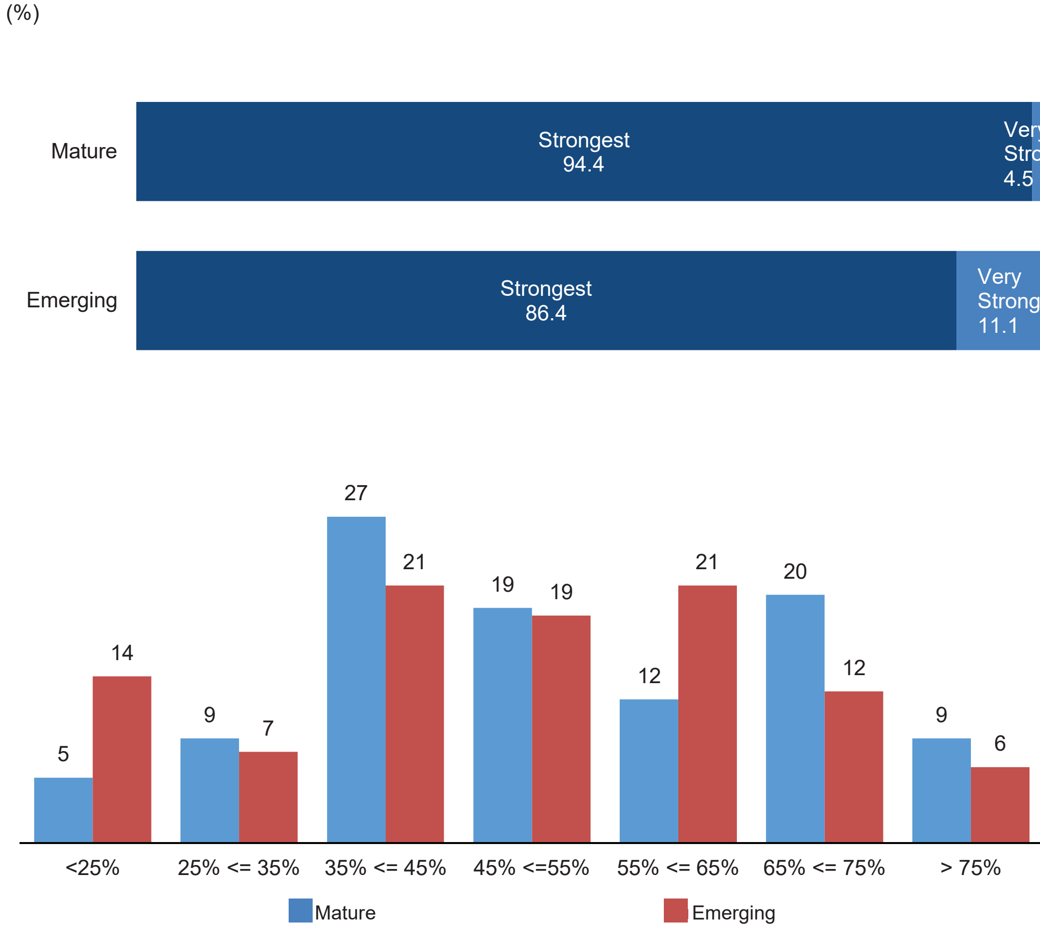
Risk-Adjusted Capitalisation: Best's Capital Adequacy Ratio (BCAR) Assessment

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%.

Analysis shows that 90% of EMEA rating units are within the Strongest assessment of risk-adjusted capitalisation, exceeding the 25% threshold. The median BCAR for the universe of rated EMEA entities is approximately 49%. AM Best also assesses stressed BCAR scores to provide insight into a company's balance sheet strength shortly after it experiences a catastrophic event.

At present, most rated companies' stressed BCAR scores are contained within the current assessment, or falling within one level of the initial assessment. The vast majority of the population with strongest BCARs have a comfortable buffer above the 25% threshold with most companies operating with BCARs between 35% and 55%. There has been a general decline in risk-adjusted capitalisation levels compared with pre-pandemic levels, but improved earnings generation and prudent capital management has largely reversed that trend in 2021.

Exhibit 8
BCAR Scores of EMEA Ratings @99.6% VaR (%), with Breakdown of BCAR Assessments by Percentage of Rating Units



Values below 2.0 are not labelled.
Source: AM Best data and research

AM Best notes that some companies with exceptionally strong 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 low-risk asset profiles, with the vast majority of the risk being borne out of underwriting. This has supported the balance sheet resilience of most carriers operating in mature markets during heightened capital market volatility at the beginning of the COVID-19 pandemic.

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 smaller capital bases, which incur concentration and illiquidity charges in AM Best's capital model. Despite the elevated asset risk charges observed in emerging markets, more than 85% of rating units have BCAR scores at the Strongest level. It is common for emerging market companies to have low levels of net underwriting leverage, which results in significantly lower underwriting risk capital requirements compared with mature market ratings.

