[redacted]

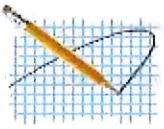
03/21/2016 03:28 PM

To "Methodology.commentary@ambest.com" <Methodology.commentary@ambest.com>
cc
Subject Hedge funds within the BCAR model

Hi – In regards to changes on the asset side of the equation, can you please clarify whether there have been any material changes made if an insurer has a lot of hedge fund exposure? For example, let's say an insurer has a high concentration to hedge funds whose historical beta's have been below 0.5x? Is the use of beta a new addition to the BCAR model? Related, Should I be taking into account the higher asset charges highlighted in the slide deck, or will there be a potential offset in that the hedge fund's beta's will now be applied whereas they weren't in the past? My phone number is below if it's easier to briefly chat over the phone. Thank you

[redacted]

[redacted]



"[redacted]
03/22/2016 03:43 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc [redacted]
Subject Questions on BCAR

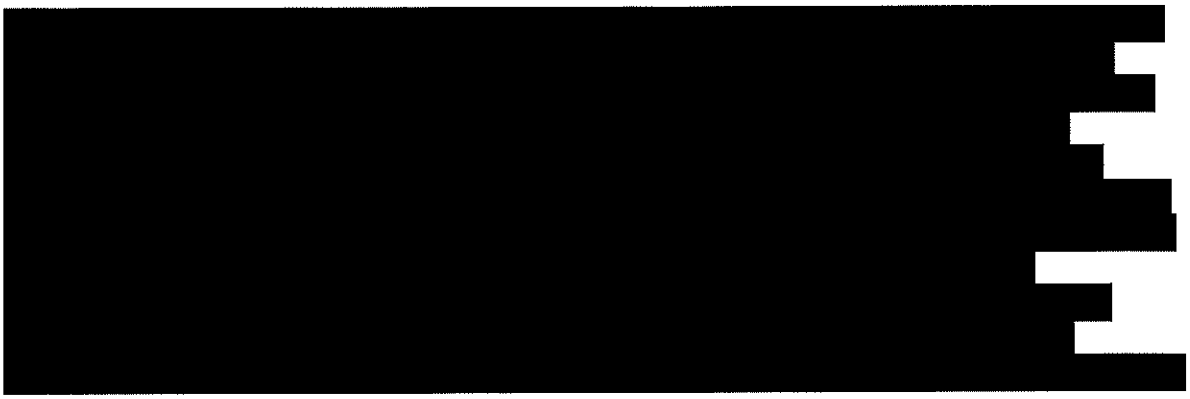
Dear Sir or Madam,

Thank you for the various webinars over these past few days to go through the revised rating methodology and US P&C BCAR. We would have a couple of questions regarding to the upcoming BCAR models:

1- We noted that the baseline risk charges will be derived from an ESG. How frequent will these risk charges be updated?
2- On listed equity, the baseline risk charge for the US P&C BCAR will be based on the volatility of the S&P 500. How will the risk charges be determined for company domicile in overseas or has investment in different countries/regions?
3- Also, will the listed equity stress test still applies to companies which allocate a certain percentage of their investment assets in listed equities? If so, how the stress test will be applied in the BCAR models?
4- What would be the fundamental differences between the Universal BCAR with the US P&C and L&H models?
5- Would AM Best consider to build regional BCAR models or even a specific one for reinsurer?

We look forward to hearing from you soon,
Many thanks for your reply,
Best regards,

[redacted]



[redacted]

03/23/2016 02:58 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject RE: AM Best Proposed BCAR Methodology Question

Greetings AM Best,

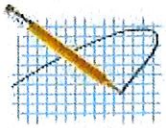
Our question about released methodology is below and should be treated as confidential:

- Can you minimize the impact to B8 in the STRESS analysis at each VAR by choosing the order of events that results in the lowest net CAT loss for both events. 100 & 50, 100 & 100, 100 & 200, etc.? For example, at the 99.5% VaR or 200-year event level and also have the 100-year occurrence stress test can you apply the order that would minimize impact to company or is there a designated order? Initially we thought there seems to be some differing positions when reading page 35 of the DRAFT_UnderstandingBestsCapitalAdequacyRatio_PC_March10.2016.pdf and also viewed the AM Best Overview of Best's New U.S. P/C BCAR (about 45 min in).

Thank you in advance for your response.

[redacted]

[redacted]



**Van Durboraw <vbd@rhpga.com>**
03/23/2016 10:52 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject New BCAR and preferred stock

To whom it may concern:

I have watched the recent presentation (Great job!) and downloaded the slide deck and was wondering if there is any more information about preferred stocks and how they impact results. We are a small Texas only homeowners insurance company, and recently started to put a little money into preferred stocks and given the expected drop in the curve due to who we are (regional property company) I want to try and minimize any other downward shifts.

Thanks.

Van

Van Durboraw
Chief Financial Officer
RHP General Agency, Inc.
Southern Vanguard Insurance Company
713.337.5085
vbd@rhpga.com

[redacted]

03/28/2016 11:05 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject BCAR Comments

1 attachment

BCAR Comments.docx

Thank you for offering the opportunity to provide comments on your new BCAR model.

First and foremost, we believe this is a significant step that will improve the differentiation among companies. Thank you for committing the resources to this project.

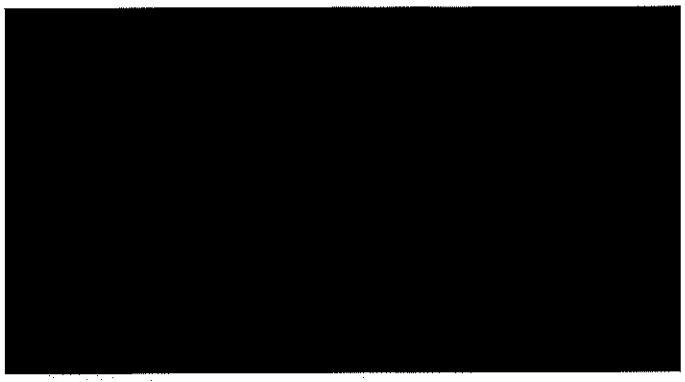
These comments are on subjects admittedly limited to only a few companies in the industry; in speaking to [redacted] after his presentation at your conference, I understand that our analyst may have flexibility to incorporate them on a one-off basis, but I think they are worth noting in any case.

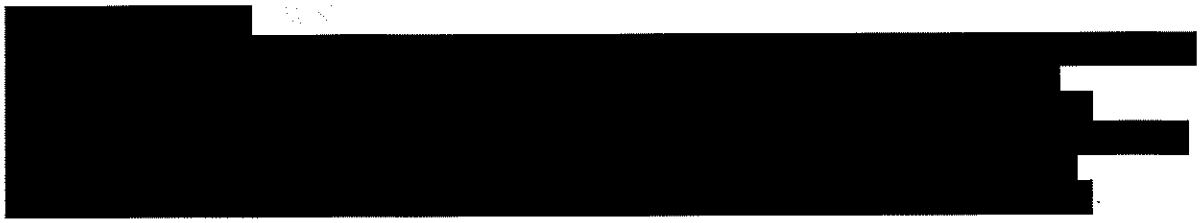
1. Surplus Notes – [redacted]

2. Deferred Tax Liabilities associated with Unrealized Capital Gains – [redacted] Once again, we believe BCAR is a fair representation for the 5.0% and 1.0% return periods, but does not give appropriate credit for the value of unrealized capital gains at the tail.

3. In conversations with [redacted] last summer, we understand that AM Best has worked hard to analyze the securities held on schedule BA. [redacted]

[redacted]





[redacted]

04/01/2016 12:49 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>

[redacted]

Subject BCAR Commentary

1 attachment

[redacted]

To whom it may concern,

Following conversations with our lead analyst for [redacted], cc'd here, we would like to formally pass along our comments on the latest BCAR methodology update.

We appreciate your consideration and feedback.

[redacted]

[redacted]

[redacted]
Comments on BCAR Methodology Update

We have been studying the updated BCAR methodology more and would like to bring forth a couple of comments related to catastrophe management (i.e. PML). As we read the new BCAR methodology, we think base case PML will be run on return periods of 20, 100, 200, 500 and 1,000 years. This will be a global all perils occurrence PML (i.e. there will no longer be a wind versus earthquake ("EQ") differentiation). The stress test will be an additional 100 year global all perils occurrence event on top of the base case PML return period scenario.

1. Can you please confirm that our understanding is correct?
2. Also, we believe that point "4" on page 35 is a positive change in that it says second event net PML can be adjusted for changes in net reinsurance structure after the first event. We think it would be good to clarify that this is a change in both the assumed and ceded reinsurance structures. [redacted]

We believe the change to looking at global all perils occurrence PML further out on the tail is a positive change in assessing potential tail risk. However, we believe significant extreme tail risk that exists at the tail for multiple loss events may be worthwhile for AM Best to also assess.

[redacted]

This is just one example of how third party models can be deficient, especially at the tail. Certain books of business have huge exposures to this type of event, especially primary business, binder business and uncapped reinsurance treaties. [redacted]

We believe that without digging deeper into the practices of individual (re)insurance companies AM Best is at risk of considering all PML representations equal when there can be great differentiations. These differences would have the largest impact on PMLs of primary carriers and reinsurers writing considerable tail exposure at return periods beyond the periods the rating agencies assess in their capital models.

[redacted]

We thank you for your consideration of our thoughts and ask that you please forward them to the appropriate individuals accumulating feedback on the BCAR model. We also think these points are important as you assess the overall credit worthiness of [redacted].

[redacted]

<dvose@andovercos.com>
04/07/2016 02:25 PM

To <methodology.commentary@ambest.com>
cc
Subject AM BEST ISSUES REVISED BEST'S CREDIT RATING METHODOLOGY, REQUESTS COMMENTS

1 attachment

BEST - COMMENTS.docx

Attached are comments from Don Vose at The Andover Companies in reference to the above subject.

Thank you for your consideration.

Looking ahead to the imposition of Best's new BCAR, it's appropriate to share some observations as to its potential impact on both AM Best and its rated companies.

Turning to Best first, this major change in approach whereby you have significantly "moved the cheese" could have some noteworthy impact on how Best is viewed in context of its credibility. For several decades, Best has used a method of evaluation that has stood the test of time and to the best of my knowledge has produced no embarrassing sudden implosions of an A-rated company as a result of any deficiency in Best's review process. In other words, a classic example of "if it ain't broke, don't fix it" seems to exist here. Further, Best's own data shows over many decades insolvencies particularly among A-rated companies are almost nonexistent and to the extent that they happen inadequate reinsurance is a small percentage of a small percentage. In fact, amongst the small percentage of insolvencies, the vast majority are as a result of too rapid growth, and inadequate loss reserves—a condition easily identified using IRIS techniques.

Incorporation of a more robust stochastic approach in your rating technique is indeed fraught with perils. I'm assuming your approach with this method is to utilize a more sophisticated "state-of-the-art" technique in order to achieve an enhanced degree of analytic accuracy. While you may have "ticked the box" for sophistication, stochastic models and accuracy do not go hand-in-hand.

[redacted]

These examples involving our company alone are just the tip of the iceberg as to the inadequacies, inconsistencies, and ultimately inaccuracies of models. Thus, your predicate for this new approach is fundamentally flawed and arguably is even more so as you ask companies to manage to more and more remote probabilities (possibilities).

Further as to credibility issues, there is a great likelihood that some company balance sheets heretofore highly rated will suffer under the new criteria of managing to extremely remote possibilities.

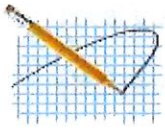
One could reasonably ask given no change to the underlying data, but with a change to the outcome, was Best previously using a flawed approach? Another possibility is the previous approach was correct and the new one is flawed. Finally, there is the possibility--with this question being raised--that like with the models, neither approach is correct. These are serious questions with serious implications.

Turning to the impact on the companies, as Best is very well aware, the property insurance business is highly competitive with very low margins. There is an old adage to the effect that you can spend yourself into the poorhouse hence eliminating your profit buying reinsurance. The practical implication of this new process is that in order for us to maintain our A+ rating which we've enjoyed since the 1930's, we will be forced to spend over time tens of millions of dollars for essentially unnecessary reinsurance coverage protecting against a highly speculative, extremely unlikely event forecast by very flawed sources. In our opinion, spending millions of dollars to protect against a highly unlikely event is neither prudent nor wise given that we view our surplus as the ultimate efficient reinsurance hedge.

Another significant problem that will ultimately arise for us is difficulties with our regulatory agencies. As these additional reinsurance costs flow through to the bottom line, the necessary rate adjustments to cover these additional costs are very likely to be met by extreme push back from the regulators.

You may be aware of the problems encountered by the Mass Fair Plan, which buys an extraordinarily large amount of reinsurance, in terms of getting rate increases precisely because the regulators aren't convinced that reinsurance costs driven by the models are an appropriate inclusion in their rate filing. As a result of this position, the Mass Fair Plan has not been able to get a rate increase for the last eight years and I see little likelihood that we would do any better when our costs for this additional coverage are taken into consideration. The ultimate implication for this would be that we would face a "Hobbesian Dilemma" as to whether we reduce our reinsurance costs to a level that the regulators feel is appropriate and have an opportunity to maintain adequate rates, or do we maintain our reinsurance spend in order to maintain our rating and in affect make it quite likely we will be unable to secure a profitable result.

I thank you for the opportunity to present these thoughts to you, and hope that your colleagues might see some merit to them



[redacted]

04/18/2016 02:57 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>

[redacted]

Subject Investment-Related Comments/Questions on Changes to the New BCAR Methodology

Here are some investment-related questions we have as it pertains to the proposed new methodology:

1. Does A.M. Best distinguish at all between sinking fund preferred stock versus perpetual preferred stock? This question may pertain to the current BCAR as well, but we're particularly interested in future treatment under the new model.
2. Why is only one year used in the calculation of Beta and R-Squared for common stocks and BA assets? This seems like a short horizon.
3. Here are some questions related specifically to the treatment of Schedule BA assets:
   a. Why are only hedge fund indices considered in determining the risk factors -- what about private equity?
   b. Which hedge fund indices were used?
   c. Why assume that all hedge funds are 10% more volatile than the S&P 500? Our investment strategy focuses on absolute return hedge funds that have lower volatility than the S&P 500.

Thanks in advance for your consideration.

[redacted]

[redacted]

04/18/2016 03:58 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc

Subject Suggested simple improvement to the Stochastic BCAR

The new stochastic BCAR formula represents a considerable advancement. Those who have contributed to its development deserve much praise. However, there are two material criticisms of this new formula:

- First, while the formula introduces Cat risk, it does not measure the risk of more than 1 severe cat event occurring within the same year. The risk of a 2nd major Cat event should be considered.
- Second, because the Cat risk has been placed outside of the square root in the formula, the VaR statistics are not measures of 1-in-"so many years" events. Rather, they are measures of two such events occurring in the same year. One of them is a Cat event and the other is some non-Cat risk to which the entity is exposed. Unfortunately, many persons – even some who should know better – are incorrectly referring to the new results as measures of an entity's ability to withstand 1-in-20, 1-in-100, 1-in-200, 1-in-500, and 1-in-1,000 year events. That is not the case. Rather, the new formula produces results analogous to the old formula's Stressed BCAR test.

We can overcome both criticisms with just two modifications:

1. Make the new BCAR a stress test. Do so by first subjecting each entity to a 1-in-100 year Cat event (see Note below).
2. Next, apply the five VaR standards to the entity's remaining capital using the new stochastic BCAR, but with one change to the formula: The Cat risk (i.e., potential for a 2nd Cat event) would now be placed inside the square root formula.

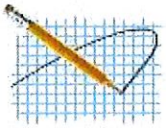
After this simple modification we are left with a measure of an entity's ability to withstand those 1-in-20, 1-in-100, 1-in-200, 1-in-500, and 1-in-1,000 year events *after* having already been subjected to a 1-in-100 year Cat event.

Note: Using a 1-in-100 year Cat event as the stress test rather than some other risk or some greater-return period Cat event is suggested with good reasons. Following are several of them:

- ✓ It's more feasible to have two major Cat events in a year than two of any other major risk category, such as a financial market collapses.
- ✓ Anything greater than 1-in-100 year return periods could render much of an entity's TIV destroyed or damaged and not yet fully repaired when the 2nd event occurs. This would be especially true for the entities with risk concentration, such as single-state and regional companies.
- ✓ A higher return period standard for this stress test could adversely influence the reinsurance market by altering the amounts of limits entities purchase in their Cat programs. Prices would soar in such a demand market. Available capacity could suffer. New entrants could be drawn to the property reinsurance sector, and that can open up a host of concerns about the quality and regulation of these new players. Many entities may be forced to consider non-traditional reinsurance schemes, such as ILWs.

✓ There would likely be material IRS tax benefits from an extreme Cat event, such as credit against taxable income from the prior 5 calendar years and government disaster relief aid. With no consideration of these probably benefits being recognized in the BCAR formula, a stress based upon the 1-in-100 year Cat event is really a greater shock to an entity's capital than the actual net impact that would likely occur.

[redacted]



[redacted]

05/10/2016 10:07 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject BCAR call for comment - May 5 update note

**Hello Team AM Best,**

**Please see [redacted] thoughts below in answer to the questions posed in the May 5, 2016 update note.**

**Please respond to the following questions via the methodology inbox at methodology.commentary@ambest.com.**

1. Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".

The building block approach is transparent, however the effort to quantify and disclose the presumably normal analytical subjectivity in the form of the various assessments – business profile, operating performance, ERM and comprehensive - may lead to more questions from rated credits about how the peer analysis was conducted and conclusions reached.

2. Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.

No comments

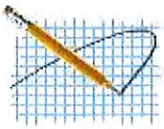
3. What are your views on using VaR metrics for risk modeling in general? Do your view s concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?

We agree with the latest commentary that VaR metrics on the tail beyond 99.6 (1/250) are subject to a very high degree of uncertainty. Even with a portfolio model of 100,000 years (iterations), there are only 400 iterations beyond the 1/250 tail and many of these events are improbable, at best – e.g. windstorm tracks that do not make scientific sense, New Madrid EQ losses of a substantial level combined with another major cat event, etc. On this point, we see a discussion of aggregate exposure as important to the understanding of overall risk.

Regards,

[redacted]

[redacted]



[redacted]

05/10/2016 03:25 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject FW: BCAR Comments

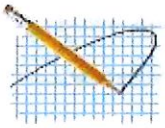
In response to item #3 in the attached:

"We have found that catastrophe models today are wildly inaccurate in general, and do a poor job predicting losses in a given book of business as a result of a given event, even in the lower VaR metrics. The fact that models change drastically from one version to the next indicates that modelling in general is rudimentary and unreliable. In many cases, relevant data is not analyzed rendering the model itself invalid.

For example, we have found that wind speeds during a hurricane have less direct correlation to resulting damage than proximity of trees to houses. During hurricanes Ike and Rita, hurricane wind speed was not a direct determinate of damage to an individual home. Proximity of the home to pine trees was solely the determining factor on whether or not the home was damaged in the storm. For example, two houses near each other both experienced 100mph winds. The home with no pine trees in the vicinity had minor superficial damage. The home with a 90 foot pine tree ten feet from the house was destroyed due to the tree falling and smashing through the roof. Models do not model this essential criteria: proximately to falling trees. The models are simply modelling the wrong stuff.

VaR measures of 99.8 and 99.9 model events that, by definition, happen rarely and very little actual data can be used to formulate a valid model. Further, even if these were accurate, few companies would build their risk model around transferring all risk for "one in thousand" year events. Insurance companies are paid to manage risk. Without retaining any risk, they can hardly be expected to be able to produce profits.

[redacted]



**Lewis Augustine <laugustine@UE.ORG>**
05/11/2016 04:39 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc [redacted]
Subject Feedback on questions

I am responding to the third question you sent for commentary. I have never been a big fan of using VAR. It looks at one point on the event curve and says nothing about the events that are more extreme than VAR. In the past, I've looked at two approaches to address this point. One is to average several events around VAR, to make sure that the one VAR point is not just an aberration. The second is to look at TVAR, which averages all the extreme events together to look at the whole tail of the distribution. I am not sure how practical these methods are, but generally speaking, they are improvements over the VAR approach. VAR, on the other hand, is easier to understand and measure.

I am also interested in how the modeling companies will align their capital models with the new methodology and if they will be in sync with your release schedule.

Kind regards,

Lew Augustine

**Lewis V. Augustine, FCAS, ARe, CERA**
VP & Chief Actuary and Chief Risk Officer

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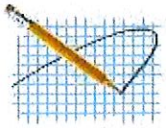

[redacted]

05/20/2016 04:32 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject FW: BCRM and MCAR Feedback

**From:** [redacted]
**Sent:** Friday, May 20, 2016 3:17 PM
**To:** 'commentary@ambest.com'
**Subject:** BCRM and MCAR Feedback

[redacted]. Here are my responses to the questions posed in the Update to Best's Credit Rating Methodology and BCAR Call for Comment dated May 5, 2016.

1. Yes, I do feel that I understand the building block approach to the BCRM.
2. I do not disagree with any of the parameters in the BCRM although I have not seen a specific example of these put into practice.
3. I have no objection to using VaR as a metric. It seems very appropriate to use for BCAR. The accuracy of the modeled results at the 99.8 and 99.9 VaR are very suspect at best. We have at best 100 years of good data on the significant risk sources. In addition, in the past 20 years there have been several incidences where the results of the expected cat losses produced by industry models have been radically altered year over year at the 100 year return time. It's only reasonable to expect that the results of the economic scenario generators would be similarly volatile. Going out further into the tail increases the impact of the volatility. This could result in radically different indicated ratings for companies due to no other reason than changes in the model being used. In my opinion, you are stretching the limits of what types of events for which any company can reasonably prepare.

Please let me know if you have any questions. Thanks! [redacted]

[redacted]

[redacted]

05/24/2016 10:20 AM

To "'methodology.commentary@ambest.com"' <methodology.commentary@ambest.com>

[redacted]

Subject Feedback to BCRM and U.S. P/C BCAR

[redacted]

we formally submit the following comments with respect to the draft revisions to A.M. Best's credit rating methodology and BCAR criteria released on March 10, 2016 and the Best's Briefing released on May 5, 2016.

We recognize the value of A.M. Best's objectives to modernize its capital and ratings evaluations, and we generally have no concerns with the measured use of a Value at Risk (VaR) metric to determine specific risk levels during those evaluations. However, we do have significant concerns with the proposed use of return periods at the extreme end of the curve, such as the 1:500 (99.8 VaR) and 1:1000 (99.9 VaR) return periods. We view such extreme return periods to carry significant potential model risk and therefore do not believe they should be considered in determining capital adequacy. We are concerned that the 1:500 and 1:1000 values for risks modeled stochastically under the proposed BCAR model will be based on data and assumptions that cannot be reasonably supported from a historical or scientific perspective. We strongly encourage A.M. Best to reconsider its proposed inclusion of such hypothetical and unreliable values within the criteria A.M. Best utilizes to establish capital requirements and to determine the health of insurance entities.

We support maintaining calculations of the higher VaR amounts in order to help foster discussions of those results from an enterprise risk management perspective. We believe information regarding individual companies' views of modeled tail events and management of modeled tail risk will be helpful to A.M. Best in evaluating risk appetites and risk tolerances across the universe of companies A.M. Best reviews.

We appreciate the opportunity to comment on this important issue.

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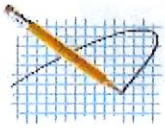
[redacted]

[redacted]

[redacted]



[redacted]

05/26/2016 12:22 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc

Subject Re: A.M. Best Briefing: Additional Comments Sought on Revised Best's Credit Rating Methodology

Comments from [redacted] on the survey questions:

- Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No". –Yes our team understands the BCRM model.

- Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management or Comprehensive Adjustment in BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions. -No disagreement

What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 and 99.9)?

Var metrics are good for risk modelling in general because the testing is across a large number of risk scenarios. If they are used for modelling capital requirements, it will be very important that these are applied fairly across different companies and different risks. As we get into the tail risk, defining 1 in 50 or 100 year events is hard. Applicable historical data available is very limited. Defining these scenarios is especially hard for financial assumptions like stock market returns and interest rates. While we understand and appreciate the theoretical approach, practically it is impossible to come up with tests that far in the tail that are meaningful and reliable.

Also both BCAR ( and NAIC ratios) are used for comparing companies. Because of that, companies have started monitoring those ratios annually and even quarterly. Var testing is expensive and time consuming. It would be hard to run thousands of scenarios every quarter for all different risks especially for small companies.

Due to the above observations, we agree that Var testing is more appropriate in other parts of the BCRM model rather than the BCAR.

[redacted]

[redacted]

[redacted]

06/03/2016 05:54 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject FW: feedback on BCAR and BCRM Update Briefing from [redacted]

1 attachment

BCAR and BCRM Update Briefing.pdf

Looks like I missed the "methodology" in the address.
Hope it works now...
Best regards,

[redacted]
**Sent:** Friday, June 03, 2016 11:51 AM
**To:** 'commentary@ambest.com'
[redacted]
**Subject:** feedback on BCAR and BCRM Update Briefing from [redacted]

Dear Ladies and Gentlemen from AM Best,

Pleas find below the feedback to your issues raised in attached update briefing:

1. **Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".**
Generally we understand the approach outlined in the BCRM.
More guidance and clarity on how to specify a rating unit (leading / non-leading) rating unit would be appreciated for insurance sub-Groups.
Additionally it would be beneficial to better understand the weighting between the different Building Blocks within the rating process.

2. **Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.**
No

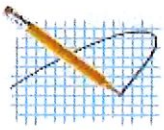
3. **What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?**
The approach generally makes sense. The high confidence intervals lack the real experience of such sever events and reliability on results therefore weakens. On the other side the extreme results allow to differentiate better between financially strong and well protected entities versus weaker ones. Nonetheless we would be cautious with

the interpretation of results on these high return periods and would be interested to better understand how they impact the final outcome of the rating process.

[redacted]

[redacted]

[redacted]



[redacted]

06/07/2016 09:42 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject BCAR Rating Model Changes

To whom it may concern:

In response to the latest proposed criteria updates issued by AM Best on March 10th and May 5th , we would like to formally submit a comment on the use of extreme tail assumptions in the calculation of required capital. My comments specifically address the third question posed in the May 5th briefing. We have no issue with responsible use of a Value at Risk (VaR) metric to quantify risk and appreciate one of the primary objectives of the proposed BCAR was to better differentiate companies by looking at their tail exposure. However, any model's credibility is highly questionable at the 1:500 and 1:1000 VaR levels and therefore we feel these levels should not be used to assess balance sheet strength but rather used as a discussion of tail risk management.

We appreciate the opportunity to comment on the criteria, but would prefer to have our comments remain confidential.

[redacted]

[redacted]
06/13/2016 10:52 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject [redacted]

1 attachment

AM Best Methodology Response - [redacted]

[redacted] the request for feedback contained within the May 5, 2016 document titled *Update to Best's Credit Rating Methodology and BCAR Call for Comment* .

Thank You,

[redacted]

[redacted]

**TO:** A.M. BEST

[redacted] [redacted]

**SUBJECT:** UPDATE TO BEST'S CREDIT RATING METHODOLOGY – MARKET FEEDBACK REQUEST

**DATE:** JUNE 13, 2016

To Whom It May Concern:

[redacted] appreciates the opportunity to comment on the update to A. M. Best's credit rating methodology, and specifically the three questions contained within the request for market feedback as part of the May 5, 2016 document titled *Update to Best's Credit Rating Methodology and BCAR Call for Comment.*

1) *Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".*

   The general concept of the Building Block approach appears to be reasonable in the aggregate. We do have concerns that the rating scale based on the initial balance sheet strength assessment skews too low. For example a company with the strongest initial balance sheet strength is only eligible for a base ICR of a+/a, which translates to an FSR of A. While there are ways to subsequently increase ICR via analysis of other building blocks, these blocks appear to be geared toward maintaining an adequate or neutral relationship to the overall base rating (as evidenced by the preponderance of negative adjustments over positive adjustments available), and would only enhance the ICR under rare situations. Therefore it appears the path to achieving an ICR greater than a+/a is difficult, though perhaps by design.

   On the Rating Methodology webcast, it was noted that a company's credit report would contain an illustration of the building block presentation as detailed in the webcast, which would illustrate the development of the rating components. We believe this is a positive step to building transparency of the process. However it appears the credit report will only contain high level descriptors and no further analysis of the details behind the rating. It would be beneficial to receive detailed information regarding rating rationale as well, to further aid transparency into the rating process and facilitate discussion with the rating analyst.

2) *Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.*

   Parameters outlined for the various building blocks appear to be similar to those previously used. Regarding the updated formula (Adjusted Policyholder Surplus (APHS) – Net Required

Capital (NRC)) / APHS, we have concerns that this new formula diverges from not only the past formula (APHS / NRC) but also from other standard capital formulas such as RBC (and in [redacted], with our proprietary capital adequacy ratios as well). While RBC and the current BCAR formula have their differences, the overall concept of the two calculations is relatively similar as they both present a measure of surplus/capital divided by a required capital amount. The inherent risk in such a formula change is that results may become more difficult to interpret as the updated formula strays from common industry presentation. When presenting capital adequacy ratios in succession, the new BCAR presentation will require an awkward qualifier to disclose it is not presented on the same relative basis as compared to other measures. Furthermore we feel the new presentation illustrates similar information as the old formula, and this change is more cosmetic in nature with no accompanying advantage or benefit over the old formula. To that end, our recommendation is to keep this portion of the BCAR formula the same.

3) *What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?*

It has become industry best practice to use VaR as a metric to measure risk, and as such it is currently a consistent measure across other companies. VaR is also simpler to communicate than other risk metrics. When calculated at a point on the tail that is not too extreme, VaR can provide a valuable view of risk for which a company can encounter stressful situations and continue with operations. As the metric moves to more extreme points, it can still provide the business with scenarios to monitor. However, the values may not be stable at each reporting period and could eventually become too high of a level to manage the business.

A 99.8 or 99.9 VaR metric can provide the business with remote scenarios to monitor. Though managing to these levels would be difficult as values can be unstable at reporting periods and would produce greater variability in the output of the model results. In addition, model accuracy becomes increasingly deficient at the higher levels, which exacerbates the reliability of any model utilized.

In conclusion, we encourage A.M. Best to consider these comments as you continue to assess the new Credit Rating Methodology and BCAR model. Thank you again for the opportunity to comment on this proposal. [redacted]

[redacted]

[redacted]

06/14/2016 11:20 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Comment on proposed methodology

Good afternoon.

With reference to the proposed review of Best's Credit Rating Methodology by AM Best, in particular on the country risk tiering presented on page 17 – 18 of the RfC: from the reading it could be interpreted that a sovereign ceiling is being established. So the ratings might move mechanically up and downwards following changes in the country tiering.

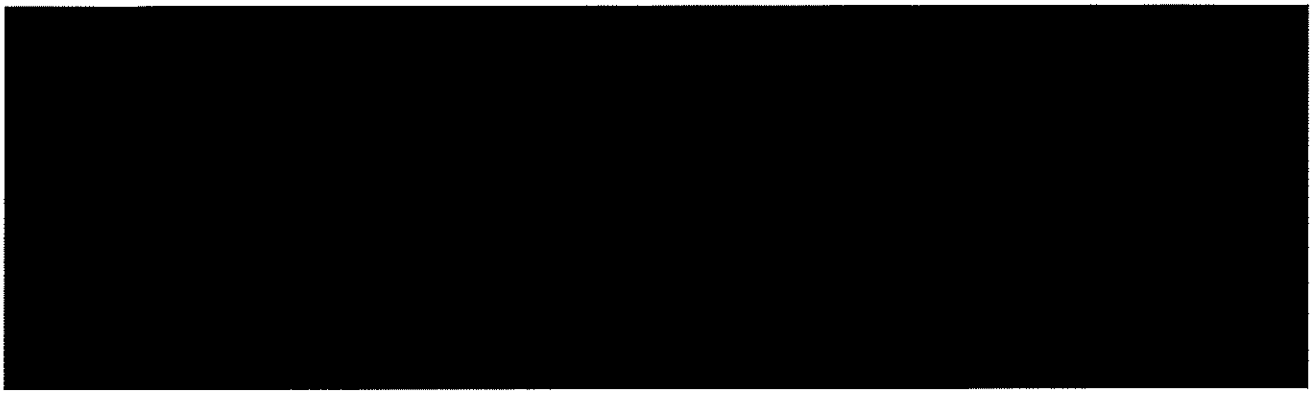
Being the stated aim of the RfC to achieve "a reorganization of the current methodology", in order not have misinterpretation, we would suggest to include in the document a statement like *"A.M. Best does not place a cap on its FSRs based on the sovereign credit rating of the country in which the rated entity is domiciled, or materially exposed to."* (from the paper Financial Strength Ratings, Sovereign Credit Risk, and Country Risk FAQ, March 3, 2016).

Many thanks for your attention.

Best.

[redacted]

[redacted]



Thank you.

**Kevin C. Banwart,** CPA, AIAF
Treasurer & CFO
Pharmacists Mutual Companies
808 HWY 18 W | PO Box 370
Algona, IA 50511
D. 515.395.7255 | F. 515.295.9306
E. Kevin.Banwart@phmic.com

[redacted]
**Sent:** Thursday, May 05, 2016 5:57 PM
**To:** Kevin Banwart
**Subject:** Best's Credit Rating Methodology update

Dear Colleague,

The comment period on the revised Best's Credit Rating Methodology (BCRM) and U.S. Property Casualty Best's Capital Adequacy Ratio (BCAR) is approximately halfway over and A.M. Best continues to review the proposed changes and evaluate the potential impact on rated companies. For your information, please find attached a briefing released today by A.M. Best.

Please let me know if you have any immediate concerns

Best Regards,

[redacted]

Comments to A.M. Best on Revised BCAR
6/20/16

A. BCAR Calculation

Defined: (Have – Required) / Have

- Have – The Adjusted Surplus the Company has
- Required – The Required Capital for the VaR specified

We believe the denominator should be Required so that scores are comparable between companies.

Example:

| | Company A | Company B |
|---|---|---|
| Have | $100 M | $200 M |
| Required | $90 M | $90 M |
| Score | 0.10 | 0.55 |

Company A has $10 M more surplus than Required for the given VaR level. Company B has $110 M more surplus than Required. Company B has 11 times more "extra" surplus than Company A; however, Company B's score is only 5.5 times higher. If the denominator is changed to be Required, Company A's score would be 0.111 and Company B's score would be 1.222 or 11 times that of Company A. The comparison is now meaningful.

B. VaR and Casualty exposure

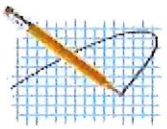
Your document states: For these reasons, A.M. Best is assessing the merits of hard coding the impacts of extreme confidence intervals such as the 99.8 and 99.9 VaRs into the balance sheet strength assessment. Rather, these intervals and other relevant data points might be more appropriate in another part of the BCRM – for example, as a component of Enterprise Risk Management, and the linkage between these extreme events and a company's risk tolerance and risk appetite statements.

In theory, we see no issue with a VaR of 99.8% or 99.9%. However, A.M. Best should be clearer as to what an A++ rating is intended to mean. Does A.M. Best intend to opine that an A++ rated company would be expected to remain solvent in all but the 0.1% worst year? A.M Best should indicate what each rating level is intended to convey and use VaR levels that correspond to them.

In addition, A.M. Best seems to be deciding that property catastrophe can be modeled and insurers concentrated in property will receive intense scrutiny in the new model. Meanwhile, companies that specialize in very risky casualty exposures will not. This issue is compounded by the possibly undue consideration that A.M. Best gives to short term operational results.

For example, consider two Workers Compensation specialists with identical balance sheets and business portfolios. Company X buys $5 million of reinsurance per occurrence at a rate of 10% of Direct Premium. Company Y buys $30 million of reinsurance per occurrence at a rate of 25% of Direct Premium. The new model does not seem to capture the huge risk Company X is retaining. Meanwhile, since a $30 million loss may be a 1% event, the consequence of X's decision will probably not be apparent in X's 5 or 10 year operating results. Company Y, although much more secure, will have operating 5 and 10 year operating results that are significantly less profitable, and A.M. Best will likely rate X higher than Y.

A.M. Best should research how to model casualty exposures at various VaR levels. Even if the new BCAR is never implemented, the example of Company X and Y likely exists today.



[redacted]

06/20/2016 05:48 PM

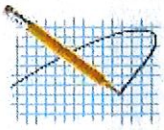
To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject New Methodology Question

I have a question on the charges applied to equity security holdings. I understand that the baseline factors are based upon expected (unfavorable) returns over each return period used in the model. Are these factors based on pre-tax or post-tax returns. If pre-tax, is there any consideration in the model for the deferred tax liability associated with associated unrealized losses?

Your insight is appreciated. Please feel free to call me, if appropriate.

[redacted]

[redacted]



[redacted]

06/21/2016 01:44 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc [redacted]

Subject Comment on the planned revisions to its core rating methodology, Best's Credit Rating Methodology (BCRM), as well as its criteria procedure for the U.S. property/casualty Best's Capital Adequacy Ratio (BCAR).

1. Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".

We understand the building block approach, however we believe the BCRM is not sufficiently transparent. Moreover, we feel the methodology is less transparent than the current approach. The building blocks are unfairly skewed towards downwards movements. The reason provided by AM Best when enquiring on the reasons was "we felt this is more appropriate". Where is objectivity and transparency in this?

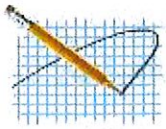
2. Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management or Comprehensive Adjustment in BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.

Business Profile is defined very vaguely defined and we suggest to consider a more concrete and objective measure such as "Line of Business Profile" and "Source of Distribution" to be more transparent.
Enterprise Risk Management is an appropriate dimension only with reasonable symmetric up/down movement as well as a reasonable and transparent methodology to rate the ERM of a company (similar to S&P).

Comprehensive Adjustment is not making any sense and is totally wrong in the context. We propose to remove it altogether. It is just a placeholder to justify going out with a methodology, which is not sufficiently tested. If the methodology is robust, the manual adjustments should be removed in favor of objectivity.

3. What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 and 99.9)?

VaR is only appropriate and justified in a risk areas such as high frequency day-trading, where potential skewness and other problems of the loss function can be compensated through sufficient data and the time horizon is short. In particular VaR is not appropriate for (Re) Insurance industry. This is unfortunately only reflected in the Swiss regulation until now. Furthermore, trying to quantify/estimate such a measure at 99.8 or 99.9 in insurance industry is theoretically not sound, practically very difficult to implement in a transparent way and in essence without any meaning in any context except catastrophes.



**Beau Lescott <blescott@crvflp.com>**
06/23/2016 05:10 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject Question on BCAR changes

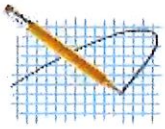
Hi,

I am doing insurance industry research and I was hoping someone from AM Best might be able to speak to me about BCAR and how it might change with respect to fixed income risk weightings.

Thank you,

Beau Lescott

**Beau Lescott**
**Chimney Rock Investments**
**(212) 257-5571**
**blescott@crvflp.com**



'[redacted]
06/24/2016 12:10 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject [redacted] - Comment Letter Regarding Revised Credit Rating Methodology

1 attachment

Confidential Comment Letter - AM Best Revised Methodology.doc

Attached is our comment letter regarding the proposed revised credit rating methodology announced on March 10, 2016. We request this comment letter be kept confidential.

[redacted]

[redacted]

[redacted]

June 24, 2016

Confidential

A.M. Best
Ambest Road
Oldwick, NJ 08858

Via E-mail:
Attn: methodology.commentary@ambest.com

Re: Proposed Revisions to Best's Credit Rating Methodology (BCRM) and U.S. Property/Casualty (P/C) Best's Capital Adequacy Ratio (BCAR)

Dear Sir or Madam:

The [redacted] appreciates the opportunity to comment on the proposed revisions to A.M. Best's core credit rating methodology, Best's Credit Rating Methodology (BCRM) and A.M. Best's proposed revisions for the criteria procedure for the U.S. property/casualty (P/C) Best's Capital Adequacy Ratio (BCAR).

