

AM Best's Italy Insurance Market Briefing - Milan

15 June 2023

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Riccardo Ciccozzi
Director, Market Development, Europe

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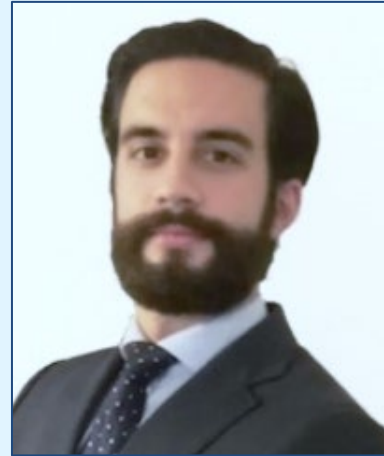
Presenters



**Riccardo
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**Angela
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Financial
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Agenda: Italy Insurance Market Briefing - Milan

10:30 Welcome and Introductory Comments

Riccardo Ciccozzi, Director, Market Development – Europe

10:40 Delegated Underwriting/MGA Market Update

Riccardo Ciccozzi, Director, Market Development – Europe

11:00 The Global Reinsurance Market: Perspectives, Outlook & 1.4.23 Renewals

Dr. Angela Yeo, Senior Director, Head of Analytics & Operations

11:30 AM Best's Hot Topics

Jose Berenguer, Senior Financial Analyst

Andrea Porta, Financial Analyst

12:00 Q&A and Closing Remarks

12:15 Networking Lunch

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Disclaimer

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Delegated Underwriting/MGA Market Update

Riccardo Ciccozzi - Director, Market Development - Europe

What is a Delegated Underwriting Authority Enterprise (DUAE)?

DUAE: Third party entity contracted by a (re)insurer to perform underwriting, claims handling, and/or administrative functions for their carrier partners.

DUAE is a blanket term for:

Appointed Representatives

Coverholders

Direct Authorizations

Managing General Agents

Managing General Underwriters

Program Administrators

Program Underwriters

Underwriting Agencies

Functions can include:

- Binding coverage
- Underwriting and pricing
- Settling claims
- Appointing retail and commercial agents
- Accessing niche segments and markets
- Managing all or part of the insurance business of an insurer
- Acting as insurance agent or broker for the insurer
- Working as an intermediary between insurers, agents, and insured

Why Now?

Increasing role of DUAEs/MGAs in the insurance value/distribution chain

More rated (re)insurers engaging with DUAEs/MGAs

Broadens AM Best's service offerings within its chosen sector

Increasing interest from key stakeholders – capacity providers, investors, intermediaries, regulators

Global DUAЕ Market Segment Outlook – Positive

Tailwinds

Ongoing growth, driven by technology, talent and diverse sources of capital

Increased interest in program business by capacity providers

Private equity backing and M&A aiding development of the sector

Headwinds

A potential pullback of capital and risk-bearing capacity, as well as elevated reinsurance costs

Looming economic challenges, including elevated inflation

Best's Performance Assessment for Delegated Underwriting Authority Enterprises (PA For DUAEs)

Due to the increase in DUAEs' premiums, an independent assessment adds value to the marketplace by providing a tool to differentiate among these organizations.



A forward looking, independent, and objective non-credit opinion of a DUAE's ability to service business partners.



Provides greater transparency to DUAEs, as it offers a global benchmark across all types and sizes of delegated authority organizations.



Can be used by DUAEs that allows them to differentiate themselves in the marketplace, and users of DUAEs can use the PA as a tool for evaluating and selecting the right partner for their business.



A DUAE may use the PA with regulators for licensing or jurisdictional authorization.

AM Best's Process for Assessing DUAEs

AM Best uses quantitative and qualitative elements to assess the strengths and weaknesses of a DUAE.

Our interactive process entails:






- Gathering information.
- Engaging with clients in a formal management meeting.
- Assessing key factors.
- Assessment committee interaction.
- Public dissemination (if the DUAE agrees).
- Performance Assessment Report.



DUAE Assessment Outcomes

- A PA is assigned an outlook of Positive, Stable, or Negative.
- PAs are maintained/surveilled/updated annually, if the DUAE remains in the interactive assessment process.
- Withdrawal of a PA will need a final assessment.

Best’s PA Scale and Assessment Categories:

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

A better overall PA indicates that the DUAE is more likely to:

- Achieve greater long-term stability through effective business.
- Maintain a strong financial profile.
- Provide high-level service.
- Maintain strong business relationships & governance.

Benefits for DUAEs



Establishes credibility and trust within the insurance industry and regulators.



Differentiates capabilities from competitors to assist DUAEs in securing capacity from carriers and capital from investors.



Demonstrates expertise and effectiveness in key operational areas.



Provides a uniform and independent evaluation of DUAEs from a respected third party.



Offers a global benchmark across all types and sizes of DUAEs.



Showcases transparency to the marketplace.



Enhances a DUAEs marketing and promotional efforts.

Q&A

The Global Reinsurance Market: Perspectives, Outlook & 1.4.23 Renewals

Dr. Angela Yeo - Senior Director, Head of Analytics & Operations

Global Reinsurance Market – Discussion Outline

Results Drive Improving Pricing and Terms

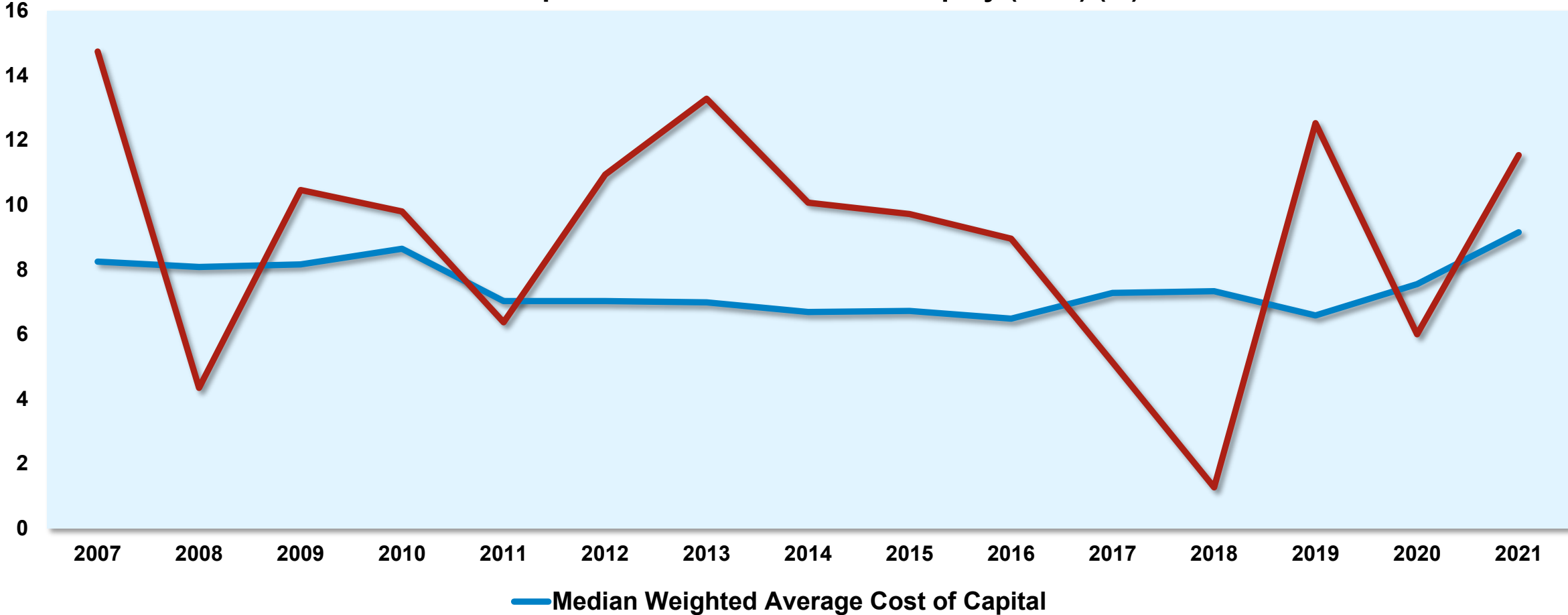
Market Well Capitalised – Subject to Asset Volatility