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 the BCAR and balance sheet strength assessments for mature and emerging markets is illustrated in **Exhibit 9**. Over the course of the surveillance period, the balance sheet quality for both mature and emerging markets has remained relatively stable.

As noted above, over 90% of EMEA rating units have BCAR scores within the Strongest category. However, only 11% of the mature market population had balance sheet assessment at the Strongest level during 2021—showing that although BCAR is very important to AM Best's analysis, it is not the only consideration when looking at balance sheet strength.

Exhibit 9

EMEA Ratings – Changes in BCAR vs Balance Sheet Strength, 2021

(%)

Mature Markets

BCAR Assessment	Balance Sheet Strength: Strongest	Very Strong	Strong	Adequate	Weak
Strongest	10.5	**67.4**	**13.7**	3.2	-
Very Strong	-	1.1	2.1	1.1	-
Strong	-	-	-	1.1	-
Adequate	-	-	-	-	-
Weak	-	-	-	-	-
Very Weak	-	-	-	-	-

Emerging Markets

BCAR Assessment	Balance Sheet Strength: Strongest	Very Strong	Strong	Adequate	Weak
Strongest	1.2	**59.3**	**25.9**	-	-
Very Strong	-	2.5	6.2	2.5	-
Strong	-	-	-	1.2	-
Adequate	-	-	-	-	-
Weak	-	-	-	-	1.2
Very Weak	-	-	-	-	-

Source: AM Best data and research

The vast majority of companies have a balance sheet strength assessment of Very Strong (68% in mature markets and 62% in emerging markets). 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 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 mitigating factors. Almost two fifths 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, with 15% of emerging market rating units having a BCAR assessment of Very Strong or below, compared with just 5% for mature markets.

Beyond BCAR: Other Drivers of Balance Sheet Strength

Mature Markets

For 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. Hence, the majority of companies seem to benefit from sound financial flexibility and liquidity, with appropriate stress testing performed on their balance sheets.

Against the backdrop of increasing inflation pressure and robust underwriting discipline in most markets, more intense focus on reserve adequacy is also underpinning balance sheet strength, which has been a weaker balance sheet factor for some carriers in the past.

Non-life market participants tend to have very conservative investment profiles; however, there can be some concentration in local markets or to a particular asset class, which could lower the quality of the overall investment portfolio. At the outbreak of the COVID-19 pandemic, increased volatility prompted mature non-life players to reduce the pockets of higher risk assets. This has strengthened overall conservative investment profiles. 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 higher levels of reinsurance dependence and issues around quality and concentration of assets. Access to capital 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. Increased levels of financial leverage have partly been driven by the relatively low cost of capital in recent years. This can be a risk if financial market volatilely and investor uncertainty were to make it difficult to issue new debt instruments.

Emerging Markets

While the risk-adjusted capitalisation of emerging market players is generally robust, other balance sheet components play an important role in the 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)insurers 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, with concentration risk on non-investment grade assets. Even when the liquidity of the market is good, a negative impact may arise from stress tests relating to large losses, or write-downs for many companies. This impact becomes amplified if the assessment identifies inadequacies of reserving approaches or the utilisation of insufficient capital management tools.

In addition, the financial flexibility of emerging market companies is often much weaker than mature market counterparts. Most emerging market companies do not issue 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.

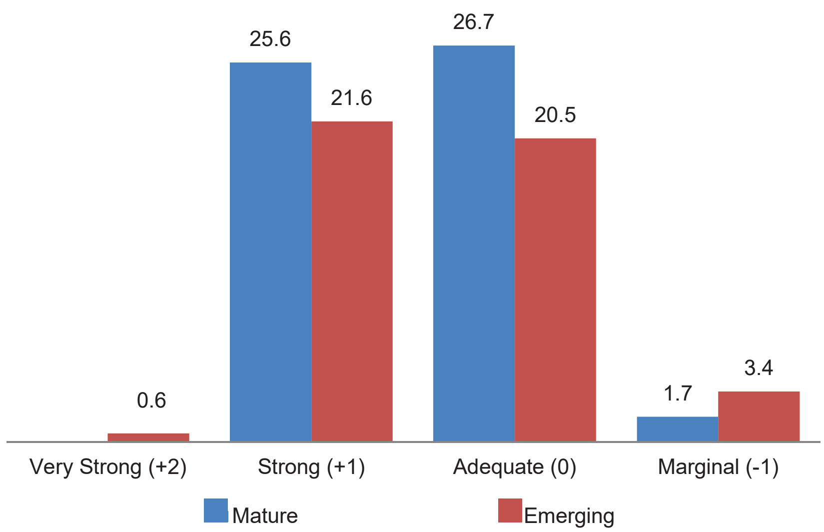
Operating Performance

Operating performance assessments for EMEA companies centre mainly around the Adequate to Strong categories (see **Exhibit 10**), with a relatively similar distribution between both mature and emerging markets. At present, there is only one company with an assessment of Very Strong.

