Insurance Market Briefing - Europe

14:00 GMT (15:00 CET)

11 November 2020

Mahesh Mistry
Senior Director
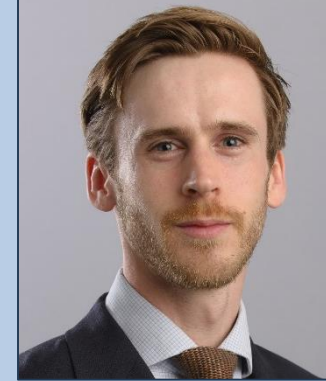Credit Rating Criteria, Research & Analytics

Ghislain Le Cam
Director
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Anthony Silverman
Director
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Michael Dunckley
Associate Director
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Valeria Ermakova
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Alex Rafferty
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Pierre Tournier
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Victoria Ohorodnyk
Associate Director
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Agenda

14:00 Introduction & Best's Credit Rating Methodology: Reflections on Emerging Industry Issues
Mahesh Mistry, Senior Director, Credit Rating Criteria Research & Analytics (Session Chair throughout)

14:05 Innovation
Speakers
Valeria Ermakova, Associate Director, Analytics
Victoria Ohorodnyk, Associate Director, Analytics

14:25 Environmental Social Governance (ESG)
Speakers
Jessica Botelho-Young, Associate Director, Analytics
Michael Dunckley, Associate Director, Analytics

14:45 IFRS 17
Speakers
Anthony Silverman, Director - Credit Rating Criteria, Research & Analytics
Pierre Tournier, Associate Director, Analytics

15:05 Lessons Learnt from COVID-19: Enterprise Risk Management Observations and Importance of Stress Testing
Speakers
Ghislain Le Cam, Director, Analytics
Alex Rafferty, Associate Director, Analytics

15:25 Q&A

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Disclaimer

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No part of this presentation amounts to sales / marketing activity and AM Best's Rating Division employees are prohibited from participating in commercial discussions.

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

Best's Credit Rating Methodology - Reflections on Emerging Industry Issues

Mahesh Mistry, Senior Director,
Credit Rating Criteria, Research & Analytics

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Discussion Topics

Innovation

Environmental Social Governance (ESG)

IFRS 17

Lessons Learnt from COVID-19

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Innovation

Valeria Ermakova, Associate Director, Analytics
Victoria Ohorodnyk, Associate Director, Analytics

Scoring and Assessing Innovation: Input & Output Score

Leadership	**Resources**	**Culture**	**Processes and Structure**
	Results	**Level of Transformation**	

Input Score = **Leadership** + **Culture** + **Resources** + **Processes and Structure**

Output Score **= 2 × (Results + Level of Transformation)**

Innovation Score = Input Score + Output Score

Scoring and Assessing Innovation: Five Possible Assessments of Innovation Capability

Minimal
- Score of less than 12

Moderate
- Score between 12 and 17

Significant
- Score between 18 and 22

Prominent
- Score between 23 and 27

Leader
- Score of 28 or higher
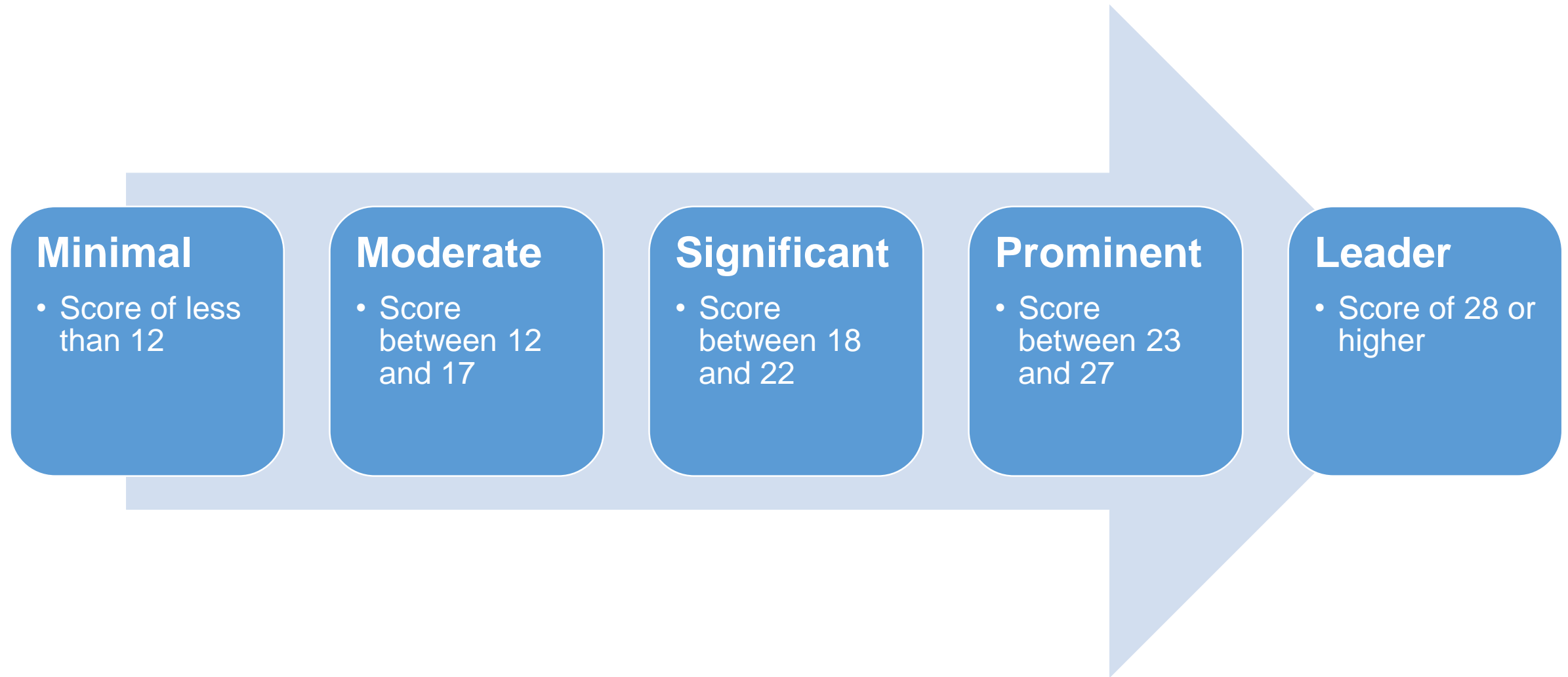
BCRM Building Blocks: Innovation - Part of Business Profile

