

# **AM Best's Methodology Review Seminar**

**12 November 2019**

etc.venues, London



# Agenda: Methodology Review Seminar

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## **14:25 Welcome & Introduction**

*Carlos Wong-Fupuy  
Senior Director*

## **14:30 Best's Credit Rating Methodology (BCRM): Benchmarking Review**

*Mahesh Mistry, Senior Director, Analytics  
Jalpa Thanky, Senior Financial Analyst*

## **15:00 Best's Credit Rating Methodology (BCRM) in an Evolving Landscape Stress-Testing & Non-Modelled Risks • ESG • Innovation • IFRS 17**

*Carlos Wong-Fupuy, Senior Director  
Jessica Botelho-Young,  
Senior Financial Analyst  
Valeria Ermakova,  
Senior Financial Analyst  
Anthony Silverman, Associate Director*

## **15:45 Q&A Interactive Discussion**

## **16:30 Close**



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# **Best's Credit Rating Methodology (BCRM): Benchmarking Review**

**Mahesh Mistry**

**Senior Director, Analytics**

**Jalpa Thanky**

**Senior Financial Analyst**

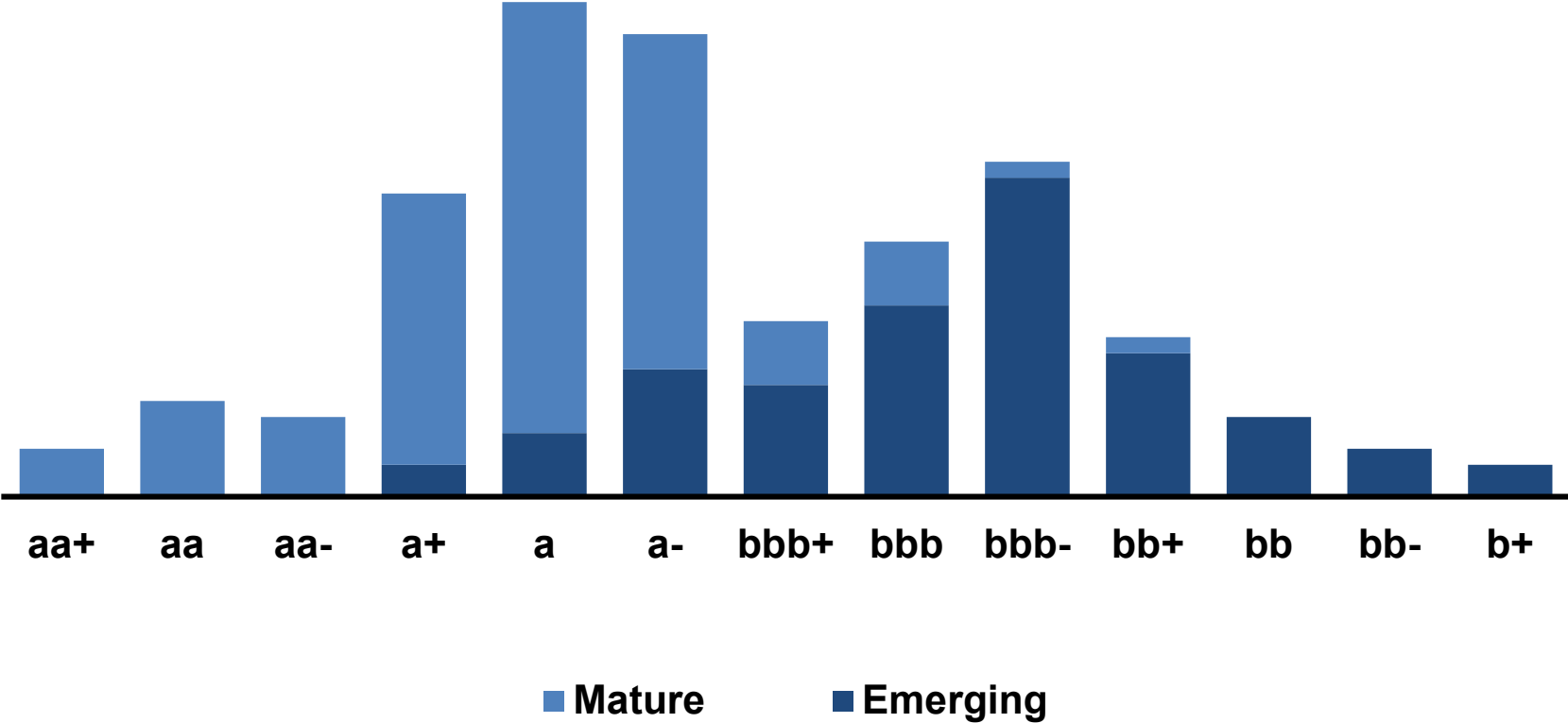


# Issuer Credit Ratings (ICR) and Financial Strength Ratings (FSR)

| Long-Term ICR | FSR |
|---------------|-----|
| aaa<br>aa+    | A++ |
| aa<br>aa-     | A+  |
| a+<br>a       | A   |
| a-            | A-  |
| bbb+<br>bbb   | B++ |
| bbb-          | B+  |

| Long-Term ICR | FSR |
|---------------|-----|
| bb+<br>bb     | B   |
| bb-           | B-  |
| b+<br>b       | C++ |
| b-            | C+  |
| ccc+<br>ccc   | C   |
| ccc-<br>cc    | C-  |

# Issuer Credit Ratings: Overview

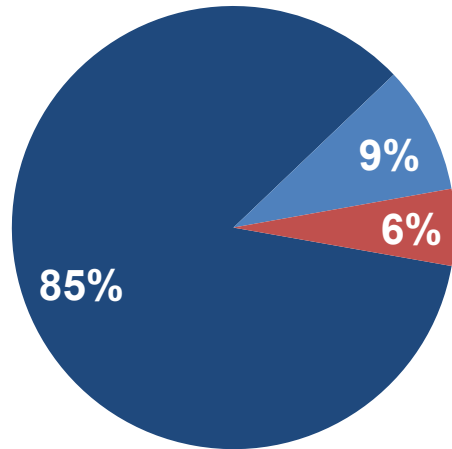


\*Analysis is performed at rating unit level



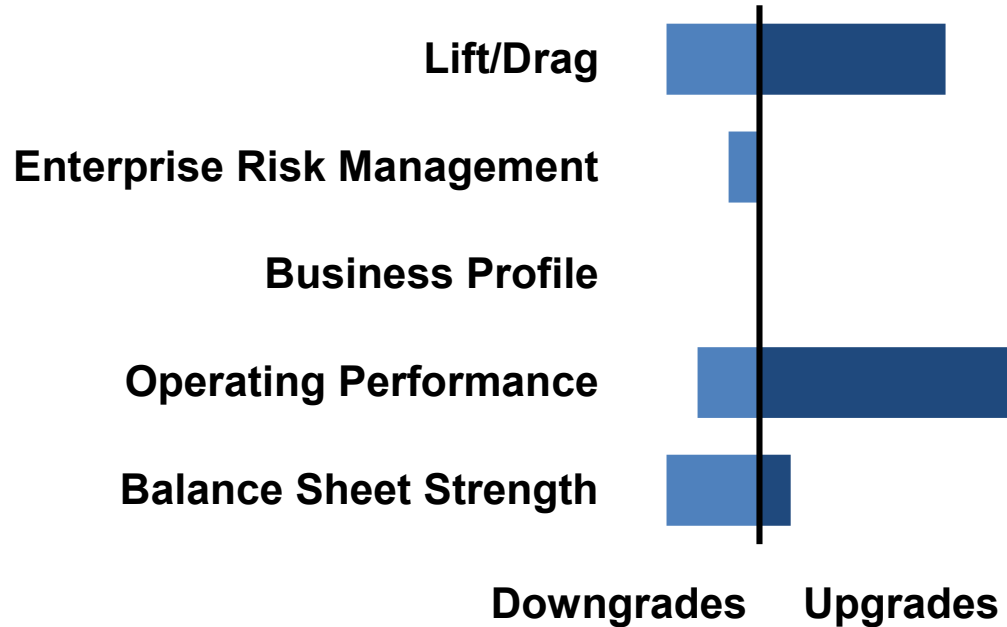
# Drivers of Rating Upgrades & Downgrades

