

Best's Credit Rating Methodology (BCRM)

The Rating Process and Its Value



Best's Credit Rating Methodology – Rating Process Overview

About AM Best

Founded in 1899, AM Best is the world's first, largest and only global credit rating agency specializing in the insurance industry and insurance-linked securities. Best's Credit Ratings are an assessment of an insurer's financial strength, creditworthiness and their ability to honor obligations to policyholders.

AM Best's insurance data, market intelligence, and analytical resources provide a critical perspective to help insurers, financial professionals and consumers make informed decisions. Our analysts' diverse financial, operational, claims, underwriting and actuarial backgrounds equip them to deliver insight that helps support and guide the insurance industry.

We provide 3,600 ratings on companies of all sizes in more than 100 countries, including over 200 alternative risk transfer entities and more than 450 mutual companies. Headquartered in the United States, the company has regional offices in London, Amsterdam, Dubai, Hong Kong, Singapore and Mexico City.

Best's Credit Ratings (BCRs)

A BCR serves as a valuable, forward-looking opinion for consumers, insurance agents, financial advisors, banks and other financial institutions to support prudent decision-making. The ratings help the financial industry and consumers understand the financial strength and creditworthiness of insurance companies worldwide.

AM Best assigns various types of BCRs to a wide variety of insurance organizations, from single legal entity insurers to complex, multinational enterprises with diversified operations.

Best's Credit Rating Scales

Translation of Issuer Credit Ratings to Financial Strength Ratings

Long-Term ICR	FSR
aaa, aa+	A++
aa, aa-	A+
a+, a	A
a-	A-
bbb+, bbb	B++
bbb-	B+
bb+, bb	B
bb-	B-
b+, b	C++
b-	C+
ccc+, ccc	C
ccc-, cc	C-
c	D

AM Best Credit Rating Definitions

- **Best's Issuer Credit Rating (ICR):** An independent opinion of an entity's ability to meet its ongoing financial obligations, issued on either a long- or short-term basis
- **Best's Financial Strength Rating (FSR):** An independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations
- **Best's Issue Credit Rating (IR):** An independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation, issued on a long- or short-term basis
- **Best's National Scale Rating (NSR):** A relative measure of creditworthiness in a specific local jurisdiction that is issued on a long-term basis and derived exclusively by mapping the NSR from a corresponding global Issuer Credit Rating (ICR) using a transition chart

The Value of a Best's Credit Rating

- AM Best is the only global credit rating agency focused solely on insurance.
- We provide an independent, third-party assessment of business profile, operating performance, business profile and enterprise risk management.
- Our rating process promotes credibility, transparency and acceptance for new market/business penetration.
- We rate new formations, startups and companies of all sizes.
- Best's Credit Rating Methodology (BCRM) is publicly shared and transparent.
- Best's Credit Ratings are registered by regulatory authorities around the world. [Click here](#) for the full list.
- We rate risk transfer, single-parent captives, group captives, risk retention groups (RRGs) and protected cells in a number of domiciles.
- Our unmatched access to global insurance data, industry intelligence and analytical resources helps us deliver an essential perspective to the marketplace.

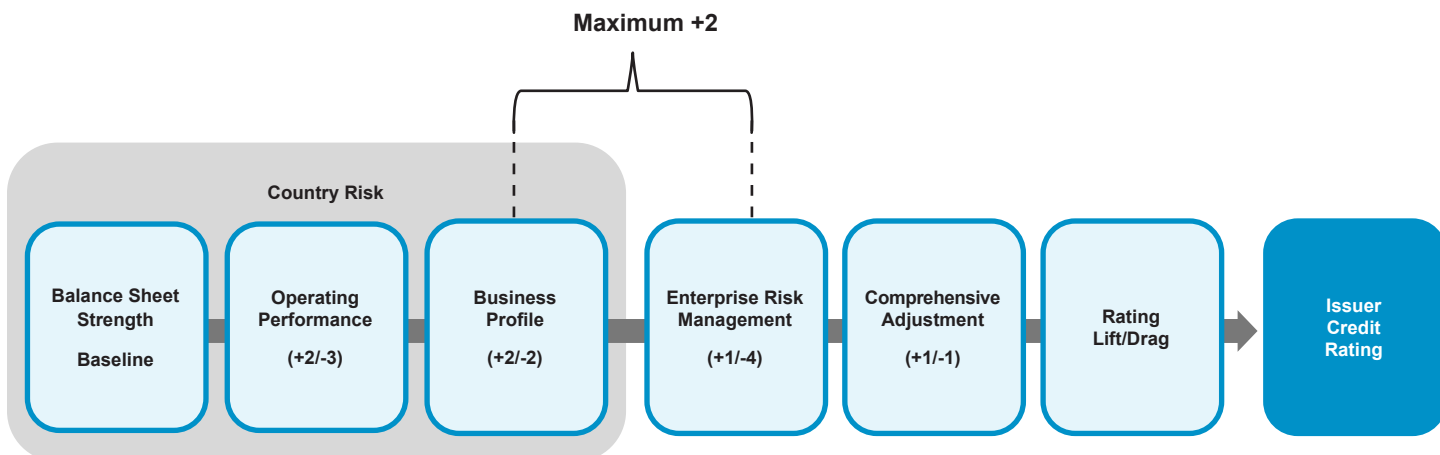
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Best’s Credit Rating Methodology (BCRM)

Best’s Credit Rating Methodology provides a comprehensive explanation of AM Best’s rating process. Key rating factors—including an insurer’s balance sheet strength, operating performance, business profile and enterprise risk management (ERM)—are qualitatively and quantitatively evaluated during the rating process.