[redacted]

[redacted] truly appreciates the effort and diligence of A.M. Best to provide greater detail, clarity and transparency to the rating process. We recognize that the proposed revisions to A.M. Best's core rating methodology do not represent a fundamental change to the rating analysis and provides added transparency with its proposed building block approach, accordingly, we have limited our comments to matters related only to the proposed BCAR criteria procedures update for U.S. property/casualty companies.

Our comments pertaining to the proposed BCAR criteria procedures update for U.S. property/casualty companies are as follows:

Available Capital ("AC") - It is our understanding that there were no changes proposed in the measurement of AC with the exception of the treatment of Catastrophe Risk as a component of Net Required Capital as opposed to the existing treatment as a reduction in AC. Accordingly we have no comments related to AC at this time.

Net Required Capital ("NRC") – We have summarized our comments with respect to the proposed changes to NRC commencing with each component of Gross Required Capital followed by commentary related to the Covariance Adjustment.

Gross required capital – (B1) Fixed Income Securities Risk

Our primary comments pertaining to investments relate to the treatment of tax-exempt municipals Specifically does the proposed BCAR methodology take into account differences in the observed credit default risk and interest rate risk of tax-exempt municipals as compared to U. S. treasury securities and corporate bonds? See related Interest Rate Risk comment section following also.

1) It is our understanding that default risk in the proposed capital model is quantified based on credit rating, time to maturity and recovery rate. Does the proposed BCAR methodology distinguish between the much lower historical default rate of municipal bonds of the same credit rating relative to corporate bonds? For example, the average 10 year cumulative default rate of Aaa and Aa-rated municipal bonds (period 1970-2014) was 0.00% and 0.01%, respectively, while it was 0.48% and 0.99% for corporate issuers. We believe it should.

2) Are pre-refunded municipals treated as credit-risky bonds in the proposed capital model? These securities are typically defeased with U.S. Treasuries held in an escrow account and comprise approximately 20% of our municipal portfolio. We believe any credit risk on pre-refunded municipals should be based on the underlying securities held in escrow.

Gross required capital – (B2) Equity Securities Risk

3) We observe the significant increase in the capital factors used for common equity in the proposed model and note that they are approximately 20% higher than those generated in the economic scenario generator ("ESG") used by us.

4) We observe that the current proposed capital factors for Company Occupied Real Estate and Investment Real Estate utilize the same capital risk charge factors. We believe that the inherit risks in Company Occupied real estate is inherently lower based on the nature and use of such property and accordingly would expect that a lower capital risk charge factor would be more appropriate.

5) With respect to securities lending collateral we recommend that the baseline charge of 10% be changed to provide a look-through approach to more appropriately reflect the amount of credit risk. The collateral is currently disclosed in Schedule DL in the U.S. statutory statements.

Gross required capital – (B3) Interest Rate Risk

6) It is our understanding that interest rate risk in the proposed capital model is quantified using specific changes in interest rates based on the A.M. Best ESG results for the five year U. S. Treasury. While the magnitude of these interest rate changes appear reasonable (and consistent with results from the ESG that we use) and appropriate for use for U.S. taxable bonds, does the proposed BCAR methodology make any distinction to account for the lower interest rate volatility of tax exempt municipals? On average, the magnitude of historical yield curve changes for the tax-exempt municipal reference curve is about 80% of the size of interest rate changes for US treasuries. We believe it should.

7) We understand that the proposal assumes that a tail event for interest rate shocks occurs at the exact same time as an equivalent tail event for a catastrophe. The likelihood of, for example, a 1-in-20 (95%) interest rate shock at the same time as 1-in-20 catastrophe is far less than 1-in-20. We recommend that the proposal give consideration to the above observation.

8) The liquidity requirements for catastrophes are historically spread out over time and therefore not instantaneous with the event occurrence, with slower payouts for larger events. As such, most insurers can meet cash demands from even the largest catastrophe through normal operating cash flows as opposed to having to liquidate investments. We recommend that the proposal consider and give credit to operating cash flows in addressing the cash needs from catastrophes.

9) If investments need to be liquidated, the proposal assumes that the liquidation is spread out across all assets, regardless of maturity or duration. We would expect that in practice if liquidation is needed then the shorter duration assets are more likely to be liquidated. Part of the reason is the ability to re-position the portfolio duration and liquidity as new cash flows come in. We recommend that the proposal give consideration to the above observation.

Gross required capital – (B4) Credit Risk

10) We consider the 5% charge for deferred agents' balances to be excessive based on historical write-off experience and the ability to cancel the remaining coverage due to non-payment which reduces the collection risk.

11) We believe that the use of 100% default rates for unrated reinsurers may materially overstate the risk associated with captives, as such captives may be owned by highly rated and very strong companies. We recommend that when captives are a material portion of the recoverable, the proposal should have an alternative approach assessing credit risk which gives consideration to underlying ownership structure.

12) Regarding reinsurance collectability, the limitation of only 90% credit for collateral may materially overstate the collectability risk for catastrophe bonds. We recommend that the

treatment of collateral related to catastrophe bonds be separately evaluated based on the underlying collateral and reinsurance agreement terms.

Gross required capital – (B5) Loss and LAE Reserves Risk

13) The proposal appears to be based on only one year's Schedule P filings. In contrast, the Casualty Actuarial Society's RBC Dependencies and Calibration Working Party has been able to group Schedule Ps over multiple years to obtain longer experience periods. This has allowed them to study whether certain items (such as correlations and risk factors) are stable over time. We recommend that consideration be given to the above, which at a minimum would provide a basis for evaluating how stable some of the recommended factors are over time.

14) For reserve development, basing the "stability" factors on Schedule P case development may not be accurate, as it can be impacted by a change in mix by company. The underlying development can be perfectly stable by sub-line, but a change in mix can cause the proposed model to impute instability that does not exist. In addition, changes in case reserve adequacy sometimes occur due to different claim management strategies, that may not affect total estimated ultimate indications. We believe the stability should be assessed with regard to total incurred estimates and not solely on case incurred estimates.

15) Is consideration giving to the concept that not all potential adverse development may be knowable in one year? To the extent that it takes longer to emerge, an operation with positive franchise value (and hence probably future earnings) will be able to generate capital through future calendar and/or accident year earnings which would serve to offset or absorb adverse emergence.

Gross required capital – (B6) Net Premiums Written

16) See comment 13 above.

Gross required capital – (B7) Business Risk

17) No comments at this time.

Gross required capital – (B8) Catastrophe Risk

18) We would consider the far tail values being proposed for use in BCAR (specifically the 99.9% and possibly the 99.8%) to be more speculative than reliable. That level is beyond the ability to reliably model and validate. Part of the reason is that many risks are over-time risks, not within a set period of time risks. In other words, the risk is that the environment will change as opposed to the risk of tail outcome within the existing

environment. We also note that the proposed model seeks to parameterize the 1-in-1000 risk using only 10,000 simulations, implying only about 10 observations to estimate this tail value. It is our current understanding that Best's Briefing issued on May 5, 2016 has given recognition to this concern of ours.

19) We recommend that the Supplemental Rating Questionnaire ("SRQ") be revised to provide for the reporting of the required "all-perils" catastrophe exposures together with the estimated load for loss adjustment expenses.

Covariance Adjustment

21) We believe it would be appropriate to include the catastrophe charge included in the co-variance calculation (i.e. inclusion in the square root), as opposed to the current proposal to exclude it from the covariance formula. Placing this risk outside the covariance implies that it is perfectly correlated with the overall level of the other risks which we do not believe to be appropriate.

Summary

Thank you for the opportunity to comment on the proposed revisions to the BCRM and BCAR. We know that A.M. Best has been diligent in their approach to provide greater detail, clarity and transparency in the rating process. As permitted, we request that our response remain confidential. If we can assist you in any way, we would be pleased to answer any questions and discuss our views in any form you may hold. If you have any questions or would like to discuss our comments, please feel free to call me at [redacted]

[redacted]

PINNACOL
ASSURANCE

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pinnacol.com

Kathy Kranz
VP and Chief Financial Officer

June 23, 2016

A.M. Best
1 Ambest Rd
Oldwick, NJ 08858

Re: Comment on New BCAR Methodology

Pinnacol Assurance has reviewed the proposed new BCAR methodology. We have two concerns that we would like A.M. Best to consider before finalizing the methodology. First, the increase in investment risk factors should be offset to some degree by an assessment of diversification of investment portfolios. Second, the reserve and underwriting risk size categories include companies in the "large" category that are not truly large. The "large" thresholds should be higher.

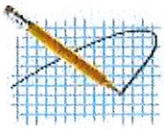
The changes in investment risk factors for most securities have increased dramatically. These increased factors may be justified by the isolated risk of each individual category. While the covariance adjustment in BCAR can reduce required capital between fixed income (B1) and equity-type (B2) securities, it does not include any analysis of the diversification of the entire investment portfolio. [redacted] We think some assessment of the diversification of the investment portfolio should be added to the BCAR analysis of net required capital.

Our other concern is the approximately $30 million threshold for "large" company size in both reserve and underwriting risk for the workers compensation line. A company with $31 million in either premiums or reserves is much more volatile than a truly large company [redacted] Including the experience from these smaller companies will cause the large company factors to be higher than they should be. It is not unusual to have an individual workers compensation claim that ranges from $1 million to $5 million. A company with only $31 million in reserves is going to have a lot of volatility in their reserve balance when one of those comes in compared to a company the size of Pinnacol that sees and absorbs claims like that regularly. A $100 million threshold seems like a more reasonable level to determine that a company is "large" in the workers compensation line of business.

We appreciate the opportunity to comment on the new methodology. If you have any questions on these comments, please contact me at 303-361-4864 or Kathy.Kranz@pinnacol.com.

Regards,

Kathy Kranz



[redacted]

06/27/2016 04:40 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject BCRM and BCAR questions

Below are answers to the questions raised in the Update Briefing dated May 5, 2016. Also included are additional questions. Please keep these anonymous.

Questions from BCAR and BCRM Update Briefing – May 5, 2016 (Will respond to the following questions via the methodology inbox at methodology.commentary@ambest.com) :

1. Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".

A: Yes for the most part. The BCAR can only get a company up to "a+" ICR = "A" FSR rating. Other components (Business Profile, Operating performance, ERM and comprehensive adjustment) can increase/decrease the score.
What are the "specific metrics" looked at that makes a company's operating performance, business profile, ERM and comprehensive adjustment - Very Strong, Strong, Adequate, Weak or Very Weak. Please provide an example of these specific metrics.

2. Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.

A: On Balance Sheet performance, why can balance sheet strength only get a company to an "a +" ICR ("A" FSR)?

On ERM, why can ERM reduce score by 4 notches (the most of any component) but only increase it 1 notch? ERM is slanted to reduce a rating instead of increase it.

3. What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?

A: In general, VaR is the best view of risk (vs. TVAR, other measures). Looking at 5 confidence levels takes away some of the drawback of VaR in that it looks at a "single value" on probability distribution and provides no other information about other potential values that are beyond that single value. The probability distribution can be based on observed historical outcomes, a theoretical distribution, professional judgement or a combination of the 3. How will BCAR be simulated to determine the 5 VaR statistical confidence levels? Based on historical outcomes, a theoretical distribution, professional judgement or a combination of the 3?

In terms of going out into the tail, there is more uncertainty the further out you go - how do you get comfortable with a 500-yr or 1000-yr event/loss when we've never seen one. This might work for risks (i.e. NAT CAT) where there is science (CAT models) and data but not for pure underwriting risk (reserve and premium) where there is no history on this.

Other Questions/Comments on model in general:

**Economic Scenario Generator (ESG)** - Regarding the ESG that is used to simulate investment risk charges; Who developed (what vendor) the ESG and how? How often is the ESG updated? What are the basic assumptions behind the ESG? How often is it recalibrated?

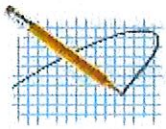
**Credit Risk charges** – why are the risk charges for "affiliated" reinsurance recoverable so high? Starting at 4% at VaR 95 to 50% at VaR 99.9%.

**CAT PML** – Is property CAT risk being picked up twice in the model? Once in premium risk (property premium (including CAT) with a risk charge) and then within the CAT PML charge?

**Company Internal Capital Models** – More detail (example) of what AMB approach looks like to incorporate internal model results in its methodology and how that will be factored into the balance sheet strength score.

Best Regards,

[redacted]



[redacted]

06/28/2016 05:32 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Comments on New A.M. Best Methodology (Anonymous)

Hello,

Please find below our anonymous comments regarding both of the new methodologies.

## New BCAR Model Methodology

1. Why is PML risk not included in the co-variance diversification formula, considering that catastrophe risk is relatively uncorrelated to most risks held by P&C insurance companies?
2. How will mandatory state reinsurance pools be treated for credit risk when they are not tied to the relevant state's general obligation funds?
3. For some entities which have regional catastrophe exposure, a 2nd PML event was historically assessed to arrive at a "Stressed" BCAR
    a. With new 5-point VaR assessment, will any 2nd events be charged, in addition to 1/500, 1/1,000?
4. Will the profitability/size factors for NWP/Reserve risk be made available for rated companies' internal use?
5. How will intercompany reinsurance recoverables be treated from a required capital perspective? (For example, will consolidated Rating Unit be charged for credit risk of recoverable and reserve risk?)

## Best's Credit Rating Methodology

6. How should the different VaR points be thought of from a rating perspective?
    a. How will the rating process change for subsidiaries using this new VaR model?
7. New greater focus on Rating Units: after determining group rating, what are quantifiable benchmarks for subsidiaries? Or will meeting requirements for "(g)" status automatically confer group rating? (Previous system was to hold subsidiaries to slightly lower BCAR requirements than their lead company in order to receive its same rating)
8. To what level of detail will the new Credit Rating Methodology be applied to rated entities?
    a. Will rated firms receive reports or commentary showing scores in the various ratios and their assignment to various rubrics? (Applies most importantly to lead rating unit)
    b. Will HoldCo receive notched rating off of lead rating unit, or will full analysis be performed and shared with rated entities?

Thanks,

[redacted]

[redacted]

06/29/2016 11:43 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>

[redacted]

Subject Comments for AM Best

1 attachment

Comments For AM Best 062716.docx

The attached word document contains our feedback. We formally request anonymity in name and company when publishing. Thank you.

[redacted]

[redacted]

## AM Best Specific Questions, *Anonymity in name and company is requested in our feedback.*

1. Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".

**Response:** The process makes sense. Transparency in its application to an individual insurer will ensure understanding in practice.

2. Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.

**Response:** The parameters make sense. Transparency in its application to an individual insurer will ensure understanding in practice.

3. What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?

**Response:**

- **VaR Metric.** VaR is a reasonable metric for a required capital measure. Reliance on one point of a distribution may lack stability of results. If VaR is AM Best's metric of choice, multiple VaRs are necessary.
- **99.8 & 99.9 Thresholds.** These extreme points on the distribution may be unreliable and inconsistently developed. For a 50,000 trial distribution, there are only 99 trials larger than a 99.8 VaR and 49 trials larger than a 99.9 VaR which raises the question of reliability. With respect to inconsistency, catastrophe PML is function of which vendor model is licensed by an insurer. Vendor results vary greatly. In addition, 99.8 and 99.9 VaR thresholds are too extreme to define required capital levels but do add value in an ERM assessment.
- **95 Thresholds.** Likewise, a 95 VaR level is not extreme enough to assess required capital. If an insurer's BCAR is not significantly above zero at a 95 VaR, would a 95 VaR add value to an analyst's knowledge of the financial condition of a company beyond metrics already available to the analyst?
- **99.5 & 99.6 Thresholds.** These levels provide consistency with regulatory models of other advanced jurisdictions and of other rating agencies.
- **Multiple Thresholds.** In order to supplement one point on a distribution, multiple thresholds is a reasonable solution. Five VaRs can continue to be considered with a tighter band of thresholds. For slope of BCAR to be of value, a minimum of four VaRs may be necessary. Example, 1 in 150 (99.33), 1 in 200 (99.5), 1 in 250 (99.6), 1 in 300(99.67).
- **Alternatives.** The average of trials surrounding a specific VaR measure may be an alternative that provides greater stability and consistency than a single point. Example, average of 100 trials above and 100 trials below a certain VaR threshold). A tail Value at Risk measure might also be an alternative.

## Additional Feedback, *Anonymity in name and company is requested in our feedback.*

**Premium Risk and Catastrophe Risk Overlap.**

- Is required capital for Catastrophe ("Cat") exposures duplicated in Premium Risk and Catastrophe Risk charges? Written premium related to cat exposures is included in the premium risk calculation. If premium risk capital factors are based on data that includes cat experience, the premium risk capital factors contemplate cat risk.

**Catastrophe ("Cat") Risk.**

- All Perils PML provides a more comprehensive view of cat risk.
- The cat load included within premium provides funds to pay for cat losses. Consider deducting cat-related premium from cat PMLs?

**Investment Risk.**

- Consider preferred treatment for mutual funds due to their additional portfolio diversification relative direct investment in stocks and bonds.

**Liquidity/Interest Rate Risk.** Consider the following:

- Varying basis point change according to duration and rating bands.
- Re-calibrating basis point amounts as the economic environment changes.
- Are 290 and 310 basis point changes too extreme for a capital measure relative to the current interest rate environment? Example, yield on 10 year bond yield is currently well below 2%.

**Reinsurance Recoverable Risk.**

- Inclusion of duration of recoverable and diversification across reinsurers improves the analysis.
- Consider global approach to treatment of items of analyst discretion such as treatment of collateral/trusts, Pools & Association.
- Consider inclusion of contingent commission within recoverable. When right of offset language is included in the reinsurance contract, incorporation of contingent commission is more complete representation of risk.

**Question - Greater Insight on AM Best's Perspective on Slope of BCAR across VaR Thresholds.**

- What is acceptable/concerning slope to AM Best?
- What impact does slope have on the assessment of balance sheet strength and the overall rating?
- Is the impact quantitatively determined?

**Clarity of the following BCAR components will contribute to AM Best's goal of transparency surrounding an individual company's BCAR analysis:**

- Starting point ESG assumptions
- Calculation of reinsurance dependence factor
- Calculation of investment diversification factor
- Stage of underwriting cycle assumption and itemization of adjustments to capital factors
- Reserve risk stability factor in reserve risk and distributional shift in premium risk that is applied in a company's BCAR analysis
- Reinsurance recoverable capital factors by reinsurer or by rating
- Factors considered in determining treatment of collateral/funds held

[redacted]>

06/29/2016 02:21 PM

To <methodology.commentary@ambest.com>
cc
Subject BCAR comment

1 attachment

AM_BEST_ASSET_RISK_CHARGE_comment.docx

Attached please see the comment on the AM Best stochastic BCAR

[redacted]

**TO: A.M. Best Company**

[redacted]

**SUBJECT: The case for lowering the equity risk charge in the stochastic-based BCAR**

We look forward to stochastic-based enhancements to A.M. Best's Capital Adequacy Ratio (BCAR) model due to launch in the second quarter of 2016. We believe this update is, in general, a step in the right direction with the changes made to tail risk particularly helpful when assessing the default rating of insurance companies. Using stochastic-based modeling and Value at Risk (VaR) metrics will align nicely with the overall ratings process as companies adopt this approach into their risk management frameworks.

## INVESTMENT RISK

However, we believe the changes to investment risk charges are less well considered. Investment risk has become an important issue in recent years as rating agency charges have discouraged carriers from using equities, an empirically proven hedge against the potential for increasing interest rates and inflation. We feel A.M. Best's new investment risk charges, and those relating to equities risk in particular, do not reflect the current economic environment. The charges are too high and have forced carriers to move their investments into fixed income at a time of historically low interest rates. Furthermore, the new BCAR model does not account for correlations between the asset and liability side which may have implications in future financial environments.

## EQUITIES VS FIXED INCOME

A.M. Best's negative view on investment risk is not supported by past performance. As Figure 1 shows, equities significantly outperformed every other major asset class, including fixed income, between 1802 and 2013 (with a long-term return of 6.7% compared to 3.5% for fixed income). Moreover, equities have historically served as a natural hedge against inflation, particularly during times of low interest rates (see Figure 2).

**Figure 1:** Total Returns on US Stocks, Bonds, Bills, Gold and the Dollar – 1802 to 2013
*(Source: The Future for Investors by Jeremy Siegel)*

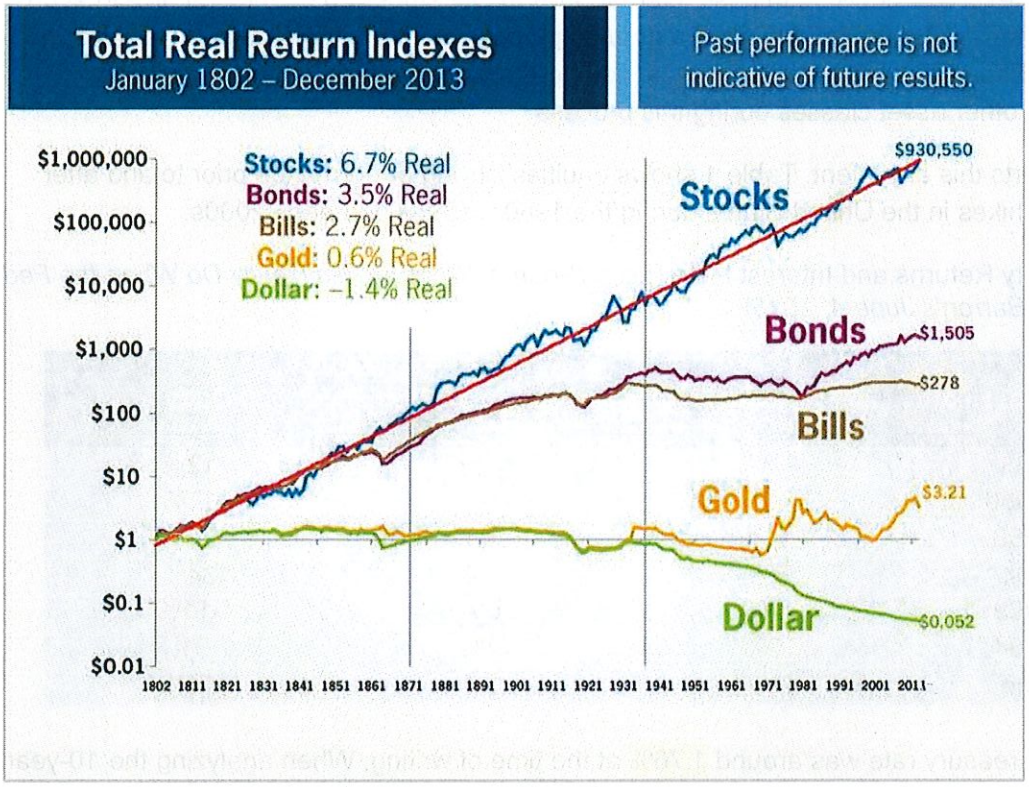
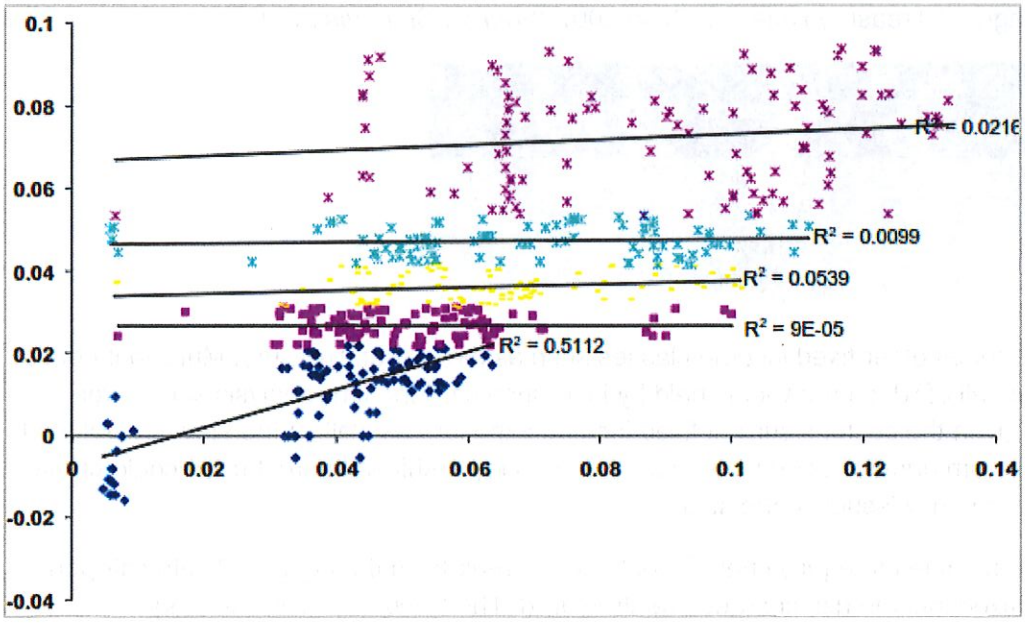



**Figure 2:** Historical Changes to Year-on-Year Inflation vs One Year Yields *(Source: Conning)*



## FEDERAL RESERVE TIGHTENING AND EQUITY RETURNS

The Federal Reserve's decision to raise interest rates in December 2015, the first hike in almost a decade, is likely to be the beginning of a gradual process toward interest rate normalization. Although the Fed will be raising rates from a historically low base, equities have generally outperformed other asset classes during this process.

History supports this argument. Table 1 shows equities' strong performance prior to and after six initial rate hikes in the United States during the 1980s, 1990s and early 2000s.

**Table 1:** Equity Returns and Interest Rate Rises *(Source: What Stocks Really Do When the Fed Hikes Rates, Barron's June 4, 2015)*

| Date of Initial Hike | 250 Days Before | 250 Days After | 500 Days After |
|---|---|---|---|
| 5/2/1983 | 37% | -1% | 12% |
| 12/16/1986 | 19% | -6% | 11% |
| 3/29/1988 | -11% | 12% | 31% |
| 2/4/1994 | 5% | 1% | 34% |
| 6/30/1999 | 20% | 6% | -11% |
| 6/30/2004 | 15% | 4% | 9% |
| **Average** | **14%** | **3%** | **14%** |

The 10-year Treasury rate was around 1.76% at the time of writing. When analyzing the 10-year Treasury over the last 50 years or so, there are four distinct time periods that can be averaged, all of which are significantly higher than today (see Table 2).

**Table 2:** Average 10-Treasury Rate – 1967 to 2007 *(Source: St. Louis Fed)*

| Time Period | Average 10-Treasury Rate |
|---|---|
| 1996 to 2007 | 5.11% |
| 1967 to 1977 | 6.78% |
| 1986 to 1995 | 7.68% |
| 1978 to 1985 | 11.30% |

This holds true for all other fixed income classes such as the 5-year Treasury, Municipal bonds and Corporates, all of which are widely held by insurance carriers. Our analysis shows, for example, that given the sector's current fixed income exposure as well as the elevated value of high-grade, medium duration fixed income securities, a rapid shift in interest rates could create illiquidity if not solvency issues in the sector.

One way of addressing the equity charge would be to breakdown the equity risk into categories, similar to how fixed income risk charges are structured. The Securities and Exchange

Commission (SEC) uses different (albeit static) risk factors when assessing liquidity risk for broker dealers. The SEC separates equities into the following three categories:

1. National market stocks: These stocks are actively traded and have three or more market makers. A risk charge of 15% is applied to this category.
2. Limited market stocks: These stocks have a limited market with only one or two market makers. A risk charge of 40% is applied to this category.
3. No market: These stocks have no market makers, or are private equity. A risk charge of 100% is applied to this category.

Interest rate and inflation risks are increasing. Elevating the risk charge for an asset class that protects the balance sheet from this risk would deprive insurance carriers of one of their most potent tools to combat this risk. Given the likelihood of sustained interest rate rises over the next few years, we believe that A.M. Best's equity risk charge should be significantly lower than the 50% outlined recently at the A.M. Best Review / Preview conference.

Once a more normalized interest rate environment is established, the scales should be shifted back to equity charges being higher and fixed income charges being lower. Failing to take into account current, unprecedented macroeconomic conditions would be to rely too much on modeled outputs, without actually looking at the whole picture. This would, in turn, run the risk of rendering carriers' balance sheets more susceptible than necessary to interest rate and inflation risk in the near-term.

[redacted]

Sincere regards,

[redacted]

## APPENDIX

Interest rates rose at one of the fastest rates in recent memory across all fixed income products during the late 1970s and early 1980s. Using the time period of 1979 to 1981 as a study, we ran a series of evaluations for fixed income and equities portfolios to assess the impact of gains and losses. This was done by using a statement value of USD 850 million for investment at the start of 1979. Each evaluation study assumed that the total USD 850 million was invested in one asset class only. Total capital was invested into each of the following classes of bonds: AAA, BAA, municipal and 10-year Treasuries. The equity investment used the S&P 500 and the Russell 2000.

| **Bond Portfolio of BAA** | *Statement Value* | *Avg Mat (Yrs)* | *Yield* | | |
|---|---|---|---|---|---|
| | $ 850,000 | 5.6 | 10.00% | | |
| **Time Period** | *Statement Value* | *Avg Mat (Yrs)* | Average Rate (during period) | *Possible loss* | *Possible % loss* |
| *1979* | $ 825,756 | 5.6 | 10.69% | $ (24,244) | -2.9% |
| *1980* | $ 730,624 | 5.6 | 13.67% | $ (119,376) | -14.0% |
| *1981* | $ 660,663 | 5.6 | 16.20% | $ (189,337) | -22.3% |
| *High* | $ 635,909 | 5.6 | 17.18% | $ (214,091) | -25.2% |
| **Bond Portfolio of Muni's** | *Statement Value* | *Avg Mat (Yrs)* | *Yield* | | |
| | $ 850,000 | 5.6 | 6.00% | | |
| **Time Period** | *Statement Value* | *Avg Mat (Yrs)* | Average Rate (during period) | *Possible loss* | *Possible % loss* |
| *1979* | $ 829,538 | 5.6 | 6.52% | $ (20,462) | -2.4% |
| *1980* | $ 753,734 | 5.6 | 8.59% | $ (96,266) | -11.3% |
| *1981* | $ 658,469 | 5.6 | 11.58% | $ (191,531) | -22.5% |
| *High* | $ 619,201 | 5.6 | 12.97% | $ (230,799) | -27.2% |
| **Bond Portfolio of 10 Year T** | *Statement Value* | *Avg Mat (Yrs)* | *Yield* | | |
| | $ 850,000 | 5.6 | 9.00% | | |
| **Time Period** | *Statement Value* | *Avg Mat (Yrs)* | Average Rate (during period) | *Possible loss* | *Possible % loss* |
| *1979* | $ 834,017 | 5.6 | 9.44% | $ (15,983) | -1.9% |
| *1980* | $ 765,297 | 5.6 | 11.46% | $ (84,703) | -10.0% |
| *1981* | $ 688,715 | 5.6 | 14.00% | $ (161,285) | -19.0% |
| *High* | $ 672,340 | 5.6 | 14.59% | $ (177,660) | -20.9% |
| **Bond Portfolio of AAA** | *Statement Value* | *Avg Mat (Yrs)* | *Yield* | | |
| | $ 850,000 | 5.6 | 9.00% | | |
| **Time Period** | *Statement Value* | *Avg Mat (Yrs)* | Average Rate (during period) | *Possible loss* | *Possible % loss* |
| *1979* | $ 827,232 | 5.6 | 9.63% | $ (22,768) | -2.7% |
| *1980* | $ 750,027 | 5.6 | 11.94% | $ (99,973) | -11.8% |
| *1981* | $ 679,771 | 5.6 | 14.32% | $ (170,229) | -20.0% |
| *High* | $ 654,080 | 5.6 | 15.27% | $ (195,920) | -23.0% |

During times of rising rates, our study clearly shows that fixed income performs poorly and large losses would have to be taken if portfolios needed to be liquidated. Conversely, equities outperform by a large margin. The same capital of USD 850 million invested in either the S&P 500 index or the small cap Russell 2000 index performs well.

| S&P 500 | Statement Value at 1/31/1979 | shares | |
|---|---|---|---|
| | $ 850,005 | 8,506 | |
| **Time Period** | Statement Value | Unrealized Gain/Loss | Gain/Loss% |
| 1979 | $ 971,045 | $ 121,040 | 14.2% |
| 1980 | $ 1,101,952 | $ 251,948 | 29.6% |
| 1981 | $ 1,024,122 | $ 174,118 | 20.5% |
| **Russell 2000** | Statement Value at 1/31/1979 | shares | |
| | $ 850,023 | 19,240 | |
| **Time Period** | Statement Value | Unrealized Gain/Loss | Gain/Loss% |
| 1979 | $ 1,164,020 | $ 313,997 | 36.9% |
| 1980 | $ 1,430,109 | $ 580,086 | 68.2% |
| 1981 | $ 1,365,270 | $ 515,247 | 60.6% |

We also assessed performances during times of falling interest rates by analyzing the time period from 2000 to 2003 (when rates declined precipitously). Under this scenario, bonds saw gains and stocks declined.

| Bond Portfolio of BAA | Statement Value | Avg Mat (Yrs) | Yield | | |
|---|---|---|---|---|---|
| | $ 850,000 | 5.6 | 8.90% | | |
| **Time Period** | Statement Value | Avg Mat (Yrs) | Average Rate (during period) | Possible gain | Possible % gain |
| 2000 | $ 875,913 | 5.6 | 8.21% | $ 25,913 | 3.0% |
| 2001 | $ 885,156 | 5.6 | 7.97% | $ 35,156 | 4.1% |
| 2002 | $ 907,199 | 5.6 | 7.41% | $ 57,199 | 6.7% |
| High | $ 949,549 | 5.6 | 6.38% | $ 99,549 | 11.7% |
| **Bond Portfolio of Muni's** | Statement Value | Avg Mat (Yrs) | Yield | | |
| | $ 850,000 | 5.6 | 6.00% | | |
| **Time Period** | Statement Value | Avg Mat (Yrs) | Average Rate (during period) | Possible gain | Possible % gain |
| 2000 | $ 872,303 | 5.6 | 5.45% | $ 22,303 | 2.6% |
| 2001 | $ 886,609 | 5.6 | 5.11% | $ 36,609 | 4.3% |
| 2002 | $ 896,586 | 5.6 | 4.87% | $ 46,586 | 5.5% |
| High | $ 916,419 | 5.6 | 4.41% | $ 66,419 | 7.8% |
| **Bond Portfolio of 10 year T** | Statement Value | Avg Mat (Yrs) | Yield | | |
| | $ 850,000 | 5.6 | 6.44% | | |
| **Time Period** | Statement Value | Avg Mat (Yrs) | Average Rate (during period) | Possible gain | Possible % gain |
| 2000 | $ 884,746 | 5.6 | 5.58% | $ 34,746 | 4.1% |
| 2001 | $ 907,438 | 5.6 | 5.04% | $ 57,438 | 6.8% |
| 2002 | $ 945,482 | 5.6 | 4.17% | $ 95,482 | 11.2% |
| High | $ 972,835 | 5.6 | 3.57% | $ 122,835 | 14.5% |
| **Bond Portfolio of AAA** | Statement Value | Avg Mat (Yrs) | Yield | | |
| | $ 850,000 | 5.6 | 7.99% | | |
| **Time Period** | Statement Value | Avg Mat (Yrs) | Average Rate (during period) | Possible gain | Possible % gain |
| 2000 | $ 871,876 | 5.6 | 7.42% | $ 21,876 | 2.6% |
| 2001 | $ 891,637 | 5.6 | 6.92% | $ 41,637 | 4.9% |
| 2002 | $ 922,321 | 5.6 | 6.17% | $ 72,321 | 8.5% |
| High | $ 963,064 | 5.6 | 5.22% | $ 113,064 | 13.3% |

| S&P 500 | Statement Value at 1/31/1979 | shares | |
|---|---|---|---|
| | $ 851,124 | 586 | |
| **Time Period** | Statement Value | Unrealized Gain/Loss | Gain/Loss% |
| 2000 | $ 732,184 | $ (118,940) | -14.0% |
| 2001 | $ 631,075 | $ (220,049) | -25.9% |
| 2002 | $ 564,664 | $ (286,460) | -33.7% |

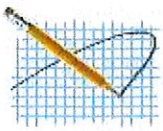
| Russell 2000 | Statement Value at 1/31/1979 | shares | |
|---|---|---|---|
| | $ 850,500 | 1,680 | |
| **Time Period** | Statement Value | Unrealized Gain/Loss | Gain/Loss% |
| 2000 | $ 815,338 | $ (35,162) | -4.1% |
| 2001 | $ 857,926 | $ 7,426 | 0.9% |
| 2002 | $ 740,880 | $ (109,620) | -12.9% |

Asset class volatility was also reviewed. The volatility of the S&P 500 index monthly from 1928 until May 2016 was 5.4%. The biggest monthly decline occurred in 1931 (30%), followed by a 22% monthly decline in 1987. The largest one month upsides occurred in July and August of 1931 (36% and 39%, respectively).

Russell 2000 data only goes back to 1979 and has a monthly volatility of 5.6%. The largest one month loss was 30% in 1987. The largest one month gains were 16.4% in February 2000 and 15% in April 2009.

In order to compare the volatility across all asset classes during the same time period, the starting point was 1962 until April 2016.

| S&P500 | AAA bonds | BAA bonds | Muni | 10-year Treasury |
|---|---|---|---|---|
| 4.3% | 2.8% | 2.5% | 3.6% | 4.7% |



[redacted]

06/30/2016 05:59 AM

To <methodology.commentary@ambest.com>
cc [redacted]
Subject [request] Comments on Draft of BCRM and BCAR

Dear. Sir/Madam

In response to your request of March 10, 2016, we have submitted comments on draft of the U.S. propety/casualty (P/C) Best's Capital Adequacy Ratio (BCAR) as follows.
We would like to request that our comments are kept confidential.

[Comments on draft of BCAR]

□. Structural Overview
In this revision, investment risk capital factor for common stocks has significantly increased from 15%. However, we do not think it is appropriate to increase the capital factor when catastrophe risk and investment risk are integrated with simple sum, assuming correlation of 1.
First, there is no clear evidence of high correlation between catastrophe risk and investment risk. On the one hand, it is clear that there are no cause-and-effect relationships that catastrophe risk occurs when investment risk occurs. On the other hand, it is certainly possible that investment risk happens due to the occurrence of the catastrophe risk. However, catastrophe risk occurs on a specific region, and thus is a local event, which is less likely to affect the overall stock market. Even if the overall stock market falls, the negative effect is usually temporal and does not last permanently. Instead, positive effect would rather be observed sometimes in light of reconstruction demand. Therefore the correlation between catastrophe risk and investment risk should be low and is quite unlikely to be 1 at least.
Second, the conservativeness by assuming the correlation between catastrophe risk and investment risk to be 1 will vary according to insurer's portfolio. If insurer's portfolio is inclined to one of the two, the diversification benefit between catastrophe risk and investment risk is not so large anyway. Thus the effect of conservativeness is also small. On the other hand, if insurer's portfolio is well balanced and diversified, the diversification benefit is the largest. In this case, assuming correlation of 1 leads to too conservative evaluation. In other words, evaluation will lose consistency among insurers, which is not appropriate for the rating evaluation method.
Please note that not only investment risk, but also net written premiums risk and loss & LAE reserves risk are set to have correlation of 1 to catastrophe risk. There are, however, no serious issues with these correlations in light of consistency of rating evaluation. Thisi is because all insurers take net premium risk and loss & LAE reserves risk and thus every insurer will be similarly affected.

