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AM Best's
Europe Insurance Market Briefing & Methodology Review Seminar - London

07 November 2023

Agenda – Methodology Review Seminar

14:15 Welcome and Introductory Comments
Mahesh Mistry, Senior Director, Head of Analytics - London

14:20 Benchmarking EMEA Ratings
Jose Berenguer, Associate Director, Analytics
Ben Diaz-Clegg, Senior Financial Analyst

14:40 Closer Look - Revisions to Holding Company Analysis and Available Capital
Kanika Thukral, Associate Director, Analytics
Michael Dunckley, Associate Director, Analytics

15:00 Criteria Focus - The Importance of Stress Testing
Jessica Botelho-Young, Associate Director, Analytics
Valeria Ermakova, Associate Director, Analytics

15:25 IFRS 17 - In Action. Current State of Play
Anthony Silverman, Director, Credit Rating Criteria, Research & Analytics

15:50 Q&A
AM Best Credit Rating Analysts

16:30 Close

Disclaimer

Disclaimer

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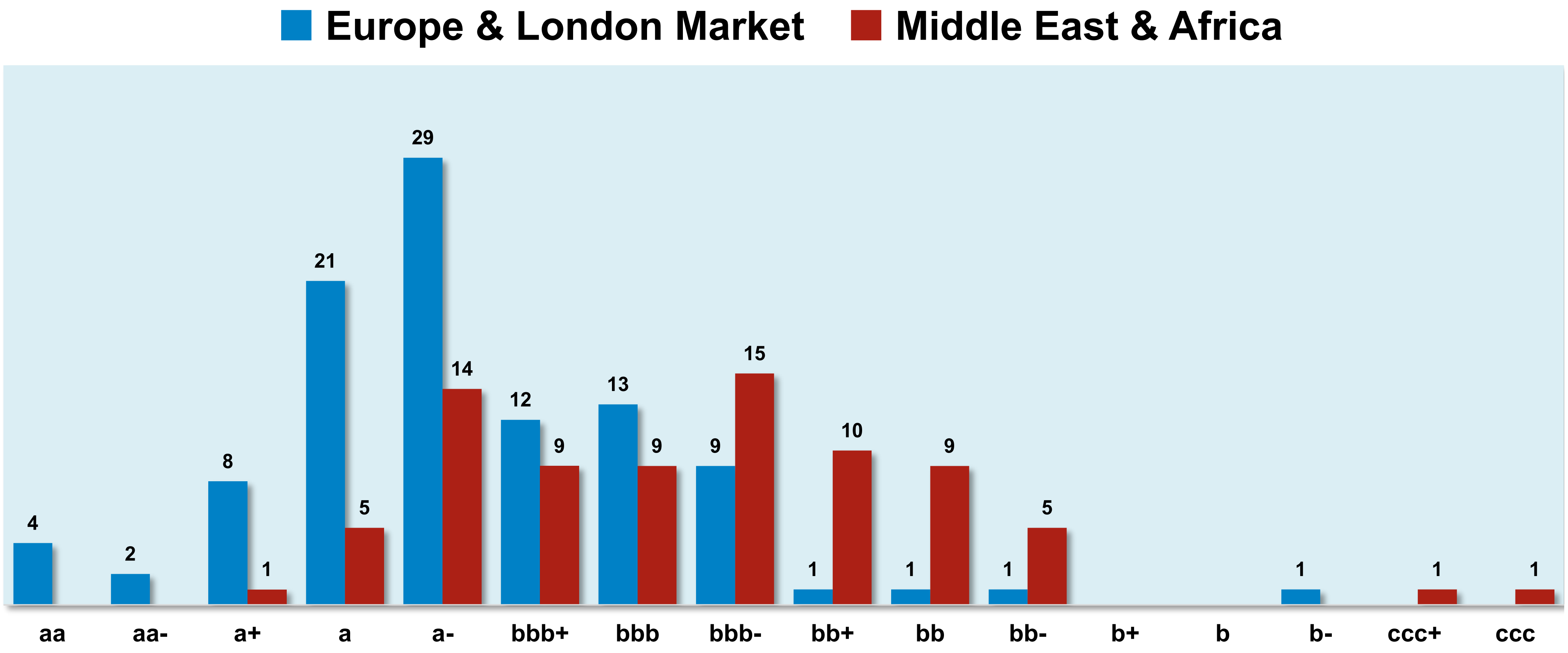
Any queries of a commercial nature should be directed to AM Best's Market Development function.

Benchmarking EMEA Ratings

Benjamin Diaz-Clegg
Senior Financial Analyst

Jose Berenguer
Associate Director, Analytics

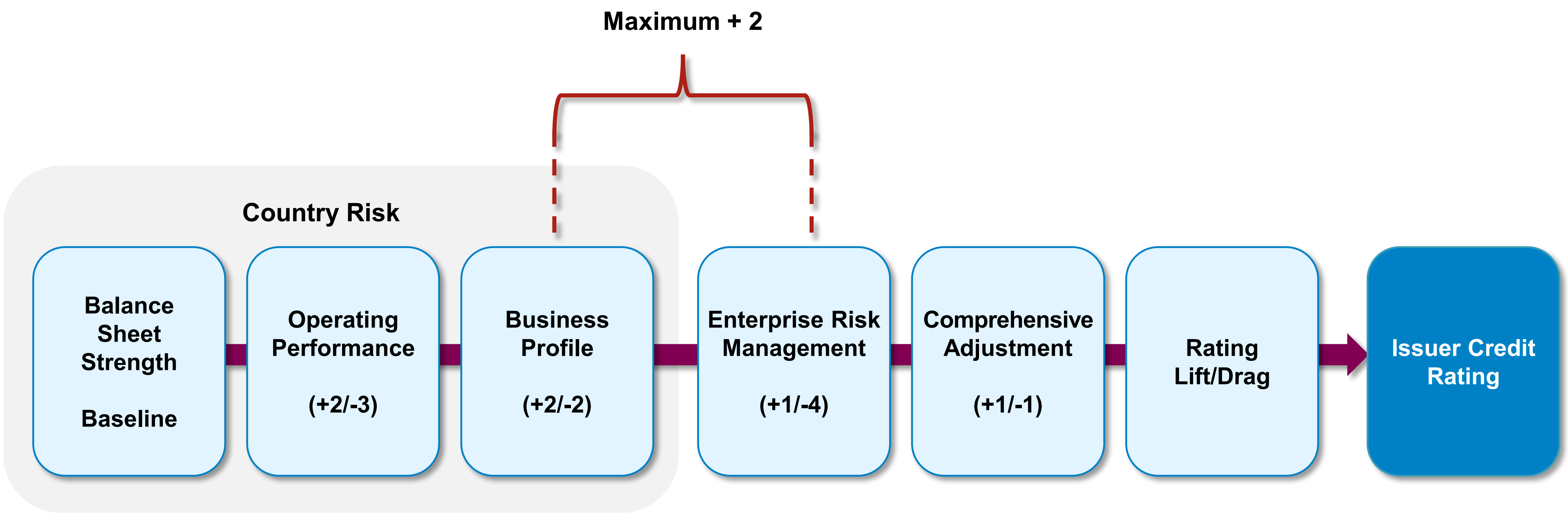
Issuer Credit Ratings EMEA – Count



Our Insight, Your Advantage™

Data as at September 2023
Source: AM Best data and research

AM Best's Rating Process - Recap



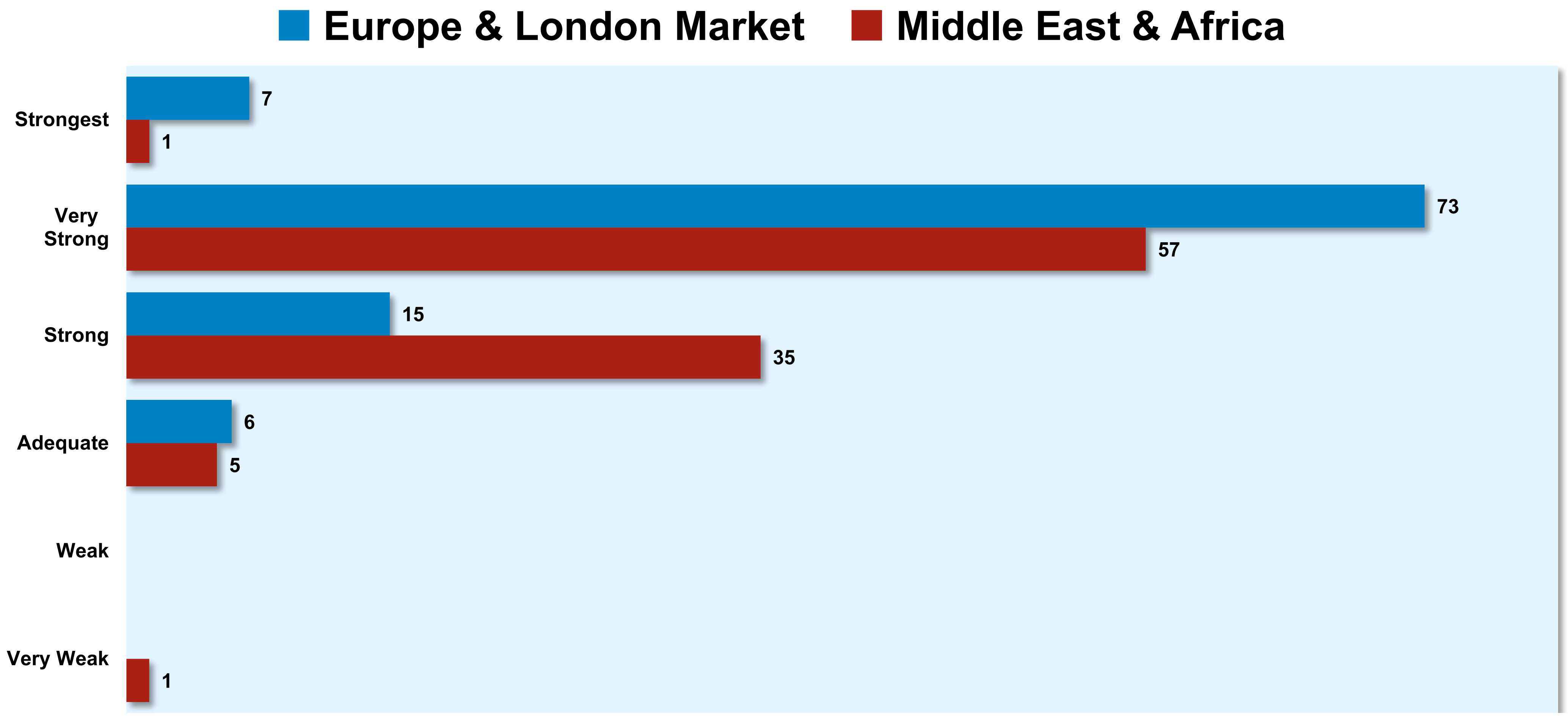
Source: Best's Credit Rating Methodology

AM Best's Rating Process - Recap

Balance Sheet Strength Baseline	Operating Performance (+2/-3)	Business Profile (+2/-2)	Enterprise Risk Management (+1/-4)
Assessment	**Assessment**	**Assessment**	**Assessment**
Strongest	Very Strong +2	Very Favorable +2	Very Strong +1
Very Strong	Strong +1	Favorable +1	Appropriate 0
Strong	Adequate 0	Neutral 0	Marginal -1
Adequate	Marginal -1	Limited -1	Weak -2
Weak	Weak -2	Very Limited -2	Very Weak -3/4
Very Weak	Very Weak -3		

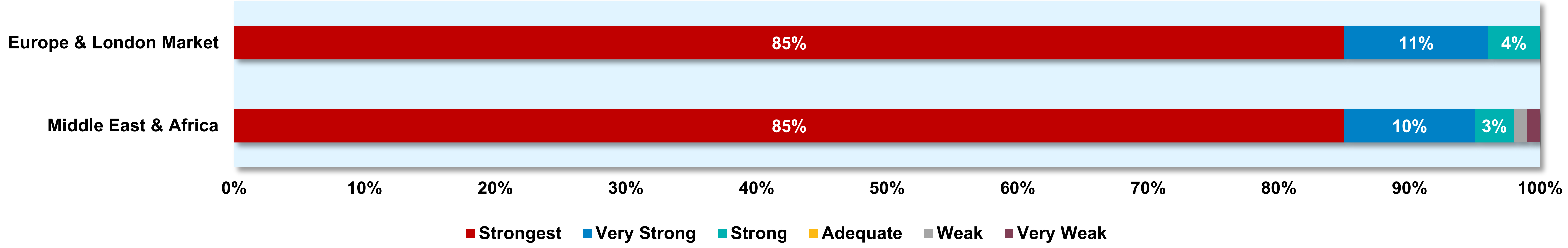
Source: Best's Credit Rating Methodology

