AM Best's Insurance Market Briefing & Networking Reception - Bermuda

March 7, 2023

Agenda

Welcoming Remarks – Matthew Mosher

Global Reinsurance Update – Anthony Diodato

Trends in Cyber & Florida – Stefan Holzberger

Growth of Delegated Underwriting – Greg Williams

Specialty Fronting Model – Ken Johnson

Methodology Update: Holding Company & Available Capital – Mahesh Mistry

AM Best's Insurance Market Briefing & Networking Reception - Bermuda

Matthew Mosher – President & CEO, AM Best Rating Services

Global Reinsurance Update

Anthony Diodato – Managing Director AM Best

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Global Reinsurance – Outlook Stable

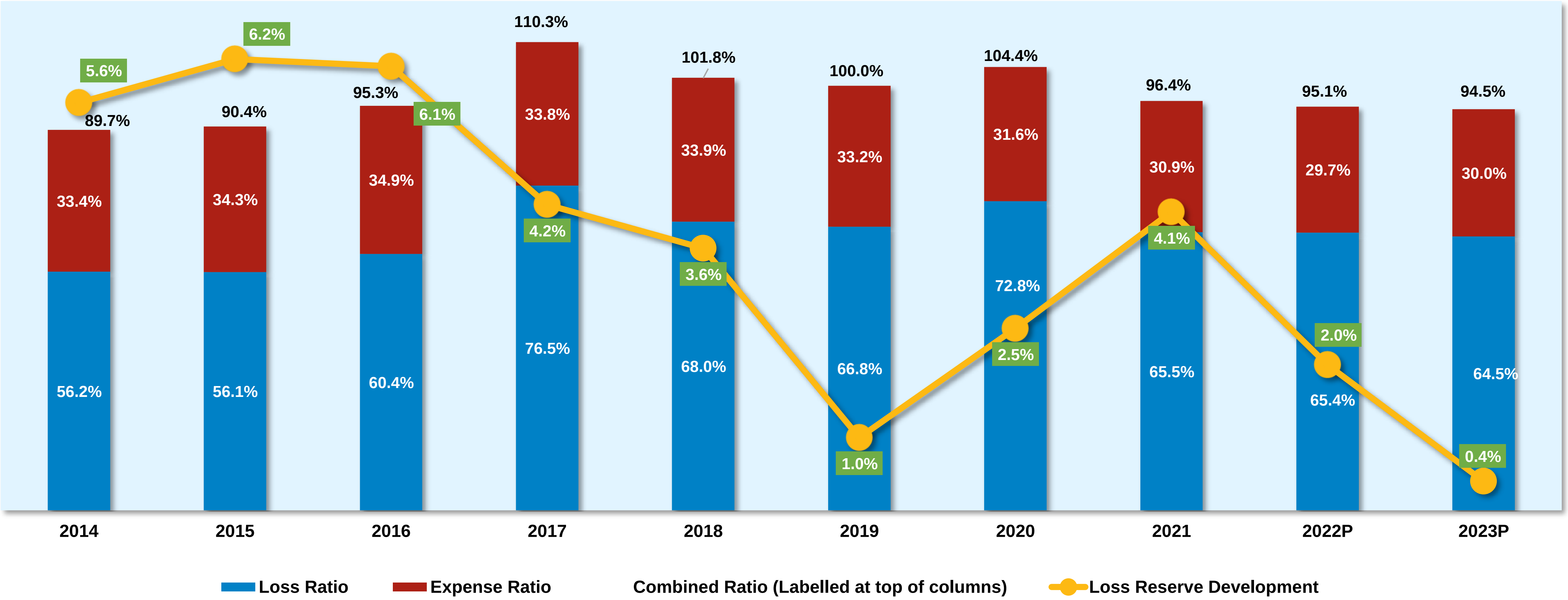
- Positive and negative drivers offsetting each other:
  - Protracted renewals characterized by significantly improved pricing, terms and conditions
  - Dislocation was not as severe as originally anticipated
  - Some client relationships under pressure
  - Available capital ≠ Deployed capacity
  - New capital still hesitant. Flight to quality exacerbated
  - Ability to meet cost of capital still in question

Global Reinsurance – Outlook Stable

- Economic / external environment has changed
  - Risk environment perceived as more challenging to price and model
  - Recession and inflationary fears
  - New risk-adjusted investment options have emerged
  - Long-term, broad economic relevance may be a challenge

Global Reinsurance Market Performance

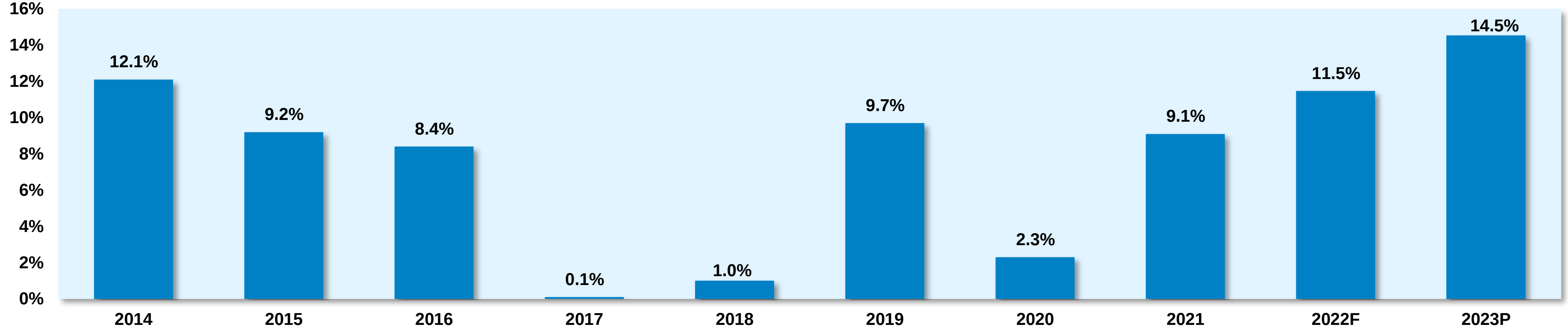
Loss and Expense Ratios and Positive Loss Reserve Development



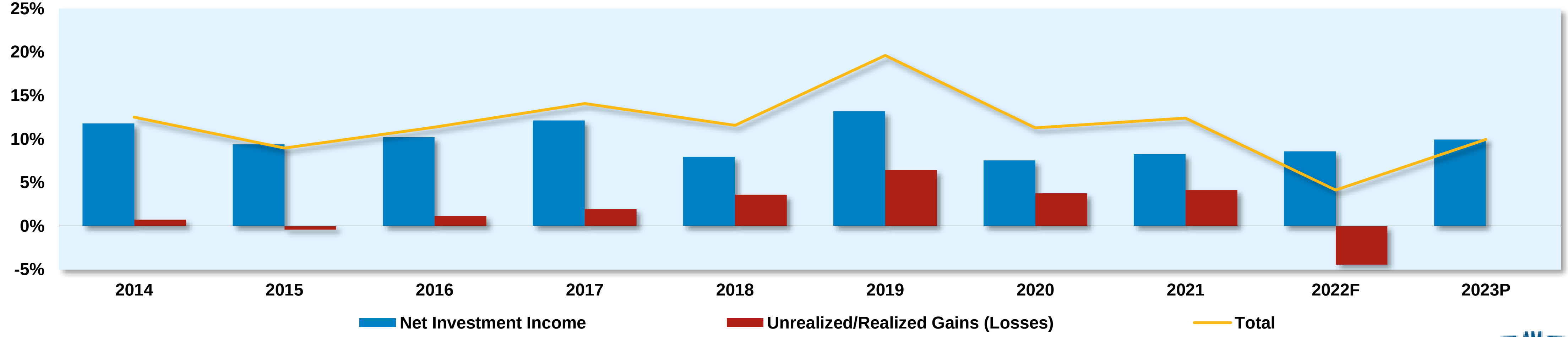
Our Insight, Your Advantage™

Global Reinsurance Market Trends

Return on Equity



Net Investment Income & Realized / Unrealized Gains (Losses) as a % of Avg PHS



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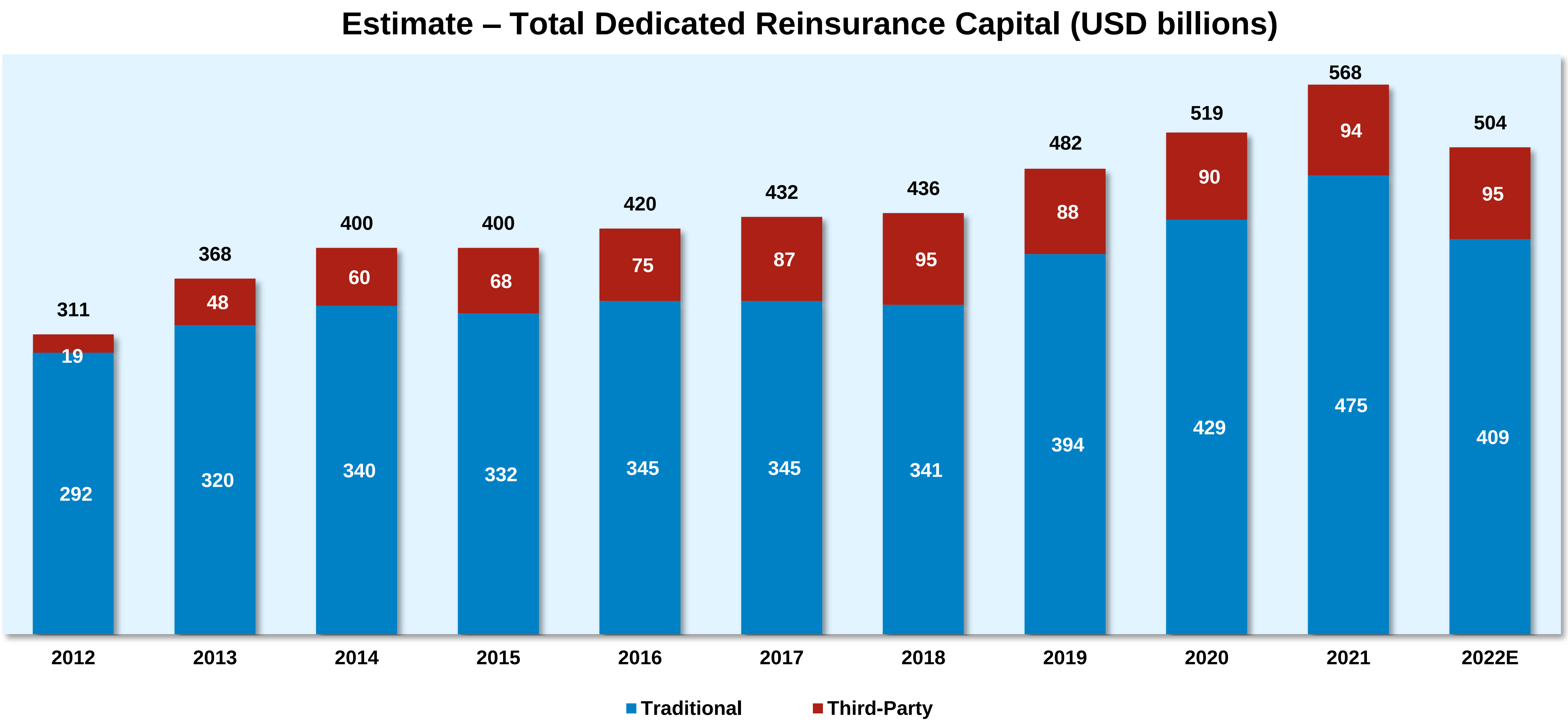
Global Reinsurance Market Capital



