



Why you can't compare apples and oranges

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AM Best maintains an ongoing dialogue with clients and users regarding its rating process, including the differences between insurance impairments and defaults, traditionally used to compare ratings. Most critically, we observe that impairment rates for insurers are much higher than default rates. In considering default statistics, the definition of default and initial sample set being tested are critical considerations. One can't merely acknowledge there is a difference and then ignore the difference while purporting to provide the full story. Our position is that it is not possible to compare apples and oranges, that impairments and defaults are not one and the same, and that the numbers are certainly not comparable.

AM Best has a long and established track-record and expertise in the insurance sector to analyse and assess the risks inherent in an insurance company. Rather than applying a cap to a rating without due consideration of an individual organisation's profile, we believe true analysis of a company's risk is a more appropriate approach. We see no analytical justification that start-up ratings should be capped at bbb+. There is no statistical evidence to support such a rating cap or any suggestion that start-ups have a default or impairment record that is consistent with a bbb+ or below.

It is also a myth that all start-ups receive an AM Best A-. In some cases our ratings, often unpublished, are more conservative than those given by other rating agencies.

Furthermore, while the ability of an insurance company to pay its obligations is influenced by its country of domicile's sovereign rating, we do not believe applying a cap for an insurance rating at the sovereign is appropriate. There have been several instances of sovereign defaults where the insurance market has continued to function. AM Best was the first rating agency to set out the reasons why a hard cap was unsuitable, with another rating agency subsequently adopting that methodology.

Finally in its recent study of rating equivalence within the European framework, the European Insurance and Occupational Pensions Authority (EIOPA) concluded that A- level ratings from the major rating agencies are equivalent. We anticipate the National Association of Insurance Commissioners (NAIC) will also maintain its conviction and continue to base its "Secure 4" credit risk-based capital charges on an A- from NRSRO rating agencies.

A.M. Best continues to believe that the use of statistics and rating methodology is best discussed in a format where the key issues can be questioned and reviewed, and we will be doing so, where necessary, including in our meetings throughout this week.

See appendix 4 on "The Truth Behind Insurance Impairment & Corporate Default Studies" in our new *Global Reinsurance Report* Sept 2016