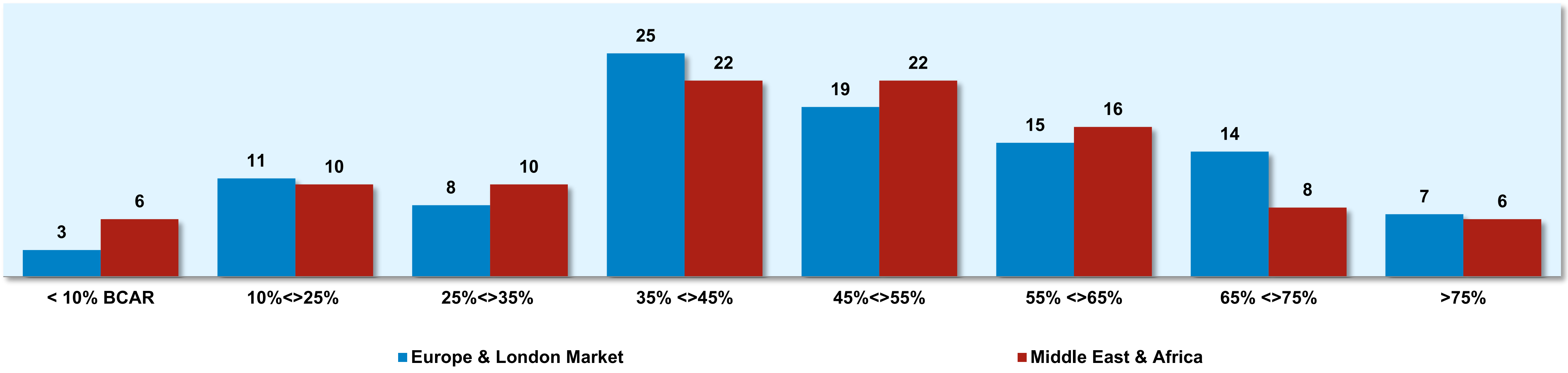
Balance Sheet Strength - Distribution of Assessments (%)



Data as at September 2023
Source: AM Best data and research

Balance Sheet Strength - Distribution of BCAR Scores (%)





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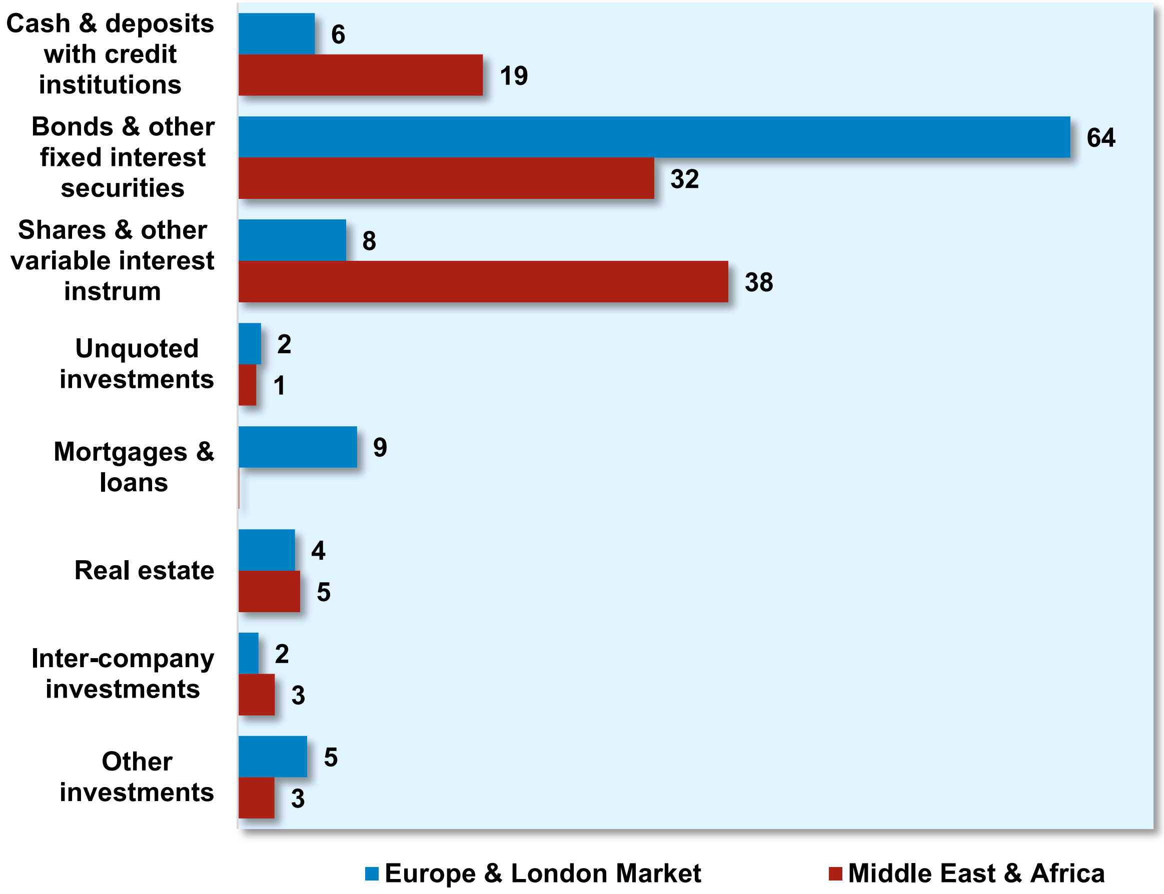
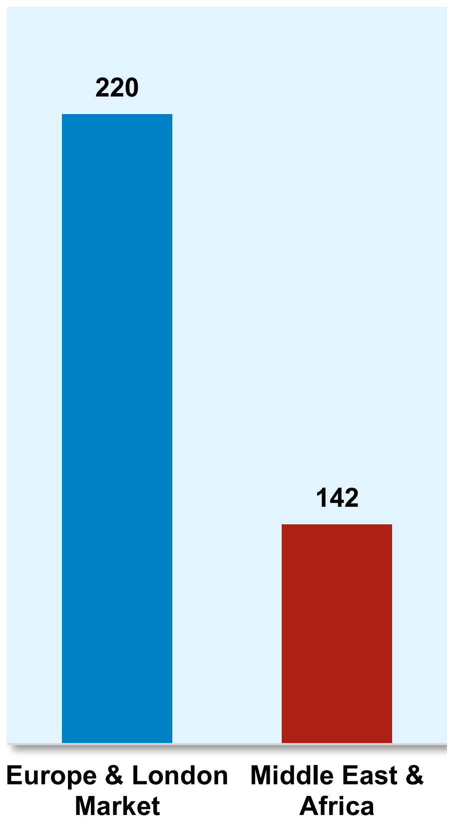
Data as at September 2023
Source: AM Best data and research

Balance Sheet Strength – Distribution of Capital Requirements (%)

Balance Sheet Strength EMEA – Distribution of Investments



Underwriting Leverage
(Gross Written Premium/Shareholders' Funds)
2022



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Data as at year-end 2022
Source: AM Best data and research

Balance Sheet Strength vs BCAR Distribution (%)

Europe & London Market

BCAR Assessment \ Balance Sheet Strength	Strongest	Very Strong	Strong	Adequate	Weak	Very Weak
Strongest	7	68	7	3		
Very Strong		4	5	2		
Strong			3	1		
Adequate						
Weak						
Very Weak						

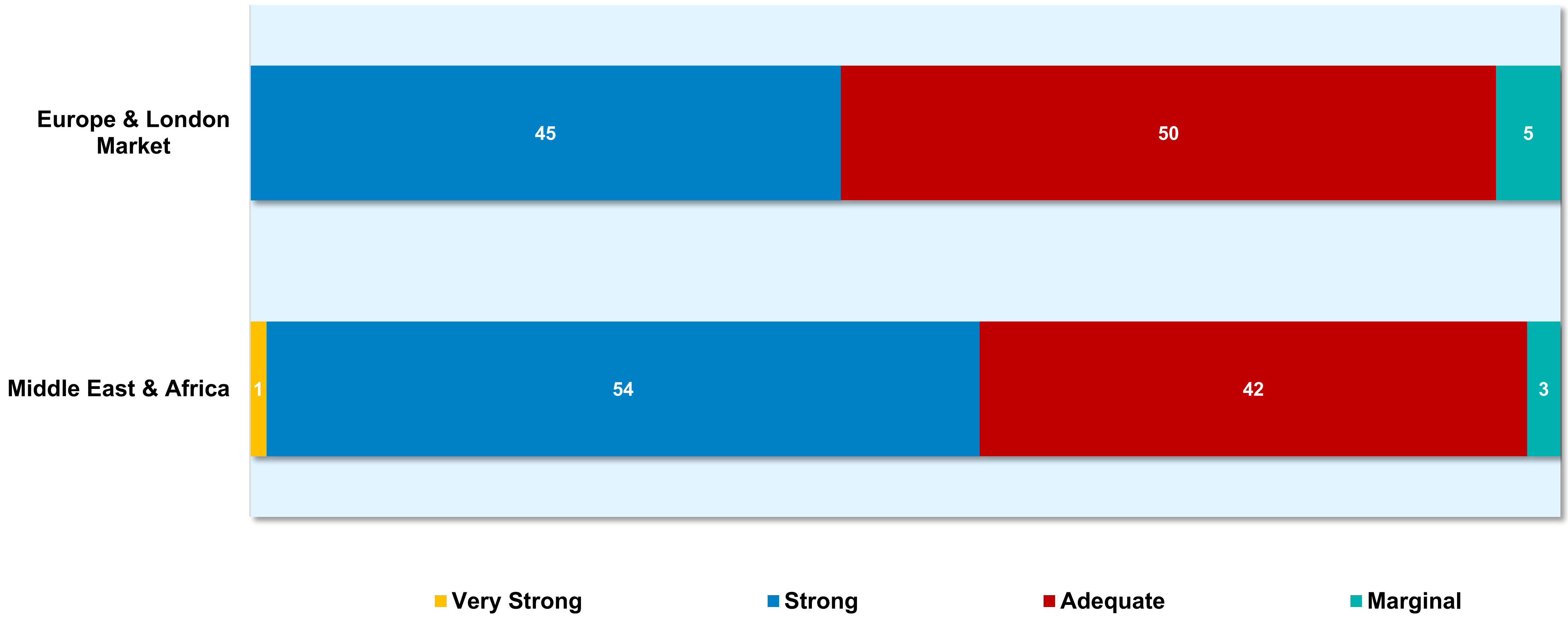
Middle East & Africa

BCAR Assessment \ Balance Sheet Strength	Strongest	Very Strong	Strong	Adequate	Weak	Very Weak
Strongest	1	56	24			
Very Strong		1	9	1		
Strong			3			
Adequate				1		
Weak				1		
Very Weak						3

Other Quantitative & Qualitative Considerations

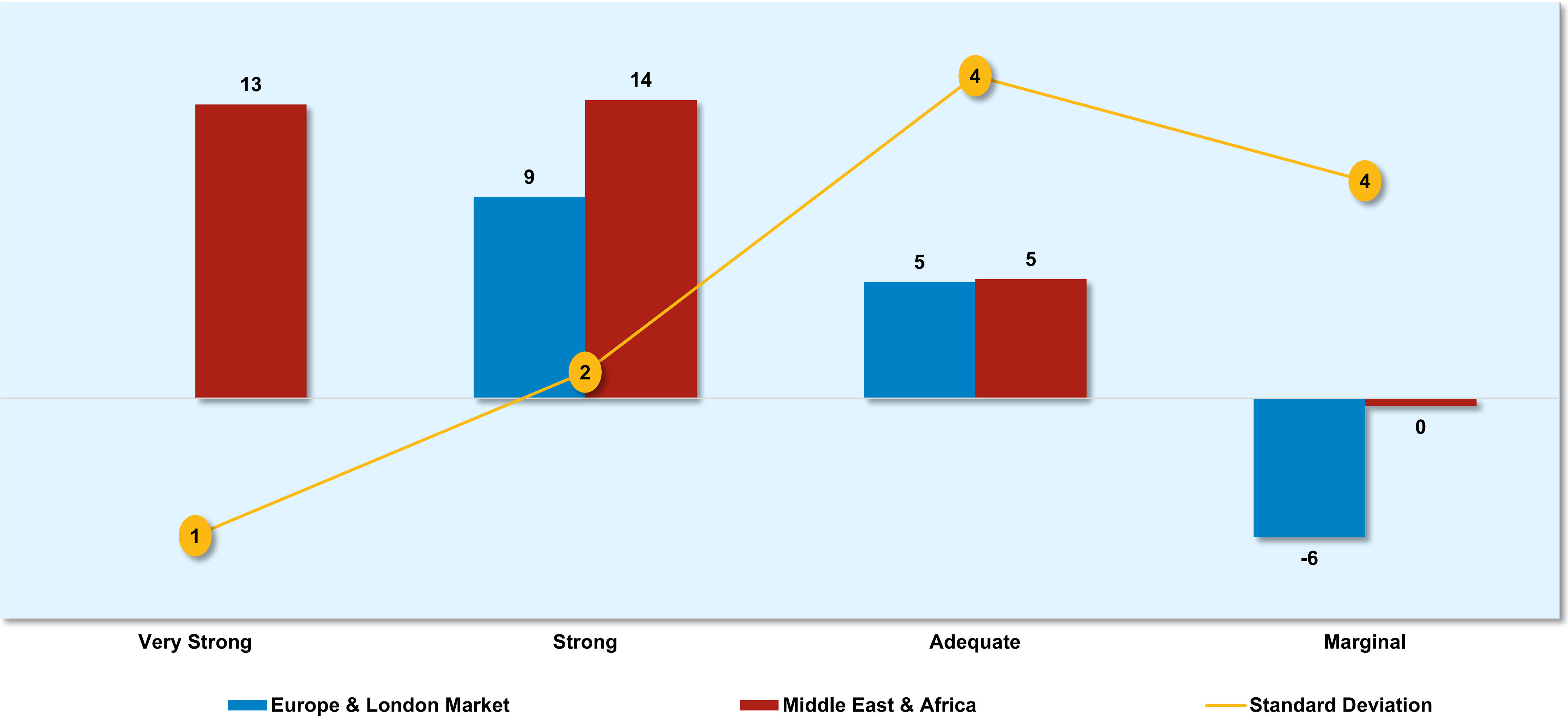
- Asset quality / diversification
- Stress test
- Asset liability matching
- Liquidity
- Reinsurance quality / appropriateness / dependence
- Reserve adequacy
- Fungibility of capital
- Internal capital model

