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AM Best's Europe Insurance Market Briefing & Methodology Review Seminar - London



20 October 2021

Agenda – Methodology Review Seminar (BST)

14:25 Welcome and Introductory Comments

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

14:30 IFRS 17 – Nearing the Horizon

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

14:55 ESG in Best's Credit Rating Methodology (BCRM)

*Mahesh Mistry, Senior Director, Credit Rating Criteria,
Research & Analytics*
Michael Dunckley, Associate Director, Analytics

15:15 Scoring and Assessing Innovation

Victoria Ohorodnyk, Associate Director, Analytics

15:30 Performance Assessments for Delegated Underwriting Authority Enterprises: An Overview and the Assessment Process

*Mahesh Mistry, Senior Director, Credit Rating Criteria,
Research & Analytics*
Myles Gould, Director, Analytics

15:50 Q&A Interactive Panel Discussion

AM Best Credit Rating Analysts

16:30 Close



Any Questions?

Please use this link or the QR code to submit questions to our speakers



glsr.live/ambestlondon21



Don't forget to include your NAME and COMPANY

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

IFRS 17 – Nearing the Horizon

Pierre Tournier – Associate Director, Analytics, AM Best

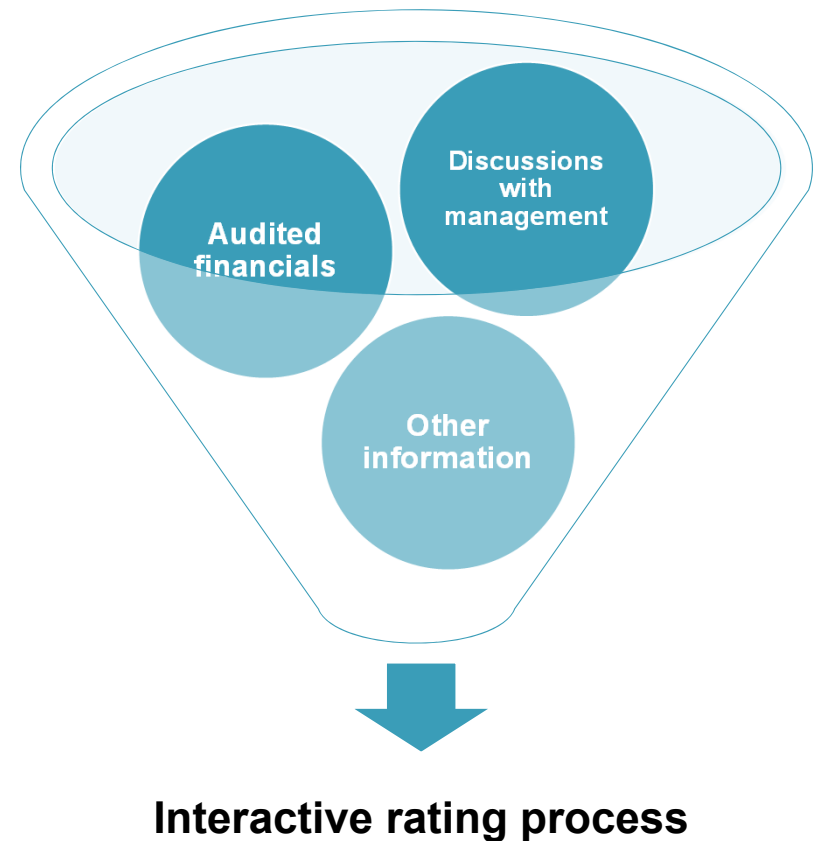
Tony Silverman – Director, Credit Rating Criteria, Research & Analytics, AM Best

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IFRS 17 – Analytical Considerations

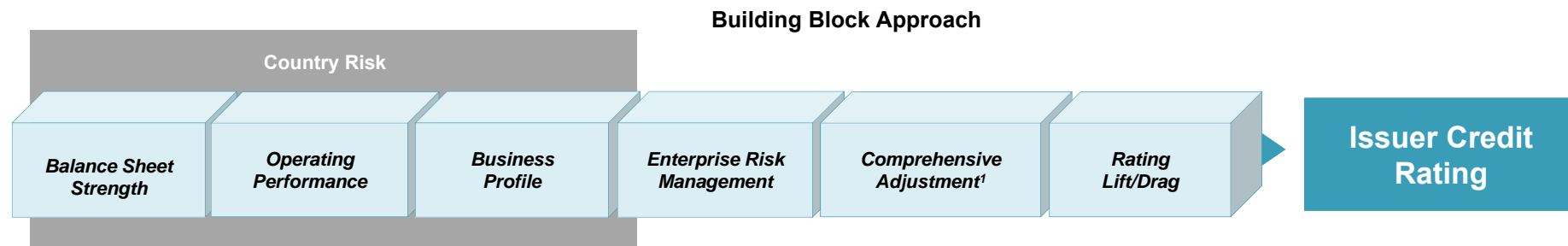
- Audited financial statements are a key input in the ratings process
- AM Best already rates insurers who report under a variety of standards
- Rating process should be agnostic to the reporting standards



IFRS 17 – Analytical Challenges

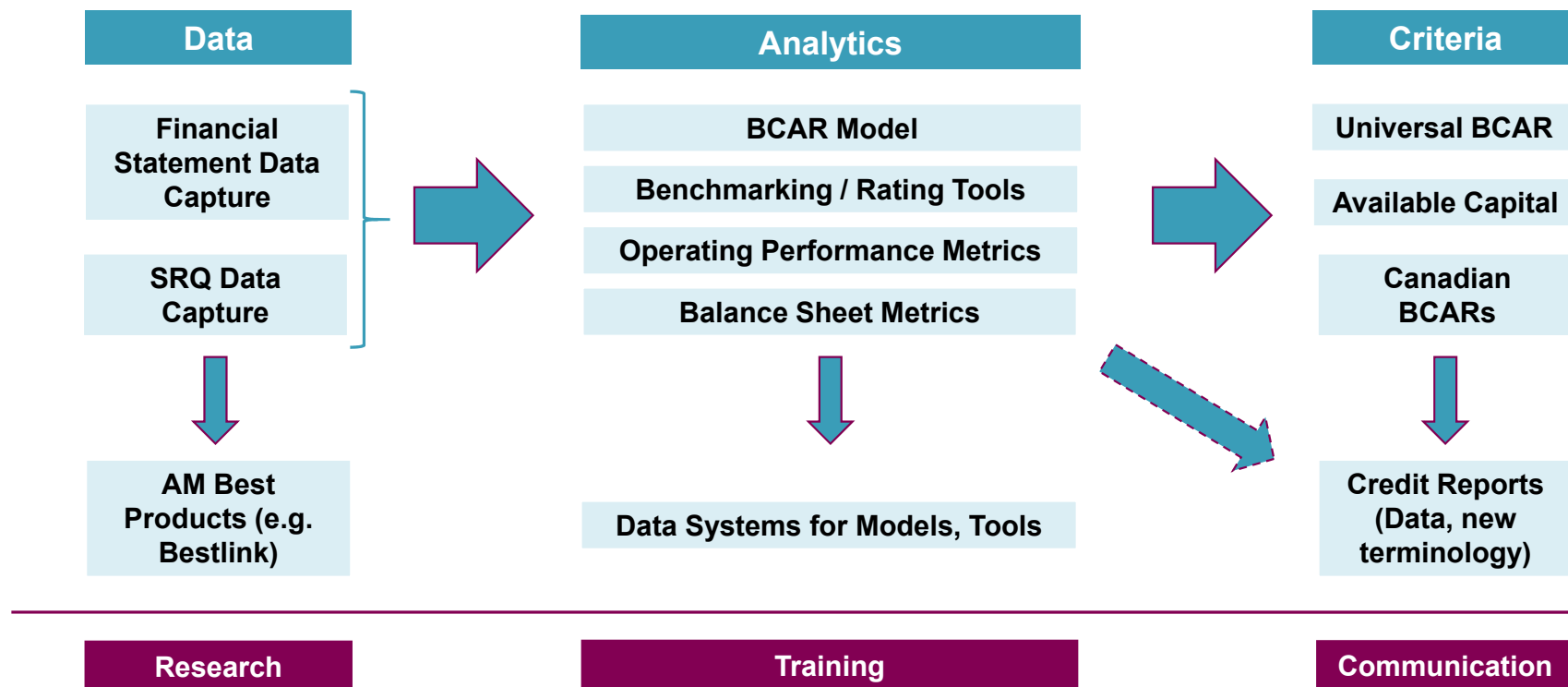
- Analysts will need a working knowledge of IFRS 17 and how it impacts their analysis
- There will be significant changes which will require analysts quickly educate themselves
 - Impact at adoption
 - Quantity and granularity of information provided
 - Understanding sensitivity of results to economic factors
 - Earnings development
- Timing is tight. While we've known about IFRS 17 for years, analysts will likely need to wait until accounts are published