## Overall Rating Movements



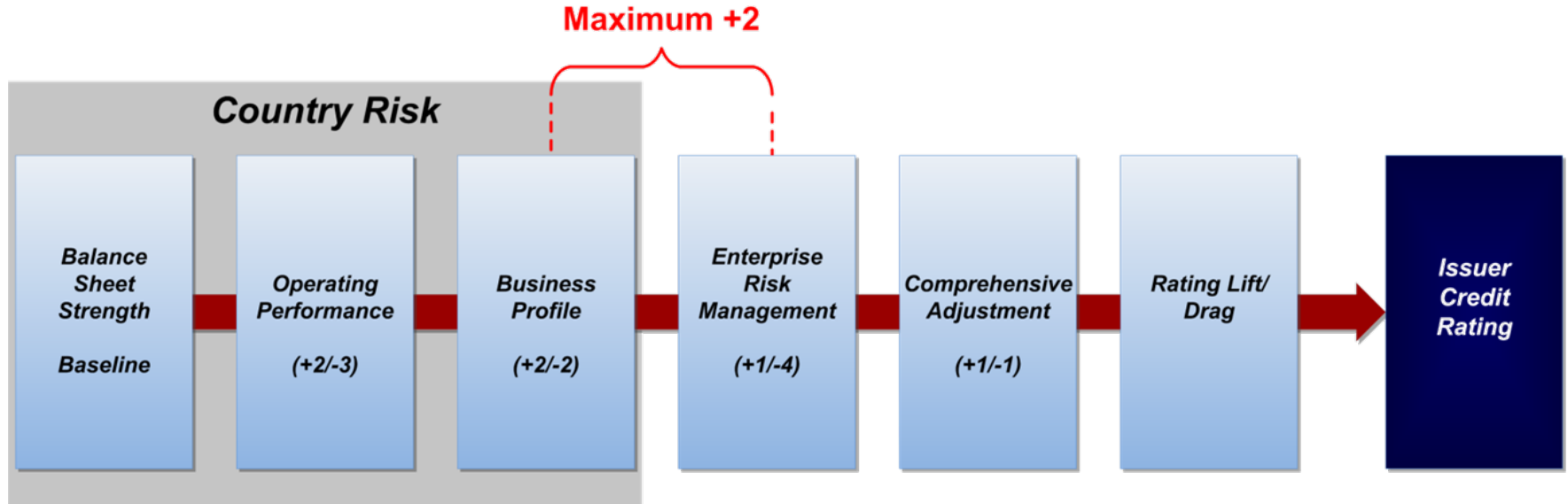
■ Affirmation  
■ Upgrade  
■ Downgrade

## Upgrades & Downgrades by Building Block





# AM Best's Rating Process: Recap

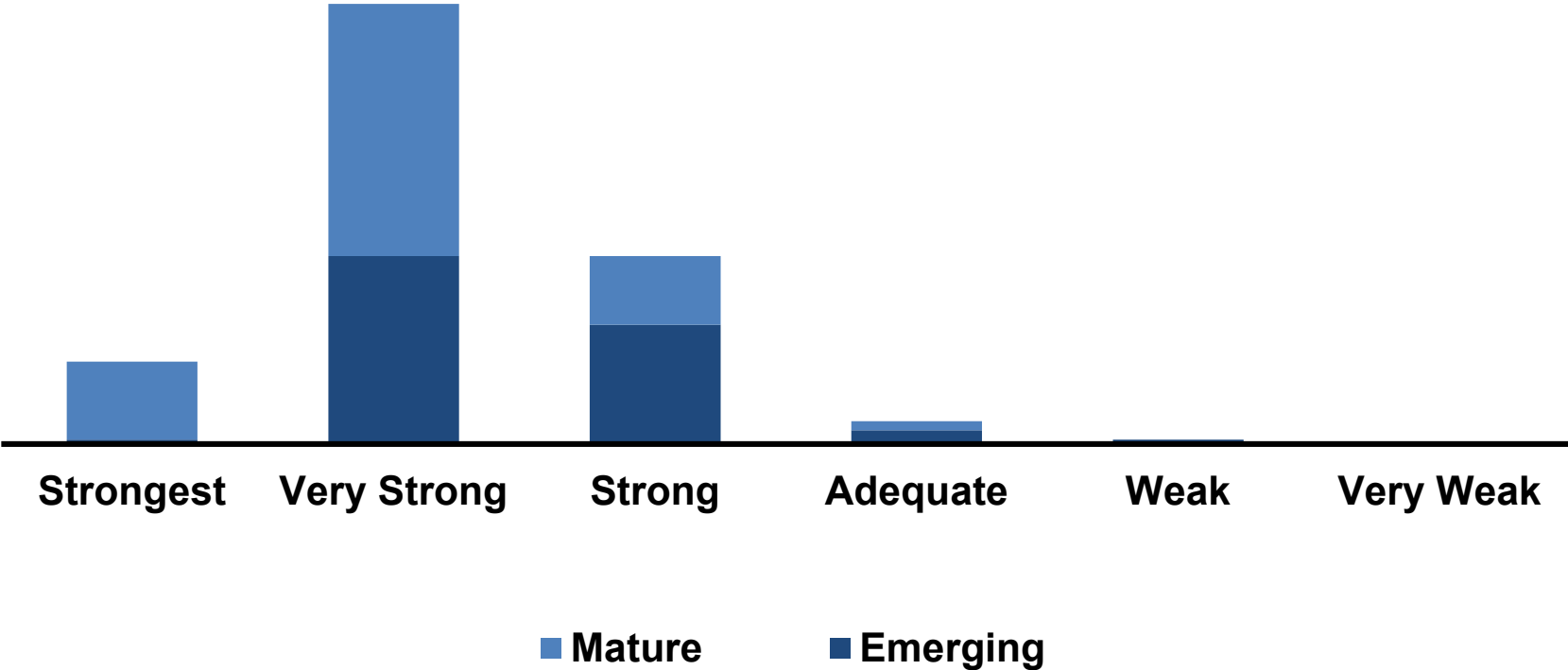


# AM Best's Rating Process: Recap

| <div>Balance Sheet Strength</div> <div>Baseline</div> | <div>Operating Performance</div> <div>(+2/-3)</div> | <div>Business Profile</div> <div>(+2/-2)</div> | <div>Enterprise Risk Management</div> <div>(+1/-4)</div> |
|---|---|--|--|
| Assessment  | Assessment  | Assessment                                     | Assessment   |
| Strongest   | Very Strong +2                                      | Very Favourable +2                             | Very Strong +1   |
| Very Strong   | Strong +1   | Favourable +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  |  |  |



# Balance Sheet Strength: Distribution of Assessments



■ Mature ■ Emerging



# Balance Sheet Strength: The Baseline Assessment

## Overall Balance Sheet Strength Assessment

| Combined Balance Sheet Assessment<br>(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      |
|   | Very Strong       | a/a-          | a/a-          | a-/bbb+       | bbb+/bbb       | bbb/bbb-      |
|   | Strong            | a-/bbb+       | a-/bbb+       | bbb+/bbb/bbb- | bbb/bbb-/bb+   | bbb-/bb+/bb   |
|   | Adequate          | bbb+/bbb/bbb- | bbb+/bbb/bbb- | bbb-/bb+/bb   | bb+/bb/bb-     | bb/bb-/b+     |
|   | Weak              | bb+/bb/bb-    | bb+/bb/bb-    | bb-/b+/b      | b+/b/b-        | b/b-/ccc+     |
|   | Very Weak         | b+ and below  | b+ and below  | b- and below  | ccc+ and below | ccc and below |

# Best's Capital Adequacy Ratio (BCRM) Guidelines

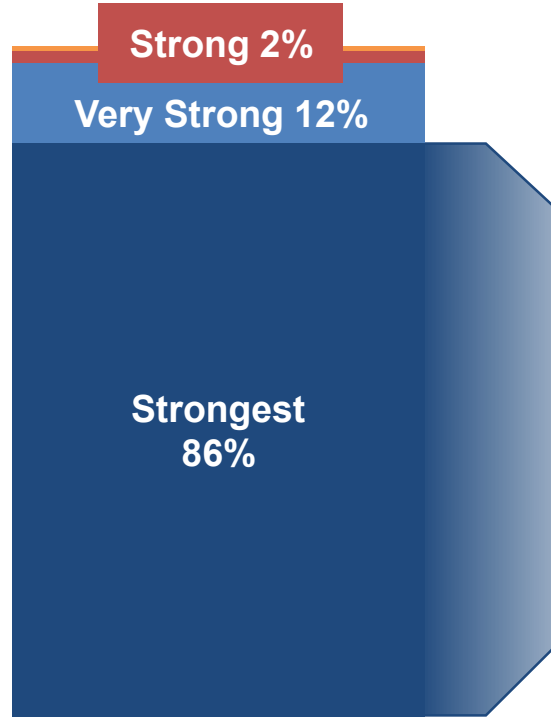
$$\text{BCAR} = \frac{(\text{Available Capital} - \text{Net Required Capital})}{\text{Available Capital}} \times 100$$

| VaR 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       |

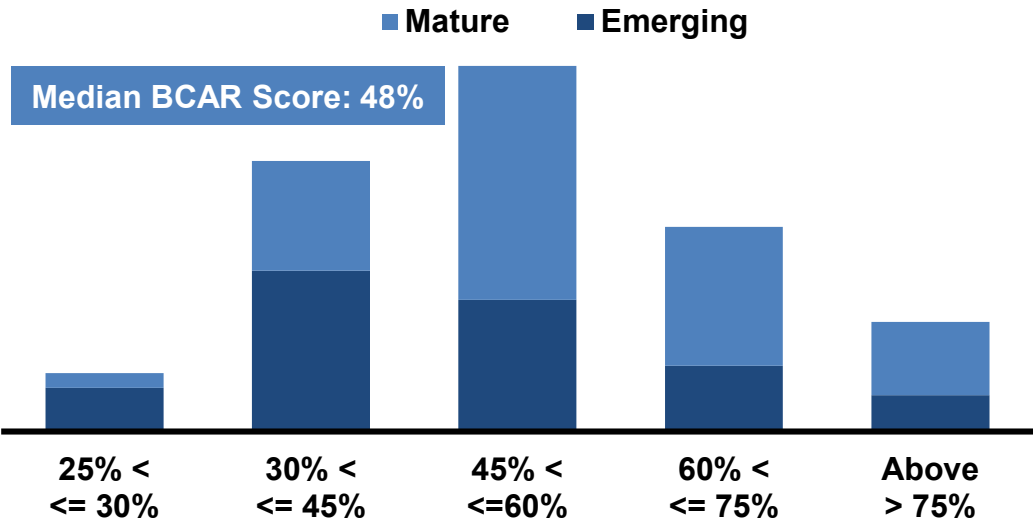
\* Companies with < 20 million USD in capital & surplus cannot score in strongest category

# BCAR: Assessment & Distribution

## BCAR Assessment



## Distribution of BCAR Scores @ 99.6% VaR within Strongest Category



# Balance Sheet Strength: Relationship of BCAR

| Mature  |             | Balance Sheet Strength |             |        |          |      |
|---------|-------------|------------------------|-------------|--------|----------|------|
| 2017-18 | Assessment  | Strongest              | Very Strong | Strong | Adequate | Weak |
| BCAR    | Strongest   | 16%                    | 61%         | 8%     | 1%       | -    |
|         | Very Strong | 3%                     | 4%          | 5%     | -        | -    |
|         | Strong      | -                      | -           | 1%     | -        | -    |
|         | Adequate    | -                      | -           | -      | 1%       | -    |
|         | Weak        | -                      | -           | -      | -        | -    |
|         | Very Weak   | -                      | -           | -      | -        | -    |

For both mature and emerging markets, most companies have a balance sheet strength assessment of “Very Strong”

| 2018-19 |             | Balance Sheet Strength |             |        |          |      |
|---------|-------------|------------------------|-------------|--------|----------|------|
|         | Assessment  | Strongest              | Very Strong | Strong | Adequate | Weak |
| BCAR    | Strongest   | 19%                    | 54%         | 15%    | -        | -    |
|         | Very Strong | -                      | 8%          | 2%     | 1%       | -    |
|         | Strong      | -                      | -           | -      | 1%       | -    |
|         | Adequate    | -                      | -           | -      | -        | -    |
|         | Weak        | -                      | -           | -      | -        | -    |
|         | Very Weak   | -                      | -           | -      | -        | -    |