Exhibit 10

EMEA Ratings – Operating Performance Assessments

(%)



Source: AM Best data and research

The vast majority of Strong assessments are companies that are market leaders, or insurers with stable profiles that have consistently generated strong returns for a long period, with a solid profit-generating pattern expected to continue over the short-to-medium term.

The only company that has achieved the highest assessment is an emerging market player that has consistently demonstrated market leading financial metrics that are expected to continue over the medium-term. The company's performance has also been accompanied by an increasingly stronger market profile with year-on-year improvements in absolute earnings. Financial metrics significantly outweigh regional and global peers.

Exhibits 11, **12** and **13** illustrate the 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 Strong category.

The drivers of underwriting results tend to slightly differ between mature and emerging markets. One of the features of emerging markets 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, 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 reinsurance market with 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.

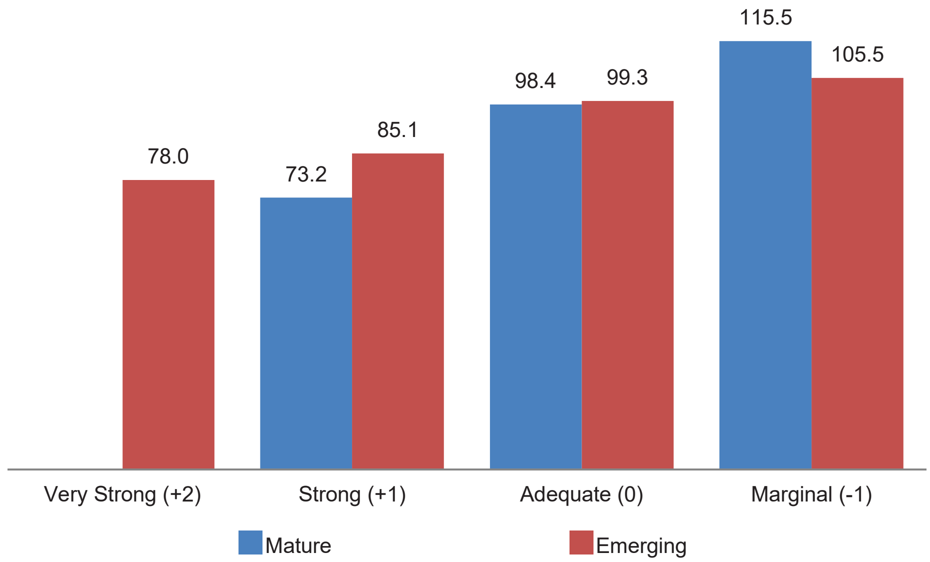
Similarly, for mature markets, average ROEs (adjusted for inflation) are -5.2% for companies assessed as Marginal and increase to 15% for those assessed as Strong.

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.

Exhibit 11

EMEA Ratings – Five-Year (2016-2020) Average Combined Ratio

(%)

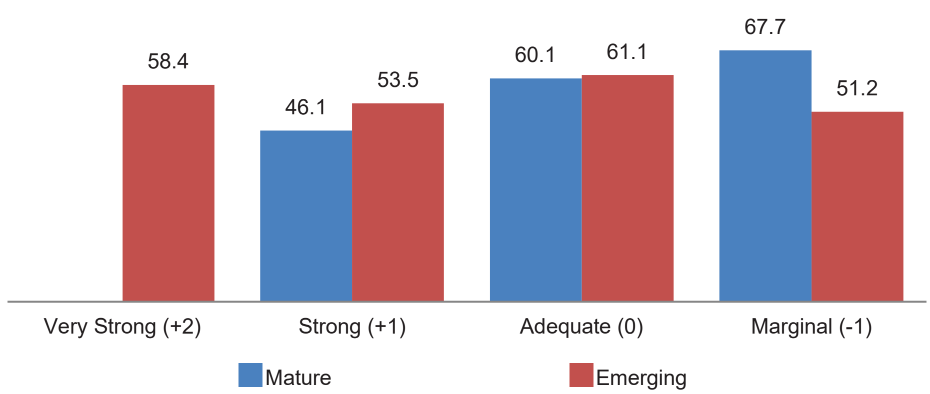


Source: AM Best data and research

Exhibit 12

EMEA Ratings – Five-Year (2016-2020) Average Loss Ratio

(%)