IFRS 17 – Analytical Considerations



- Because the presentation of the underlying information will change, the analysis supporting certain building blocks may evolve
- Analysis supporting Balance Sheet Strength and Operating Performance are most likely to be impacted
- Some examples include:
 - Impact at adoption and comparing to pre-IFRS 17 financials
 - Understanding profitability metrics and earnings attribution
 - Expectations regarding reserve development
 - Interpreting impact on leverage metrics

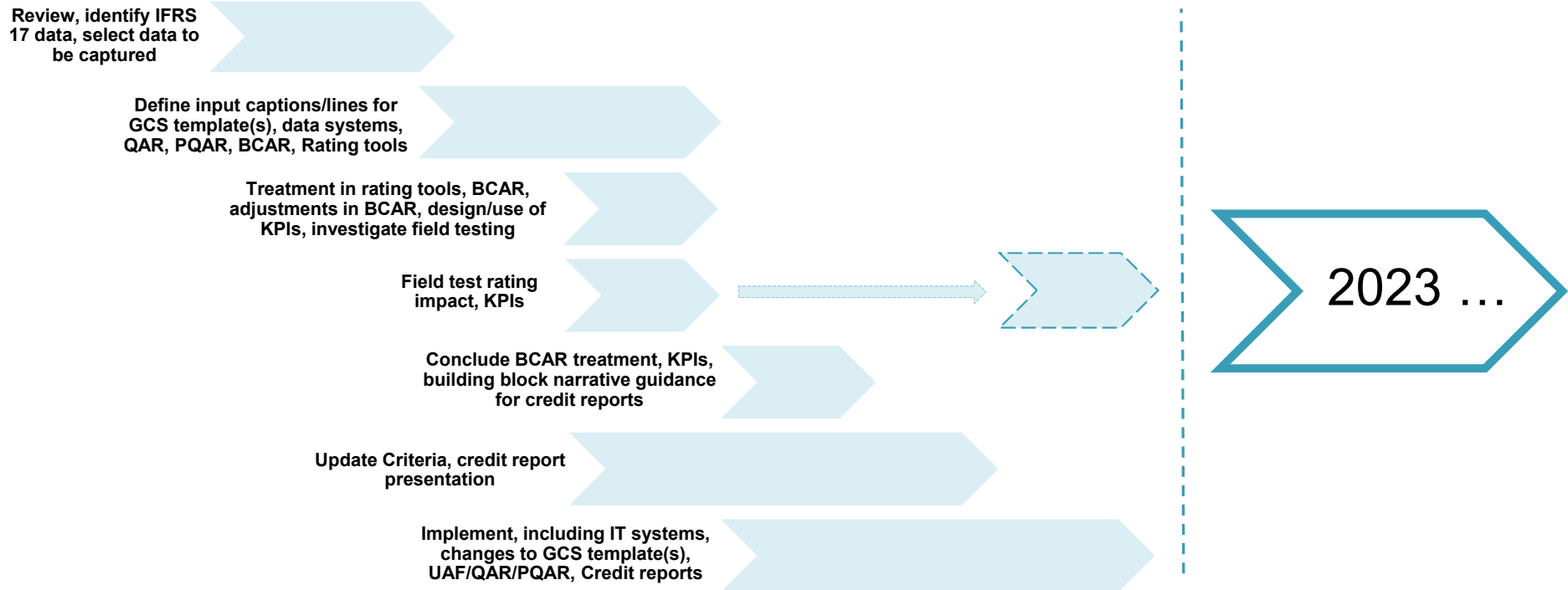
IFRS 17 – Will Permeate Most Activities



Global – Except US, Japan, Mexico (Convergence Project)

Country	Adoption of IFRS 17	Implementation Year	Applied Insurers	Comments
United States	No	n/a	None	Adopted for subsidiaries in other countries that report under IFRS. US subs of international groups may also report under the standard
Canada	Yes	2023	All Insurers	Advanced stage of implementation
EU (Inc. UK)	Yes	2023	Listed Insurers	Only listed insurers required to adopt the standard; many insurers may still report under local GAAP. EU27 optional carve-out likely on annual cohorts for certain products
Switzerland	Allowed	n/a	Allowed option/special cases	Zurich Ins and Swiss Re will adopt standard to be in line with peers
Eastern Europe	Yes	2023	Listed Insurers	Most insurers are listed and reporting under IFRS
Bermuda	Allowed	n/a	Allowed	IFRS reporters will use, but some could switch to US GAAP if peer group is US
GCC	Yes	2023	Listed Insurers	Most insurers are listed and reporting under IFRS. Kuwait is an exception
Middle East (ex. GCC)	Yes	2023	Listed Insurers	Implementation may be delayed for some countries
Africa	Yes	2023	Listed Insurers	Implementation may be delayed for some countries. Exceptions Egypt, some gov't owned entities
LATAM	Yes	2023	Listed Insurers	Implementation may be delayed for some countries. Mexico is local standards for financial sector, with project to converge to IFRS
ASIA	Yes	2023	Listed/all Insurers	S Korea likely 100% of insurers. Implementation may be delayed for some countries. Taiwan, Vietnam (2026), Indonesia, Philippines (2025), Thailand (2024)
Japan	No	n/a	None	Companies can voluntarily adopt standard in addition to J-GAAP
China	Chinese equiv	2023, 2026	Listed; others	Formally Chinese Accounting Standards, but expected to closely replicate IFRS 17
India	Indian equiv	2025	All Insurers	Indian Accounting Standard 117 (equiv to IFRS 17) and RBC at the same time
Australia, New Zealand	Yes	2023	All Insurers	Under-going consultation with market

Timeline for AM Best



- Training runs alongside above
- Criteria and credit report work moving into focus

KPIs, Industry Consensus Still Developing

- Non-life CoRs calculated Net / Gross and Net / Net, for PAA business and for total non-life
- Product CoR comparisons will change due to discounting
- Contributions to RoE allocated to P&C, Life, Reinsurance – and also for CSM, risk adjustment, investment result
- Group RoEs calculated as reported – and also with CSM as equity, with loss component in CSM, and with various combinations of these
- Flexibility still retained at this stage

Ratings, BCAR, Criteria

- Near term rating changes not expected, though new presentation, new data for rating committees
- Richer data set for life may have implications for Criteria
- Economic value due to long-term business in available capital will use CSM (and risk adjustment?) for IFRS reporters
- Treatment of DAC to accommodate IFRS 17 data
- Assessment of P&C reserve keywords, equity in reserves will evolve

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Pierre Tournier

**Associate Director,
Analytics, AM Best**

Tony Silverman

**Director, Credit Rating
Criteria, Research &
Analytics, AM Best**

ESG in Best's Credit Rating Methodology (BCRM)

Mahesh Mistry – Senior Director, Criteria Research & Analytics

Michael Dunckley – Associate Director, Analytics

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Wednesday, 20 October 2021

Understanding ESG Concepts: General Perspective

The consideration of environmental, social and governance factors alongside financial factors



Environmental factors relate to resource use, pollution, climate risk, energy use, waste management, and other physical environmental challenges and opportunities



Social factors relate to how a company interacts with the communities it operates in, its suppliers, employees, and broader stakeholders



Governance factors relate to procedures and processes according to which a company is directed and controlled

Translating into Criteria: Importance of ESG Factors are on the Rise

AM Best has explicitly integrated consideration of ESG factors alongside traditional financial factors into its credit rating methodology

Best's Credit Rating Methodology (BCRM)

Balance Sheet Strength

- **Climate risk**
- ESG integration in investing activities
- Stranded assets

Operating Performance

- Social inflation
- ESG-related litigation
- Impact of ESG integration on profitability

Business Profile

- Underwriting exclusions
- Changing demographics
- Data privacy
- Reputational risk

Enterprise Risk Management

- **Corporate governance**
- **Stress testing**
- Financial and non-financial risks

- ESG factors, where material and relevant, may impact any one, or several building blocks
- Impact of ESG is viewed purely from an analytical perspective: focusing on the impact on the credit rating
- No judgement is made on the ethical value of ESG activities, or ESG credentials of the company

ESG in Credit Ratings

- ESG commentary included within Best's Credit Rating Methodology (Pages 28-31)
- ESG is relevant when it has a visible impact on financial strength. Positive or negative ESG attributes may have no impact on credit quality
- ESG exposures may not be uniform – understanding the type of company, lines of business, level of risk transfer, operating jurisdictions and government participation in risks are important
- The short and long term impact on Financial Strength of ESG risks and opportunities is likely to vary depending on the nature of the company
- ESG risks or opportunities that may be less relevant today, may become more important in the future
- Approach is generally forward looking
- ESG is important but not a new concept: Environmental risks and governance have always been considered in credit ratings
- Discussions, where relevant, may consider the following topics:

Strategy

Climate Risk

Capital Structure

Underwriting

Investment

ERM

Regulation

ESG Impact on Credit Quality

ESG Credit Factors are the intersection between standard credit factors and ESG factors that are applicable to the insurance industry – ESG are not new factors but a subset of credit factors

Credit
Factors

ESG Credit
Factors

ESG
Factors

AM Best analyses credit issues and how these risks / opportunities can affect the Financial Strength of insurers. If risks / opportunities fall outside of expectation (relative to market, peer group), then there could be an impact on financial strength. This could be a positive or a negative impact

Are ESG risks and opportunities* relevant?