Operating Performance - Distribution of Assessments (%)



Our Insight, Your Advantage™
Data as at September 2023
Source: AM Best data and research

Operating Performance – Five-Year (2018-2022) Return on Equity & Standard Deviation (%)



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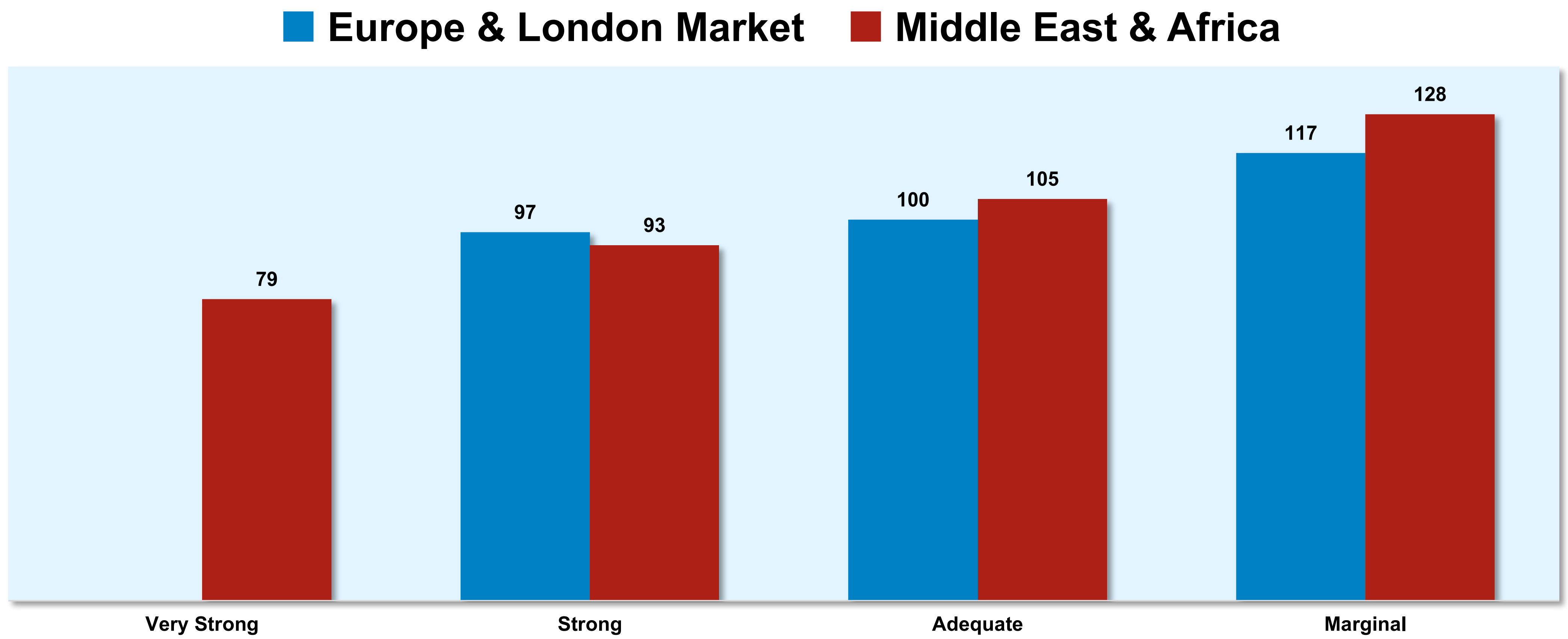
Source: AM Best data and research

Operating Performance – Five-Year (2018-2022) Average Combined Ratio (%)



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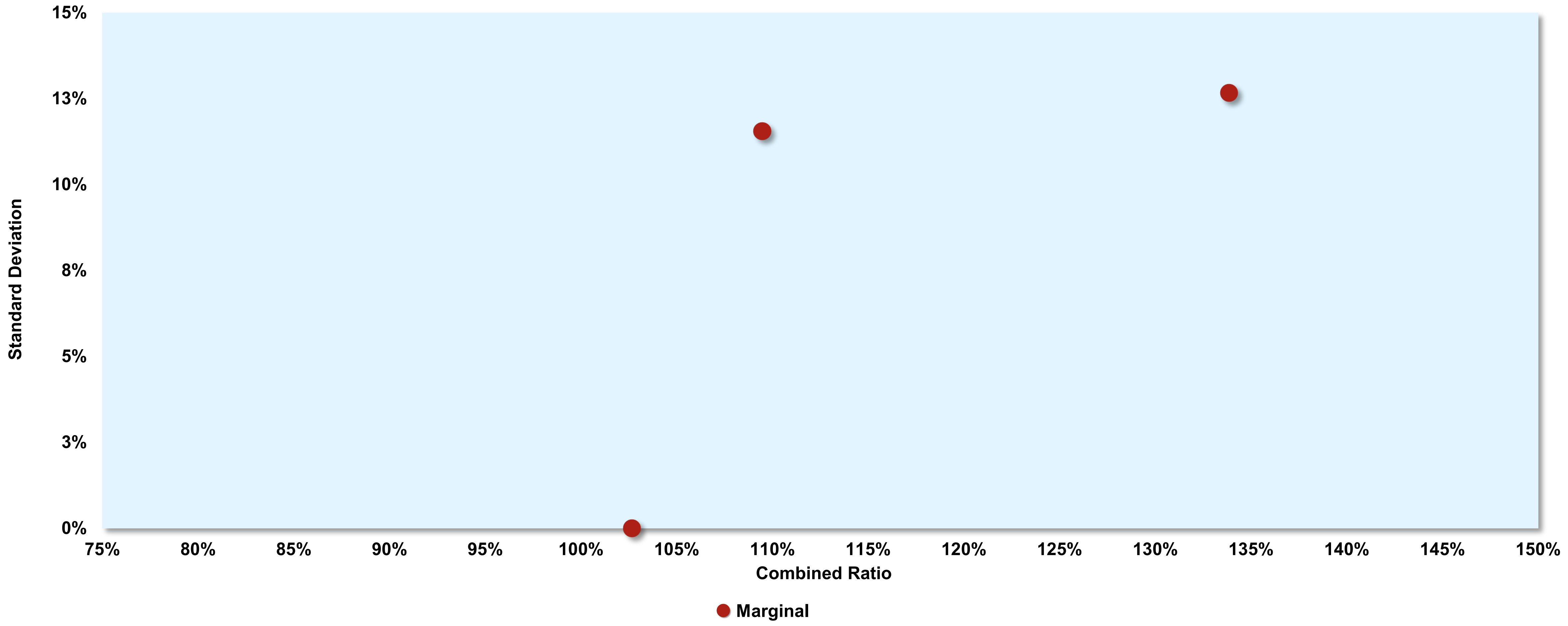
Source: AM Best data and research

Operating Performance – Five-Year (2018-2022) Combined Ratio vs Standard Deviation



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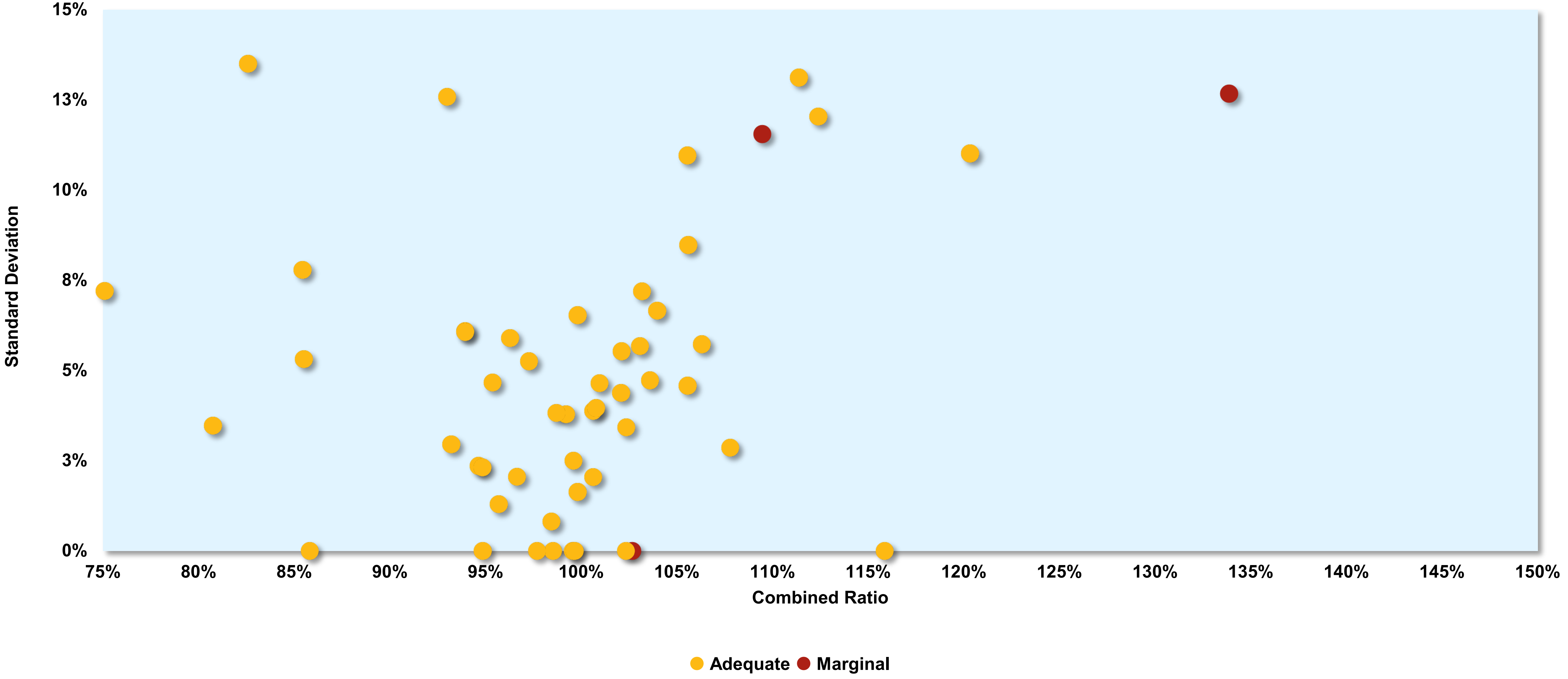
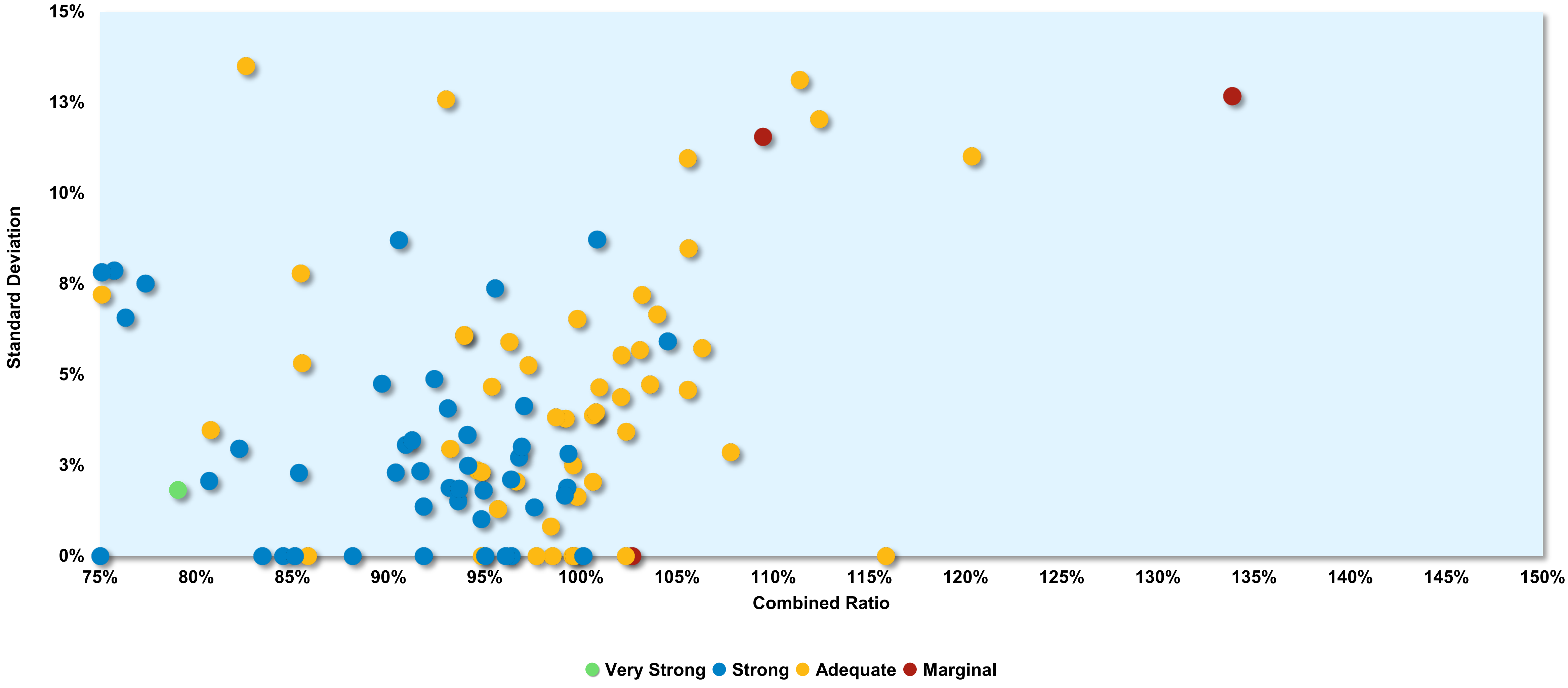
Source: AM Best data and research