The foundational building blocks of AM Best’s rating approach are outlined below.

AM Best’s Rating Process



Balance Sheet Strength

AM Best’s rating analysis is an interactive process that begins with an evaluation of the company’s balance sheet strength. This evaluation includes a three-part analysis focusing on the following areas:

1. The insurance rating unit (the insurer)
2. The financial flexibility and risks associated with the insurer’s holding company and/or ownership structure
3. The impact of country risk on the insurer’s balance sheet strength

Baseline Balance Sheet Strength Assessment

The assessments of the insurance company (Part 1) and its holding company (Part 2) result in the company’s “Combined Balance Sheet Strength Assessment.” AM Best arrives at a company’s baseline balance sheet strength assessment by incorporating country risk (Part 3).

The baseline is selected for the company from the various options in the Overall Balance Sheet Assessment chart and is determined through analytical judgment and rating committee review.

Balance Sheet Strength Assessment Factors	
<ul style="list-style-type: none"> • BCAR • Quality and appropriateness of reinsurance programs • Quality and diversification of assets • Financial and operating leverage 	<ul style="list-style-type: none"> • Adequacy of reserves • Liquidity • Quality of capital • Internal economic capital models

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Best's Capital Adequacy Ratio (BCAR)

The measurement of the insurer's capital adequacy is key to the balance sheet assessment. AM Best uses its Best's Capital Adequacy Ratio to differentiate an insurer's balance sheet strength and determine whether its capitalization is appropriate for its risk profile.

BCAR evaluates many of the insurer's balance sheet risks simultaneously, generates an estimate of the capital needed to support those risks at different confidence intervals and compares it with the insurer's available capital.

BCAR Assessment

VaR Confidence Level (%)	BCAR	BCAR Assessment
99.6	> 25 at 99.6	Strongest
99.6	> 10 at 99.6 & ≤ 25 at 99.6	Very Strong
99.5	> 0 at 99.5 & ≤ 10 at 99.6	Strong
99	> 0 at 99 & ≤ 0 at 99.5	Adequate
95	> 0 at 95 & ≤ 0 at 99	Weak
95	≤ 0 at 95	Very Weak

Country Risk

Country risk and its assessment are incorporated into the analysis of balance sheet strength, operating performance and business profile. AM Best defines country risk as the risk that country-specific factors will adversely affect an insurer's ability to meet its financial obligations.

Overall Balance Sheet Strength Assessment

Combined Balance Sheet Assessment (Rating Unit/Holding Company)	Country Risk Tier					
	CRT-1	CRT-2	CRT-3	CRT-4	CRT-5	
Strongest	a+/a	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb+/bbb
Very Strong	a/a-	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb/bbb-
Strong	a-/bbb+	a-/bbb+	bbb+/bbb/bbb-	bbb/bbb-/bb+	bbb-/bb+/bb	bbb-/bb+/bb
Adequate	bbb+/bbb/bbb-	bbb+/bbb/bbb-	bbb-/bb+/bb	bb+/bb/bb-	bb/bb-/b+	bb/bb-/b+
Weak	bb+/bb/bb-	bb+/bb/bb-	bb-/b+/b	b+/b/b-	b/b-/ccc+	b/b-/ccc+
Very Weak	b+ and below	b+ and below	b- and below	ccc+ and below	ccc and below	ccc and below

Operating Performance

The second building block of AM Best's rating process is operating performance. This analysis can result in an increase, decrease or no change to the baseline assessment. Possible adjustments range from +2 notches to -3 notches.

AM Best views operating performance as a leading indicator of future balance sheet strength and long-term financial stability. A company's profitability affects its ability to generate earnings, and profitable insurance operations are essential for a company to operate as a going concern.

In general, more diversity in earnings streams leads to greater stability in operating performance. AM Best's analysis of operating performance focuses on the stability, diversity and sustainability of the company's earnings sources and the interplay between earnings and liabilities.

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Business Profile

Business profile is the third building block in AM Best's rating process and is a highly qualitative component of AM Best's rating evaluation. Business profile may ultimately affect an insurer's current and future operating performance and, in turn, its long-term financial strength and ability to meet its obligations to policyholders. Possible adjustments for business profile range from +2 notches to -2 notches.