Outlook: Stable – Drivers Remain in Flux

**Global Reinsurance Market
Results Drive
Improving Pricing and Terms**

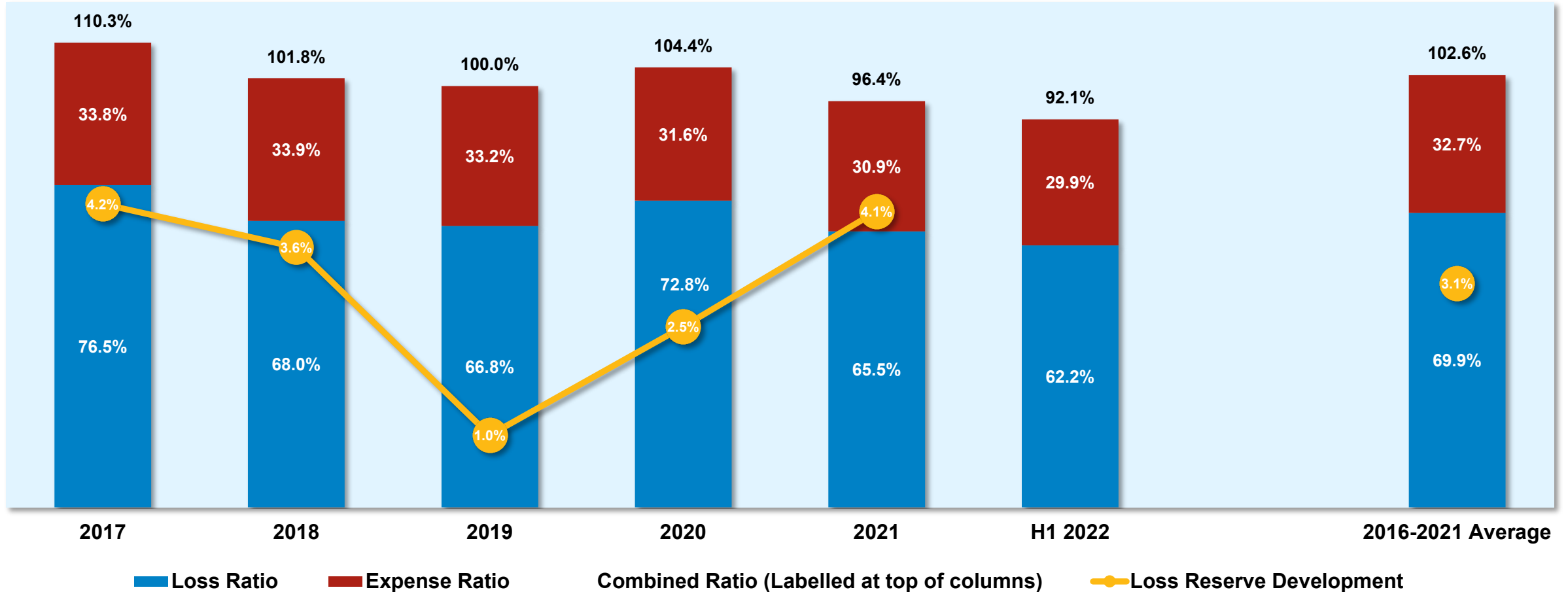
Global Reinsurance Market Performance

Reinsurers' Median Weighted Average Cost of Capital (WACC)
Compared to Median Return on Equity (ROE) (%)