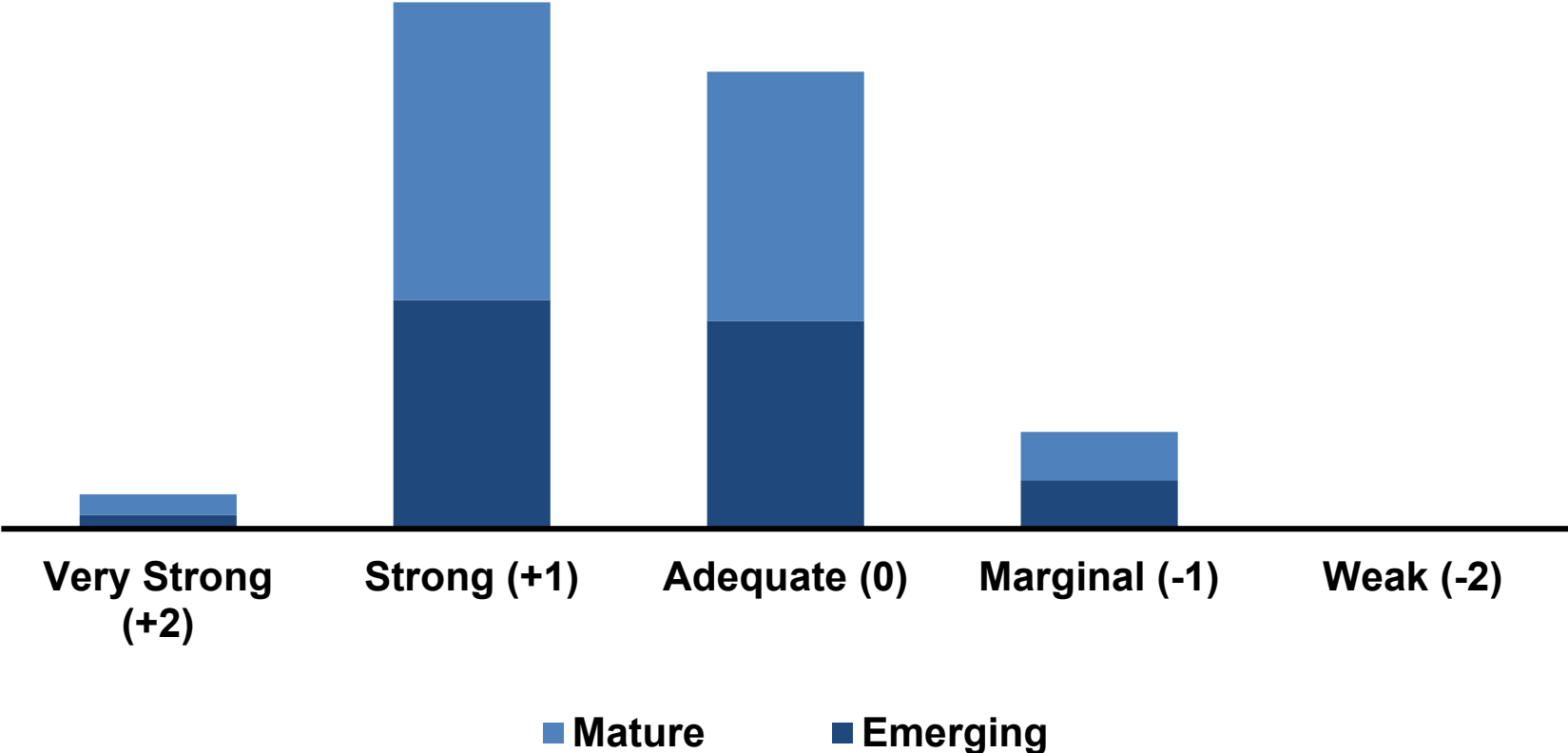
Over the surveillance period, there has been a slight deterioration in the balance sheet strength assessment

The BCAR is not the sole determinant of balance sheet strength

| Emerging |             | Balance Sheet Strength |             |        |          |      |
|----------|-------------|------------------------|-------------|--------|----------|------|
| 2017-18  | Assessment  | Strongest              | Very Strong | Strong | Adequate | Weak |
| BCAR     | Strongest   | 2%                     | 60%         | 20%    | -        | -    |
|          | Very Strong | -                      | 3%          | 11%    | -        | -    |
|          | Strong      | -                      | -           | 3%     | -        | -    |
|          | Adequate    | -                      | -           | -      | 2%       | -    |
|          | Weak        | -                      | -           | -      | -        | -    |
|          | Very Weak   | -                      | -           | -      | -        | -    |

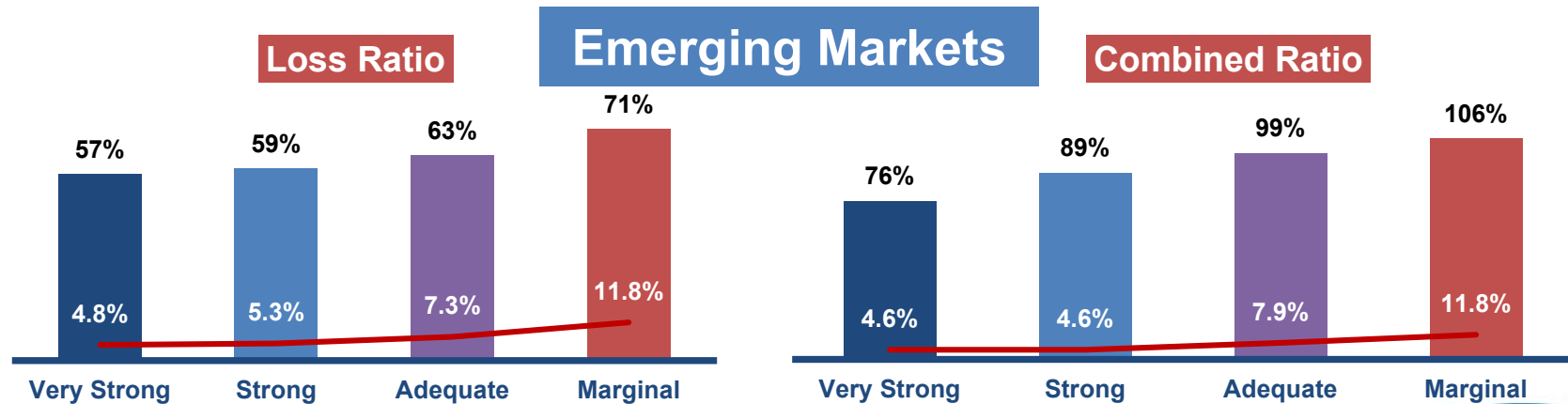
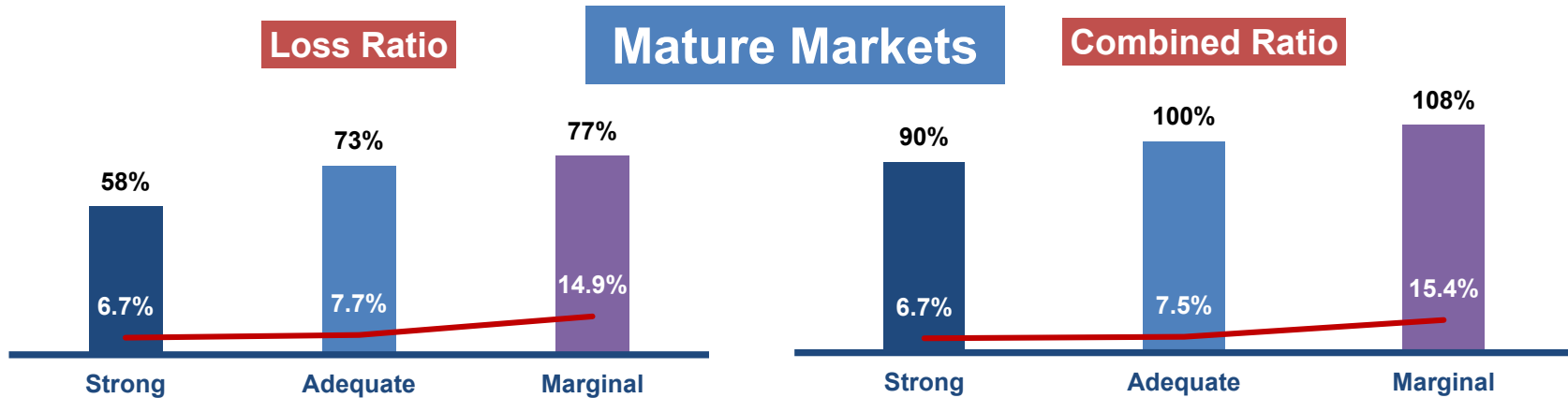
| 2018-19 |             | Balance Sheet Strength |             |        |          |      |
|---------|-------------|------------------------|-------------|--------|----------|------|
|         | Assessment  | Strongest              | Very Strong | Strong | Adequate | Weak |
| BCAR    | Strongest   | 1%                     | 57%         | 25%    | -        | -    |
|         | Very Strong | -                      | -           | 10%    | 3%       | -    |
|         | Strong      | -                      | -           | 1%     | 1%       | -    |
|         | Adequate    | -                      | -           | -      | -        | -    |
|         | Weak        | -                      | -           | -      | -        | -    |
|         | Very Weak   | -                      | -           | -      | -        | 1%   |