Based on the two points mentioned above, three options are left for consistent risk evaluation.

a. First option: If catastrophe risk and investment risk are to be evaluated fairly and individually, these risks should be integrated based on appropriate correlation and the diversification benefit should be fairly evaluated.

b. Second option: We think the first option is the most general method, however, if A.M.Best believes that it is appropriate to evaluate insurers' solvency after the occurrence of catastrophe risk, catastrophe risk should be simply added to the integrated risk of catastrophe risk and investment risk. Because the second catastrophe risk might occur after the first catastrophe

risk. It is rather possible that wind and flood risks happen in succession. Therefore, there is no reason to exclude the second catastrophe risk in evaluating insurer's solvency after the first catastrophe risk and it should be integrated with other risks.

c. Third option: the second option is rational, but is not easy for everyone to explain why catastrophe risk has to be considered twice. Therefore if A.M.Best would like to adopt the method that catastrophe risk is considered only once, the capital factor for investment risks should be lower than the proposed number and be same level as those of the current BCAR.

In summary since there are close relationship between the individual evaluation method and the integration method of catastrophe risk and investment risk, BCAR model should be designed based on the comprehensive understanding of these relationship. We believe that one of the three options mentioned above should be adopted for the new BCAR model.

□. Investment Risk, Interest Rate Risk
In our view, universal version should ensure that conglomerates with globally diversified business will be evaluated properly.

a. We would like to request that risk factors for the non-US market should be applied for the exposure of non-US markets. [redacted]

b. Geographical diversification benefit should be considered in calculating investment risk and interest rate risk when an insurer has geographically diversified portfolio. [redacted]

□. Reserve Risk
In BCAR for US P&Cs, Reserve Risk is to be calculated based on Typical Reserve Risk Capital Factors, but Typical Reserve Risk Capital Factors for Size Category Large are 3%-182% higher than the reserve risk factors used in ICS's 2015 Quantitative Field Testing (99.5VaR), and excessively conservative in our view.
We believe excessive conservatism should be avoided in the preparation of the Universal version.

□. Premium Risk
In BCAR for US P&Cs, Premium Risk is to be calculated based on Typical Premium Risk Capital Factors, but Typical Premium Risk Capital Factors for Size Category Large are 8%-89% higher than the Premium risk factors used in ICS's 2015 Quantitative Field Testing (99.5VaR), and excessively conservative in our view.
We believe excessive conservatism should be avoided in the preparation of the Universal version.

□. Available Capital
There is an item for "Goodwill & Intangibles" in "Other Adjustments" of "Capital & Capital Adjustments" in Exhibit G.1. If this item is same as "Intangible Assets (Goodwill +PVFP)" of the current BCAR, [redacted]

[redacted]

a. [redacted]

[redacted]

Please feel free to contuct us if you have any questions about the comments.

Sincerely yours,

[redacted]

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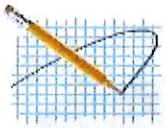
[redacted]

**********



[redacted]

06/30/2016 07:30 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc

Subject Comments on Updated BCAR Methodology

[redacted] is commenting on the draft criteria procedure described in "Understanding Best's Capital Adequacy Ratio (BCAR) for U.S. Property/Casualty Insurers," dated March 10, 2016. We request that these comments be treated as confidential and do not wish to have [redacted] attached to them in any published record or public forum.

1. Equity capital factors: For several reasons, we believe that the equity security capital factors proposed in the new BCAR model criteria are excessively punitive. In general, applying assigning capital factors based on expected investment returns over infrequent return periods ignores the resilience of the equity markets throughout their history. Unlike underwriting catastrophe losses, investment losses have historically recovered and achieved long-term returns that have exceeded those of other major classes of holding. [redacted] Since two standard deviations from the mean is approximately the 95th percentile, this suggests that a capital factor on equities of 21% may be more appropriate than the 25% that the proposed methodology uses at VaR 95. Further, there is no apparent "tax effect" on the capital factor or to adjusted surplus that accounts for the increase in the deferred tax asset (or offset to an existing deferred tax liability) that would result from an equity investment loss. As a result, the impact to the capital requirement and the adjusted surplus used in these calculations do not appear to be evaluated on the same basis. We believe that establishing the starting point for the equities capital factor at 20% and netting it down to account for a 35% statutory tax rate to 13% is a more appropriate treatment and reflects the actual impact to company capital.

2. Return periods: We believe that the use of the 1-in-500 and 1-in-1000 year return periods are not reliable enough to use as an input for evaluating company debt and financial strength ratings. Results at those return periods are highly sensitive to model assumptions and inputs and are likely to change materially over the periods that the new methodology and criteria will be in use. In our opinion, this introduces unnecessary volatility into the ratings process.

3. Use of the economic scenario generator: We also believe that additional information needs to be provided regarding the Economic Scenario Generator (ESG) assumptions used in developing the capital factors throughout the revised BCAR model to facilitate greater transparency. Our experience with stochastic capital models suggest that they are highly sensitive to the underlying assumptions within the ESG for a given model period. To understand the capital factors, one must understand the inputs to the ESG and we ask that A.M. Best provide more detail to industry regarding how those inputs are developed and validated and how capital factors are expected to change year-over-year based upon economic assumptions included in the ESG.

These comments are provided for your consideration and we look forward to future discussions on the topic.

[redacted]

**Michelle Rogers <mrogers@namic.org>**
06/30/2016 12:34 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject NAMIC Comments on proposed revisions to Bests' Credit Rating Methodology (BCRM) and Best's Capital Adequacy Ratio (BCAR)

1 attachment

A.M. Best Proposed Revisions to BCRM-BCAR - NAMIC Comment Letter - FINAL.pdf

Thank you for the opportunity to comment on the A.M. Best proposed revisions to the Credit Rating Methodology (BCRM) and Capital Adequacy Ratio (BCAR). Attached is the comment letter reflecting NAMIC's suggestions and comments on the revisions. We appreciate the opportunity to provide our members' view on potential methodology improvements. If there are any questions please do not hesitate to contact me.

Sincerely,

Michelle Rogers

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**Michelle M. Rogers, JD**
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June 30, 2016

A.M. Best Company
Ambest Road
Oldwick, NJ 08858
VIA: methodology.commentary@ambest.com

RE: NAMIC formal comments on proposed revisions to Bests' Credit Rating Methodology (BCRM) and Best's Capital Adequacy Ratio (BCAR)

[redacted]

Thank you so much for the opportunity to review and provide comment on the proposed changes to the A.M. Best Credit Rating Methodology (BCRM) and Capital Adequacy Ratio (BCAR). NAMIC represents a diverse spectrum of insurers that rely on insurance credit ratings used for many purposes including reinsurance, regulatory, lending and government programs. Consequently, NAMIC has a significant interest in the practices for rating member companies and the measurement methodology used by A.M. Best to develop the factors that are used in the rating process.

NAMIC is the largest property/casualty insurance trade association in the country, with more than 1,400 member companies representing 39 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC member companies serve more than 170 million policyholders and write more than $230 billion in annual premiums. Our members account for 54 percent of homeowners, 43 percent of automobile, and 32 percent of the business insurance markets. Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

We have reviewed the documents and are pleased to provide comment in order to help advance our mutual interests of having a robust, accurate, effective and transparent credit rating mechanism that is focused on insurance companies and insurance groups.

## NAMIC COMMENTS - EXECUTIVE SUMMARY

NAMIC has a wide range of members from the smallest farm mutuals to the very largest mutuals, reciprocals and stock members. Our members are primarily mutual insurers so concerns about the treatment of mutuals will be the focus of our remarks. In addition, among our membership we have over 500 members that operate in a single state, 100 or so that consider themselves niche writers and approximately 40 who write a single line of business. We hope that the information we provide A.M. Best will help to explain our various members' issues and will be helpful to all concerned.

The proposed revisions to the BCRM and BCAR systems have been evolving over the last couple of years. NAMIC appreciates the transparent nature of the discussions, the frequent webinars and Q and A sessions offered and the individual company analysis tools A.M. Best has provided for the industry related to these changes. Several revisions and improvements in response to industry have been made by A.M. Best already that will ease the transition and improve the accuracy of the methodology. We specifically welcome the proposal of May 5, 2016 not to utilize the 99.8% and 99.9% VaR levels in determining the Balance Sheet Strength Assessment. Once finalized, this proposed change could alleviate the most critical concerns for many of our members. The remaining issues for NAMIC members include the redundancy of the criteria that affect NAMIC members, the subjectivity in the notching, and technical questions related to investment risk assessment, VaR metrics/stochastic modeling and catastrophe risk treatment.

NAMIC's specific concerns and recommendations are as follows:

- Concern: There is an unintended downward impact of the proposed rating process on mutual companies in general and single state and niche insurers in particular.
    - NAMIC recommends changes to the BCAR calculations to allow positive notching, or higher Balance Sheet Strength Assessment ratings, for firms that are capitalized more than 500% of NAIC RBC requirements.
    - The duplication of positive notching credit for sophisticated modeling should be replaced with an outcomes-based analysis to determine if the company, based on its own risk profile, is successfully managing its enterprise risk appropriate to the nature, scope and complexity of its enterprise.
    - NAMIC recommends A.M. Best consider additional factors to offset lack of diversity like company longevity in the geographic/niche market, low customer turnover, stability of distribution channel and its fitness for the purpose of serving the carrier's customer population.
    - NAMIC encourages A.M. Best to develop the most appropriate benchmarks for rating including those that reflect mutual company strengths. Maintaining the best stock and mutual criteria for benchmarking would provide the best unbiased results.
- Concern: The process, as set forth in the proposal, seems to provide subjective authority to the A.M. Best analyst to downgrade companies with less range for upgrades to companies.
    - NAMIC recommends including more detail in the methodology description reflecting the internal and external checks and balances A.M. Best applies to manage the subjectivity of the analyst's judgment.
    - NAMIC recommends reconsidering the levels of subjective judgment an A.M. Best analyst can use in the rating process.
- Finally, we have some technical issues/questions including:
    - Concern: The use of identical investment risk factors for Life and P/C insurers is not appropriate due to distinct differences in business models;
        - NAMIC proposes that A.M. Best conduct risk analysis and risk weighting for various investments that would be appropriate for companies that only operate in a property-casualty environment and perhaps even for multi-line companies.
    - Concern: Should the methodology use VaR metrics and stochastic modeling proposed to develop P/C risks?
        - NAMIC agrees with the A.M. Best suggestion in the May 5, 2016 update that confidence intervals of 99.8% and 99.9% VaR be eliminated from the

balance sheet strength assessment. We also suggest that any information collected at these confidence intervals should remain confidential and not be published in any A.M. Best public reports or databases.
    - NAMIC agrees that stochastic modeling is more often a tool of the ERM analysis and may be more appropriate in that context for the BCRM. NAMIC supports the use of stochastic modeling on a company by company basis but recommends recognition that such modeling is not determinative of the ERM scoring.
- Concern: NAMIC suggests changes to the enhanced emphasis on catastrophe risk in the proposed process.
    - NAMIC recommends consistency with actuarial practice that would suggest the adjustment of catastrophe risk by the covariance calculation.

NAMIC is pleased with the transparency of the A.M. Best proposed revisions to the BCRM methodology. The review process provided has been informative. The comment opportunity is a welcome approach considering the significance of the changes. NAMIC remains willing to assist with any further improvements to the credit rating process.

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**NAMIC COMMENTS -- A.M. BEST PROPOSED REVISIONS**

**General Issues**

**A. Downward Impact of Proposed Rating Process on Mutual Single State/Niche Companies**

Mutual insurers that operate in a single state often provide coverage for risks that are similar in many ways to more urban risks but are remote in location, insignificant in market size or so dispersed that larger carriers do not address their needs. This was the model of many new mutual insurers during their emergence in the 1800's and 1900's. These visionaries who started such insurance companies provided a ready market for these rural policyholders whose needs were either unmet by large carriers or who were being unfairly charged the same premiums as policyholders in much more congested, risky communities. The growth of this rural mutual industry marked the birth of significant changes in insurance rating and underwriting practices, including recognition of risk relativities between territories smaller than states, creation of unique policy language designed to address unique needs and the development of multiple criteria for the evaluation of risks.

Similarly mutual insurers operating in niche markets provide insurance products for unique industries. By developing a level of understanding of those industries they can provide tailored risk management tools, tailored underwriting/claims handling, and tailored insurance products/premiums to address real needs and leverage a knowledge advantage over general insurers. The niche carriers over time have brought the concept of specific industry-customized underwriting, claims handling, loss control and pricing to all commercial insurers, but continue to bring the best services to the niche markets they serve. Mutual single state and niche insurers have shown over time to be innovators in insurance and while some have grown to extraordinary size many have thrived for decades continuing to improve their products and services for the special focused markets they set out to serve when they were originally organized.

While these single state and niche carriers may not have the diversification that a large, complex carrier has, neither do they have the unknown risks and management challenges that complexity and diversification can unexpectedly and disastrously (*e.g.* AIG) bring to a multi-jurisdictional carrier. Granted small and niche carriers can be poorly managed, as is true with a carrier of any size or geographic scope, but the proposed A.M. Best BCAR and BCRM criteria appear to have a bias that will produce downward rating pressure for these specialty-focused companies in the industry.

Unfortunately the proposed criteria will create a greater potential for smaller specialty companies to suffer rating downgrades despite strong financial performance, years of successful operation, effective management and first-rate competence in their marketplace. The proposed criteria will place rating pressure on companies that exhibit:

- lack of diversification across many company features – product writings, loss reserves, geography, assets, production sources and reinsurers;
- limits on their ability to raise capital as mutuals;
- perceived immaturity of ERM practices;
- perceived lack of pricing sophistication; and
- volatility of results – which is inherent with smaller companies.

At the same time the methodology does not take into account the value of a company's longevity in the marketplace, the simple (not complex) nature of their business, their knowledge of their customers, the geographic or product risk they face, the very high levels of surplus some mutuals carry to offset capital concerns, the focused attention to fewer and typically more well established distribution channels. In addition, the A.M. Best criteria directs little attention to the over-reliance of an insurer on economic capital models that do not work, as witnessed by the failure during the financial crisis of companies with sophisticated pricing and capital models.

Based on our understanding of the proposed BCRM, the highest rating a typical single state NAMIC member company can initially obtain under the Balance Sheet Strength Assessment is an Issuer Credit Rating of "a+". The rating is then "notched" for Operating Performance – which for many smaller companies in our membership may well be limited to one notch. This would adjust the ICR rating to "aa-". The next assessment is Business Profile and again, many companies in our membership would probably be notched down one level due to single state focus. This would adjust the ICR rating to "a+". The final assessment is ERM. We assume most of our members will be able to demonstrate adequate ERM for their business risks which would result in no notching to the rating. So regardless of how strong and reputable a NAMIC member company is in their region and regardless of their longevity as an insurer for over 100 years, the highest rating they could realistically achieve is a Financial Strength Rating of "A". We suspect many of our member companies may start with an initial Balance Sheet Assessment ICR rating of "a" which would limit them to a Financial Strength Rating of "A-" despite decades of successful operations.

The possibility of duplicative downward notching and the minimal upward notches available should be addressed in the final version of the methodology. The A.M. Best criteria should provide the opportunity for strong and successful NAMIC members to obtain the highest ratings. As it is currently designed and calibrated, we suspect many will lose their "A" and "A+" Financial Strength Ratings.

**Recommendations:** NAMIC believes that A.M. Best did not change the criteria to indicate a negative view of or credit rating issue with mutual single state and niche companies, but these are the potential unintended consequences. We recommend that adjustments to the criteria to recognize the values represented by this segment of the industry and the potential balance between the values that diversified, complex companies offer would be an improvement in the criteria that would reflect the actual performance of companies. Suggestions we have for such revisions are as follows:

- *BCAR – Rewards for High Capitalization*: NAMIC recommends changes to the BCAR calculations to allow positive notching, or higher Balance Sheet Strength Assessment ratings, for firms that are capitalized more than 500% of NAIC RBC requirements. This would allow for these companies to offset the negative implications of the mutual structure with the positive realization that mutual insurers generally hold higher levels of capital than non-mutuals.

- *BCAR and Enterprise Risk Management (ERM) – Reduce Overemphasis on Modeling*: NAMIC notes that both the BCAR balance sheet strength assessment and the ERM criteria consider the sophistication of the economic/internal capital modeling developed by a company. This applies a redundant upgrade for companies exhibiting extensive capital modeling process that we believe will unfairly disadvantage mutuals, single state and niche companies. While some of these entities use more sophisticated modeling, the more important issue to focus on is the company's outcomes and performance. Is the company really appropriately managing, mitigating, transferring, and estimating/identifying its risks? On an outcomes-basis, is the entity successful in their risk management of all their risks, tolerances, factors and possible events? Overreliance on a sophisticated model without the overlay of sound reasoning, proper assumptions and identification of missing elements is not only unhelpful, it can be its own distinct risk by creating a false level of confidence. It is not the model that makes the company successful in ERM; it is the attention to the details and critical review of the entire program by the leadership team and ERM professionals. Small mutuals, single state and niche companies can have successful ERM programs without complex technology and should be reviewed for their results, not the technology they employ. The duplication of credit for sophisticated modeling should be eliminated and replaced with an outcomes-based analysis to determine if the company, based on its own risk profile, is successfully managing its enterprise risk appropriate to the nature, scope and complexity of its enterprise.

- *Business Profile – Balance Diversification with Simplicity:* The diversification of a company is significantly rewarded in this element of the BCRM process. Diversification of product or geographic scope and diversification of distribution channels are all viewed favorably under the criteria. There is no consideration of the complexity that selling multiple products, operating under different state/country laws or managing the sales efforts of varying distribution channels can bring to a company. While there is value in assuring that a company has options and will not become insolvent because of a single product, regulatory decision or distribution channel, there is also value in simplicity that is not recognized in the proposed credit rating process.

A company that has operated in the same geographic area or served the same niche market for over 100 years, with minimal customer turnover, with distribution channels that suit those customers and operate in that geographic area or niche market, is not rewarded under the formula. Such a company will have significantly more: 1) specific knowledge of its customers and the risks each pose; 2) knowledge of the products they write; and 3) experience with the risks and claims related to the geographic area or niche business.

In the A.M. Best proposed revisions there are no credits provided for this unique knowledge set. Companies that do not have significant diversification may balance that weakness with such knowledge and experience. NAMIC suggests that the benefits of a smaller or less diversified organization should at least protect against negative notching for lack of diversification in the methodology. If not properly addressed, this implied rating pressure for "lack of diversification" will prompt many companies to engage in "diversifying" to achieve future rating benefit – which if not done properly could lead to financial instability.

One approach is to continue crediting companies with diversity as set forth in the proposed methodology, but for non-diversified companies, before downgrading them, examine additional metrics that may offset their lack of diversification. The following are some additional metrics for consideration: company longevity in the geographic market, low customer turnover, size of the market, stability of distribution channel and its fitness for the purpose of serving the carrier's target customers. If these factors or other factors could be used to justify similar upward notching for those non-diverse carriers it could provide a more accurate view of the credit risk of the organization.

**B. Subjective Authority -- BCAR Results and BCRM Notching**

The revision discussions related to the BCAR and BCRM have revealed a great deal about the criteria and the thought process of A.M. Best analysts. The transparency of the process and the frequency of the discussions with interested parties are very welcome. Despite this transparency there remain some unknowns in the rating process. On the face of the proposal the apparent analyst discretion within the methodology can mean the difference between a very strong score and a much weaker score for an organization. This discretion is notable in the BCRM Exhibit A.6 showing the range of balance sheet strength assessments available to the analyst. The balance sheet strength is the baseline for the whole analysis and, therefore, a significant element of the methodology.

From reviewing the proposed BCRM it seems analysts have significant authority to apply subjective downward and upward notching. This subjectivity in the process has to be carefully controlled and managed to protect the validity and/or reputation of the rating system. This is especially noteworthy since the downward notching range is greater than the upward notching range, and there is not a clear definition of the objective reasons and/or calibration for supporting the notching. We suggest that additional information about the specific internal processes A.M. Best employs before finally adopting any analyst's recommendations for notching would be a valuable addition to the methodology.

**Recommendation:** NAMIC raises this issue based on the information provided in the proposed methodology and not based on the experiences of rated companies. If A.M. Best actually requires

more objective information from an analyst to determine the balance sheet strength assessment and apply notching, then we recommend an amendment to the BCRM to include a more specific notching guideline. This revision would provide a great deal more transparency in the criteria and would support soundness of the rating process.

**Technical Questions**

A. **Identical Investment Risk Factors for Life and P/C insurers**

Under the proposed revisions is it not clear if there will be differences in the analysis of investment risk for life and property-casualty companies. This issue has arisen in numerous discussions with the NAIC and with regulators. Our position is that while the particular investments viewed in isolation may seem to carry the same risk regardless of whether held by a life or property-casualty company, the goals of particular investment strategies and portfolio diversifications are not the same. Under a life business model the goal is to achieve accurate asset-liability matching for long term products. Under a property-casualty business model the goal of capital is strength of policyholder surplus, liquidity and keeping pace with inflation (claim costs are significantly impacted by inflation – *e.g.* medical costs, construction costs, and auto repair prices). Life insurers generally have fixed future liabilities based on policy limits, but property-casualty insurers' future claims will vary significantly depending on catastrophic and inflationary forces. As a result of the differences in investment goals, property-casualty insurers are more heavily invested in municipal bonds, treasuries and common stock which offer greater liquidity and a hedge against inflation and life insurers are more heavily invested in corporate bonds and mortgage investments that match the terms of their liabilities.

The differences in business models are reflected in the NAIC RBC analysis as well. There are differences in the way that life and property-casualty companies report realized investment capital gains/losses that are based on statutory accounting principles. Life companies are required to establish asset valuation reserves (AVR) as a direct charge to surplus to offset potential credit-related investment losses on all invested asset categories. Life companies are also required to use an Interest Maintenance Reserve (IMR) for all types of fixed income investments, to capture all of the realized capital gains and losses which result from changes in the overall level of interest rates as they occur. Once captured, these capital gains or losses are amortized into income over the remaining life of the investments sold. In addition to these accounting differences, the RBC formula inputs include differences in tax treatment between life and non-life investments. Neither AVR nor IMR are utilized in the property-casualty reporting. This illustrates the significant differences in life and non-life investments reporting that support different treatment of investment risks.

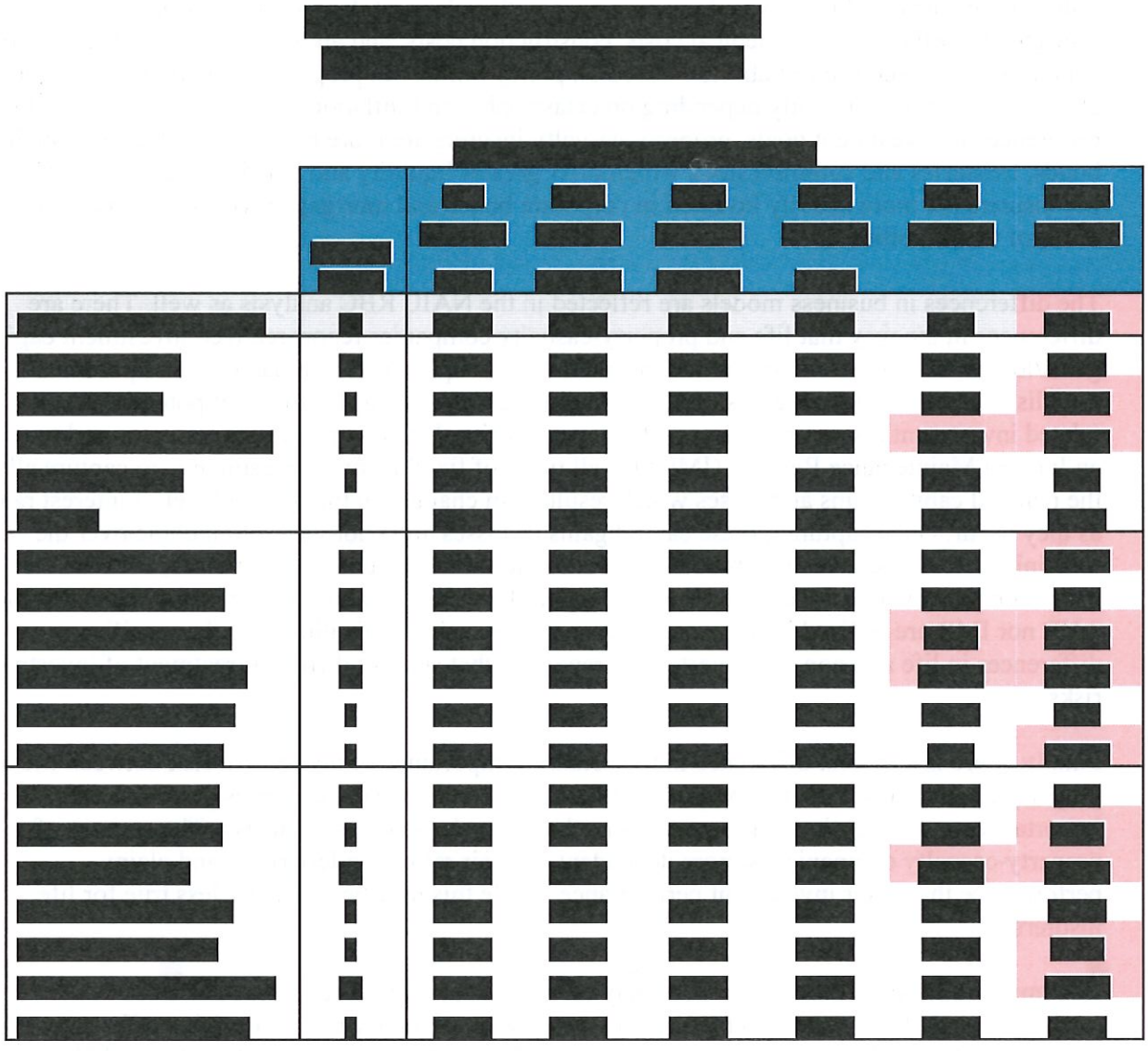
Finally, there is a critical difference in the actuarial importance of investment risk between life and property-casualty insurers. For purposes of RBC, property-casualty actuaries put far more importance on the premium and reserve risks than they do on investment risk. The success of property-casualty companies is more dependent on their rating, underwriting and claim performance than their investment performance, while this may be relatively less true for life insurers.

**Recommendations:** These differences may or may not be addressed in the A.M Best methodology, but we wanted to be sure you were aware of the significance of the differences. We recommend that different risk analysis and risk weighting for various investments would be

appropriate for companies that only operate in a property-casualty environment and even for multi-line companies. If there is interest in further discussions around this issue we will be happy to work with A.M. Best to identify the appropriate investment risk analysis.

**B. VaR Metrics and Stochastic Modeling**

The proposed revisions originally included assessment risks on a VaR basis including 1:500 and 1:1000 return periods with confidence levels up to 99.9%. In the May 5, 2016 "Update to Best's Credit Rating Methodology and BCAR Call for Comment," revisions were proposed based on comments already received that will have a drastic impact on the capital requirement proposal. NAMIC favors the elimination of the confidence intervals of 99.8% and 99.9% VaR from the balance sheet assessment. At these very high levels of confidence we agree with the A.M. Best May 5 update that the information is less accurate, more volatile and more sensitive to assumption errors. These limitations are especially true in the global context.



[redacted] conducted an analysis of 92 NAMIC mutual member companies to determine the potential BCAR impact of the inclusion of confidence levels of 99.8 and 99.9 VaR (see Exhibit 1). The companies participating represented multiple regions, sizes, product lines and profiles. The data analysis by [redacted] illustrates the concern about using the higher return periods to achieve these confidence levels. The results at the higher confidence levels are quite volatile and show little relationship to current company ratings. The average BCAR score for all NAMIC companies in this sample fail at the 1:1000 return period and many "A-" and "B++" rated companies fail at the 1:500 and 1:1000 return periods. The lack of reliable historical data to evaluate the tail risk, results in uncertainty and potentially inaccurate information. Any reliance on this type of information to assess balance sheet strength is misplaced.

A.M. Best indicates that it intends to collect the information at the higher confidence levels for use in the ERM analysis, but will not apply the information to Balance Sheet Strength Assessment. Based on the [redacted] Analysis, NAMIC believes that any publication of this information would be potentially harmful. This harm may disproportionately impact small companies as modeling at high confidence levels for small companies remains imprecise and abstract. However, any company could suffer unintended consequences – including competitive, regulatory or counterparty consequences – from publication of specific confidence level information. In fact, for a company undergoing a ratings review, public disclosure of modeling results would have the potential to increase enterprise risk. Certainly A.M. Best does not intend for its process to create increased risk to the rated entities. For these reasons we strongly recommend that any information collected at any confidence intervals should remain confidential and not part of public reporting.

A.M. Best also seeks feedback on the use of these higher return periods and confidence levels in the modeling used in ERM analysis. NAMIC agrees that this modeling is more often a tool of the ERM analysis and may be more appropriate in that context for the BCRM. However, there are many ways to develop a successful ERM program. More important factors are: 1) whether the program is designed for the company's unique risks so that it will be incorporated into decision-making; and 2) whether management's view of enterprise risks is thoughtful and measured. The use of a particular model with particular confidence levels is not indicative of success for every company. So while it makes sense to consider stochastic analysis and high confidence levels in the ERM context, these features should not be the only factors that lead to upward notching for ERM.

Finally, in the May 5th update, A.M. Best questions the use of stochastic simulations on an industry level. NAMIC agrees that the use of stochastic simulations in the rating of companies applied on a case-by-case basis is more reasonable. Stochastic simulations may not be appropriate for all companies rated and may not be comparatively relevant for every line of insurance or every enterprise risk. We support a review of the field testing that has been initiated by A.M. Best with rated companies to determine the outcomes of stochastic simulations before adopting the changes to the methodology at an industry level.

**Recommendations:** NAMIC appreciates the attempts to make the rating process more precise providing a better measurement of the strength of companies rated.

- NAMIC agrees with the A.M. Best suggestion in the May 5, 2016 update that confidence intervals of 99.8% and 99.9% VaR be eliminated from the balance sheet strength

assessment. We also suggest that any information collected at these confidence intervals remain confidential.

- NAMIC agrees that stochastic modeling is more often a tool of the ERM analysis and may be more appropriate in that context for the BCRM. However, there are many ways to develop a successful ERM program and the analysis should consider incorporation of ERM into decision-making, management's view of any modeling, and the results of the ERM program instead of over-relying on modeling. NAMIC supports the use of stochastic modeling on a company by company basis but recommends that such modeling not be strictly determinative of the ERM scoring.

**C. Catastrophe Risk Emphasis**

The consideration of catastrophe risk as a direct capital requirement instead of one considered within the covariance calculation is inconsistent with the NAIC RBC proposed approach to catastrophe risk. While we are aware that there are significant differences between the goals of rating capital and regulatory capital requirements, for the most part, the structure has remained similar. Variations between the two capital models have usually been illustrated in calibration levels, factors and the BCRM, not in significant differences in formula structure.

Catastrophe risk is certainly an important component of risk and one worthy of a separate risk category, but it should be captured in the context of premiums and reserves. It should be included in the covariance calculation at each confidence level, not excluded.

- The calculation of cat risk at the rating unit level makes the direct impact on required capital all the more significant. Once all of the modeled cat risks of all rating units are consolidated at the holding company level the impact could be very significant.
- Actuarial best practice is to include within the covariance calculation items that are not correlated to each other and put outside the covariance calculation the risk categories that are related to each other. Cat risk is not necessarily related to premium risk, reserve risk, investment risk etc.
- The proposal states that the treatment of cat risks as a direct addition to required capital is taken since such risks can occur concurrently with non-cat risks. However, under this logic by adding all modeled cat losses for the entire enterprise together, the proposal also anticipates that every cat risk insured within a holding company will or could occur in the same year. Since this is very unlikely to happen, inclusion in the covariance calculation is justified.
- Ratings are reviewed annually, and adjustments can be made if there are problems with the occurrence of a catastrophe. It is unnecessary to add this level of uncertainty to the rating process when it can be corrected the following year.
- Finally, we ask that you clarify that the catastrophe risk analysis in the BCRM methodology is made on a tax-adjusted basis as tax implications can have a significant impact on catastrophe risk.

**Recommendation:** The importance of catastrophe risk in the BCAR criteria is overestimated by adding a rating unit's modeled cat losses directly to the required capital at each confidence level and excluding them from the covariance calculation. NAMIC urges the adjustment of catastrophe risk by the covariance calculation.

**Conclusion**

Overall the changes in the A.M. Best methodology represent improvements to the process of developing credit rating for property-casualty companies. Many of our members indicate that the added precision of the formula will reveal the significant strength of the mutual business model in general and mutual insurance companies in particular. There remain some areas of possible improvement that we have discussed in this letter:

- NAMIC believes the negative impact of the revised methodology for mutual, single state or niche carriers was not intended to indicate a credit rating issue with mutual, single state and niche companies, but those may be the unintended consequences. We made several suggestions to improve the potential rating for these companies.
- The perceived authority granted to the analysts to revise a rating unit or holding company score related to notching either the Balance Sheet Strength or several levels of the BCRM seems to create significant latitude for varying ratings for similarly situated companies. NAMIC recommends more specific notching guidelines be disclosed.
- The analysis of investment risk the same for life and non-life companies was questioned by NAMIC. Differing business models generating different investment portfolio structures warrant a new look at this issue.
- The May 5 Update proposed by A.M. Best to eliminate higher confidence levels from the BCAR analysis and to use stochastic simulations as indicated on a company-by-company basis is supported by NAMIC. We also included our recommendations on confidentiality of all modeling information and on ERM evaluations on an outcomes basis.
- Finally, NAMIC raised concerns about the BCAR catastrophe risk placement as a direct addition to required capital. We suggest adjusting cat risks by the covariance calculation.

Of course, NAMIC is willing to discuss all issues raised with A.M. Best and remains optimistic that reasonable resolutions can be reached. It is in the best interests of A.M Best and the entire industry that the rating analysis is done fairly and comparatively accurately. Identifying reasonable revisions that will improve the accuracy of the rating is our common goal. We hope these suggestions have proven valuable and productive in A.M. Best's efforts to improve its rating system. Thank you for the opportunity to provide comment and for the transparent nature of the review process.

Sincerely,

Michelle Rogers

Michelle M. Rogers
Director of Financial and Regulatory Policy
National Association of Mutual Insurance Companies

[redacted]
06/30/2016 02:11 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
[redacted]
Subject Comments on BCRM - BCAR

1 attachment

Bond Example.xlsx

Good Afternoon,

We would like to provide confidential comments on AM Best's updated Capital Adequacy Ratio (BCAR). We believe that our comments are not specific to our firm, but would rather not be identified as from [redacted] in your published commentary.

Overall, we believe that the model is improved in many significant ways. We particularly like how much thought has gone into the various stress levels.

We have comments related to the fixed income or B1 charges. Specifically:

1) While we like that the model factors in the duration and future default risk inherent in a fixed income portfolio, we feel strongly that coupon income should be explicitly contemplated as an offset.
    a. In a hypothetical portfolio of 10 securities, of which Security A defaults in year 5, it's our understanding that the loss-given-default on that security is considered in the capital requirements. We believe that the coupon income of Security A paid in years 1 to 4 should similarly be considered as an offset to the loss-given-default
    b. In that same hypothetical portfolio, the other 9 securities which did not default would pay coupons throughout the period. This stream of income is part of the benefits of the fixed income strategy, and should also be factored in as an offset to the modeled loss in a stressed scenario
2) The loss-given-default is currently modeled as a set percentage depending up rating of a security derived from unsecured bond default data. We believe this can be improved by reflecting the anticipated recovery of different security types. Loans, for example, have a much higher historical recovery rate than bonds due to their seniority and collateral characteristics. It is sensible to reflect these in a required capital calculation.

We have include a simplified example to illustrate point 1 in the attached spreadsheet.

We understand, on the other hand, that loss reserves are discounted at 4.0% in the revised AM Best model, and that this inherently can be considered to provide for the coupon income that we note is missing above. However, we feel that this can potentially significantly understate the coupon income for a few reasons:

(1) Per SNL Interactive, the US P&C industry's loss reserves total $608.6 billion, and the total Cash & Investments total $1.53 trillion. This implies roughly a 40% reserve to invested assets ratio. By providing a 4.0 discount rate on just the liabilities, we believe the model assumes no investment income on the remaining 60% of invested assets, despite simulating future defaults on those assets.
(2) There is potentially a 'time period' mismatch, as credit instruments are simulated to default over a 10 year period, whereas the duration of the liability portfolio can be much shorter (or longer) than that. For example, a hypothetical short tailed writer may only be getting a year or two's coupon income credit on its loss reserves while having defaults on its investment going out to 10 years.
(3) A 4.0 percent discount rate may not be appropriate for all insurers. For insurers with higher risk assets, the capital change would be based upon the risky assets, but the 4.0 percent discount rate is likely based upon an industry wide portfolio. In effect, an insurer is 'credited' with 4.0 percent investment income regardless of the composition of the assets.

Please feel free to contact with any questions or concerns.

Regards,

[redacted]

[redacted]

[redacted]

| | Face Value | Coupon | Default (Simulated) | | | Coupon Stream | | |
|---|---|---|---|---|---|---|---|---|
| | | | Year 1 | Year 2 | Year 3 | Year 1 | Year 2 | Year 3 |
| Bond 1 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 2 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 3 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 4 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 5 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 6 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 7 | 100 | 4.0% | 0 | 0 | 0 | 4 | 4 | 4 |
| Bond 8 | 100 | 4.0% | 40 | 0 | 0 | 0 | 0 | 0 |
| Bond 9 | 100 | 4.0% | 0 | 40 | 0 | 4 | 0 | 0 |
| Bond 10 | 100 | 4.0% | 0 | 0 | 40 | 4 | 4 | 0 |
| Total | | | 40 | 40 | 40 | 36 | 32 | 28 |

Nominal Defaults $ (120)
NPV Defaults $ (111) <---Current AM Best Capital Requirement

Nominal Cashflow (24) <--- Nominal Adverse Impact on Year 0 Balance Sheet

"Petruzziello, Armando"
<ARMANDO.PETRUZZIELLO@LibertyMutual.com>

06/30/2016 03:16 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Request for Comment - BCRM / BCAR

2 attachments

AM Best Comment letter 6-30.docx Skm554-17-016063015090.pdf

Attached please find Liberty Mutual's response for the 'request for comment'

*Thank you,*

*Armando Petruzziello*
Investor Relations
(617) 654-3417
Armando.Petruzziello@LibertyMutual.com

June 30, 2016

A.M. Best
1 Ambest Road
Oldwick, New Jersey 08858

Re: Request for Comment – Best's Credit Rating Methodology ("BCRM") and criteria procedure for the U.S. property/casualty (P/C) Best's Capital Adequacy Ratio ("BCAR")

Liberty Mutual Insurance Group (LMIG) is a diversified global insurer and the sixth largest global property and casualty insurer in the world. The Company ranks 73th on the Fortune 100 list of largest corporations in the United States based on 2015 revenue. As of March 31, 2016, LMIG has approximately $124 billion in consolidated assets and $104 billion in consolidated liabilities. Consolidated revenues were approximately $38 billion for the year ended December 31, 2015.

We appreciate the opportunity to provide A.M. Best with feedback pertaining to the request for comment– Best's Credit Rating Methodology ("BCRM") and criteria procedure for the U.S. property/casualty (P/C) Best's Capital Adequacy Ratio ("BCAR") that was published on March 10, 2016.

Overall, the proposed criteria and additional transparency into A.M. Best's rating process is commendable. The methodology is reasonable and logical, allowing for insurers to have a better understanding of the evaluation and ratings assessment process. That said, there are a few points of concern that should be addressed.

**Enterprise Risk Management (ERM) adjustment (*BCRM*)**

The adjustment range for ERM (+1/-4) is disproportionately skewed to the negative. ERM capabilities are one of the greatest differentiators between insurers' risk profiles, and one of the best indicators of how prepared a given company is for the imminent but rare worst case scenario. This is why it has been a cornerstone of Liberty's strategy for many years. An insurer's primary duty to its policyholders is to manage its business in a way which allows it to always have the resources to pay claims as they arise.