Country Risk

| Balance Sheet Strength\n\nBaseline | Operating Performance\n\n(+2/-3) | Business Profile\n\n(+2/-2) | Enterprise Risk Management\n\n(+1/-4) | Comprehensive Adjustment\n\n(+1/-1) | Rating Lift/Drag | Issuer Credit Rating |
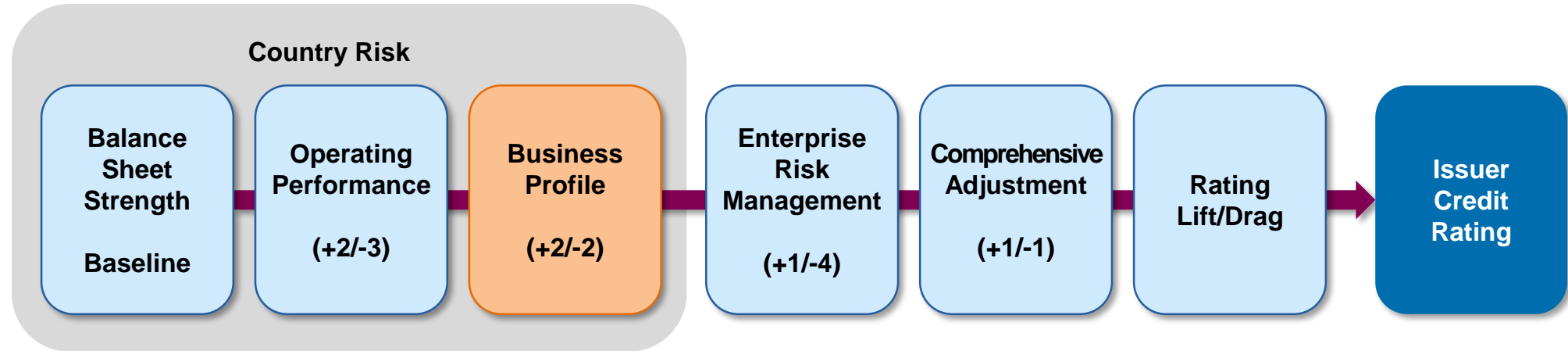
Business Profile Components

• **Market Position**	• **Management Quality**
• **Pricing Sophistication & Data Quality**	• **Regulatory, Event, and Country Risks**
• **Product Risk**	• **Distribution Channels**
• **Degree of Competition**	• **Product/Geographic Concentration**
• **Innovation**	

Innovation Output: 1 to 4 for each component. Total score is doubled

$$\text{Output score} = 2 \times \left[\boxed{\textbf{Results}} \quad \boxed{\textbf{Level of Transformation}} \right]$$

COVID-19 and Insurance Innovation

Challenges	Opportunities
Economic recession	Push to enhance customer experience
Decline in premium volumes	Cost reduction through digital solutions
Operational disruptions	New product design
Market volatility	Sales productivity
Underwriting losses	Underwriting efficiency
Innovation projects postponed	Automated claims processing
	Cultural shifts

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Environmental Social Governance (ESG)

Michael Dunckley, Associate Director, Analytics
Jessica Botelho-Young, Associate Director, Analytics

ESG within the BCRM

Balance Sheet Strength	Operating Performance	Business Profile	Enterprise Risk Management
• Climate risk • ESG integration in investing activities • Stranded assets	• Social inflation • ESG-related litigation • ESG integration	• Underwriting exclusions • Changing demographics • Data privacy • Reputational risk	• Corporate governance • Stress testing • Financial and non-financial risks

ESG Rating Factors

1 Natural catastrophe or weather-related events (including the stress testing capabilities and non-modelled risks) are the key elements leading to the credit rating action

2 Other environmental risks (including transitional and liability risks) are the key elements leading to the credit rating action

3 Change in investment composition and/or investment financial performance due to integration of environmental or social factors are the key elements leading to the credit rating action