# Operating Performance: Distribution of Assessments



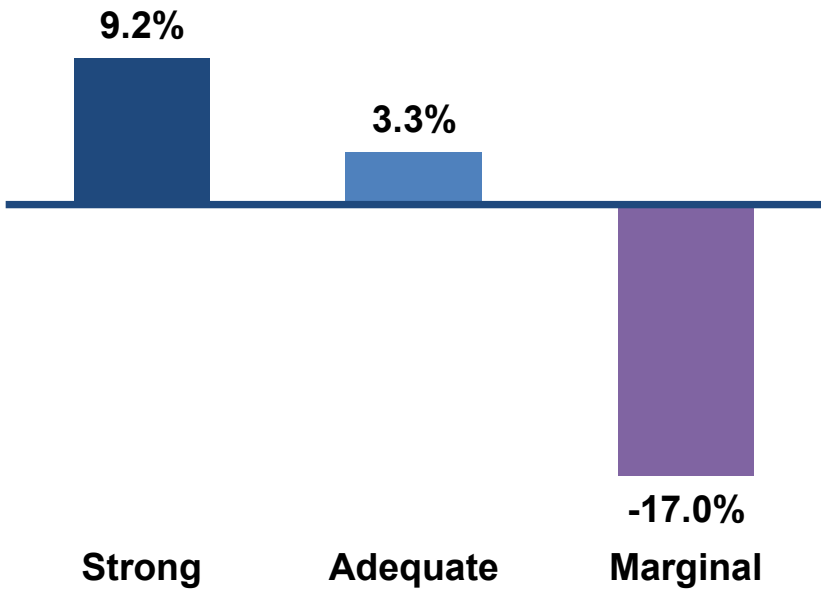


# Operating Performance (Five Year Average)

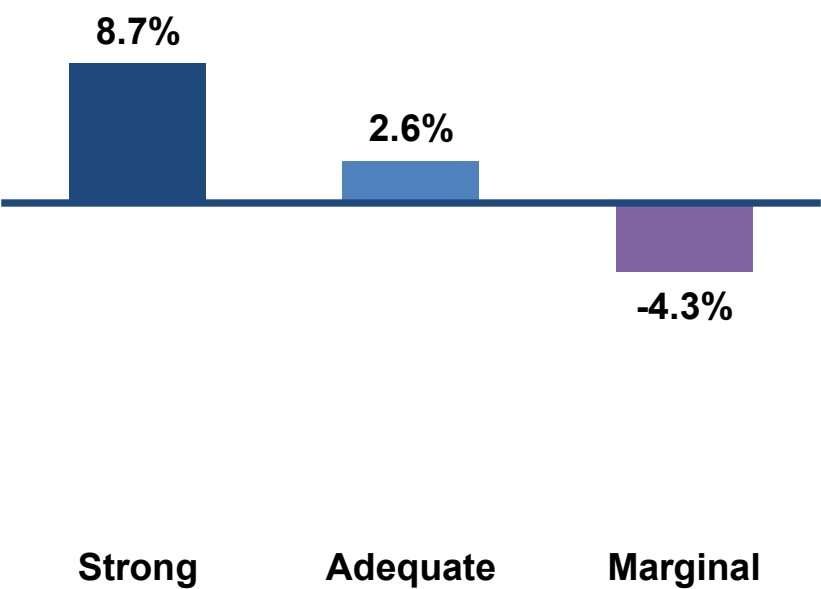


# Operating Performance

## Mature Markets – Five Year Average Real Return on Equity



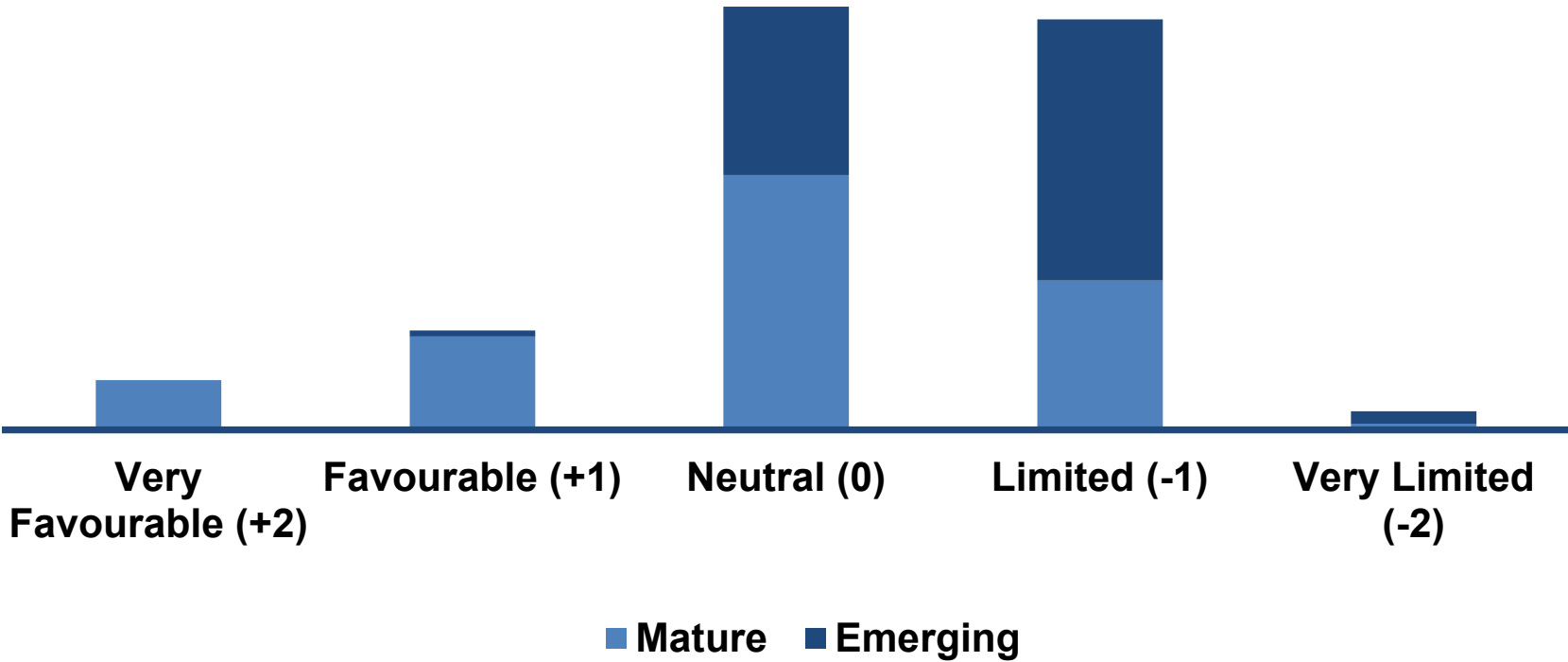
## Emerging Markets – Five Year Average Real Return on Equity



\* For mature markets, data on “Marginal” is skewed due to a small sample size  
\*\* Return On Equity adjusted for five-year average inflation



# Business Profile: Distribution of Assessments

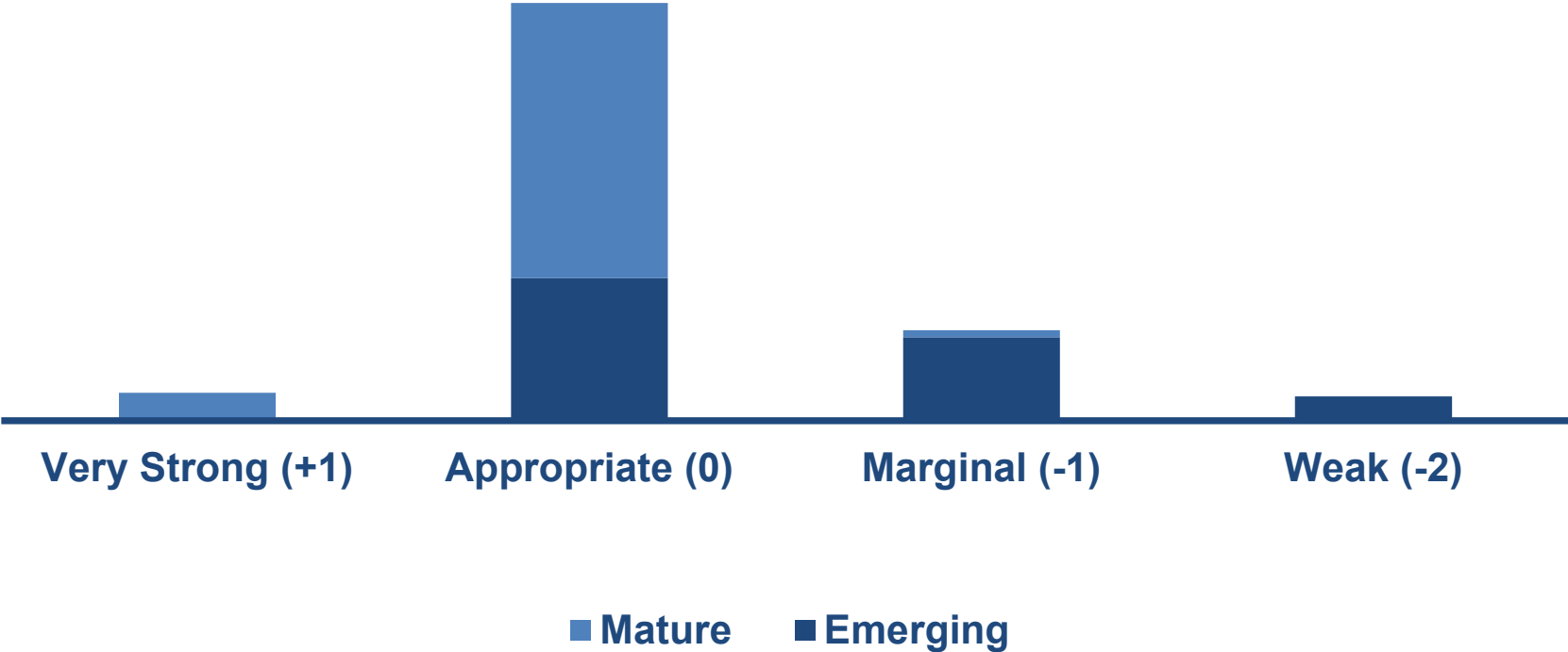


# Business Profile: General Characteristics

| Very Favourable  | Favourable  | Neutral   | Limited   |
|--|---|---|---|
| <p>Superior global franchise</p> <p>Excellent product &amp; geographical diversification</p> <p>Excellent access to business through multiple distribution channels</p> <p>Market leaders across key segments</p> <p>Pricing sophistication</p> <p>Core markets/products performing well</p> <p>Significant innovation</p> | <p>Leading position in a single market or niche segment</p> <p>Good product &amp; geographical diversification</p> <p>Strong access to markets through key distribution channels</p> <p>Extensive inhouse expertise</p> <p>Good data and pricing sophistication</p> <p>Core lines performing well</p> | <p>Strong market profile in a small market</p> <p>Limited size on global scale</p> <p>Narrow profile on net basis</p> <p>Some dependence on third parties</p> <p>High degree of competition</p> <p>Moderate economic/ political/regulatory risk</p> | <p>SME and monoline insurers</p> <p>Limited product &amp; geographical diversification</p> <p>Very limited profile on global scale</p> <p>Narrow profile on net basis</p> <p>High dependence on third parties</p> <p>High degree of competition</p> <p>High economic/ political/regulatory risk</p> <p>Limited innovation</p> |
| <p><b>Munich Re, Swiss Re, Allianz, Generali</b></p>   | <p><b>Covea, Atradius, Lloyd's, QBE</b></p>   | <p><b>ENI, Oman Ins, GIG, LocalTapiola</b></p>  | <p><b>Fortegra, Noor Takaful, EA Re</b></p>   |

