

AM Best Response to Comment: Rating Captives and Other Alternative Risk Transfer Entities

On December 2, 2024, AM Best proposed revisions to the Alternative Risk Transfer criteria procedure (renamed Rating Captives and Other Alternative Risk Transfer Entities). The Call for Comment (CFC) period for this draft criteria procedure ended on February 20, 2025. There is no impact on any currently published Best's Credit Ratings as a result of the material revisions to the Rating Captives and Other Alternative Risk Transfer Entities criteria procedure.

Revisions made to Rating Captives and Other Alternative Risk Transfer Entities include the following:

- Renamed the criteria procedure to 'Rating Captives and Other Alternative Risk Transfer Entities'
- Broadened the nomenclature used for definitions and descriptions of cell companies / entities
- Established a clear path to assigning an ICR and an FSR to cell entities
- Summarized operational and legal foundation requirements for cell entities seeking ratings
- Added detail to support acceptable Letters of Credit (LOCs) conditions
- Other minor non-material editorial revisions. These changes add clarity or were stylistic or grammatical in nature.

During the CFC period, AM Best did not receive any written comments (public, private or anonymous) from market participants in the insurance industry or other interested parties on the proposed revisions to the criteria procedure. The following frequently asked questions (FAQs) address key themes within the materially revised criteria.

FAQs

1) Why is AM Best making revisions to Rating Captives and Other Alternative Risk Transfer Entities?

The revisions to the criteria procedure serve to provide transparency and clarifications to existing practices while recognizing and incorporating current market conditions and appropriately capturing the latest alternative risk transfer entities used in insurance markets across the globe.

2) What entities are affected by revisions to this criteria procedure?

The primary population of this market segment affected by the material changes to the criteria procedure are cell companies, notably those with incorporated cell entities. Alternative risk transfer entities not affected by these changes include captives (single parent, pure, and group), risk retention groups, and self-insurance funds.

3) What sections of Best's Credit Rating Methodology (BCRM) are impacted by these changes?



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No changes have been made to the core building block analysis of balance sheet strength, operating performance, business profile, enterprise risk management and lift and drag.

4) What benefit do these material changes provide?

The changes to Rating Captives and Other Alternative Risk Transfer Entities establish a pathway for assigning Issuer Credit Ratings (ICR) and Financial Strength Ratings (FSR) to incorporated cell entities.

5) What nomenclature has been updated?

The revised criteria procedure includes nomenclature updates to better reflect the entity structures developed in the industry and considers the use of varied terminology in different jurisdictions. The new descriptions include:

- Cell Company – CC
- Incorporated Cell Company – ICC
- Incorporated Cell – IC
- Unincorporated Cell Company – UCC
- Unincorporated Cell – UC
- Mixed Cell Company – MCC

The limited definition of Protected Cell Company – PCC has been removed from the criteria document.

6) What path to assigning an ICR and FSR to cell entities was retained?

The updated criteria procedure retains the path for assigning ratings to UCCs as an overall entity, and not assigning separate ratings to individual UCs. The rating of the UCC is informed by the creditworthiness of the weakest individual UC as evaluated following the BCRM. This path is referred to as the “weakest link approach.” Since only one rating is assigned to the UCC, the rating must take all policyholder obligations into consideration and is therefore capped by the creditworthiness of the weakest cell.

7) What is the new path for assigning an ICR and FSR to cell entities?

AM Best may assign ratings to one or more individual ICs, reflecting that each of the ICs in an ICC or an MCC is an individually incorporated and licensed legal entity. An IC’s reliance on the ICC or MCC, e.g., for management or administrative support, will be considered as part of the assessment of business profile and enterprise risk management (ERM).

8) What are the factors that AM Best considers in order to determine if a rating can be assigned to an IC or a UCC?



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Given the growing use of CCs as a risk management tool for innovative and creative (re)insurance transactions, along with evolving regulatory frameworks for CCs, AM Best may conduct further analytical assessments as part of the rating process or in the process of assigning a rating (you pick). This may include in-depth discussions with jurisdictional authorities, third-party legal reviews, or consultations with external actuaries. As part of this process, items to be reviewed may include the following:

- Cell company laws, including any jurisdictional legal precedents that may change the way AM Best views the sanctity of cells
- Rules about the bankruptcy and dissolution of cells, including the history of disputes related to cell structures in the jurisdiction in which the cell company is formed
- Usage of entities such as series LLCs or other vehicles that resemble cell companies
- Issues that may arise regarding how ICs and UCs can interact with each other under the same MCC
- Structure of the transactions the cells engage in
- Interpretation of funding agreements, reinsurance contracts, dispute resolution mechanisms, and other legal agreements
- Loss profile of the business being conducted in a UC, IC, or series LLC, especially for asset classes without publicly available performance data
- Limitations of loss data and alternative data sets that may approximate the performance of the subject business
- Fulfillment of certain regulatory requirements, if applicable, when the cells are used for issuing securities

9) Is any entity excluded from being assigned an FSR under the Rating Captives and Other Alternative Risk Transfer Entities criteria procedure?

Yes. For UCCs and ICs that issue structured finance instruments, AM Best will not assign an FSR.

10) What changes have been made to address Letters of Credit as they relate to alternative risk transfer entities?

The revised criteria procedure includes revised language to provide clarity on Letters of Credit eligible for consideration as equity credit in the calculation of available capital.

11) What other additional revisions were made to the criteria procedure?

Additional edits were made throughout the criteria procedure to add clarity around the application and use of Rating Captives and Other Alternative Risk Transfer Entities.