Operating Performance – Five-Year (2018-2022) Combined Ratio vs Standard Deviation

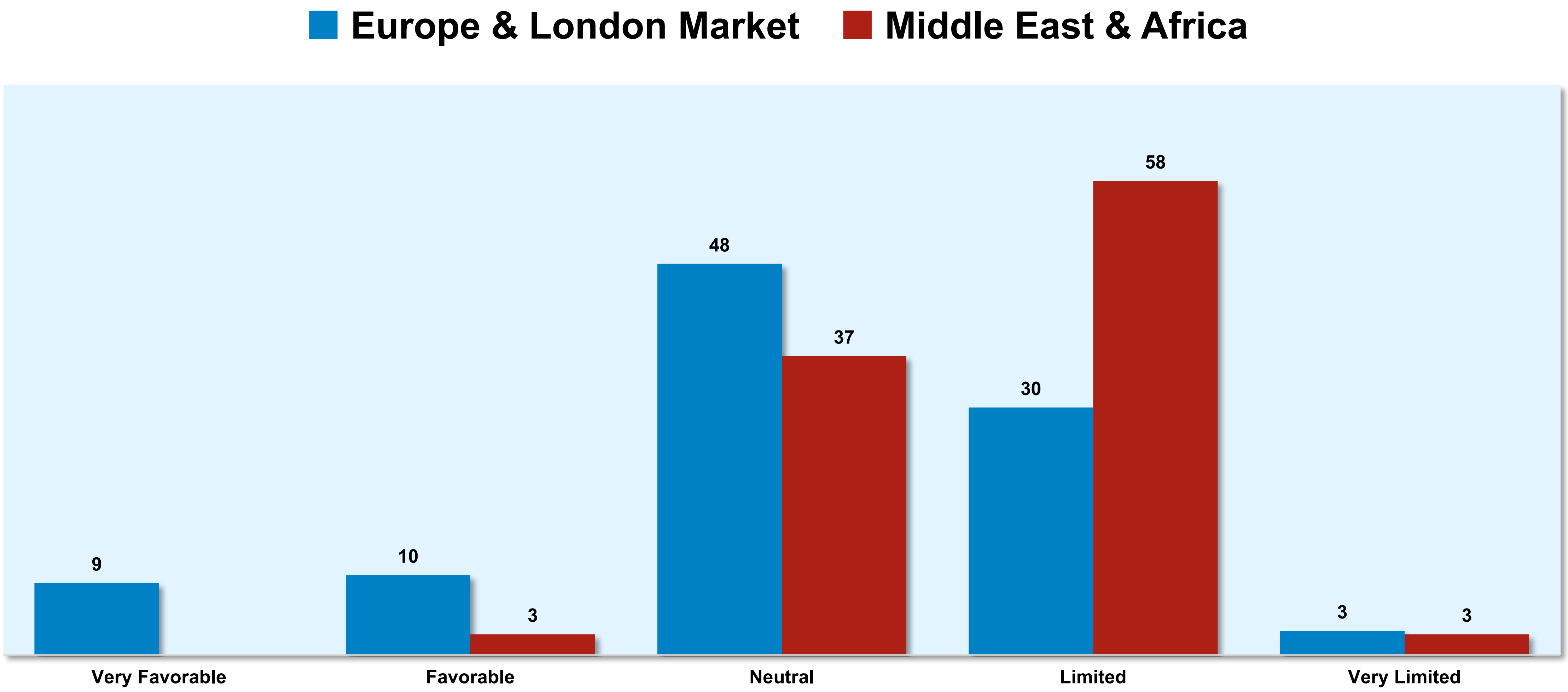


Operating Performance – Five-Year (2018-2022)
Combined Ratio vs Standard Deviation



Source: AM Best data and research

Business Profile – Distribution of Assessments (%)



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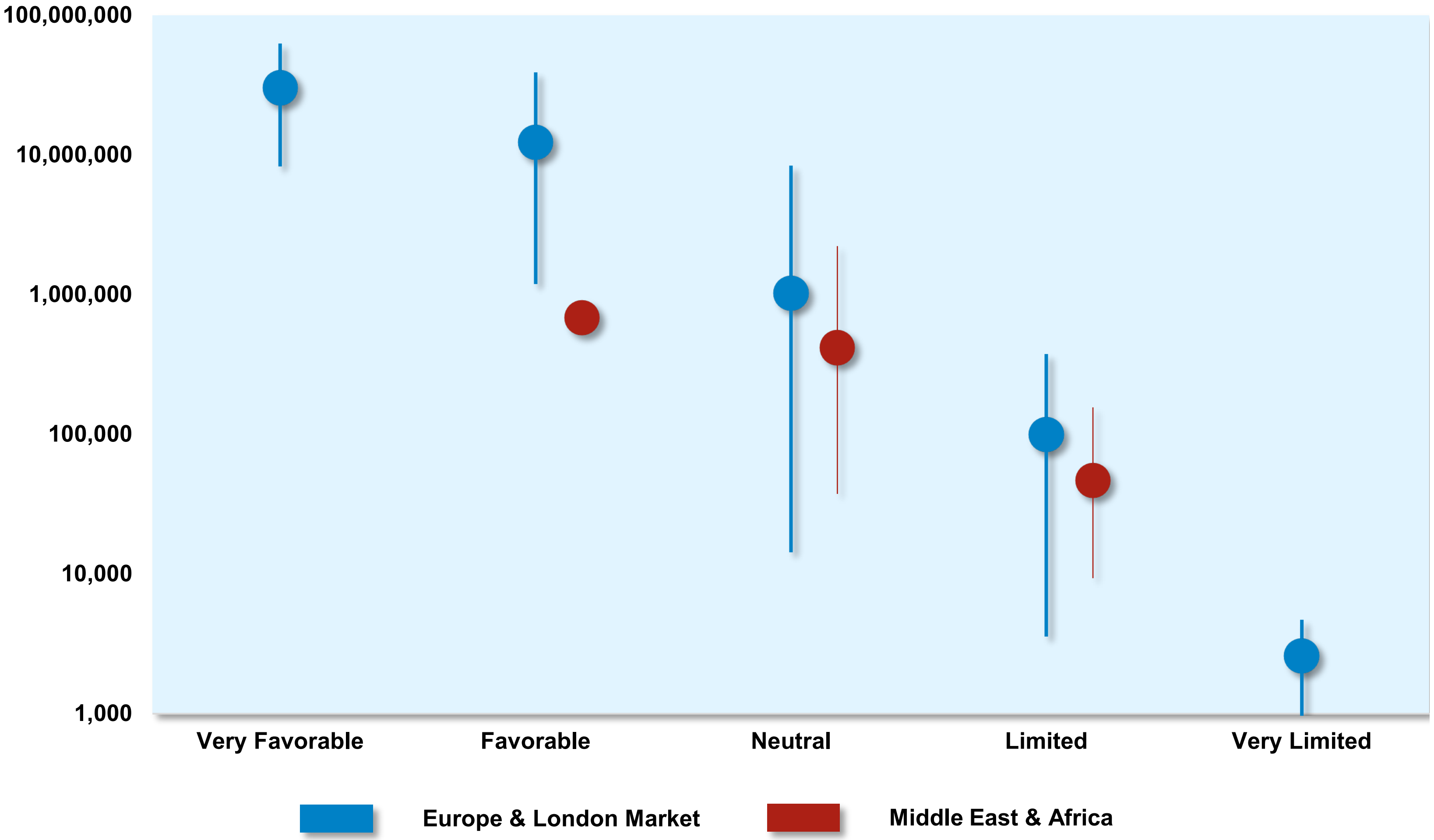
Data as at September 2023
Source: AM Best data and research

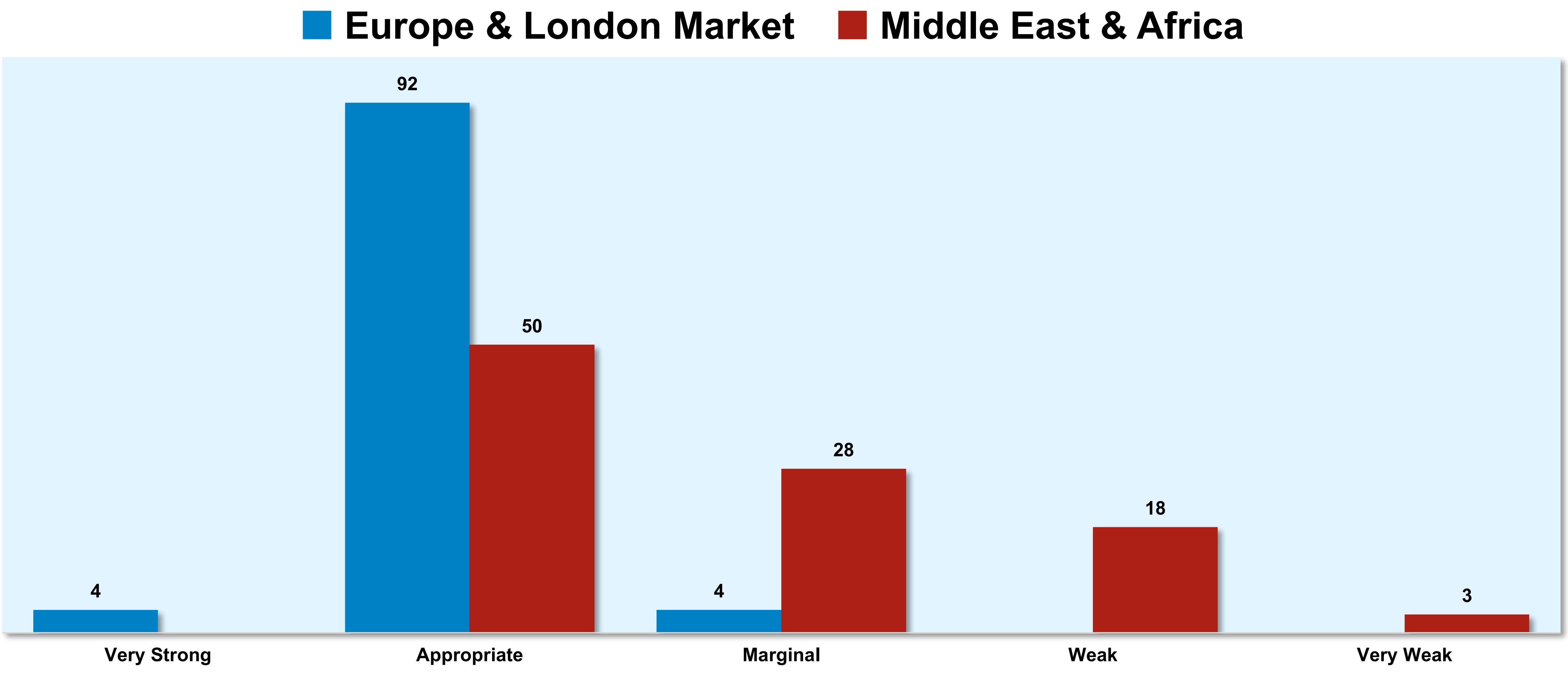
Business Profile – Average Net Earned Premium (USD 000)



Business Profile Review Components	
Product/ Geographic Concentration	Product Risk
Market Position	Degree of Competition
Pricing Sophistication & Data Quality	Management Quality
Regulatory, Event & Market Risks	Distribution Channels
Innovation	