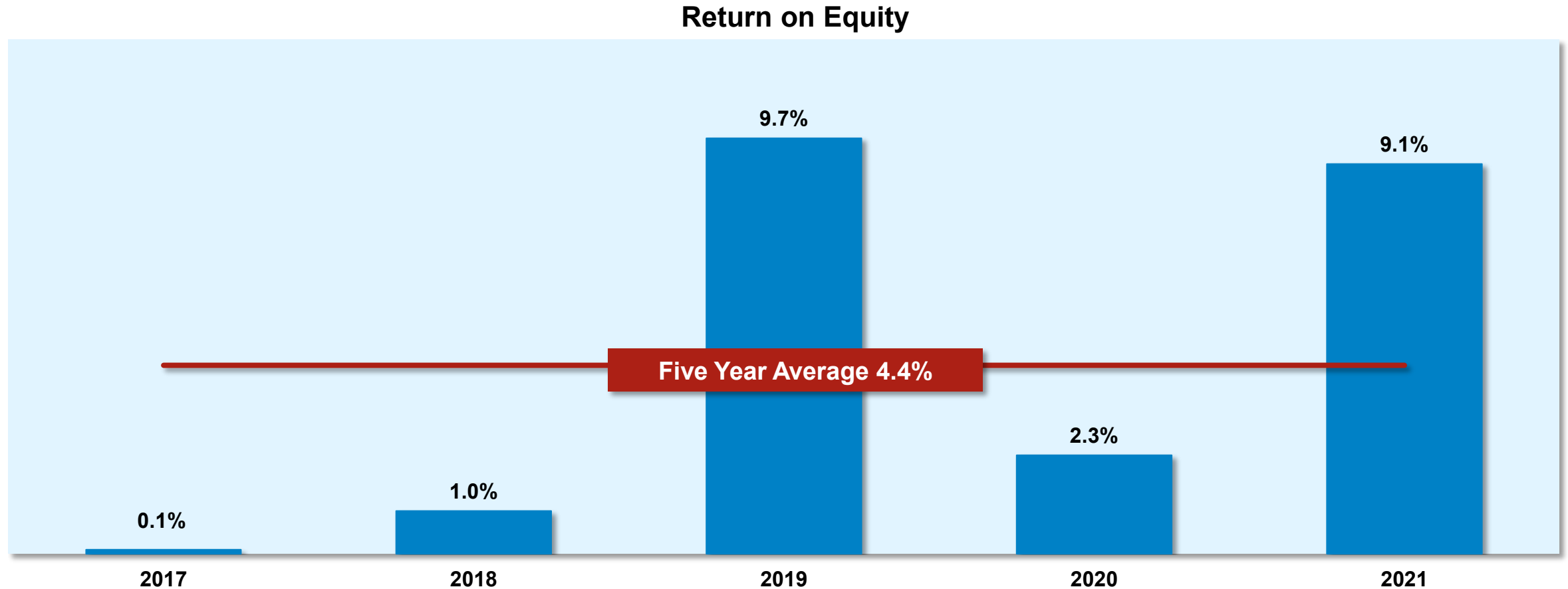


Global Reinsurance Market Performance

Loss and Expense Ratios and Positive Loss Reserve Development



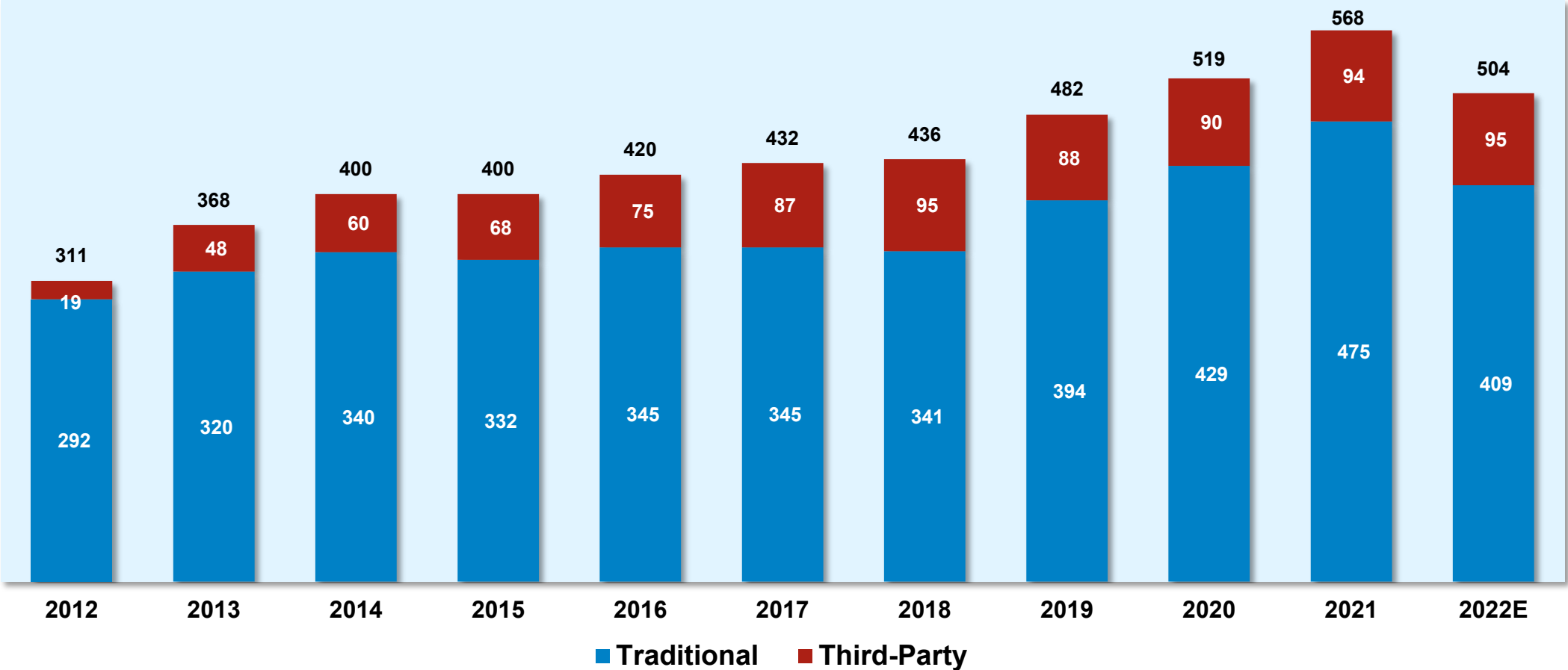
Global Reinsurance Market Performance



**Global Reinsurance Market
Well Capitalised
Subject to Asset Volatility**

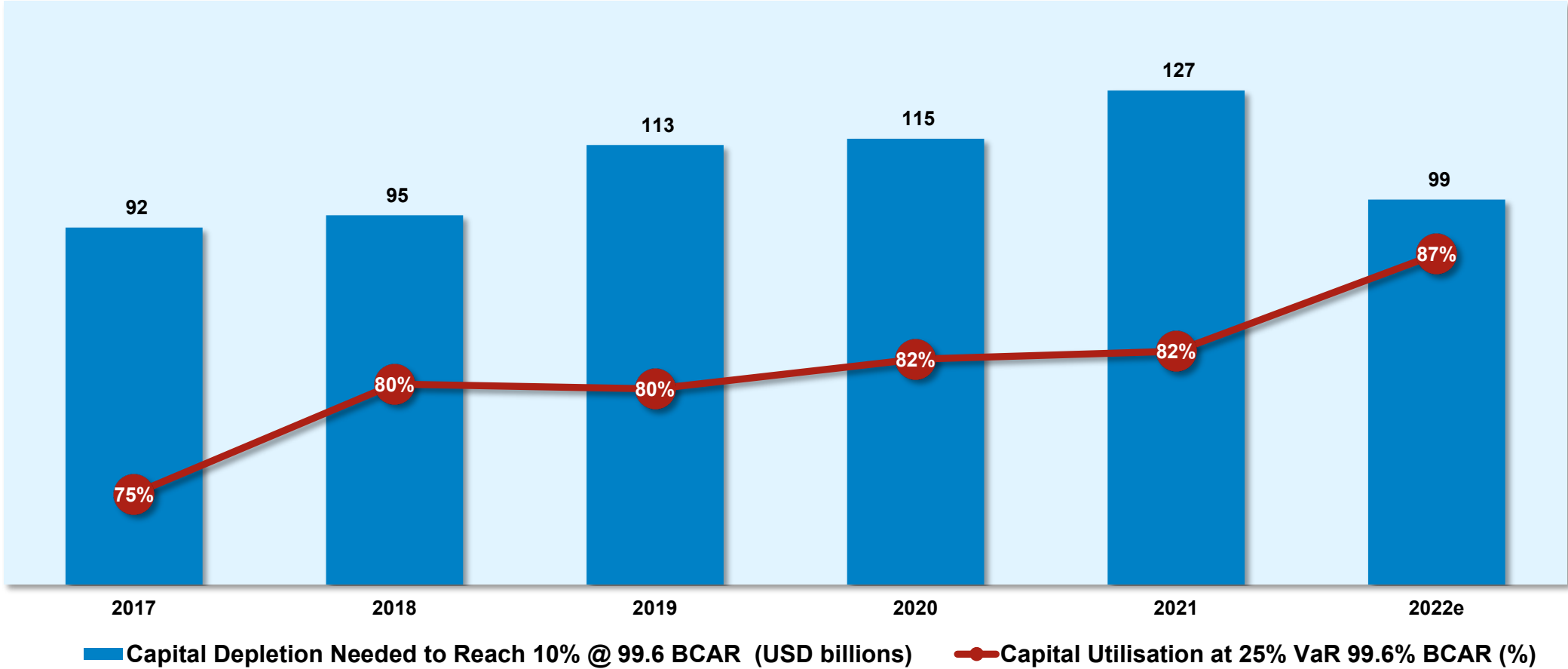
Global Reinsurance Market Capital

Estimate – Total Dedicated Reinsurance Capital (USD billions)



Global Reinsurance Market Capital

Capital Utilisation (USD billions)



Global Reinsurance Market Outlook – Stable Drivers Remain in Flux

Global Reinsurance Market Outlook – Stable

Headwinds

Heightened natural catastrophe activity continues to test investor risk appetite

Geopolitical and economic uncertainty: inflation, rising interest rates, risk of recession

New capital is cautious despite improved pricing and tighter T&Cs. Similar constraints on the ILS side, particularly for retro capacity

Segment well capitalised, but interest rate hikes and volatile investment markets have materially reduced shareholders' equity on a MV basis

Inflationary pressures and the risk of recession make profitability targets more challenging

Tailwinds

Sustained upward pricing trends, improving terms and conditions

More stable results following shifts in business mix. Positive reserve development

Segment remains well capitalised but subject to asset market volatility.