4 Change in product composition and/or financial performance due to integration of environmental or social factors are the key elements leading to the credit rating action

5 Reputational risks stemming from environmental, social or governance factors are the key elements leading to the credit rating action

6 Governance factors are the key elements leading to the credit rating action

Recent Market Developments

Europe

- Banks and insurers in France to undergo climate risk stress tests [2020]

- Bank of England plans to test the UK financial system's resilience to climate change [2021]

- European Commission consultation paper on the renewed sustainable finance strategy

Middle East

- UAE environment ministry and Insurance Authority form plan to help insurers deal with climate change

- Dubai financial authorities publish guiding principles on sustainable finance

North America

- NAIC establishes a Climate Risk and Resilience Working Group

- Department of Financial Services hired its first Director of Sustainability & Climate Initiatives

- NYC comptroller urges insurers to divest from coal

Asia Pacific

- Australia's prudential regulator to develop industry guidance on climate-related financial risks

- Monetary Authority of Singapore consultation paper on its Guidelines on Environmental Risk Management for Insurers [2021]

Recent Market Developments

Climate stress tests	Increase in sustainability / green bond issuance
Introduction of climate stress tests by French central bank for banks and insurers	2020: Munich Re EUR 1.25 billion green bond
	2020: Unipol EUR 750 million green bond
Introduction of climate stress tests by PRA and ACP for life and non-life companies	2020: Metlife USD 750 million green bond
	2019: Generali EUR 600 million green bond
EIOPA published consultation on the use of climate change risk scenarios in ORSA	2019: CNP Assurances EUR 750 million green bond
	2019: Sun Life CAD 750 million sustainability bond
	2018: Manulife CAD 600 million green bond

Coal debate continues

IFRS 17

Anthony Silverman, Director,
Credit Rating Criteria, Research & Analytics
Pierre Tournier, Associate Director, Analytics

2020 Amendments

Effective Date

- January 2023 – some will go later

Deferred Acquisition Costs

- DAC, but not as we know it
- Will be spread over renewals/future business
- Two acquisition cost amounts in balance sheet – amount to be amortised over existing contracts, and "DAC"

Profit Recognition

- Various matching provisions for reinsurance, derivatives

CSM amortised over investment service

Resolved, or not?

- Annual cohorts for VFA

EFRAG
European Financial Reporting Advisory Group

EFRAG's Draft Letter to the European Commission Regarding Endorsement of IFRS 17 *Insurance Contracts* as amended in June 2020

John Berrigan
Director Genera
European Comm
1049 Brussels

30 September 2

Dear Mr Berriga

UK Endorsement Board
Technical Advisory Group on IFRS 17 *Insurance Contracts*

Purpose

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IFRS 17

Insurance Contracts

In March 2004 the International Accounting Standards Board (Board) issued IFRS 4 *Insurance Contracts*. IFRS 4 was an interim standard which was meant to be in place until the Board completed its project on insurance contracts. IFRS 4 permitted entities to use a wide variety of accounting practices for insurance contracts, reflecting national accounting requirements and variations of those requirements, subject to limited improvements and specified disclosures.

In May 2017, the Board completed its project on insurance contracts with the issuance of IFRS 17 *Insurance Contracts*. IFRS 17 replaces IFRS 4 and sets out principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of IFRS 17.

In June 2020, the Board issued *Amendments to IFRS 17*. The objective of the amendments is to assist entities implementing the Standard, while not unduly disrupting implementation or diminishing the usefulness of the information provided by applying IFRS 17.

Other Standards have made minor consequential amendments to IFRS 17, including *Amendments to References to the Conceptual Framework in IFRS Standards* (issued March 2018) and *Definition of Material* (Amendments to IAS 1 and IAS 8) (issued October 2018).

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AM Best and IFRS 17

Organise Data Gathering

AMB already ahead on this, with caveat that it is on basis of current view of disclosure