Data as at year-end 2022
Source: AM Best data and research

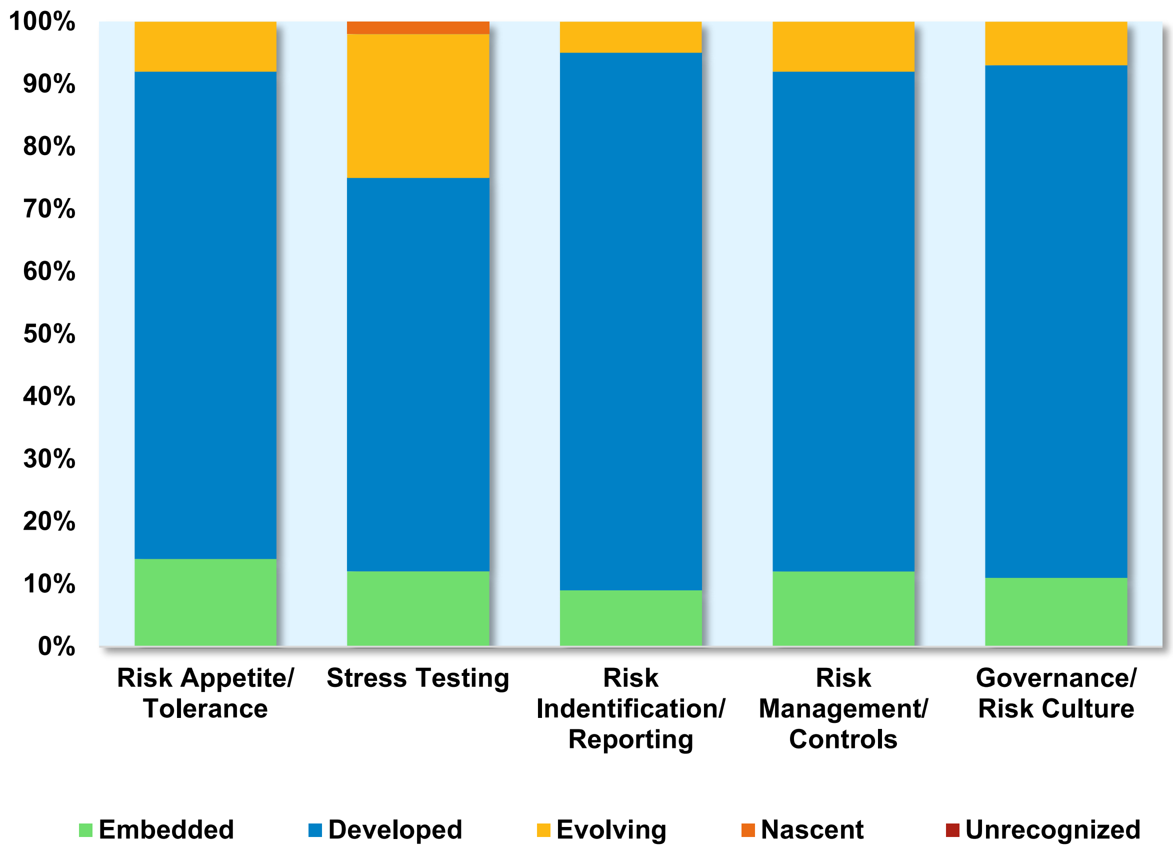
Enterprise Risk Management – Distribution of Assessments (%)



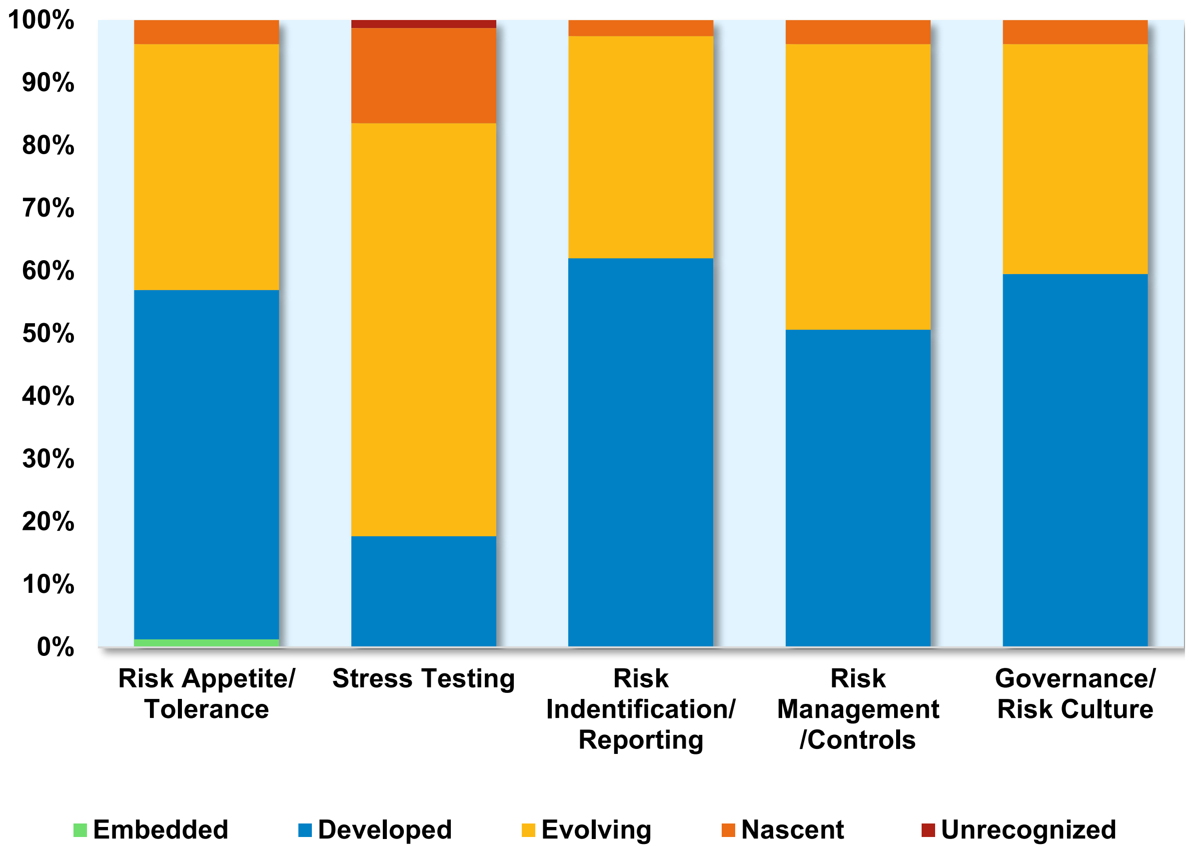
Data as at September 2023
Source: AM Best data and research

Enterprise Risk Management – Distribution of Risk Framework Assessments (%)

Europe & London Market



Middle East & Africa

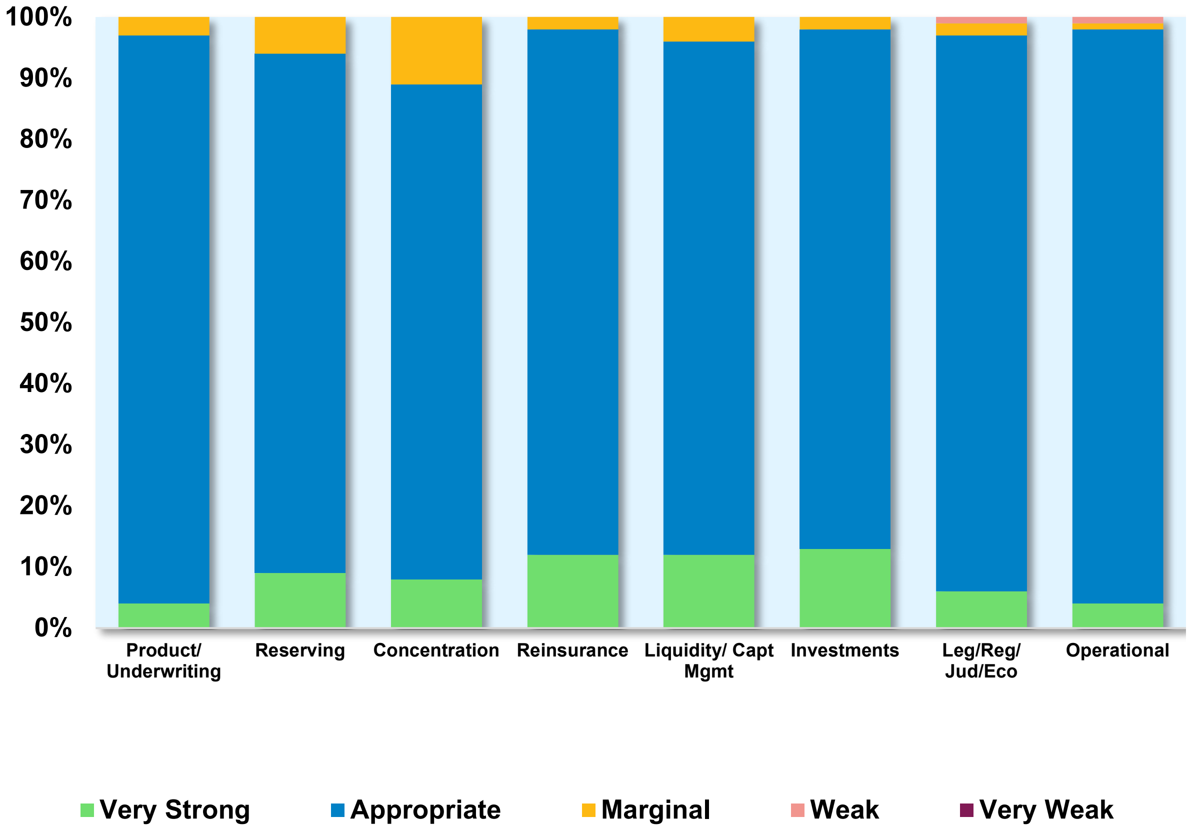


Our Insight, Your Advantage™

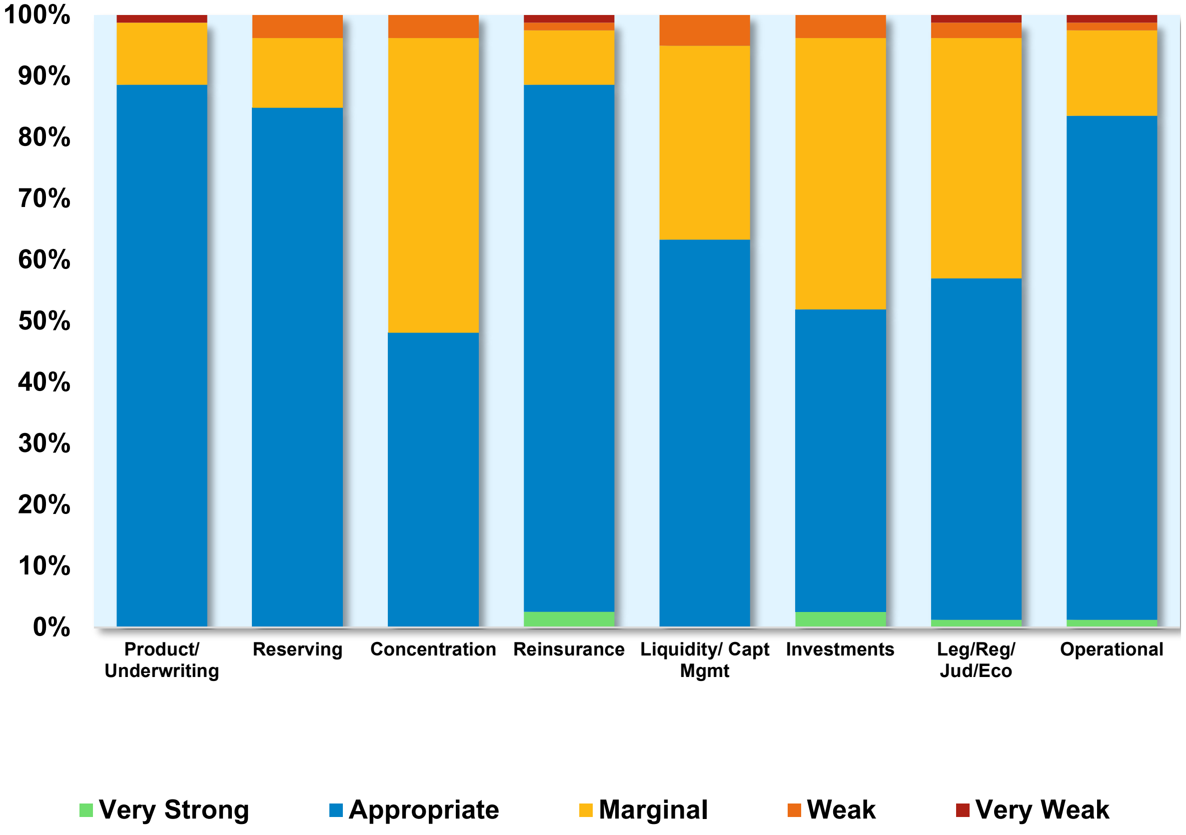
Data as at September 2023
Source: AM Best data and research

Enterprise Risk Management – Distribution of Risk Capability Assessments (%)

Europe & London Market



Middle East & Africa



Data as at September 2023
Source: AM Best data and research

Q&A

Benjamin Diaz-Clegg
Senior Financial Analyst

Jose Berenguer
Associate Director, Analytics

Use the QR code to submit questions to our speakers

Don’t forget to include your NAME and COMPANY

Enhancements to Rating Criteria

BCRM: Holding Company & Issue Credit Ratings
Available Capital & Holding Company Analysis

Kanika Thukral – Associate Director, Analytics
Michael Dunckley – Associate Director, Analytics

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

Impact of Changes

Section 1: Holding Company Notching and Issue Credit Ratings

Background

- Proposed revisions –
  Only affect Section IV: Insurance Holding Company and Issue Credit Ratings
- BCRM –
  No changes have been made to the analysis of core building blocks

Treatment on Notching

- Current treatment is typically three notches from Operating Company ICR applied globally

Impact on Ratings

- Revisions to BCRM –
  Will affect less than 5% of global ratings, including issue ratings
- Treatment of debt –
  Unchanged, however, any associated debt is likely to move in line with Non-Operating Holding Company notching movements

BCRM Criteria Introduction: Notching Difference

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

- Rating level of operating company
- Group capital fungibility
- Other relevant features such as the degree of successful diversification evidenced at the IHC
- Prudential regulatory oversight of the group

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

Regulation

The importance of regulation in the assessment:

- Regulation is important to determining the notching difference – Understand whether the regulatory focus is on each legal entity or also on groups of companies
- Two new terms that focus primarily on regulation –
  Collective Capital Management Groups (CCMG)
  Entity Prioritized Structures (EPS)
- Also important –
  A view of corporate capital management policy

Entity Prioritized Structures (EPS)