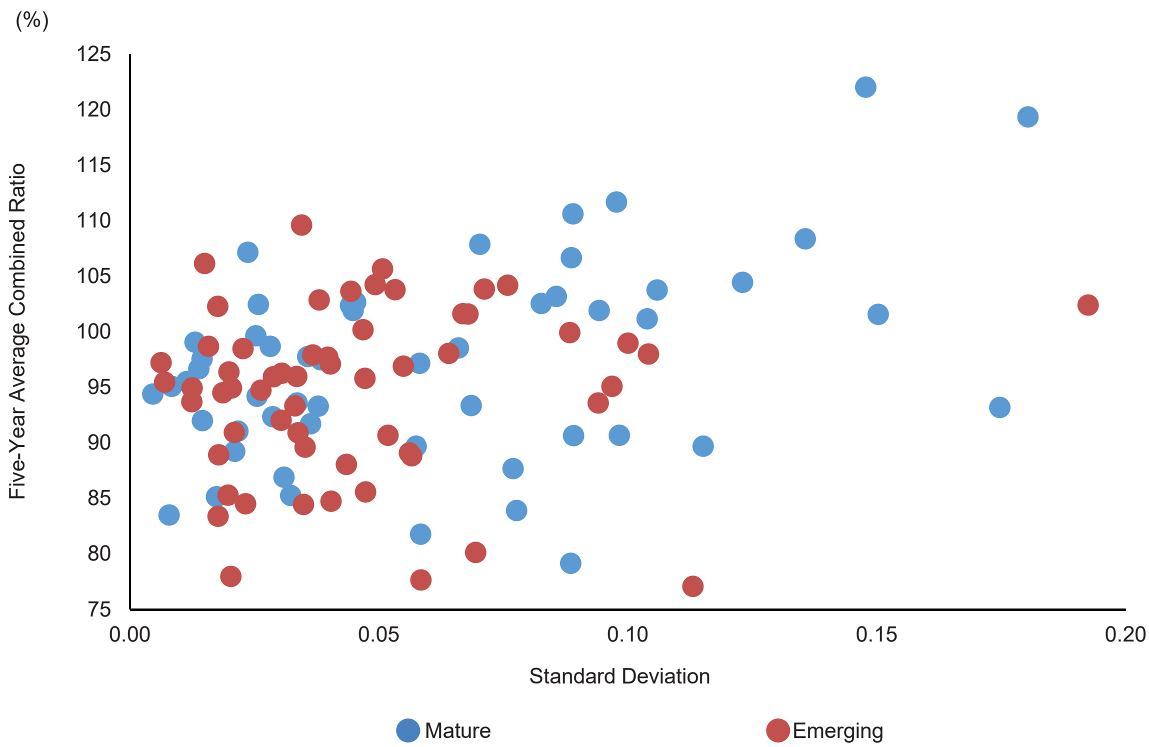


Source: AM Best data and research

Those with combined ratios of around or marginally below 100% are likely to be considered Adequate. For companies that are assessed as higher, 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.

Exhibit 13

EMEA Ratings – Five-Year (2016-2020) Average Combined Ratio Standard Deviation in Mature an Emerging Markets



Source: AM Best data and research

As such, the combined ratio's average standard deviation for developed market companies tends to be above that of emerging market companies (see **Exhibit 13**). This can be explained by the presence of insurance captives in the sample. These are generally located in the developed market 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 benefit from a certain financial flexibility emanating from their parent. This flexibility mitigates risks that show a potentially higher technical performance volatility.

When considering ROE for the whole population (**Exhibit 14**), the Strong category produces, on average, high 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.

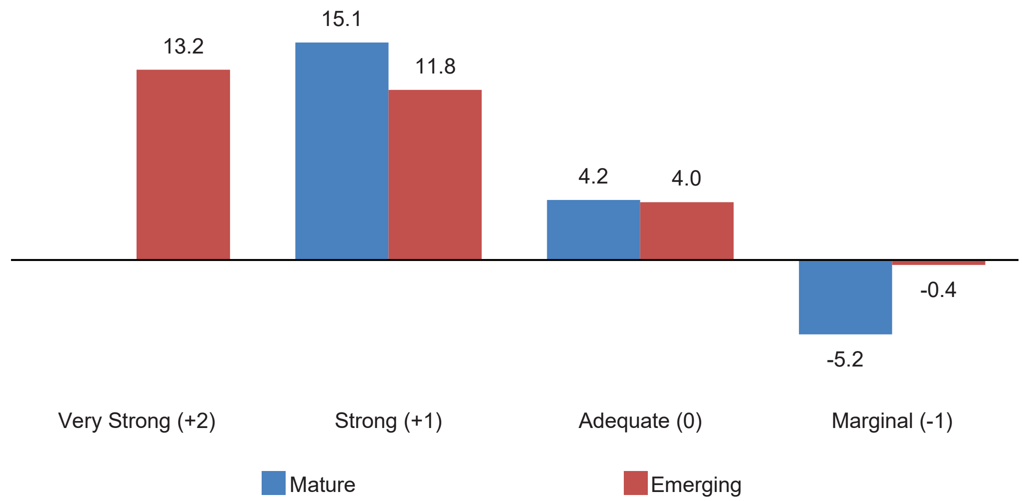
Operating performance metrics of emerging market companies need to be considered with caution. When taking into account returns in real terms, the performance may not be as good as the nominal figures seem to imply. In certain territories, inflation and interest rates may be particularly high (this can 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 in the five years prior to losses from hurricanes Harvey, Irma and Maria, with very low standard deviation. However, following the catastrophe losses of 2017, such companies experienced a material spike in claims,

Exhibit 14

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

(%)



Source: AM Best data and research

wiping out 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.