Sort Data for BCAR

Follows directly from data gathering

Treatment of CSM, RA

KPIs and their Calculation

Work currently ongoing

Criteria, Credit Reports

Benchmarking

When data available
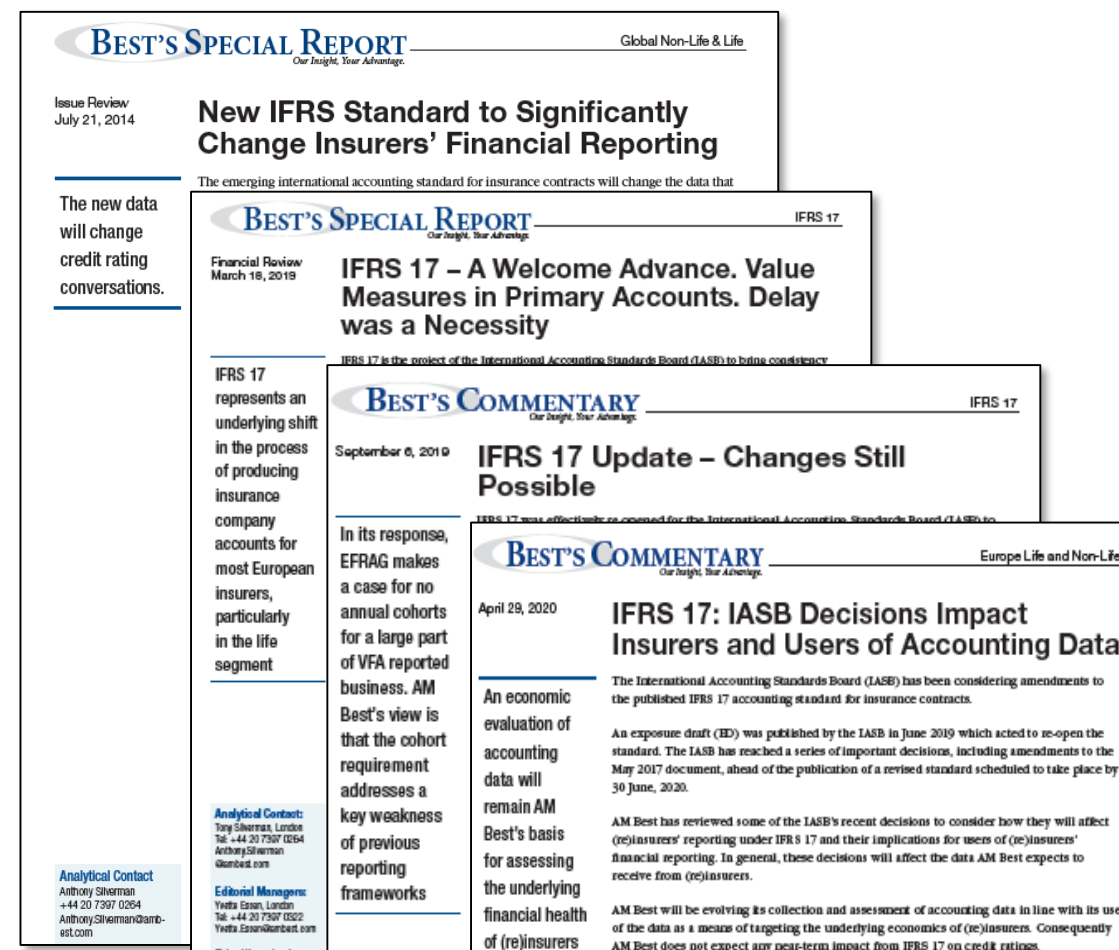
Some Consequences

Final shape of reporting yet to emerge

Near-term rating changes not expected, nevertheless:

- **Consistency**
  - Global groups
  - US activities of IFRS reporters will be under IFRS 17

- **KPIs, Capital Adjustments**
  - Less use of supplementary or regulatory reporting in life
  - Cohort data in life?
  - Combined ratios continue, but some changes
  - Product CoR comparisons likely to change with discounting

- **Impact of Run-off Deals**
  - P&L impact will change

- **The investment return conversation will evolve**

IFRS 17 Project Status, July 2020
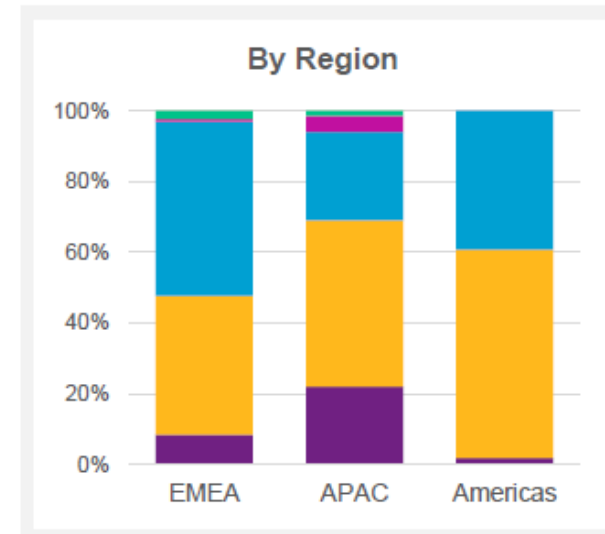
Source: Willis Towers Watson survey

- Not answered
- Finished
- More than halfway through
- Less than halfway through
- Not started

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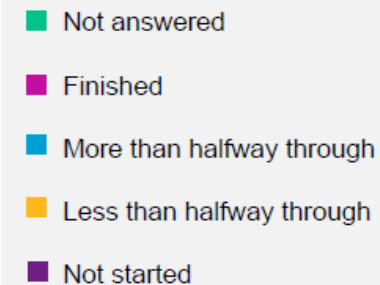
Challenges Facing Insurers

Internal

- Increased Granularity
- Consolidation
- Data
- Modelling
- Balance Sheet Volatility
- Uncertain Timing
- Increased Analysis

External

- Education
- Financial sensitivities
- Treatment of inforce
- Consolidation of subsidiaries
- ALM Program
- Changes to Business
- Comparison to Peers