Sources: Estimates by Guy Carpenter and AM Best

ILS Market Challenges

- Broadly, the same issues that are faced by the traditional reinsurance market except for these additional circumstances:

Impermanence of capital

High risk concentration

ILS Capacity Estimate by Segment

- ILS market capacity is estimated at approximately $93 billion as of September 2022 by Aon & $95 billion by Guy Carpenter
  - Catastrophe bonds – approximately $33-$34 billion*
  - Collateralized reinsurance – approximately $48-$50 billion*
  - Sidecars – approximately $6-$7 billion*
  - ILW – approximately $5-$6 billion*

*Excludes cat bonds projected to have total losses; some ranges based on AM Best's conversation with ILS managers

ILS De-Risking Trends

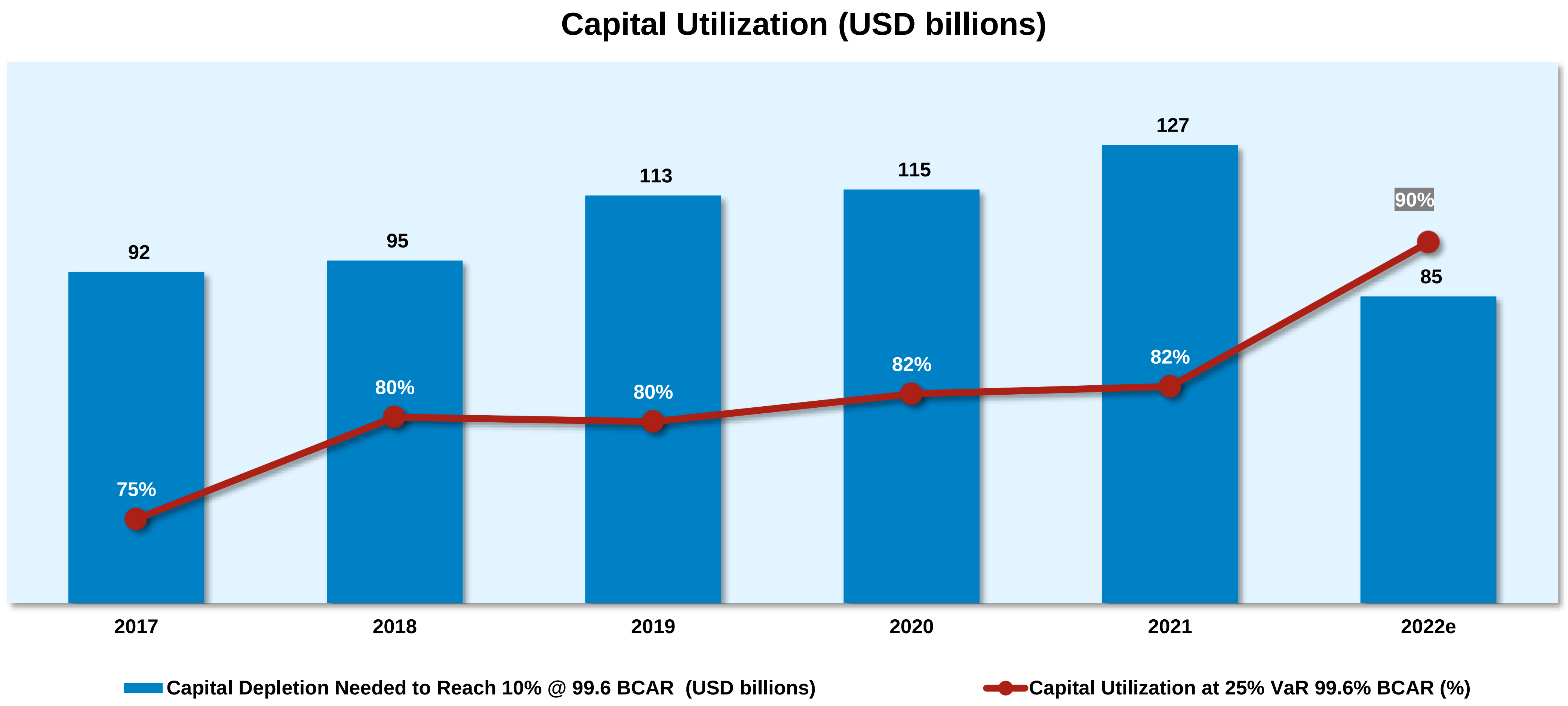
Increasing attachment points

Focusing on well modeled risks

Excluding events such as riots, strikes, cyber risk, etc.

Improvement in buffer loss tables

Global Reinsurance Market Capital



Global Reinsurance – Challenges Ahead

Mid-year renewals: sustained pricing trends?

Florida legislative changes

Non-catastrophe lines: casualty, specialty

Incoming capital: is there a class of 202x ?

Innovation and relevance in a more complex risk environment

Trends in Cyber and Florida

Stefan Holzberger – Chief Rating Officer, AM Best

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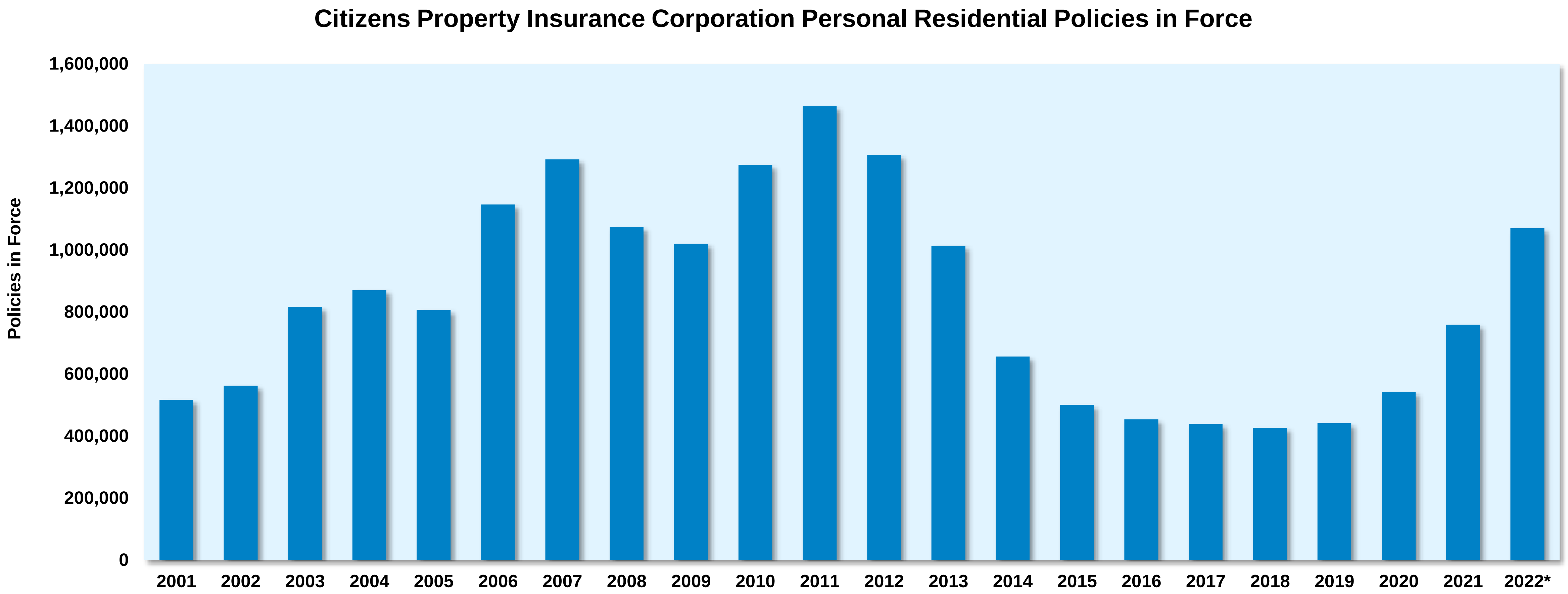
AM Best Update:
Florida Property Market

Florida Property Market

Homeowners Market Share of Top 10 National Writers DPW ($ millions)						
	Total US		Other Than Florida		Florida	
Company	DPW	Market Share	DPW	Market Share	DPW	Market Share
State Farm Group	22,046	18.4	21,219	19.8	827	6.7
Allstate Insurance Group	10,501	8.8	10,178	9.5	322	2.6
Liberty Mutual Insurance Companies	8,383	7.0	8,315	7.8	68	0.5
USAA Group	7,987	6.7	7,478	7.0	509	4.1
Farmers Insurance Group	7,608	6.4	7,424	6.9	184	1.5
Travelers Group	5,557	4.6	5,537	5.2	21	0.2
American Family Insurance Group	5,002	4.2	4,966	4.6	36	0.3
Nationwide Group	3,522	2.9	3,405	3.2	118	0.9
Chubb INA Group	3,208	2.7	2,870	2.7	338	2.7
Progressive Insurance Group	2,217	1.9	1,676	1.6	541	4.4
Top 5	56,525	47.3	54,615	50.9	1,910	15.4
Top 10	76,032	63.6	73,069	68.2	2,962	23.9