AM Best factors into its assessments the earnings profile from both investment and underwriting activities and the level of volatility achieved by rated entities 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 the impact of inflation, changes in interest rates or potential geopolitical developments) as part of its operating performance analysis.

Business Profile

Most assessments of business profile for (re)insurance companies fall within the Neutral to Limited categories (see **Exhibit 15**). Less than 5% of the 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 their profiles are supplemented by excellent distribution capabilities with multiple sources of revenues. These companies are market leaders that can dictate pricing. They are sophisticated in terms of their underwriting, and the data quality that they possess. These companies tend to be at the forefront of innovation (see **Exhibit 16**).

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.

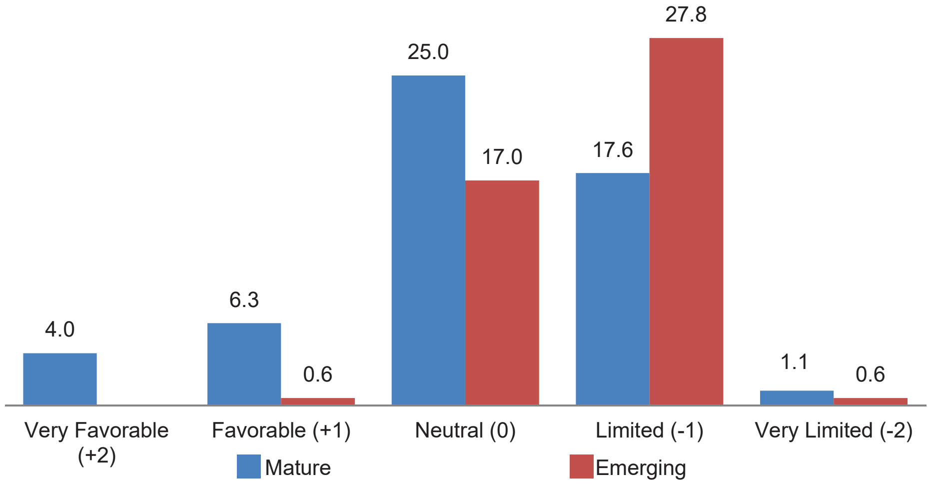
Insurance captives generally tend to be qualified as Neutral or Limited as they generally show little diversification, because of the role they play. In addition captives potentially have less control over their premium distribution than traditional insurers. While certain captives may suffer from a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

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 (see **Exhibit 17**). 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.

Exhibit 15

EMEA Ratings – Business Profile Assessment

(%)



Source: AM Best data and research

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 may be 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.

Exhibit 16

EMEA Ratings – 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

Not shown: Very Limited (-2). For further information, please see Best's Credit Rating Methodology (BCRM).

Enterprise Risk Management

AM Best's ERM assessment focuses on three components; the risk framework evaluation, the risk profile evaluation and the overall assessment. As **Exhibit 18** 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.

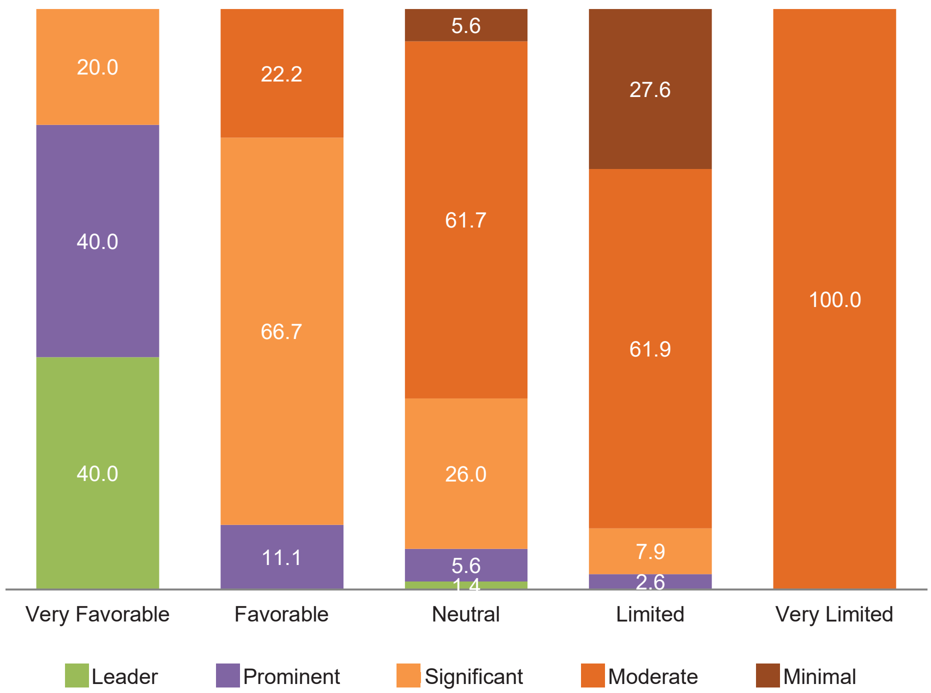
Overall, less than 3% of the population has a Very Strong ERM assessment. In order to achieve the highest assessment, companies need to demonstrate that their risk management approach has been effectively utilised over the medium-to-long term, and is adding value to the organisation. A company needs to demonstrate that ERM is effective and embedded across its organisation.