# Enterprise Risk Management: Distribution of Assessments

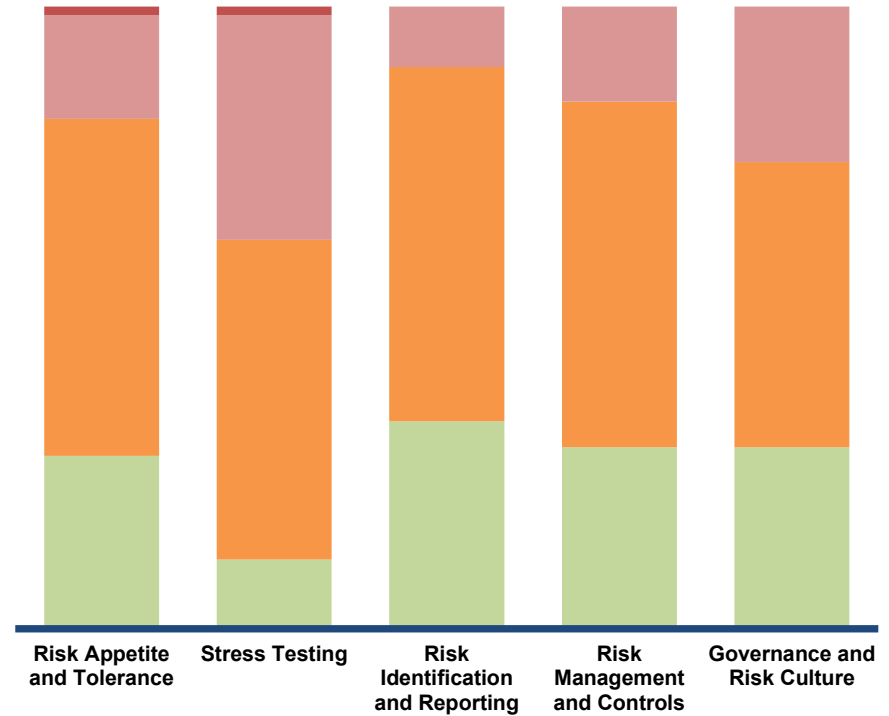
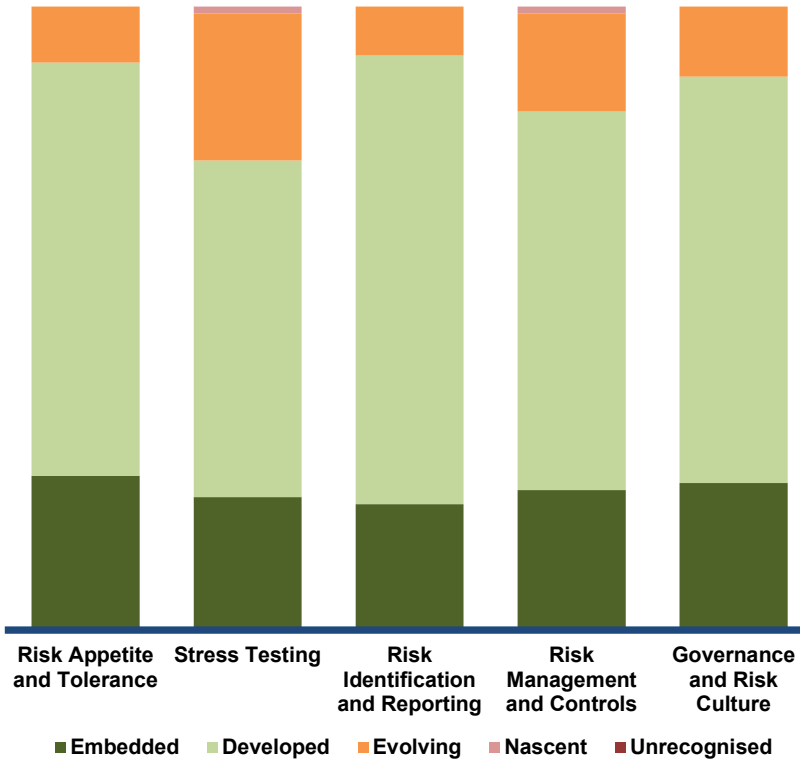
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# ERM: Risk Framework Evaluation

## Mature Markets

## Emerging Markets

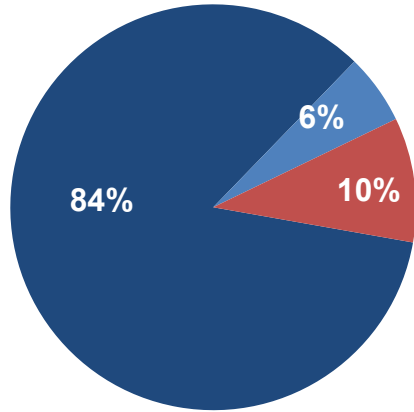


# ERM: General Characteristics

| Very Strong   | Appropriate   | Marginal  | Weak  |
|---|---|---|---|
| <p>Formalised risk appetite/tolerances</p> <p>Defined risk reporting roles/responsibilities</p> <p>Regular stress/scenario testing</p> <p>Superior risk control/monitoring procedures</p> <p>Horizon scanning</p> <p>Sophisticated inhouse modelling &amp; tools</p> <p>Fully embedded risk framework</p> <p>Strong governance &amp; risk culture</p> | <p>Defined risk appetite/tolerances</p> <p>Periodic stress/scenario testing</p> <p>Robust risk control/monitoring procedures</p> <p>Advanced inhouse modelling &amp; tools</p> <p>Risk framework partially utilised for strategic decision making</p> <p>Developing governance &amp; risk culture</p> | <p>Basic risk appetite/tolerances</p> <p>Evolving risk control/monitoring procedures</p> <p>No evidence of stress/scenario testing</p> <p>Some third-party reliance</p> <p>Little alignment between risk framework &amp; business strategy</p> <p>Emerging governance &amp; risk culture</p> <p>Moderate economic/political/regulatory risk</p> | <p>Indistinct risk appetite/tolerances</p> <p>History of ERM failures/regulatory breaches</p> <p>Extensive third-party reliance</p> <p>No alignment between risk framework &amp; business strategy</p> <p>Underdeveloped governance &amp; risk culture</p> <p>High economic/political/regulatory risk</p> |
| <p><b>Munich Re, Swiss Re, SCOR, Allianz</b></p>  | <p><b>Covea, Atradius, Lloyd's, QBE</b></p>   | <p><b>Arab Orient, Noor Takaful, EA Re</b></p>  | <p><b>Kenya Re, Ghana Re, Nomad Ins</b></p>   |

# Final Remarks

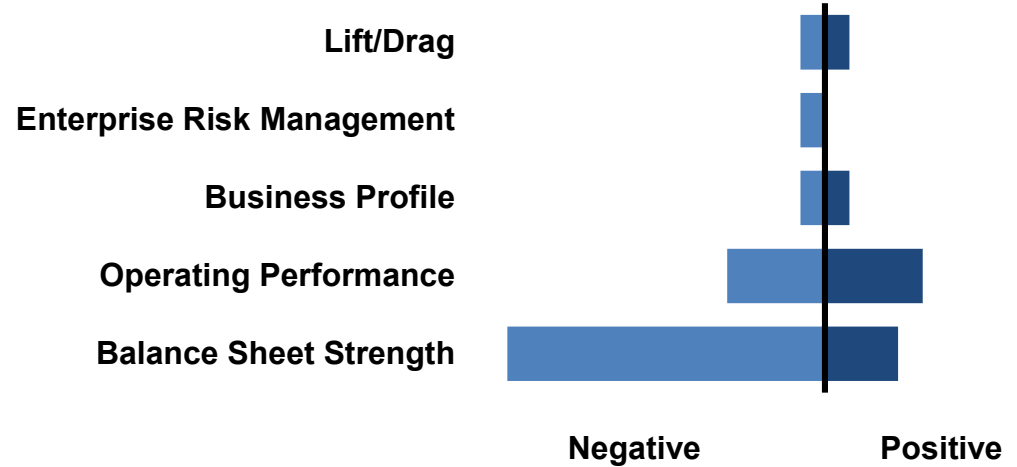
## Rating Outlook by Rating Unit



■ Stable ■ Positive ■ Negative

- Balance sheet – ability to absorb shocks
- Sustainability of financial metrics
- Performance relative to peers
- Effectiveness of ERM

## Rating Outlook by Building Block



- Changes to market conditions
- Geopolitical landscape
- Organisational restructuring
- Country Risk



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# Q&A

**Mahesh Mistry**

**Senior Director, Analytics**

**Jalpa Thanky**

**Senior Financial Analyst**

# **Best's Credit Rating Methodology (BCRM) in an Evolving Landscape**

**Carlos  
Wong-Fupuy  
Senior  
Director**

**Jessica  
Botelho-Young  
Senior Financial  
Analyst**

**Valeria  
Ermakova  
Senior Financial  
Analyst**

**Tony  
Silverman  
Associate  
Director**



## Hot Topics

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**Stress testing and non-modelled risks**

**Environmental, Social and Governance (ESG) risks**

**Innovation**

**IFRS 17**

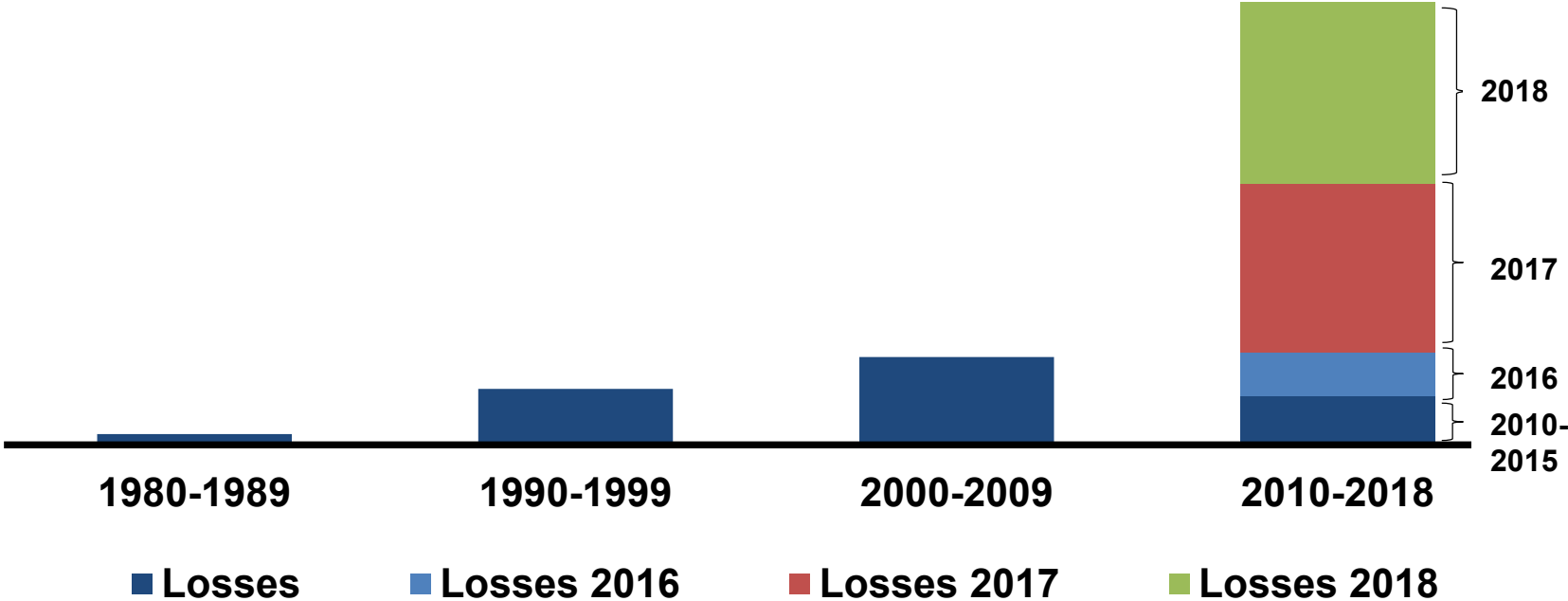
# **Stress Testing and Non-Modelled Risks**