Our commitment to ERM, and what we believe to be the responsible way to run an insurance business, comes at a significant cost that a large proportion of the industry foregoes. The time and money that we invest to maintain a strong ERM culture makes us significantly more stable. ERM is an investment that Liberty Mutual continues to devote resources towards in order to best preserve capital and ensure the long term success and stability of the company.

The current scale only incentivizes insurers to be "good enough," which in the long term will discourage innovation in the ERM space and stall the evolution of risk management practices that are critical to keeping up with the market's evolving and developing risks and challenges.

*Proposal:*
Increase the upper range of the ERM adjustment to +2 while maintaining the lower end of the scale. This way, an "adequate" company would receive no adjustment, and all companies will be incentivized both positively and negatively to develop sufficient ERM practices.

**Operating Performance Benchmarks (*BCRM*)**

The rating process incorporates quantitative and qualitative measures to evaluate the sources of risk to an organization's financial health. The analysis also includes comparisons to peers, industry standards, and proprietary benchmarks. Due to the diversity of product offerings in today's market, companies must be analyzed in the context of an appropriate benchmark. The current peer group selection criteria is unclear, and thus the context around peer comparisons is uncertain.

*Proposal:*
We believe there is opportunity to improve the transparency around this selection process. Liberty Mutual is one of the most diversified insurance companies by product mix, geography, and distribution channel. Each of these universes can have significant impact in determining an appropriate peer group/benchmark. Additional transparency, as well as dialogue with the rating unit will render a more appropriate peer group/ benchmark and provide better context when analyzing operating performance.

**Catastrophe Risk charge (*BCAR*)**

We agree that the use of a modeled all-perils occurrence distribution is an appropriate way to measure this risk. However, we have concerns about the use of extreme measures such as the 99.8% VaR (1-in-500 year return period) and the 99.9% VaR (1-in-1000 year return period) in computing the B8 charge for the following reasons:

- The reliability of catastrophe models at such extreme return periods is far beyond uncertain. Commercial catastrophe model (e.g., AIR, RMS) loss estimates are based on a little over one hundred years of historical data. The most severe windstorm since 1900 in terms of current modeled losses, the 1926 Miami Hurricane, is estimated to have been about a 1-in-110 year event. Modeled extrapolations of estimated losses at return periods beyond that point, such as the 1-in-500 and 1-in-1000 year levels being proposed for the new B8 charge, are therefore highly judgmental and subject to a great amount of variability and uncertainty.

- Further, companies cannot manage exposures this deep in the tail through reinsurance – there simply is no market for such risks. This means that there is no ability for insurers to reduce their B8 charge under the proposed calculation for the upper two VaR level calculations through risk mitigation. Our understanding is that most large insurers' reinsurance programs for occurrence losses max out at modeled loss return periods anywhere from 1-in-100 to 1-in-200 years, in large part because insurers/reinsurers do not have confidence in the modeled losses for more extreme events.

- Finally, it is not operationally nor economically viable for companies to hold capital for such extreme and unprecedented events. Tying up capital for highly improbable events is inefficient because the likelihood of having to use this capital to pay claims is so remote. Insurers would incur a huge opportunity cost by not being able to deploy this capital towards improved capabilities or profitable ventures.

*Proposal:*
We would recommend that the B8 charge rely on modeled occurrence loss estimates which the industry considers more credible, such as the 1-in-100 year and/or the 1-in-250 year return period.

TVAR (99%) is the average of the worst 1% of years (all the years greater than the 100 year return period loss, and similar to the metric we use internally). This metric is typically fairly close to the 250 return period result but provides a representation of the volatility of the tail. It also accounts for the Aggregate Annual loss not just the maximum Occurrence loss.

We also believe that the B8 charge should be included in the covariance adjustment by adding $(B8)^2$ to the other risks under the square root sign. Catastrophe risk is idiosyncratic, and has been shown to be a diversifying peril that is largely uncorrelated with investment, credit, reserve, and premium risk in economic capital modeling frameworks. We therefore believe that adding it to the BCAR calculation outside of the covariance adjustment overstates its impact to a company's overall risk profile.

**Underwriting charges *(BCAR)***

*Premium & Reserve Factors*
The calculation of premium and loss reserve capital factors for a rating unit begins with the selection of an industry baseline probability distribution for each schedule P line of business segregated by magnitude of the rating unit. Baseline distributions are then shifted based on rating unit specific information reflecting historic profitability and volatility. For premium in particular, any change in current market conditions is demonstrated by an underwriting cycle adjustment that reflects the impact of current pricing on underwriting risk. We believe that there is not enough transparency around how rating unit specific information is incorporated and the resulting charges. Additionally, we believe companies can take deliberate actions to improve profitability and reduce volatility of their go-forward business that is not reflected in the historical data.

*Proposal:*
We recommend that there be more transparency around rating unit specific capital charges and what drives the deviations from the baseline distributions. This will enable better dialogue and understanding around A.M. Best's view of various risks.

We also recommend that rating units be afforded the opportunity to present alternative historical perspectives if there have been material actions taken within their book of business to improve profitability and/or reduce volatility. [redacted] As premium risk is forward-looking by one year, this will reflect a more accurate view of current risks than the historical information provides.

We also believe that there should be flexibility and judgment around determining the appropriate market cycle adjustment based on company specific information. For example, from a commercial lines perspective, Liberty Mutual is heavily weighted in small commercial business. Current industry pricing surveys indicate commercial lines pricing is negative, suggesting a soft cycle. We do not believe this is the case with small commercial based on competitor information

as well as our own pricing experience. Therefore, this over-generalization creates a punitive effect when small commercial business is wrongly categorized in a soft cycle.

*Adverse Development Cover treatment*
Currently, large adverse development covers are handled offline on a case by case basis. The charges and relief associated with these agreements should be integrated into the model rather than handled discretely offline to provide uniformity to the treatment and increase ease of use of the model.

**Schedule BA assets (*BCAR*)**

Capital charges on BA assets increase dramatically under the proposed criteria. There is a disparity between the diversity of this class of assets and the broad-based method of assigning an overall charge to the grouping. Although we do recognize and appreciate the opportunity to share greater details of our portfolio to reduce charges on a case by case basis, an opportunity exists to formalize the process by assigning capital charges at a more granular level.

*Proposal:*
We would recommend leveraging information from the SRQ process as well as industry research to assign capital charges to prevalent segments in the industry's portfolio of other investments. This will create a more accurate aggregate charge for BA assets for individual companies rather than a "one size fits all" approach. Introducing a spectrum of charges based on different segments of BA assets will provide a more accurate and appropriate approach to assigning risk. The industry research required to better identify segment charges will help build expertise, for companies and analysts alike, in the attributes and risks of these investments.

**Summary**

Although we feel that the proposed changes to the Best's Credit Rating Methodology ("BCRM") and criteria procedure for the U.S. property/casualty (P/C) Best's Capital Adequacy Ratio ("BCAR") are a step in the right direction, we believe there are a few areas that should be revised. Namely, we see opportunities for greater transparency and accuracy in the enterprise risk management evaluation, peer group/benchmarks, the catastrophe risk charge, the calculation of premium and loss reserve capital factors, and the charges associated with Schedule BA assets. We look forward to further dialogue around our areas of concern.

Sincerely,

Armando Petruzziello
*Director, Investor Relations*
Liberty Mutual Insurance Group

[redacted]
06/30/2016 04:33 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
[redacted]

Subject Comments regarding draft criteria for BCRM and BCAR

1 attachment

[redacted] BCRM and US PC BCAR 2016.06.30.pdf

Please see attached [redacted] comments regarding the proposed updates to BCRM and to BCAR for US PC insurers, exposed for comment on March 10, 2016.

[redacted].

Please let me know if you have questions or comments. We look forward to the next phase of developments for these proposals.

Best regards,

[redacted]

[redacted]

June 30, 2016

Dear A.M. Best:

Thank you for the opportunity to comment on your two draft methodology articles released on March 10, 2016: *Best's Credit Rating Methodology (BCRM): Global Life and Non-Life Insurance Edition* and *Understanding Best's Capital Adequacy Ratio (BCAR) for U.S. Property/Casualty Insurers*. Our comments also consider the update published by A.M. Best on May 5, 2016.

[redacted] would like to request anonymity of our comments. We understand that A.M. Best may publish our comments but without naming the person or company submitting them, based on our request.

On May 5, A.M. Best published a market briefing, requesting additional comments on Revised Best's Credit Rating Methodology. Three specific questions were posted:

- Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".

- Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management or Comprehensive Adjustment in BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.

- What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 and 99.9)?

**BCRM**

On the first two questions regarding BCRM, we would comment that we welcome the proposed changes, which are a significant improvement in transparency. Broadly, the building block approach is understandable, and we appreciate the fact that it makes explicit some elements that had been only implicit in the current BCRM, such as the impact of factors such as business profile, operating performance, ERM, and holding company strength or weakness.

We do believe that transparency would be further improved by the inclusion of more quantitative benchmarks in the methodology. We recognize that it is useful to use a mix of qualitative and quantitative factors in the rating process. However, for purely quantitative factors, such as financial leverage or interest coverage, it would be helpful to users to have benchmarks or guidelines to better understand A.M. Best's interpretation of strength or weakness.

[redacted]

**VaR approach for BCAR**

Our comments on VaR and the proposed new BCAR approach focus on two areas: catastrophe risk and investment risk associated with nonaffiliated bonds.

Catastrophe Risk

Value at Risk (VaR) is a well-established and well-practiced risk modeling technical in the banking and insurance industries. It has been used in various regulatory capital model such as Europe Solvency II. Most of the internal capital models developed by insurance companies use the VaR technical. A key benefit of using the VaR technical is the ability to link the capital adequacy to rating target by relating confidence levels in the VaR calculation to empirical default probabilities at different rating target. While data limitations, especially the lack of extreme event data for certain risk factors, may limit the accuracy of the VaR at higher confidence level, there are statistical techniques to counter such limitations. In other words, the potential accuracy issue at higher confidence level does not negate VaR as a useful risk and capital modeling metrics.

The way A.M. Best designs the new BCAR model, especially with regards to the cat PML, however, exacerbates the problem of the inaccuracy of VaR at higher confidence levels. Instead of including the cat PML charge into the standard covariance formula together with all other risk components, the proposal leaves the cat PML charge outside of the covariance formula resulting in a dollar for dollar impact on the net requirement capital. As the confidence level increases, the contribution of the cat PML charge to the total net required capital also increases. Therefore any inaccuracy or uncertainties in the cat PML at higher confidence level become a greater issue for the accuracy or the uncertainty of the net required capital.

We recommend the following two approaches to address the issue.

1. In the first approach, which is our preferred approach, is to include the cat PML charge into the covariance formula together with all other risk components. This will dampen the dominance of the cat PML charge at higher confidence levels and therefore reduce the concerns about the inaccuracy or uncertainties regarding the determination of cat PML at higher confidence levels. Such a treatment is also consistent with statistical theory and empirical evidence. It is known that there is little correlation between catastrophic risk and financial market risks, and relatively low correction between catastrophic risk and other underwriting risks such as premium risk for attritional losses and reserve risk. Therefore including the cat PML into the covariance formula is quite natural and justifiable

2. Alternatively, A.M. Best can adapt the current BCAR treatment of the cat PML and subtract the cat PML at for example 1-in-200 year or 99.5% confidence level from the available capital. This should avoid the need to calculation cat PML at higher confidence levels such as 99.8% or 99.9%

[redacted]

Nonaffilliated Bonds

The proposed approach for non-affiliated bonds applies an economic scenario generator (ESG) to simulate bond defaults based on credit quality and maturity distribution of an insurer's portfolio. We see two fundamental problems in application of the proposed approach:

1. A.M. Best has not published any details of the parameters underlying the ESG, which makes it very difficult for an insurer to evaluate the underlying assumptions for appropriateness. That not only limits our ability to provide feedback on the proposal, but also limits our ability to understand the model's treatment of our actual risk exposure. Although A.M. Best provided outputs from the model to rated insurers, the output with respect to credit risk charges is based on summarized ratings (mapped to NAIC designations) for the portfolio as a whole. Therefore, we cannot assess the impact on our required capital of small changes in credit quality or maturity profile of the portfolio. Many companies use rating agency models as an input to risk and capital management decisions in order to hold capital consistent with a target rating level. The lack of transparency in the current proposal makes such analysis very difficult and undermines the goal of improving transparency.

2. Although not explicit in the proposal, A.M. Best indicated at their briefing on March 30 that it would use NRSRO ratings as the basis for credit quality in the model. However, we know that for structured securities, particularly RMBS and CMBS, recoveries (and therefore stressed losses) can vary widely across low-rated securities. The NAIC recognized this issue beginning in 2010, when it began engaging asset management firms (currently BlackRock) to model individual securities to develop appropriate loss severities and to map them to NAIC categories based on the modeled loss severity potential. We believe that this method, which is similar to an approach currently used by S&P in their model, is a more appropriate method to assessing risk in these securities. In comparison, A.M. Best's assumption that low rated bonds all have 20% recovery is punitive and fails to recognize differences in security structure and loss potential. This is likely to be a more significant issue when BCAR is updated for life insurers, many of whom have significant holdings of these asset classes that were either purchased at deep discounts or written down as impaired, and currently have very low future expected losses.

We thank you for considering our feedback, and we look forward to future dialog with A.M. Best as the criteria proposals advance.

[redacted]

[redacted]

06/30/2016 05:04 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject BCAR Comment

Dear Sir/Ma'am,

Before the close of the public comment period, we wanted to express our strong belief that the analysis of catastrophe loss scenarios under the proposed new BCAR model are extremely punitive. In Particular, at the 99.8 and 99.9 VaR levels, modeling is extremely abstract and unreliable due to the lack of significant empirical data on which to draw. We feel A.M. Best, the industry and the broader constituencies that rely on the ratings that result from these calculations would be better served if these more extreme scenarios were eliminated from the calculation of BCAR scores. We request confidential treatment of this comment, with no publication in the results of consultation section of your website.

Thank you,

[redacted]

[redacted]

06/30/2016 05:48 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc [redacted]

Subject [redacted] comments on BCAR exposure draft

3 attachments

BCAR Draft Criteria Comments and Questions - [redacted].dotx

Discussion on Correlation Matrices.dotx

AM Best Reserve Risk Correlation Matrix Original and Adjusted - [redacted]

[redacted]

Hope all is well.

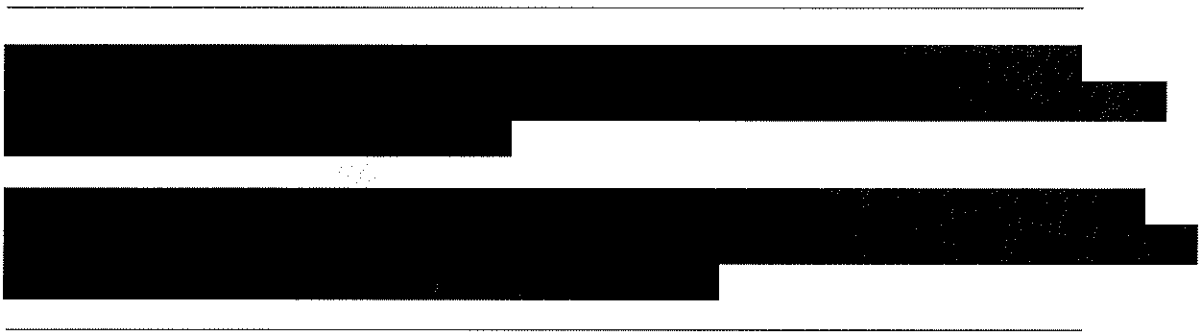
Just copying you in on our [redacted] comments to the BCAR exposure draft. This reflects feedback from our advisory team but also actuarial and catastrophe teams.

I have also included a discussion of correlation matrices that you mentioned you would be interested in seeing.

Would be happy to discuss any of these items in depth with you and others at AM Best if you would like.

Hope you have a good July 4th weekend.

[redacted]



[redacted] [redacted] **submits the following comments to AM Best's draft updated "Understanding Best's Capital Adequacy Ratio (BCAR) for US Property/Casualty Insurers"**

## Confidence Intervals:

In the proposed BCAR model, utilizing a multiple confidence interval (CI) evaluation approach is useful in understanding risk across the entire distribution as well as highlighting tail risk. Value at Risk (VaR) as a risk metric is well understood in the industry and is similar to the Probable Maximum Loss (PML) metric used in catastrophe modeling output. VaR is the foundation of risk management processes in the banking industry. However the effectiveness of using VaR at higher return periods, e,g, 1-500 and 1-1000 year level, should be evaluated critically.

For EQ risk we believe these higher return periods (500 and 1000) are useful as extreme events are meaningfully evaluated by professionals inside and outside the insurance industry. For example, the USGS National Seismic Hazard Maps (NSHM) shows earthquake risk to various locations in the United States. These maps are commonly provided for roughly 500, 1000, and 2500 year return period events. These maps are the basis for vendor catastrophe models and construction industry design standards. Specifically, in both the Pacific Northwest (Cascadia Subduction Zone) and Midwest (New Madrid fault) the USGS estimate mean recurrence intervals are greater than 200 year and are around 500 year for major events similar to the Tohoku earthquake. For California EQ, there are meaningful modeled losses at the lower 100 and 200 year levels due to the higher frequency of historical EQ events. However, some major events are not fully captured until higher return periods are considered. Therefore, for the EQ peril it is important to look beyond the 200 year VaR confidence level.

For Hurricane risk, it has been our experience that many companies evaluate return periods up to 200 and 250 but practices vary. For the larger companies, this is typically an issue when considering global regulatory capital standards. Companies also look at the 500 year level when evaluating their risk management, but it is given less weight. It is not our experience that the 1000 level is closely evaluated. However, it may also be worth considering raising the lowest confidence interval from 20 year to 50 year. The lowest capital standard companies typically considered for capital management purposes is 50 year (1-20 is considered more of an earnings risk measure than capital standard). Also, typical engineering guidelines and construction codes minimally reflect the 50 year return period wind speeds for residential and commercial buildings for a given location. In general during a hurricane, building structural integrity is breached above the basic design wind speed of a 50 year event. Therefore, it may be useful to set the lowest capital standard no lower than the 1-50 year event used in the building industry.

For the reasons noted above, we suggest considering differentiating the emphasis put on the various confidence levels when evaluating capital scores for companies with differing catastrophe exposure profiles. For companies whose main exposure is EQ, more evaluation weight could be given to the higher intervals. For Hurricane exposed companies, more

evaluation weight could be given to the lower end confidence intervals. An alternate approach may be to eliminate the 1000 year period and only use 50, 100, 200, and 500. AM Best could add another period such as 333 or 350. Adding a 250 year CI most likely would not provide materially more information than the 200 year event as industry modeled loss estimates at 250 are basically the same as 200, differ by 10%.

For risks other than Catastrophe, e.g. UW risk and Credit Risk, the 1-1000 confidence level may be further questioned as it may not result in statistical convergence unless 100,000+ simulations are run. For example when running 10,000 simulations, the 1-1000 year confidence level is the 10$^{th}$ worst result which could be subject to simulation "noise" if re-run under a different random number generator, i.e. the simulated results may not be "statistically robust". We realize that could be accounted for by using a fixed random generator. However, that approach takes away from a transparent external understanding of the risk charges generated by the model. Also it reduces the ability for companies to evaluate their BCAR results in the context of output from their own internal capital models.

## Catastrophe Risk Diversification:

We suggest that Catastrophe Risk (B8) be included in the co-variance adjustment (i.e. included under the "Square-Root rule"). The industry typically considers catastrophe risk to be independent of other UW risk and asset risk. This industry perspective is demonstrated by the growing Insurance Linked Securities (ILS) market. Asset and UW managers increasingly view ILS securities as a new asset class which is not correlated to their current portfolios. While it risk factors may theoretically show some correlation in very extreme tail events, this would be true of all the all the risk factors and not just catastrophe risk.

We understand that AM Best expects companies to at least cover their catastrophe risk. However, while the Square-Root rule is "sub-additive" (i.e. combined risk charges are lower than the simple sum of risk charges), it results in a combined charge that is always greater (usually significantly) than the largest single risk charge. Therefore, the total required capital will always be larger than the catastrophe risk charge.

Furthermore, we suggest considering not tax affecting the catastrophe risk charge. It is difficult to forecast the future tax position of a company. Also, tax rates can vary by type of company and country. The other risk charges do not appear to be similarly tax affected.

We understand that including Catastrophe Risk within the covariance adjustment and removing the tax effect would roughly be offsetting changes in the aggregate. However, it may provide more equitable treatment of catastrophe risk by company.

## Underwriting Risk Charges

It is our understanding that the probability distributions which drive underwriting required capital were based on a curve fitting using Schedule P data for 10 years for Premium Risk and 8 years for Reserve Risk (page 21-22 of BCAR document) going back to accident year 2003. It may be useful to consider Schedule P data prior to 2003. While accident years over 10 years old cannot be developed beyond 10 years, including additional historical information (even though truncated) may improve the accurateness of the fitted loss curves. This would particularly be the case for Casualty and Workers Compensation lines of business which the industry experienced periods of significant spikes in loss ratios and loss development in the years prior to 2003.



With regards to Reserve risk, we suggest considering having the discount rate reflect payments out to a 30 year horizon instead of the current 10 year view. In particular for WC reserves, payments can stretch out well beyond 10 years. Also this would mirror the treatment of ceded recoverables which are proposed to be discounted over a 30 year period (albeit with defaults calculated only over next 10 years).

## UW Correlation Matrix:

In evaluating and testing the Premium and Reserve Risk correlation matrices published in the document, we noticed the matrices were inconsistent, or in technical terms not "positive semi-definite." While the diagonal symmetry of the matrices ensures that any pair-wise set of correlations are consistent, further tests need to be applied to ensure any "n-tuple" set of correlations are also consistent. Our application of those tests on the published matrices indicated that the matrices are not consistent on that higher level. We have attached a spreadsheet demonstrating how a particular selected set of three correlation factors from the published reserve correlation matrix is not consistent.

It is our understanding that the simulation software package AM Best uses will accept an inconsistent correlation matrix. However, it will adjust the entries to make them consistent (unfortunately without explicit notice to the user). We have also attached what we believe are the adjusted matrices that are ultimately being used by the simulation package. While the applied correlation matrices are directionally similar to the original matrices, individual correlation factors are materially different. We suggest AM Best consider revisiting the select correlation matrices or alternatively publish the adjusted matrices.

Furthermore, our analysis appears to indicate that the diversification credit derived from applying the correlation matrices seems to grow at the higher confidence levels. In other words, the lines of business become less correlated in the tail of the joint distribution. We believe this is a result of using the standard correlation method in the simulation package (i.e. the "Gaussian Copula") in which effective correlation decreases as you go out in the tail. However, it can be argued (Extreme Value Theory) that correlation between lines of business should grow stronger in the tail. It may be difficult to implement a different correlation technique. However, it is important to understand that under the current approach the impact of correlation can be diminished at the higher confidence intervals.

## Stochastic Simulation Framework:

We feel it is important for companies to be able to understand for capital management and forecasting purposes how the UW risk simulations in Stochastic BCAR are performed in more detail. For normal business plan scenarios reflecting small changes, acceptable forecasting can be done using the implied "typical" UW risk factors as provided in the document appendix. However, for business plan scenarios which forecast significant changes (e.g. entering or exiting a line either by growth or reinsurance) applying the "typical" factors algebraically will not be accurate due to altering the mix of business and the changing impact of the correlation matrices.

For this reason, we suggest AM Best publically provide the industry loss distribution parameters (mean, standard deviation, shift, and truncation) utilized in the model. It would be useful to have more numerical examples of how the company profitability, reserve stability, and other company specific measures impact the final applied loss curves.

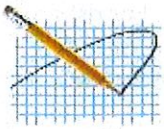
The proposed Stochastic BCAR framework is a major step forward in capital modeling which utilizes modern risk modeling techniques and technology. It is a significant improvement from the current "risk factor" based approach which originated in the 1990's. In the past years, many companies have developed stochastic based internal economic capital



models. For those companies, the proposed BCAR model provides a useful external yardstick for comparing and communicating their "own view of risk". And for companies who have not yet adopted ECM, stochastic BCAR would be a useful starting point for developing their modeling expertise and "own view" of risk perspective.

Therefore, the proposed Stochastic BCAR modeling framework would be a useful catalyst in moving the industry forward with regard to risk modeling and risk management expertise. However, in order to facilitate that continued evolution, it would be useful for AM Best to provide additional detail and transparency in the specifics of the loss modeling underlying Stochastic BCAR.





[redacted]

06/30/2016 06:38 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Formal Response to AMBest on the new rating methodology

Dear Sir,

I am responding on behalf of [redacted] to your request for market feedback on BCRM as noted in the Market Briefing 5th May 2016.

*1. Do you fully understand the Building Block approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response in "No".*

We understand the new BCRM building block approach, the new methodology is transparent and well-articulated in the draft methodology documentation.

*2. Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.*

The two significant comments we have are in regards to A.M. Best's proposed consideration of internal economic capital (EC) models.

In the Balance Sheet Strength section there is a detailed discussion on how A.M. Best may give more consideration to company-run EC models, relative to rating units' reported BCAR scores. This section also notes that EC models are valuable tools within the overall risk management framework. But in the ERM section there is no mention of EC models. It is not clear how A.M. Best will consider EC models in relation to the overall ERM rating. We would have expected EC models to have greater influence for most companies on the overall ERM rating factor and only companies with superior EC models will gain benefit in their BCAR scores.

In A.M. Best's discussion on EC models it is noted that certain elements of operational and strategic risk are not easily quantified and we agree with this statement. But we disagree with A.M. Best's statement that they expect companies to allocate some portion of capital within their EC models as a placeholder for this limitation. We believe that a number of operational and, in particular, strategic risks are not possible to quantify in terms of capital and it is better practise to separate these risks into those that can and those that cannot be quantified. For those risks which cannot be quantified in terms of capital it is better to monitor, manage and mitigate these risk rather than assigning a capital load. In fact assigning a capital load could

actually be detrimental to the business as a whole for some risks, such as Competition. For risks of this sort, an additional capital loading would not mitigate the risk. Indeed, in the case of Competition, increased capital could lead to a loss of competitiveness, and hence increase the risk itself.

*3. What are your views on using VaR metrics for risk modelling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?*

We agree with the commentary from the A.M. Best's market briefing on 5th May that VaR is an intuitive risk metric and is a good measure to use when looking to improve the transparency and consistency of A.M. Best's rating process across the market. The metric becomes less useful, credible and more volatile as one goes out into the tail. It also becomes more difficult to communicate and impossible to (in)validate in the extreme tail of the distribution.

Kind regards,

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

07/01/2016 12:15 PM

[redacted] on Rating Criteria

1 attachment

Respsonse to A.M. Best Criteria - June 2016 Final.pdf

All,

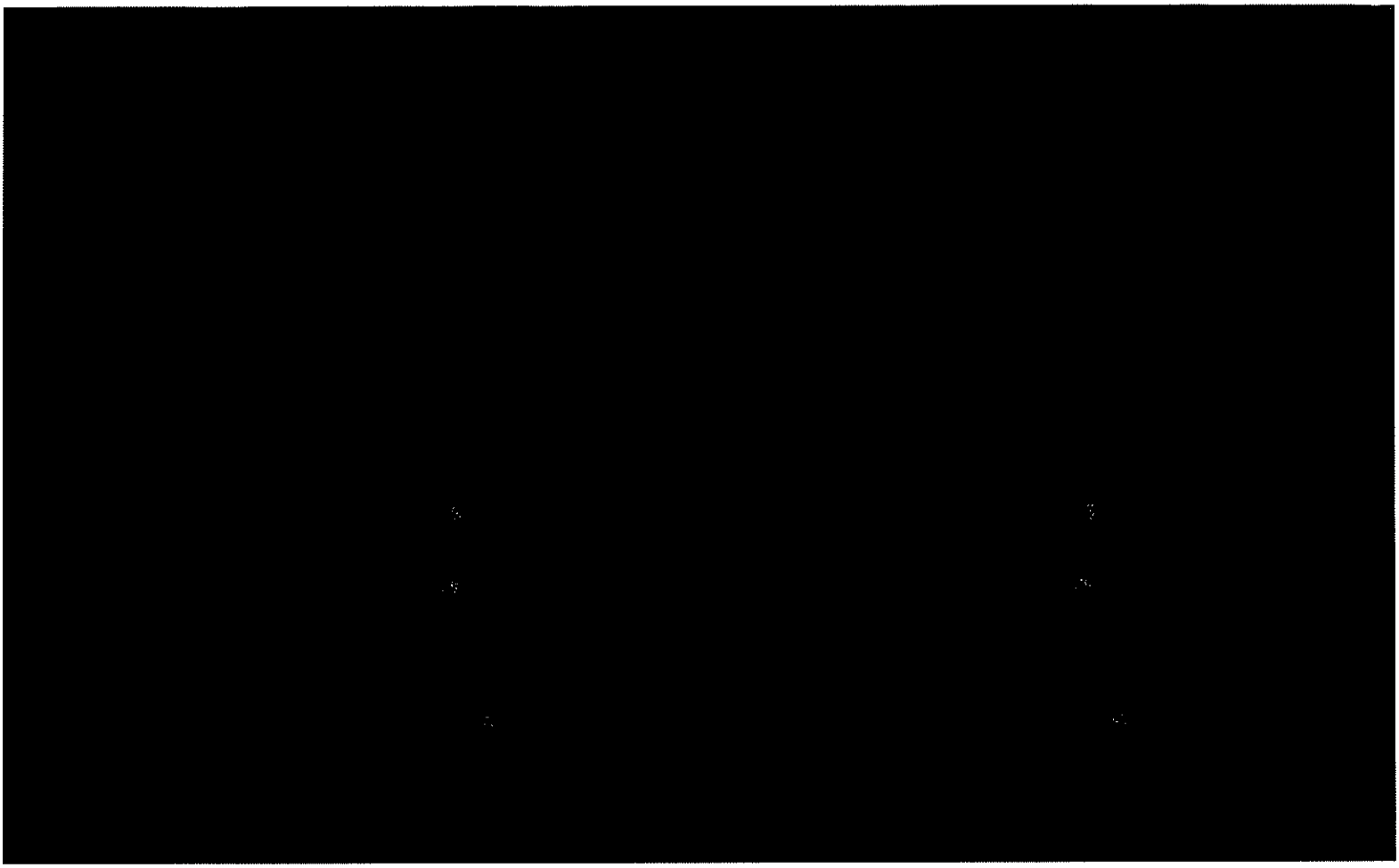
Thanks for your time yesterday. Attached please find our formal feedback on the criteria for the BCRM and BCAR for US P/C Insurers.

Regards,

[redacted]

[redacted]





# Response to A.M. Best Criteria

Best's Credit Rating Methodology (BCRM) and Best's Capital Adequacy Ratio (BCAR) for U.S. Property / Casualty Insurers

June 2016

[redacted]

[redacted]

# Section A. Response to questions from Update to BCRM and BCAR Call for Comment

1. A.M. Best Question: Do you fully understand the Building Block Approach outlined in the BCRM and is it sufficiently transparent? Please explain if your response is "No".

   [redacted]: We understand the Building Block Approach and believe it provides the framework for better transparency in the rating process. [redacted] and our clients applaud A.M. Best's effort to increase the transparency of the rating process and analysis to the market. Given the breadth of the subject and application and interpretation by a broad audience, we believe there are aspects where even greater clarity would be helpful. Below are common questions we received from our clients:

   - Will management have the opportunity to review and discuss the analyst's evaluation of each of the rating factors and sub-assessments prior to the analysis being presented to the rating committee?
   - Will the evaluation of rating factors be added to A.M. Best's company reports or otherwise made public?
   - Will the proposed criteria lead to new survey questions or requests?

   In addition to greater clarification around the rating process, we received a number of comments regarding concerns that analysts and the rating committee may have too much discretion under the proposed framework. Examples include:

   - Holding Company (pp. 15 – 16, 39 – 49)
     - Criteria indicates the impact of holding company on balance sheet strength assessment is determined following analysis of all related quantitative and qualitative metrics. However, the criteria does not provide benchmarks for key quantitative metrics, therefore clients are concerned this assessment may not be consistent and subject to analyst discretion.
     - We recommend A.M. Best provides benchmarks for positive, neutral and negative holding company assessment characteristics on typical financial leverage and coverage ratios as discussed on page 40 – 42

   - Operating Performance (pp. 19 – 20, 52 – 60)
     - While the criteria provides a sample benchmarking report and performance / earnings metrics, it would be helpful to provide examples that align with each assessment

   - Business Profile (pp. 20 – 21, 61 – 67)
     - Indicates "The rating analyst will qualitatively combine each of the sub-assessments into a single business profile assessment". We recognize A.M. Best's approach is to allow flexibility in determining which characteristics can most likely impact an insurer's financial strength. However, we believe there should be additional guidance on how results from the sub-assessments fit into the overall business profile assessment.

- Rating Enhancement / Drag (pp. 23, 78 – 80)
  - Given a range of zero to four notches for enhancement or drag on non-lead rating units, there is limited information that addresses when one notch is granted compared to when four notches may be granted. We understand rating enhancement will be limited by the difference between the lead rating unit's rating and the subsidiary's stand-alone rating, but addressing factors that drive maximum enhancement / drag would be helpful.

2. A.M. Best Question: Are there any parameters outlined for Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management, or Comprehensive Adjustment in the BCRM that you disagree with? If so, please explain which parts you disagree with and provide alternative suggestions.

[redacted]: There are two main parameters [redacted] disagrees with – ERM differentiation and mapping of BCAR confidence intervals to issuer credit ratings. We believe that there is too little differentiation within the proposed ERM assessment and that the BCAR mapping is too conservative.

- Enterprise Risk Management – ERM (pp.21 – 22, 68 – 75)
  - Proposed methodology heavily penalizes companies for not having appropriate ERM, but provides little benefit to those that excel in this discipline
  - The approach seems to value 'adequate' ERM and 'strong' ERM as the same, even though there may be significant differences between those two levels of maturity, effort and ultimate risk management
  - We recommend greater differentiation should be recognized within the ERM assessment and propose to add a level for 'Strong' with a '+1' adjustment and make 'Very Strong' a '+2' adjustment

- Proposed mapping of BCAR confidence interval results to issuer credit rating is too conservative and disproportionately impacts regional companies
  - For example, the 99.5 confidence interval or 200 year return period indicates an ICR of "a-" or "bbb+". This is a significant increase in capital requirements relative to current BCAR standards.
  - We believe the mapping of the BCAR confidence interval results to ICR should be adjusted to reflect passing significant capital requirements at the higher confidence intervals. We propose the following mapping:

| Description | Confidence Interval | Current ICR Mapping | Proposed ICR Mapping |
|---|---|---|---|
| | | aaa / aa+ / aa / aa- | aaa / aa+ / aa |
| Strongest | > 99.9 | a+ / a | aa- / a+ |
| Very Strong | > 99.8 | a / a- | a+ / a |
| Strong | > 99.5 | a- / bbb+ | a / a- |
| Adequate | > 99.0 | bbb+ / bbb / bbb- | bbb+ / bbb / bbb- |
| Weak | > 95.0 | bb+ / bb / bb- | bb+ / bb / bb- |
| Very Weak | < 95.0 | b+ or lower | b+ or lower |

3. A.M. Best Question: What are your views on using VaR metrics for risk modeling in general? Do your views concerning the value of these metrics change as one goes out into the tail (e.g., VaR 99.8 & 99.9)?

[redacted]: We believe the use of VaR metrics is appropriate given the new BCAR model will analyze multiple confidence intervals, thus capturing multiple values within the probability distribution. While we recognize that the higher confidence intervals enable A.M. Best to capture tail risk, the utilization of VaR 99.8 and 99.9 is too conservative and should be capped at a lower confidence interval, such as the VaR 99.6. Analyzing higher return periods leads to increased model dependency and many companies would have difficulty managing capital requirements at those confidence intervals.

- For purposes of the BCAR framework, we believe that a VaR metric with results at multiple confidence intervals is more appropriate than TVaR (tail value at risk)

- Catastrophe models have proven to be unstable at times with significant changes occurring without necessarily being supported by historical evidence. Using VaR 99.8 and 99.9 confidence intervals brings added volatility without necessarily indicating a change in risk profile. These events are unprecedented by any historical proportions and are too severe for a reasonable assessment of balance sheet strength, especially given the highest ICR is 'a+'.

- We propose capping tail risk at the 250 year return period to be consistent with industry practices, which corresponds to VaR 99.6.
  - We believe the 250 year return period is an acceptable benchmark to capture catastrophe tail risk while enabling companies to adequately manage risk
  - Based upon [redacted] Catastrophe Risk Tolerance study, many companies manage catastrophe tail risk up to a 250 year return period
  - It is challenging for many insurers to manage catastrophe risk based on 500 year and 1,000 year return periods, especially given the capital requirements within the current BCAR framework
  - We understand and agree with A.M. Best's assessment from the May 5th briefing that there is a high level of model uncertainty at higher return periods and a lack of consistency across companies and geographies in capturing this level of tail risk

# Section B. Additional Comments on BCRM

Additional comments on the BCRM are discussed below.

- Less volatile performance relative to the benchmark (p. 20)
  - How does A.M. Best measure and benchmark volatility?
- Excessive reliance on reinsurance (p. 32)
  - Please provide a benchmark for ceded PML to PHS in determining excessive reliance on reinsurance
    - Please clarify return period used for this assessment
    - Will A.M. Best consider tactical use of reinsurance to determine whether high ceded PML to PHS is truly excessive reliance on reinsurance versus a capital management strategy?
- Adjusted and unadjusted financial leverage (pp. 33 – 34, 40 – 41)
  - Does A.M. Best prioritize adjusted financial leverage over unadjusted financial leverage?
- Double leverage (p. 35)
  - Please provide the formula for double leverage and a benchmark for high double leverage
- Economic capital model – Incorporated into the determination of capital requirements (p. 37)
  - Please indicate the maximum credit A.M. Best will give from an economic capital model with respect to "determination of capital requirements"
- Adjusted fixed charge (p. 42)
  - Please provide formula for adjusted fixed charges
- Selecting Benchmark Composites (p. 54)
  - Benchmarking exposes rating analysis to potential selection bias of the peer group and/or clustering of ratings for companies A.M. Best deems as peers. To mitigate concerns over these issues and in support of greater transparency, will A.M. Best analysts provide management with the peers they are being compared against in advance of presenting to the rating committee? Will A.M. Best consider input from companies regarding the peer group?
- Product risk (pp. 64 – 65)
  - We recommend A.M. Best provides their baseline view of product risk (low, average, or high) for all lines of business
- Risk Impact Worksheet
  - Given the importance of ERM to companies and the rating and in support of greater transparency, will the Risk Impact Worksheet analysis be provided to companies?

# Section C. Comments on BCAR for US P/C Insurers

Comments on stochastic-based BCAR for US P/C insurers are addressed below.

- The current BCAR model is a key capital management framework for companies. Many clients use industry and peer group BCAR results for benchmarking purposes in determining their BCAR target. While the new BCAR will provide results at multiple confidence intervals, beyond having a score greater than zero at a specific confidence interval, clients are looking for industry and peer group benchmarks for BCAR results by rating level and confidence interval.