Emerging market companies tend to have Appropriate to Weak risk management practices, 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.

Exhibit 17

EMEA Ratings – Innovation Assessment by Business Profile

(%)

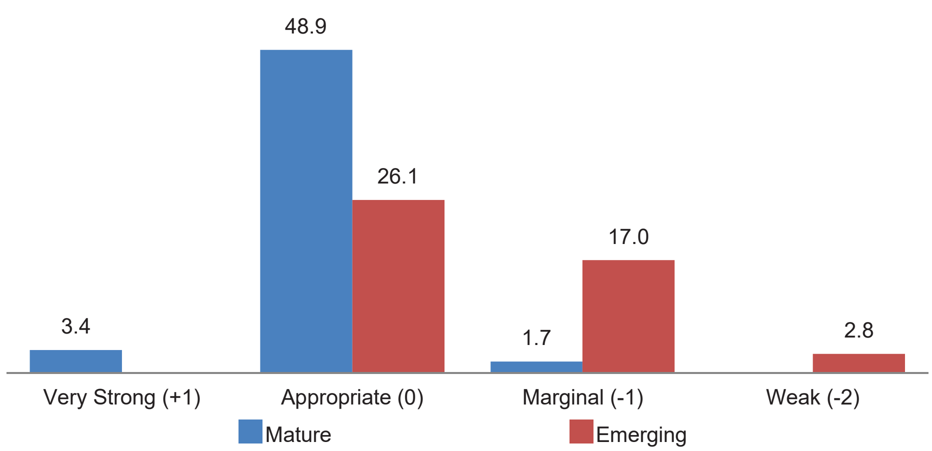


Source: AM Best data and research

Exhibit 18

EMEA Ratings – Enterprise Risk Management Assessment

(%)