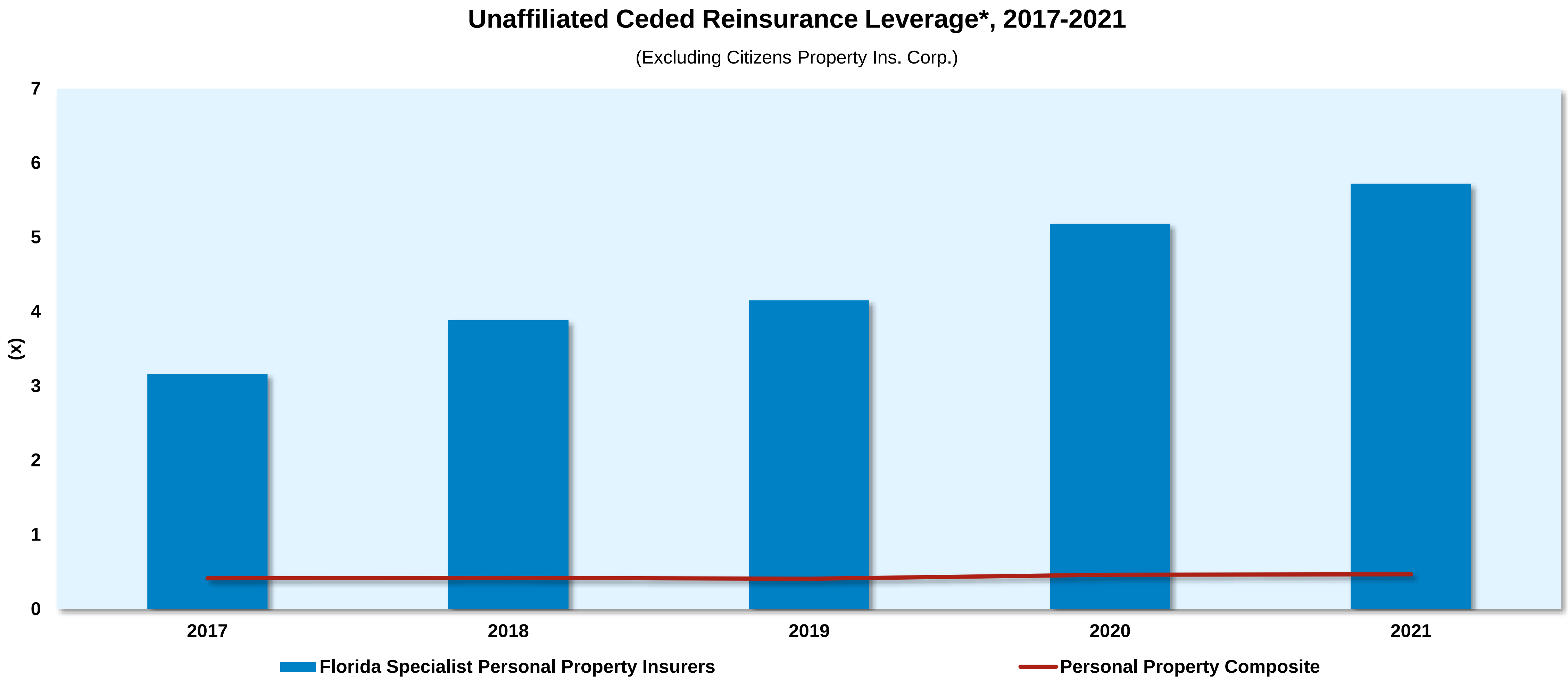
Florida Property Market



* Third quarter data.

Note: Excludes policies tagged for takeout via the depopulation program but still serviced by Citizens Property Insurance Corporation. The 2006 policy count does not include 142,890 policies assumed from Poe Financial Group because they remained on the Poe system at the end of that calendar year.

Florida Property Market



* Defined as reinsurance recoverables and ceded premiums written to policyholder surplus, net of US affiliates

Florida Property Market

Florida Homeowners Insurer Insolvencies		
Year	**Company**	
2023	• **United Property & Casualty**	
2022	• **Avatar Property and Casualty** • **South Fidelity Insurance Co.** • **Weston P&C Insurance Co.**	• **St. Johns Insurance Co.** • **Lighthouse Property Ins.** • **FedNat Insurance**
2021	• **Gulfstream P&C Insurance Co.**	• **American Capital Assurance**
2019	• **Florida Specialty Insurance Co.**	

Stopped writing new business in Florida:

- Progressive (certain counties)
- TypTap
- First Community
- People's Trust
- AIG
- Florida Farm Bureau
- Centauri

Florida Property Market

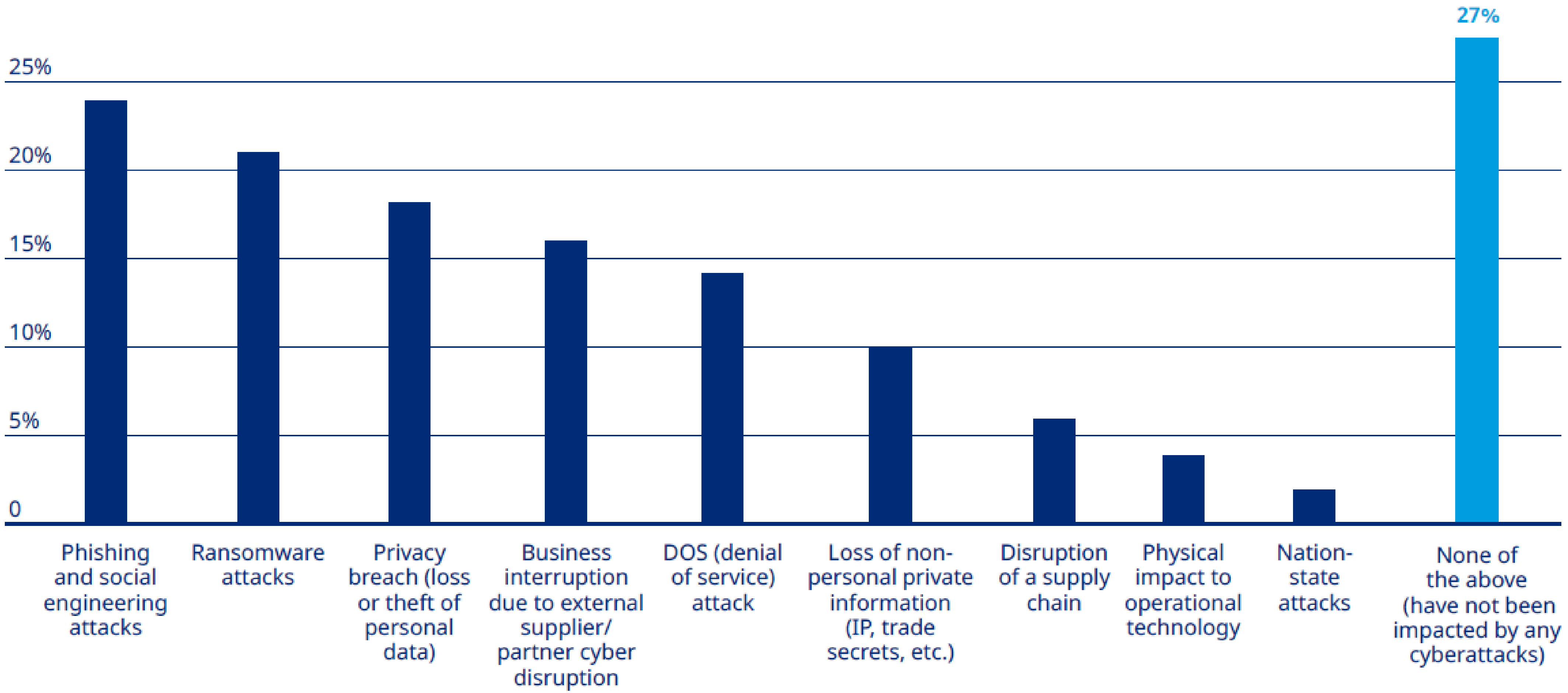
- May & December 2022 special legislative sessions
  - Eliminated one-way attorney fees
  - Eliminated assignment of benefits (AOB)
  - Created the Reinsurance to Assist Policyholder (RAP) Program
- Current state of the market
  - Hurricane Ian driving spike in lawsuits
  - Trial bar expected to contest new legislation
  - Possible reinsurance capacity shortfall at mid-year renewals
  - Improvements likely over the *medium term*
  - Longstanding imbalance between risk exposure and premium volume remains

Florida Property Market

- Why doesn't AM Best rate more Florida property companies?
  - Reinsurance dependence = credit risk
  - Ceded premium leverage is 10x greater than national average (5.7x vs. 0.5x)
  - Rising retentions due to reinsurance capacity shortfall
    - Income statement protection is gone
  - Reinsurance no longer cheap capital
    - Balance sheet protection is expensive… and limited
- Building Block rating analysis
  - Balance Sheet Strength (BSS) – risk-adjusted capital stress scenario
  - Operating Performance – cat and *normalized* combined ratios
  - Business Profile – geographic and LOB concentration
  - ERM – risk appetite in relation to BSS and financial flexibility

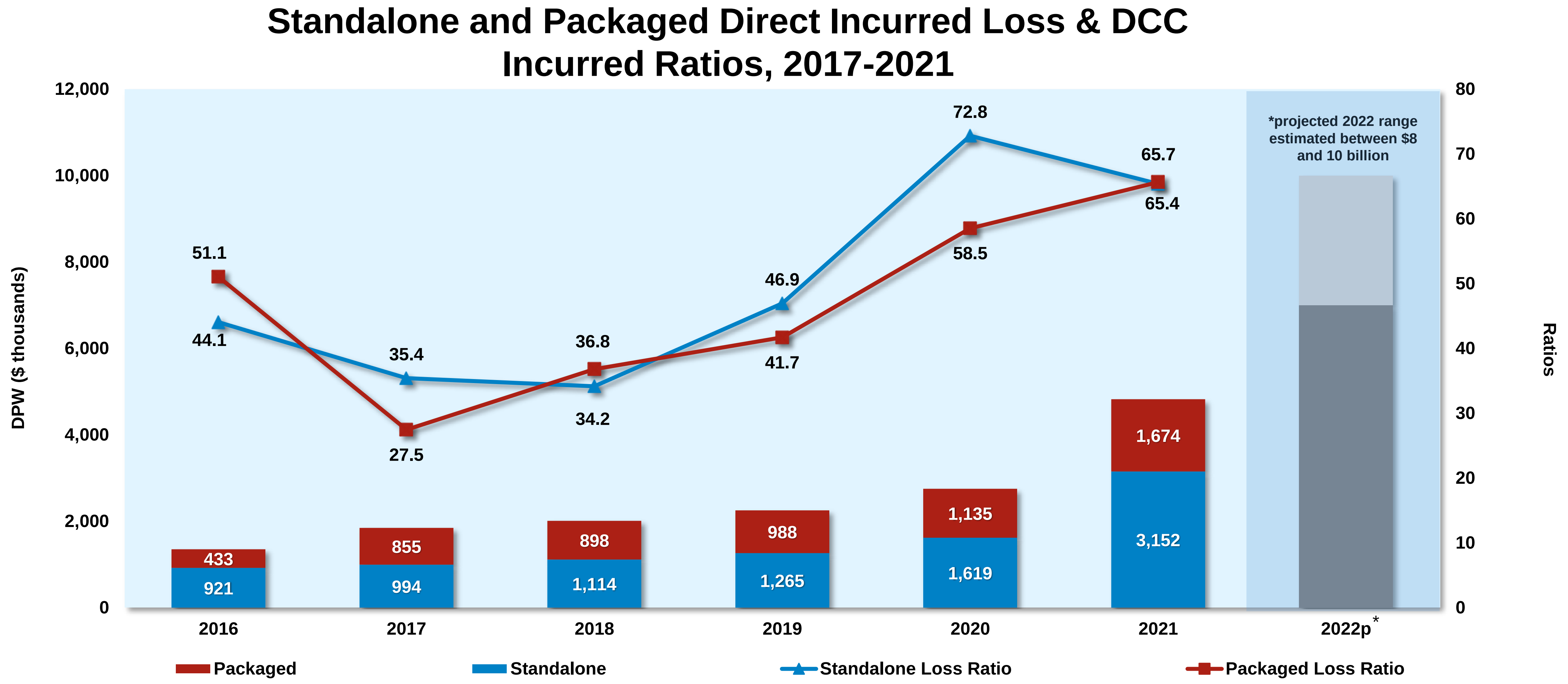
Cyber Insurance:
AM Best's Views & Perspectives