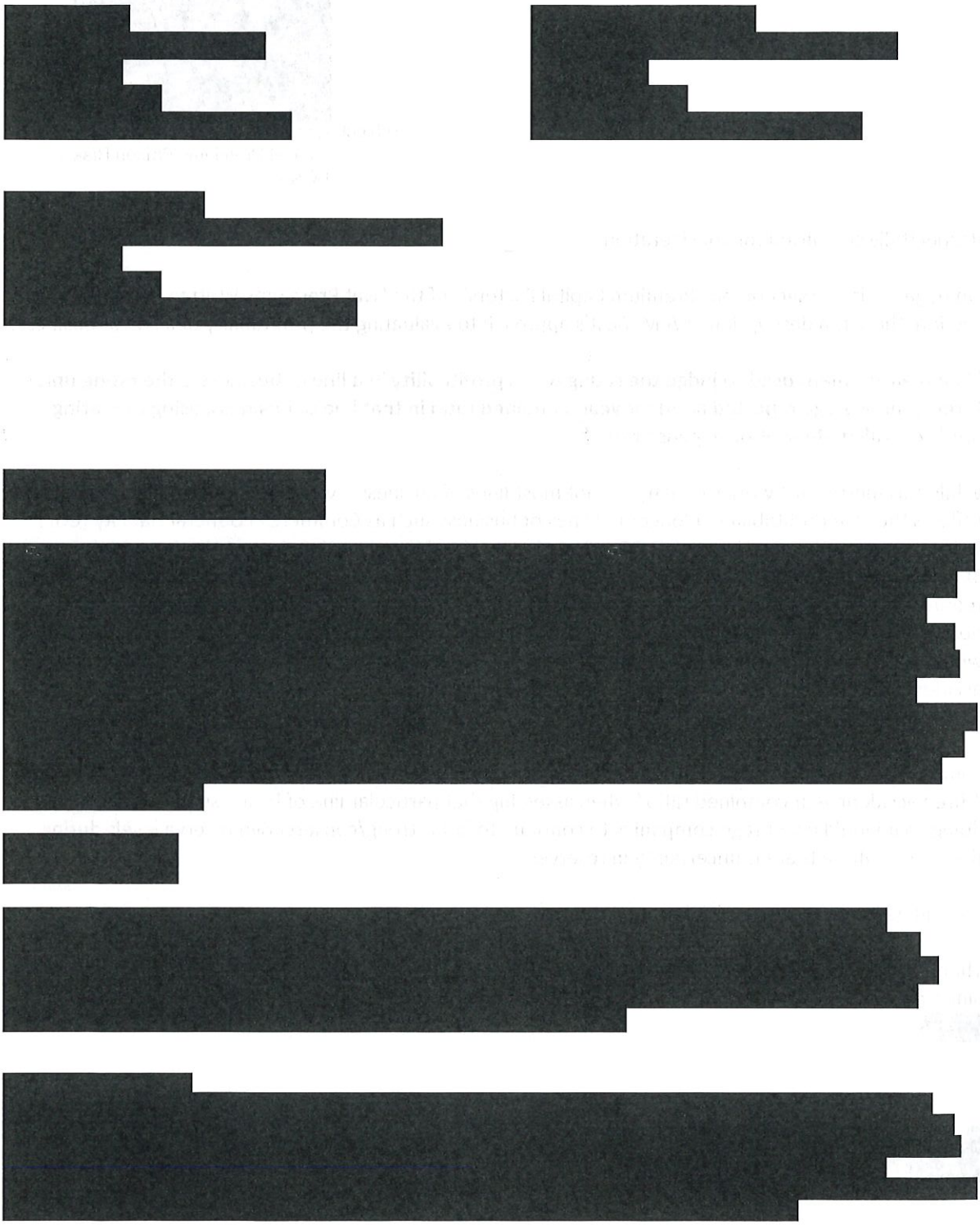
- Interest rate risk is being driven by two uncorrelated events, a large catastrophe event and increase in interest rates. We believe that increasing the conservatism on two uncorrelated variables to derive capital requirements leads to risk charges beyond the respective confidence interval. We recommend making the gross PML constant across all confidence intervals and suggest using the 100 year All Perils PML to align with the catastrophe stress test approach.

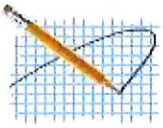
- Clients have expressed concern regarding lack of transparency in computing the risk charge on reinsurance recoverables. Under the current BCAR model, companies and analysts can use a simple spreadsheet to reconcile to the appropriate asset risk factor on reinsurance recoverables. Under the proposed BCAR model, there does not appear to be an easy way for clients to replicate the asset risk charges. As a result, common client questions include:

  - How do we know whether the new BCAR model is pulling the appropriate reinsurer rating? For example, could typos on Schedule F lead to a highly rated reinsurer identified as not rated?
  - Is concentration risk inflated by pooling companies by rating?
  - How does the model consider clauses in most reinsurance contracts that require mandatory collateralization if a reinsurer falls below a certain trigger?

- We understand the premium capital factors for homeowners and other property lines of business are adjusted lower to consider catastrophe losses based upon historical volatility. However, we believe the capital factors are still too punitive. [redacted]

## Contact Information





[redacted]

11/22/2016 11:52 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>

[redacted]

Subject Comment on evaluating profitability in the Net Premiums Written Risk in BCAR

Respectfully submitted for consideration:

On page 29, in the section on "Premium Capital Factors", of the "Net Premiums Written Risk (B6)" section, there is a description of A.M. Best's approach to evaluating the profitability of a line of business:

**"The measurement used to judge the rating unit's profitability in a line of business is the rating unit's three-year average reported accident year combined ratio in that line of business, using the rating unit's overall underwriting expense ratio."**

While this metric may work for many – if not most lines of business – we do not believe it accurately reflects the true profitability of longer tail lines of business such as Commercial General Liability (CGL) written on an occurrence basis. For CGL, there is considerable uncertainty in reserves beyond the 36month age of the typical accident year. The better companies will not likely release potential reserve redundancies in CGL occurrence business until at least 60 months of age for an accident year – and possibly longer if the company has a material amount of Products Liability exposure included such as would be evident if it writes a significant amount of CGL for Manufacturing classes. And thus the three accident year combined ratio may not reflect true profitability.

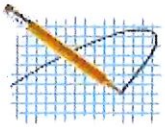
We are not necessarily suggesting that AM Best change it's metric. But rather, it might consider a company's actual historical record of development beyond 36 months, and make an adjustment to the "three accident year combined ratio" when assessing that particular line of business's profitability. By doing so it would encourage companies to continue to hold strong/conservative reserve levels during the period where there is uncertainty in reserves.

I would be happy to discuss/elaborate if there are any questions.

Thanks for the opportunity to provide commentary!
Sincerely,

[redacted]

[redacted]



[redacted]

12/01/2016 10:41 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject methodology commentary

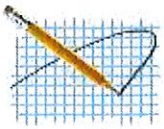
Good morning,

I read through our results and through the methodology documentation. [redacted] I know other items go into the overall rating, but it's hard to get a sense of the overall ratio. Is there some scale that is developed? Is there some comparison for other companies our size so we know how we are doing?

As a reader of the methodology, it doesn't provide much insight or comparison so overall it's not very helpful. Also, It seems like the biggest factors in the differences between VaR95 and VaR99.8 comes in the total underwriting risk and the factors that are assessed at each of the various intervals. How are those capital factors determined and are they unique to each company? I'm just trying to get a better understanding of the origin. How as a company can we affect change if we don't know how the factors are developed as well as we know how we are doing in comparison to other companies?

Thanks!

[redacted]



[redacted]

12/05/2016 10:04 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject Goodwill adjustment - BCAR

Good Morning,

Will goodwill no longer be a component of equity risk rather only an adjustment to available capital? Under current methodology, goodwill is a risk charge through equity risk which is subject to the covariance adjustment. This clarification will aid us in continuing to assess the model.

Best,

[redacted]

[redacted]

[redacted]

12/06/2016 11:20 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject FW: Goodwill adjustment - BCAR

Good Morning,

After speaking with [redacted] I would like to clarify the below question and also ask that this be anonymous.

[redacted] Under the current BCAR methodology, goodwill is a component of B2 – Equity risk, which, as an "affiliated" investment would be a 100% risk charge with no adjustment to available capital. Under the proposed methodology, goodwill is an adjustment to available capital.

**Question: Under the proposed methodology, will goodwill continue to be a component of the B2 – Equity risk as a 100% risk charge affiliated investment or will this only be an adjustment to available capital?**

Thank you for your help in understanding.

Best,

[redacted]

[redacted]

[redacted]

02/24/2017 10:29 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc [redacted]

Subject RE: A.M. Best Announces Release of Draft Criteria

1 attachment

Responses BCAR Methodology Changes.pdf

Greetings,

In the attached pdf please find responses to the "Request for Market Feedback" (page 1) and additional comments/questions on the BCAR criteria changes (page 2). As indicated in the attached, **all responses are to be kept anonymous**. If further clarification on these responses is needed, do not hesitate to contact me.

Best Regards,

[redacted]

We are very pleased to announce the publication of draft criteria for Understanding Universal BCAR and Understanding BCAR for U.S and Canadian Life/Health Insurers. Additionally, we are also releasing updated drafts of Understanding BCAR for U.S. Property/Casualty Insurers and Best's Credit Rating Methodology (BCRM). These draft documents are available on the methodology section of our website, accessible via this link http://www3.ambest.com/ambv/ratingmethodology/. The consultation period will remain open until March 1st, 2017 and we would encourage your input via the methodology.commentary@ambest.com

We look forward to working with you to explain the model in more detail and to work through the results of your own company during the consultation period. We will be in contact shortly to identify any company-specific additional information required to refine your model output.

If you have any questions, please let me know.

[redacted]

NOTE: RESPONSES ARE TO BE KEPT ANONYMOUS

**AMB Request for Feedback**

1. What is an appropriate capital treatment for deferred tax assets (DTA) when viewed within a global capital framework? How should the DTA be viewed under stress scenarios?
    - No Response

2. The BCRM added specific commentary on the ERM Framework Evaluation. Are there any other areas of ERM that should be considered as part of the analytical review process?
    - No Response

3. In the absence of modeled PMLs, how is exposure best evaluated? What is your view of estimating large potential losses without PMLs? Please provide any proxies that could be used instead.
    - Response: In the absence of PMLs, total insured value in a defined geographic area, such as county or zip code, may be a useful proxy. Using catastrophe models, A.M. Best could create baseline estimates of catastrophe potential that could be applied to the geographic area.

4. What are, in your opinion, the key differences between your internal capital assessment (either based on internal capital models or regulatory capital) and A.M. Best's BCAR? Which risk charges are most different from your own internal models? What elements were included in your own models that gave you comfort that they sufficiently covered the risk?
    - Response: Key differences between our internal capital assessment and the BCAR include the level of risk in the common stock and schedule BA portfolios, the evaluation of liquidity risk, the covariance adjustment between major risk sources, and business risk.

5. Is Beta an appropriate risk measure for equity risk? If not, what is a more appropriate measure?
    - Response: Yes, Beta is an appropriate risk measure for equity risk.

6. The proposed BCRM captures the risks related to domicile in an explicit manner, mainly through additional charges on investments in the BCAR and in the overall balance sheet strength assessment building block through the CRT impact. What is your view about this approach, conceptually and with regard to the magnitude of this particular impact?
    - No Response

**Additional Questions / Comments regarding the BCAR Methodology Change**

1. Under the proposed methodology, will goodwill continue to be a component of the B2 - Equity risk as a 100% Risk charge (affiliated investment) or will this only be an adjustment to available capital?

2. Rather than assessing reinsurers that do not have a published A.M. Best ICR a 100% impairment rate, would A.M. Best be able to incorporate financial ratings of other agencies using the electronic only column of Schedule F Part 3 (new for 2016)?

3. Would A.M. Best be willing to provide clarification is needed on the "as is" and "as will be" basis. What material changes will be used in this evaluation? Will only the "as is" BCAR be published?

4. All Schedule BA asset classes receive the same risk charge. However, a diversified portfolio of hedge and debt funds presents a lower volatility strategy versus straight private equity funds. The lower volatility is supported by historical returns. We believe these volatility differences should be reflected in the risk weightings for Schedule BA asset classes.

5. Would A.M. Best be willing to disclose the provider of the third-party ESG? What methodology/process is used to parameterize the ESG?

6. Has A.M. Best considered using the ESG to model dependence between the B1, B2, and B3 components?

7. Why does the BCAR model have a different time horizon view of Nonaffiliated Bonds versus Common Stocks? Bond defaults are considered for up to ten years, while the price volatility of stocks is one year.

8. When calculating Interest Rate Risk, would it be more appropriate to use Gross PMLs that correspond with the VaR level, rather than the 1 in 100 year PML across all VaR levels?

9. How did A.M. Best establish the 10% minimum applied to the rating unit's decline in market value of fixed income assets? Has A.M. Best modeled the other reasons for a short-term cash need which considers incoming cash flows and currently held cash?

[redacted]

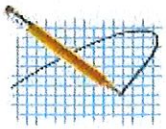
12/06/2016 11:17 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject Sustainability

Good morning – does AM Best factor ESG (environmental, social & governance) analysis into their current rating methodology or is it on the horizon for potential consideration?
Thank you.

Best,

[redacted]



**Jim Doherty <jdoherty@fosnj.com>**
12/13/2016 08:58 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject New BCAR - Catastrophe Pre-Tax

Good morning. We are a regional Mutual company writing business in New Jersey, Maryland and now Pennsylvania. We have been following the developments of both the new BCAR and the BCRM.

We would like to request consideration for you to use the Catastrophe Risk in the BCAR calculation on an after tax basis. [redacted]

James R. Doherty, CPA, MBA
President and CEO
Farmers Mutual Fire Ins Co of Salem
(856) 935-1851 x117
jdoherty@fosnj.com

[redacted]

12/16/2016 11:01 AM

To <methodology.commentary@ambest.com>
cc
Subject New BCAR

Regarding methodology, I would offer the following comments:

1. The B8 charge for the catastrophe loss PML's should be reduced by the cat-related premium that is collected against these risks. This represents a significant offset to this risk and would highlight relative risk amongst peers.
2. At the same time, the B6 premium charge should be reduced by the related cat premium to avoid double counting of this risk.
3. The stress test version of the BCAR should use the after-tax 1-100 PML, consistent with other components of surplus.
4. The methodology should be more specific on how/when credit is given for debt capital in the Available Capital section

I would be happy to discuss in greater detail and can be reached at the number below.

Best regards,

[redacted]

[redacted]

[redacted]

[redacted]

12/21/2016 12:11 PM

To methodology.commentary@ambest.com
cc
Subject Draft BCAR questions / comments

I would prefer that my questions and comments not be made public.

After reviewing the draft BCAR model for the [redacted] we have the following questions.

C-1
1) We noticed that Guaranteed Separate Account risk has not been included. Is that intentional?
2) Not all of our [redacted] reinsurance ceded is being captured. We seem to be missing cash and equity risk ceded. Note that we believe this information can be pulled from the SRQ, page 17, Question 20b, Column 7, Other Non-Rated
3) How is the bond risk being calculated? It appears inconsistent. For example, we noticed that the sum of the bond and short term book values less [redacted] ceded multiplied by the risk factors does not equal the RBC risk. This same methodology works with preferred stock.

C-3
1) In the Life Insurance Reserves section, why are the capital factors for Non-Interest Sensitive Reserves and Interest Sensitive Reserves identical? Is that intentional?

Thank you and please contact me if you have any questions.

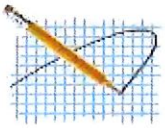
[redacted]

---

**********

[redacted]

**********



[redacted]

12/27/2016 03:25 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject comments pertaining to the new BCRM criteria procedure

Thank you for sending us the latest BCAR scores under the proposed new criteria. We appreciate the opportunity to comment on the proposed changes.
Best has made some material changes to the BCAR formula since March and we agree in large part with those proposed changes. A notable exception is the change in the tax treatment of cat risk. We strongly encourage Best to re-consider the definition of "cat risk" within the BCAR model to recognize the tax offsets that are explicitly outlined in the US tax code. We recognize Best's motivation for this change was in part due to adding cat risk under the square root in the covariance calculation and the fact other risks in BCAR do not recognize tax. However, this change ignores the reality of doing business in the US and can significantly impact capital adequacy scores, creating pricing disadvantages to those US entities requiring a need to hold more capital and/or a potential need to buy higher levels of reinsurance. Ultimately, the short term impact of cat events means companies are back to "regular" operations shortly thereafter and can recognize the tax benefits to offset future or past taxes. This should be considered differently than pricing and reserve risks in the BCAR model that can extend over multiple periods resulting in an inability to recognize those tax benefits. If the BCAR model is fundamentally setting required capital based on the "net" impact to surplus, Best should recognize taxes in the definition of "net" exposure from cat risk, especially for companies that have historically been profitable and will return to profitable operations following a large cat event. As Ben Franklin stated..."*In this world nothing can be said to be certain, except death and taxes* ". The certainty of taxes and the unique impact of cat events relative to other BCAR risks should be considered when defining "net" cat risk for the purposes of setting required capital so US companies are not, in effect, holding capital against credit risk of the IRS.

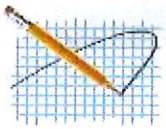
We hope this feedback is influential in your considerations of this important assumption and look forward to hearing your views on this issue.

[redacted]

[redacted]

[redacted]

[redacted]



**George Badry Shehata <badry.g@gig.com.eg>**
01/18/2017 09:32 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
[redacted]

Subject FW: A.M. Best - Updated BCAR

Dear Sirs ,

I do appreciate very much your efforts in making BCAR model much better in assessing the adequacy of capital .

Please note that based on the results sent for review from [redacted] using the modified model, I just have two comments :

First : Regarding the calculation of PML for 1 in 50/100/200/250/500 years , gross and net . Please be informed that the information needed to calculate PML @ these different confident levels mentioned in the model is not available to us in my company, and I believe to the whole Egyptian market , and maybe for the majority of MENA insurers due to the lake of advanced tools and models that can help in doing so.
I was asking if AM Best has any references that may help in that through providing certain tools that can be used in the calculation, or otherwise, considering that by any mean in the model modification process.

Second : Fixed income risk charge increased sharply in the new version of BCAR. For example for investments in sovereign bonds (B+,B, B- category ) , it's now 31.4% for VaR @ 95% confidence level and much higher in the other VaR scenarios; while it was 11.3% only last year using the previous BCAR version even after applying the country investment charges (CIC ) ?!! such Jump in the risk charge almost triple the required capital for investment risk and eventually affecting greatly our capital adequacy position. My question is regarding such abnormal increase , and if it can be reconsidered; Otherwise appreciate if you can share with me the rationale behind that if it was due to new assessment from AM BEST experts .

Many Thanks ,

George Badry Shehata - CIRM
Deputy General Manager, Enterprise Risk Management Department

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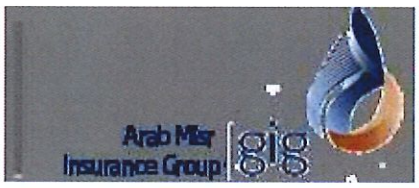

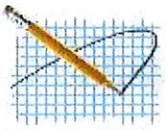

'[redacted]>

01/23/2017 02:52 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>

cc

Subject Anonymous Comments on New BCAR Methodology

1 attachment

Anonymous Comments AM Best New BCAR Methodology January 2017.docx

Dear A. M. Best,

We appreciate your option for us to anonymously submit comments regarding the new BCAR methodology. Even though my email will automatically be "tagged" with our company's and my information, the attached letter has been done in a way that does not identify our company or me.

Thank you,

[redacted]

[redacted]

[redacted]

[redacted]

January 23, 2017

A.M. Best Company
Ambest Road
Oldwick, NJ 08858-0700

Thank you for offering us the opportunity to provide comments on the new Best's Credit Rating Methodology (BCRM) and the Best's Capital Adequacy Ratio (BCAR) papers.

We agree with the use of Beta as a measure of equity risk. It aligns with the inherently intuitive logic that if, for example, a specific equity has a Beta of 1.5, and the market moves 10%, then you would expect the best estimate of that individual equity movement to be 15%.

In addition:

- We believe you have met your stated objectives of greater transparency and consistency.

- We like the way the new formula for BCAR reflects five varying confidence levels of stress testing while keeping in place your Building Blocks approach of evaluating Balance Sheet Strength, Operating Performance, Business Profile, Enterprise Risk Management (ERM) and other rating considerations not captured in the first four Building Blocks.

- We like the way the new formula for BCAR produces a simple 0 to 100 result scale for all Adjusted Capital numbers at or above Required Capital. We created handy formulas to convert an old BCAR percentage to a new BCAR number and vice versa. This helps clearly communicate the new scale while we are getting familiar with it, as illustrated below:

- New BCAR Number=100-(10,000/(Old BCAR%)) Illustration

| Old BCAR Percentage | New BCAR Number (Nearest 0.1) |
|---|---|
| 100 | 0 |
| 200 | 50 |
| 300 | 66.7 |
| 400 | 75 |
| 500 | 80 |
| 600 | 83.3 |
| 700 | 85.7 |
| 800 | 87.5 |
| 900 | 88.9 |
| 1,000 | 90 |
| Infinite | 100 |

Old BCAR%=10,000/(100-New BCAR Number) Illustration

| New BCAR Number | Old BCAR % (Nearest 0.1) |
|---|---|
| 0 | 100 |
| 10 | 111.1 |
| 20 | 125 |
| 30 | 142.9 |
| 40 | 166.7 |
| 50 | 200 |
| 60 | 250 |
| 70 | 333.3 |
| 80 | 500 |
| 90 | 1,000 |
| 100 | Infinite |

- We like the way the new Required Capital formula continues the tradition of combining independence and correlation measures with the various sub-components to yield an appropriate covariance adjustment.

- The increasing interest and depth of the fourth building block analysis (ERM component) over the last eight to ten years is appropriate given the uncertain economic, geographic, political and other risks.

- In the USA City Tiered terrorism risk factors, you may want to consider moving New York City and Washington, D.C. to their own factor category with even higher factors than Los Angeles and other Tier 1 terrorism risk cities, given their financial and political prominence and the 9/11 tragedy.

[redacted]

02/02/2017 07:49 AM

To methodology.commentary@ambest.com

cc [redacted]

Subject Comments to Am Best Understand Universal BCAR

Dear AM Best,

Many thanks for refreshing the BCAR model and increasing the transparency around the methodology by publishing a model methodology paper. I have 2 remarks, the first one being of extreme importance for good acceptance of the model.

1. Within the whole paper of approx 30 pages, there are 7 lines on half of the equation, meaning the available capital. That is clearly a shortcoming in the methodology, and I would suggest that the model user should have a clear understanding of every line of the available capital model calculation pasted here:

**Available Capital Components:**

| | | | |
|---|---|---|---|
| 15 | Reported Capital (Policyholders Surplus) | | |
| 16 | Capital Contribution | | |
| 17 | Pro Forma Reported Capital | | |
| 18 | Liquidity Reserves (French Acontng) | | |
| 19 | Equalization Reserves (German Acontng) | | |
| 20 | Rückstellung for Beitragsrückerstattung (German L/H Bonus Reserves) | | |
| 21 | Contingency Reserves (French or Swiss Acontng) | | |
| 22 | DAC Equity (Statutory Accounting,HGB) PC Only | | |
| 23 | Reinsurance Provision | | |
| 24 | Loss Reserve Equity | | |
| 25 | Convertible Bond Equity | | |
| 26 | Asset Equity - Affiliates and Participations | | |
| 27 | Asset Equity - Bonds (Non-Affiliated) | | |
| 28 | Asset Equity - Equity (Non-Affiliated) | | |
| 29 | Asset Equity - Real Estate | | |
| 30 | Asset Equity - Other | | |
| 31 | Other Taxable Adjustments | | |
| 32 | Other Taxable Adjustments | | |
| 33 | Sub-total | | |
| 34 | Intangible Assets (Goodwill + PVFP) | | |
| 35 | Recent Loss - Net - (After-Taxes and Reinsurance) | | |
| 36 | Unearned Premium Capital Charge (P/C Only) | | |
| 37 | DAC Charge under GAAP (Life Only) % Charge | 100.00% | |
| 38 | Reduction to DAC Equity due to high Loss Ratio(P/C Only) | | |
| 39 | Future Dividends | | |
| 40 | Future Losses (D) (Deferred Taxes) | | |
| 41 | Other taxable reductions to surplus | | |
| 42 | Available Capital (AC) | | |

I would suggest you put a new RfC out explaining the available capital components and gathering comments from the participants before finalising the methodology.

2. This is a universal model. Can you explain to which industry do the economic scenario generator related?

Many thanks for taking my comments on board. [redacted]

Best regards, [redacted]

[redacted]

[redacted]

**Marcin Kowalski**
**<marcin.kowalski@polishre.com>**
02/09/2017 11:16 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc [redacted]
Subject RE: New BCAR model - Polish Re

Dear Sirs,

Referring to your e-mail below please see our questions/remarks regarding point 2:

1. BCRM procedure:
   a. Net Cat PML is moved to required capital. That causes rescaling of BCAR ratio so old results need to recalculated if we want to compare.
   b. What level of confidence (VaR) was used to calibrate capital factors for previous BCAR model? In order to compare BCAR score from updated version of the model with old one which VaR should be analyzed?

Our general comment is that we get quite different outputs in updated model however it is difficult to say how that could affect rating level.

We would appreciate your comments in this respect.

Thank you in advance,
Best regards,

**Marcin Kowalski**
Executive Director
Underwriting Department

**Polish Reinsurance Company**
4, Bytomska Street; 01-612 Warsaw, PL

T: +48 22 832 02 56
M: +48 602 679 990
Email: marcin.kowalski@polishre.com

POLISH REINSURANCE COMPANY
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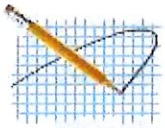


[redacted]

02/09/2017 06:18 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject BCAR Comments for your consideration

Thank you for soliciting feedback on the revised BCAR model. Your webinar and published materials were very well done and you have proactively addressed many potential questions or concerns I thought companies might have. I would ask that you consider the following points as you finalize the BCAR model and communications related to the model.

- An ESG was used to create and apply stochastic based factors within the model. I hope you provide the ESG output used and information about how frequently you plan on updating your ESG output.
- For each company there will be an initial BCAR from the model and Adjusted BCAR results. Please provide each company transparency about the reason and type of adjustments made to the initial BCAR results.
- Once all companies are run through the new BCAR, please publish aggregate results, at least for the life companies, and indicate not only low and high scores (anonymously of course), but also where the 25$^{th}$, 50$^{th}$, and 75$^{th}$ percentiles (or some other range) fall. This will enable companies to know on a comparative basis how their scores look without specific company names being provided.
- The model does not appear to give credit for liabilities that can pass experience through to the client. For example, whole life dividends provide a mechanism for sharing investment losses through adjustments to the dividend.
- In addition to product features that can reduce the risk to the insurance company, many companies have active asset liability management (ALM) programs. The model should include an adjustment for ALM practices
    - Certain liabilities are longer duration and therefore should be matched with longer duration assets. The fairly large and increasing risk charges for longer duration assets in general, and real estate in particular, may discourage companies from performing ALM in order to reduce their asset risk charges. That would seem to introduce reinvestment risks to the portfolio that do not appear to be measured in the model.
- I hope you can provide some additional transparency around the loss, given default assumptions. The range in the materials appears to be from 20% to 55%, which is higher than we have experienced in our

company. Similarly, the expected loss numbers seem high. We would like for you to provide more information about the time period used to calculate your LGD and EL, as well as information about how often you will update your assumptions.

- The model does not appear to take into account the fact that some longer duration assets simply can be held through the cycle without a need to liquidate when prices are lower – real estate is a great example. While I agree prices may fall, unless a company has a liquidity need, the company should be able to hold the real estate asset until prices rebound. Instead of having high asset (in this example real estate) charges, we suggest addressing liquidity risk more directly. [redacted] real estate losses are significantly below the levels used in your model; again, I would like you to publish more details on the data used and how often it will be updated.
    - The risk charge for BA real estate holdings is similarly higher than our past experience, and does not appear to recognize the ability to hold the asset until prices recover.
- The charge for corporate owned life insurance (COLI) assets increased materially from your prior charge of 0.8%; it is now 5%. I hope there can be more transparency about the driver for that change and whether it will be reviewed and updated on a periodic basis.
- The model's reinsurance risk charge should be adjustable to recognize when reinsurance utilized may have significantly lower risk characteristics. [redacted]
- Similar to the comment above about asset charges not reflecting the different product characteristics, it does not appear that the mortality charges recognize that certain products enable the insurer to share experience with the customers. [redacted]
- There is limited transparency into how the health reserve factors were derived and they appear significantly higher than the life factors. Can additional information be provided?
- Finally, the C3 factors indicate they assume matched portfolios and still have a factor for withdrawals where market value adjustments (MVA) exist. If a portfolio is matched, and there is a MVA, I am not sure why there needs to be an additional C3 risk charge. As noted earlier, we

suggest liquidity risk be handled separately from the capital model.

Please contact me if you have questions about any of these points or want to discuss any of them in more detail. Thank you.

February 20, 2017

We appreciate the opportunity to respond, and also appreciate AM Best's move to increase transparency.

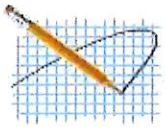
[redacted]

If you have questions, please let us know.

[redacted]

- Will details be provided of how each score was arrived at? Will this be public?
- Will there be an attempt to rate 'through a cycle', to avoid a double 'hit' as a result of methodology – for example, if capital model results are low because of tail events (with guaranteed businesses in a bad year for example), will business model also be notched down because of that as well? Our observation is that AM Best has always kept a long term view, and has done well keeping all considerations in their line of sight as they assign ratings. We assume this same type of approach will be taken with the new methodology.
- Does AM Best plan to change the stochastically arrived at factors used in the capital model annually? I assume they are more of a long-term view, but what would be a reason to make a change? How often do you intend to review these, absent impact from significant events?
- Will this methodology change or impact the process for gathering data from companies?
- In your rating methodology you talk about considering the insurer's internal capital model. You note that for AM Beset to consider that capital model, the issuer will need to have the ability to explain significant differences between their internal model and the BCAR model. Will you be willing to provide more detail about BCAR so that issuers can make a good comparison?
- Can you expand on your expectations of how frequently the economic capital model should be run? Please expand on what is meant by "capability to create short, medium and long-term time horizons for several risk/return measures" as it relates to the capital model.
- The ERM scoring is very 'wide' - stated range of +1/-4. Why the wide range? Is a +1 score possible to achieve?
- [redacted]
- Why didn't AM Best use risk taxonomies already in use? And will there be flexibility for companies using different taxonomies when they try to map to AM Best's?
  It is a true statement that there is not one standard risk taxonomy used by companies today. There are those that are commonly used, for example Basel II.
  And within those taxonomies used, there are certain commonalities:
  - all list 'risks', not outcomes
  - all have external and internal focus

  Our concern is that AM Best's chosen risks are unique, and could make mapping to AM Best's taxonomies quite difficult in some cases.



[redacted]
02/22/2017 12:17 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject [redacted]

1 attachment

AM Best - Request for Comment - [redacted]

Hello,

Please see attached our comments on the draft methodology. If you have any questions, please feel free to contact me (contact information in signature), I would be happy to discuss further. Thank you,

[redacted]

**A.M. Best Request for Market Feedback**

*Send to: methodology.commentary@ambest.com*

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

1. What is an appropriate capital treatment for deferred tax assets (DTA) when viewed within a global capital framework? How should the DTA be viewed under stress scenarios?

   No response.

2. The BCRM added specific commentary on the ERM Framework Evaluation. Are there any other areas of ERM that should be considered as part of the analytical review process?

   No.

3. In the absence of modeled PMLs, how is exposure best evaluated? What is your view of estimating large potential losses without PMLs? Please provide any proxies that could be used instead.

   No response.

4. What are, in your opinion, the key differences between your internal capital assessment (either based on internal capital models or regulatory capital) and A.M. Best's BCAR? Which risk charges are most different from your own internal models? What elements were included in your own models that gave you comfort that they sufficiently covered the risk?

   [redacted]:

   - **UPR discounting for long-duration contracts**:
     - [redacted]
     - **BCAR model**: while loss reserves are discounted using discount factors within the reserve risk calculation, there is no discount factor applied to the UPR balance

- [redacted]

- **Recommendation**: we believe a discount factor should be applied to the UPR for long-duration contracts to align with the treatment of loss reserves; this discount factor should be company-specific as the duration of the underlying contracts can vary significantly between businesses

- **Interest rate risk calculation**:
  - [redacted]

  - **BCAR model**: an interest rate stress test is performed which assumes an event that requires significant liquidity occurs at the same time as a defined interest rate shock, and which "assumes a rating unit is no more likely to liquidate a fixed income asset than it is to liquidate any other liquid asset" (Understanding BCAR Draft, pg. 17)

  - **Issue**: The BCAR's assumption quoted above is not realistic, as insurers with large cash balances are better protected against the need to liquidate fixed income securities at a loss; as a result the interest rate stress test does not give enough credit to insurers holding large cash balances versus those with high levels of invested assets

  - **Recommendation**: the BCAR should first reduce the PML by cash holdings, then calculate the ratio of the remaining PML balance to non-cash liquid assets; this percentage could then be applied as before (this assumes that a rating unit would most likely use cash first, and then would be no more likely to liquidate a fixed income asset than any other non-cash liquid asset)

  - The 10% minimum should also be removed or substantially lowered, as it would penalize insurers with large cash balances who are less susceptible overall to crisis events that require the liquidation of fixed income securities

5. Is Beta an appropriate risk measure for equity risk? If not, what is a more appropriate measure?

   Yes.

6. The proposed BCRM captures the risks related to domicile in an explicit manner, mainly through additional charges on investments in the BCAR and in the overall balance sheet strength

assessment building block through the CRT impact. What is your view about this approach, conceptually and with regard to the magnitude of this particular impact?

No response.

[redacted]

02/23/2017 09:40 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Comments on proposed new criteria procedure for Universal BCAR

Good afternoon.

Please find here following a few comments on proposed new criteria procedure for its Universal BCAR:

Investment risk - Bond

- Excluding AAA-rated Sovereign bonds, no differentiation between Government and Corporate bonds is considered.
- We strongly believe that different treatment among issuers (as per AAA-rated) should be taken into account.

Investment risk - Interest rate

- The bucket 'Guarantee between 1%- 5%' is too wide. We believe that an increased level of granularity should better capture the risk profile of the life business.

Underwriting Life risk - Mortality

- The capital charge applied seems very penalizing (roughly 5x) compared to Solvency 2 Standard Formula and/or Generali Internal Model.
- The capital factor seems very high considering both cat (also considering market benchmark, e.g. Swiss Re) and trend mortality risk.

Stock – not affiliated

- A capital charge of 100% is applied, while the fair value of this asset class is considered in the Available Capital. Why not to deduct the value from AC ?

Applied Stresses – Percentile comparison

- Comparing the stresses for different percentiles, it seems that the probability distribution of the losses follows a normal distribution, which is a strong assumption if we think to all the risks considered in the BCAR model.
- Taking for granted the stress at 99.5%, this assumption leads to have $95^{th}$-tile and $99^{th}$ –tile stresses higher than expected (taking into consideration different probability distributions , like student-T distributions) and $99.6^{th}$ –tile and $99.8^{th}$ – tile lower than expected.

Please let us know for any clarification needed.

Best.

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]
02/27/2017 05:21 PM

To methodology.commentary@ambest.com
cc
Subject U.S. Life/Health BCAR Commentary - [redacted]

1 attachment

A.M. Best BCAR for Life Insurers - [redacted] - March 2017.pdf

Good Afternoon,

Please refer to the attachment below for commentary related to the proposed BCAR methodology for U.S. and Canadian Life/Health Insurers. We appreciate the chance to provide commentary and applaud A.M. Best for its transparency and willingness to seek insights from industry experts on this very important topic. We ask that the body of our memo remain confidential, but we welcome our appendix questions and responses to be shared anonymously.

Thank you,

[redacted]

[redacted]

February 27, 2017

[redacted] appreciates the chance to provide comment on the November 14, 2016 draft criteria from A.M. Best, "Understanding BCAR for U.S. and Canadian Life/Health Insurers." We applaud A.M. Best for its transparency and willingness to seek insights from industry experts on this very important and impactful topic. We have thoroughly reviewed the criteria and have material comments regarding C1 Investment Risk, C3 Interest Rate/Market Risk and diversification of risks. Additionally, we have attached an appendix of less material questions and comments. We ask that the body of our memo remain confidential, but we welcome our appendix questions and responses to be shared anonymously.

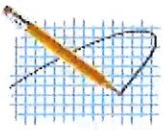
[redacted]

**Appendix – Additional anonymous BCAR methodology questions**

| # | Topic | Question |
|---|---|---|
| | Rating process | How much will potentially lower BCAR scores factor into a Company's overall FSR? |
| | BCAR scores | How will AM Best evaluate differences in BCAR scores for VA and FIA writers caused by the model change which will likely now be even wider? |
| | Rating process | Does the new BCAR model have any impact on the ratings of Companies regarded as "core" within an insurance group if the model change causes standalone FSR's to deviate more significantly from parent FSRs? |
| | ESG | Is more detailed ESG model documentation, including methods, data and assumptions, available for review? |
| | ESG | Is the ESG model real world or risk neutral? Note that the scenario generator used for VA market risk is a real world scenario generator. |
| | C1 | Is more detailed C1 model documentation, including methods, data and assumptions, available for review? |
| | C1 | Do all Schedule D investments get the charges shown in Appendix 1: Baseline Bond Risk Charges as a starting point? |
| | C1 | How did the loss model account for differences in defaults and recoveries across different asset classes? |
| | C1 | How was the scaling performed to take the 92% VaR level charges for commercial mortgage loans to the 95%, 99%, 99.5%, and 99.6% VaR levels? If the normal distribution was not used, what assumptions were used to do the scaling? |
| | C1 | It is noted that the ESG calculated risk factors are a baseline and can be adjusted for a company's specific profile. What types of adjustments might be made here? |
| | C1 | For fixed income assets, is the modeling done on defaults only, or is it based also on spreads (market value movements due to rating transition)? |
| | C1 | Are recoveries assumed to be reinvested throughout the 10-year projection? If so, how is this done within the model? |
| | C1 | Why was a 4% discount rate chosen? Is this a pre-tax rate or after-tax? |
| | C1 | What is the supporting data set used to validate the 55% assumed recovery for higher rated bonds moving to 20% for the lowest rated bonds? |
| | C1 | What bond ratings should be used when filling the SRQ? |
| | C1 | What is the break point for when an insurer's participation in foreign investments needs to be calculated and how is this adjustment calculated? |
| | C1 | Regarding the market value of fixed income investments in the modeling, are you running two models, one in default-only mode and one in a mark-to-market mode? Or is the mark to market mode only applicable for non-C1 factors? |
| | C1 | The risk factor for cash and cash equivalents has doubled from the current model. How was this determined? |

| | | |
|---|---|---|
| | C3 | Is more detailed C3 model documentation, including methods, data and assumptions, available for review? |
| | C3 | How is the 1,000 scenario subset determined? |
| | C3 | How does the AM Best model account for management levers? |
| | C3 VA Market Risk | How does AM Best anticipate reflecting C3P2 going forward given the latest NAIC project to reform AG43 and C3P2? |
| | C3 VA Market Risk | Does AM Best allow for a smoothing mechanism similar to what is in the current NAIC 9-step approach? |

[redacted]



[redacted]

02/28/2017 08:30 AM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>
cc
Subject BCRM Comments

Good morning. Thank you for sending us the latest BCAR scores under the proposed new criteria. We appreciate the opportunity to comment on the proposed changes.
We believe AM Best has significantly improved the calculation of required capital in the changes AM Best has proposed to the BCAR formula since March. A notable exception is the change in the tax treatment in the definition of catastrophe risk (cat risk). We strongly urge AM Best to re-consider the definition of cat risk within the BCAR model to recognize the tax offsets for US companies that are explicitly outlined in the US tax code. We believe AM Best's motivation for this change was in part due to adding cat risk under the square root rule in the covariance calculation and the fact other risks in BCAR model included in the covariance calculation do not recognize tax. However, we believe cat risk is much different than the other risks in the BCAR model. The impact is immediate and then companies are back to "normal" operations shortly thereafter making the recognition of such tax recoveries quantifiable and achievable as opposed to other risks in the BCAR covariance adjustment that may take many years to settle making recognition of those recoveries difficult or result in write-offs of DTA's. If the BCAR model is fundamentally setting required capital based on the "net" impact to surplus, we believe AM Best should recognize taxes in the definition of "net" exposure from cat risk, especially for companies that have historically been profitable and will return to profitable operations following a large cat event. We believe the certainty of taxes and the unique and short term impact of cat events relative to other BCAR risks should be considered when defining "net" cat risk for the purposes of setting required capital so US companies are not, in effect, holding capital against credit risk of the Internal Revenue Service and are on equal footing with companies from non-taxable jurisdictions.