**Carlos  
Wong-Fupuy  
Senior  
Director**



# Stress Testing and Non-Modelled Risks

## Wildfire Insured Losses Since 1980 (USD billion at 2018 Prices)



# Stress Testing and Non-Modelled Risks

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- Recent catastrophe losses call for increased scrutiny in modelling
  - Loss creep
  - Trapped capital – catastrophe losses do have reserve tails
  - Pricing uncertainty
- Wildfire insured losses: not very well modelled but becoming more prevalent
- Cyber risks
- Economic stress scenarios

# Stress Testing and Non-Modelled Risks

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- **Current BCRM:**

- Prescribed stress tests for natural catastrophes and terrorism
- Stress Testing:
  - BCAR and Balance Sheet Strength Assessment, including liquidity
  - Enterprise Risk Management

- **Expected:**

- More scrutiny on stress testing and non-modelled risks
- Comparability across the industry
- Suggested stress tests based on risk profile (?)

# **Environmental, Social and Governance (ESG) Risks**

**Jessica Botelho-Young**  
**Senior Financial Analyst**





# Agenda

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**Defining ESG**

**ESG in Best's Credit Rating Methodology (BCRM)**

**Credit Rating Implications**

**Looking Forward**

**Closing Remarks**

# Agenda

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**Defining ESG**

**ESG in Best's Credit Rating Methodology (BCRM)**

**Credit Rating Implications**

**Looking Forward**

**Closing Remarks**



# Defining ESG

A set of metrics used by investors to assess a company's risks which may not be captured by conventional financial metrics with the intention of enhancing long-term returns



**Environmental** criteria look at how a company performs as a steward of the natural environment



**Social** criteria examine how a company manages relationships with its employees, suppliers, customers, and the communities where it operates



**Governance** deals with the company's leadership, executive pay, audits, internal controls, and shareholder rights

# Defining ESG

- Climate change
- Carbon emissions
- Natural resources
- Pollution and waste
- Environmental opportunities

## Environmental



- Human capital
- Product liability
- Stakeholder opposition
- Health and safety
- Social opportunities

## Social



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

## Governance



# Agenda

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Defining ESG

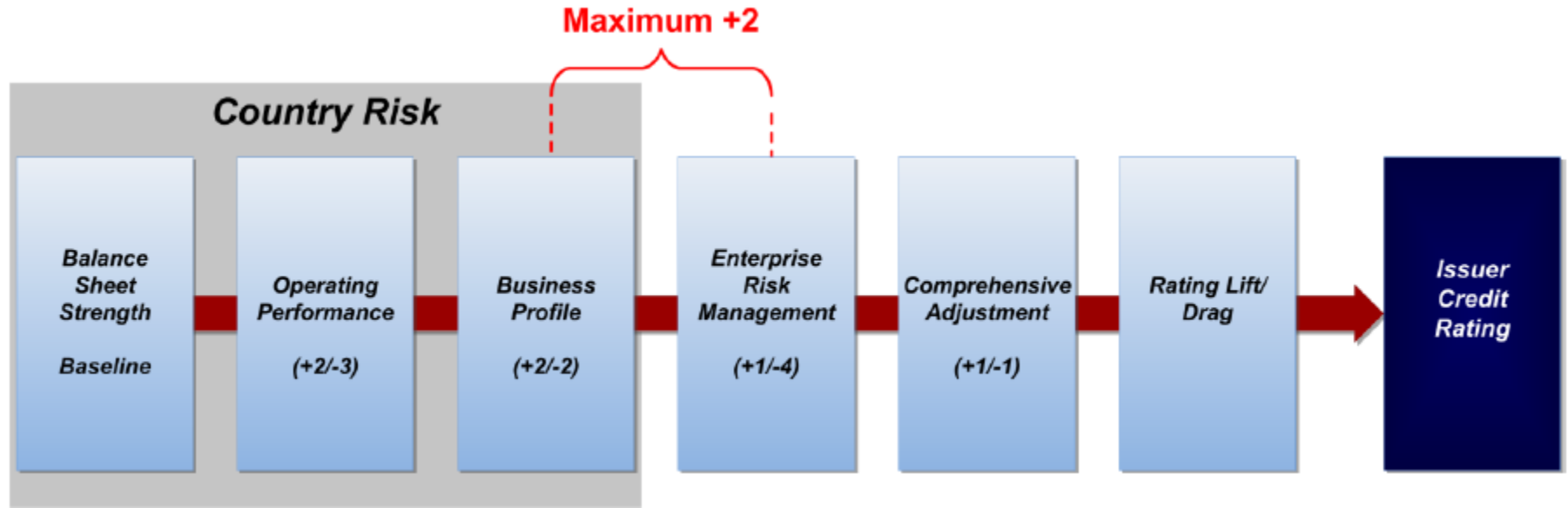
**ESG in Best's Credit Rating Methodology (BCRM)**

Credit Rating Implications

Looking Forward

Closing Remarks

# ESG in the BCRM



# ESG in the BCRM

## Best's Credit Rating Methodology (BCRM)

### Environmental, Social & Governance (ESG) Factors

Since the turn of the new millennium, the term "ESG" (environmental, social and governance) integration—often understood as an approach to business practices with strong consideration for ethical or moral values—has been gaining traction.

With no industry-wide ESG standards in place, it can be overwhelming for market players to fully understand how to implement and disclose ESG practices. Despite this, several factors usually considered ESG-related may be found throughout this document and are evaluated, to determine their materiality in respect of a particular building block.

### Balance Sheet Strength

Environmental factors are considered a severe threat to the balance sheet strength of property and casualty insurers because of the potentially significant, rapid and unexpected impact of such losses. AM Best expects insurers accepting catastrophe risk to be able to demonstrate that they can effectively manage it – including consideration for material impact from climate change trends, with the potential to increase the severity and frequency of natural catastrophe events - and have the financial wherewithal to absorb potential losses.

Asset risk is another key component of the balance sheet strength assessment. From a credit rating perspective, AM Best would discuss how ESG integration, where being adopted, fits within the investment process.

An important point to make is that strong ESG integration does not necessarily translate into higher credit quality of an investment portfolio. For example, investments in untested technologies, start-ups or taking insurance risks that cannot be reliably priced due to lack of information may carry increased credit risks.

### Operating Performance

The current absence of global guidance for the insurance industry on how to integrate ESG risks into the underwriting process has led to the development of various approaches. A growing number of market participants are implementing exclusion criteria within their underwriting lines thereby eliminating certain "toxic" risks, the most common being controversial weapons, coal-based energy production and extraction, and tar sands. At the same time, ESG risks are being considered in the underwriting process through risk selection, geocoding and other metrics to avoid areas subject to higher climate related loss severity. Changes in the insurance portfolio mix may have a material impact on prospective underwriting margins, trends and volatility.

In addition to this, key to the discussion regarding ESG integration is determining if there are sustained enhancements to the composition of investment portfolios that ultimately translate into prolonged improvements in the performance of assets held by insurers.



## Best's Credit Rating Methodology (BCRM)

### Business Profile

At the same time as insurers are withdrawing from certain types of business not in line with their ESG principles, some opportunities are being recognized such as the development of new products that incorporate social and environmental values. For life and health writers, this may include products which promote a healthy lifestyle. For P&C insurers, this may be the development of products or solutions to support risks connected with renewable energy. These new products would be viewed within the scope of "Product Risk" as part of the business profile assessment.

Changing demographics offer both challenges and opportunities for insurers. Those who are attuned to customer needs, are innovative and have access to data will be most successful in defending their market position. Alternatively, the business profile assessment may be impacted negatively following an ESG related scandal, which has the potential to materially damage the company's reputation and brand, and could have repercussions on the company's ability to generate new business and retain existing customers.

### Country Risk

AM Best's country risk evaluation entails both a data-driven assessment, which includes ESG factors such as social stability, to score the level of risk in a given country and a qualitative determination of country-specific conditions affecting an insurer's operating environment.

### Enterprise Risk Management (ERM)

The "G" in ESG is considered explicitly under the ERM building block. Governance and Risk Culture are key components within the Framework evaluation review components. AM Best's evaluation of an insurer's risk management system framework takes a holistic view of the insurer's risk management system and its associated strategies, processes, tools and owners.

The "E" in ESG is also factored into the ERM assessment as the quality of an insurer's catastrophe stress testing program influences the enterprise risk management assessment. What-if scenario testing using severe events in areas with concentrated exposures is crucial to understanding maximum potential loss and managing catastrophe risk. Companies also need to consider potential un-modeled scenarios in addition to model output to ensure that they are not overexposed to unforeseen events.

ESG integration can also reduce reputational and operational risks as ESG can assist companies to identify risks or opportunities that may not be captured by conventional financial metrics. Given ESG's potential financial impact, the practice of quantifying and integrating climate change risks into risk management and underwriting is also likely to grow in importance.