Types of cyberattacks experienced by organization



Source: The State of Cyber Resilience - report by Marsh and Microsoft

Direct Premiums Written



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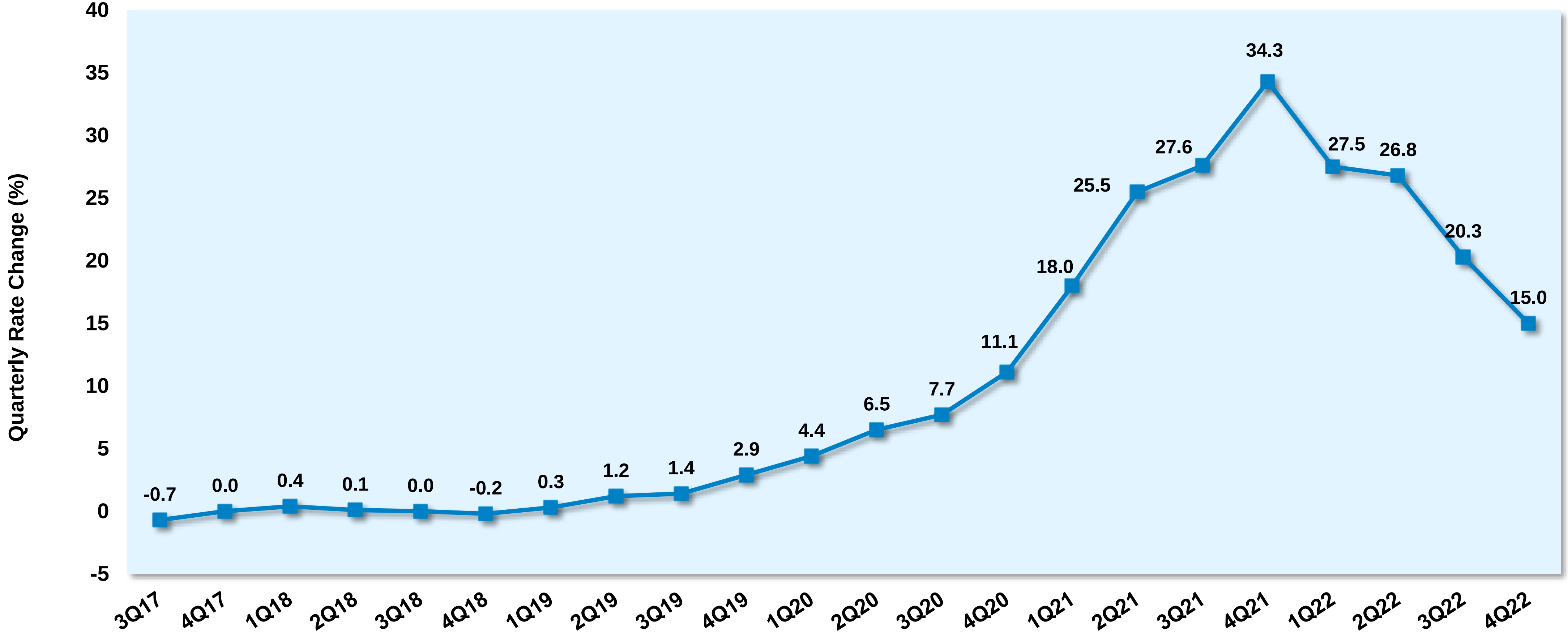
Rate Increases – Healthy But Moderating



Source: CIAB

The Future of Cyber

- More broadly accepted
- Positive long-term growth prospects
- Investment in technology and people is critical
- It’s more than insurance… it’s a partnership

Greater market awareness + improved cyber security hygiene = safer, more secure overall digital ecosystem

Cyber Loss Modeling

- Models are relatively new and not yet truly tested
  - Many models focused on underwriting selection
  - Some produce PMLs
- What constitutes a tail event?
  - Amazon Web Services outage
- Probabilistic modelling
- Deterministic modelling – Realistic disaster scenarios
- Capturing affirmative vs. silent cyber coverages

Rating Considerations

- Balance Sheet Strength
  - – BCAR, cyber modelling, reinsurance dependence, reserves, liquidity
- Operating Performance
  - – Business plans & assumptions, past loss experience
  - – Track record – projected vs. actual results
- Business Profile
  - – Concentration vs. diversification, product risk
- ERM
  - – Framework, risk appetite / tolerance, risk aggregation, risk mgmt. capabilities

The Growing Role of Delegated Underwriting

Greg Williams – Senior Director

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Agenda

Delegated Underwriting Authority Basics

Market Trends and Outlook

Performance Assessments for Delegated Underwriting Authority Enterprises

Delegated Underwriting Authority Basics

What Is a Delegated Underwriting Authority Enterprise (DUAE)?

- AM Best defines a DUAE as a third-party entity that is appointed by a (re)insurer, through contractual agreements, to perform underwriting, claims handling, and/or administrative functions on behalf of their carrier partners

- Typically carried out by insurers, DUAE's functions can include:

Binding coverage	**Underwriting and pricing**	**Settling claims**	**Appointing retail agents in a certain region**	**Access to niche segments and markets**

- The DUAE manages all or part of the insurance business of an insurer and acts as an insurance agent or broker for the insurer, while working as the intermediary between insurers and agents, and/or insured

What Is a Delegated Underwriting Authority Enterprise (DUAE)?

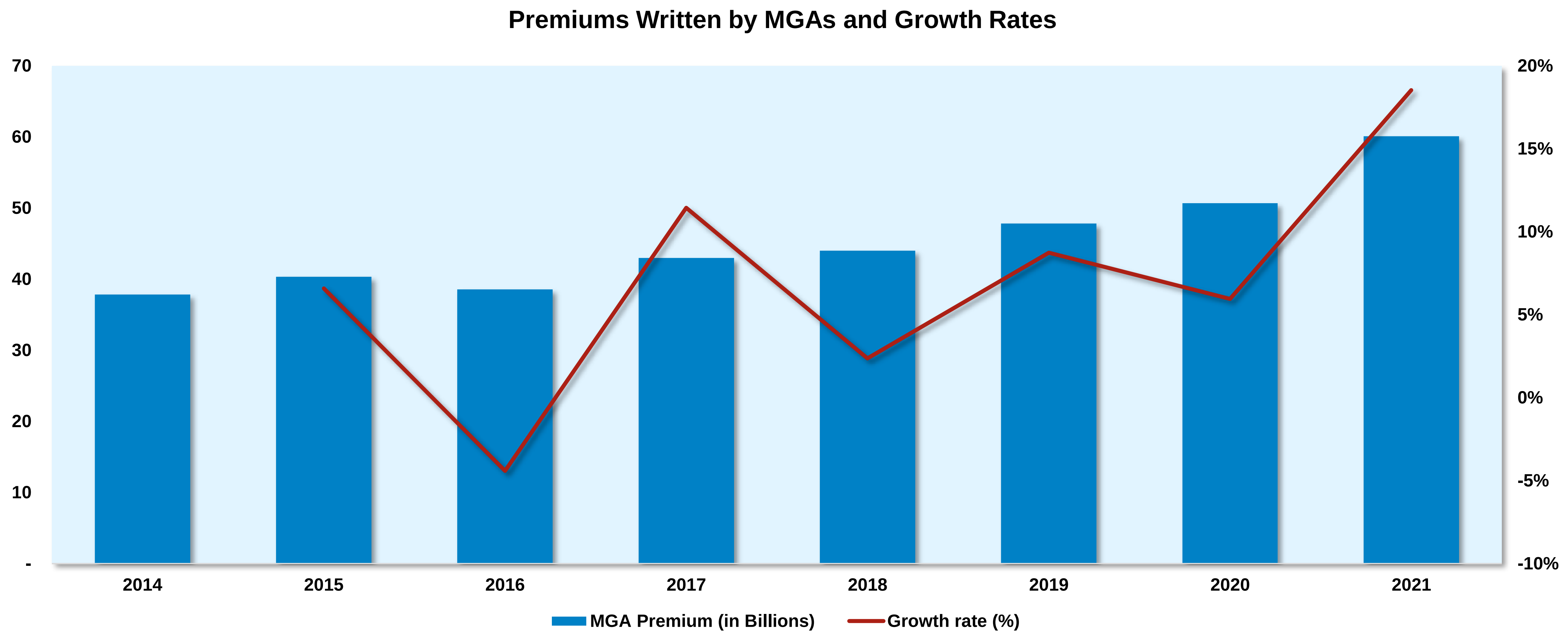
DUAE is used as a blanket term to capture:
• Managing General Agents (MGAs) • Managing General Underwriters • Coverholders • Program Administrators • Program Underwriters • Underwriting Agencies • Direct Authorizations • Appointed Representatives

Partnerships with DUAEs

- Allow insurers to achieve growth targets and execute diversification strategies in line with their risk appetite
- Among the key benefits DUAEs provide:
  - Risk class expertise
  - Product line expertise
  - Geographic expertise
  - Niche market relationships
- Generally unencumbered by legacy systems
- Incubators for digital processes and new technologies
- Alignment of interests remains critical

DUAE Market Trends and Outlook

Premiums Written by MGAs – U.S.



DUAE Current Market Trends & Observations

- Pricing continues to be strong – some moderation
- “A Market for All Cycles”
- Talent pool expanding and deepening
- M&A continues
- Rise of fronters
- Capacity trends
  - Reinsurer appetite
  - Captives
  - ILS participation

Global DUAE Outlook

- On December 5, 2022, AM Best assigned a positive outlook for the global DUAE market.
- Outlook predicated on:
  - Ongoing growth driven by technology, talent, and diverse sources of capital
  - Growing interest in program business by capacity providers
  - Private equity investments in the DUAE Market
- Near-term concerns:
  - A potential pullback of capital and risk-bearing capacity
  - Elevated reinsurance costs; compressed MGA commissions
  - Economical challenges, including inflation

Performance Assessments for Delegated Underwriting Authority Enterprises

(PA for DUAE)

Recap on Methodology Rollout

Draft methodology released for comment in March 2021

Received extensive feedback from market participants (DUAEs, insurance carriers, brokers, regulators, associations)

Beta testing was conducted during the second half of 2021 to refine processes and information requirements

Methodology released live on February 1, 2022

Five public PAs released to-date

PA for DUAEs Components

Key Assessment Factor	Max Points
Underwriting Capabilities	10 (steps of 2)
Governance and Internal Controls	10 (steps of 2)
Financial Condition	10 (steps of 2)
Organizational Talent	5
Depth and Breadth of Relationship	5

A higher overall number of points indicates the DUAE's relative ability to perform services on behalf of its insurance partners through:

- effective business underwriting
- strong financial condition
- excellent access to business
- high-level service
- strong business relationships and governance

Best's PA for DUAEs = Underwriting Capabilities + Governance and Internal Controls + Financial Condition + Organizational Talent + Depth and Breadth of Relationships

* Underwriting Capabilities, Governance & Internal Controls and Financial Condition have twice the weight of other components

PA for DUAEs – Final Outcome

Assessment Categories	Assessment Symbols	Assessment Ranges
Exceptional	PA-1	34-40
Excellent	PA-2	27-33
Strong	PA-3	20-26
Fair	PA-4	13-19
Weak	PA-5	Up to 12

The PA scale outlines the DUAE's:

- Relative ability to perform services on behalf of its insurance partners
- Underwriting expertise
- Financial performance indicators
- Company processes
- Appropriateness of governance and internal controls

Published Performance Assessments

	Castel U/W Agencies, Ltd.	CargoCorp	FIIA	Delta International Limited	Amwins Group
2021 GWP (USD million)	190.9	9.6	47.0	52.8	2,632.4
Example Lines of Business	Warranty & Indemnity, Mega Yachts, Construction	Marine	Professional Liability	Liability / Property	Various
Primary Markets	UK and Europe	Latin America	US	New Zealand / Australia / Singapore	US
Parent Company	Arch Capital Group Limited	Standalone Entity	Standalone Entity	Standalone Entity	Amwins Group, LLC
Performance Assessment / Outlook	**PA-2 (Excellent) / Stable**	**PA-3 (Strong) / Stable**	**PA-3 (Strong) / Stable**	**PA-2 (Excellent) / Stable**	**PA-1 (Exceptional) / Stable**
Effective Date	04/04/2022	04/04/2022	04/25/2022	8/22/2022	10/3/2022

Press Releases & PA Reports

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AM Best Assigns Performance Assessment to Castel Underwriting Agencies Limited and Castel Underwriting Europe B.V.