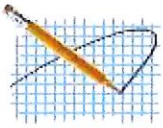
We hope this feedback is influential in your considerations of this important assumption and look forward to hearing your views on this issue.
Thank you,

[redacted]

[redacted]

[redacted]

[redacted]



[redacted]

02/28/2017 10:00 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject FW: Regarding [redacted] 2015 Preliminary BCAR Review

[redacted]

**Sent:** Monday, February 27, 2017 7:58 PM

[redacted]

**Subject:** [redacted]

**Importance:** High

[redacted]

Thank you again for the opportunity to review the preliminary BCAR output for [redacted] We have a few follow-up questions.

**Questions specific to Best's Capital Adequacy Ratio, or BCAR:**

1. Under the previous BCAR model, [redacted]s capital consistently placed at the top ranking (the level supporting a rating of [redacted]). With the same balance sheet and business profile -- but under the new BCAR model, [redacted] now appears to rank [redacted] the top ([redacted]. Given the importance of the BCAR calculation to the overall rating, this is concerning to us:
   a. **Can you tell us whether a majority of [redacted] peer [redacted] companies experienced a similar result under the new BCAR methodology?**
   b. **Did any life companies that you consider to be [redacted] peers have a more favorable outcome under the new BCAR calculation than under the old?**

2. Is our understanding correct that "Available Capital" is strictly a statutory measure?
   a. **Is it correct that any Adjustments to Available Capital for Intangibles and Goodwill would apply only to statutory-basis Intangible Assets and Goodwill**, and would not consider any GAAP-basis balances?

3. In A.M. Best's "Understanding BCAR for U.S. and Canadian Life/Health Insurers," there is a reference to stress tests for the BCAR:
   a. **Are you able to tell us more about what stress tests might be used in A.M. Best's analysis?** (For example, would you be looking at specific interest rate scenarios?)
   b. **Did A.M. Best apply stress tests in your 2015 Preliminary BCAR Review?**

**Questions regarding the newly framed ratings methodology (Best's Credit Rating Methodology, or BCRM):**

1. **Which [redacted] companies comprise the Peer Group that A.M. Best uses for the ratings analysis of [redacted]**

2. We understand that the BCRM is a reorganization of the current methodology, utilizing a building block approach to provide greater detail, clarity and transparency to the rating analysis. The BCRM offers a forum for discussion with analytical staff and also will provide greater consistency in the rating process. While the methodology is being updated, the core components of the analytical process — a review of balance sheet strength, operating performance, business profile and enterprise risk management — remain as the key pillars and thus do not represent a fundamental change to the rating analysis.

With that in mind, **it would seem that the new BCRM does not signal a change in the assessment of Enterprise Risk Management. Is that correct?**

a. If not, could you please tell us how the ERM assessment will be different under the new ratings framework?

3. A.M. Best's report of the rating assessment factors under BCRM: Do you anticipate any changes to the structure and content of the A.M. Best Credit Report to track with the new rating framework?

[redacted]

Best regards,

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

**Sent:** Wednesday, November 30, 2016 10:09 AM

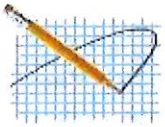
[redacted]

**Subject:** 2015 Preliminary BCAR Review

[redacted]

[redacted]

[redacted]



[redacted]
02/28/2017 02:07 PM

To methodology.commentary@ambest.com
[redacted],
Subject Feedback on BCRM/BCAR criteria update

February 28, 2017

Criteria Update: BCRM and BCAR
A.M. Best Methodology Commentary

The [redacted] appreciates the opportunity to comment on the updated draft of the Best's Credit Rating Methodology and revised Best's Capital Adequacy Ratio Criteria. Representatives from Finance and Enterprise Risk Management functions worked together to provide comments. Our responses to the A. M. Best's questions follow.

1. **What is an appropriate capital treatment for deferred tax assets (DTA) when viewed within a global framework? How should the DTA be viewed under stress scenarios?**

   Under a global framework, we believe that deferred tax assets should be included as part of available capital, but at a discounted value since they cannot be liquidated. Under stress scenarios, we believe it would be appropriate for DTA to not be included in available capital.

2. **The BCRM added specific commentary on the ERM Framework Evaluation. Are there any other areas of ERM that should be considered as part of the analytics review process?**

   We believe that ERM rating component encompasses all relevant areas of ERM. *Governance and Risk Culture* can further elaborate on delineation between different lines of defence: business line that creates and owns the risk, ERM function that provides objective oversight of risk management activities, and internal audit that provides independent review of risk management.

3. **In the absence of modeled PMLs, how is exposure best evaluated? What is your view of estimating large potential losses without PMLs? Please provide any proxies that could be used instead.**

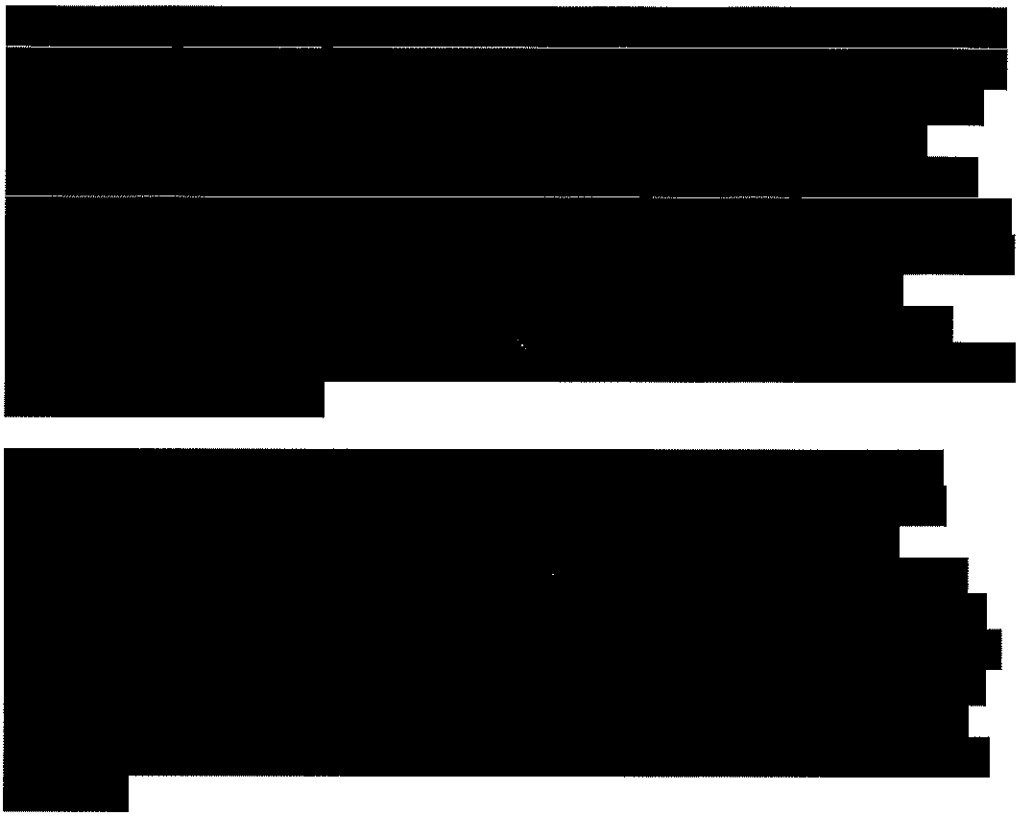
   Proxies identified in the BCAR procedure documents are consistent with how we would approach estimating exposure in absence of PMLs. Some of the proxies we would consider:

   · Concentration of total insured value by region and line of business, with more detailed analysis for catastrophe prone areas.
   · Trended, on-level, historical cat losses, adjusted for change in mix of business and coverage offerings.

4. **What are, in your opinion, the key differences between your internal capital assessment and A.M. Best's BCAR? Which risk charges are most different from your own internal model? What elements were included in your models that gave**

**you comfort that they sufficiently covered the risk?**

The statistic we use for risk measurement is Tail Value at Risk (TVaR) rather than A.M. Best's choice of Value at Risk (VaR). By definition, TVaR produces larger values than VaR, as it is the average value *given that the outcome exceeds the desired confidence level.* We evaluate our capital needs at the 99.5$^{th}$, 99.6$^{th}$, 99.7$^{th}$ and 99.8$^{th}$ percentiles.



Generally speaking, the risk charges for insurance and market risk in the BCAR are greater than those in our internal assessment.

5. **Is Beta an appropriate risk measure for equity risk? If not, what is a more appropriate measure?**

Yes, we think that described use of Beta in BCAR to relate the rating unit's common stocks portfolio to volatility of the market is an appropriate approach to measure equity risk.

6. **The proposed BCRM captures the risks related to domicile in an explicit manner, mainly through additional charges on investments in the BCAR and in the overall balance sheet strength assessment building block through the CRT impact. What is your view about this approach, conceptually and with regard to the magnitude of this particular impact?**

We find this approach reasonable, but would expect some diversification credit on

the investment side.

[redacted] trusts that the comments provided will be of value.
We would like to request anonymous treatment of these comments.
We thank you for offering us the opportunity to respond.

Sincerely,

[redacted]

[redacted]

[redacted]

02/28/2017 03:41 PM

To [redacted]

Subject RE: [redacted] draft BCAR output

[redacted],

Thank you for sharing the BCAR information with us and for soliciting our input. We have completed our initial review of the adjusted BCAR model and calculation. Please find our comments and questions below. We'd be happy to schedule a call to discuss after you have a chance to review them. We'll be in touch as well if we have additional questions. Thank you.

- We noted that the new BCAR formula increases the C-1 factors, and is comprised of both 1) the absolute level of the charges being generally up, and 2) the slope of the factors also changed quite a bit. Did your models show that a correction was needed to both the overall level of the C-1 risk factors as well as their relationship to each other? The C-1 increase is heavily weighted to the highest asset quality categories, as compared to the below investment grade categories. [redacted] as there something in your modeling that pointed to a correction needed to the weighting of the risk factors? We are curious as to the logic and methodology behind this change, as it seems that this would incentivize a company to invest in riskier assets than may be prudent or responsible.
- We had a similar question regarding the C-3 interest rate risk factors. Are the increases related to overall corrections needed to the risk factors themselves, or their relationship to each other? [redacted] ll factors were increased across the board, but in each category the least risky were increased the most. Was some disconnect found in the modeling of the existing reserve factors in those categories? The new C-3 model shows very little difference among the C-3 factors in each category based on when surrender period expires.
- The combination of the increases in risk for the C-1 and C-3 non-equity factors also produces what may be an unintended consequence related to the covariance adjustment. In the old BCAR formula, the covariance for our C-1 and C-3 risk reduced those components to about 93% of their calculated amount. Under the new method, the higher weightings of the C-1 and C-3 components changes the covariance for those components to about 98%. We would assume that this is not an uncommon result of the new model. Was there some reason for the concentration of additional risk to the C-1 and C-3 categories? Did something in your modeling point to a shortfall in those risks compared to the other C-risk categories?
- The new rating assessment for companies at CRT-1 "very strong" starting at a/a- appears to have a fair amount of downside risk (+6/-10), especially in the ERM assessment (+1/-4), [redacted]

- A few other more specific observations/questions:
  - [redacted]
  - Possibly related to the first bullet point above, the reinsurance default factors were formerly (similar to the NAIC approach) calibrated to be equal to the default charge for an NAIC 1 bond. At VaR 99.6, the new charges are 413% of the old ones, much higher than the NAIC 1 bond increase of 265% noted above. Did something change in your underlying assumptions related to reinsurer default risk?
  - If we interpret our report correctly, there may be a change in how C-2 mortality risk is calculated. In most capital formulas, including the old BCAR, Ordinary+Industrial are combined, and Group+Credit are combined before applying the laddered C-2 factors. With the Adjusted BCAR, they appear to be done in four separate calculations and not combined prior to applying the factors. Is that correct? This additional split causes more NAR to be charged at the highest initial factor level. [redacted]

[redacted]

[redacted]

1 March 2017

CONFIDENTIAL

A.M. Best Company Inc.
Via email: methodology.commentary@ambest.com

**Proposed ratings methodology for [redacted]: Submission**

## 1. INTRODUCTION

We refer to your advice that A.M. Best is consulting on proposed changes to its Financial Strength Rating Methodology and is presently seeking submissions in respect of this.

[redacted] has significant concerns regarding the proposed changes and the potential impact on its business, and welcomes the opportunity to engage with you on the proposed changes. In this submission [redacted] sets out its principle concerns on a high level basis. Given the potentially serious impact on our business, [redacted] would also welcome the opportunity to discuss the issues highlighted in this submission, in person if that would assist, as part of the consultation process.

We request that A.M. Best treat this submission as confidential and keep these comments anonymous.

### Background to this submission

[redacted]. As we understand it the key factors of the new methodology which are relevant to [redacted] are:

- A revised baseline balance sheet strength (the capital adequacy) assessment model with new thresholds.
- The use of specified other factors to adjust (up or down) the base balance sheet strength i.e. enterprise risk management, operating performance and business profile.
- Full analysis of both the non-lead rating unit [redacted] and also the lead rating unit [redacted] and "lift or drag" of the non-lead rating unit by the lead rating unit assessment.

[redacted]

## 2. SUMMARY OF KEY POINTS

In summary, [redacted] has four main concerns regarding the proposed changes:

- [redacted]
- The rating methodology appears to assign no value to unimpaired goodwill or other intangible assets, with the exception of customer contracts, relating to profitably performing prior business acquisitions.
- [redacted]
- [redacted]

[redacted]

## 3. [redacted]

[redacted]

We have discussed these points with A.M. Best rating analysts in previous years, and would be happy to discuss further.

[redacted]

[redacted]

## 4. BACKGROUND TO [redacted]

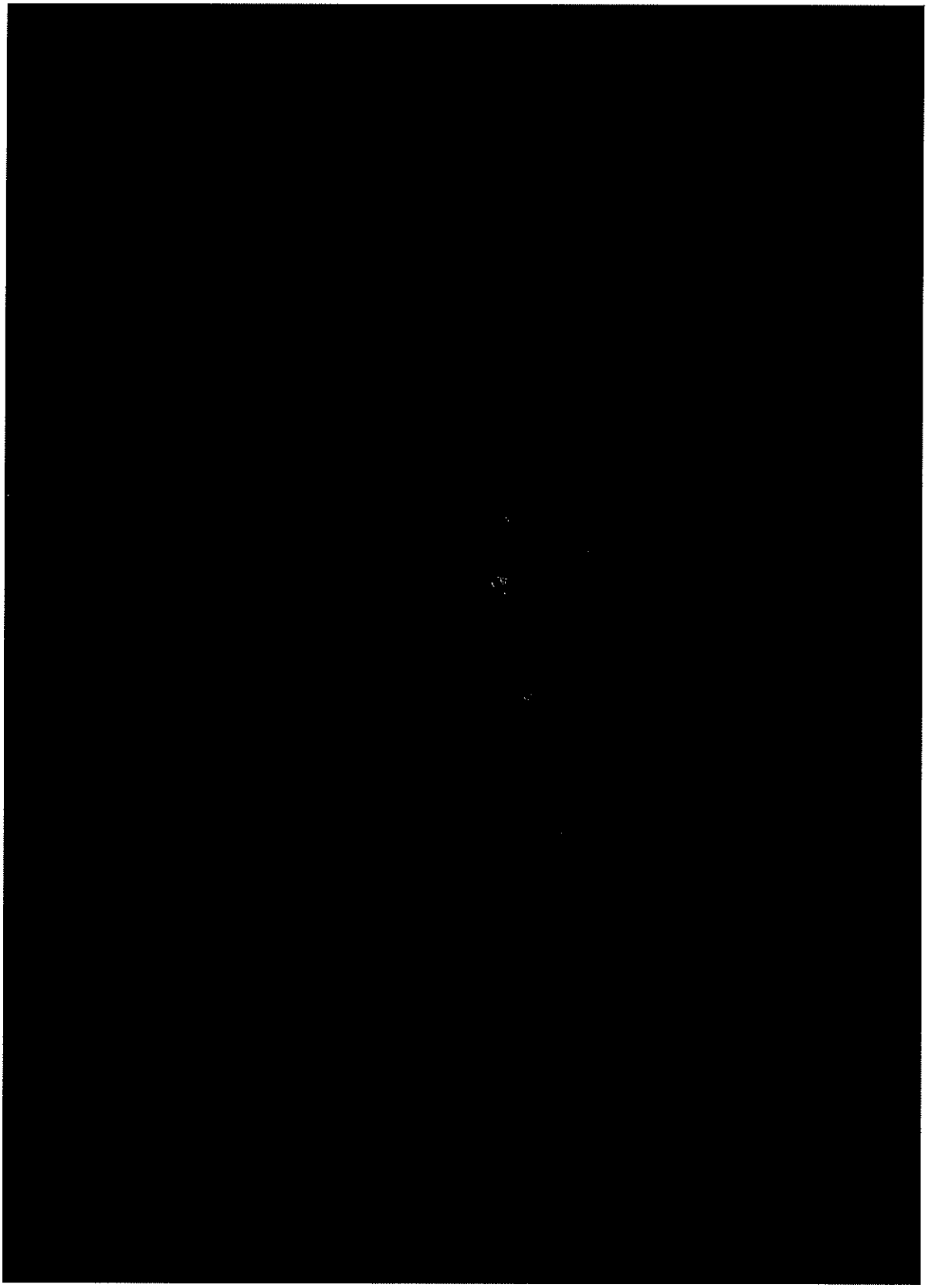
[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]

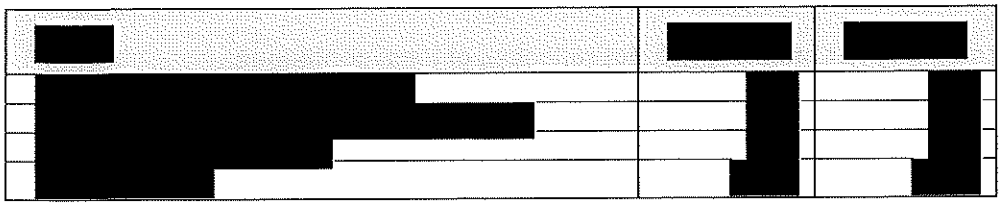
[redacted]

| [redacted] | [redacted] | [redacted] |
|---|---|---|
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |
| [redacted] | [redacted] | [redacted] |

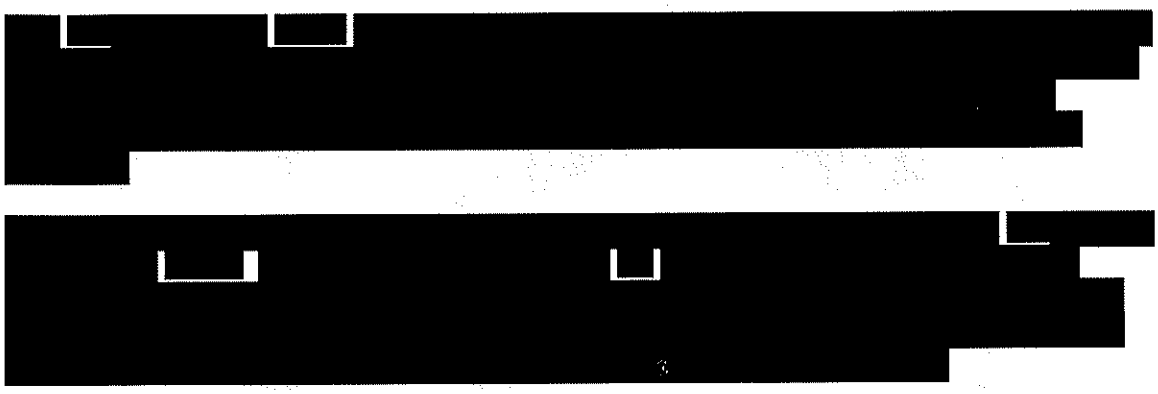
[redacted]



[redacted] solvency ratios as at 30 June 2016 and 31 December 2016 are shown below for [redacted]



**Reserving for financial reporting**



| Insurer | Risk Margin | POS |
|---|---|---|
| **Risk Margins for [redacted] after diversification (FY16)** | | |
| [redacted] | 6.0% | 95% |
| [redacted] | 5.9% | 95% |
| [redacted] | | |
| [redacted] | 7.7% | >95% |
| [redacted] | 2.5% | 75% |
| [redacted] | 8.7% | >95% |
| [redacted] | | |
| [redacted] | 21.0% | 90% |
| [redacted] | 8.9% | 89% |
| [redacted] | 16.2% | 90% |

Source for other insurers: 2015 Annual Reports for each insurer

## 5. KEY POINTS

### a) Proposed calculation of premium risk not reflective of local conditions

[redacted]

We request further detail on how analysts would determine any adjustment to be applied to reflect local market conditions.

[redacted]

### b) Goodwill and intangible assets

[redacted]

[redacted]

[redacted] would suggest that for rating purposes it would be appropriate to re-categorise the goodwill and other intangible assets (specifically software, brand and trademarks) as "investment in subsidiaries" and would suggest that the proposed BCAR ratings methodology should recognise the value of these investments, reflecting their forecast profitability contribution to [redacted]

We submit that, if the intangible assets are not recognised, that the cash-flows the businesses are expected to generate should be recognised for rating purposes.

**c) Lack of transparency regarding how drag adjustments will be assessed**

In the indicative calculations which have been provided to us by the A.M. Best ratings team, it appears that [redacted] has been considered to be the lead rating unit for [redacted] We suggest that [redacted] may be the more relevant entity to be considered as the lead rating unit, as the ultimate parent [redacted] However, the points we make below apply in either case.

A.M. Best has indicated that there could be a drag on [redacted] rating due to the rating of the lead rating entity (with reference to [redacted]). Drag adjustments can be between one and four notches.

A.M. Best has indicated the broad issues which will be considered in determining the amount of drag to be applied. However, based on the information provided, it is not possible to determine with any specificity the likely drag which would be applied in a given case.

Given the very wide range, and the significant commercial, financial and market perception risk a downgrade represents, we request further detail on how A.M. Best will assess this adjustment. Without further guidance it will be very difficult for [redacted] to form even an approximate view of the rating it is likely to obtain.

Further guidance will assist [redacted] to prepare relevant material for A.M. Best and, if necessary, estimate the impact of possible changes to Group structure. In particular, it would be helpful to understand how (or if) a subsidiary could potentially minimise the impact a lead rating entity may have on its rating.

[redacted]

**d) Potential for downgrade despite no change in business**

[redacted]

The purpose of the Financial Strength Rating is to provide information and assurance to our customers of [redacted] financial strength and ability to meet its ongoing insurance policy and contract obligations.

[redacted]

**e) Methodology rollout**

[redacted] seeks guidance on the timing of A.M. Best's proposed methodology rollout and how this is proposed to be managed in practice relative to the annual rating review period [redacted]

[redacted] has assumed there will be a deliberate, open and transparent communications strategy to clearly convey the proposed ratings methodology impacts to [redacted], the market and the wider financial services community prior to the methodology rollout or application of the methodology.

[redacted]

## 6. SUGGESTIONS FOR CONSIDERATION

In view of the points raised, [redacted] asks that A.M. Best review some of the proposed changes to the methodology. For the qualitative elements of the methodology, we request more detail on how A.M. Best assesses those elements.

We outline below some specific suggestions regarding aspects which we believe require further consideration and/or potential amendments.

[redacted]

Alternatively, if a global approach to the methodology is preferred without adjustment for specific jurisdictions, a mechanism could be introduced to the ratings methodology which incorporates deductions to the premium risk capital calculation where claims risk is considered to be lower and/or less volatile.

We would be happy to assist and participate in discussions with A.M. Best in this regard.

### Goodwill and intangible assets

[redacted] seeks input and clarification from the methodology team regarding the treatment of goodwill and intangible assets in relation to the points raised. We suggest that the methodology team re-categorise the goodwill and other intangible assets as "investment in subsidiaries" for rating purposes and further suggest that the proposed BCAR ratings methodology should recognise the value of these investments.

### Clarification regarding ratings drag/lift from Lead Rating Unit

We suggest that further clarity be incorporated into the methodology regarding the impact of potential drag/lift from an insurer's Lead Rating Unit. The wide range of potential impact, being a ratings impact of 1 to 4 notches, is very wide and makes it difficult for [redacted] to determine even a broad indication of its potential ratings outcome.

[redacted] seeks clarity regarding the rating process for [redacted] and what the ratings magnitude of any drag / lift impact might be. Further, we would welcome explanation on the weighting assigned to the parental BCAR metric relative to other rating factors.

### Other opportunities for rating enhancement

We would appreciate any feedback from the methodology team regarding any action that [redacted] might be able to take more broadly to enhance its Financial Strength Rating in light of the proposed changes.

## 7. CONCLUSION

As stated at the outset, this submission provides a summary of [redacted] key comments and concerns regarding the proposed changes. The proposal potentially carries serious consequences for [redacted] and we seek to engage further and provide additional assistance as required.

On behalf of [redacted] I or other representatives of [redacted] would welcome the opportunity to further discuss our submission with you.

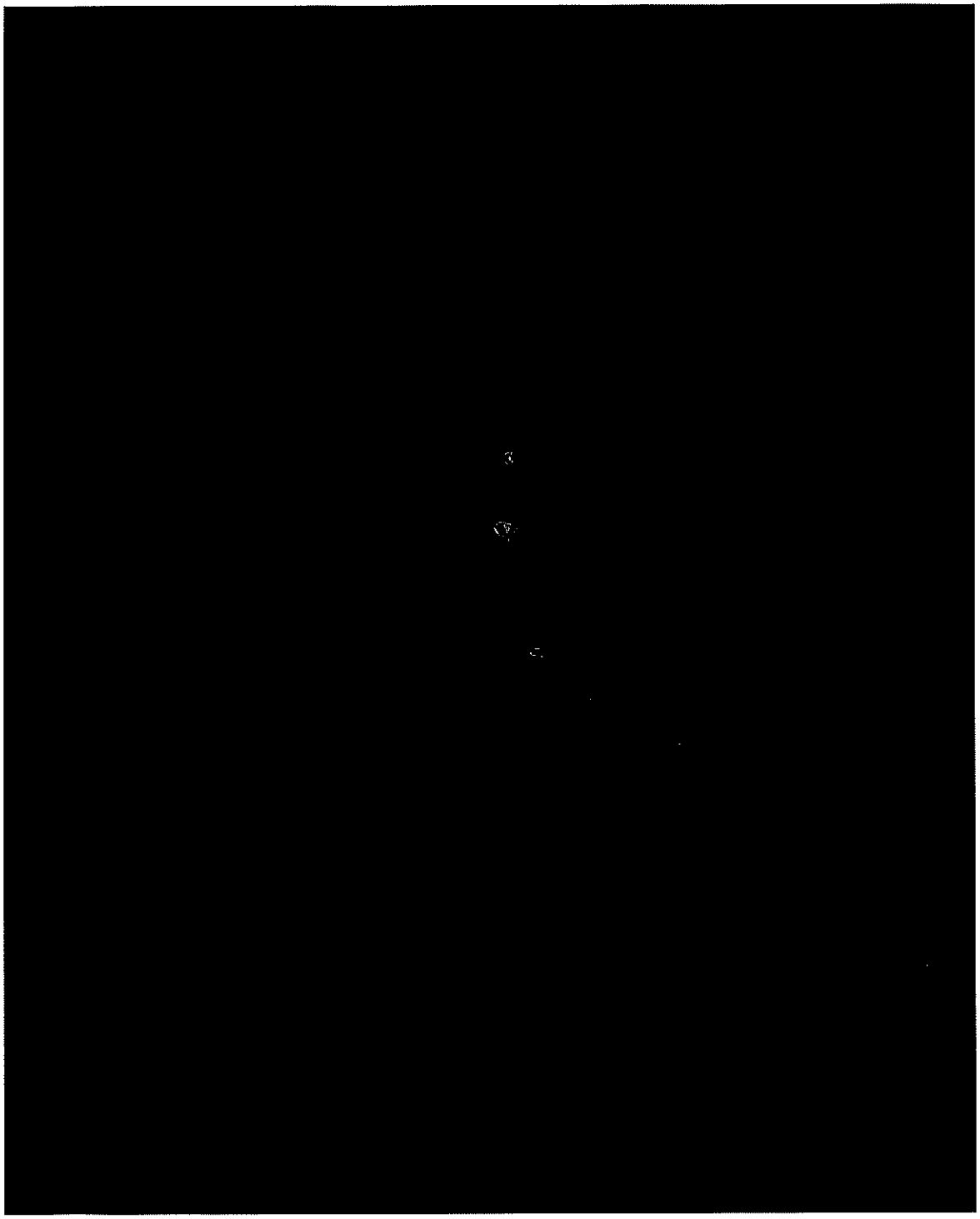
Yours sincerely

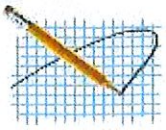
[redacted]

[redacted]

**Appendix**

This section provides further details on premium risk, which is the largest component of the BCAR capital requirement. We have previously advised A.M. Best of a range of factors which reduce health insurance premium risk in [redacted], which are summarised below:





**Michelle Rogers <mrogers@namic.org>**
03/01/2017 10:52 AM

To [redacted]
"methodology.commentary@ambest.com"
<methodology.commentary@ambest.com>
[redacted]>
Subject AM Best Second Revision to BCAR and BCRM Methodology -- NAMIC Comments

1 attachment

A.M. Best Proposed Re-Drafted Revisions to BCRM-BCAR - NAMIC Comment Letter - FINAL.pdf

[redacted]

Attached please find the NAMIC comments on the second revision to the BCAR/BCRM methodology proposed by A.M. Best last November. As usual we appreciate the cooperative process A.M. Best has utilized to address these revisions. That open process has been appreciated by both NAMIC and its members. We would like to schedule time to discuss these issues after you have had a chance to review them. Please contact me when you want to schedule a discussion.

**Michelle M. Rogers, JD**
Assistant Vice President, International and Regulatory Affairs
National Association of Mutual Insurance Companies
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Phone: 202.628.1558 | Fax: 202.628.1601

March 1, 2017

A.M. Best Company
Ambest Road
Oldwick, NJ 08858
VIA: methodology.commentary@ambest.com

RE: NAMIC formal comments on Second Version Proposed Revisions to Bests' Credit Rating Methodology (BCRM) and Best's Capital Adequacy Ratio (BCAR)

[redacted]

Thank you so much for the opportunity to review and provide comment on the Second Version to the proposed changes to the A.M. Best Credit Rating Methodology (BCRM) and Capital Adequacy Ratio (BCAR). NAMIC represents a diverse spectrum of insurers that rely on insurance credit ratings used for many purposes including reinsurance, regulatory, lending and government programs. Consequently, NAMIC has a significant interest in the practices for rating member companies and the measurement methodology used by A.M. Best to develop the factors that are used in the rating process.

NAMIC is the largest property/casualty insurance trade association in the country, with more than 1,400 member companies representing 39 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country's largest national insurers. NAMIC member companies serve more than 170 million policyholders and write more than $230 billion in annual premiums. Our members account for 54 percent of homeowners, 43 percent of automobile, and 32 percent of the business insurance markets. Through our advocacy programs we promote public policy solutions that benefit NAMIC member companies and the policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

NAMIC has a wide range of members from the smallest farm mutuals to the very largest mutuals, reciprocals and stock members. Our members are primarily mutual insurers and all property/casualty insurers so concerns about the treatment of mutual property/casualty will be the focus of our remarks. In addition, among our membership we have over 500 members that operate in a single state, 100 or so that consider themselves niche writers and approximately 40 who write a single line of business. We hope that the information we provide A.M. Best will help to explain our various members' issues and will be helpful to all concerned.

We have reviewed the revised documents and are pleased to provide comment in order to help advance our mutual interests of having a robust, accurate, effective, and transparent credit rating mechanism that is focused on insurance companies and insurance groups.

The proposed revisions to the BCRM and BCAR systems have been evolving over the last couple of years. As we mentioned in our last comment, we truly appreciate the transparent nature of the discussions, the frequent webinars and Q and A sessions offered and the individual company analysis tools A.M. Best has provided for the industry related to these changes. Several revisions and improvements in response to industry have been made by A.M. Best already that will ease the transition and improve the accuracy of the methodology. We specifically welcome the decision not to utilize the 99.8% and 99.9% VaR levels in determining the Balance Sheet Strength Assessment. This proposed change helps alleviate the most critical concerns for many of our members. We also appreciate the decision to move the Catastrophe PML charge into the covariance calculation.

The remaining questions NAMIC members have arising from the second revision include questions about the proposed pre-tax treatment of catastrophe PMLs within the covariance in the BCAR, uncertainty about the new stress testing anticipated for 1/100 year earthquakes and hurricanes, the revised treatment of reinsurance recoverable, and the level of common stock baseline capital factors. If we could have an opportunity to discuss these issues with you after the close of the comment period to better communicate the impact and to understand your thoughts that would be very helpful.

- **Tax Treatment of Catastrophe PMLs** – A.M. Best did revise the placement of Catastrophe PML capital to facilitate adjustment by the covariance calculation. However, when the estimates were moved they were included on a pre-tax basis instead of an after-tax basis. In the property/casualty industry tax implications are critical to smoothing out the impact of catastrophes. Deferred Tax Assets and Deferred Tax Liabilities play an important role for property/casualty insurers' balance sheets. Changing this aspect of the Balance Sheet strength assessment ignores that reality. We would like to better understand the rational for this proposal in the second revision.
- **Reinsurance Recoverables** – The revised system for assessing reinsurance recoverables is much less intuitive to NAMIC members and will not be an easy revision in the model for them to test for the impacts. One of the specific concerns that has been raised is "required" purchase of association reinsurance products in some lines and states. If there is only one option, then the excessive reliance notch down and the unrated status of these reinsurers could be very damaging companies operating in those states and lines of risk. In addition, when property/casualty insurers utilize a single reinsurer they may be able to negotiate multi-year contracts with less pricing volatility. We would like to discuss this with you in more detail to better explain these concerns and to understand the process.
- **New Stress Testing** – The 1 in 100 year earthquake and hurricane stress testing envisioned for the property/casualty industry remains unclear. If we could discuss in more detail how this testing would work, the factors that would be used, the treatment of tax consequences, that would be very helpful.
- **Common Stock Baseline Capital Factor** – The A.M. Best capital factor for common stock within acceptable levels is set at 38-44%. This doubles or triples the capital factors for common stock used for RBC which is currently 15% (and may rise to 19.5%). With the inclusion of beta adjustment to the stock NAMIC members wonder why there is such a significant shift in capital factor for common stock. In addition, the factor doesn't seem to recognize any credit for diversification of the investments in the stock portfolio. We would appreciate the opportunity to discuss to see if there is room for revision of this factor.

It is in the best interests of A.M Best and the entire industry that the rating analysis is done fairly and comparatively accurately and better understanding of the revisions and the goals would be much appreciated. Reasonable revisions to the methodology that will improve the accuracy of the rating is our common goal. We look forward to discussions of these remaining points of concern. Thank you for the opportunity to provide comment and for the transparent nature of the review process.

Sincerely,

Michelle Rogers

Michelle M. Rogers
Assistant Vice President International and Regulatory Affairs
National Association of Mutual Insurance Companies

[redacted]

**CONFIDENTIAL**

March 1st, 2017

[redacted]

**A.M. BEST**
Email transmission: methodology.commentary@ambest.com

**Re: Comments requested on A.M. Best Criteria Procedure-Understanding BCAR for U.S. and Canadian Life/Health Insurers**

First, we appreciate and would like to thank A.M. Best for going through the efforts of seeking and giving the industry the opportunity to provide their feedback on the significant changes proposed to the methodology and calculation of the BCAR, an important criteria procedure to its rating process.

Please find below our comments, which are divided in the following categories:

1. General
2. Risk Specific
3. Formatting/Missing/Inconsistency Information
4. Grandfathering/Transition

Please note that we will refer to your draft document, *Understanding BCAR for U.S. and Canadian Life/Health Insurers,* issued on November 14, 2016, as "The Procedure" or "new BCAR".

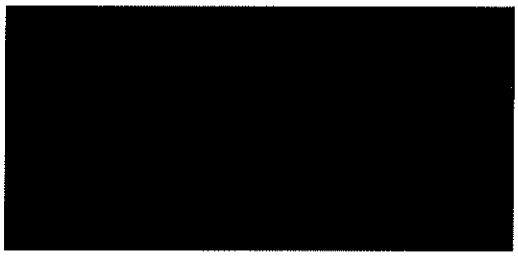
## 1. General

We noticed that the current and the new BCAR models include certain adjustments aiming to address certain specific differences between U.S. and Canadian statutory financial statements. However, in the same light, we believe that certain additional factors and/or adjustments specific to Canadian insurance companies should also be taken into account in the new BCAR.

### 1.1. Value at Risk (VaR)

We noticed that the new BCAR will use different confidence levels for its assessment of relative balance sheet strength. We believe that the proposed confidence levels seem relatively high for this assessment when compared to the current BCAR model.

[redacted]





## 2. Risk Specific

### 2.1. C1: Investment Risk

***Government Bonds***

We noticed that Canadian Federal government bonds are included in this category. We believe that Canadian Provincial bonds should also be included in this category, similar to the LICAT model. Alternatively, the baseline risk charges should be adjusted at levels located in between those of Federal bonds and Non affiliated bonds at the very least.

Canadian Provincial bonds are backed by the taxing power of the issuing governments and are usually considered as the most secure type of bond investment after Federal bonds because of their low credit risk. The markets recognize these differences in characteristics since Provincial bonds have much lower credit spreads and yields than those of corporate bonds, even with similar credit ratings.

Provincial bonds will generally have a credit spread of 25 basis points higher than Federal bonds. A corporate bond with the same credit rating of a Province will usually have a credit spread of 60 basis points and above compared to Federal bonds.

Furthermore, there is an equalization system in place in Canada whereas the Federal government makes payments to less wealthy Canadian Provinces to equalize the Provinces' "fiscal capacity", i.e. their ability to generate tax revenues. Therefore, such equalization system serves as a type of additional guarantee/collateral for these bonds.

***Reinsurance Risk Charge***

As there has not been any insolvency of life reinsurers for decades in the U.S., and ever in Canada, we wonder on what the reinsurance baseline risk charges are derived from and how have they been established. If the risk charges have been based on "AA" rated corporate bonds, it definitively has some flaws, namely the Probability of Default and Loss Given Default that are much lower for regulated life insurers with the same rating compared to any other corporation in North America. Furthermore, the asset build up included in the long-term nature of permanent life insurance, which represents a saving portion, ends up in large reserves that are accessible, in addition to Capital, when necessary and should not be penalized as such.

[redacted]



The Procedure does not specify which basis should be used for the calculation of reserve ceded. There are different accounting basis that can be used, namely U.S. STAT, U.S. GAAP or Canadian GAAP. For sure, Canadian GAAP reserves are clearly not appropriate for this risk charge as Canadian reserves include conservatism, such as PfAD (Provision for Adverse Deviation). Margins for Adverse Deviation which are included in the insurance liabilities aim to specifically address the risk of future deviations on each of the assumptions used in calculating the best estimate of insurance liabilities. In essence, these provisions serve to insure that the confidence level is met. If one wants to use Canadian GAAP reserves, it should exclude the PfADs to get a proxy for real economic value of the liability at risk; otherwise it would create a perverse effect of discouraging higher reserves as it would be detrimental to required capital.

We are wondering why the risk charge of 0.8% of the current BCAR has been almost quadrupled to 3.1% at VaR 99.5 level in the new BCAR?