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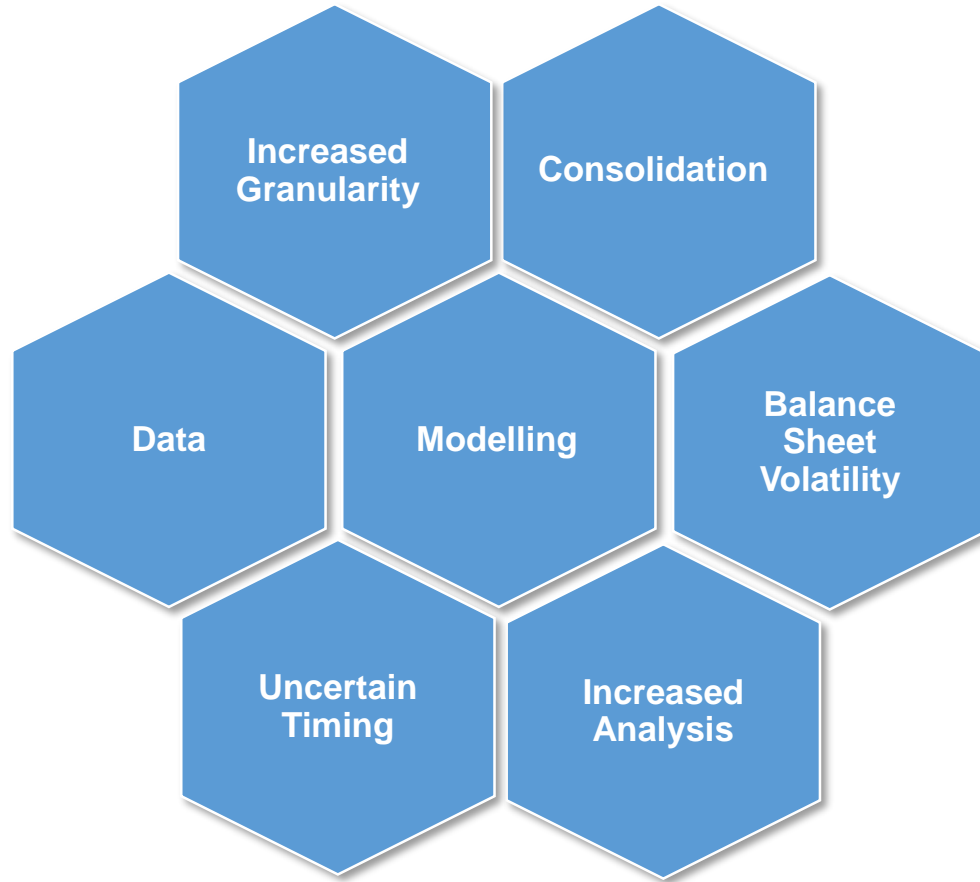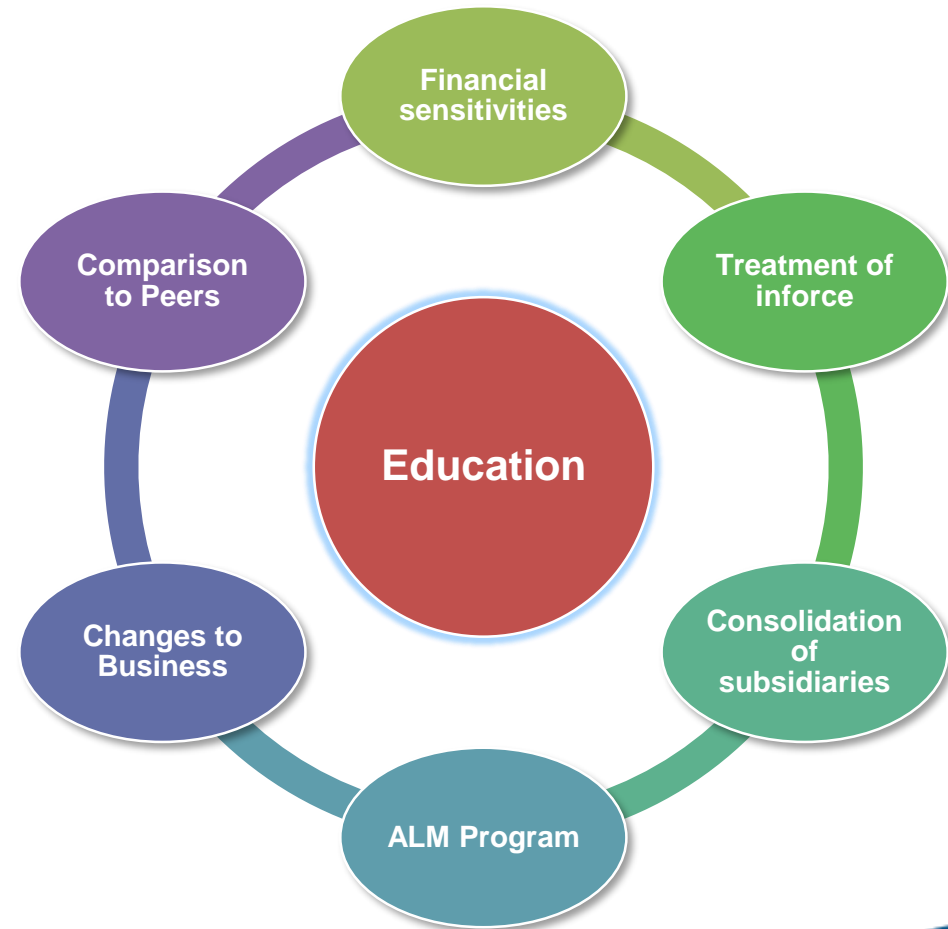
Impact on AM Best-rated Companies