How is the company managing them?

* ESG risks and opportunities will vary by company subject to their profile, exposures, protection and market(s) they operate in

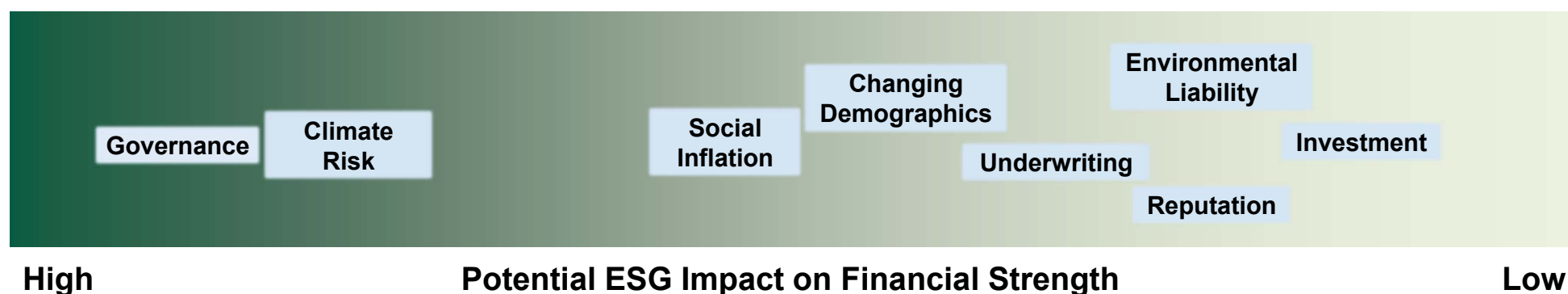
Some ESG issues may seem less important today, but may have greater importance over the medium-to-long term, and thereby have the possibility to impact financial strength, particularly if no action is taken. The concept is forward looking to understand how companies will shape (if required) their business in light of forthcoming challenges

ESG Potential Impact on Credit Quality

The impact of ESG Factors on financial strength are not uniform and can vary due to:

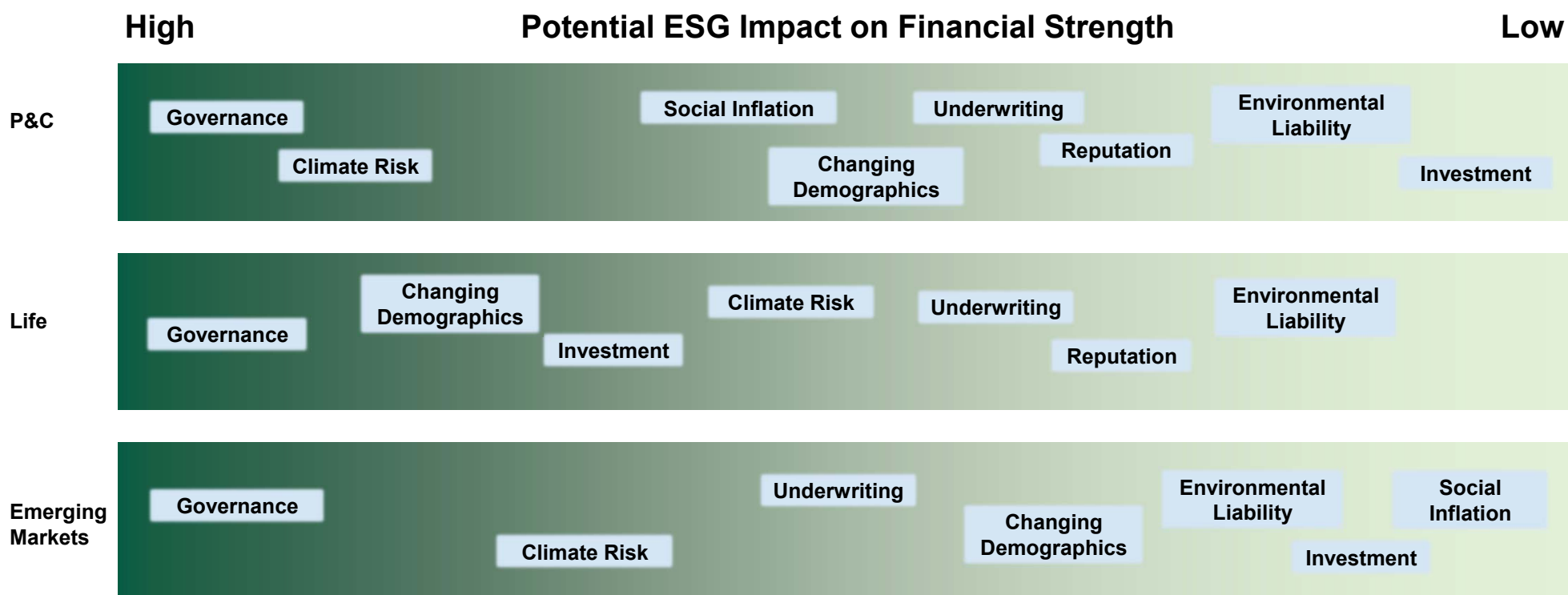
- Type of company
- Exposure
- Level of risk transfer
- The markets a company operates in

Issues like Governance and Climate Risk can have a material impact on an insurers financial strength