Using a 3.1% risk charge (VaR 99.5 and above) of reinsurance ceded reserves exceeds, in most circumstances, the equivalent risk charge amount that would be calculated by replacing these reinsurance ceded reserves with bonds issued by these same reinsurers. Furthermore, in case of default, these bonds would suffer credit losses that are significantly higher than those of the reinsurance ceded reserves, as debt liabilities rank lower than insurance liabilities in the event of insolvency.

Reinsurance is a risk management tool. It is understandable that the risk charges increase with the Confidence Level, but such charge should be independent of the level reinsurance used. One of the reasons is that Canadian Regulators have put in place strict guidelines and requirements' regarding what is required to take a reserve credit (B3 guideline, Reinsurance Security Agreements, Trusts and LOC's in favor of the Canadian ceding company, etc.).

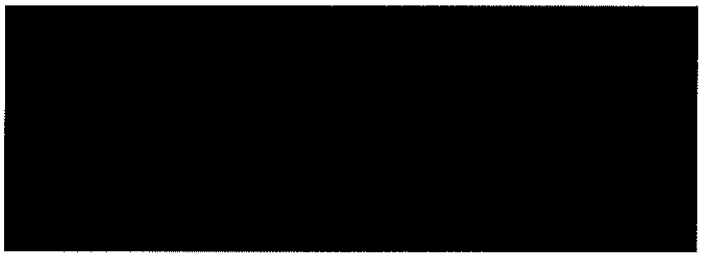
The BCAR also does not make a distinction between registered and unregistered reinsurance. Unregistered reinsurance should be given credit for the collateral portion, as the credit risk for that portion is very different than the uncollateralized portion.

The BCAR also does not make a distinction between reinsurance and retrocession. Based on the spread of risk concept, retrocession risk should have a much lower risk charge, especially for quota-share agreements.

***Spread of Risk (SOR) Factor Adjustment***

Adding a risk multiplier to investments' capital requirements for companies with invested assets of less than $500M, even though those investments could all be governmental or AAA rated, is not appropriate. Such a multiplier has no relation with the insurance liabilities, the capital and the levels of risks assumed by such a company (larger company = more risks assumed). The risk charge by maturity and credit rating should be sufficient to address risks associated with each investment and such a multiplier is unwarranted.

[redacted]





## 2.2. C2: Mortality & Morbidity (Insurance Risk Charges)

***Mortality Risk Charges***

We noted this component does not consider the average policy size, as it is a key component of risk diversification and spread of risk. By ignoring this element, it implies that the risk for 100 small $1000 policies is equivalent to one policy of $100,000. We suggest that the risk charge be revised accordingly to address this situation. One way to accomplish this would be to choose the Baseline Mortality Factors using Volume of insurance gross of reinsurance while keeping its application on a volume of insurance net of reinsurance.

***Diversification Credit***

The Procedure seems to apply to Health business only. Life insurance benefit greatly from diversification as well. We suggest that the risk charge be revised accordingly to address this situation.

## 2.3. D: Available Capital

***Intangible assets – Software and systems***

In our opinion, we believe that intangible assets related to software developed in-house that are necessary for the administration of life insurance business have a certain value. Insurance companies enter into contracts with policyholders that last for long periods of time, such as 10, 20, 30 years, and even a lifetime. These life insurance products often have unique characteristics from one company to another which make such software absolutely required to properly manage the related policies and reinsurance agreements. In business combinations, the purchaser of a portfolio of insurance policies is rarely able to transfer them to its own systems and manage them properly and efficiently without having to resort to the seller's proprietary software. As such, he must then assign a value to the software in the purchase price allocation, which is often used for many years following the purchase.

***Negative Reserves (Canada only)***

Even though one of the reasons negative reserves are created is initial acquisition costs, negative reserves also arise for other reasons as well, one being the underlying profit of a product. Actually, for some policies/cessions, Canadian GAAP reserves start positive and progress toward becoming negative in 5 to 10 years and remain negative until the maturity of the cession, which might be 30-40 years later. Therefore, negative reserves should not be deducted completely from the Capital in order to reflect the long term nature of the life insurance business. Also, negative reserve reflects the fact that, in Canada, premiums are guaranteed.

Although we recognize that there may be some uncertainties about the realization of these negative reserves, just like the insurance liability amounts they are associated with, we believe the new BCAR model should allow a portion of these negative reserves to be included in available capital, just like LICAT permits it.

[redacted]

## 3. Formatting/Missing/Inconsistency Information

- Exhibit C.8 shows some non-zero charges for the category "Reserve Ceded to Affiliates". However, the language beforehand on page 16 is saying "Risk charges are applicable only to those amounts related to unaffiliated companies".

- Exhibit C.9 is reversed in showing the four different confidence levels as rows compared to pretty much all tables which are shown in columns.

- Exhibit C.10 seems to be missing factors for life insurance; is it included in "All Other General Amount Group"?.

- Exhibit C.11 should probably specify "Life & Annuity **Net of Reinsurance** Premium/Deposits".

- Under Stress Tests (page 25), it should be noted that reinsurance in life industry in North America is usually risk attaching and therefore the loss of reinsurance for mortality should therefore only have a marginal impact overall as it will only impact new business and none of the inforce.

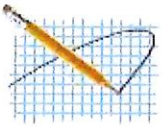
## 4. Grandfathering/Transition

As with any new model, one expects to have some calibration to do and fix anomalies with time. Depending on particular situations for each insurance company, A.M. Best might want to introduce the concept of grandfathering for some specific risk charges that suddenly increase. For other specific risk charges, the concept of a longer transition might be better.

We would be pleased to discuss and meet with A.M. Best to expand on any of these comments as well as to discuss how this new BCAR might affect [redacted] operations.

Best regards,

[redacted]



[redacted]

03/01/2017 03:46 PM

To "'methodology.commentary@ambest.com'" <methodology.commentary@ambest.com>

[redacted]

Subject [redacted]
BCAR Model

Dear Sirs:

[redacted] appreciates the opportunity to comment on the new BCAR Model Framework. It provided an opportunity to review the output of that model that [redacted] and [redacted] provided to us in November 2016. We attempted to replicate the results of the new model. Based on that work, we feel that the BCAR model would provide greater value if there was a higher level of transparency regarding the details of the calculations, including sensitivities of the capital factors to changes in the Economic Scenario Generator (ESG) assumptions and their resulting impact on the parameters.

Areas where [redacted] feels improvements would be helpful:

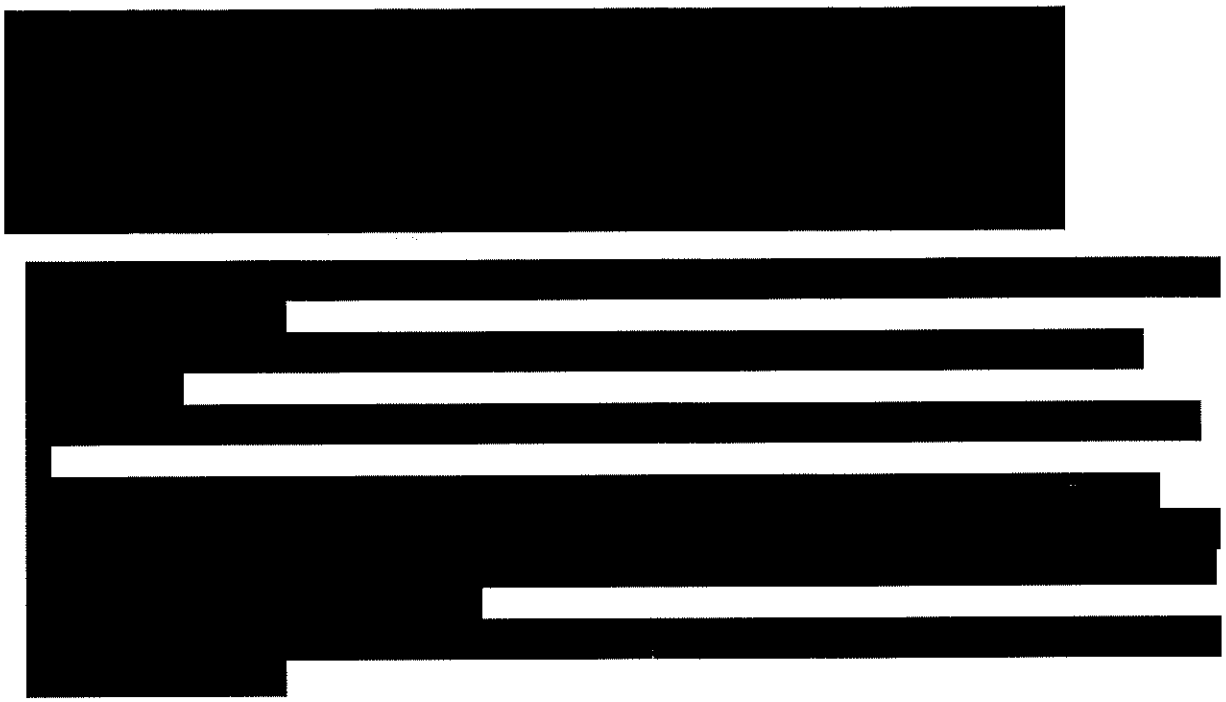
1. Additional information on the asset side
   a. [redacted]
   b. Asset information provided by Best did not remove Funds Withheld and Modco amounts from statement values provided, but the capital charges were computed net of these values. This was also verified on the 2/16/2017 call with analysts
2. On Insurance Risk (C-2) – factors associated with Mortality were unclear – we were unable to reproduce the ordinary net at risk calculations (we require the four net at risk bands for each of the VaR levels to make these calculations.
3. Explain how the diversification factor for Insurance Risk (C-2) is developed.
4. Understand the sensitivity of the capital factors at the various levels of VaR based on changes to the Economic Scenario Generator (ESG), or inputs into the ESG.
5. Describe the range of analyst adjustments that are made both specific for [redacted] and others that may be common in the industry.

We want to reiterate our appreciation for the opportunity to comment on the model and we look forward to our continued discussions.

Thank you.

[redacted]

[redacted]



[redacted]

03/01/2017 05:05 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Comments on Draft BCAR U.S/Canada L&H Insurers

1 attachment

AM Best BCAR Comments.doc

Attached are our comments/questions on the draft L&H BCAR methodology. We appreciate the opportunity that AM Best has given the industry to comment. We do request that our comments be kept anonymous/confidential.

[redacted]

Please keep anonymous/confidential

C-1 Asset Default Risk Bond Factors:

- Has there been a comparison done on AM Best's approach and results versus the report issued by the American Academy of Actuaries which was used as the basis for proposed bond factors for NAIC RBC? The AM Best factors at the 95% return time in general seem materially higher than what is being proposed by RBC (which is supposed to represent the 92% return time). What are AM Best's views on the methodology used including assumptions regarding offset for expected defaults that would be expected to be covered by reserves through Asset Adequacy Analysis and assumed tax recovery on defaults. Are assumptions made for either of these items in the AM Best approach?
- Some clarity would be helpful on the basis for maturity groupings, are these final maturity dates, dates to worst, or some calculated weighted average life? It would be helpful to understand how this applied to asset classes with some level of optionality or amortization.
- For RMBS / CMBS, will NAIC model price breakpoints get used to classify in NAIC buckets?
- Has AM Best compared the factors to published long term default / loss studies such as those from S&P/Moody's? If so how do averages tie to simulated ESG averages over various horizons? How do tail percentiles relate to worst periods in default studies?
- There's no distinction/variability in recovery rates by bond seniority / capital structure / covenant protection, for ex. Senior Secured Bank loans would get same charge or unsecured bonds or Preferred stocks is there some mechanism to adjust for this?
- Are GSE RMBS securities classified as exempt?
- How are companies supposed to think about ALM as the bond factors now penalize companies that have longer duration liabilities for matching? The new C-3 factors appear to penalize a company for being mismatched but the criteria does not lay out specifically what the penalty would be. It would be helpful to have further clarification so companies can understand how the tradeoff in risks is going to be captured in the BCAR model.

C-1: Real Estate/Schedule BA Real Estate Factors:

- What is the justification for the divergence between Sch A and Sch BA real estate charges? An asset may only be Schedule BA vs Schedule A due to the use of JV Structure where the company does not own the entire asset which doesn't necessarily result in a more risky position. [redacted] Underlying property liquidity may vary also. One category is not necessarily

more or less liquid than another as that really will depend on the underlying real estate asset.

- It would be helpful to have more clarity on the methodology for development of charges Schedule BA Real Estate vs Schedule A Real Estate Held for Sale. Schedule A seems to be tied to VaR based on NCREIF index simulations. Additional clarity would be helpful on:
    1. The time horizon used? If the time horizon is short why is this appropriate since this is not a mark to market asset class on Stat Balance Sheet rather it's an impairment asset class (under Equity method), only if underlying cash flow fundamentals change.
    2. How is the smoothing bias handled for NCREIF based parameters?
    3. How is deal leverage handled?

- Schedule BA RE/baseline charges seem to be tied to a simulation based 1yr VaR for common stocks adjusted up by 10% then adjusted for RE asset class vs baseline (although these are very close). Same questions as above for Schedule A. [redacted] True valuations are only relevant at time of sale and subject to specific transaction comps / DCF and are therefore not subject to public market volatility exhibited by public equities (incl. REIT indices) or hedge fund baskets.

- If the same RE is held in an internally managed fund, where Stat companies buy shares rather than owning a percentage of [redacted] structure the accounting treatment changes to mark to market accounting. Does the change in structure change the underlying capital factor applied (e.g. would it still get Schedule BA charges)?

- What specific information about either specific deals or asset class strategy in general would need to be provided to potentially move the factor applied on [redacted] closer to the Real Estate factors vs the baseline charges for Schedule BA Real Estate?

C-1 Reinsurance Credit Risk:

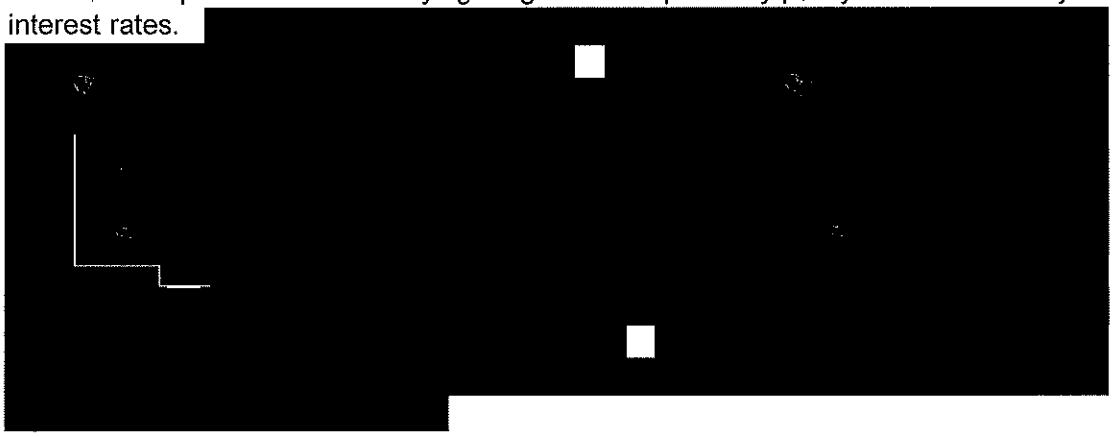
- The criteria does not address mitigation that may be in place in a reinsurance deal such as a letter of credit or a trust account. It would seem that a company should get credit for this mitigation when assessing a capital charge.

C-2 Mortality/Morbidity Risk:

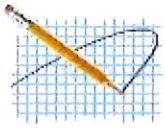
- Certain products may have risk limiting features that might not be captured in industry curves and not readily apparent in adjustments made for company level experience depending on the time frame used and results experienced. For example Credit L&H business maybe structured such that there the distribution arrangements include a contingent commission/profit share component that reduces downside volatility and underwriting risk. There should be some mechanism to discuss these features with the analytical team and have them reflected in the capital factors if appropriate.

C-3 Interest rate risk charge for Life Insurance:

- It is difficult to assess the appropriateness of the overall increase in the capital charge applied to life insurance reserves for interest risk without seeing detail on how the cash flows and scenarios were generated to arrive at the factors. In any event, it does not seem appropriate for there to be one set of factors for all life insurance products as different life products have varying degrees of optionality/policyholder sensitivity to interest rates.



- It would be helpful to have some clarity on how liability duration is to be calculated



[redacted]

03/01/2017 05:15 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject BCAR Forecasting Question

Good afternoon. I am inquiring to better understand if A.M. Best will be providing any type of forecasting/projection tools that will enable a company to project BCAR results under the new methodology.

Background
Under the old methodology – [redacted] Each company would receive capital contributions from its respective parent company commensurate with our forecasts.

The new methodology appears significantly more complex for a company to build models of its own to project and monitor BCAR levels.

I want this comment to remain confidential and not be exposed to public audiences.

Sincerely

[redacted]

[redacted]

[redacted]
03/01/2017 05:15 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>
cc
Subject Comment Letter BCAR Methodology

1 attachment

AM Best BCAR Comment Letter.pdf

Please find attached [redacted] comment letter submission concerning the proposed BCAR methodology. Thank you for providing the opportunity to comment and we would welcome the opportunity to discuss the matters identified in our comment letter further.

[redacted]

[redacted]

[redacted]

Private and Confidential

March 1, 2017

[redacted]

methodology.commentary@ambest.com

RE: Feedback on A.M. Best's Proposed Capital Adequacy Ratio Methodology

Thank you for the opportunity to comment on the proposed BCAR model. We request that these comments be kept private.

Through various discussions we have uncovered a number of significant concerns. We have first listed a general list of those concerns and then provided additional detail on each. We would welcome an in-person meeting with A.M Best to further discuss our concerns.

Significant Concerns:

1. C-3 Factors don't consider living benefit guarantees inside the general account. This, together with the C-1 factors disadvantages insurance companies issuing fixed indexed annuities (FIAs) with living benefits as most of the liabilities are covered by guarantees that are not considered in the modeling. Proper asset liability matching (ALM) for FIAs with living benefits requires longer duration assets to back the expected cash flows of the liabilities. Annuity contracts with guarantees will surrender at lower rates than deferred annuities without guarantees. We would like a set of factors added for this type of product feature.

2. C-1 Collateralized Loan Obligation ("CLO") concentration factors applied through analyst adjustments may not fully take into account the 1) the **low default rate** on CLO assets demonstrated over multiple market cycles during a time period approaching approximately 25 years and the underlying secured loans within CLOs, 2) **diversification** of the secured loans within the CLO structures, structural protections including **par subordination** that are provided CLO structures and 4) increasing **liquidity** of the CLO asset class. The concentration factors applied to CLOs through the analyst adjustment are not consistent with their risk and expected [redacted]

default probability, especially in comparison to other assets with similar ratings profiles. These assets should have the same charge regardless of the form of the asset.

3. The VaR concept does not consider expected defaults that are built into reserves where capital should only cover unexpected defaults. Loss Given Default (LGD) amounts assume a sale is required at a significant loss when historically such assets may actually pay off somewhat near original par, if held a sufficient length of time. As long as cash obligations can be met in the meantime assets will not actually be sold at a loss when they are expected to recover most of the original value.

4. C-1 Factors grade up to a 10-year period rather than following empirical default research.

1. C-3 Factors Ignore Guarantees

Fixed and fixed indexed annuities have both living and death benefit guarantees in the current marketplace. Contracts with guarantees will behave significantly different than traditional deferred annuities. Contracts will surrender at lower rates where contract owners may intend to hold for life rather than traditional deferred annuities.

Because of the length of the liabilities the assets used to back the liabilities also must be longer. Proper ALM would expect some level of match between asset duration and liability duration. The proposed model charges relatively high factors on the C-1 asset side and also charges relatively high factors on the C-3 liability side as if the two pieces are completely disconnected. In the management of the company these are very directly connected and managed appropriately.

The current categories mention MVA and remaining surrender charge schedule when these are both much less relevant to the contract owner behavior compared to the value of the living or death benefits. To ignore these benefits entirely is not appropriate modeling practice. The model may not be able to cover every nuance of guarantees; however, an attempt should be made to include guarantees on general account products by introducing a distinct set of factors for this product feature.

2. CLO Concentration Charge

Overview / Background

Beginning in 2015, AM Best applied a "concentration" charge for Collateralized Loan Obligations ("CLOs") due to the exposure to the asset class within its investment portfolio. AM Best does not view the factors used to reflect the default risk of rated corporate debt securities sufficient to capture all of the risks in a portfolio utilizing structured products.

In situations where portfolios have high concentrations of structured products relative to total capital, AM Best feels like an additional risk charge should be applied to reflect an "increased" risk profile. AM Best determined the RBC factor should be derived from the VaR of the market risk of such structured products with a risk charge almost double the base factor.

**Overview of CLOs**

A CLO is as a collateralized loan obligation, which is a pool of senior secured loans, typically at 40-60% LTV on the underlying borrowers. The principal and interest proceeds of the underlying secured loans are sold to investors in the form of debt securities (i.e. tranches) which have various levels of senior claim. More senior tranches will have the highest credit ratings and commensurately lowest coupons as they receive the first of the collateral cash flows and the lower-rated mezzanine and junior tranches will pay higher coupons and receive their cash flows after the senior tranches.

We have highlighted below the key data points and features of CLOs which demonstrate why the concentration charge is unjustified.

**Loan default history**

- Loans, in fact, rarely have sustained periods of high defaults
- During the financial crisis, defaults of loans hit 11% for a brief period, then dropped to more normalized levels
- CLOs during the financial crisis performed as designed, with **no BBB tranche losses or impairments in any deal over the entire market**

[redacted]

- In a low-default environment like the current one, CLO BBBs have an enormous amount of subordination and coverage from portfolio losses
- Recent default history for CLOs compared to US Corporates shown below:

**CLO Default Rates vs. Corporate Default Rates (bps)**
**(Cumulative)**

| Credit Rating | US CLO Default Rate 1994-2013 | US Corporates Default Rate (5year) | US Corporates Default Rate (10year) | US Corporates Default Rate (15year) |
|---|---|---|---|---|
| AAA | 0.0% | 0.4% | 0.9% | 1.3% |
| AA | 0.0% | 0.5% | 1.2% | 1.7% |
| A | 0.5% | 0.8% | 2.1% | 3.2% |
| BBB | 0.3% | 2.4% | 5.3% | 7.6% |
| BB | 1.7% | 9.2% | 16.7% | 20.5% |
| B | 2.6% | 21.4% | 29.9% | 34.1% |

This chart illustrates the default history exhibited by CLOs over the past 20 years. **Even the mezzanine tranches (BB and B) performed better than BBB US Corporates over 10 and 15 year periods**

**CLOs are portfolios of loans that are highly diversified. CLOs minimize single-issuer risk that is faced in corporate debt securities**

- Typical CLOs have a maximum single issuer exposure of 1-2%. Most CLOs have at least 150 positions in a given portfolio, and 350 positions is not uncommon.

- The **sources** of cash flow for the CLO are extremely diverse in number of obligors as well as industries, ranging from companies in aerospace to software. (Typical CLOs have a maximum industry exposure of 7.5%)

- CLO managers have different approaches to portfolios and are actively managed
  - Each CLO is internally diversified and CLOs exhibit low overlap with each other.

  - CLOs managed by different managers typically have portfolio overlaps of 25% - 33%.

[redacted]

**CLOs have attractive structural protections including active management and par subordination which allows for collateral impairment without impairment of the CLO position**

- BBB tranches have par subordination ranging from 11.5% - 13.5%, meaning simplistically that each CLO must lose this amount of collateral to impair the BBB tranche
- However, par subordination alone does not indicate tranche impairment, as CLOs have structural features that divert cash flows to debt repayment when losses occur. Thus, the market uses breakevens to estimate loss hurdles
    - At a 70% recovery rate (the long term loan recovery rate on senior secured loans), BBB tranches can typically withstand annual default rates of 15-18%
    - Even at a stressed 50% recovery rate, BBBs can typically withstand annual default rates of 9-10%
    - **Cumulative defaults** for these tranches would have to reach **approximately 50% to impair the BBBs**

CLOs are actively managed; managers trade underlying loans in order to generate gains and to minimize collateral losses due to credit degradation. Thus it is often observed that good CLO managers experience collateral default rates well below those of the general universe of equivalently rated leveraged loans. Also, it is required that the equity tranche is retained at least in part by the CLO managers which provides strong alignment of interests between the debt tranches and the CLO manager.

In addition to active management, leveraged-loan CLOs have two other important sets of features that make for an attractive risk profile. The first are structural, i.e., overcollateralization, interest coverage and interest diversion tests, industry diversity tests, single obligor limits and limits on CCC buckets. The second are features of the underlying leveraged loan collateral.

**Liquidity in CLOs has increased over time**

- With $72 billion in new issuance in 2016, CLOs issued the same amount of paper as the CMBS market
- There are approximately $450 billion in outstanding CLOs, which has led to a thriving secondary market ($90 billion in volume in 2016)
- With a very hot refi market (which extends current CLOs) and new global AAA demand, the market for CLO issuance is expected to be strong again in 2017

[redacted]

**CLO Concentration Conclusion**

The CLO asset class has performed extremely well through cycles with a default history better than similarly rated corporate debt securities. CLO structures have no single issuer/industry risk, increased structural protections, par subordination which provides coverage to protect against underlying portfolio losses, and liquidity due to the growing market. CLOs are also managed actively leading to further out performance. For those reasons, **the CLO asset class should not be considered to have a higher risk profile** than its comparable corporate debt securities. We believe the CLO concentration risk is unfair and unjustified. The assumption that the risk is almost twice as great as that of similarly-rated corporate debt is not supported by the historical performance of these assets. We want to ensure the proposed criteria for applying a concentration adjustment allows the analyst to consider these factors when considering an additional concentration charge including an initial assessment of whether the original C-1 risk charge is sufficient.

3. Value-at-Risk (VaR) Concept

The VaR concept is favored in commercial and investment banks to capture short-term exposure and the **potential** loss in value of their traded portfolios from adverse market movements over a specified period of time. The basic problems with VaR are that it usually only considers a short-time frame, for example, losses in the next year and usually assumes expected defaults actually result in some historical view of immediate losses after a default. This is an extremely short-term view of the world when the insurance obligations are much longer than 1 year. In reality, an insurance company will attempt to ride out defaults where some future recovery is expected rather than just realize all the losses through sales.

In addition, the insurance company already is holding a provision for some level of expected defaults through the AVR. AVR reacts over time to cover expected defaults therefore capital only needs to cover unexpected defaults rather than all of the defaults. This concept of default in excess of expected defaults is not considered within the VaR concept where it seems every dollar of default has to be covered out of capital.

Generally, VaR focuses on marked to market tails which may make sense when analyzing tail scenarios and thereby capital requirements of a financial issuer who is not levered. For investors who are levered (like insurance companies), VaR does not work in isolation because the marked to market on the asset portfolio does not need to be realized but only

[redacted]

the tail default and associated losses need to be realized. In short, insurance companies are not mark-to-market vehicles. Furthermore, to the extent that the authors agree with the aforementioned but still think it to be important that despite this, insurers should still be solvent for any given marked to market, understanding that this mark will not be realized, then the authors must apply the VaR concept not just to the left hand side of the balance sheet, but also to right hand side of the balance sheet, resulting in a net VaR metric, rather than a gross VaR metric on the asset side only. Anything short of this is a gross overestimation of the capital requirements for insurers, especially fixed annuity writers.

4. C-1 Factor Grading

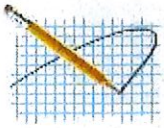
The proposed methodology considers increasing capital charges for increasing time to maturity, all else constant, which is consistent with widely published empirical research from the NRSRO's. That said, capital charges stop increasing with time to maturity under the proposed methodology which is not consistent with empirical research nor is it consistent with theory as it pertains to unexpected losses on a non-risk-free fixed income portfolio. Quite simply stated, as time to maturity increases so too should the expected and unexpected losses associated with the asset. The proposed methodology blindly assumed that once an asset reaches beyond ten years to maturity, all theory and empiricism is no longer applicable which is a serious shortcoming to the recommended approach.

We appreciate the opportunity to comment on the proposed changes and would be available to meet and discuss these matters further.

Respectfully submitted,

[redacted]

[redacted]



[redacted]

03/01/2017 05:28 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

[redacted]

Subject Response to A.M. Best Methodology Change Questions

Hello,

Please see below our anonymous responses to you specific questions. We have no other comments.

1. What is an appropriate capital treatment for deferred tax assets (DTA) when viewed within a global capital framework? How should the DTA be viewed under stress scenarios?
    a. Response: In a global capital framework, DTAs should be computed and recognized following the accounting principles of individual regulatory regimes and aggregated on an enterprise basis, not recalculated for any specific regulatory regime. For stressed scenarios, it is our view that DTA effects should be computed and recognized in accordance with the accounting principles of the regulatory regime.
2. The BCRM added specific commentary on the ERM Framework Evaluation. Are there any other areas of ERM that should be considered as part of the analytical review process?
    a. Response: A deeper review of internal capital models would provide more insights for A.M. Best into how individual companies model and manage risk while also more appropriately modeling company specific risk factors.
3. In the absence of modeled PMLs, how is exposure best evaluated? What is your view of estimating large potential losses without PMLs? Please provide any proxies that could be used instead.
    a. Response: In the absence of modeled PMLs, exposure is best evaluated through past loss experience for similar events, geographic risk profiles, and industry-wide data to evaluate exposures. [redacted] view is that estimating large potential losses without PMLs confidence levels would be challenging, but could be estimated at a high level. Items in Force and total insured value of Catastrophe exposed zip codes, would be proxies that could be used in the absence of PML data.
4. What are, in your opinion, the key differences between your internal capital assessment (either based on internal capital models or regulatory capital) and A.M. Best's BCAR? Which risk charges are most different from your own internal models? What elements were included in your own models that gave your comfort that they sufficiently covered the risk?
    a. [redacted]

[redacted]

5. Is Beta an appropriate risk measure for equity risk? If not, what is a more appropriate measure?

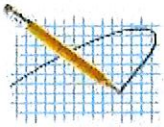
   a. Response: Beta is an appropriate risk measure for equity risk.

6. The proposed BCRM captures the risks related to domicile in an explicit manner, mainly through additional charges on investments in the BCAR and in the overall balance sheet strength assessment building block through the Country Risk Tier (CRT) impact. What is your view about this approach, conceptually and with regard to the magnitude of this particular impact?

   a. Response: [redacted]

Thanks,

[redacted]



[redacted]

03/02/2017 12:00 AM

To <methodology.commentary@ambest.com>
cc [redacted]
Subject [request] Comments on Draft of BCRM and BCAR

Dear. Sir/Madam

In response to your request of November 15 2016, we have submitted comments on Updated Draft of BCAR as follows.
We would like to request that our comments are kept confidential.

[Comments on draft of BCAR]
1.
What is an appropriate capital treatment for deferred tax assets (DTA) when viewed within a global capital framework? How should the DTA be viewed under stress scenarios?

We comment on DTL (Deferred Tax Liability) as well as DTA (Deferred Tax Assets), both of which are important issues.

DTA:
First, DTA on the balance sheet should be included in the available capital as the audit firm has affirmed it has an asset value.

Second, as long as an insurer is capable of earning sustainable profits, additional DTA should also be included in the calculation of the risk amount and the stress loss from natural catastrophe. In other words, the risk amount and the stress loss should be calculated on post-tax basis.

Because calculating the risk amount and the loss for stress test on post-tax basis is consistent with the calculation of the capital, which is the sum of the post-tax profit in every year.

Such tax effects can be calculated by the following way.

For an insurer which has been earning stable profits, it is very likely that the insurer can recognize the additional DTA by considering the future profits, even if a loss exceeds annual profit.

Note that the additional DTA can be recognized by quantifying an impact to capital by multiplying pre-tax risk amount (or stress losses amount) and (1 - tax rate).

On the other hand, for an insurer which incurred losses or booked unstable profits in the previous years, it is difficult to recognize the additional DTA in the year of annual losses. In this case, calculating the effect on the available capital on pre-tax basis is appropriate as proposed; the additional DTA should not be included.

In summary, when calculating the risk amount and the stress loss for natural catastrophe, the treatment of the DTA should be determined, whether on pre-tax basis or post-tax basis, depending on stability and sustainability to earn profits in the future.

DTL:
Certainly the treatment for DTA is important, but the treatment for DTL, deferred tax liability is also important, especially for Japanese insurers, when considering a loss absorption effect by the tax. In addition, the tax effect by the DTL is sure and easy to calculate, so it should be reflected in BCAR as well as that by DTL.

As Japanese insurers have been holding a large amount of business-related stocks for several decades, its unrealized gains are large due to its low book values. The post-tax value of unrealized gain is recorded in capital and the rest of it is recorded in liability as DTL. [redacted]

DTL is not capital, but liability. Therefore, it can reduce the impact on the capital when the market value of the stocks decreases. If the market value of the stock decreases, the unrealized gain also decreases. But the capital decreases only by the post-tax value basis. The rest of it is absorbed by the decrease of the DTL. This is the loss absorbing effect or the tax effect by DTL.

The tax effect by DTA is uncertain as DTA is dependent on the future profit and expects the reduction of the tax regarding it. Therefore, the asset value of DTA should carefully be examined as mentioned earlier.

On the other hand, the tax effect by DTL is certain as DTL is not dependent on the future profit. Instead, the tax effect by DTL calculates the reduction of the expected tax payment regarding the unrealized gain, which already exits. Therefore, there is no room to discuss the appropriateness of the tax effect by DTL.

The tax effect by DTL can be reflected in BCAR by calculating the investment risk as the following way.

A: the amount of the asset by market value
R: the risk charge for the asset
P: the proportion of unrealized gain to the market value
T: the tax rate

A * if( R<P, R*(1–T), P*(1-T)+(R-P))

Though this calculation may seem to be slightly complicated, it is appropriate as it can reflect the tax effect only on the unrealized gain.

Note that for an insurer which can record additional DTA, the total tax effect by both DTA and DTL is calculated by A*(1-T) as the insurer can record the additional DTA for (R-P).

[redacted]

4.
What are, in your opinion, the key differences between your internal capital assessment (either based on internal capital models or regulatory capital) and A.M. Best's BCAR? Which risk charges are most different from your own internal models? What elements were included in your own models that gave you comfort that they sufficiently covered the risk?

We comment on the difference between BCAR and our internal model in light of capital, risk amount and stress test below.

Capital

The tax effect of the other intangible fixed asset, a part of the intangible fixed asset, should be reflected in calculating the available capital. Because it has the tax effect in financial accounting basis. [redacted]

The negative goodwill should be added to the available capital in the same manner as the goodwill is reduced from the available capital. When a company acquires other company by the amount less than its net asset value, the profit is recorded in liability as negative goodwill in order not to record this profit at once. Therefore, it should be added to the available capital as it is a profit in light of economic basis. [redacted]

Risk amount

The most significant differences are reserve risk and premium risk. Two reasons: One is that risk charges are much higher than ours and the other is that BCAR does not evaluate the diversification effect between countries or regions.

The risk charges for reserve risk and premium risk in BCAR are too conservative in our view as these are much higher than those in ICS.

To be more specific, In BCAR for US P&Cs, Reserve Risk is to be calculated based on Typical Reserve Risk Capital Factors, but Typical Reserve Risk Capital Factors for Size Category

Large are 3%~182% higher than the reserve risk factors used in ICS's 2015 Quantitative Field Testing (99.5VaR), and excessively conservative in our view.

As with the Reserve Risk, In BCAR for US P&Cs, Premium Risk is to be calculated based on Typical Premium Risk Capital Factors, but Typical Premium Risk Capital Factors for Size Category Large are 8%~89% higher than the Premium risk factors used in ICS's 2015 Quantitative Field Testing (99.5VaR), and excessively conservative in our view.

[redacted]

The diversification effect between countries or regions can be incorporated into BCAR by calculating as follows using additional data by regions and lines.

Amount of line A = SQRT( (Amount of line A in region 1)^2+(Amount of line A in region 2)^2+...)
Risk amount of line A = Amount of line A * risk charge for line A

[redacted]

Stress Test
In the stress test for natural catastrophe, an amount equal to 40% of the pre-tax PML is added to loss reserve to recognize its reserve risk. However, PML is usually calculated on ultimate loss basis, so its reserve risk does not need to be considered. Therefore, 40% of the pre-tax PML should not be added to loss reserve.

5.
Is Beta an appropriate risk measure for equity risk? If not, what is a more appropriate measure?

We agree that beta is an appropriate risk measure for equity risk.

Please feel free to contuct us if you have any questions about the comments.

Sincerely yours,

[redacted]

[redacted]

[redacted]

March 1, 2017

***Via email to methodology.commentary@ambest.com***

[redacted]

**Re: Update on Draft BCRM and Understanding BCAR for U.S. Property/Casualty Insurers**

[redacted]

[redacted]thanks A.M. Best for the opportunity to provide comments on two draft documents, *Best's Credit Rating Methodology* ("BCRM Paper") and *Understanding BCAR for U.S. and Canadian Life/Health* ("BCAR Paper"). We are pleased to provide feedback on the proposed changes to the ratings methodology and the BCAR calculation and underlying risk factor charges.

As part of our review of the BCAR Paper, we compared the capital requirement under the proposed charges to the current BCAR calculation and to our internal target capital. The proposed C-1 Bond charges are significantly higher than the current BCAR model and significantly higher than our internal target capital. Our understanding is that the revised charges are based on stochastic modeling of defaults by ratings and maturity. The paper did not specify how well the resulting charges correspond to historical empirical data. We seek clarification whether it is A.M. Best's view that the current charges have been significantly underestimating the default risk inherent in most insurers' investment portfolios, and thus a material increase is warranted. We would also like to understand the timing of future changes, and whether then new methodology implies that the C-1 charges will be updated on a regular basis (i.e. annually) based on updates to the underlying model.

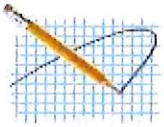
Another comment on the BCAR Paper is the selection of the BCAR formula's denominator. The proposed formula is BCAR = (Available Capital – Required Capital)/Available Capital. The formula's denominator of Available Capital rather than Required Capital seems to dampen the impact of holding excess capital. In our view, it seems more straightforward to calculate the excess or shortfall as a percent of the Required Capital.

The BCRM Paper provides additional details for the full development of the rating, which builds upon the BCAR calculation. For each section (Balance Sheet Strength, Operating Performance, Business Profile and ERM), the paper outlines the factors that will be examined in making the determination of an increase, decrease or no change in the baseline rating. We appreciate the additional guidance provided. However, the paper does not provide tangible criteria (i.e. numerical thresholds) on how to determine a company's level (e.g. positive, neutral, negative) for each section's factors or subfactors. Other rating agencies have recently provided more transparent guidance, which allows companies to determine a more accurate self-assessment of their ratings.

[redacted]

The Operating Performance section of the BCRM Paper describes a process where a company's performance criteria will be compared to key operating performance metrics of relevant benchmarks, where the benchmarks are determined by A.M. Best. The paper explains that the benchmarks are created as composites of relevant peers but does not specify how the benchmarks and peer groups are determined. It would be helpful for companies to be informed of A.M. Best's assumed benchmark competition and be allowed to opine on the peer group selections. In addition, the paper does not provide specifics as to which performance metric will be compared with its peers. It is unclear whether the comparison is between publicly disclosed information only, or if confidential data is used. Further clarity regarding the comparisons would be helpful in performing a comparative self-assessment.

We thank A.M. Best for the opportunity to provide our feedback and look forward to receiving your comments.