The business profile review includes evaluation of the following factors:

- Market position
- Degree of competition
- Distribution channels
- Pricing sophistication and data quality
- Management quality
- Product and geographic location
- Product risk
- Regulatory, event, market and country risks

Enterprise Risk Management (ERM)

ERM is the fourth building block in the rating process. The impact of ERM on an insurer's rating is based on understanding the development and implementation of an insurer's risk management framework as well as the insurer's risk management capability relative to its risk profile. The framework and the risk evaluations include the following sub-assessments:

Framework Evaluation	Risk Evaluation	
<ul style="list-style-type: none">• Risk identification and reporting• Risk appetite and tolerance• Stress testing and non-modeled risks• Risk management and controls• Governance and risk culture	<ul style="list-style-type: none">• Product and underwriting• Reserving• Concentration• Reinsurance	<ul style="list-style-type: none">• Liquidity and capital management• Investments• Legislative, regulatory, judicial and economic• Operational

If a rating unit is practicing sound risk management and executing its strategy effectively, the results will be evident in successful performance over the long term. Possible adjustments for ERM range from +1 notch to -4 notches.

Companies with complex global business profiles have a need for a robust and comprehensive ERM program. In many cases, the complexities and demands of these companies' "Very Favorable" business profiles require an equally "Very Strong" ERM. Acknowledging this interaction, and the limited impact that these two highly qualitative building blocks may have on credit strength, the combined impact between business profile and ERM will be restricted to a maximum of +2 notches. This calculation would only affect those companies that have both a "Very Favorable" business profile assessment and a "Very Strong" ERM assessment.

Comprehensive Adjustment

A comprehensive adjustment may be applied in the rating process when the company being reviewed has an uncommon strength or weakness that exceeds (or is less than) what has been captured through the rating process up to this point. A comprehensive adjustment can increase or decrease the assessment by a maximum of 1 notch. The vast majority of ratings will not require a comprehensive adjustment.

Rating Lift/Drag

In this step, the company may be afforded lift (or drag) based on factors such as integration, strategic importance and contribution to the overall enterprise. The amount of lift or drag assigned depends on the specific circumstances of the insurer. For further details, please visit www3.ambest.com/ambv/ratingmethodology.

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The Credit Rating Process

The typical duration from signed contract to ratings dissemination is generally about eight to twelve weeks. Each interactively rated entity is assigned to a rating analyst, who manages the ongoing interaction with company management and conducts the fundamental credit analysis as described in AM Best's rating criteria.

BCRs are initially determined and periodically updated through a defined rating committee process. The rating committee itself consists of analytical staff and is chaired by senior rating officers. The committee approach ensures rating consistency across different business segments and maintains the integrity of the rating process (described briefly below).

1

Compile Information

The assigned analyst collects public and proprietary financial information and data to develop a tailored meeting agenda.

2

Perform Analysis

AM Best incorporates a host of quantitative and qualitative measures to evaluate the organization's financial strength.

3

Determine Best's Credit Rating

The AM Best rating committee ensures rating consistency and maintains the integrity of the rating process and methodology.

4

Disseminate Best's Credit Rating

Once accepted, the Best's Credit Rating is distributed via the AM Best website, press releases and print/digital publications. Private BCRs are disseminated to the rated entity only.

5

Monitor Best's Credit Rating

AM Best regularly monitors the rating by continually analyzing the organization's creditworthiness.

Sample Information Inputs

Private		Public
<ul style="list-style-type: none"> • Capital structure • Investment and credit guidelines • Reinsurance guidelines • Exposure to catastrophes • Enterprise risk management (ERM) • Internal capital models 	<ul style="list-style-type: none"> • Meeting with key executives • Business plans and projections • Supplemental rating questionnaire (SRQ) • Actuarial memorandum • Loss provision reports • Cash-flow stress testing 	<ul style="list-style-type: none"> • Financial statements • Reports to shareholders • Public records • Regulatory reports and disclosure notes • Audit reports • Compliance and ethical conduct reports

Characteristics of Highly Rated Insurers

- Superior and stable risk-adjusted capitalization across the various confidence levels
- Strong, predictable and sustainable operating profitability developed from a favorable lower-risk liability profile, with results exhibiting limited volatility
- Competitive advantage in branding, customer experience, investments and/or underwriting
- Competitive market position leading to pricing power in core business lines
- Strong and stable operating cash flows, with books of business demonstrating favorable retention trends
- Diversified earnings and revenue streams
- Effective use of technology and data analytics which positively impacts performance
- Product design with flexibility/risk-sharing features to effectively react to changing market environments
- Market-leading distribution system
- Comprehensive and proactive enterprise risk management
- Consistency of key metrics compared with peers
- Long-term, well-developed business strategy that has been tested over time
- Strong management team
- Key operations in stable regulatory environments



AM Best is a global credit rating agency, news publisher and data analytics provider specializing in the insurance industry. For more information, visit www.ambest.com.

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This overview document provides a quick look at the components of Best's Credit Rating Methodology (BCRM) and rating process. For more information related to the complete BCRM, including various comprehensive criteria procedures applicable to aspects of the insurance and reinsurance industry globally, please visit the Best's Credit Rating Methodology section of our website at www3.ambest.com/ambv/ratingmethodology.