LONDON, 4 April 2022—AM Best has assigned a Performance Assessment of PA-2 (Excellent) to Castel Underwriting Agencies Limited (Castel) (United Kingdom) and Castel Underwriting Europe B.V. (CUE) (Netherlands). CUE is a wholly owned subsidiary of Castel. The outlook assigned to the Performance Assessment (assessment) is stable.

This assessment reflects Castel’s excellent underwriting capabilities, excellent governance and internal controls, excellent financial condition, excellent organisational talent and excellent depth and breadth of

Specialty Fronting Model

Ken Johnson – Managing Director, AM Best

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March 7, 2023

Specialty Fronting Observations

- (Re)Emergence of the Fronting Model
- Today's Market and Rating Trends
- 2023 and Beyond

(RE)Emergence
of the Fronting Model

AM Best Rated US Fronting Companies

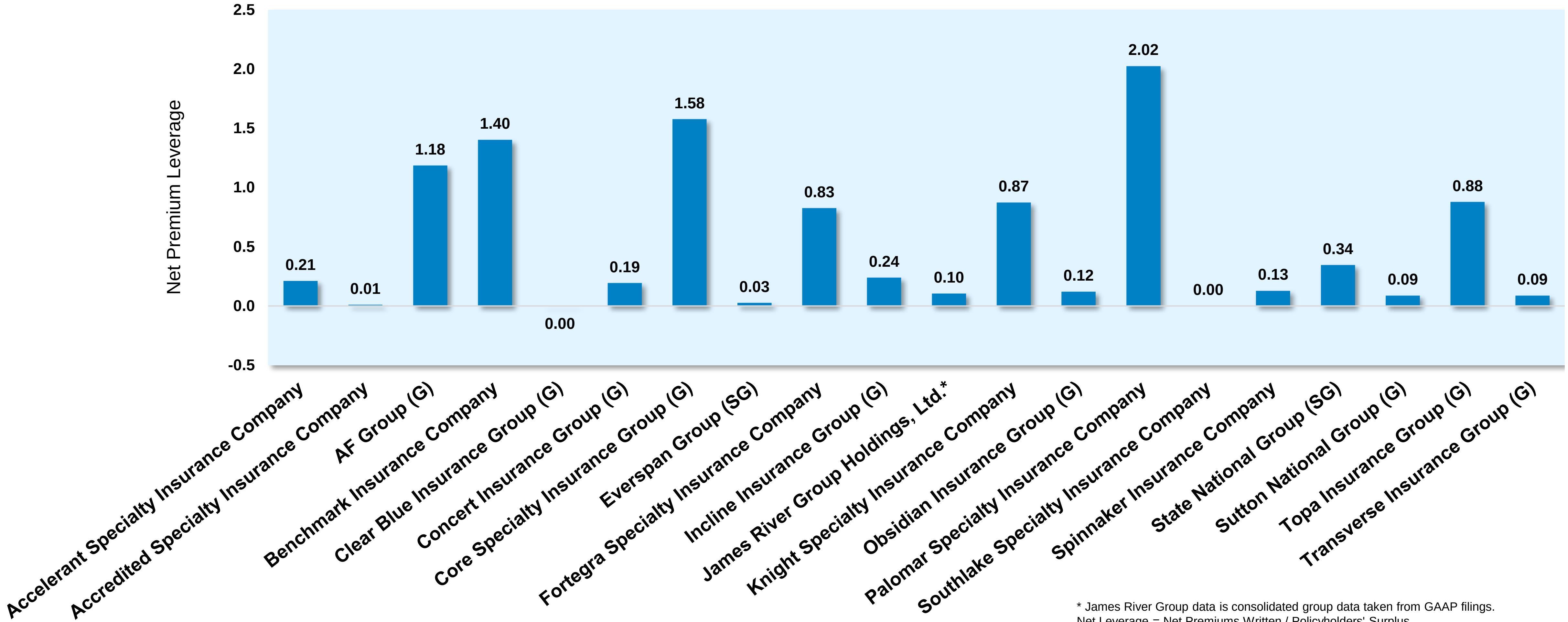
Direct Premiums Written, 2020-2021 ($ thousands)			
Company Name	2020 DPW	2021 DPW	% Change (YoY)
Accelerant Specialty Insurance Company	0	93,138	N/A
Accredited Specialty Insurance Company	0	79,961	N/A
AF Group	2,189,021	2,234,178	2.1
Benchmark Insurance Company	457,183	582,491	27.4
Clear Blue Insurance Group	753,910	1,084,416	43.8
Concert Insurance Group	49,435	46,421	-6.1
Core Specialty Insurance Group	644,454	1,326,285	105.8
Everspan Group	0	13,039	N/A
Fortegra Specialty Insurance Company	13	44,747	344107.7
Incline Insurance Group	66,357	182,314	174.7
Falls Lake Fire and Casualty Company	144,392	160,088	10.9
James River Group	1,103,993	1,322,034	19.8
Knight Specialty Insurance Company	69,073	134,529	94.8
Obsidian Insurance Group	1,512	119,324	7791.8
Palomar Specialty Insurance Company	297,763	321,770	8.1
Southlake Specialty Insurance Company	0	0	N/A
Spinnaker Insurance Company	272,941	473,954	73.6
State National Group	2,176,935	2,848,192	30.8
Sutton National Group	1,357	70,661	5107.1
Topa Insurance Group	171,542	148,274	-13.6
Transverse Insurance Group	27,835	222,358	698.8
Trisura US Insurance Group	482,432	798,949	65.6
N/A = Not Applicable			

(Re)Emergence of the Fronting Model

Drivers of Fronting Growth
• Structural Change • Traditional Market Capacity • Transfer of Underwriting Talent • Growth of Managing General Agents/Underwriters • Insurtech • Private Equity Interest • Reinsurance

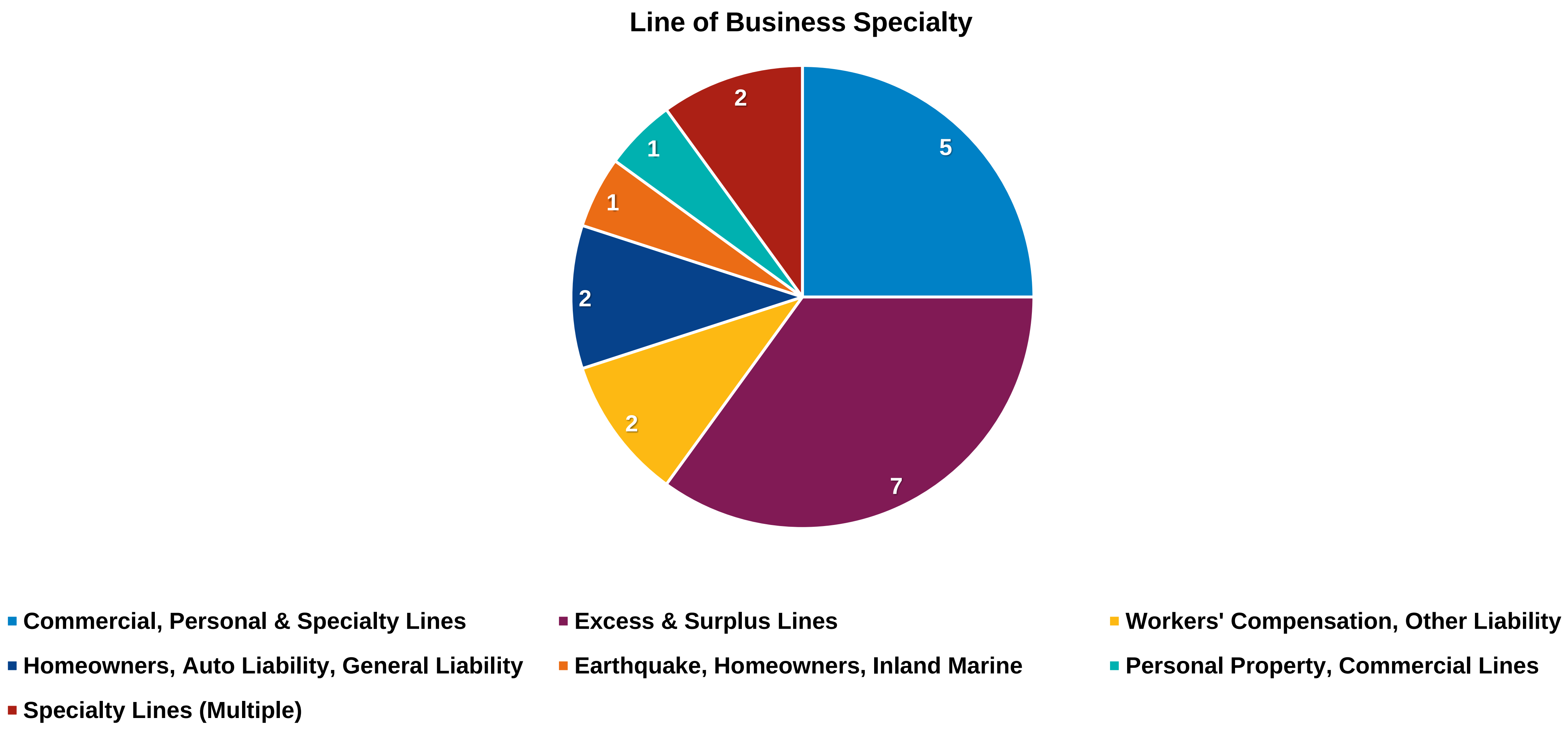
Today’s Market and Rating Trends

AM Best Rated Fronting Companies



* James River Group data is consolidated group data taken from GAAP filings.
Net Leverage = Net Premiums Written / Policyholders' Surplus.