Limited impact on ratings expected as a consequence of change in presentation

Insurers outside the US more likely to be affected

International subsidiaries will be affected if the group reports under IFRS

Some regulators are moving to IFRS, others are deferring implementation

Distribution of insurers reporting under IFRS
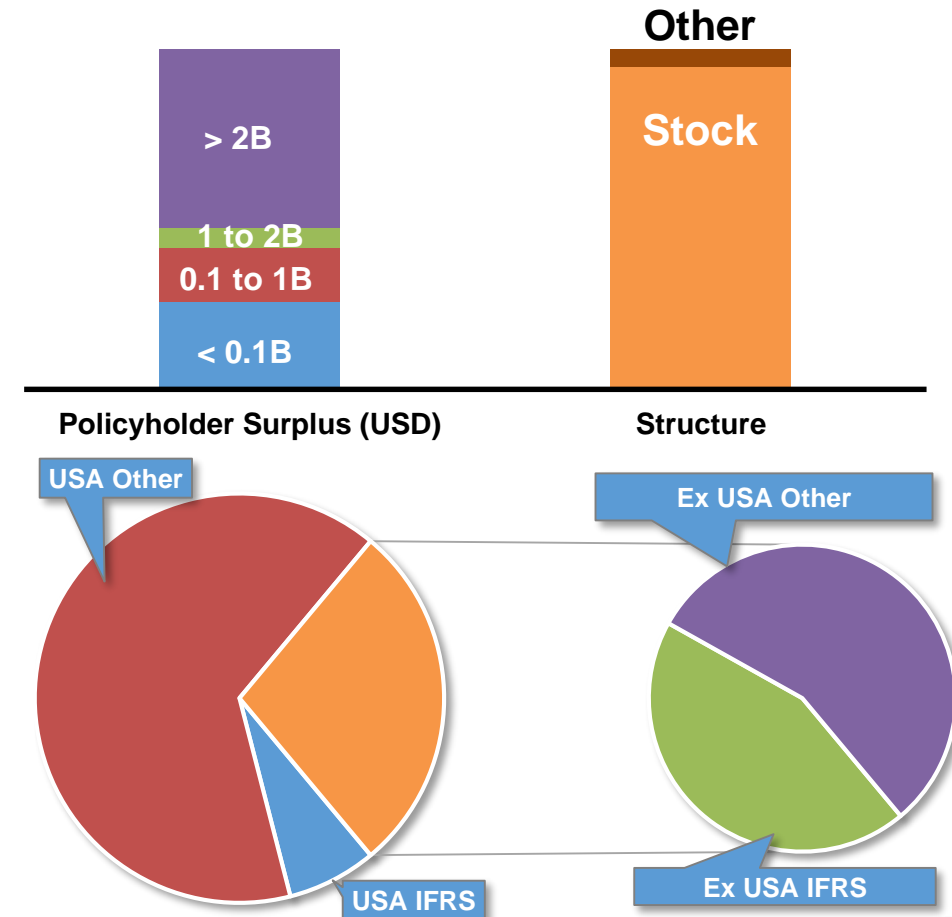
Other

Stock

> 2B

1 to 2B

0.1 to 1B

< 0.1B

Policyholder Surplus (USD)

Structure

USA Other

Ex USA Other

USA IFRS

Ex USA IFRS

Lessons Learnt from COVID-19: Enterprise Risk Management Observations and Importance of Stress Testing

Ghislain Le Cam, Director, Analytics
Alex Rafferty, Associate Director, Analytics

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Market Events Helped to Shape ERM Development

Timeline (top events):