Available ≠ Dedicated capital

Underwriting discipline

Strong demand from cedants looking for stable results and capital efficiency in an uncertain environment

Q&A

AM Best Hot Topics

Jose Berenguer - Senior Financial Analyst
Andrea Porta - Financial Analyst

IFRS 17 – Transitioning to a New Standard

IFRS 17 – Impact on AM Best’s Ratings

- Currently, AM Best’s ratings are assigned to insurers who report under different standards
- Variations in presentation of accounts do not impact credit fundamentals
- Accounts may lead to new insights, however:
 - A new model will help draw out insights from other models
 - There will also be new surprises and sensitivities to learn about
- The new presentation may influence the timing and transparency of how quickly results are shared
 - The level of optional disclosures included will impact how well results are understood
 - Volatility of year over year results may also evolve

IFRS 17 – Market Communication

- The learning curve for IFRS 17 is steep
- External communication in nascent stages:
 - Slow communication - partly because the subject is hard
- Scheduled investor presentations have been held through 2022, mostly in Q4:
 - Presentations tend to be educational and focus on key themes and high-level expectations
 - First hard numbers have been shared in Q1 2023; Parallel runs from larger companies are expected to be made available in Q2 2023
- Communication suggests that while reporting will change, the business will be unaffected
 - In many cases, management targets are expected to be carried over
 - No expected impact on targets, dividends and solvency

Using KPIs under IFRS 17

- Combined ratios
 - Practice will initially diverge
 - Net/net is the continuity option, but net/gross may become more prominent over time
- CSM
 - New + unwind versus amortised
 - New vs PVNBP
 - Contribution to available capital in BCAR
- RoE
 - Advantages to ratio using accounting as reported
 - With CSM as equity will also be used
 - Though problematic if revenue substantially delayed
- Investment result
 - New and welcome measure
- Profit contributions
 - Segment insurance services and investment result? Or allocate non-operating expenses?
- Life operating ratio
 - New and welcome ratio

Developments, Challenges and AM Best's Response – Data

Task	AM Best's Response
Gathering (very) different public data	Analytically fully specified IT stage in process
SRQ	Analytically fully specified Some existing requests will become more important: Amount of discount in reserves by line (non-life) New requests: Non-life incurred claims net creditors (re)insurance debtors – not new data New requests, new data – not a feature
Timing is fixed	On plan so far
Company data	Depends on data provision
Unknown unknowns	Some contingency in timetable

Challenges and AM Best's Response – Modelling, KPIs, etc.

Task	AM Best's Response
Model	Strategy is for an unchanged economic model Factors are not in general a function of companies' accounting standard in global BCAR Inputs are carefully specified
Key Performance Indicators (KPIs)	Many new ones Refreshed existing Large majority are unchanged
Field testing	Commences 2023
Credit reports	Careful progress to provide for all stakeholders
Resourcing	All support provided
Training	Heavily engaged

IFRS 17 – Ongoing Research

April 29, 2020 IFRS 17: IASB Decisions Impact Insurers and Users of Accounting Data

An economic evaluation of accounting data will remain AM Best's basis for assessing the underlying financial health of (re)insurers

The International Accounting Standards Board (IASB) has been considering amendments to the published IFRS 17 standard for implementation.

Regulatory Review
April 29, 2021

An expert standard
May 20
30 June

AM Best
(re)insurers
financial
receive

AM Best
of the d
AM Best

A closer link between accounting ROEs and underlying profitability should provide more transparency for financial stakeholders

Key Performance Indicators More Meaningful Under IFRS 17

Principal Takeaways

- AM Best believes that on balance IFRS 17 will be more meaningful, transparent and consistent across territories than current financial reporting standards
- IFRS 17 should better assist the universe of financial stakeholders in identifying and supporting (re)insurance activities with good economic returns and create more effective market discipline
- The new reporting standard is not anticipated to have a direct effect on credit ratings, although the data, terminology and many of the KPIs used will change
- Challenges will include discontinuities in data records and KPIs, possible comparability questions within territories, at least initially (including between IFRS and local GAAP reporters), and also costs and disruption over the implementation phase.

As IFRS 17 moves from the standard setting to implementation stage, a new chapter has opened, bringing with it fresh uncertainties. Stakeholders are starting to debate what users of (re)insurance company financial reporting will do with the new data and what the likely key performance indicators (KPIs) will be under IFRS 17.

This report explores some of the challenges and opportunities that AM Best has identified at this point as stemming from the new framework, as well as some of the KPIs it believes will be critical for both (re)insurers' financial stakeholders and (re)insurers themselves, including:

Regulatory Review
April 28, 2022

IFRS 17: Transitioning to a Standard with New Concepts and Terminology

Principal Takeaways

- In general, AM Best does not expect the introduction of IFRS 17 to have a direct impact on ratings

AM Best anticipates that industry practice on KPIs may well take two or three years to settle

Regulatory Review
May 11, 2023

A reduction in shareholders' equity is far from automatic for life insurers.

Disclosures Suggest Wide Variation in IFRS 17 Impact on Shareholders' Equity

Principal Takeaways

- The impact of transition to IFRS 17 on shareholders' equity is far more pronounced in the life insurance segment. The range of outcomes is wide for the segment and biased to the downside, although a reduction on transition is far from automatic
- Changes to the treatment of capital in participating funds often act to reduce shareholders' equity on transition
- For non-life insurers, the impact is considerably narrower and biased to the upside

For (re)insurers that report under International Financial Reporting Standards (IFRS), the transition to IFRS 17 at the beginning of 2023 impacts large parts of their external financial reporting and metrics. In recent months several (re)insurers accompanied their usual investor presentation with early estimates of a few major selected measures under the new standard.

This report analyses disclosures from certain larger (re)insurers to identify some of the more significant changes, with a focus on shareholders' equity. The report then comments on inputs for non-life reserve risk into AM Best's proprietary capital adequacy model (BCAR) under IFRS 17.