# Agenda

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Defining ESG

ESG in Best's Credit Rating Methodology (BCRM)

**Credit Rating Implications**

Looking Forward

Closing Remarks



# Credit Rating Implications

| BCRM Building Blocks | ESG Factors                |   |   |  |
|----------------------|----------------------------|---|---|--|
|                      |                            | Environmental   | Social  | Governance   |
|                      | Balance Sheet Strength     | Natural catastrophe impact<br>Asset portfolio changes | Changes in underwriting risk charges due to changes in business mix | Limited / non-material impact  |
|                      | Operating Performance      | Changes in business mix and investment returns        | Changes in business mix   | Limited / non-material impact  |
|                      | Business Profile           | Changes in business mix<br>Reputational risks         | Changes in business mix<br>Reputational risks                       | Reputational risks   |
|                      | Enterprise Risk Management | Stress testing and treatment of un-modelled risks     | Reputational and operational risks                                  | Risk management framework evaluation:<br>Governance and Risk Culture |

# Agenda

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Defining ESG

ESG in Best's Credit Rating Methodology (BCRM)

Credit Rating Implications

**Looking Forward**

Closing Remarks



# Looking Forward

## European Commission

Guidelines on reporting  
climate-related disclosures

EU Taxonomy for  
Sustainable Activities

EU Green Bond Standard

Climate Benchmarks and  
Benchmarks' ESG  
Disclosures

## European Securities and Market Authority (ESMA)

Guidelines on  
Disclosure  
Requirements  
Applicable to Credit  
Ratings

## AM Best

Research

Explicit disclosures on  
material and relevant  
ESG factors



# Agenda

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Defining ESG

ESG in Best's Credit Rating Methodology (BCRM)

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Looking Forward

Closing Remarks

## Closing Remarks

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Insurers underperform on ESG integration



AI&G urged to stop insuring Australian coal mine by 100,000 environmental protestors



Focus: Regulators' demand for action on climate change risk challenges insurers



Reserve Bank warns climate change posing increasing risk to financial stability



Climate change could put insurance firms out of business



Almost half of global reinsurance market restricts cover for coal

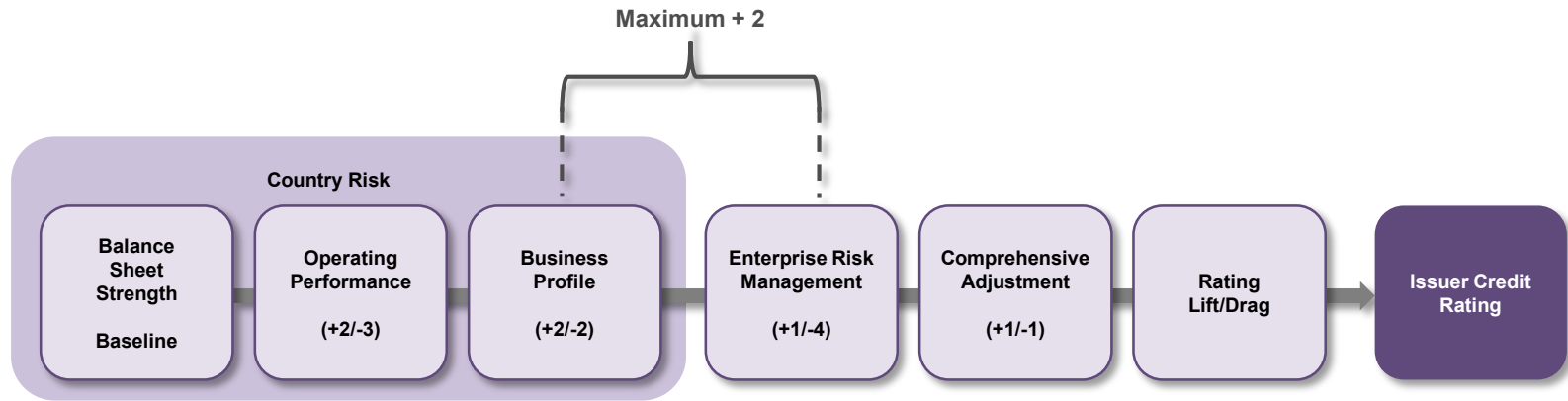
# Innovation

**Valeria  
Ermakova  
Senior Financial  
Analyst**



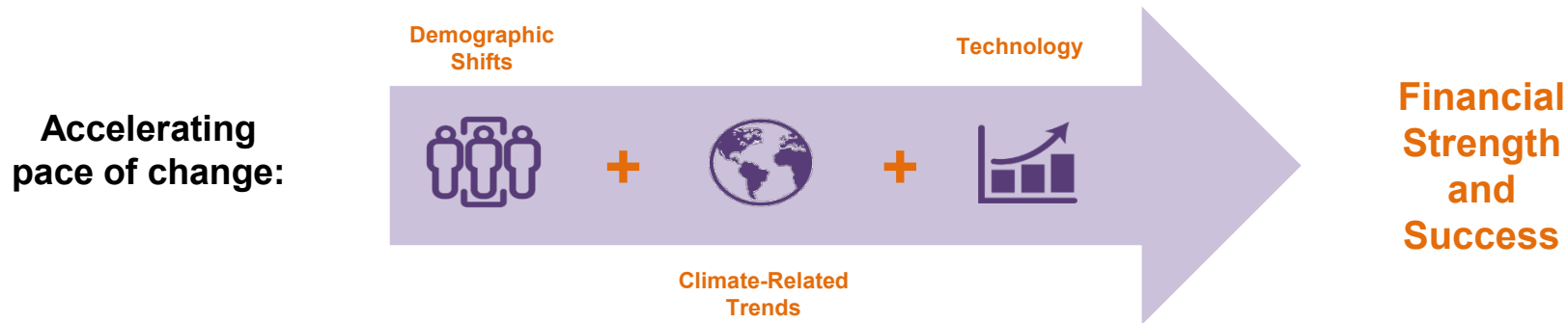
## Where Does Innovation fit in?

- Historically, AM Best has captured innovation indirectly through the various building blocks of its rating process



- We launched the innovation initiative to develop a more explicit analysis of innovation in the rating process

# Innovation and Financial Strength



**Our plan is to further understand and evaluate companies' approach to innovation**

- **How (re)insurers adapt to changes in the marketplace**
- **How (re)insurers change to improve operating efficiencies**
- **How these changes influence the financial strength and success of (re)insurers**

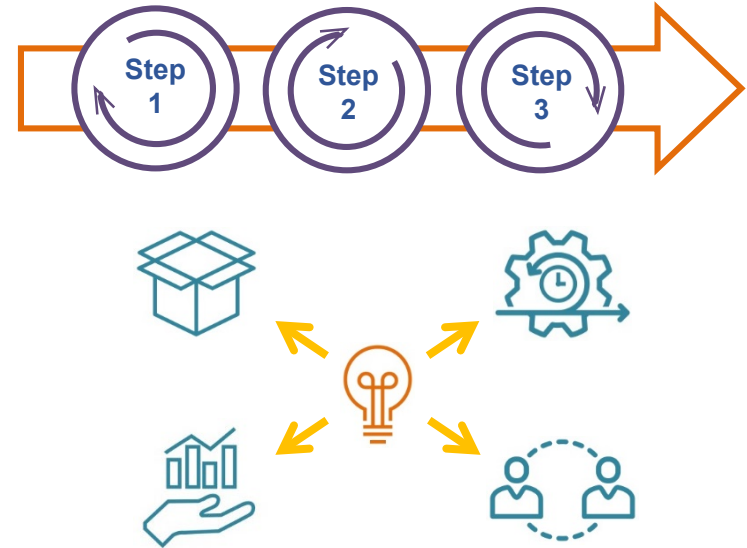


**New criteria developed**



# Innovation – AM Best Definition

- A multi-stage process...
- ... that transforms ideas into new or significantly improved:
  - Products
  - Processes
  - Services
  - Business Models
- ... that have measurable positive impact over time and enable an organisation to stay relevant and successful ...
- ... and can be created organically or adopted from external sources



# Innovation Score

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## Innovation Score Formula:

*Innovation Score = Innovation Input Score + Innovation Output Score*

# Innovation Input Score (1 to 4 for each component)

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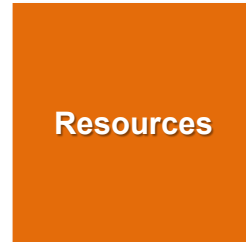
**Leadership Score =**



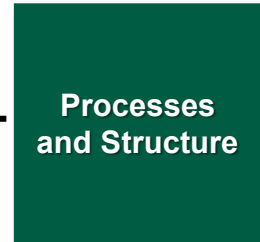
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# Leadership

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# Culture

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**Culture can either stimulate or suppress innovation**

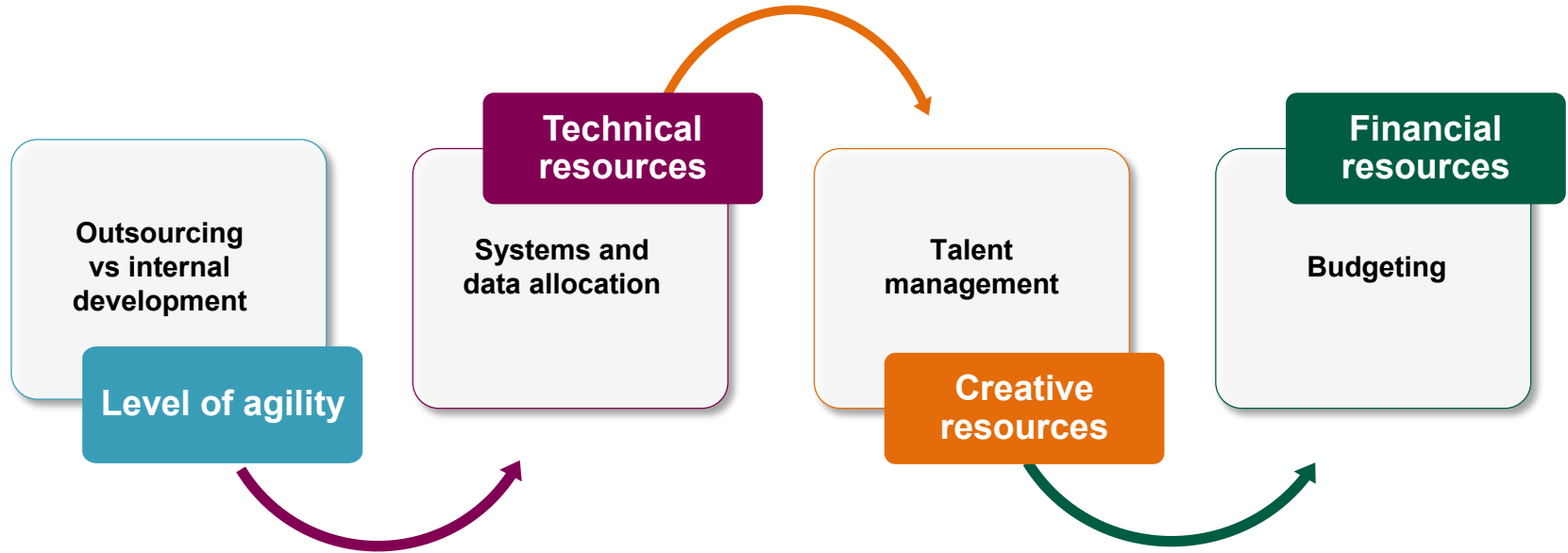
**Defined tolerance for risk-taking and possibility of failure**