Separate regulatory focus on each legal entity:

- Restricted fungibility and reduced financial flexibility across the group
- Difficult to extract capital from subsidiaries
- Limited jurisdiction over the IHC
- Capital held within operating entities
- Less excess capital at IHC

Example – US Groups

Collective Capital Management Groups (CCMG)

Regulatory focus on the group:

- Assumes greater fungibility and financial flexibility across the group
- Excess capital often held at IHC 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 Groups

Collective Capital Management Groups

CCMG characteristics favour a reduced notching difference between an operating company ICR and that of the IHC

One-notch difference to Entity Prioritized Structures

Limitations:

- Separate legal entity restrictions and regulations remain
- Groups can be far reaching with sub-groups located outside the authority of the regulatory supervisor
- National recovery and resolution schemes often drive behaviour

Criteria New Basis Tables – BCRM Changes

Typical Notching Differences – Operating Company ICR and Insurance Holding Company ICR

Entity Prioritized Structures

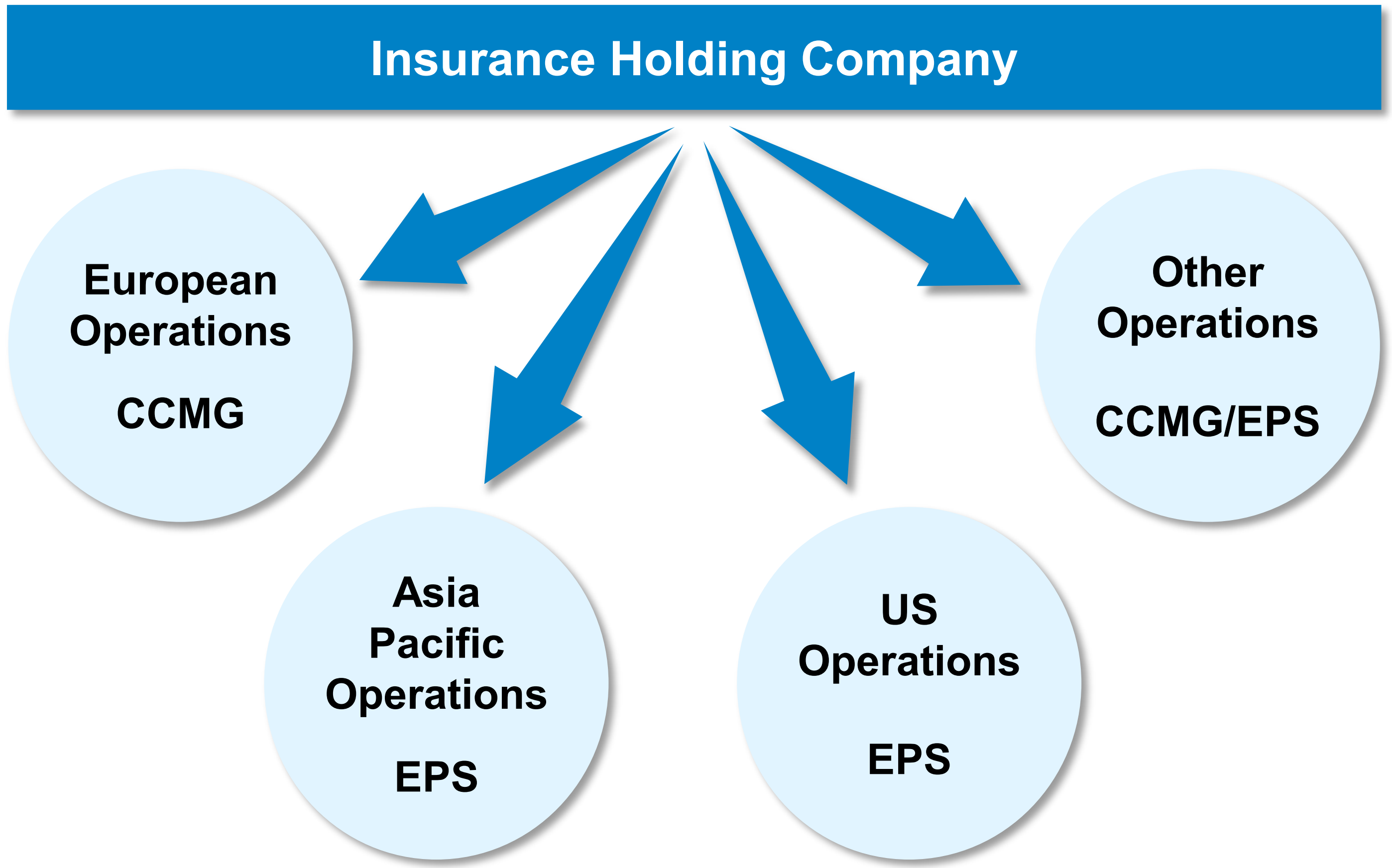
Operating Company ICR	Insurance Holding Company Notching
aaa	0 - 2
aa+	2 - 3
aa/aa-	3
a+/a/a-	3
bbb+/bbb	3
bbb-	3 - 4
bb+/bb	4
bb-	4 - 5

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

Application of Approach



It should be noted:

Cross-jurisdiction groups – Analytical judgement needs to be applied when analysing such groups

Change in structures over time –
This may change AM Best's view

Debt Notching

Notching:

Typical Difference Between Non-Operating Insurance Holding Company ICR, Debt and Preferred Stock Ratings

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

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

Section 2: Available Capital and Holding Company Analysis

Background

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

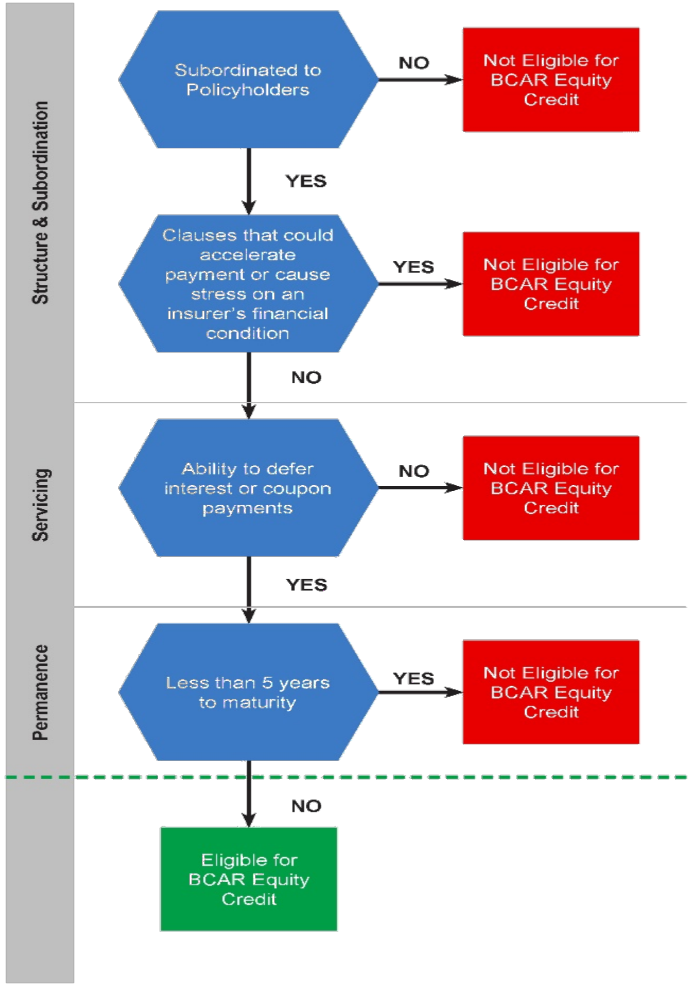
Enhancements

- Treatment of Debt under Entity Prioritized Structures
- Senior debt treatment in BCAR – provide greater transparency (justified by regulation)
- Clarify guidance on credit given in BCAR and leverage for instruments that are closer aligned to equity
- Clarifications on non-insurance operations
- Criteria title changed

Impact on Ratings

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

Clarification on BCAR Treatment – BCAR Hybrid Capital Assessment



Credit for debt that does not adhere to BCAR Capital Hybrid Assessment:

- Credit (only) where significant regulatory restrictions on the upstreaming of capital to the Insurance Holding Company (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 20% cap

Clarification of BCAR Treatment

Insurance Holding Company Debt

- Many rating units do not directly issue debt
- Where a rating unit is an operating subsidiary of an IHC – Analysts will typically run two BCAR calculations:
  - At the rating unit level
  - At the IHC/consolidated level
- When the consolidated IHC is the rating unit:
  - It may be that only one BCAR is run
- Additional clarifications included in criteria

Equity Credit for Preferred Shares

Additional flexibility 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

- AM Best grants equity credit – Hybrid securities with the characteristics of common equity
- In certain limited cases – Some hybrid securities may be treated purely as equity

Instruments Features: Permanence – Call Dates

Clarification on Treatment of Call Dates / Permanence – Call Dates	
• 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

Amortization of Debt

Clarification on Treatment of Call Dates

- Understanding the permanence and priorities on refinancing debt
- Concerns regarding the refinancing of debt may result in a reduction in credit as the term nears

Service-Oriented Activities

Insurance groups that have material non-insurance activities

- May have successful operations in related sectors
- May lead to higher leverage ratios in some cases but very strong servicing capabilities

Q&A

Kanika Thukral – Associate Director, Analytics

Michael Dunckley – Associate Director, Analytics

Use the QR code to submit questions to our speakers

The Importance of Stress Testing

Valeria Ermakova
Associate Director

Jessica Botelho-Young, CA
Associate Director

Introduction

Enterprise Risk Management (ERM)

- Stress testing for critical risks
- Contingency plans
- Assess the appropriateness of stress testing
- BCAR scores at the 99.8 confidence level

Best’s Capital Adequacy Ratio (BCAR)

- Used for stress and sensitivity analyses
- Look at business plans, capital transactions, cat events, etc
- “Stressed” vs “standard” BCAR scores
- Market and/or economic adjustments can also be made

Nat Cat Stress Testing in the BCAR

Reduce reported surplus

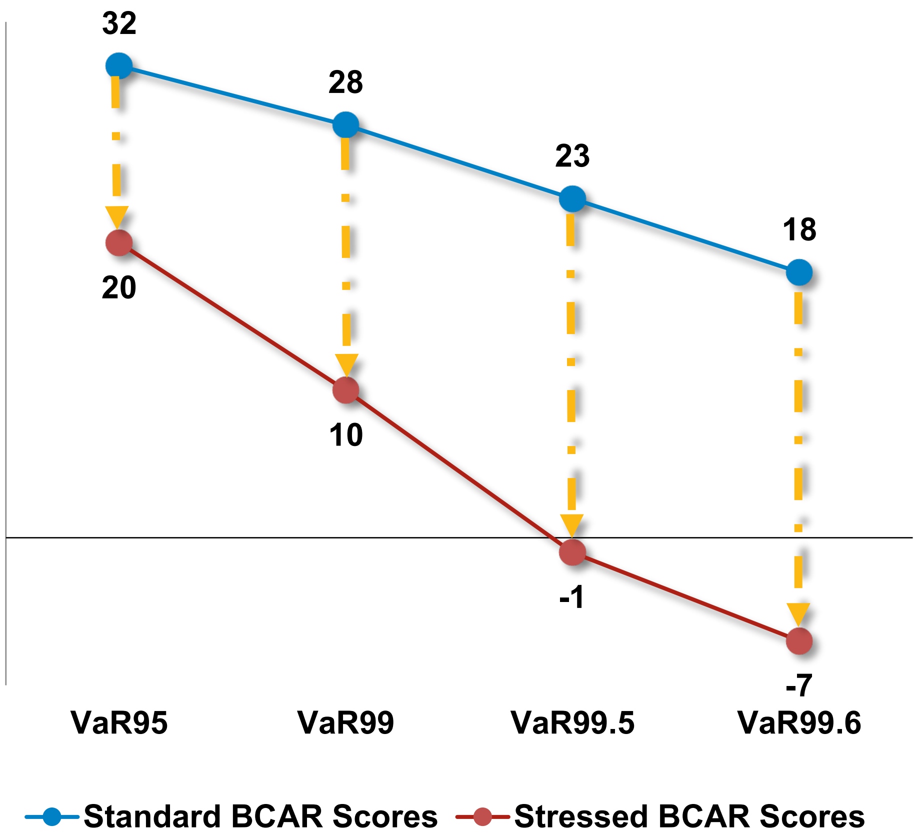
Increase reinsurance recoverables

Increase loss reserves

Consider any changes to the reinsurance structure

Stress Testing in the BCAR

Rating Unit – Interpretation with Financial Flexibility



Source: Catastrophe Analysis in AM Best Ratings

Man-Made Catastrophes

Rating considerations

- Aggregate exposure
- Full limit or modelled PML
- Management's view
- Historical losses

Examples

- Casualty scenarios
- Terrorism exposure
- Captive / industrial risks
- Cyber "cat"

AM Best's Cyber Questionnaire

General Questions

- Nature of the portfolio
- Cyber risk appetite and underwriting strategy
- Reinsurance (traditional and non-traditional)
- Use of third parties

Profile and Performance

- Types of cover offered (1st party / 3rd party)
- Limits & retention levels
- Types of insureds (size / sector) & geographies
- Loss ratios, number of claims paid / reported etc

Balance Sheet Items

- PMLs – incl. and excl. attritional losses; gross and net; model vs. management's view; impact from any model adjustments
- Deterministic scenarios: description, comparison to PMLs
- BCAR: use "larger of" (nat cat / terror / surety / cyber etc)