Visit AM Best's research pages for more information

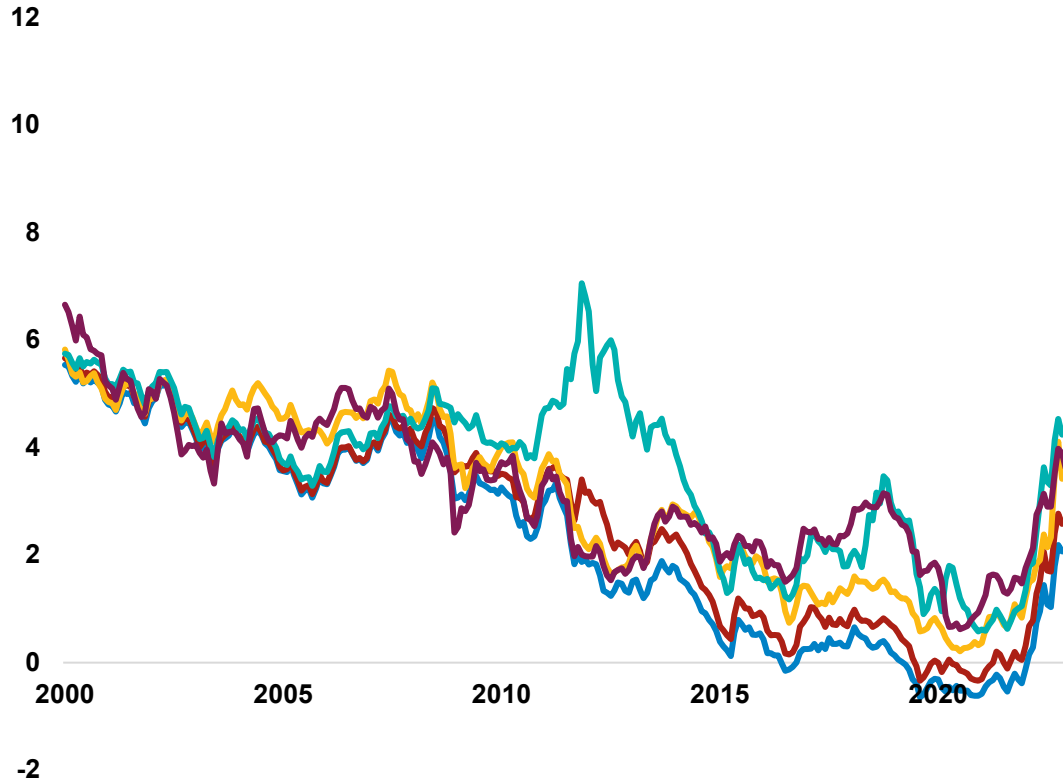


Impact of Inflation and Interest Rate Changes

Impact of Inflation and Interest Rate Changes

10 Year Interest Rate (%)

Long Term Interest Rates

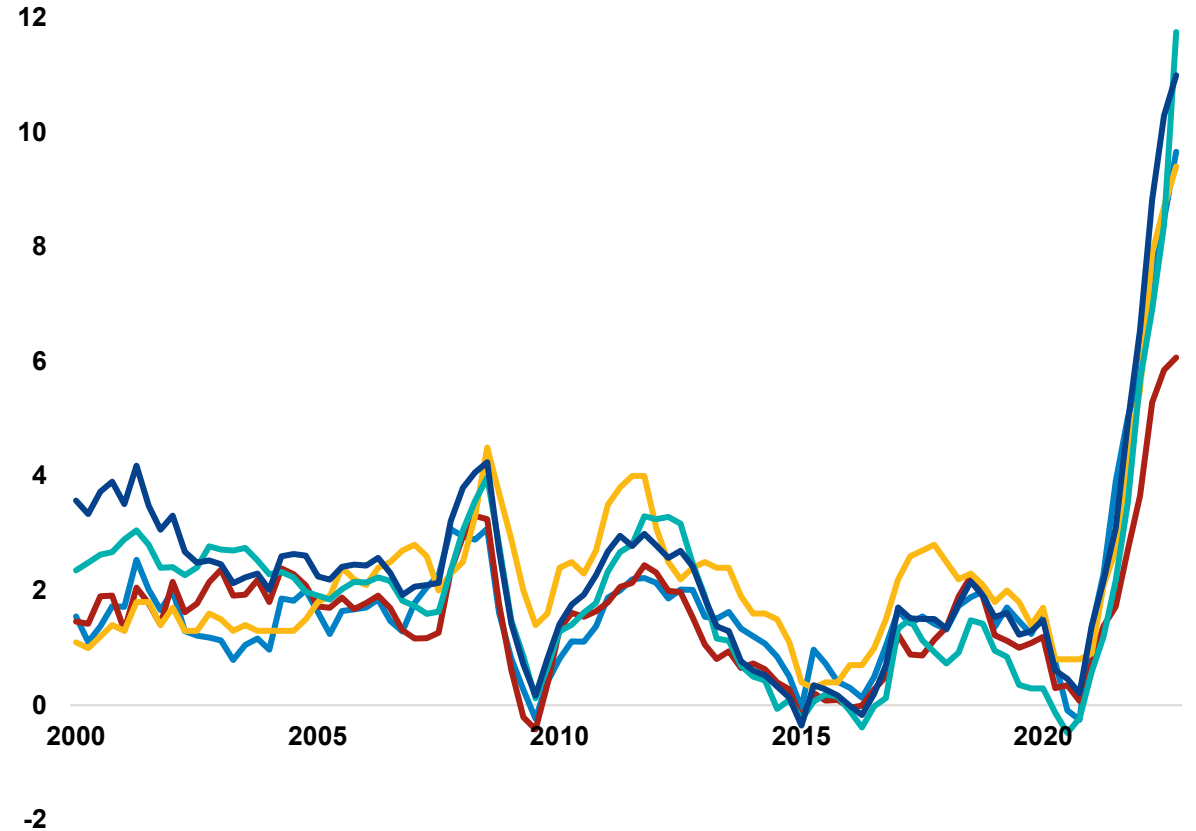


Source: OECD

— DEU — FRA — GBR — ITA — USA

Annual Growth Rate (%)