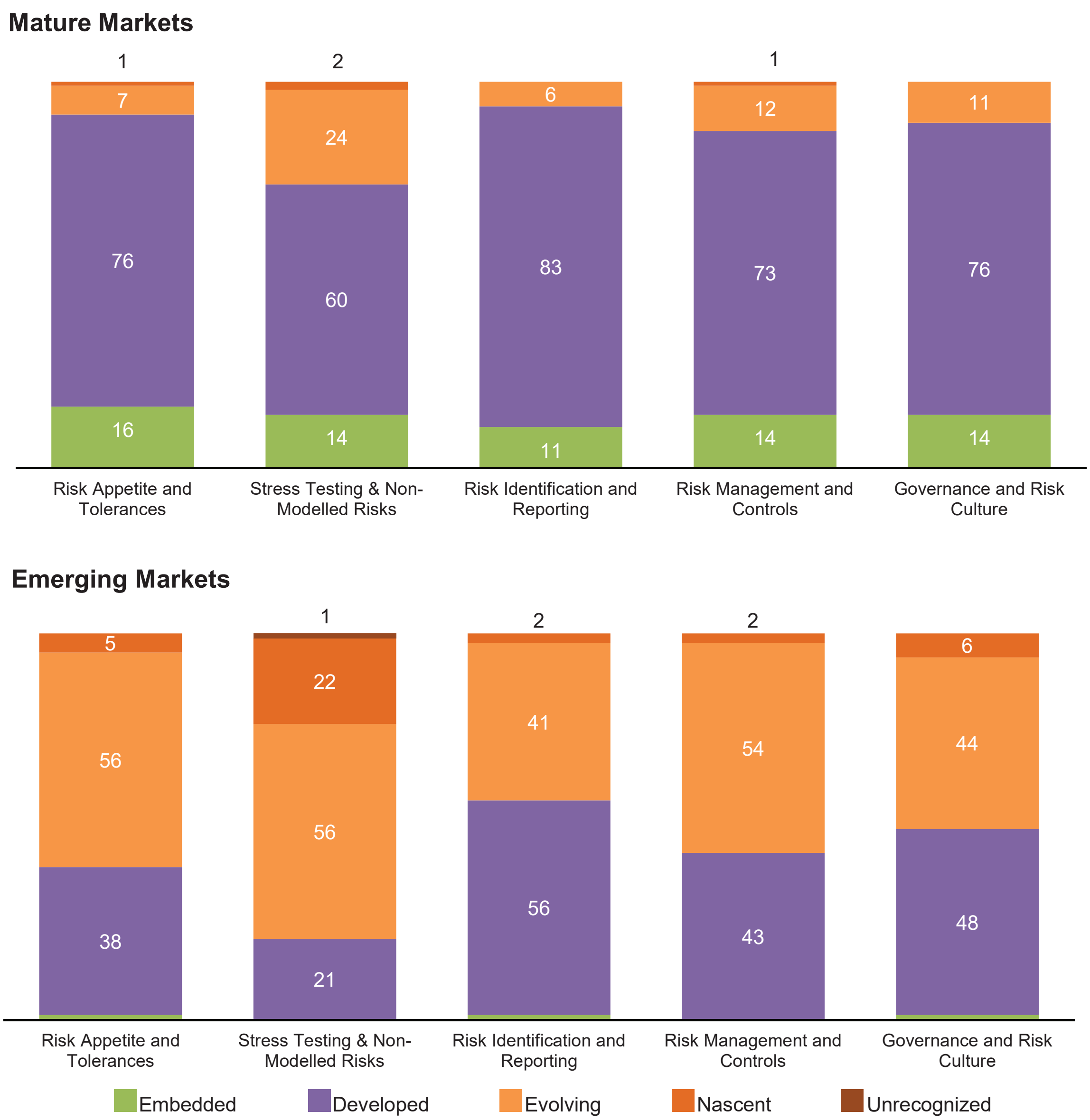
Source: AM Best data and research

AM Best's ERM risk framework evaluation component focuses on five core areas: risk appetite and tolerance, stress testing & non-modelled risks, risk identification and reporting, risk management and controls, and governance and risk culture (see **Exhibit 19**).

For mature markets, approximately 16% of companies are deemed to have an assessment of Embedded across the risk framework evaluation factors. 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

Exhibit 19
Mature and Emerging Markets – Risk Framework Evaluation
(%)