**Ability to kill ineffective projects after timely review**

**Fosters knowledge sharing, ownership and transparency**

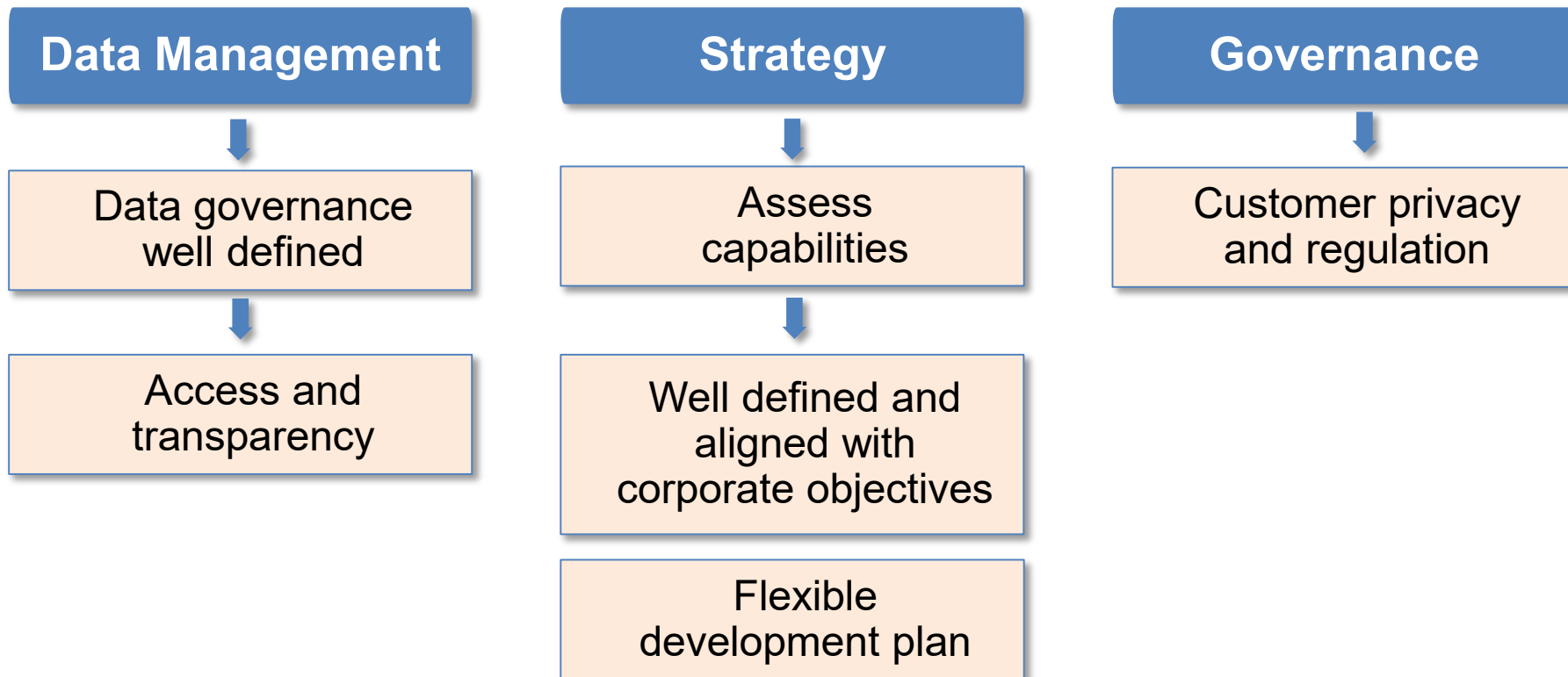
**Promotes diverse environment, e.g. backgrounds and expertise**

# Resources



## Processes and Structure

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# Innovation Output Score (1 to 4 for each component)

## Total score is doubled

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



## Results

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**Results that make investment worthwhile**



**Impact must be tangible and quantifiable**



**Mix of operational and growth-oriented innovation**



**Ability to respond to internal and external pressures**



**Incremental and disruptive innovation**

## Level of transformation

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**Value creation through transformative initiatives**

**Improved customer engagement and experience**

**Superior business model**

**Significantly enhanced growth opportunities**



## Innovation Score – Recap

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### Innovation Score Formula:

*Innovation Score = Innovation Input Score + Innovation Output Score*

## Scoring System

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**Highest**



**Lowest**

**Leader**

**28 and higher**

**Prominent**

**23-27**

**Significant**

**18-22**

**Moderate**

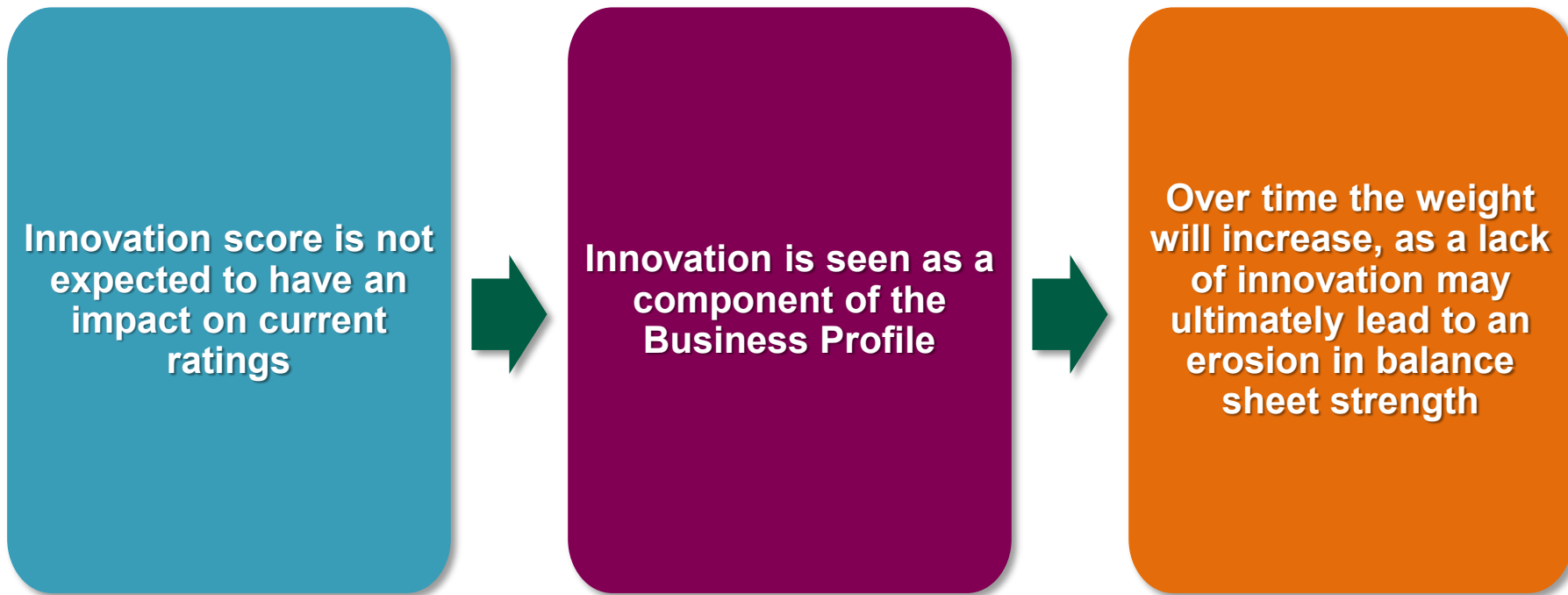
**12-17**

**Minimal**

**<12**

## Impact on Ratings

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# IFRS 17

**Tony  
Silverman  
Associate  
Director**



## Where we are now

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### **(In)consistency**

- **IFRS 4 differs across jurisdictions, differences more pronounced in life segment**
- **Asset/liability accounting mismatches**

### **Relationship to market values**

- **Current mix can't all be 'right' insurance liability**
- **Often close to 'book value' based local S1 regulatory methods. Not targeting value**

### **Image in public financial markets**

- **Seen as obscure, specialist, 'black box'**
- **Yet educated non-specialists and IT based data handlers are often the decisive audience**

# IFRS 17 – Outline

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## 1. Market values both sides of balance sheet

- Principles based
- Some choices of accounting approach – for example for non-life can choose BBA (Building Block Approach) or PAA (Premium Allocation approach)
- Reliance on auditors
- Insurance liability - discounted best estimate, plus Risk Adjustment (RA)
- Applies to global operations

## 2. No day-one profit

- Day one difference/profit goes to Contractual Service Margin (CSM), a liability
- CSM taken to profit over term of contract
- Experience variances for future coverage set against cohort's CSM
- 'Onerous contracts' losses go straight to P&L

## 3. Differences from embedded value

- 'Dual look', day one estimated profit is identified but not taken
- Delivery of new business profit is tracked
- Audited 'from the ground up'. No reference to regulatory data



# For Insurers

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- **Transition**

- Cost of new data systems and retention.  
Level of auditor involvement
- Policy on approximations used over transition for long-term business
- Uncertainty over extent non-life business subject to BBA

- **Volatility of CSM**

- Some concern on this as value measures likely more volatile than IFRS 4
- However, reflects a more volatile upper slice of value which has always been present, and often volatile, in EV reporting

- **Implications for strategy, product profile**

- Perhaps shouldn't be any, but 'what gets measured gets managed'
- For example VFA is helpful for volatile investment assets. Could products be redesigned to obtain VFA treatment?
- Value loss on back book sales may be more transparent
- And ...

## For AM Best

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- **What to do with the CSM, RA?**

- In adjusted available capital?
- Half in?

- **Life capital adjustment?**

- Where will IFRS 17 results sit versus other measures?
- Suggest much reduced adjustments/use of Solvency II

- **Data issues**

- Captions new
- Many not map onto current quantities

- **New framework**

- Language of management meetings likely to adopt new vocabulary
- Analysis will focus on new measures:
  - For example, development of risk adjustment and CSM
  - And other new KPIs

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# Q&A

**Carlos  
Wong-Fupuy  
Senior  
Director**

**Jessica  
Botelho-Young  
Senior Financial  
Analyst**

**Valeria  
Ermakova  
Senior Financial  
Analyst**

**Tony  
Silverman  
Associate  
Director**

# Q&A Interactive Discussion

# AM Best's Methodology Review Seminar

12 November 2019

etc.venues, London