The impact of some ESG credit factors may be increasing over time

ESG Potential Impact on Credit Quality is not Uniform: Examples

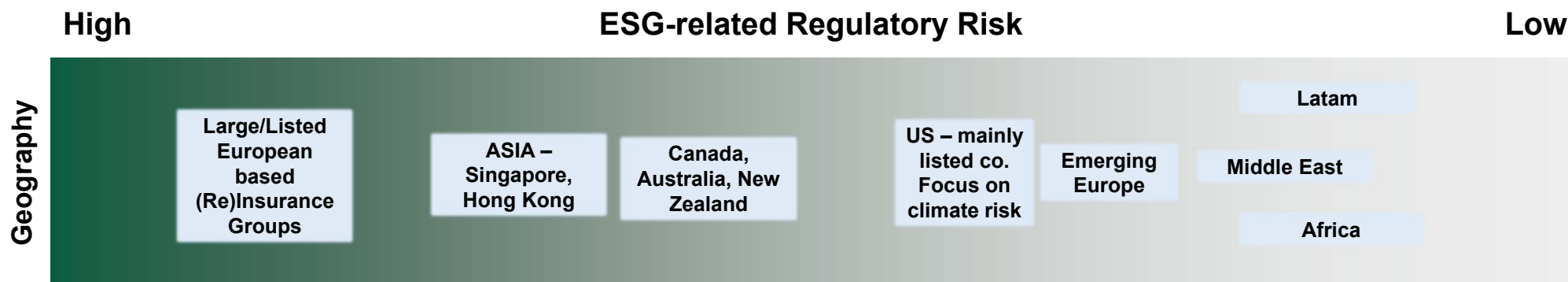


ESG and Regulation

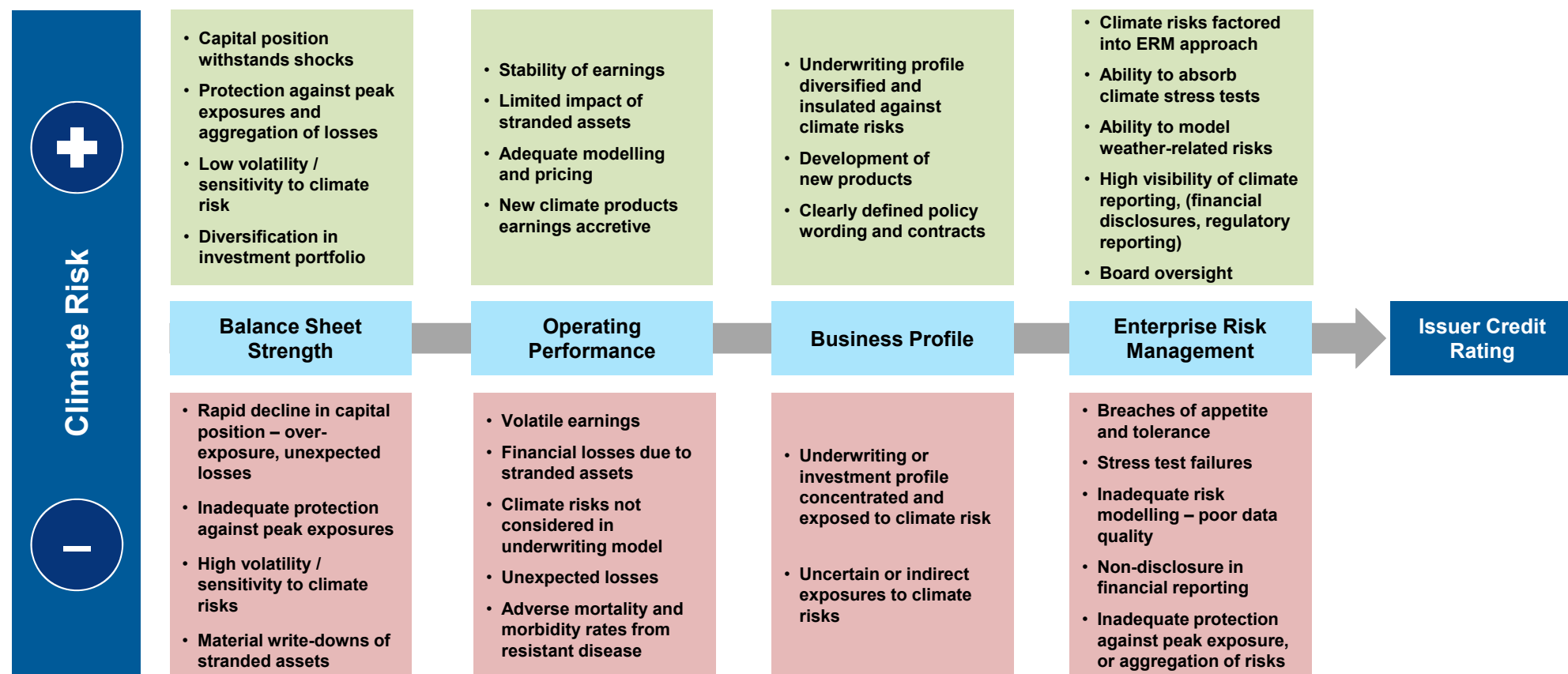
In general we see regulation as a driving force of more ESG-related activities by companies

- **Opportunity** for insurance companies to strengthen their risk awareness by coming into line with regulatory requirements
- **Risk** of non-compliance with regulatory requirements
- **Risk** of additional costs and consumption of management time associated with compliance
- **Risk** of market losses associated with forced divestment of assets

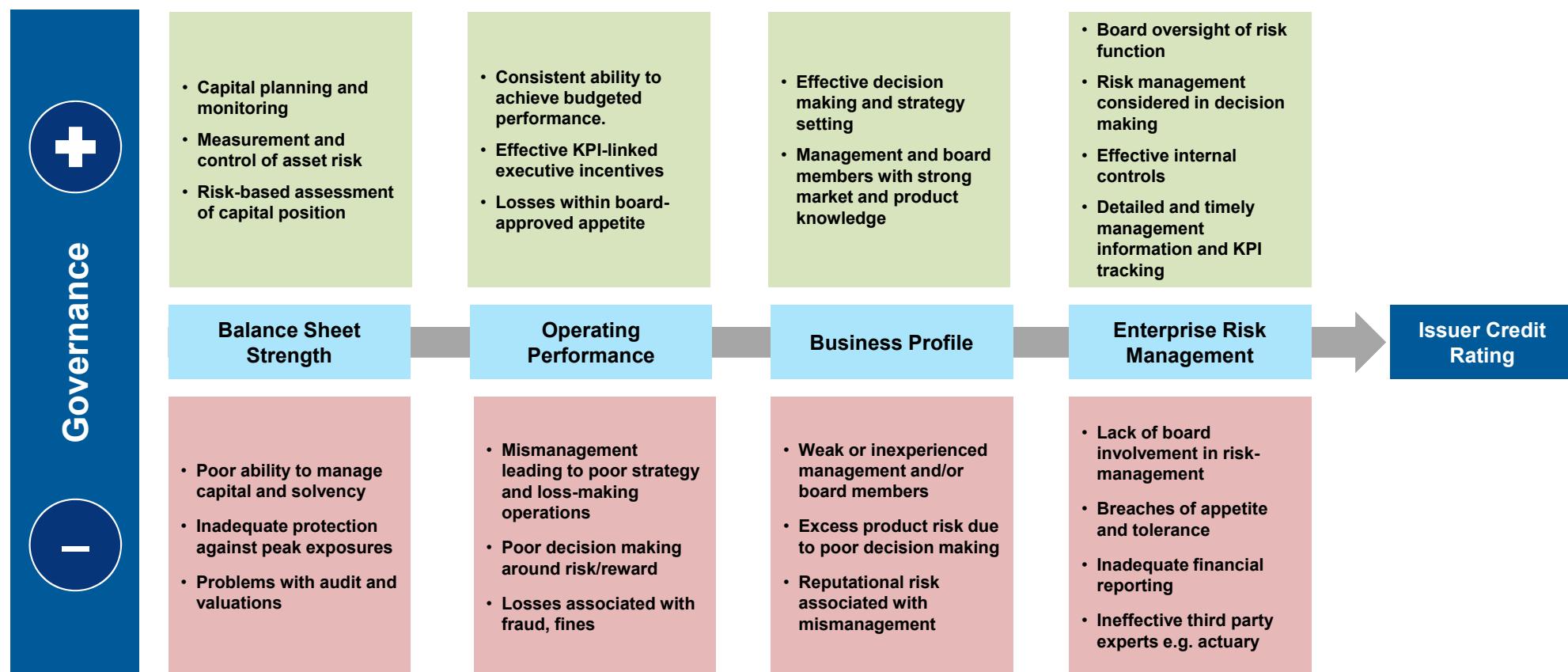
Level of risk varies considerably by geography:



Assessing Climate Risk through the Rating Process



Assessing Governance through the Rating Process



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&
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Michael Duncley

**Associate Director,
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Scoring and Assessing Innovation

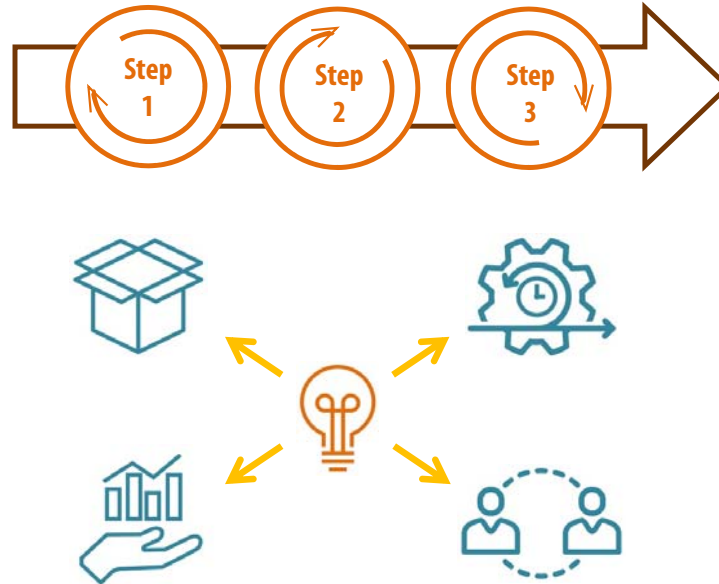
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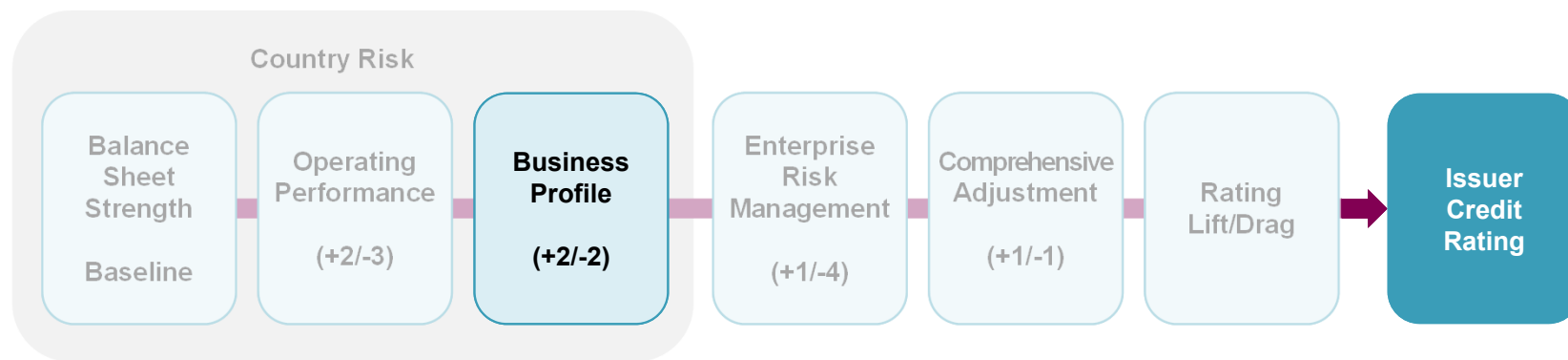
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Innovation – AM Best Definition

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



BCRM Building Blocks – Where is innovation captured?