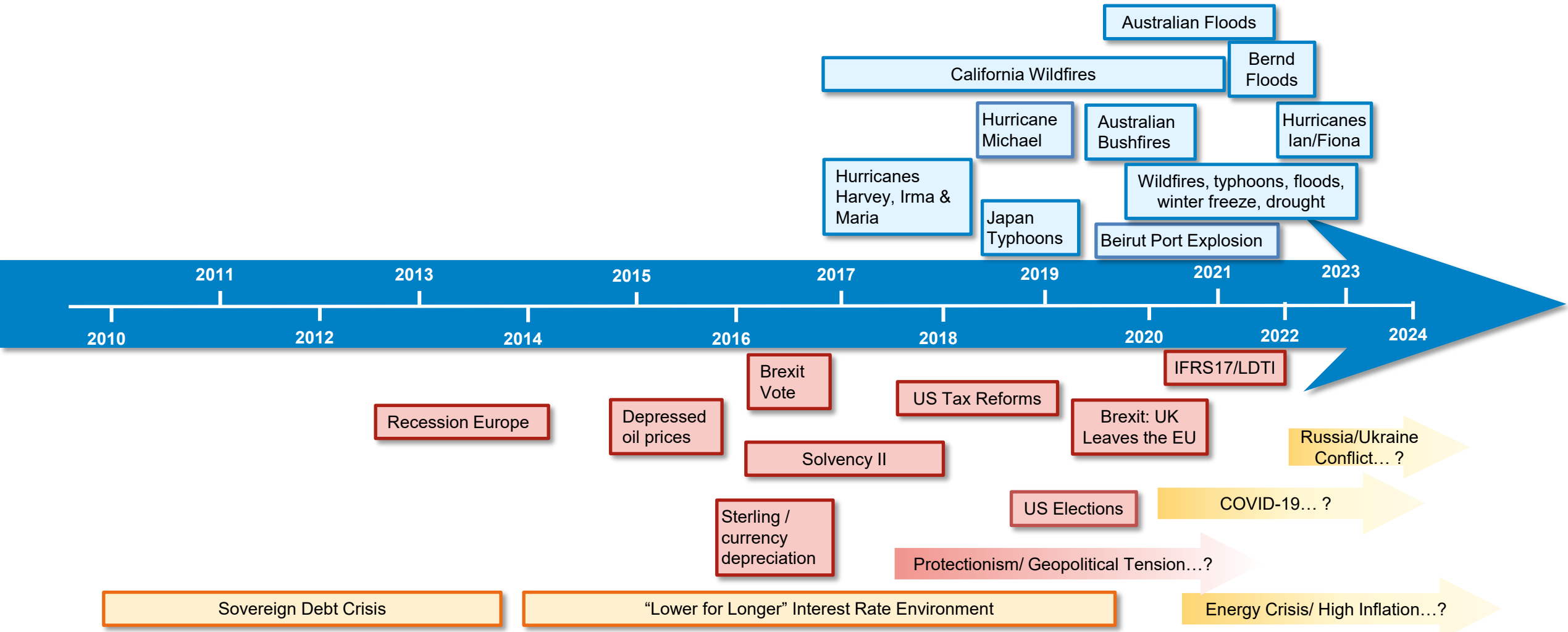
Inflation, CPI



Source: OECD

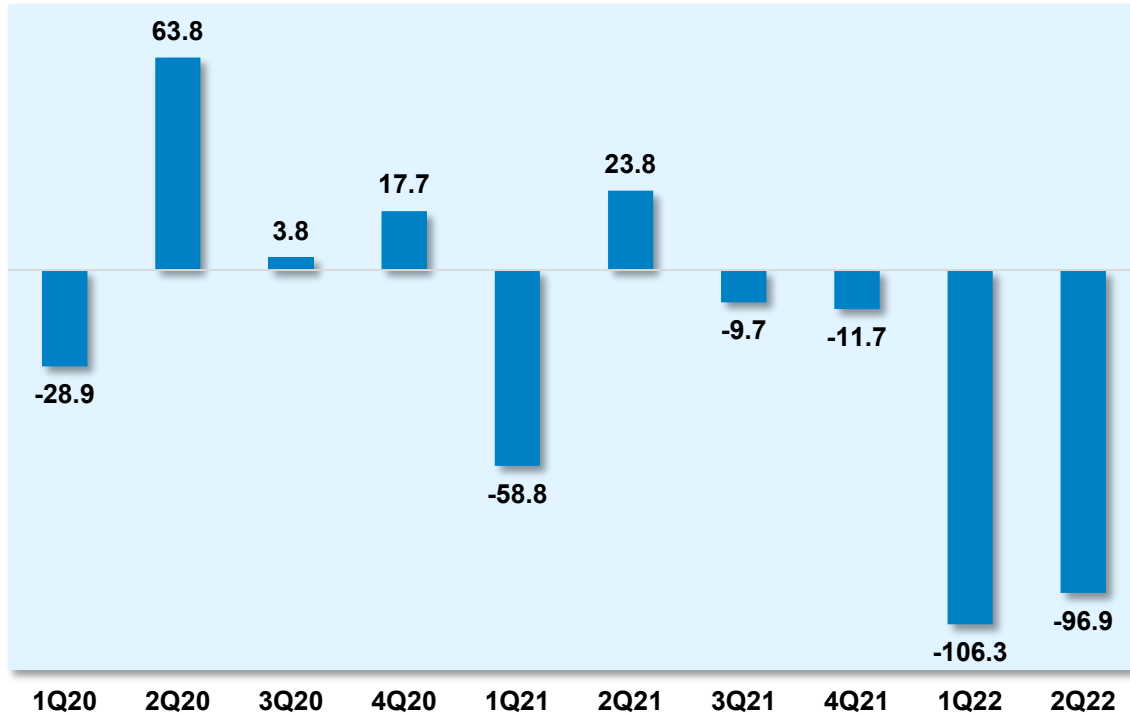
— DEU — FRA — GBR — ITA — EU27

Timeline of recent events

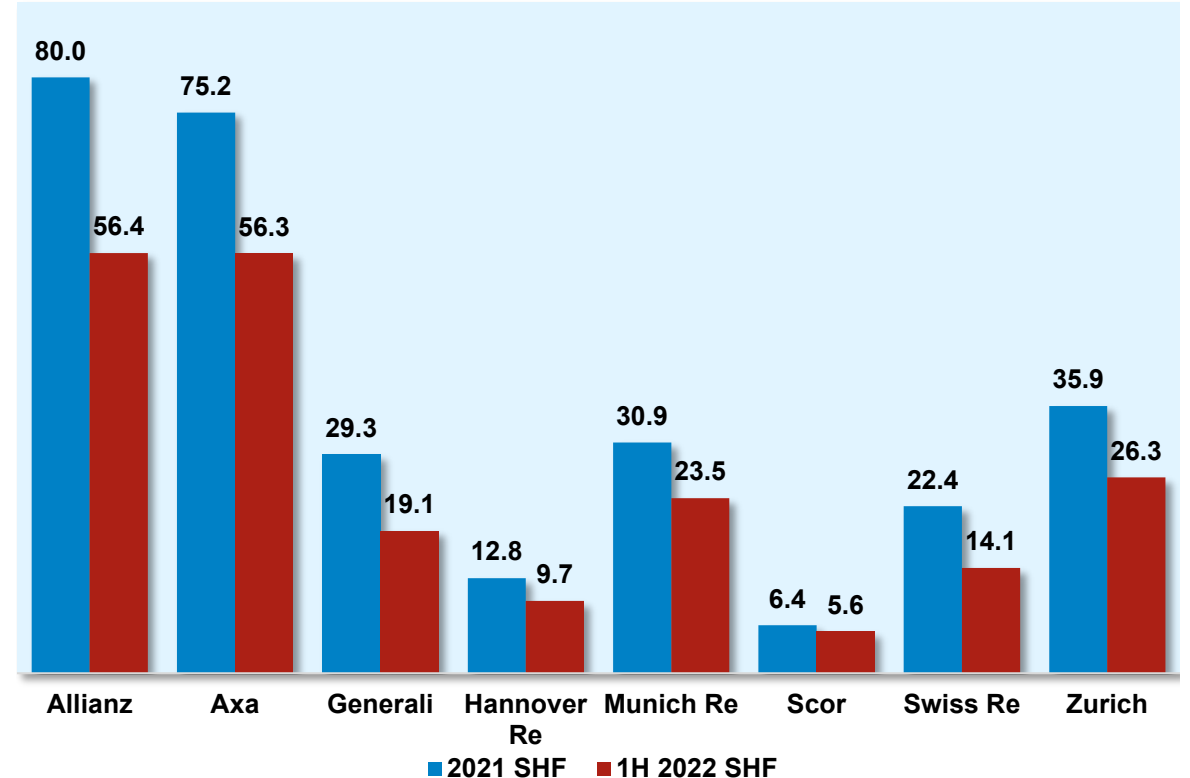


Impact of unrealised gains/losses

US GAAP Filing Insurers
Unrealised Gain/Loss on Fixed Maturities (USD billions)



Major European Listed Re/Insurers
Movement in Reported Shareholders' Funds 1H 2022 (EUR billions)



Inflation

- **Onset during COVID-19 lockdown/
change of pace due to conflict**

- Assumed short term at first, now assumed to last into 2024
- Rising interest rates

- **Insurers' Impact**

- Claims inflation
- Value proposition of life insurance products

- **Insurers' Response**

- Adjust pricing
- Revise reserving
- Change contract design
- Adjust fixed deductibles for xl contracts

- **Rating Considerations**

- Monitoring operating performance
- Performance of long-tail business lines
- ERM

Rising Interest Rates

- **Unrealised Losses Reducing Shareholders' Funds:**

- Rising interest rates and higher spreads
- Bonds comprise bulk of portfolios
- Higher default rates not yet observed
- Regulatory solvency not adversely impacted
- Reinvestment yields up

- **Insurers' Response:**

- Focus on diversification and resilience
- Credit risk in focus
- Heightened liquidity monitoring

- **Rating Considerations:**

- Economic vs accounting view
- Ability and intention to hold to maturity
- Analysis of potential liquidity requirements
- Level of RAC and ability to absorb losses

ESG in Best's Credit Rating Methodology (BCRM)

Understanding ESG Concepts

The consideration of environmental, social and governance factors alongside financial factors in the investment and underwriting decision-making processes



Environmental factors relate to resource use, pollution, climate risk, energy use, waste management, and other physical environmental challenges and opportunities



Social factors relate to how a company interacts with the communities it operates in, its suppliers, employees, and broader stakeholders



Governance factors relate to procedures and processes according to which a company is directed and controlled

What Are ESG Factors?