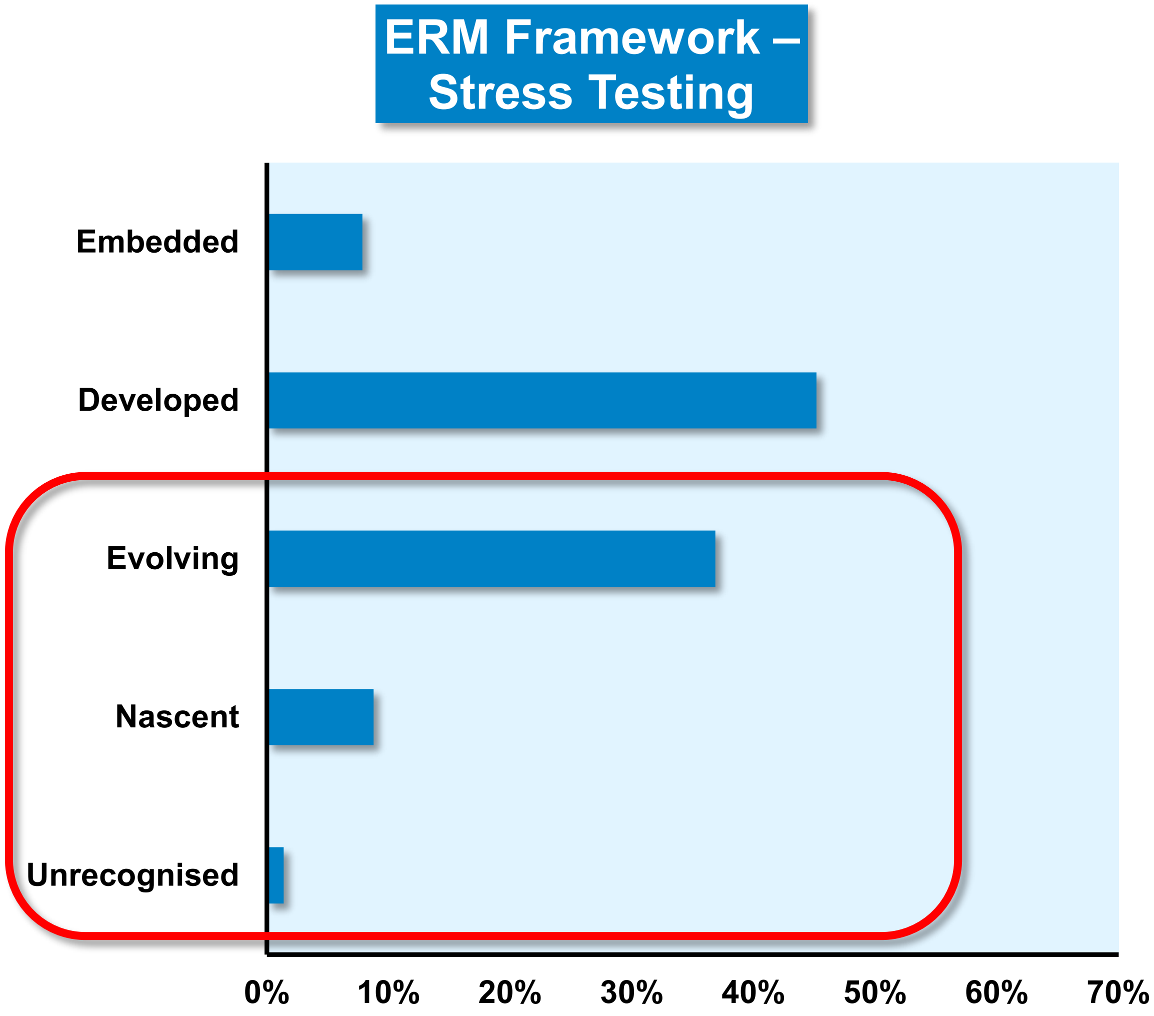
Emerging Risks – Climate Risk

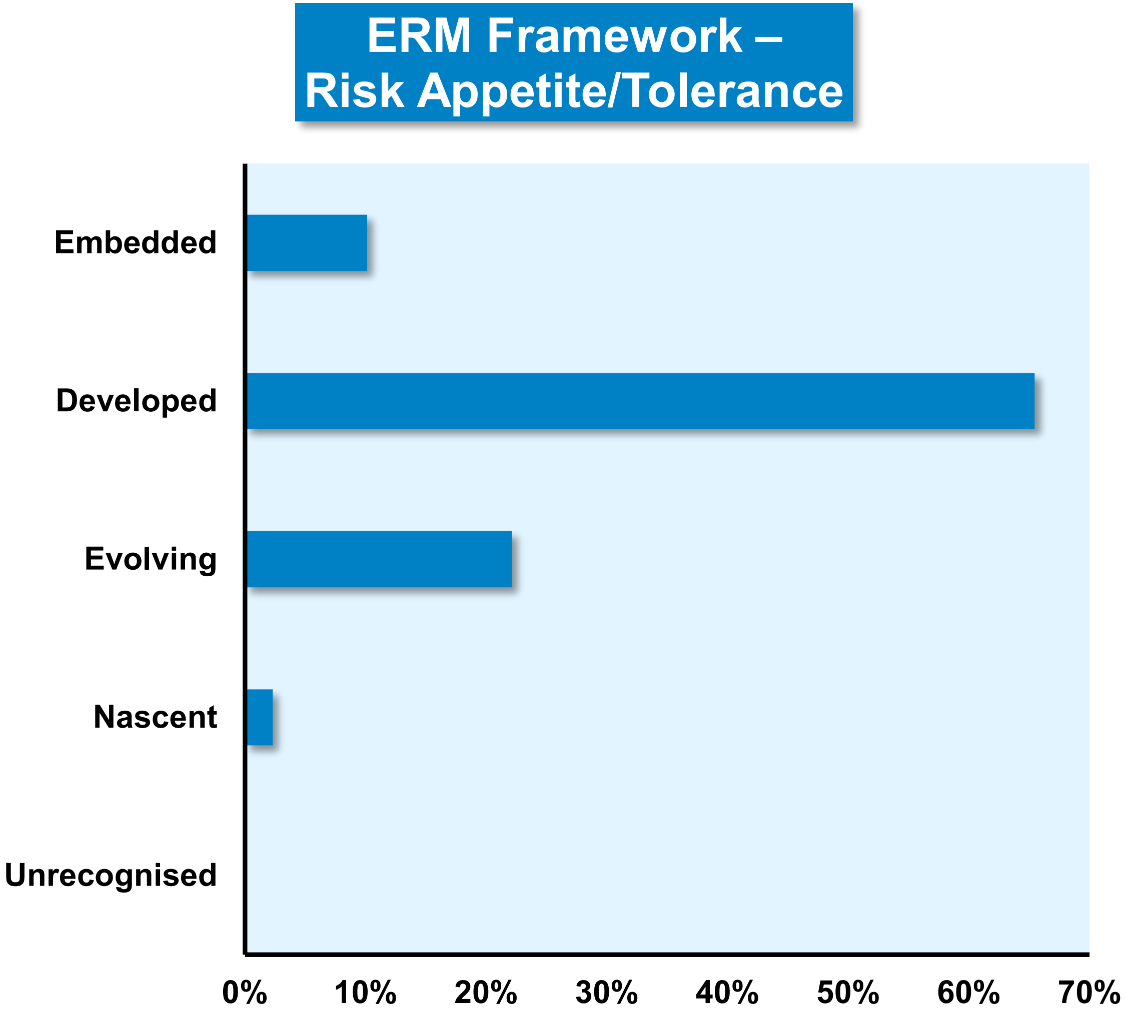
Climate Risk

	Balance Sheet Strength	Operating Performance	Business Profile	Enterprise Risk Management
+	• Capital position withstands shocks • Protection against peak exposures and aggregation of losses • Low volatility / sensitivity to climate risk • Diversification in investment portfolio	• Stability of earnings • Limited impact of stranded assets • Adequate modelling and pricing • New climate products earnings accretive	• Underwriting profile diversified and insulated against climate risks • Development of new products • Clearly defined policy wording and contracts	• Climate risks factored into ERM approach • Ability to absorb climate stress tests • Ability to model weather-related risks • High visibility of climate reporting, (financial disclosures, regulatory reporting) • Board oversight
–	• Rapid decline in capital position – over-exposure, unexpected losses • Inadequate protection against peak exposures • High volatility / sensitivity to climate risks • Material write-downs of stranded assets	• Volatile earnings • Financial losses due to stranded assets • Climate risks not considered in underwriting model • Unexpected losses • Adverse mortality and morbidity rates from resistant disease	• Underwriting or investment profile concentrated and exposed to climate risk • Uncertain or indirect exposures to climate risks	• Breaches of appetite and tolerance • Stress test failures • Inadequate risk modelling – poor data quality • Non-disclosure in financial reporting • Inadequate protection against peak exposure, or aggregation of risks

Balance Sheet Strength → Operating Performance → Business Profile → Enterprise Risk Management → **Issuer Credit Rating**

Stress Testing in the ERM Framework





Source: AM Best data and research

Importance of Reverse Stress Testing

What is Reverse Stress Testing and why is it used?

- Examines scenarios
- Identifies gaps and vulnerabilities
- Helps to develop plans to manage and mitigate key weaknesses
- Complements sensitivity and scenario analyses
- Expected by some regulators

Relevance to rating assessment?

- Explicitly captured in AM Best's ERM framework evaluation
- Helps to understand the tail and how events are managed
- Allows for better risk quantification
- Helps identify risk correlations
- A sign of ERM / market maturity

Key Takeaways

Analysts – **Consider which stresses are appropriate to perform in the BCAR**	**Natural Catastrophe** **Investment Stress** **Impact of Regulatory Changes**	**Casualty Catastrophe** **Sovereign Stress** **Dependence on Counterparties**	**Terrorism** **Liquidity Stress** **Inadequate Reserving** **Cyber**	**Single Large Losses** **Pandemic** **Accumulation of Net Exposures**

Companies –

- Should perform relevant stress testing and explain the scenarios and their impact on operations
- Should look "outside the box" to assess emerging risks and any potential correlations
- Important to get a view on reverse stress testing
- Understand contingency plans and protocols to restore capital

Q&A

Valeria Ermakova
Associate Director

Jessica Botelho-Young, CA
Associate Director

Use the QR code to submit questions to our speakers

IFRS 17 – In Action
Current State of Play

Tony Silverman
Director
Credit Rating Criteria
Research & Analytics

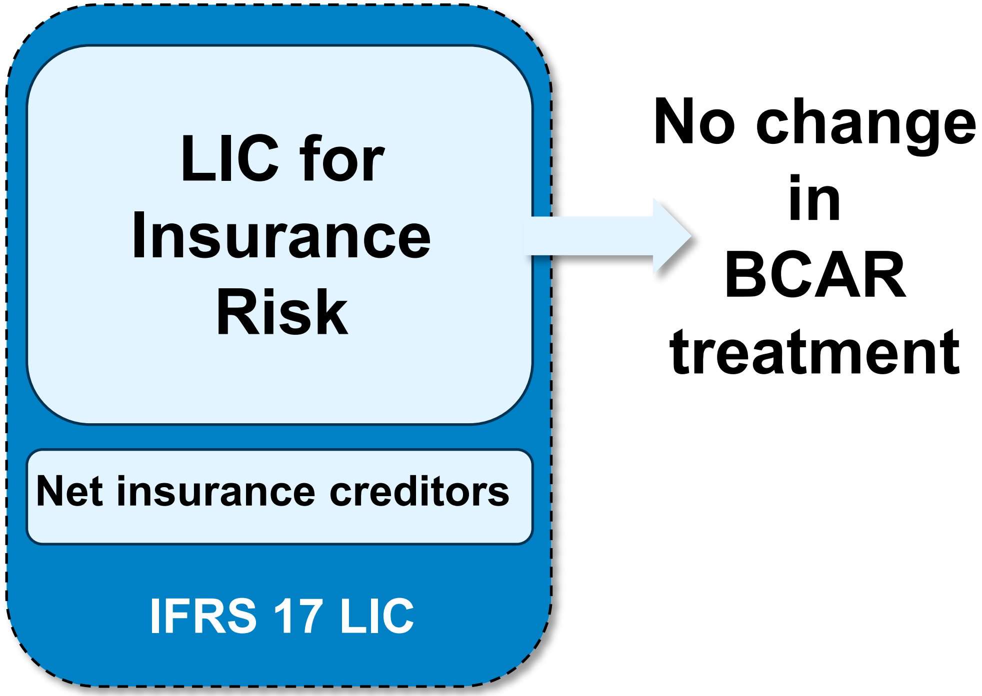
Agenda

- Summary Message
- BCAR Inputs – Some Examples
- SRQ Data
- Combined Ratios
- Life Segment KPI's
- AM Best, IFRS 17

Summary Messages

- No automatic ratings changes from IFRS 17
- BCAR model unchanged
- Primary focus for BCAR is to carefully identify inputs:
  - Such as LIC, DAC, Net Economic Value due to Long-term Business (NEVLtB)
- Some new SRQ requirements
- Enhanced KPIs under IFRS 17, more particularly in life segment
- Comparability of KPIs within IFRS 17 universe are enhanced overall, but comparisons across accounting standards will continue to require interpretation
- Expect implementation to evolve over next few years