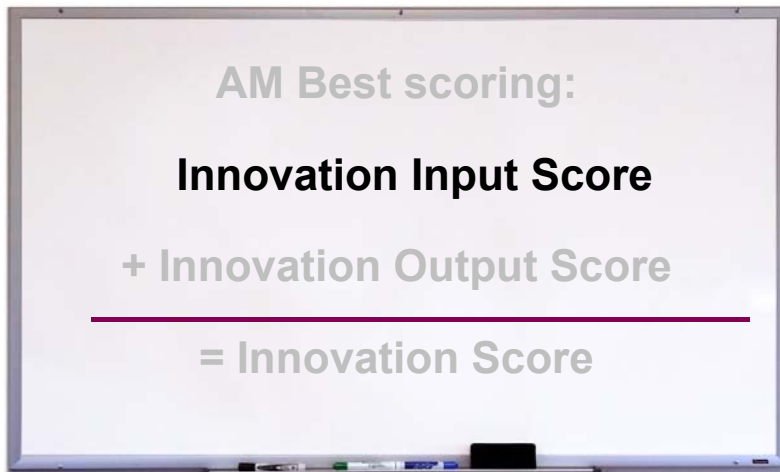
Business Profile Components	
• Market Position	• Management Quality
• Pricing Sophistication & Data Quality	• Regulatory, Event, and Country Risks
• Product Risk	• Distribution Channels
• Degree of Competition	• Product/Geographic Concentration
• Innovation	

AM Best Innovation Score

Innovation Input Score + Innovation Output Score

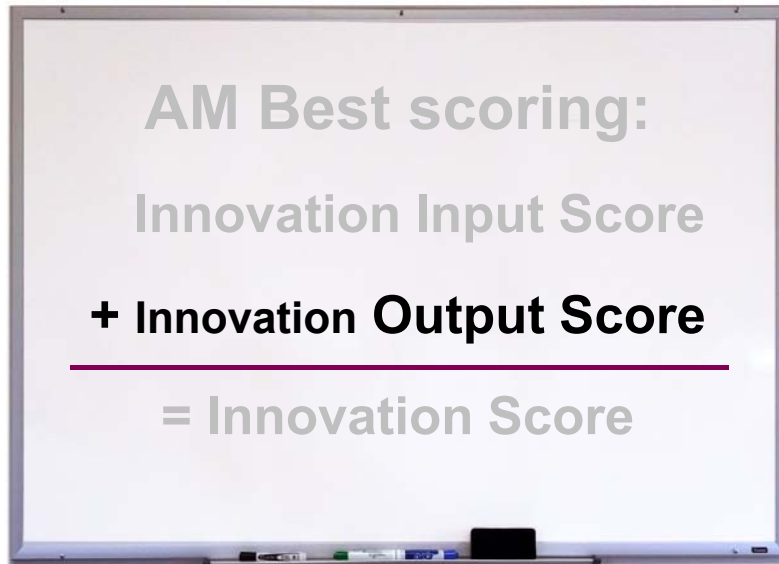


AM Best Innovation Score



Input = Leadership + Culture + Resources + Processes and Structure

AM Best Innovation Score

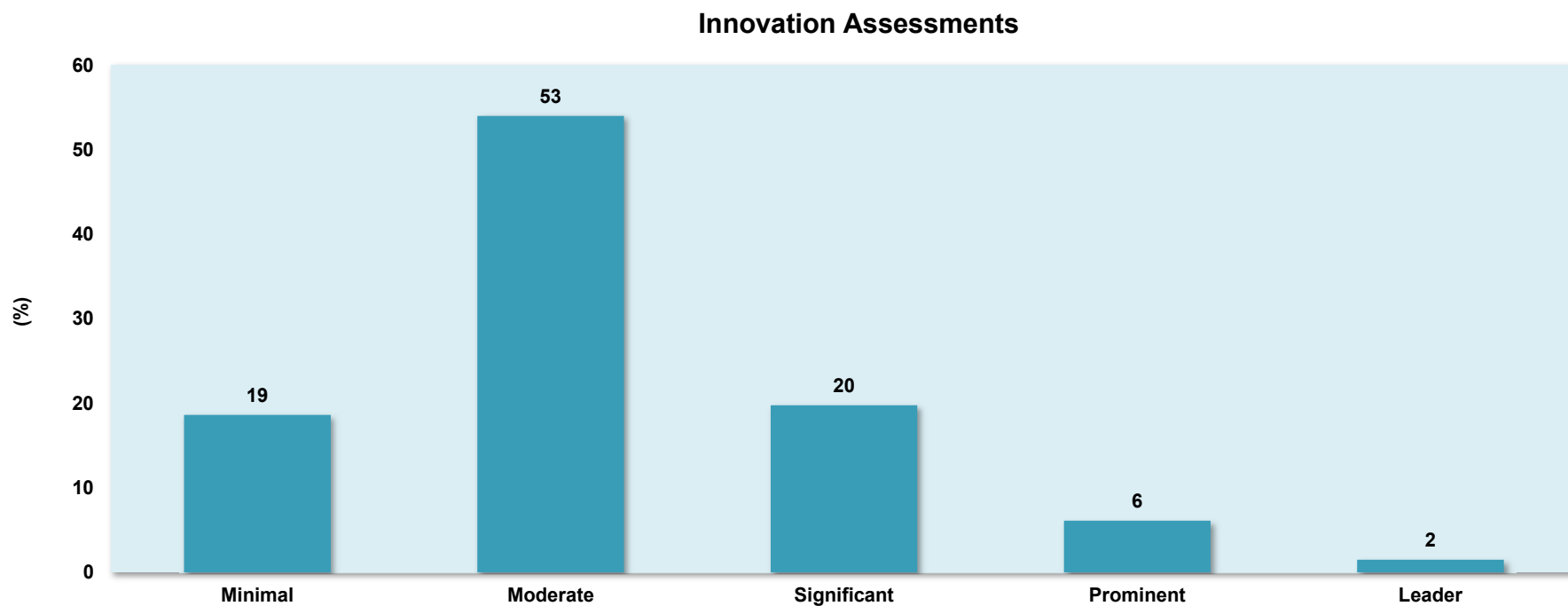


Results

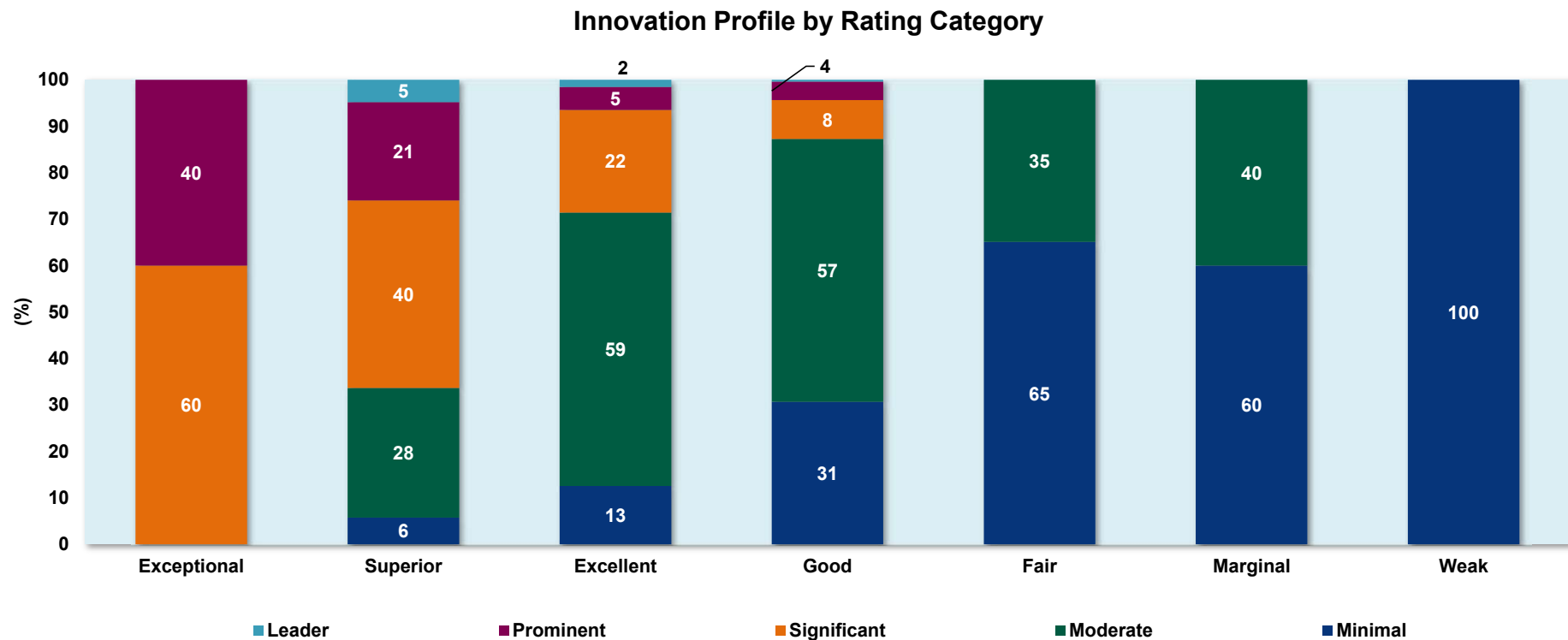
**Level of
Transformation**

$$\text{Output Score} = 2 \times (\text{Results} + \text{Level of Transformation})$$