Examples of ESG factors

- Physical risks
- Transition risks
- Liability risks
- Stress test failures
- Environmental opportunities

Environmental



- Demographic changes
- Product liability
- Social inflation
- Data privacy
- Social opportunities

Social



- Corporate governance
- Corporate behaviour
- Transparency
- Board composition
- Business ethics

Governance



Translating into Criteria – Importance of ESG Factors Are on the Rise

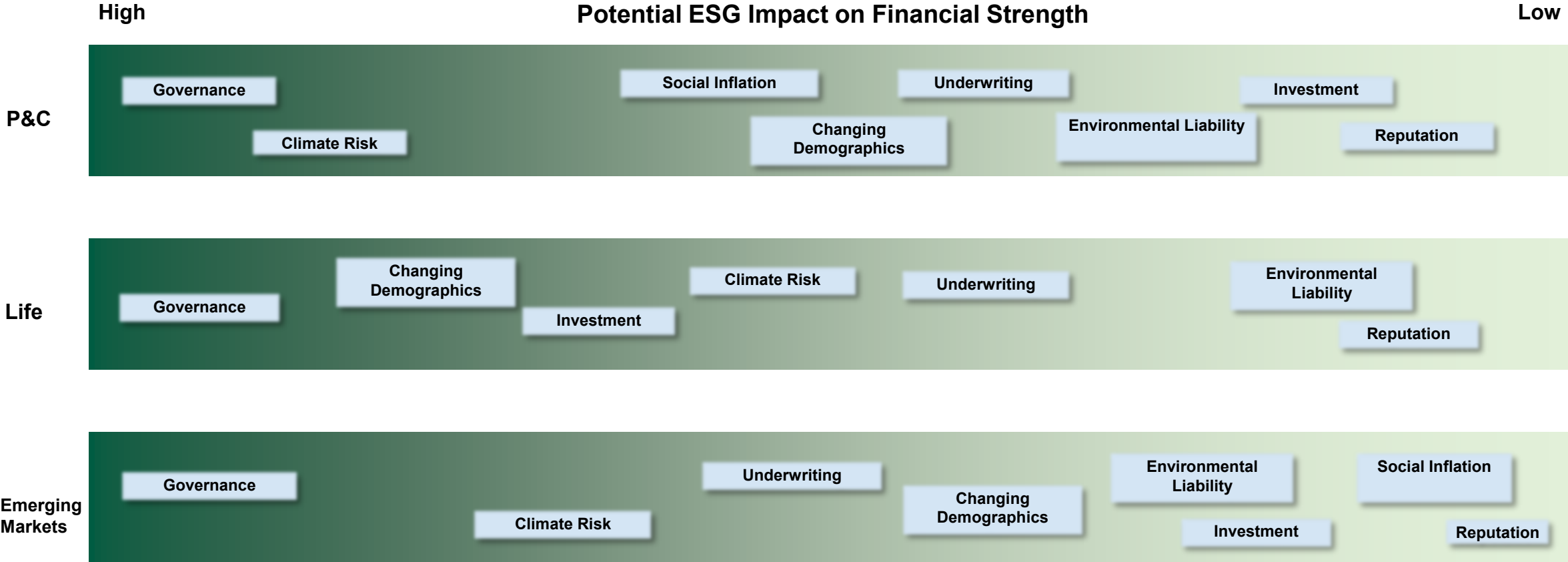
- ESG factors have always been considered in our rating process and have impacted ratings when they are material. AM Best also considers the long-term impact of ESG factors.

Balance Sheet Strength	Operating Performance	Business Profile	Enterprise Risk Management
<ul style="list-style-type: none">• Climate risk*• ESG integration in investing activities• Stranded assets	<ul style="list-style-type: none">• Social inflation• ESG-related litigation• Impact of ESG integration on profitability	<ul style="list-style-type: none">• Underwriting exclusions• Changing demographics• Data privacy• Reputational risk	<ul style="list-style-type: none">• Corporate governance*• Stress testing*• Management of insurance and non-financial risks

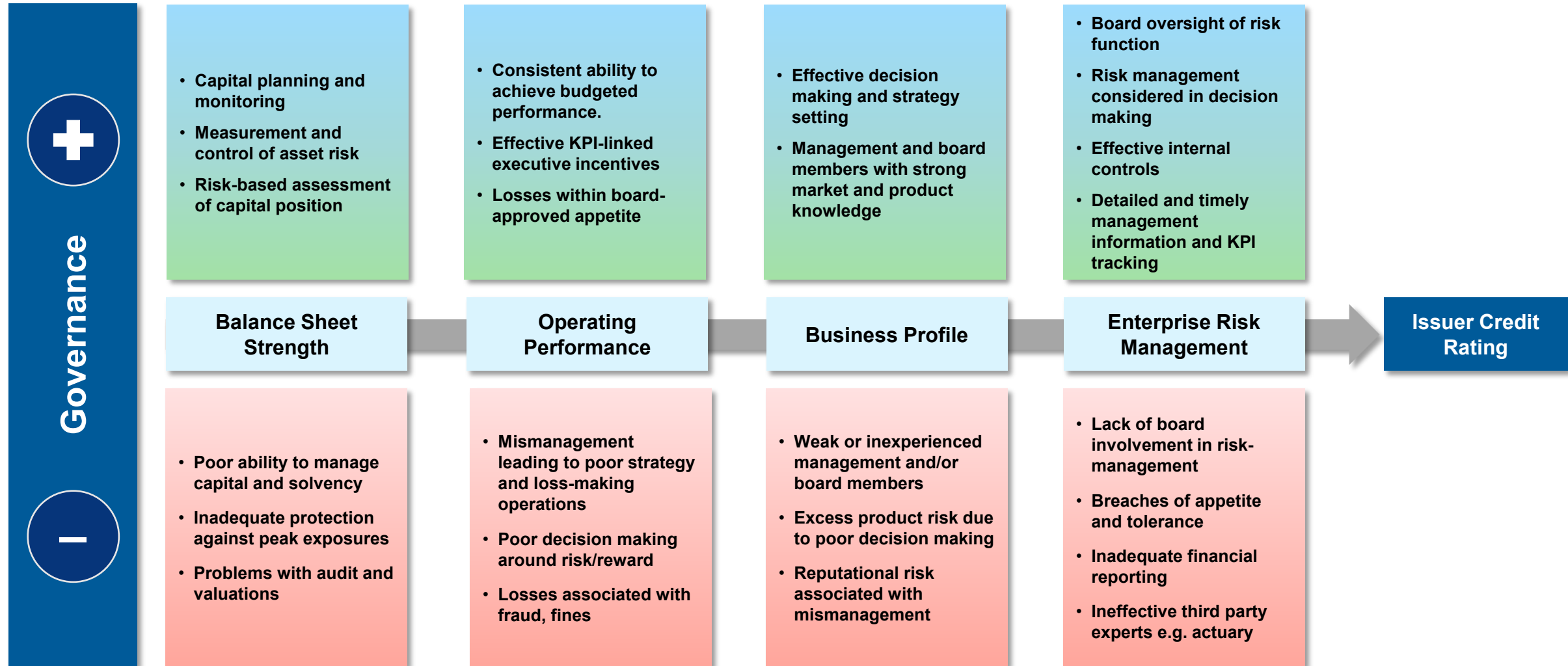
*ESG factors that are most relevant over the near-term