Insurance Creditors/Debtors, Model Unchanged

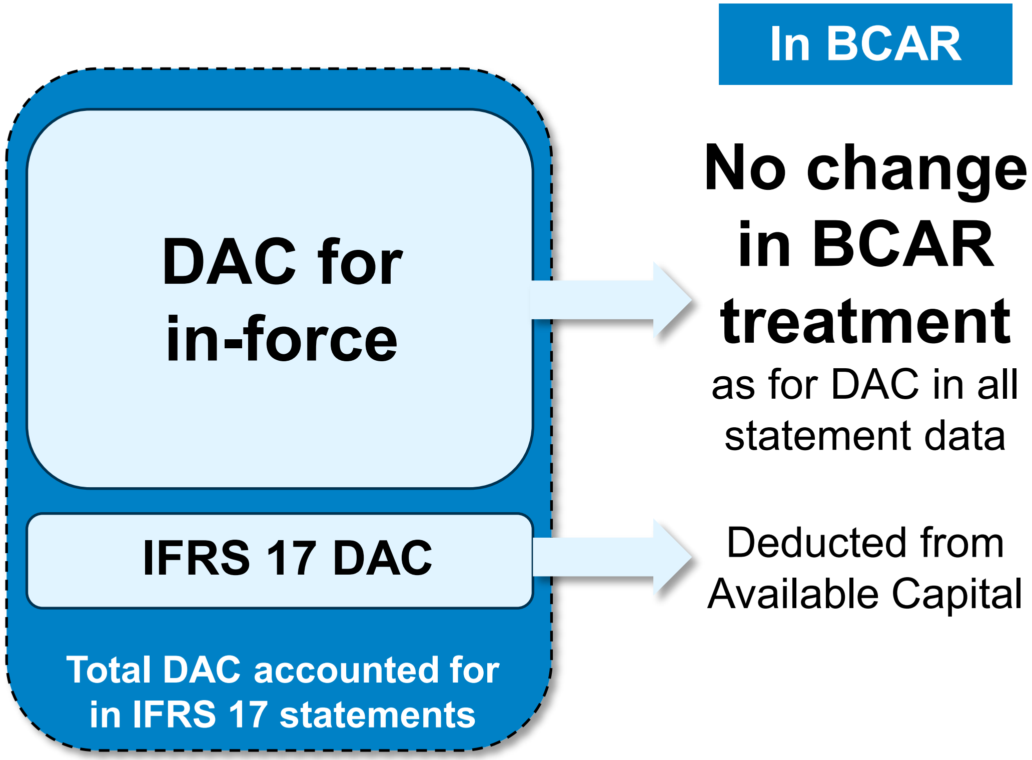


- Net insurance creditors – removed from LIC before by-line amounts input to BCAR
- BCAR model unchanged
- Net insurance creditors – obtained from:
  - Voluntary public disclosure (e.g. Allianz)
  - SRQ
  - Separate enquiry
- Net insurance creditors presented here as positive for simplicity – May be negative

DAC Under IFRS 17

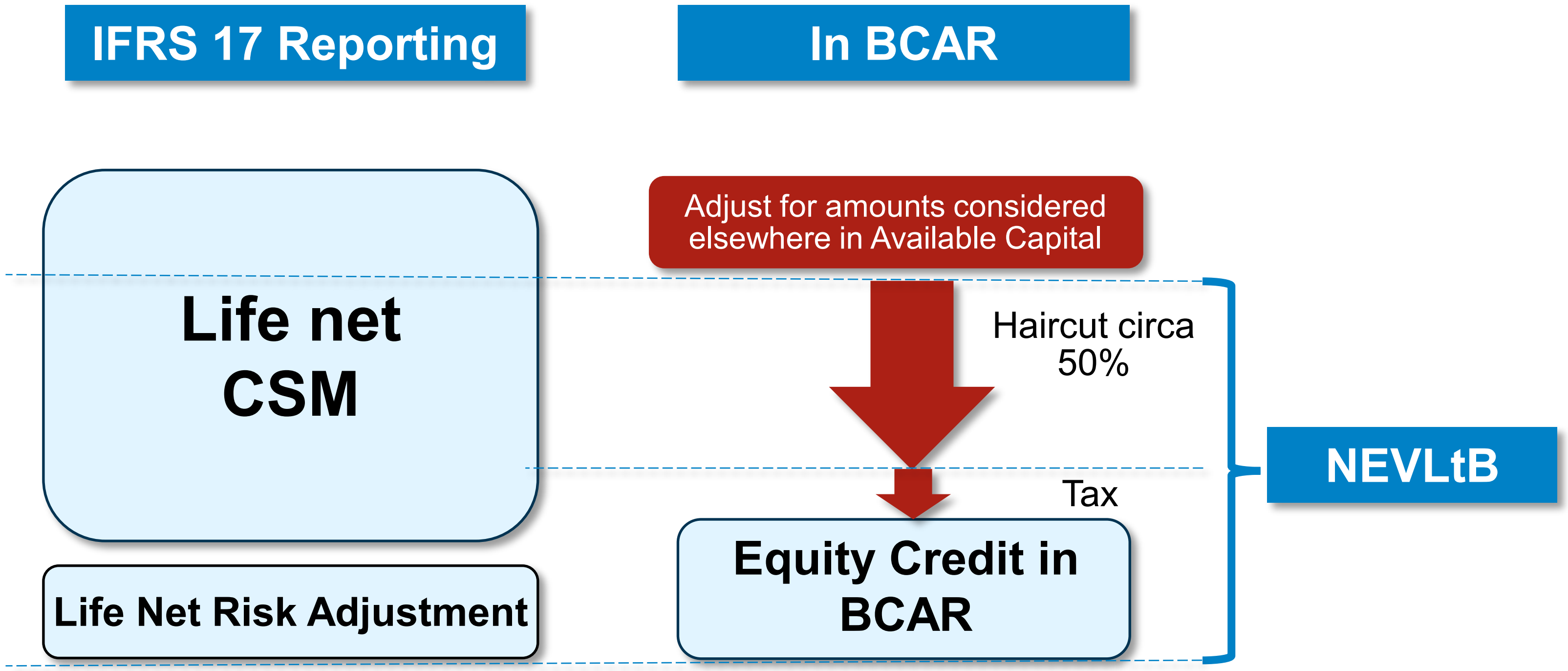
- DAC under IFRS 17 comprises
  a) In-force DAC – acquisition costs to be amortised against policies in-force on reporting date
  b) IFRS 17 DAC (an AM Best term) is a new asset – acquisition costs to be amortised against future new business
- Deferring acquisition costs – optional under IFRS 17
- IFRS 17 LRC – stated after "netting off" all DAC
- Only IFRS 17 DAC is a required disclosure
- AM Best's SRQ will ask for each separately, split non-life/life

DAC (P/C) in the BCAR



- In-force DAC requested in SRQ and used, as for DAC in other statement data, within BCAR available capital:
  - BCAR UPR capital charge (P/C only)
  - High loss ratio (P/C only)
  - Life segment in-force DAC deduction
- UPR for BCAR use calculated from LRC, use unchanged
  - Net creditors deducted, all DAC added to derive UPR for BCAR
  - Used as for UPR derived from other statement data (reinsurance credit risk factors)

Net Economic Value Due to Long-Term Business (NEVLtB)



- Basis of NEVLtB is life segment CSM + Risk Adjustment
- Adjustments made, as in criteria, for amounts considered elsewhere in available capital assessment
- Haircut is, as previously, to allow for sensitivity to market conditions

Base Exposure for Pricing Risk

BCAR Base Exposure

Non-Life

Forecast net –
insurance revenue for year following assessment date

Life

PAA –
Forecast net insurance revenue for year following assessment date

GMM/VFA –
Present value of net future cash inflows for contracts recognised in the year

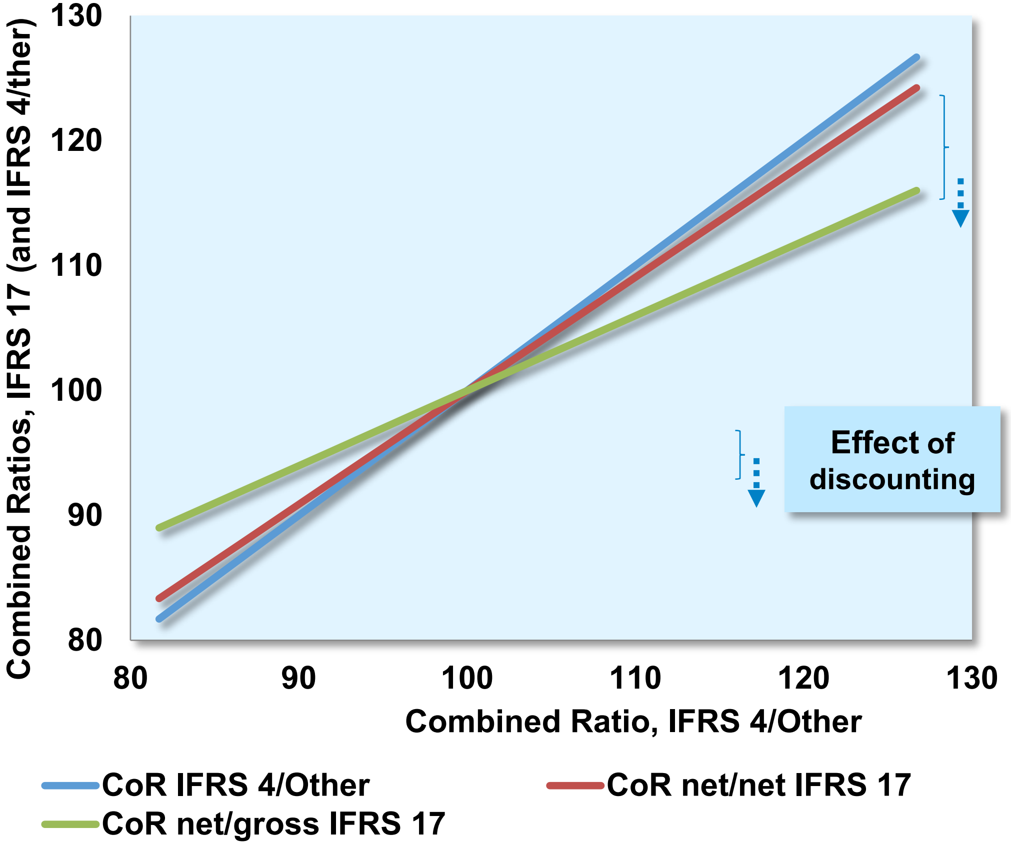
- Net written premiums usually no longer available
- Written was a proxy for forecast
- PVNBP type measure for Life GMM business available under IFRS 17

AM Best SRQ Changes for IFRS 17

- **Changes to:**
  - SQI 11, Premiums/pricing risk exposure
  - SQI 12, Non life loss reserves; SQI 16, life reserves
  - SQI 13, Non life loss reserves, discounting risk adjustment
  - SQI 36, Receivables
- **By line splits of insurance revenue** for premium/pricing risk (SQI11)
- **Clarification** that **by line splits** of non-life loss reserves, life **reserves** are **ex net creditors**
  Request for **DAC data**, **net creditors** in LIC, LRC (SQIs 12, 16)
- By line splits of discounting and risk adjustment (SQI 13)
- **Receivables,** clarification reinsurance receivables excludes net reinsurance debtors (SQI 36)

Combined Ratios

Illustrative Comparison of IFRS 17 Combined Ratios with IFRS4/Other Ratio for Insurance



- AM Best will calculate net/net and net/gross ratios
- Generally, AM Best will not remove discounting
- One-off effects of rate changes and spread movements in investment result, and wouldn't affect combined ratios
- We expect the net/net combined ratio will normally be closer to existing ratios before discounting. Both will appear in credit reports
- Comparability improved within IFRS 17 universe for like ratios

KPIs in Life Segment

- AM Best will calculate various ratios, including:
  - Revenue margins
  - New business margins, measures of progress of pipeline profit (CSM) for GMM/VFA products
  - Impact of variances and onerous contracts on segment pre-tax profit contribution (insurance and investment results less reported life non-operating expenses)
  - Return on equity measures

- Ratios in Credit Reports:
  - Pre-tax contribution to net revenue
  - Change in net CSM
  - Group Return on Capital and Surplus (with and without Life CSM as Equity)

- KPIs –
  A richer set than previously

Comparability

- Combined ratios –
  - AM Best anticipates improved comparability, and better correspondence with profitability
- Life IFRS 17 performance ratios – Will often have no equivalent in other GAAP measures
- Existing reporting standards vary –
  - Measures such as combined ratios under existing reporting standards may use differing amounts of discounted claims reserves and margin
  - Life reserves have a variety of relationships to market-type measures

- In general comparability improved within IFRS 17 universe
- AM Best recognises comparisons of accounting KPIs across accounting standards require awareness of the differences
  This may be reflected in the qualitative aspects of a rating exercise

AM Best and IFRS 17

- Early start to preparation –
  Some H1 reporting suitable to test systems
- Conversations, credit report narratives and tables –
  Will include use of new KPIs
- AM Best anticipates –
  IFRS 17 reporting will continue to attract comment for some time
- Insurers' reporting under IFRS 17 –
  To evolve over the first few years
- AM Best's use of the data, and the SRQ –
  Will remain under active review and may similarly evolve in some respects

Q&A

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Credit Rating Criteria
Research & Analytics

Use the QR code to submit questions to our speakers

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AM Best's Europe Insurance Market Briefing & Methodology Review Seminar - London

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