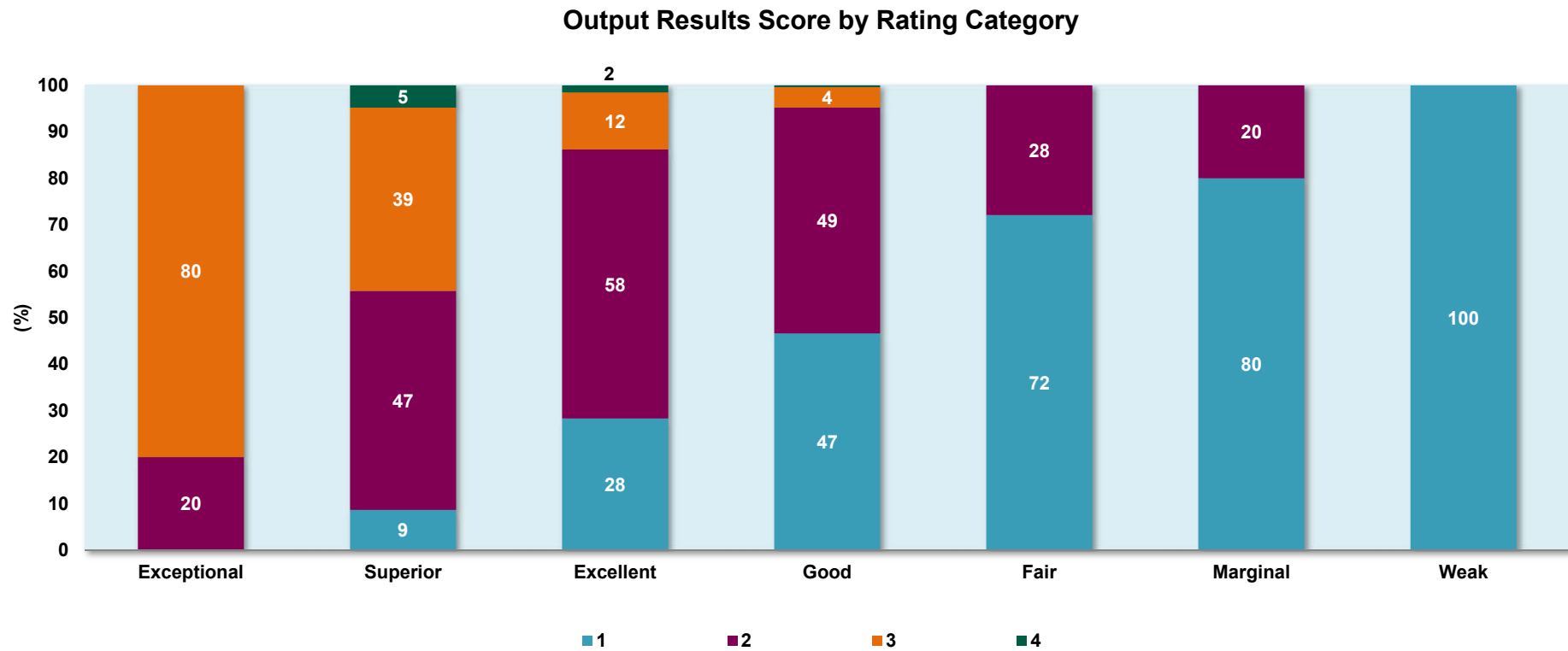
Findings – Global distribution centered on “Moderate” as of H1 2021



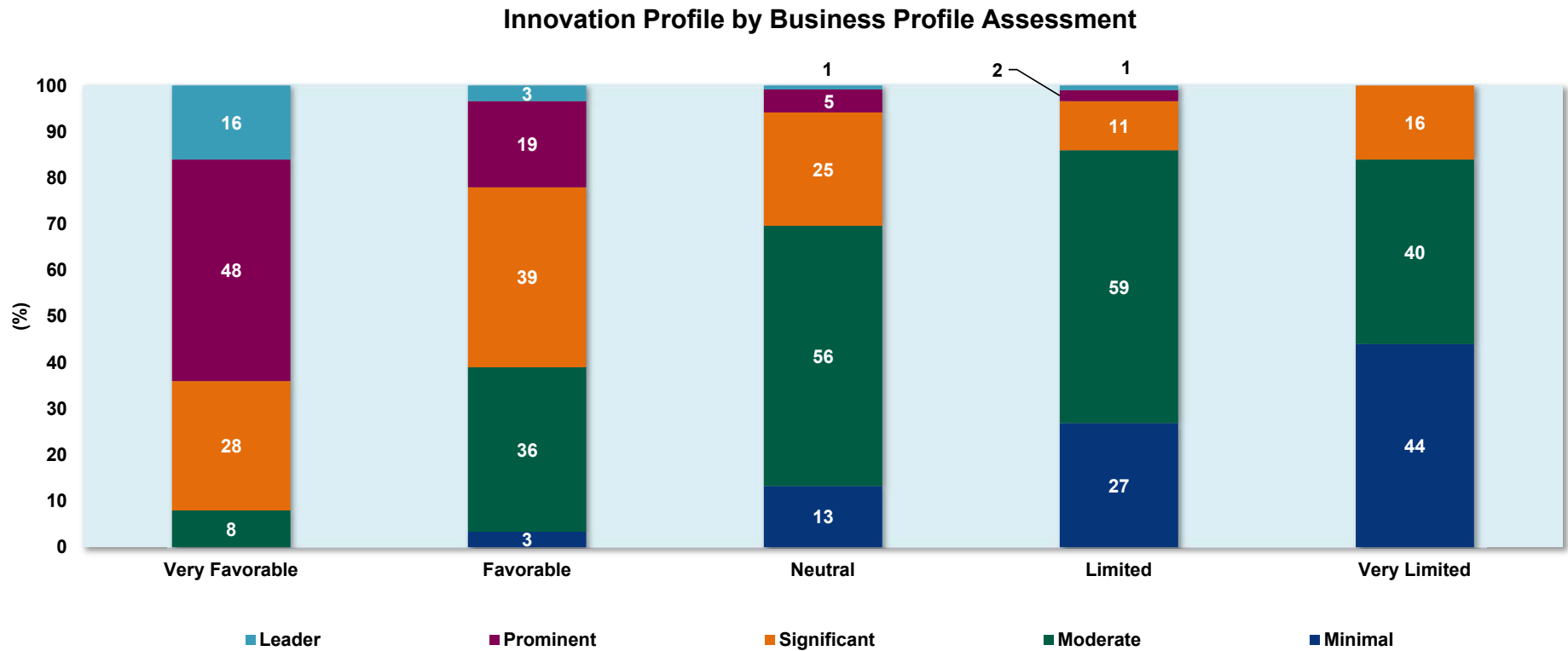
Higher rated companies are more innovative ...