AM Best Rated US Fronting Companies



Rating Trends

Balance Sheet

Operating Performance

Business Profile

Enterprise Risk Managament

AM Best Rated US Fronting Companies

Best's Credit Rating Methodology - Building Block Assessments						
Company Name	Current AM Best Financial Strength Rating	Best's Capital Adequacy Ratio (VaR 99.6)	Balance Sheet Strength Assessment	Operating Performance Assessment	Business Profile Assessment	Enterprise Risk Management Assessment
Accelerant Specialty Insurance Company	A-	45.0	Very Strong	Adequate	Limited	Appropriate
Accredited Specialty Insurance Company	A-	29.2	Very Strong	Adequate	Neutral	Appropriate
AF Group	A	35.4	Very Strong	Strong	Neutral	Appropriate
Benchmark Insurance Company	A	39.3	Very Strong	Strong	Limited	Appropriate
Clear Blue Insurance Group	A-	62.3	Very Strong	Adequate	Limited	Appropriate
Concert Insurance Group	A-	69.5	Very Strong	Adequate	Limited	Appropriate
Core Specialty Insurance Group	A-	40.9	Very Strong	Adequate	Limited	Appropriate
Everspan Group	A-	83.8	Very Strong	Adequate	Limited	Appropriate
Fortegra Specialty Insurance Company	A-	35.6	Very Strong	Adequate	Neutral	Appropriate
Incline Insurance Group	A-	85.5	Very Strong	Adequate	Limited	Appropriate
James River Group Holdings, Ltd.*	A-	13.1	Very Strong	Adequate	Neutral	Appropriate
Knight Specialty Insurance Company	A-	42.7	Very Strong	Adequate	Neutral	Appropriate
Obsidian Insurance Group	A-	76.5	Very Strong	Adequate	Limited	Appropriate
Palomar Specialty Insurance Company	A-	49.2	Very Strong	Adequate	Limited	Appropriate
Southlake Specialty Insurance Company	A-	88.0	Very Strong	Adequate	Limited	Appropriate
Spinnaker Insurance Company	A-	75.2	Very Strong	Adequate	Limited	Appropriate
State National Group	A	67.2	Strongest	Strong	Neutral	Appropriate
Sutton National Group	A-	71.1	Very Strong	Adequate	Limited	Appropriate
Topa Insurance Group	A- u	55.3	Very Strong	Adequate	Limited	Appropriate
Transverse Insurance Group	A- u	84.0	Very Strong	Adequate	Limited	Appropriate
Trisura US Insurance Group	A-	50.0	Very Strong	Adequate	Neutral	Appropriate

* James River Group Holdings data is consolidated group data taken from GAAP filings

2023 and Beyond

2023 and Beyond

Continued Growth?

What Can Go Wrong?

Reinsurance Appetite

Emerging Risks

Methodology Update: Holding Company & Available Capital

Mahesh Mistry – Senior Director, AM Best

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Highlights

The enhancements to criteria should not change our analysis and process for rating holding companies or issues, or the treatment of debt in BCAR – rather they serve to clarify existing practice

Methodologies with Proposed Revisions

Section 1: BCRM Part IV – Insurance Holding Company and Issue Credit Ratings

Section 2: Available Capital and Holding Company Analysis

Out for Comment: **28 February 2023**; End of Comment Period: **31 March 2023**

Impact of Changes

- Revisions to BCRM will affect <5% of our global ratings, including issue ratings
- Treatment of debt is unchanged, however any associated debt is likely to move in line with NOHC movements
- Revisions to Available Capital and Holding Company Analysis will not affect any ratings

Holding Company and Available Capital: Overarching Theme

Regulation / Capital Management Policy

Collective Capital Management Groups (CCMG)

Treatment for IHC Notching and Debt Treatment

Examples: Europe, Canada

Entity Prioritized Structures (EPS)

Treatment for IHC Notching and Debt Treatment

Example: US

Bermuda

Analysis should reflect:

- Regulatory jurisdictions of the group (financial flexibility, fungibility, regulatory restrictions, liquidity, cashflows)
- Capital Management approach
- Where the best information is available

- **Collective Capital Management** (CCMG) and **Entity Prioritized Structures** (EPS) are AM Best classifications
- Groups operating in Continental Europe and Canada are generally classified as CCMG - there are exceptions
- US groups are classified as EPS
- Bermuda is a unique and subject to judgment – starting point viewed as EPS
- Emerging market groups generally fall into EPS, due priority on local entities and often limitations on jurisdiction over groups
- Ensure balanced approach for notching between the Opco and IHC, and credit for debt

Section 1: Holding Company Notching and Issue Credit Ratings

Background

- Proposed revisions only affect Section IV: Insurance Holding Company and Issue Credit Ratings
- No changes have been made to the analysis of core building blocks under BCRM: Balance Sheet Strength, Operating Performance, Business Profile, ERM and Lift/Drag

Treatment on Notching

- Current treatment is typically 3-notches from Operating Company ICR applied globally
- Some have narrower notching due to either financial strength (‘aa+’ or above’ category) or diversification. Wider notching is also applied for lower rated insurers

Impact on Ratings

- Revisions to BCRM will affect <5% of our global ratings, including issue ratings
- Treatment of debt is unchanged, however any associated debt to a change in the NOHC is likely to be affected
- Bermudian groups should be judged on a case-by-case basis. Generally notching will remain unchanged, however, there is scope to move to narrower notching if justified

BCRM Criteria Introduction: Notching Difference

The notching difference between an operating company ICR and an IHC ICR depends on the following:

- The rating level of the particular operating company
- Group capital fungibility – the fungibility of available capital across entities ultimately owned by the IHC and the IHC itself
- Other relevant features such as the degree of successful diversification evidenced at the IHC
- The group's prudential regulatory oversight

Expansion of comments on notching difference makes explicit group capital fungibility and regulatory oversight

Arriving at the IHC's Rating

The rating of the IHC reflects analysis of both the credit risk implications of the IHC being a separate legal entity from the operating insurer, and the normal subordination of IHC creditors to operating company policyholders in most regulatory jurisdictions. An IHC ICR incorporates the IHC's status as a discrete legal entity separate from the operating insurer. Furthermore, prudential regulation will normally act to restrict IHCs' access to the assets of insurance subsidiaries beyond the usual consequences of separate legal entity status. These restrictions may take the form of maximum dividend levels or other constraints on the movement of funds from operating companies to IHCs.

An IHC normally does not generate significant earnings other than from subsidiary operations, which increases the risk arising from its legal separation from those subsidiaries. These considerations are represented in the notching difference between the ICR of a lead rating unit and that of its IHC.

Regulation

Introduce importance of regulation in assessment

Regulation

AM Best considers the regulatory regime under which the entity or entities operate to be a key factor in assessing the appropriate level of the notching difference between the ICR of a lead rating unit and that of its IHC. In particular, the regulator's level of oversight over an IHC will be relevant to this assessment, as it significantly determines group capital management and fungibility. The focus of regulatory regimes can vary from those where individual legal entities are the primary concern to regimes where relevant groups of companies are also considered in detail.

AM Best identifies Entity Prioritized Structures and Collective Capital Management Groups as categories of insurance groups largely determined by their regulatory environment. In many cases, insurance groups will have operations across many geographies and be subject to different forms of regulation, i.e., a mix of regimes with variation in their emphasis on legal entities and groups. AM Best will seek to understand the operating environment of the group or company and any restrictions or limitations on the flow of capital this may present for the group. Regulation may influence how a group operates, but an understanding of capital management policy is also important in determining the appropriate level of notching between the lead rating unit and the IHC.

Regulation is important to determining the notching difference: understand whether there are legal entity priorities or group consolidated views

Two new terms focussing primary on regulation: Collective Capital Management Groups (CCMG) and Entity Prioritized Structures (EPS)

A view of corporate capital management policy also important

Entity Prioritized Structures (EPS)

Entity Prioritized Structures

An insurance prudential regulatory environment may be focused on the regulation of each insurance company legal entity separately, with limited or no reference to jurisdiction over any IHC at the top of the corporate structure.

Where an insurance group primarily operates under this type of regulation AM Best may determine the group to be an Entity Prioritized Structure. Such insurance groups would typically exhibit the following characteristics:

- The regulatory regime is associated with restricted fungibility of capital between regulated operating entities in a group and their IHC.
- Regulators may gather information about the IHC, but jurisdiction over the IHC is limited.
- Excess capital is more likely held at individual operating entities, than at the IHC.

Regulatory focus on each legal entity separately:

- Restricted fungibility and reduced financial flexibility across the group
- Harder for capital extraction from subsidiaries
- Less jurisdiction over the IHC
- Capital held within operating entities
- Less excess capital at IHC
- Example: US Groups

Collective Capital Management Groups (CCMG)

Collective Capital Management Groups

An insurance prudential regulatory environment may include detailed reviews of any group of which an insurer may be a part. The group may comprise insurance and other entities, including an IHC, subsidiaries, and any other interests controlled by the group.

When such groups are subject to regulation, AM Best may determine the group to be a Collective Capital Management Group. Generally, the following characteristics are present in these instances:

- The regulatory regime is associated with enhanced fungibility of capital across the group and an ability to deploy group capital to meet requirements wherever they arise in the group.
- The IHC's and intermediate IHC's financial obligations are an explicit part of solvency measures enforced by the regulator(s).
- Excess capital is more likely to be held higher up in the group corporate structure and consequently, less capital in excess of regulatory minimums may be held at the operating subsidiary level.

Regulatory focus on the group:

- Assumes greater fungibility and financial flexibility across the group
- Excess capital held at group to support subsidiaries as required
- Group Capital Management policy. Capital allocated and managed at group level
- Easier to extract capital from subsidiaries
- Subsidiaries tend to be run to meet local solvency requirements with limited excess funds
- Example: Large European and Canadian groups

Collective Capital Management Groups (CCMG)

These factors favor a reduced notching difference between an operating company ICR and that of the IHC compared to when the group is not a Collective Capital Management Group. AM Best views regulation of groups as a developing form of prudential supervision that brings operating companies and the IHC closer in terms of financial stakeholders' exposure to solvency risk. Nevertheless, the impact on notching of categorization as a Collective Capital Management Group is normally limited in view of the following factors:

- Separate legal entities remain, often in separate jurisdictions. In a credit event, the IHC at the least will be subject to normal restrictions in each jurisdiction based on access to the assets of subsidiaries. Additionally, legal entity regulation remains in force along with associated constraints on the movement of funds
- Sub-groups may be located outside the authority of the regulatory supervisor of an IHC, impeding the flow of funds across companies in the group.
- National supervisors will usually look to protect the interests of policyholders in their territory, which is likely to influence actions in the normal course of supervision even under the territorial purview of a trans-national group regulator. Policyholder compensation schemes differ across territories and varying parties bear the costs, thus reinforcing national authorities' inclination to protect their policyholders when regulating legal entities in their jurisdiction.