- European Storm Kyrill
- Hurricanes Gustav & Ike
- Floods in Australia / New Zealand EQ / Japan EQ / Tsunami
- European & Alberta Floods
- Italian Earthquakes
- California Wildfires
- Fires in Southern CA
- Single Large Losses
- Mexico Earthquakes
- Hurricane Michael
- Australian Bushfires
- European Storm Klaus
- Thai Floods
- German Hailstorms
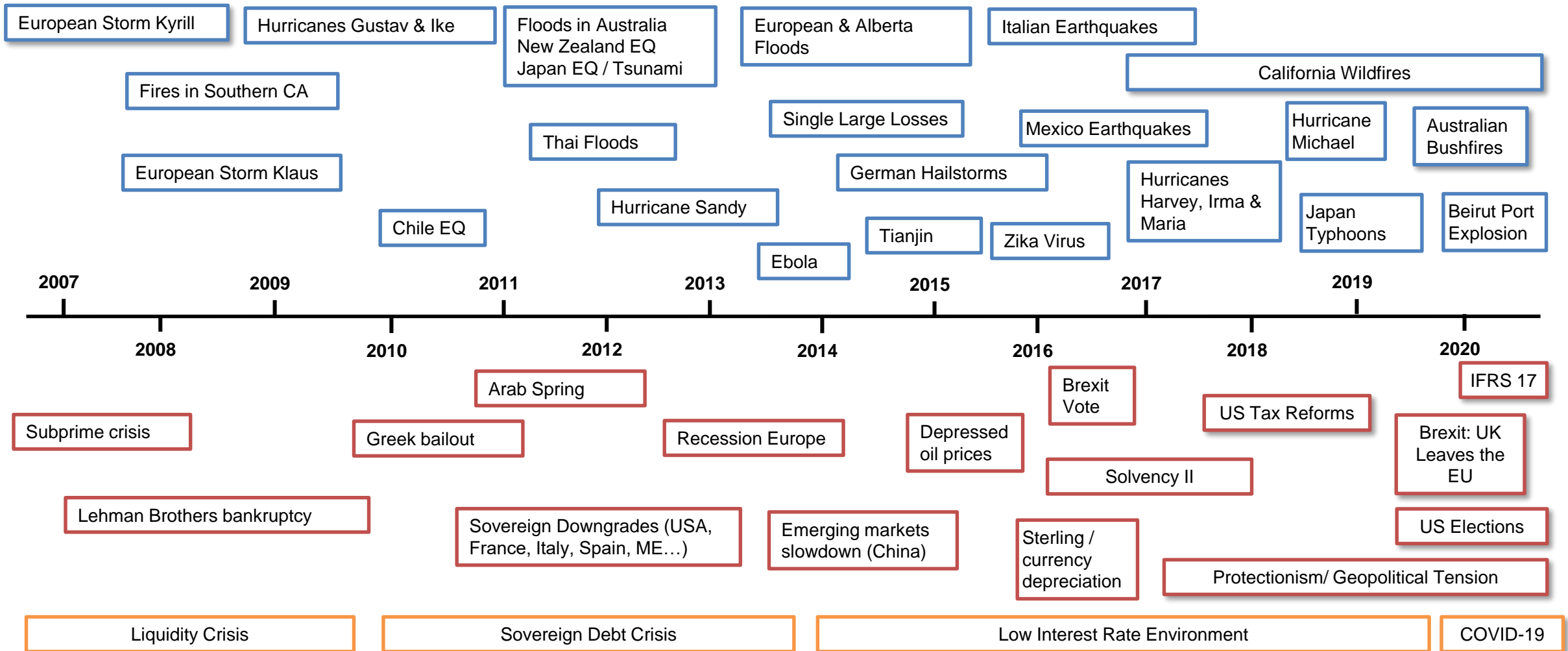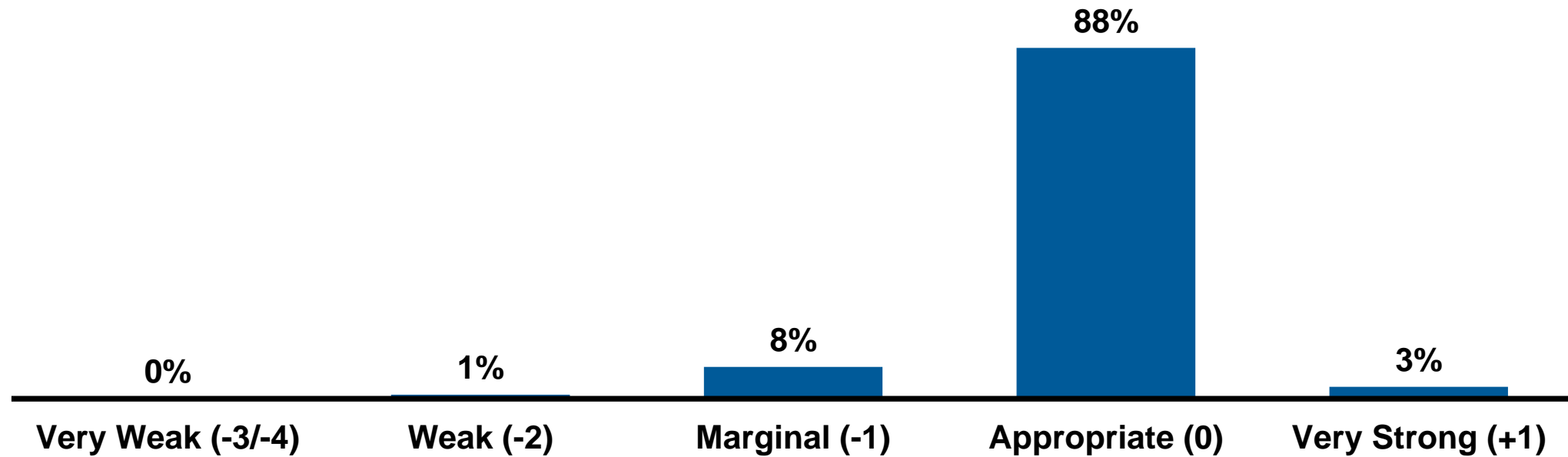- Hurricanes Harvey, Irma & Maria
- Japan Typhoons
- Beirut Port Explosion
- Hurricane Sandy
- Chile EQ
- Tianjin
- Zika Virus
- Ebola

Timeline axis: 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020

Timeline (bottom events):