... and get more results from the effort

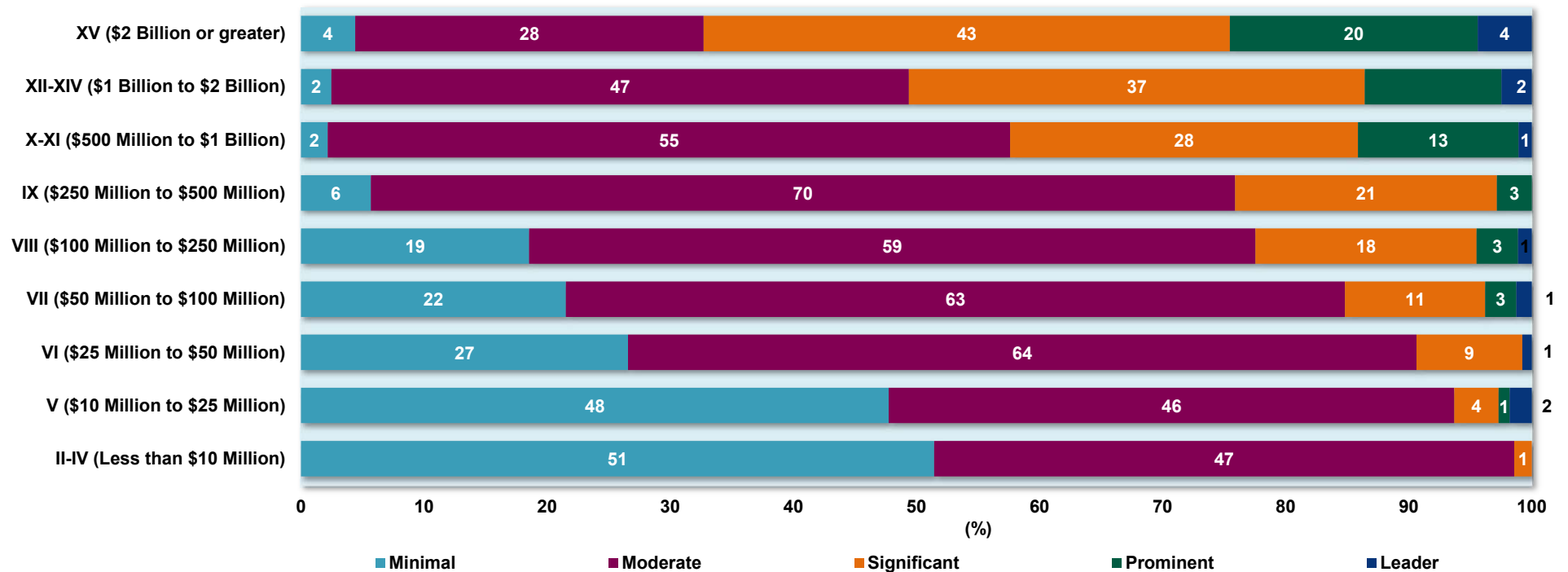


A clear link with Business Profile

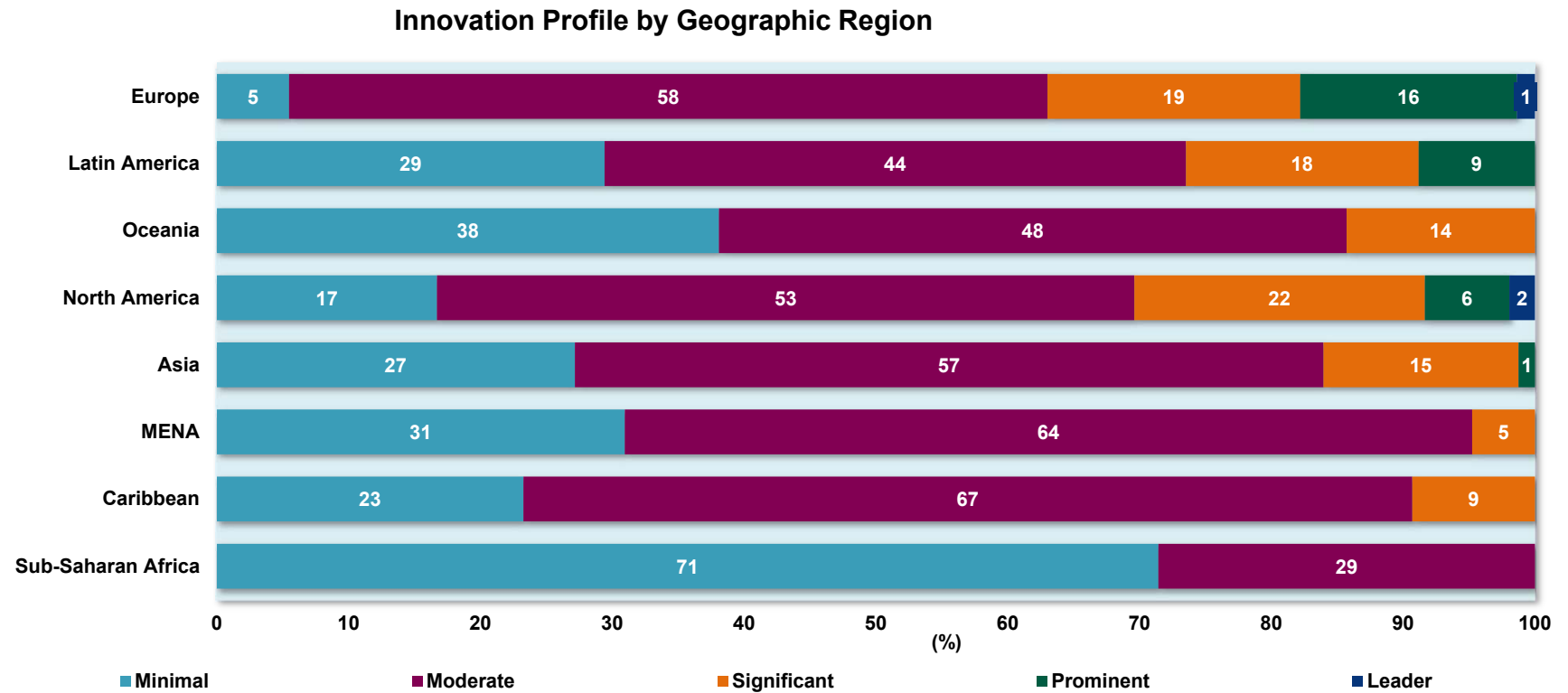


Innovation is not just for large companies

Innovation Profile by Financial Size Category

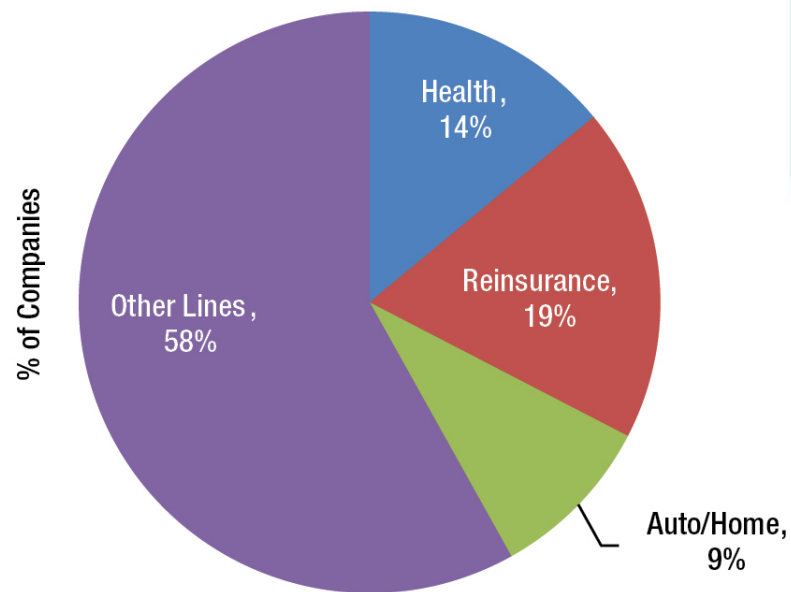


It is a global phenomenon



Lines leading the innovation push

Lines of Business Most Transformed by Innovation



Third-party capital,
insurance-linked
securities and
sidecars

Data-driven product
design, risk
selection and pricing

Vertical integration

Source: AM Best data and research

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&
A

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Associate Director,
Analytics, AM Best

Performance Assessments for Delegated Underwriting Authority Enterprises

Mahesh Mistry – Senior Director, Criteria Research & Analytics

Myles Gould – Director, Analytics

**AM Best's Europe Insurance Market Briefing &
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Latest Status

Launched by AM Best to provide Performance Assessments on Delegated Underwriting Authority Enterprises (DUAEs) globally

Methodology released for comment in March 2021

Received extensive feedback from market participants (DUAEs, insurance carriers, brokers, regulators, associations)

Currently undergoing beta testing to refine processes and information requirements

Methodology in process of being updated

Expected to go live early 2022

What is a Delegated Underwriting Authority Enterprise (DUAЕ)?

- AM Best defines a DUAЕ as a third party entity that is appointed by a (re)insurer, through contractual agreements, to perform underwriting, claims handling, and/or administrative functions on behalf of their carrier partners
- Typically carried out by insurers, DUAЕ's functions can include:

**Binding
coverage**

**Underwriting
and pricing**

**Settling
claims**

**Appointing
retail and
commercial
agents**

**Access to
niche
segments
and markets**

- The DUAЕ manages all or part of the insurance business of an insurer and acts as an insurance agent or broker for the insurer, while working as the intermediary between insurers and agents, and/or insured

What is a Delegated Underwriting Authority Enterprise (DUAЕ)?

DUAЕ is used as a blanket term to capture:

- Managing General Agents (MGAs)
- Managing General Underwriters
- Coverholders
- Program Administrators
- Program Underwriters
- Underwriting Agencies
- Direct Authorizations
- Appointed Representatives

What is a Performance Assessment (PA)?