One-notch difference to Entity Prioritized Structures

Legal entities remain

Groups can be far reaching

National recovery and resolution schemes often drive behaviour

Criteria New Basis Tables: BCRM Changes

Exhibits B1 and **B2**: Insurance Holding Company Notching Tables

- Provide greater clarity of factors that drive the notching (including rating level, group financial flexibility, fungibility of capital across the group, degree of successful diversification, liquidity management, cashflows)
- Introduce two new classifications: **Collective Capital Management Groups (CCMG)** and **Entity Prioritized Structures (EPS)**

Exhibit B.1 – Typical Notching Differences Between Operating Company ICR and Insurance Holding Company ICR for **Entity Prioritized Structures**

Operating Company ICR	Insurance Holding Company Notching
aaa	0 - 2
aa+	2 - 3
aa/aa-	3
a+/a/a-	3
bbb+/bbb	3
bbb-	3 - 4
bb+/bb	4
bb-	4 - 5

Exhibit B.2 - Typical Notching Differences Between Operating Company ICR and Insurance Holding Company for a **Collective Capital Management Group**

Operating Company ICR	Insurance Holding Company Notching
aaa	0 - 1
aa+	1 - 2
aa/aa-	2
a+/a/a-	2
bbb+/bbb	2
bbb-	2 - 3
bb+/bb	3
bb-	3 - 4

Narrower Notching

Groups Managed as Collective Capital Management Groups

A group not subject to formal group regulation, as categorized under Collective Capital Management Group as defined above, may nevertheless manage its financial obligations to both safeguard IHC creditors and to carefully ensure its capital is freely available to subsidiaries across the group. AM Best may make the determination that the group manages capital in a manner that is reliably at least equivalent to the way capital management would function for a Collective Capital Management Group. Notching differences as illustrated in **Exhibit B.2** may be applied in such cases. Successful diversification can further contribute to the security of creditors.

In order to allow some flexibility, AM Best may, in exceptional cases, grant narrower notching where a group is not subject to the group regulation normally required for categorization as a Collective Capital Management Group (CCMG).

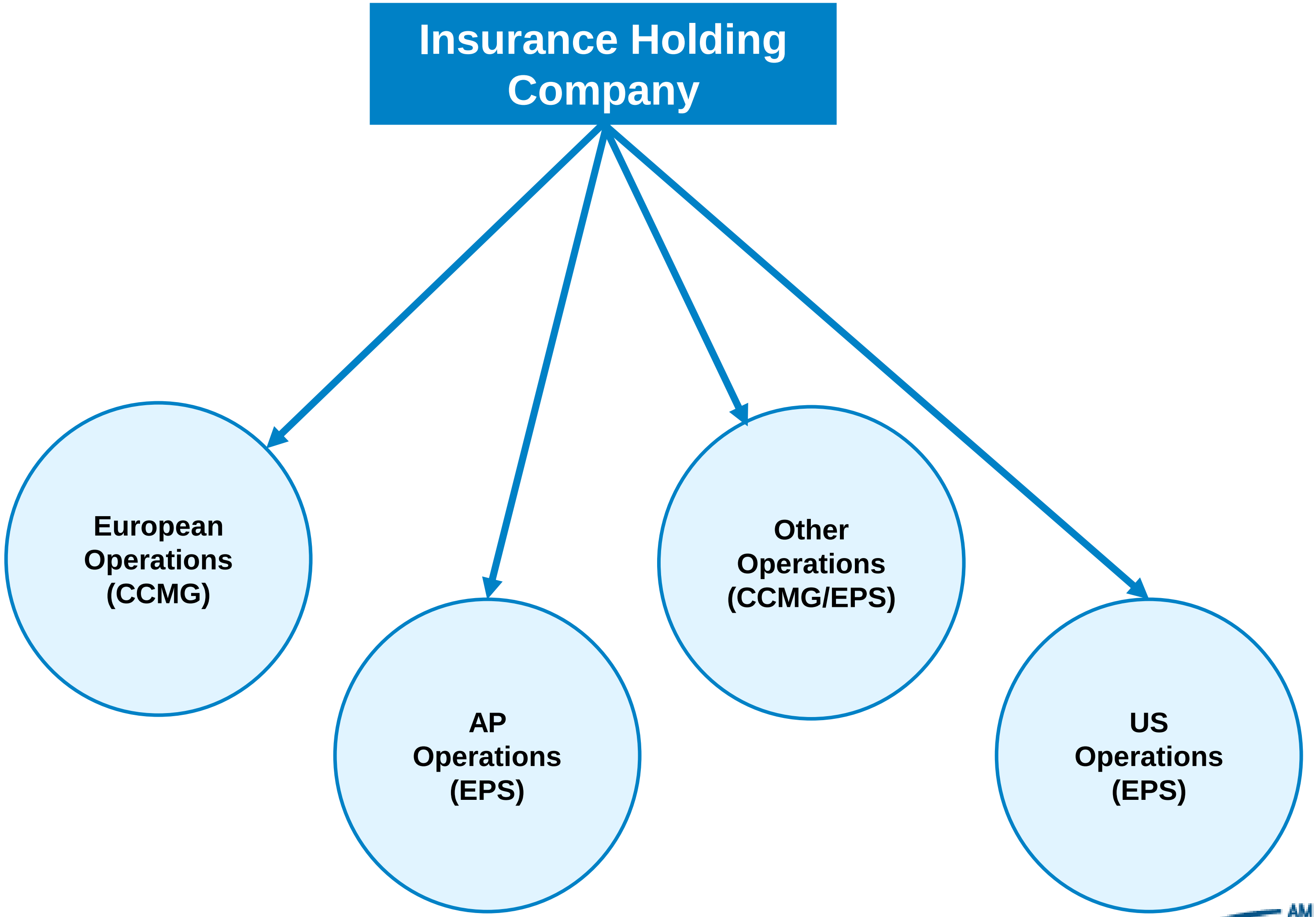
Application of Approach

Assessing IHC:

- Understand operating jurisdictions
- Capital management policy
- Best available data
- Not a look-up exercise
- No list of jurisdictions

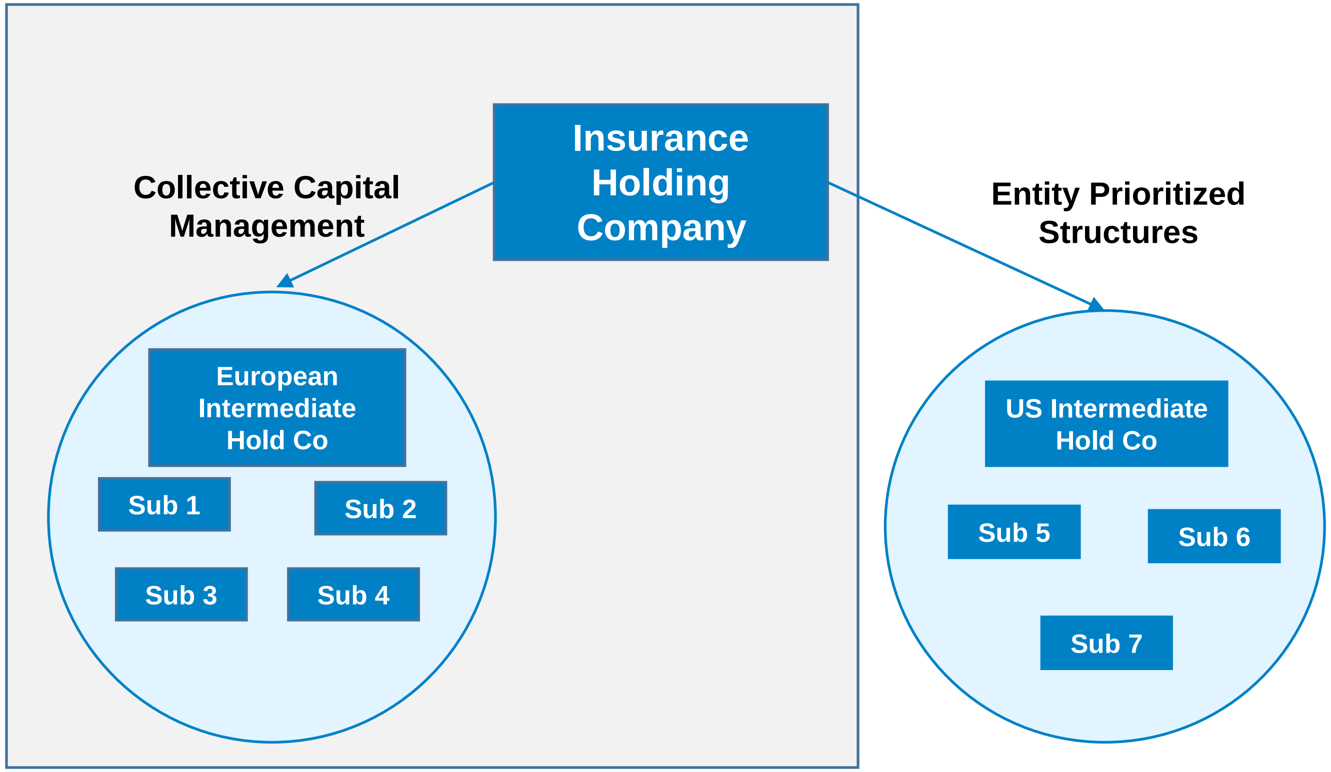
Analytical judgement needs to be applied when considering groups across jurisdictions

Note: Structures can change over time, which may change our view



Intermediate Holding Companies

The relationship between intermediate holding companies and their operating insurance subsidiaries is reviewed to assess whether a relevant sub-group is a Collective Capital Management Group and to determine appropriate notching.



Intermediate holding companies in different jurisdictions may not receive the same level of notching as the IHC.

Example: a European Group that is viewed as CCMG may have an IHC or an intermediate IHC at 2-notches, but the US Intermediate IHC may be at 3-notches under EPS. Any associated debt will follow from the respective IHC or Intermediate IHC rating.

Debt Notching

No change to debt notching (Exhibit C.1)

The move to narrower notching on NOHC will also affect issue ratings

Exhibit C.1: Typical Notching Difference Between Non-Operating Insurance Holding Company ICR and Debt and Preferred Stock Ratings

Security Type	Notches from Non-Operating Insurance Holding Company
Senior Debt	0
Subordinated Debt	-1
Junior Subordinated Debt, Trust Preferred, Capital Trust Securities, Preferred Securities/Stock	-2

Greater flexibility to widen notching if non-payment risk is deemed higher (exceptional cases)

Additionally, loss-absorption features can result in wider notching if the likelihood of a feature taking effect is determined by a trigger that is not sufficiently remote. AM Best views contingent write-downs, equity conversions, and deferral of coupon or interest payments in well-defined and solvent circumstances as potential examples of such features. An aggressive trigger that affects issue notching might, for example, be defined by reference to a regulatory solvency ratio or an earnings threshold. The volatility of an insurer's solvency may influence the assessed proximity of a loss absorption trigger.

Section 2: Available Capital and Holding Company Analysis

<u>Background</u>

- Ensure methodology reflects latest market conditions and appropriately captures the latest capital structures, instruments and features used in the market.