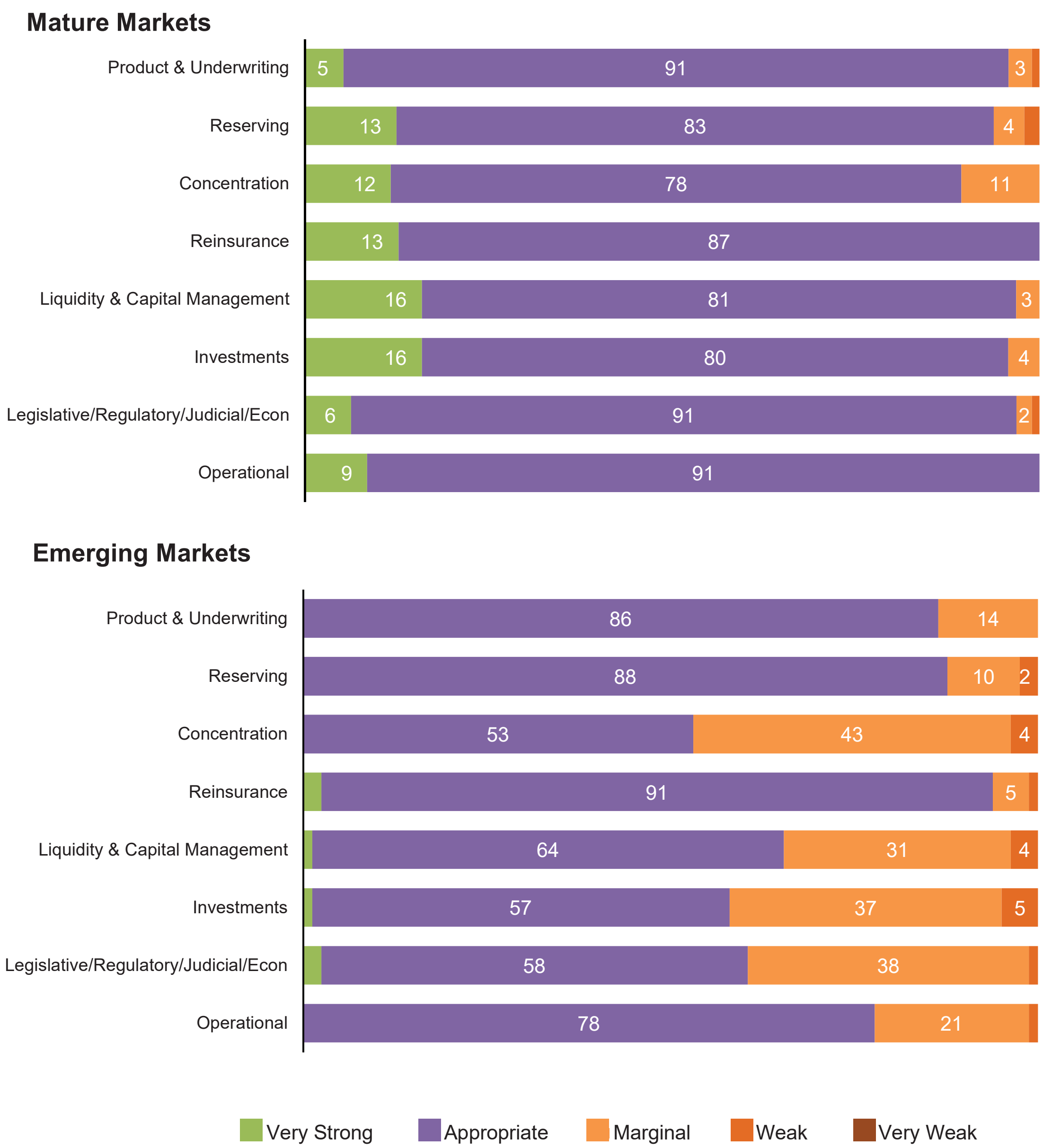
Source: AM Best data and research

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.

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

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 assessments are in the Evolving category, with a few companies in the Developed category.

Exhibit 20
Mature and Emerging Markets – Risk Capabilities Evaluation
(%)



Source: AM Best data and research

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.

In the future, AM Best expects companies operating in emerging markets will demonstrate improvements in ERM, but at the same time, benchmarks are likely to change. In order for companies to maintain their current assessments, they will need to be more proactive with their risk management practices.

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 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 20 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.

For this group, the capability is viewed generally as 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, but a lack some formalisation of their framework.

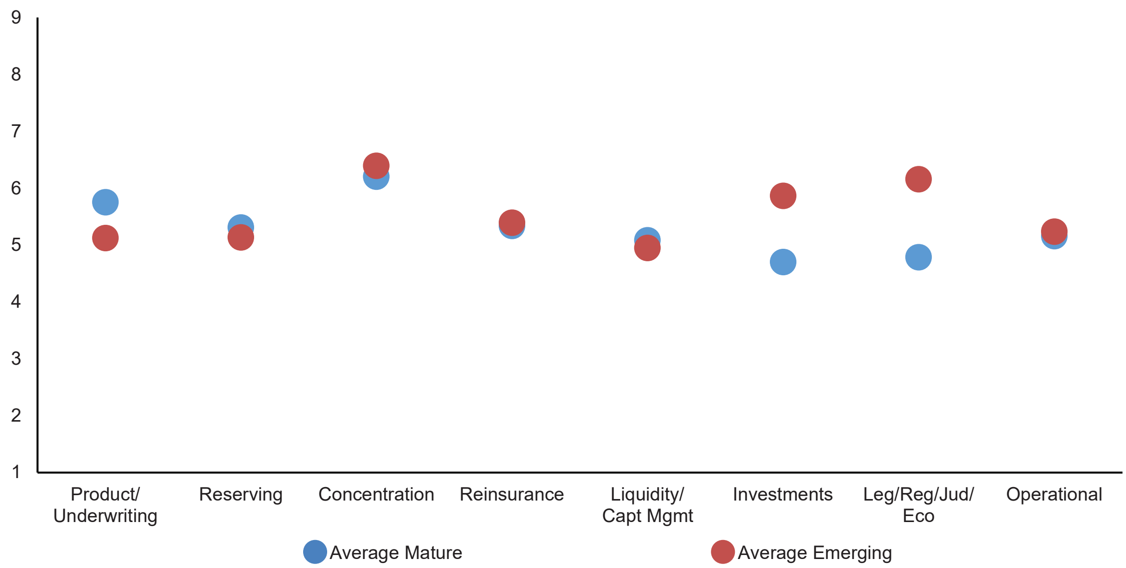
In any case, AM Best expects companies to improve their ERM approach constantly, as markets and regulations develop; the benchmarks at each assessment level are likely to rise. A company's failure to keep pace with the changing landscape and evolving risks and challenges may, over time, exert pressure on its assessment.

Exhibit 21 illustrates the risk profile evaluation 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 and investment, followed by legal, regulatory, judicial and economic risks. This reflects the risk profile of many 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.

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.

Exhibit 21
Mature and Emerging Markets – Average Risk Profile Evaluation
(1: Low Risk to 9: High Risk)



Source: AM Best data and research

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 remain within the Strongest category. Asset concentrations in high-risk investments, for example from insurers seeking higher yields in a context of low interest rates, or with exposure to riskier less liquid investments, remain a concern and add significant volatility to operating performance and capital adequacy. In some cases, (re)insurers have fallen below local solvency requirements. The adoption of prudent risk management practices is critical, to ensure that companies manage risks effectively and in a controlled manner.

Published by AM Best

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Version 010320