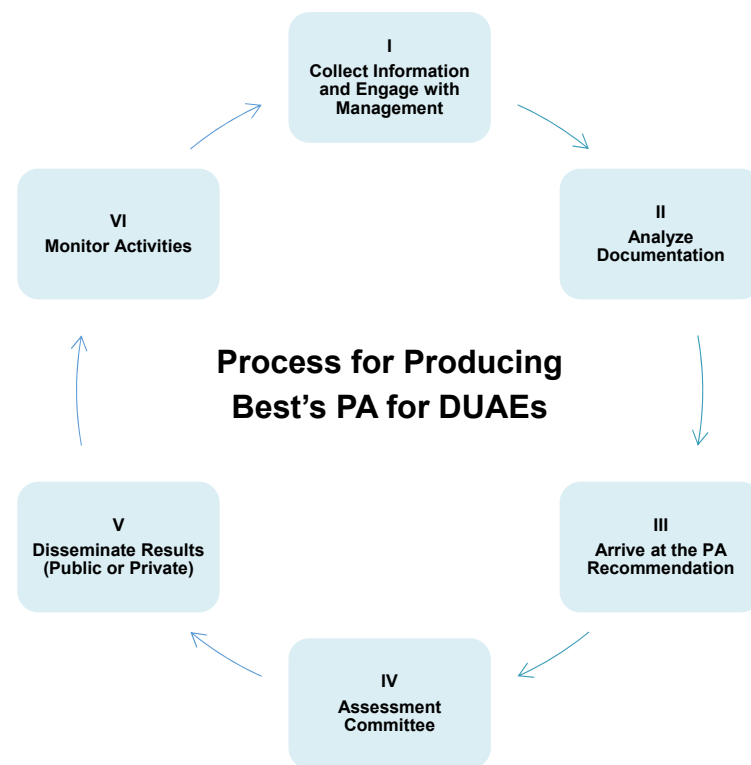
A measurement of the relative ability of an enterprise to perform services on behalf of insurance partners

Key components are assessed and assigned points based on the entity's performance

The summation of the points from each key component determines the Assessment Range which translates into the Performance Assessment

Best's Performance Assessment (PA) for Delegated Underwriting Authority Enterprises (DUAEs)

- Interactive process entails gathering information, engaging with clients (through a formal management meeting), assessing key factors, followed by an assessment committee, and public dissemination (if client agrees), and finally a Performance Assessment Report
- There are outlooks associated (Positive, Stable, and Negative) with the assessment. The DUAЕ can be placed under review
- There is no termination period, with ongoing surveillance of the DUAЕ
- Any withdrawal of a PA from the process will need a final assessment



Consideration – Legal Entity vs. Group Structure View

Performance Assessments (PAs) are typically assessed on a legal entity basis

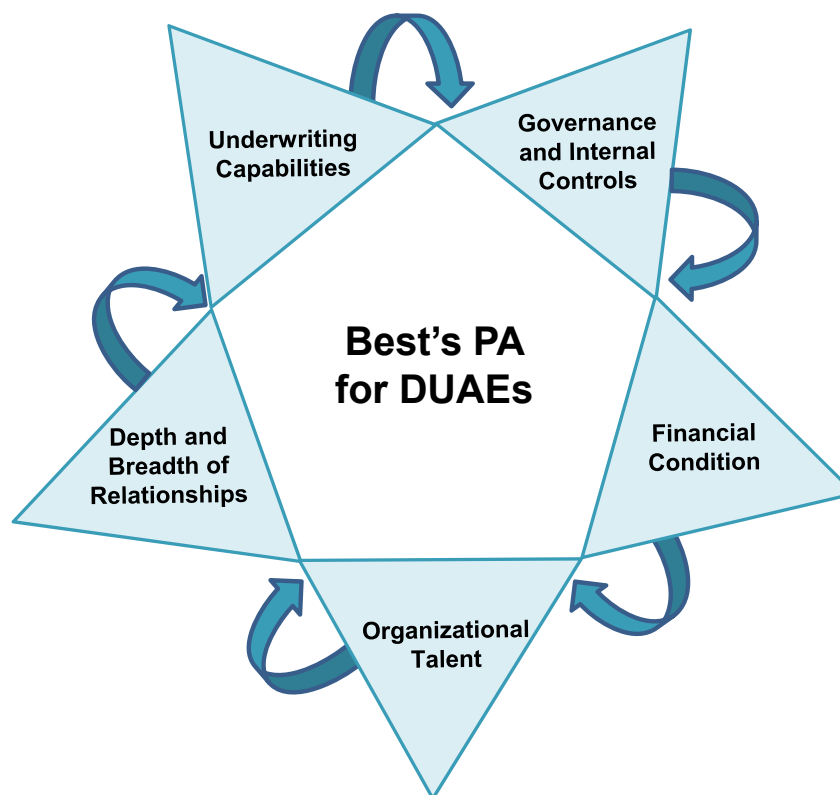
For a group with multiple legal entities (DUAEs), the assessment may be performed on each entity individually

Certain synergies amongst members of the enterprise may be recognised in the analysis of the key assessment factors

In certain cases, there may be significant commonalities and/or strategic rationales which may lead AM Best to take a group view

PAs may be higher or lower than the groups view to recognise any other strengths or weaknesses that are inherent in the DUAE

Best's Performance Assessments for DUAEs – The Five Components



Performance Assessments for DUAEs Components

Key Assessment Factor	Max Points
Underwriting Capabilities	10 (steps of 2)
Governance and Internal Controls	10 (steps of 2)
Financial Condition	10 (steps of 2)
Organizational Talent	5
Depth and Breadth of Relationships	5

A higher overall number of points indicates the DUAЕ's relative ability to perform services on behalf of its insurance partners through:

- effective business underwriting
- strong financial condition
- excellent access to business
- high-level service
- strong business relationships and governance

Best's PA for DUAЕs = Underwriting Capabilities + Governance and Internal Controls + Financial Condition + Organizational Talent + Depth and Breadth of Relationships

*** Underwriting Capabilities, Governance & Internal Controls and Financial Condition have twice the weight of other components**

Performance Assessments for DUAEs – Final Outcome

Assessment Categories	Assessment Symbols	Assessment Ranges
Exceptional	PA-1	34-40
Excellent	PA-2	27-33
Strong	PA-3	20-26
Fair	PA-4	13-19
Weak	PA-5	Up to 12

The PA scale outlines the DUAЕ's:

- Relative ability to perform services on behalf of its insurance partners
- **Alignment of interest with business partners**
- Underwriting expertise
- Financial performance indicators
- Appropriateness of governance and internal controls
- Strength of distribution and management expertise

Performance Assessments for DUAEs – Assessing Key Components

Underwriting Capabilities

Assessment	Points
Exceptional	10
Excellent	8
Strong	6
Fair	4
Weak	2

Sub-assessment Factors

- Quality of underwriting
- Underwriting results
- Underwriting competitive advantage
- Proprietary data and analytics
- **Commission structures**
- Claims management
- Experience of underwriting staff
- Technology in the underwriting process
- Limitations on exceptions/risk appetite
- Participation in profit sharing

Performance Assessments for DUAEs – Assessing Key Components

Governance and Internal Controls

Assessment	Points
Exceptional	10
Excellent	8
Strong	6
Fair	4
Weak	2

Sub-assessment Factors

- Alignment of interests
- Systems infrastructure / platforms
- Audits and other management reports
- Policies and procedures
- Disaster recovery plan
- Key person risk plan
- Service measures
- Binding contracts
- Broker contracts
- Partnerships with TPAs

Performance Assessments for DUAEs – Assessing Key Components

Financial Condition

Assessment	Points
Exceptional	10
Excellent	8
Strong	6
Fair	4
Weak	2

Sub-assessment Factors

- Review of financial statements
- Cash-flow evaluation
- Stability and sources of income
- Leverage/coverage measures
- Presence of borrowings
- Financial strength and impact from related parties
- Service Commitments
- Premium Trust Funds

Performance Assessments for DUAEs – Assessing Key Components

Organisational Talent

Assessment	Points
Exceptional	5
Excellent	4
Strong	3
Fair	2
Weak	1

Sub-assessment Factors

- Relative to size and complexity
- Tenure
- Training programs
- Management expertise
- Organisational structure

Performance Assessments for DUAEs – Assessing Key Components

Depth & Breadth of Relationships

Assessment	Points
Exceptional	5
Excellent	4
Strong	3
Fair	2
Weak	1

Sub-assessment Factors

- Strength of distribution model
- Effectiveness of programs and markets
- Consistency of relationships
- Geographic reach
- Retention of clients

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Maresh Mistry

**Senior Director, Criteria
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AM Best**

Myles Gould

Director, Analytics, AM Best

Q&A Interactive Panel Discussion

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