- ESG factors, where material and relevant, may impact any one, or several building blocks
- Impact of ESG is viewed purely from an analytical perspective: focusing on the impact on the credit rating
- No judgement is made on the ethical value of ESG activities, or ESG credentials of the company

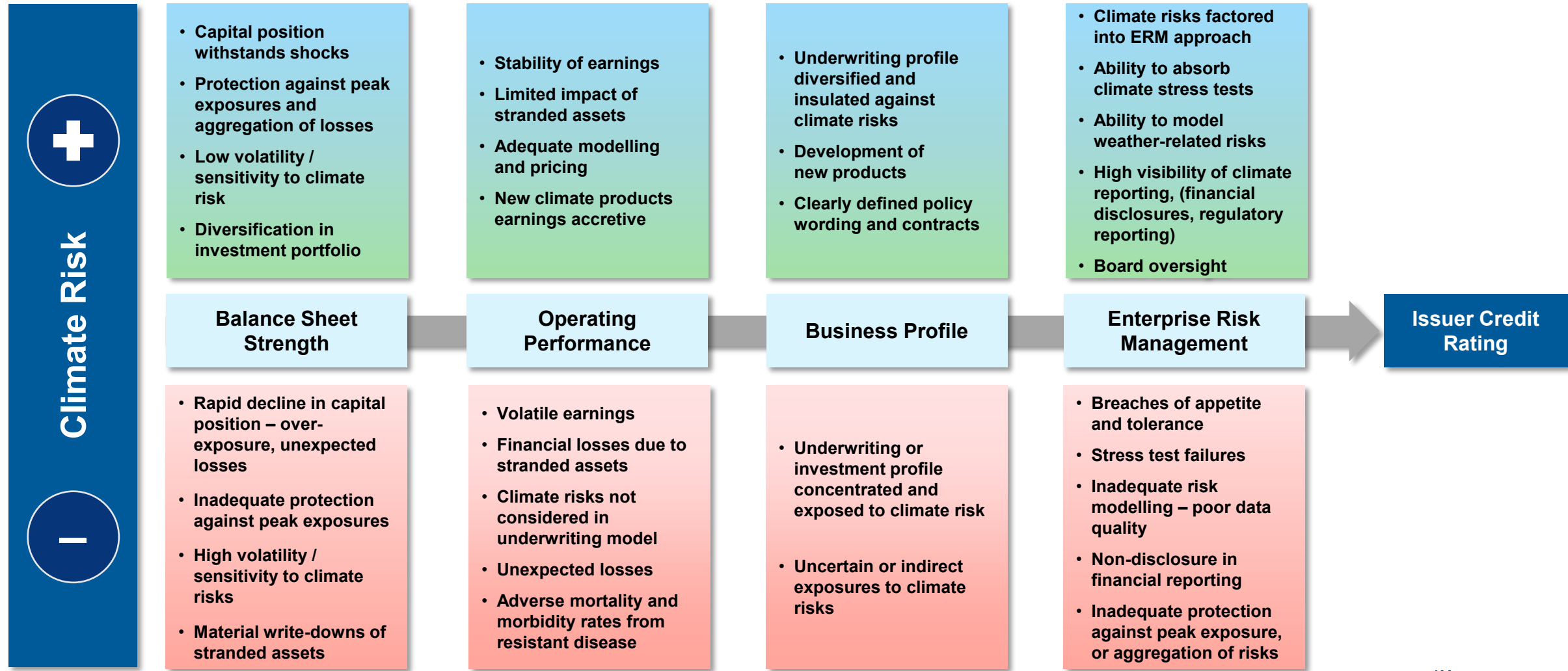
ESG Impact on Credit Quality is not Uniform – Examples



Assessing Governance through the Rating Process



Assessing Physical Climate Risk through the Rating Process



ESG – Ongoing Research

Trend Review
October 28, 2021

US Insurers' Perceptions of ESG

Summary

- Between 40% and 50% of US insurers in each segment are actively engaged with ESG.
- All segments have a focus on the "G" in ESG—governance.
- Roughly 60% of companies agree that demand from stakeholders to explicitly consider ESG factors has grown.
- There is widespread agreement across all segments that ESG is not only about identifying and measuring risk, but also about identifying opportunities.

A majority of US insurers agree that more clarity is needed from regulators particularly with respect to identifying measuring reporting factors

December 1, 2022

Corporate Governance Lessons for Insurers in the Wake of the FTX Failure

Cryptocurrency exchange FTX's collapse highlights the crucial need for effective corporate governance

The bankruptcy of cryptocurrency exchange FTX is the latest example of a corporate collapse resulting from governance failures. Although FTX is not an insurance company, the series of events leading to its collapse should nonetheless provide a sobering warning for the insurance industry. AM Best would typically take a favourable view of insurance company enterprise risk management (ERM) frameworks which incorporate lessons learned from recent events and emerging issues. Equally, we expect insurers with strong governance practices to be better able to manage risks.

Insurers generally benefit from effective ring-fencing of, and/or reserving for, resources to meet obligations to policyholders, underpinned by market discipline and regulation. However, even insurers with healthy balance sheets and sound operating performance may in some instances experience rapid deterioration in their financial strength because of weak internal controls, or poor strategic decisions linked to inadequate governance.

Trend Review
May 5, 2021

Investor Pressure Adds Momentum for Reinsurers to Integrate ESG Factors

Principal Takeaways

- All the listed reinsurers, in a recent AM Best survey of European and Asia Pacific-based (re)insurers, cited investors as creating the most - or second most - pressure to consider environmental, social and governance (ESG) risks and opportunities.

ESG integration may lead to increased financial flexibility

November 22, 2021

ESG and Insurance Credit Ratings: Frequently Asked Questions

Environmental, social, and governance (ESG) continues to be a key topic of interest among stakeholders in the insurance industry, but there is some uncertainty as to what it actually entails, and what actions or disclosures are expected from (re)insurers. (Re)insurers generally agree that more clarity is needed from regulators about the identification, measurement, and reporting of ESG factors.

AM Best believes that communicating how it views ESG factors in the context of insurance credit ratings will provide greater transparency to the market. As a result, we have developed this frequently asked questions (FAQ) document to help provide additional background and context. In addition, we have included an **ESG Glossary** at the end of the FAQ. We recognize that there are no agreed upon definitions for many ESG-related terms and this glossary provides AM Best's perspective on how these terms are used in the domain of credit ratings.

AM Best's guide to frequently asked questions about ESG and related definitions

General Information
1. What is ESG?

Visit AM Best's research pages for more information:



Q&A

Presenters

Market Development

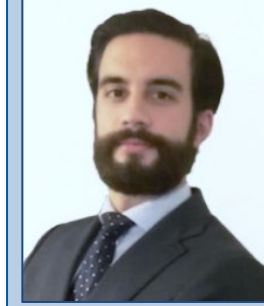


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