<u>Enhancements</u>

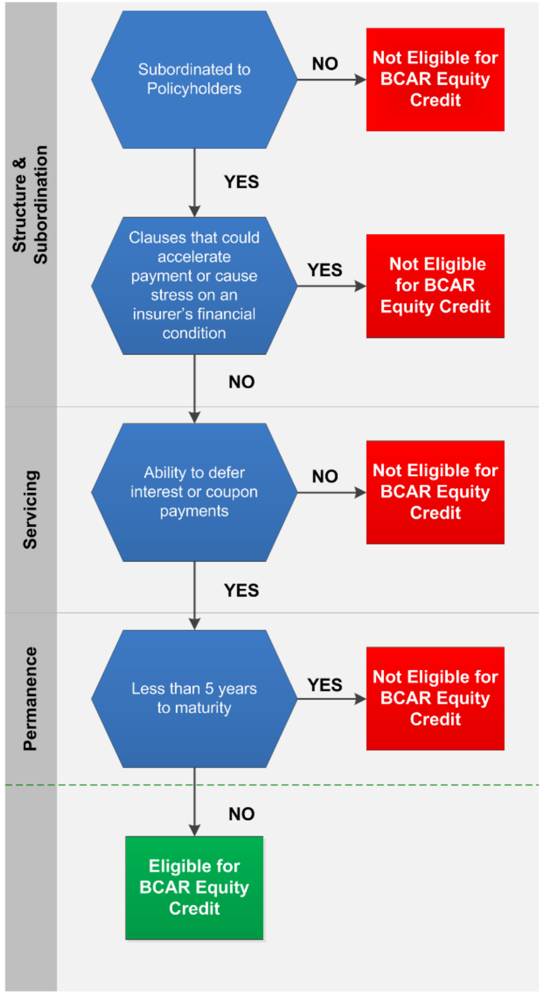
- Criteria title changed: Available Capital and <u>Insurance</u> Holding Company Analysis
- Treatment of Debt under Entity Prioritized Structures
- Provide greater transparency on senior debt treatment in BCAR. Regulation justifies variation in treatment for senior debt.
- Clarify guidance on credit given in BCAR and leverage for instruments that are closer aligned to equity
- Clarifications on non-insurance operations

<u>Ratings Impact</u>

- No impact on credit ratings as a result of these clarifications

Clarification on BCAR Treatment

Exhibit C.2: BCAR Hybrid Capital Assessment



The regulatory restrictions on fungibility of capital varies materially across jurisdictions. In some cases, AM Best identifies that restrictions on the upstreaming of funds to the IHC result in strong structural subordination of debt issued by the IHC that also is downstreamed to operating entities. Strong structural subordination ensures that debt-funded capital is available to policyholders though the debt may not conform to the guidelines set out in **Exhibit C.2**.

When there is strong structural subordination in Entity Prioritized Structures an IHC/Consolidated BCAR calculation can be completed with equity credit given for downstreamed debt issued by the IHC – including for debt that does not meet the conditions set out in **Exhibit C.2** such as senior debt. Analysts will run a BCAR on this basis with the total credit for all debt instruments (hybrid and senior debt that does not qualify as hybrid) subject to a 20% limit of the consolidated group's total available capital.

Credit for debt that does not adhere to Exhibit C.2. i.e. senior debt:

- Credit (only) where significant regulatory restrictions on the upstreaming of capital to the IHC (which issued the debt), resulting in strong structural subordination
- Given strong structural subordination, important where the debt-funded capital sits, rather than its features
- Credit given in consolidated /holding company BCAR – but subject to the 20% cap.

Other Clarifications

Equity Credit for Preferred Shares

- Clarification of treatment of hybrid securities in BCAR and leverage - allowing uncapped credit in BCAR for debt with features that align closely with common equity
- For example, convertible perpetual preference shares with no call option (other than conversion to common equity) may be eligible for full credit
- For all instruments, a detailed review of their characteristics would need to be assessed to warrant equity credit.

Clarification on Treatment of Call Dates / Amortization of Debt

- Emphasis on rationale for the debt issuance and the group’s priorities on refinancing debt
- Concerns regarding the refinancing of debt may result in a reduction in credit as the term nears

New Hybrid Debt Examples

- Consideration for Payment in Kind options
- Treatment of preferred shares

Service Oriented Activities

- Additional commentary included for insurance groups that have material non-insurance activities, such as, large US health insurers. Such companies may have successful operations in related sectors.

Focus on Bermuda

- No change in the evaluation process of Bermuda entities
- Variety of operating structures in place, for which many have international operations
- Viewed on a case-by-case basis
- An understanding of operating jurisdictions is important – regulatory priorities

- An understanding of corporate capital management policy
- Understand where the best data is available for analytical purposes subject to corporate structure
- May contain elements of both CCMG and EPS
- Ensure consistent treatment between notching and credit for debt

Collective Capital Management Groups (CCMG)

Bermuda IHC with European and Bermuda Ops

Bermuda IHC with primary Bermuda Ops

Bermuda IHC with US Ops (LRU: OpCo)

Bermuda IHC with US OpCo (LRU: Conso Group)

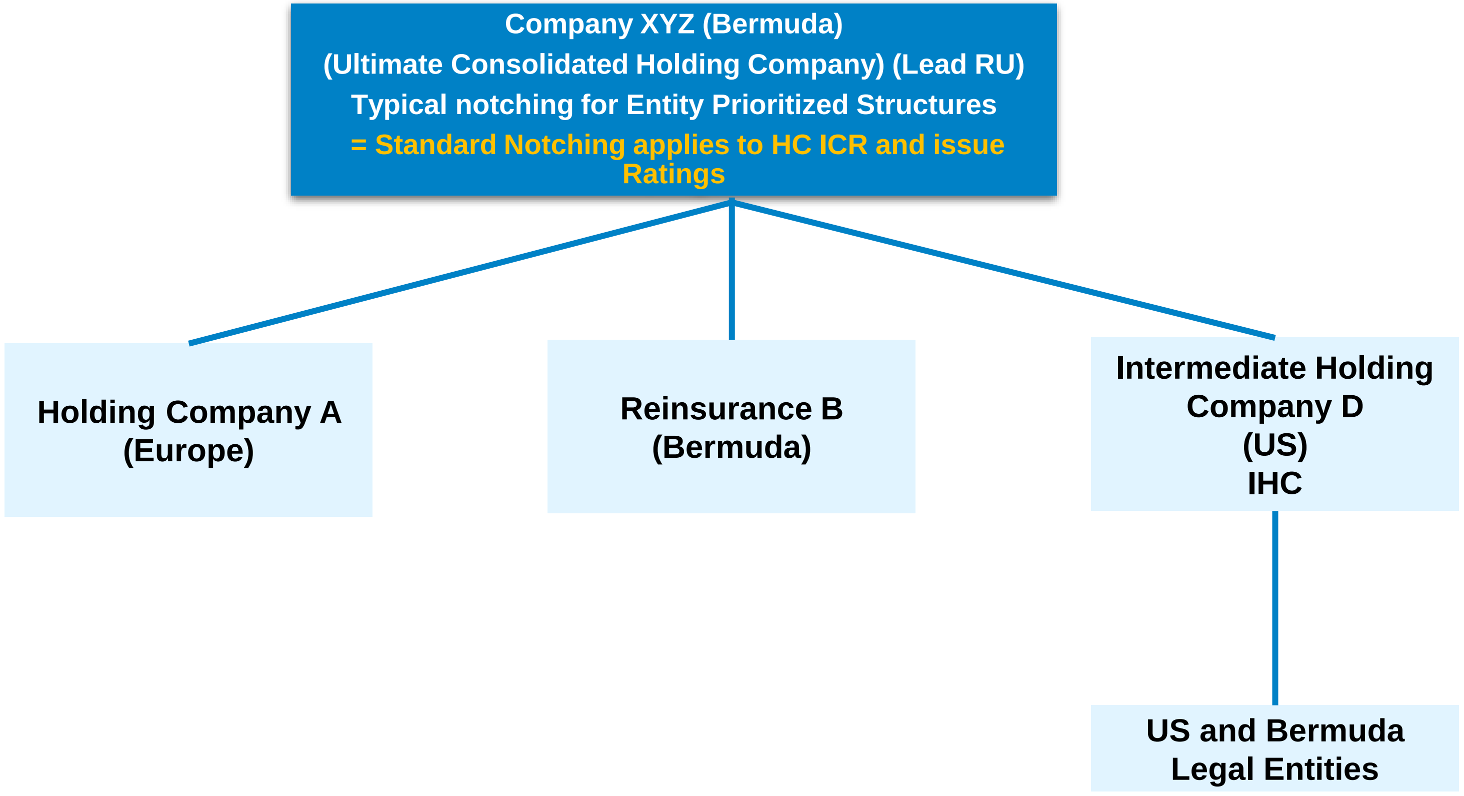
Entity Prioritized Structures (EPS)

Large European Groups with European Ops
- Operate CCMG with excess capital at IHC
- LRU: Consolidated Group
- 2 notches to hold co
- Generally no credit for senior debt

US Group with only US Ops
- Unlimited credit for senior debt in OpCo BCAR
- Check for dependence on debt in hold/conso BCAR
- 3 notches to hold co

Example: Bermuda Consolidated US GAAP (Bermuda, US, Europe)

- Majority of equity residing in US and Bermuda operations
- The group is rated on a consolidated US GAAP basis
- Debt issued by the US intermediate holding company is composed of senior and subordinated debt which is downstreamed into US and Bermuda operating legal entities
- Group mainly operates under EPS structures therefore standard notching is applied to the ultimate and intermediate holding companies, as well as to senior and subordinated debt
- Restrictions imposed on operating legal entities in the US and Bermuda indicating strong structural subordination and sometimes contractual subordination



Comment Period Ends: 31 March 2023

Q&A

The Growing Role of Delegated Underwriting: Appendix

PA for DUAEs – Assessing Key Components

Underwriting Capabilities

Assessment	Points
Exceptional	10
Excellent	8
Strong	6
Fair	4
Weak	2

Sub-assessment Factors
• Quality of underwriting • Underwriting results • Underwriting competitive advantage • Proprietary data and analytics • Experience of underwriting staff • Technology in the underwriting process • Limitations on exceptions/risk appetite

PA for DUAEs – Assessing Key Components

Governance and Internal Controls

Assessment	Points
Exceptional	10
Excellent	8
Strong	6
Fair	4
Weak	2

Sub-assessment Factors

- Alignment of interests
- Systems
- Audits and other management reports
- Policies and procedures
- Disaster recovery plan
- Key person risk plan
- Service measures
- Binding contracts
- Broker contracts
- Partnerships with TPAs

PA for DUAEs – Assessing Key Components
Financial Condition

Assessment	Points
Exceptional	10
Excellent	8
Strong	6
Fair	4
Weak	2

Sub-assessment Factors

- Analysis of financial metrics
- Participation in risk sharing

PA for DUAEs – Assessing Key Components

Organizational Talent

Assessment	Points
Exceptional	5
Excellent	4
Strong	3
Fair	2
Weak	1

Sub-assessment Factors

- Tenure
- Training programs
- Executive experience
- Organizational structure

PA for DUAEs – Assessing Key Components

Depth & Breadth of Relationships

Assessment	Points
Exceptional	5
Excellent	4
Strong	3
Fair	2
Weak	1

Sub-assessment Factors

- Number of programs and markets
- Consistency of relationships
- Geographic reach
- Retention of clients