- Subprime crisis
- Lehman Brothers bankruptcy
- Arab Spring
- Greek bailout
- Sovereign Downgrades (USA, France, Italy, Spain, ME…)
- Recession Europe
- Emerging markets slowdown (China)
- Depressed oil prices
- Brexit Vote
- Solvency II
- Sterling / currency depreciation
- US Tax Reforms
- Protectionism/ Geopolitical Tension
- IFRS 17
- Brexit: UK Leaves the EU
- US Elections

Banner rows:

- Liquidity Crisis
- Sovereign Debt Crisis
- Low Interest Rate Environment
- COVID-19

AM Best ERM Assessment

ERM Assessment Distribution – 2019

0%	1%	8%	88%	3%

Very Weak (-3/-4)   Weak (-2)   Marginal (-1)   Appropriate (0)   Very Strong (+1)

Note:
AM Best 2019 data as at 31 December 2019

Stress Testing – Weakest Framework Assessment

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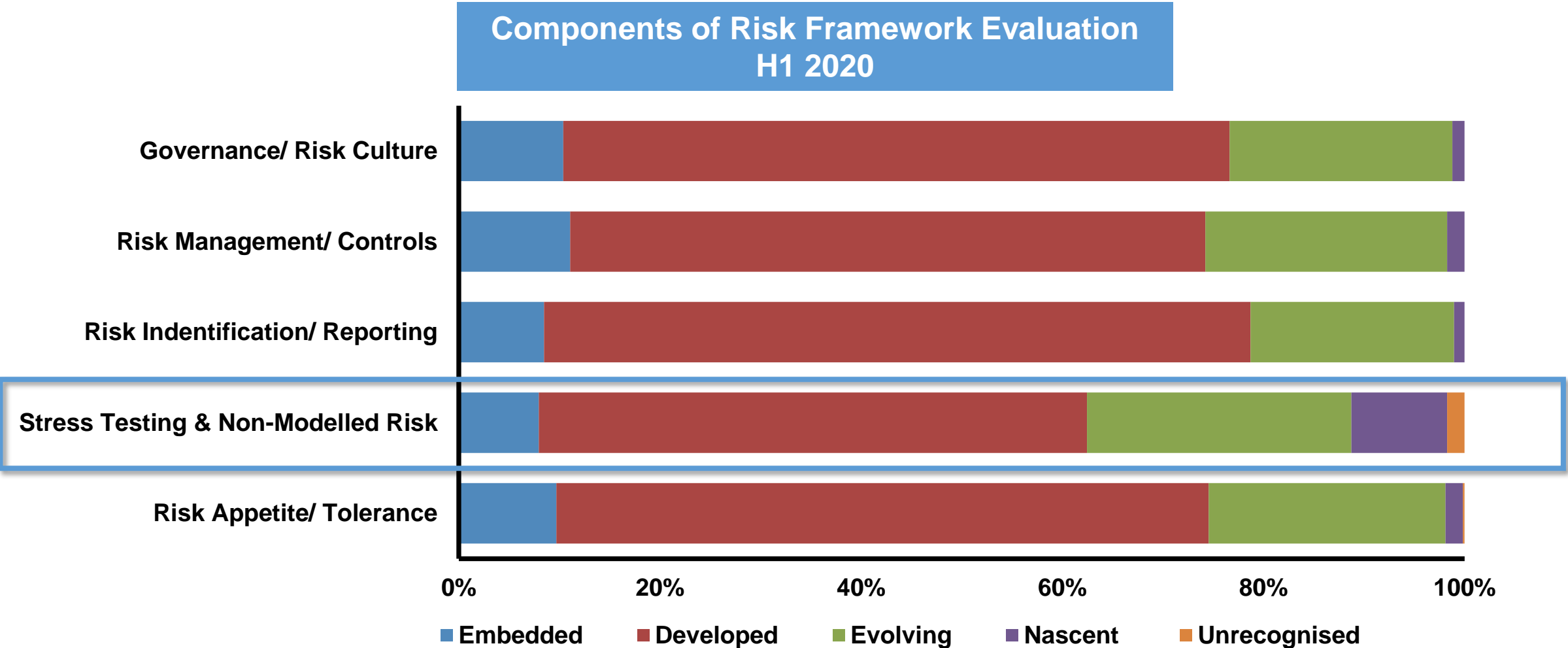
COVID-19 – ERM Themes Raised by the Pandemic

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Q&A

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Analytics

Upcoming Events

Environmental, Social, and Governance in
the (Re)Insurance Market - What's Considered?
Tuesday, November 17, 2020 at 2 PM GMT

Richard Banks
Director,
Industry Research

Jessica Botelho-Young
Associate Director,
Analytics

Ghislain Le Cam
Director,
Analytics

Maura McGuigan
Director,
Credit Rating Criteria

Please join senior AM Best analysts as they discuss key takeaways from the results of our recently conducted Environmental Social & Governance (ESG) survey, modifications to the Best Credit Rating Methodology relating to ESG factors, and key implications of ESG adoption for the insurance industry.

REGISTER HERE

Wednesday 20 October 2021

**AM Best's Insurance Market Briefing – Europe
Venue: etc.venues, St. Paul's**
Insurance Market Briefing: 08:30-13:00 GMT
Methodology Review Seminar: 14:00-16:00 GMT

More information to follow: www.ambest.com/conferences

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Insurance Market Briefing - Europe

11 November 2020