[redacted]

03/03/2017 05:08 AM

To Methodology.BCAR.Commentary@AMBEST, methodology.commentary@AMBEST
cc
Subject BCAR comments

Hello

[redacted]

**1. Available Capital**

- Based on 2015 model:
  - Life future profit should include both VIF and cost of capital, as you already apply a 50% haircut on the VIF. The way you recognize life future profits is also not explicitly covered in the documentation
  - Solvency 2 approach should be followed and the full amount of debt eligible under Solvency II should be recognized

The current approach on the life future profits leads to a negative adjustment compared to IFRS, and seems overly conservative.
As from 2016, our company will not publish MCEV figures, but rather information based on Economic Balance Sheet. We would like to get clarity on the new methodology you will apply to recognize the future value of life profits in that context.

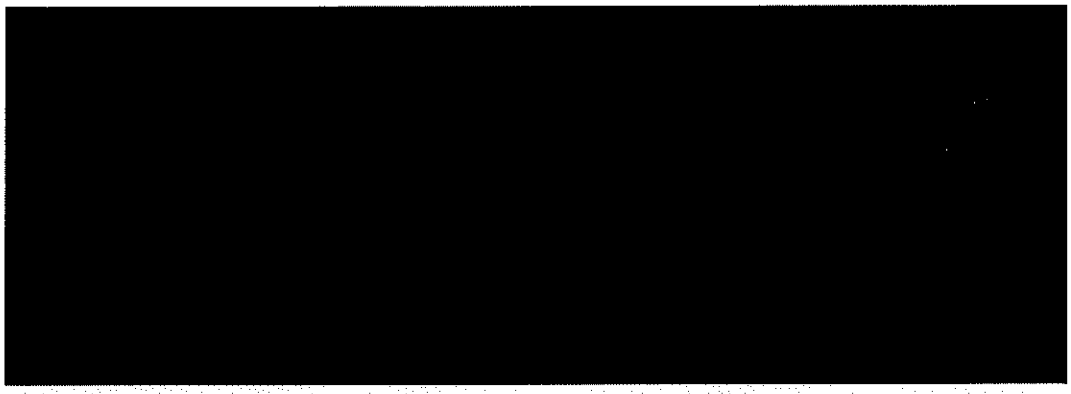
**2. Required Capital**

- Nat Cat premiums should be deducted from non-life risk premiums, as Cat risk is already factored in the capital model in the Cat risk section
- Inward Nat Cat reinstatements premiums should be deducted from the CAT risk, at it is a direct capital gain for our company after a Nat Cat event
- Cat risk should be considered net of tax, as the BCAR assesses the impact of an event at a certain confidence level and within a one year period of time. Taking the risk before tax also favours jurisdictions with low tax rates (Bermuda, etc.) and it penalizes companies based in less favourable tax jurisdictions. It should also be considered after tax as we compare it with an available capital after tax
- Broadly speaking, the way the required capital is calculated after diversification should be more transparent and replicable by the market
  - Correlation matrices are not disclosed for reserves and premiums risk
  - It is not clear how investment capital charges are calculated. In addition, we were not able to find the equity portfolio Beta and the Bonds portfolio duration treatment in the BCAR
- Overall, the BCAR factors are not suited to global reinsurers that are more diversified than most of the primary companies and are subject to different mechanisms. Furthermore, as AM Best's sample for the Universal BCAR may contain less companies than in the US, the capital factors may be less accurate. Therefore, we believe that AM Best should be in favour of a potential flexibility on the factor adjustments for European reinsurers.

**3. Other recommendations**

- Capital credit should be given for internal models developed by companies and that have validated by the regulator/and or AM BEST

Many thanks



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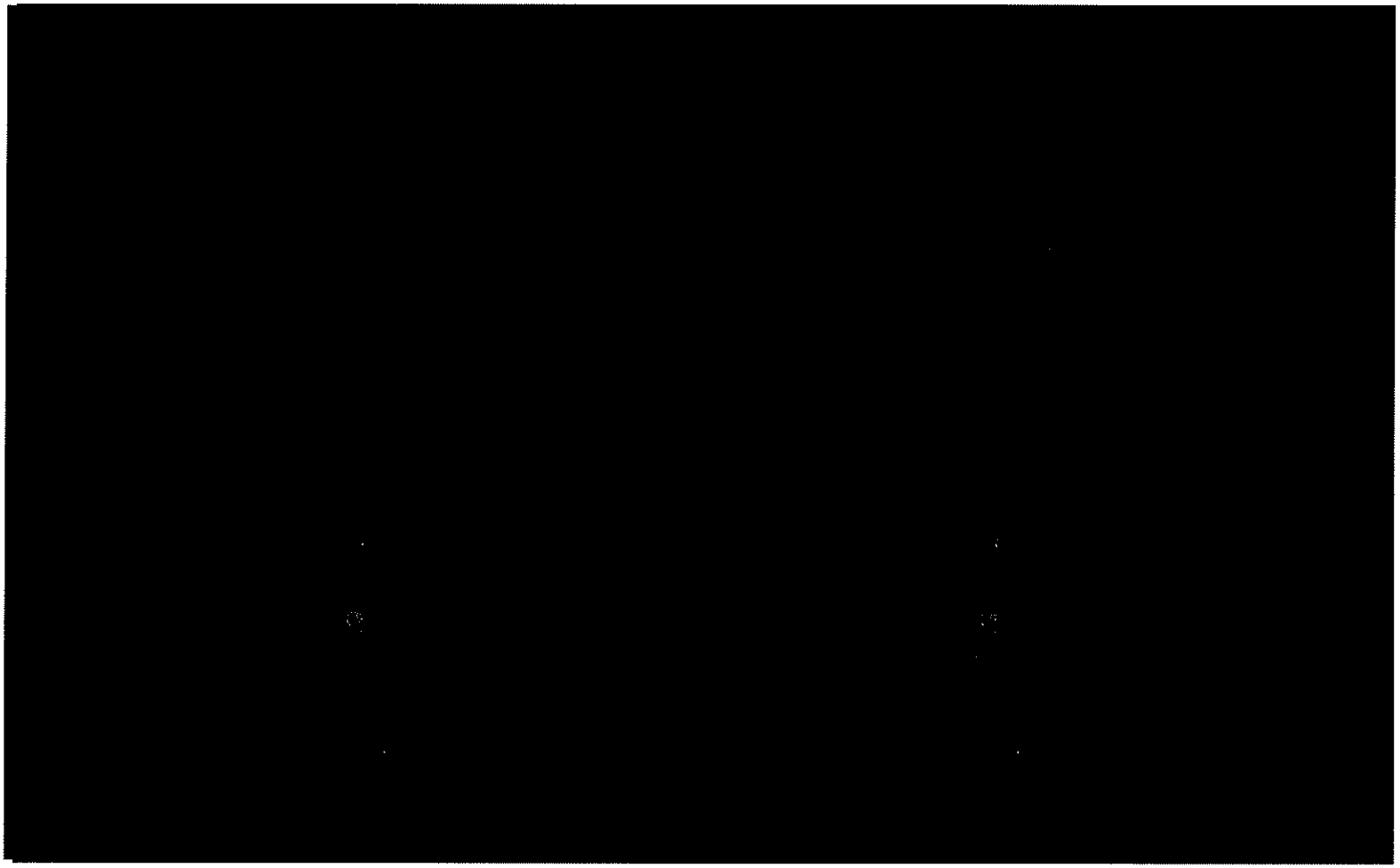


# Response to A.M. Best Criteria

Best's Credit Rating Methodology (BCRM) and Best's Capital Adequacy Ratio (BCAR) for U.S. Property / Casualty Insurers

March 1, 2017

[redacted]

[redacted]

# Section A. Response to questions from Update to BCRM and BCAR Call for Comment

1. A.M. Best Question: What is an appropriate capital treatment for deferred tax assets (DTA) when viewed within a global capital framework? How should the DTA be viewed under stress scenarios?

[redacted]

   - We have no comments on deferred tax assets.
   - Under the updated draft criteria, the catastrophe stress event is proposed to be on a pre-tax basis, consistent with the B8 risk charge. [redacted] views this treatment as inconsistent with other surplus adjustments, such as UPR equity, reserve equity and fixed income equity, which are calculated on a post-tax basis. We believe a post-tax reduction to surplus for the catastrophe stress test is a more appropriate view on a company's capital position post-event.

2. A.M. Best Question: The BCRM added specific commentary on the ERM Framework Evaluation. Are there any other areas of ERM that should be considered as part of the analytical review process?

[redacted]

   - Given the importance of ERM in the ratings process and in support of greater transparency, we believe it is important to share the Risk Impact Worksheet analysis with companies.
   - Our clients have noticed that there can be significant differences in specific analysts' experience and knowledge of ERM. With ERM its own assessment in the BCRM and publicly evaluated in the company report, we think it would be best to have an ERM specialists on the rating committee to ensure consistency for the industry. When appropriate, an ERM specialist should also be present in company annual rating meetings.
   - Other areas of the BCRM framework like the balance sheet strength assessment and operating performance rely on information that is available publicly. While qualitative factors are certainly understood to be very important in these areas, it is supported by the financial statements. ERM is different in that the basis for A.M. Best's assessment is almost entirely based on discussions with management. Therefore, we believe more time should be allotted to companies to present their ERM framework and capabilities, which may include separate discussions.
   - Publishing a negative opinion on a rating unit's ERM could have an adverse impact on a company. Given that companies have historically not had the opportunity to review their Risk Impact Worksheet, we believe a company receiving negative notching should be given a chance to respond with additional information before it is published.
   - Some groups have multiple rating units under a common ERM framework. We think it would be helpful to include more information on how A.M. Best will apply ERM assessments within groups.
   - We think it would be helpful to publish examples or guidelines for best practices in different regions globally.
   - The approach does not differentiate between 'adequate' ERM and 'strong' ERM, even though there may be significant differences between those two levels of maturity, effort and ultimate

risk management. Additionally, the proposed methodology heavily penalizes companies for not having appropriate ERM, but provides little benefit to those that excel in this discipline. We recommend greater differentiation should be recognized within the ERM assessment and propose to add a level for 'Strong' with a '+1' adjustment and make 'Very Strong' a '+2' adjustment.

- Please indicate the maximum credit A.M. Best will give from an economic capital model with respect to "determination of capital requirements."

3. A.M. Best Question: In the absence of modeled PMLs, how is exposure best evaluated? What is your view of estimating large potential losses without PMLs? Please provide any proxies that could be used instead.

[redacted] In the absence of modeled PMLs, exposures are best evaluated based on level of risk concentration and aggregation, as well as proximity of those aggregations to peak hazard zones. Peak loss potential for perils such as Hurricane and Earthquake are quite sensitive to proximity to the coasts and major fault lines, respectively, whereas Severe Thunderstorm loss potential tends to be more driven by concentrated risk and less by hazard proximity. In addition, individual severe thunderstorms are very small compared to other perils (10s of miles vs 100s of miles) and thus sub-perils such as tornadoes and hail tend to produce significant catastrophic loss only when impacting high exposure concentrations ([redacted] Companies are able to monitor exposures at a granular county or postal code level in order to understand their concentrated risk and how it has evolved over time. In addition, spider analyses allow companies to identify and understand peak risk concentrations within a given radius of a centroid that doesn't align with geo-political boundaries.

Regarding large loss estimation in the absence of modeled PMLs, this is where the industry can leverage historical events and claims data. [redacted]

4. A.M. Best Question: What are, in your opinion, the key differences between your internal capital assessment (either based on internal capital models or regulatory capital) and A.M. Best's BCAR? Which risk charges are most different from your own internal models? What elements were included in your own models that gave you comfort that they sufficiently covered the risk?

[redacted] main difference we've seen relates to how diversification/correlation is considered. Some economic capital models have more sophisticated measures to calculate diversification benefit than the BCAR square root formula. [redacted] It is our understanding that A.M. Best is calculating premium and reserve baseline factors based on 10 years of industry data. Depending on how often these baseline factors are updated, a shorter-term perspective could introduce more volatility into capital factors.

5. A.M. Best Question: Is Beta an appropriate risk measure for equity risk? If not, what is a more appropriate measure?

   [redacted] No comment on Beta.

6. A.M. Best Question: The proposed BCRM captures the risks related to domicile in an explicit manner, mainly through additional charges on investments in the BCAR and in the overall balance sheet strength assessment building block through the CRT impact. What is your view about this approach, conceptually and with regard to the magnitude of this particular impact?

   [redacted] The Universal criteria draft does not detail how the Country Investment Classes (CIC) impacts the factors. In the current Universal model, there is a multiplier relative to the CIC 1 factor. We assume this to be the same concept, but the actual multipliers were not disclosed. Additionally, the criteria does not mention whether or not the national scale ratings still apply.

## Section B. Additional Comments on BCRM

- Will management have the opportunity to review and discuss the analyst's evaluation of each of the rating factors and sub-assessments prior to the analysis being presented to the rating committee?
- Will the proposed criteria lead to new survey questions or requests?
- We recommend that A.M. Best adds a summary table to the company report that shows the assessment of each BCRM component to increase transparency in determining the rating.

Balance Sheet Strength:

- Determination of BCAR assessment
  - Provide clearer guidelines on choosing starting ICR for BCAR assessment at different levels (e.g. 'a+' or 'a' at the strongest level of BCAR).
  - Please specify how the catastrophe stressed BCAR or terror stress test will impact the BCAR assessment under proposed framework.
  - How will A.M. Best view volatility in BCAR scores when determining balance sheet assessment?

- Excessive reliance on reinsurance
  - Please provide a benchmark for ceded PML to PHS in determining excessive reliance on reinsurance and specify the return period used for this assessment.
  - How will A.M. Best consider tactical use of reinsurance to determine whether high ceded PML to PHS is truly excessive reliance on reinsurance versus a capital management strategy?

- The criteria indicates the impact of holding company on balance sheet strength assessment is determined following analysis of all related quantitative and qualitative metrics. However, the criteria

does not provide benchmarks for key quantitative metrics, therefore companies are concerned this assessment may not be consistent and subject to analyst discretion.

- We recommend that A.M. Best provides benchmarks for positive, neutral and negative holding company assessment characteristics on typical financial leverage and coverage ratios.

- Adjusted and unadjusted financial leverage
  - Does A.M. Best prioritize adjusted financial leverage over unadjusted financial leverage?

- Double leverage
  - Please provide the formula for double leverage and a benchmark for high double leverage.

- Adjusted fixed charge
  - Please provide formula for adjusted fixed charges.

Operating Performance:

- While the criteria provides a sample benchmarking report and performance / earnings metrics, it would be helpful to provide examples that align with each assessment.
  - Less volatile performance relative to the benchmark
    - How does A.M. Best measure and benchmark volatility?
  - Selecting benchmark composites
    - Benchmarking exposes rating analysis to potential selection bias of the peer group and/or clustering of ratings for companies A.M. Best deems as peers. To mitigate concerns over these issues and in support of greater transparency, we recommend that A.M. Best analysts provide management with the peers they are being compared against. Will A.M. Best consider input from companies regarding their peer group?

Business Profile:

- The criteria indicates "The rating analyst will qualitatively combine each of the sub-assessments into a single business profile assessment". We recognize A.M. Best's approach is to allow flexibility in determining which characteristics can most likely impact an insurer's financial strength. However, we believe there should be additional guidance on how results from the sub-assessments fit into the overall business profile assessment.

- We recommend that the product risk evaluation differentiate between reinsurance and insurance product lines.

Rating Enhancement / Drag:

- Given a range of zero to four notches for enhancement or drag on non-lead rating units, there is limited information that addresses when one notch is granted compared to when four notches may be granted. We understand rating enhancement will be limited by the difference between the lead rating unit's rating and the subsidiary's stand-alone rating, but addressing factors that drive maximum enhancement / drag would be helpful.

# Section C. Additional Comments on BCAR Criteria

US P&C BCAR Model:

- Under the updated draft criteria, the catastrophe stress event will be on a pre-tax basis, consistent with the B8 risk charge. [redacted] views this treatment as inconsistent with other surplus adjustments, such as UPR equity, reserve equity and fixed income equity, which are calculated on a post-tax basis. We believe a post-tax reduction to surplus for the catastrophe stress test is a more appropriate view on a company's capital position post-event.

- In addition, we received common feedback from companies that are concerned with the use of pre-tax catastrophe losses considered in the B8 risk charge. Namely, it misrepresents the economic impact of the exposure, so we recommend the B8 risk charge be applied on a post-tax basis.

- 

US Life & Health BCAR Model:

- The P&C BCAR output includes detailed pages for bond and common stock factor calculations. We recommend the life/health model also include these pages.
  - Companies would be able to review the factors for reasonability and understand how they are calculated
  - This will provide a more consistent look between the two model outputs

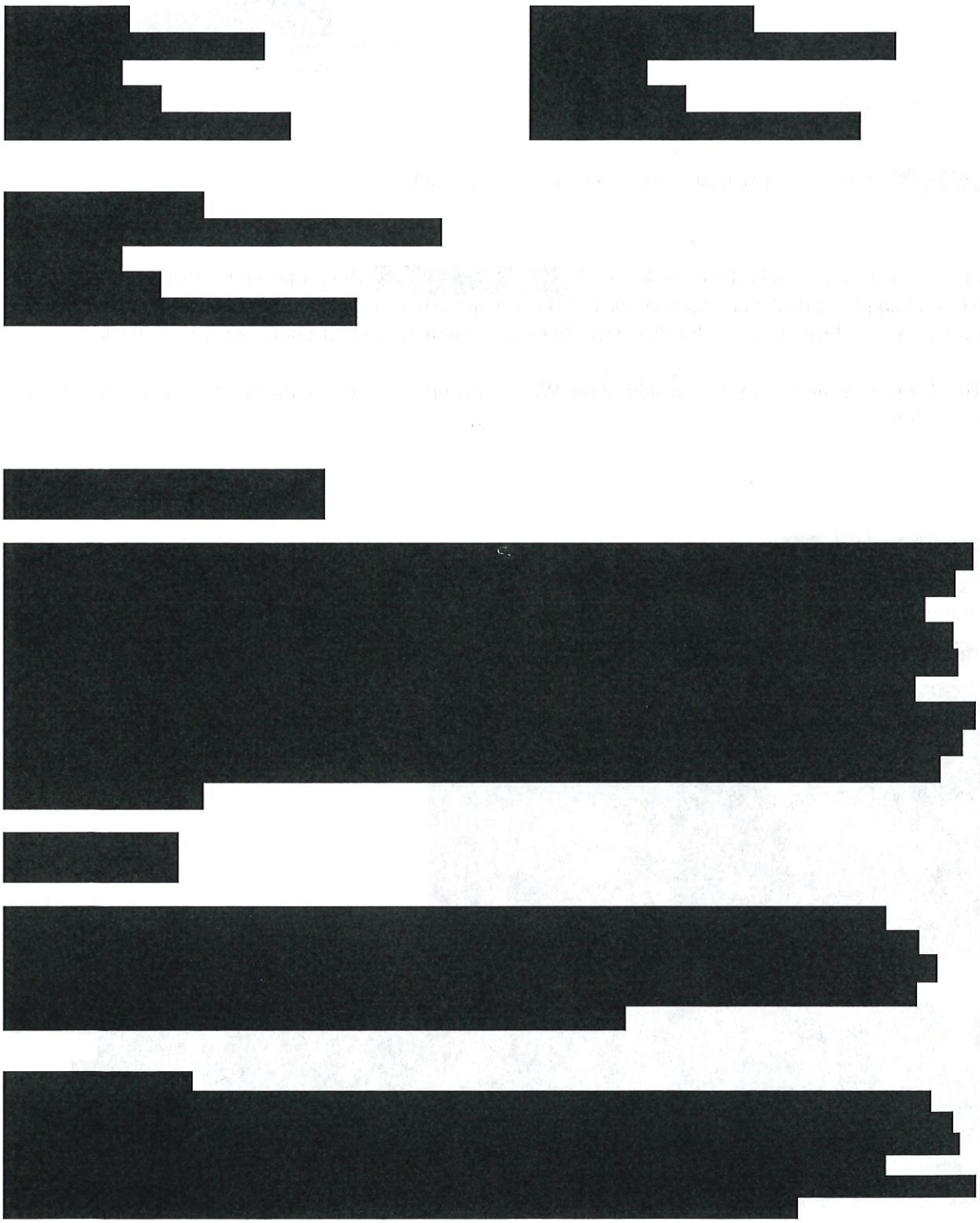
- 

Universal BCAR Model:

The above comments regarding the US P&C BCAR and US Life & Health BCAR models are also applicable to the Universal BCAR model. Below are additional comments specific to the Universal BCAR model:

- Please provide details for premium and reserve capital factors.
- Please include the correlation matrices for premiums and reserves.
- The P&C BCAR output includes detailed pages for bond and common stock factor calculations. We recommend the universal model also include these pages.
- VIF credit should include credit for cost of capital, as A.M. Best currently applies a 50% haircut on the VIF but this is not mentioned in the draft criteria.
- Consider adopting the Solvency II approach of recognizing the full amount of hybrid debt eligible under Solvency II.
- The criteria draft does not detail how the County Investment Classes (CIC) impacts the factors. In the current model, there is a multiplier relative to the CIC 1 factor. We assume this to be the same concept, but the actual multipliers were not disclosed.
- The lack of detail in the criteria paper led some clients to express concern that A.M. Best is more focused on the U.S. model and the Universal model is being derived without enough consideration to global financial and accounting differences.
- Due to data limitations of business written outside of the U.S., consider comparing capital factors to company internal models.

## Contact Information



[redacted]

03/10/2017 03:09 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>, [redacted]

Subject Proposed BCRM / BCAR Methodology Feedback

1 attachment

[redacted]Response to A.M. Best Request for Comment - FINAL.pdf

Please accept the attached feedback from [redacted] the proposed Best's Credit Rating Methodology and Best's Capital Adequacy Ratio. Given we have provided analysis specific to the impacts to our firm in the feedback, we would request **anonymous treatment** for our feedback.

Thank you very much for your consideration. We would appreciate the opportunity to speak with you in more detail.

[redacted]

[redacted]

[redacted]

March 10, 2017

[redacted]
A.M. Best Company
1 A.M. Best Road
Oldwick, NJ 08858

[redacted]

Thank you for the opportunity to provide feedback on your proposed rating methodology and capital model. We have reviewed and understand the methodology and model being proposed.

We have significant concerns regarding the implementation of the VA C3 market risk component, as it would add a high level of volatility to the C3 market risk requirement. The potential sizeable movement in required capital depending on the market environment we believe does not reflect the economic reality of the variable annuity product. In addition, the increased volatility in C3 market risk is a major departure from, and is inconsistent with, the approach taken by the NAIC, as well as the other rating agencies. This would make it very difficult for us and the industry to manage required and appropriate capital levels to run these businesses if subjected to such a methodology.

We have provided below an illustration of the sensitivity of the new A.M. Best VA C3 requirement for [redacted] throughout 2016 to demonstrate the large quarterly movements.

[redacted]

We believe the potential for excessive volatility was not what AM Best intended and our feedback aims to provide technical recommendations for adjustments to the methodology that would address these concerns.

1. **Recommend utilizing best estimate assumptions.** The proposed C3-Mkt charge is based on the distribution of results, which include policyholder behavior margins. These margins are calibrated to a prudent level of conservatism that is reasonable at CTE90 (Conditional Tail Expectations for the NAIC C3), but become unreasonably large and volatile at the 99.6$^{th}$ percentile. The volatility of the policyholder behavior margins in the extreme tail cannot be mitigated with hedging instruments. We believe that a more suitable approach would be to use the best estimate assumptions.

2. **Use a Conditional Tail Expectation (CTE) calculation versus Percentile**: Currently the C3-Mkt component of the NAIC and other rating agencies call for CTE calculations, where you see convergence of the resulting value

using 1000 market scenarios. The calculation of an exact percentile will increase the volatility of market risk by being based on a single scenario result (the 4th worst out of 1000 at the 99.6 percentile). The volatility quarter-over-quarter of a value at the 99.6 percentile can be significant, and is not a good representation of the change in risk quarter-over-quarter.

3. **Allow for 100% credit of future hedge rebalancing**: The proposed model uses the 'Adjusted' run for CTE90 calculations which does not allow for any credit (or cost) of future hedging – tools that have been effectively used to manage risk. The 'Best Efforts' run allows for a conservative estimate of the costs and benefits of future dynamic hedging. Companies that have a qualifying Clearly Defined Hedging Strategy can utilize up to 90% credit for the best efforts run. Given the strong history of risk mitigation through dynamic hedging we recommend that the AM Best C3 calculation be based solely on the 'Best Efforts' run.

As you may be aware, the NAIC is currently studying a wide range of changes to the calculation requirements for both AG43 and C3P2. One goal of the evaluation at the NAIC is to mitigate the ALM mismatch that exists in the current framework. While changes are not final they will impact the calculations and could drive meaningful changes in the numbers that are submitted for BCAR.

Thank you very much for your consideration of our concerns with the proposed capital model change. We would appreciate the opportunity to speak with you in more detail.

Sincerely,

[redacted]

[redacted]



[redacted]

October 3, 2016

A.M. Best Rating Services
Oldwick, NJ 08858

**Re: New BCAR Model – B8 Catastrophe (CAT) Risk**

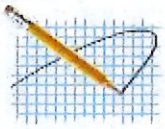
To BCAR Rating Methodology Committee:

Upon reviewing the new BCAR methodology scheduled to be rolled out late 2017, [redacted] is greatly concerned with the new catastrophe charge. It is too punitive as it leads to double and triple counting of CAT exposures. We are particularly concerned with the following examples:

- **(B6) Net Premium Written Risk**: Net Written Premium (NWP) from Annual Statement Underwriting and Investment Exhibit, Part 1, Column 1, is the input into the B6 risk component. This NWP includes a provision for both catastrophe and non-catastrophe exposures. The CAT exposure, implicit in NWP, represents the expected CAT risk portion of pricing risk. Therefore, we do not object in keeping the CAT exposure in the NWP if the premium risk charge is reduced to reflect the expected level of CAT losses and if the portion of the expected CAT loss is removed from the new CAT charge.
- **(B8) Catastrophe Risk**. The proposed CAT risk charge does not fairly represent the capital that is at risk from catastrophe exposures. Risk based capital charge should consider the risks in excess of the expected or what's anticipated in the plan rather than at the ground-up level. Therefore, the catastrophe risk charge should be catastrophe losses less the expected loss or loss anticipated in the plan. The input for the expected or planned CAT losses can be captured with the various return period data.
- **Covariance Adjustment**. We also object that the CAT charge is outside of the covariance adjustment. By placing the catastrophe risk outside of the square root formula, we are assuming zero diversification, which we know is not accurate. Since we know there is a diversification benefit that is greater than zero and the full covariance adjustment gives too much diversification benefit to the CAT, we believe A.M. Best should find a way to measure to a number between the two as a more accurate reflection of the diversification benefit. We can provide options in this regard.

[redacted]ould respectfully request in either written form or in a conference call a response to the issues we raised. We would be happy to be a resource to A.M. Best in developing a more equitable methodology in any way we can. [redacted]

[redacted]



"Alexey Laikov" <alexey.laikov@rifams.ru>
05/11/2017 06:12 AM

To methodology.commentary@ambest.com
cc
Subject A.M. Best Releases Best's Credit Rating Methodology (BCRM) Draft Criteria for Evaluating Country Risk for Comment

Dear colleagues

Thank you very much for asking our comments about A.M.Best's credit rating methodology draft criteria for evaluating country risk.

We could comment as follows:

1. From our point of view the main feature of the Russian insurance system is that financial stability of insurance risk carriers is very much dependent from their relations with very few ( from one to four) key clients. This feature generates specific country risk especially for Russia.

We would like to propose you to take that risk into account for improvement of your methodology. For example, you can ask Russian carriers looking for your ratings to provide you information about their most "fruitful" clients according to their share in Gross Revenues ( Not Premiums collected!!!) of insurance company.

2. Next point is the specific risk generated by sometimes unpredictable policy of Russian Central Bank who controls banking and insurance system.

All insurance companies in Russia keep their money in banks ( like everywhere in the World). But during last two-three years Russian Central Bank stops licenses of decades and even hundred banks. Banks, who operated leagally. And there is no effective mechanism of protection of interests of these banks clients. Insurance companies could just loose their money not because of the big claims, wrong underwriting policy, wrong investments policy, but just because of administrative reasons, because of the risk, generated by the body, authorized by State. Because of Regulative risk.

We think that these Regulative risks are part of specific country risk profile of the Russian insurance system.

With kind regards Dr. Alexey Laykov, RIFAMS Ltd. Russia

[redacted]

07/31/2017 03:56 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc [redacted]

Subject Response to A.M. Best Criteria

1 attachment

Response to A.M. Best Criteria - July 2017.pdf

A.M. Best Team,

Attached please find our comments related to draft criteria released at the end of June 2017.

We would like these comments / feedback to be kept anonymous.

Feel free to contact us if you have any questions.

Regards,

[redacted]

[redacted]

[redacted]

# Response to A.M. Best Criteria

Catastrophe Analysis in A.M. Best Ratings

The Treatment of Terrorism Risk in the Rating Evaluation

July 31, 2017

[redacted]

[redacted]

# Catastrophe Analysis in A.M. Best Ratings

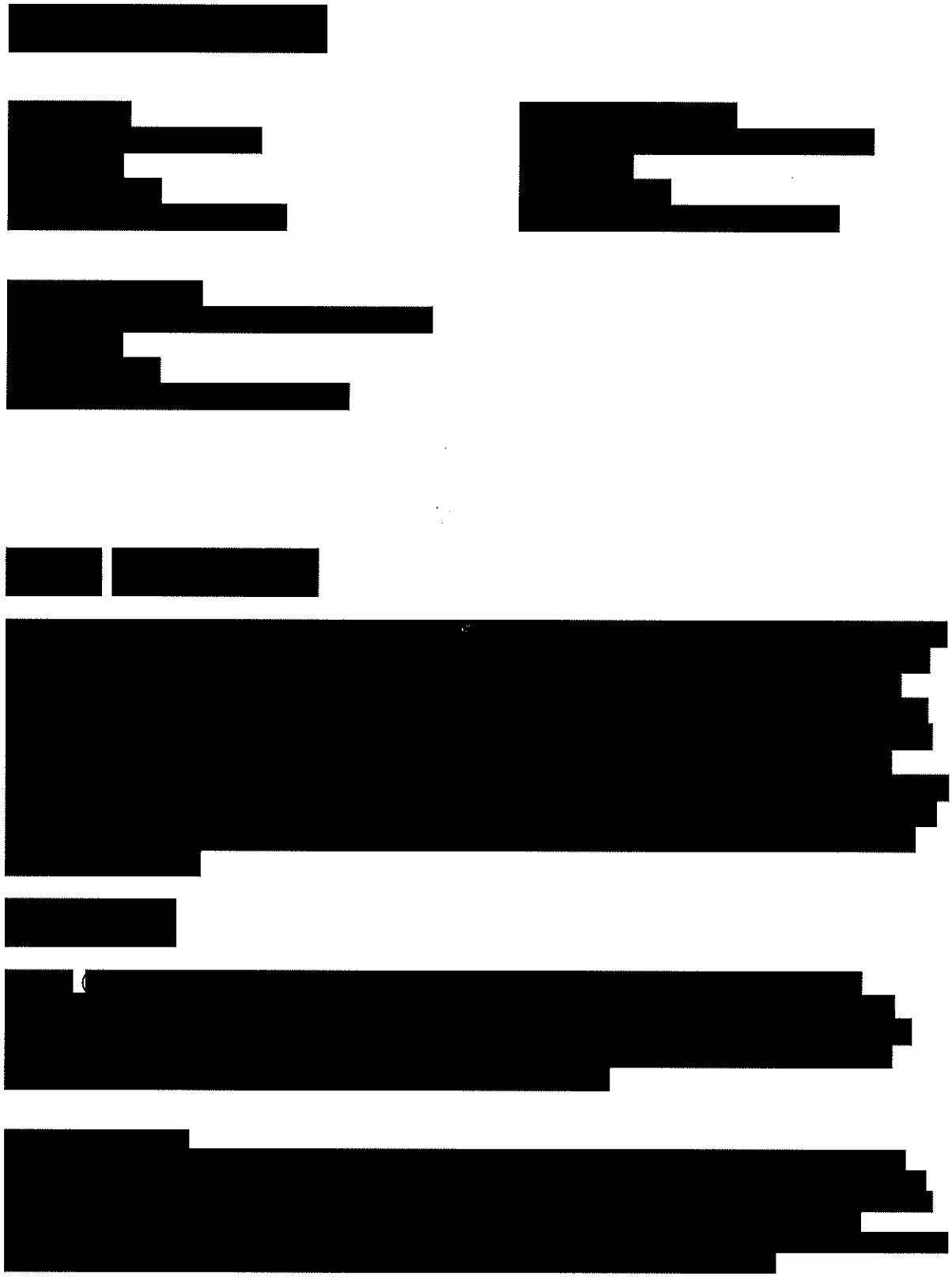
- As A.M. Best is moving to an 'All Perils' view of catastrophe risk in the stochastic-based model, there is increasing emphasis on the perils included in this PML. There are discrepancies in industry practice about what perils are included in an 'All Perils' PML due to availability of models for certain perils/locations or management's view of risk. A.M. Best may consider clarifying the 'All Perils' view to standardize the request worldwide.
- In both the current and draft catastrophe criteria, A.M. Best requires the near term hurricane PML for use in the BCAR model. When the near term concept was introduced it generated significantly higher PMLs than the long term view. RMS' approach to the near term PML has evolved into their expectations of the next several years. The current climate indications are implying a lower than average frequency and RMS' near term industry PML has decreased approximately 10% in the most recent model version. [redacted] catastrophe modeling team is still assessing the most recent AIR model release, but generally AIR's view of near-term is more stable and we expect any changes to be +/- 1%-2%.

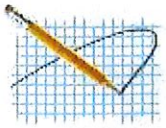
  The near-term PML is more volatile and we believe the long term view is a more consistent approach to evaluating a company's catastrophe risk.

- Potential areas for further clarification within the proposed criteria include:
  - In the proposed BCRM, the following is noted *"A.M. Best will use the ceded PML – represented by the ratio of gross PML minus pre-tax net PML relative to surplus – to evaluate a company's reliance on reinsurance. Companies with a ceded PML over an acceptable level will receive a downward adjustment to the balance sheet strength assessment."*
    - What are the acceptable levels?
  - Are there specific guidelines followed to define financial flexibility?
  - The mapping guide does not provide an indication of results that are more than 1 notch lower especially in the Strongest and Very Strong categories
  - How will the tax adjustment to the first event be calculated?
  - Will the catastrophe stressed BCAR results be published in the company report?

# The Treatment of Terrorism Risk in the Rating Evaluation

- The proposed terrorism criteria are focused on terrorism risk in the United States. It is not clear how A.M. Best evaluates terror risk outside the United States.





[redacted]

08/01/2017 09:38 AM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc

Subject Catastrophe Analysis in A.M. Best Ratings - Commentary

After reviewing the June 29th draft, I'd like to offer a comment on the Natural Catastrophe Stress Test section.

We follow your methodology for reducing reported surplus by the 1-in-100 year net post-tax PML (including reinstatement premium). The second calculation increases Reinsurance recoverables by a minimum of 40% of the difference in the gross and net 1-in-100 PML. The third calculation adds 40% of the 1-in-100-year net pre-tax PML to Loss Reserves.

Clearly the third calculation, where you add to loss reserves 40% of the 1-in-100-year net pre-tax PML seems duplicitous since the reported surplus is already being reduced by the modeled 1-in-100 year net post-tax PML. If a carrier utilizes a reinsurance company for Cat protection, the reinsurer will be carrying a loss reserve on its books for the portion of the gross incurred loss, while the primary carrier carries the net incurred loss. Uncollectible reinsurance aside, the primary carrier should not be assessed 40% of the gross PML. [redacted]

Thanks for offering us the opportunity to comment on these proposed changes.

[redacted]

[redacted]

08/16/2017 11:08 AM

To methodology.commentary@ambest.com

[redacted]

Subject Comments on the leverage calculation in the draft criteria

Please take note of the comments below. It does need to be anonymous.

We would like to share with you a few remarks and questions regarding your draft criteria "Available capital and company holding analysis".

We would appreciate to have clarity on own is the equity credit attributed to a specific deal is made up.

It is not clear if the permanence criteria reflected in table B1 refers to inception or to balance sheet date. We would be in favour of a reference to inception date as the calculation at balance sheet date would introduce volatility in the ratio.

Also, we understand that there is a qualitative assessment when attributing the equity credit. We believe it would be useful to have a clear and formulaic approach. leaving the qualitative assessment to the analytical team. That would allow our capital management specialist to easily structure the deals that meet AM Best hybrid equity criteria. Also, that would allow straight leverage peer analysis.
We believe it is better to have clearly defined KPIs and an analysis that includes other qualitative considerations.

Also we would like to bring to your attention that the dotted lines vertically going between the boxes on B1 are very confusing. Do they pre-determine the % to be added in a linear way?

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[redacted]

[redacted]



August 25, 2017

AM Best
Ambest Road
Oldwick, NJ 08858-0700

Dear Sir or Madam,

[redacted] appreciates the opportunity to comment on the proposed AM Best Credit Rating Methodology (BCRM). We are in support of the concept of a revised methodology to ensure that companies are rated fairly and against appropriate measures.

What follows are high level comments (using the references to numbered paragraphs in the proposed BCRM paper). We believe consideration of these changes will improve the BCRM.

**Enterprise Risk Management (ERM) and Business Profile Notching Limitation**
Page 24 paragraph 2 states companies with a Very Strong ERM and a Very Favorable business profile assessment [redacted] We recommend utilizing the "Comprehensive Adjustment" mechanism to assess these caps on a company by company basis as facts and circumstances can be materially different when considering these to inputs.

**Best Capital Adequacy Ratio (BCAR)**
We have the following suggestions for your consideration in the new BCAR formula:

- Under C3, section 1, which includes general account annuities not subject to discretionary withdrawals, the current factors are based on duration matching (ALM spread) less than or equal to 1 year. [redacted]. As an example that falls within this categorization, a company has the potential [redacted] The BCAR factor at the VaR 99.6 level is 2.43%. We agree this factor is reasonable for a duration mismatch of 1 (our internal model suggests about 2.30%, which is close); however, if duration mismatch is much tighter (like the 0.1 mismatch example noted above), then a reasonable factor would be only a small percentage of the current VaR 99.6 factor. [redacted]
- Another C3 topic relates to annuities that are subject to discretionary withdrawal but have ancillary insurance related benefits, such as fixed-indexed annuities with guaranteed benefits and long-term care combination products. [redacted]

- [redacted]. Z bonds do not pose more risk of a capital loss than traditional CMOs because they are last cash flow structures (while the timing of the cash flows may vary widely, you do get your principal back). From this standpoint, it does not seem appropriate [redacted] For example, the VaR 99.6 charge for an NAIC 1 bond is 2.1%, which COLI has preference over. Therefore, the charge should be less than 2.1%.
- We would appreciate [redacted] Similarly, the 25% margin creates requirements 15-20% above VaR 99.8 factors as well. Equating these required margins in terms of a VaR level suggests that these thresholds are overly conservative as they are margins above tail levels that are already extreme. We suggest that the margins are reduced so that they are not resulting in capital that is unduly conservative.

**Conclusion**

We appreciate the opportunity to share our views and we look forward to hearing about next steps in the process.

[redacted]

"[redacted]

08/25/2017 04:42 PM

To "methodology.commentary@ambest.com" <methodology.commentary@ambest.com>

cc

Subject comments - BCRM draft

Comments should be kept anonymous:

- can more clarity be provided to how operating performance will be scored based on strategic decisions (e.g. change in business mix) and how it will be assessed when compared to historical operating results and to those of our peers. Financial metrics like NI and ROE may decrease when compared to the company's historical performance however the risk profile of the company has changed. We would like to get a better understanding between operating performance and risk profile and how that will ultimately impact the rating
- with respect to reinsurance programs and concentration among reinsurers, can we get more clarity on what thresholds AM Best considers to be too concentrated? Is there an impact on AM Best's assessment if the concentration was with a traditional reinsurer or a hedge fund/Re vehicle (with the two types of companies having the same rating)?

[redacted]