

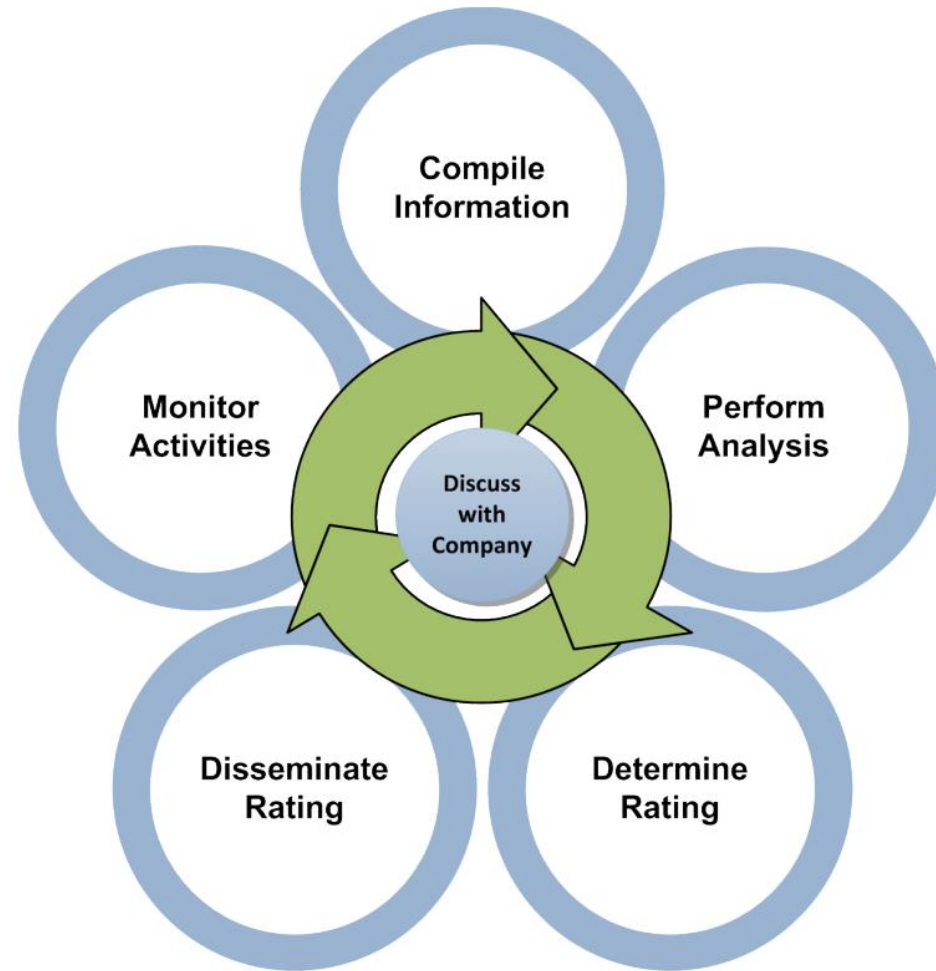
Open Meeting of the Advisory Committee on Risk-Sharing Mechanisms

Stefan Holzberger – Chief Ratings Officer, AM Best
Michael Lagomarsino – Senior Director, AM Best

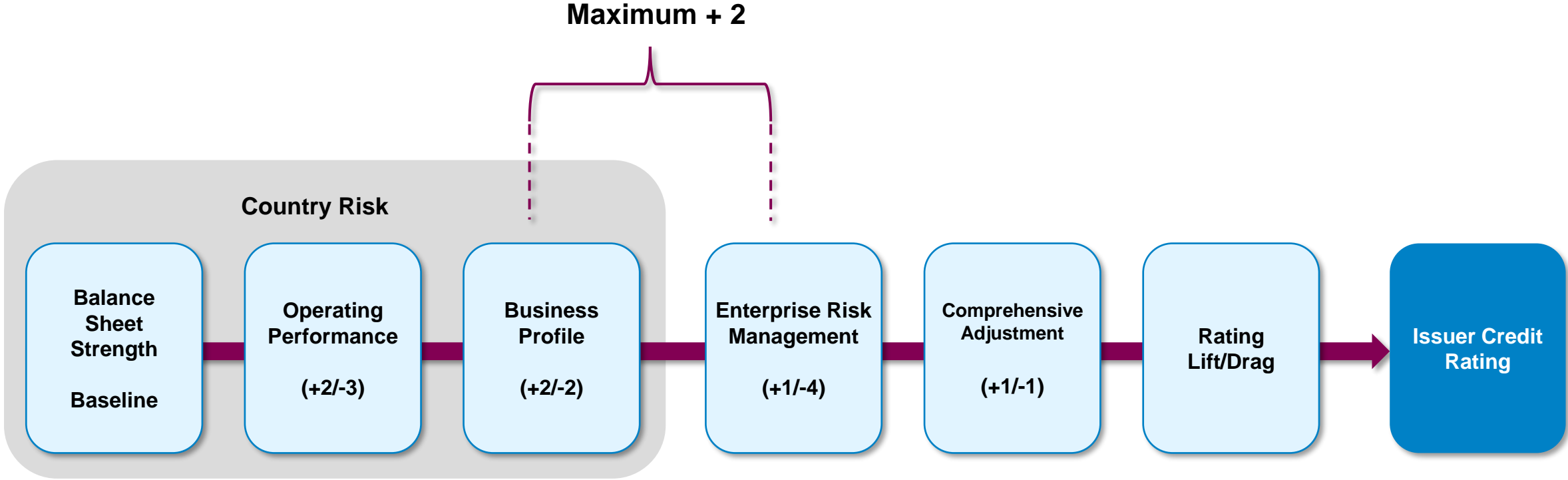
February 1, 2024

AM Best's Ratings – The Interactive Rating Process

- The foundation of the rating process is an ongoing dialogue with the rated company's management
- Ratings are determined by a rating committee
- Ratings process outlined in Best's Credit Rating Methodology (BCRM)



Building Block Approach



Underwriting affirmative cyber, where material, impacts multiple building blocks and financial strength.

Rating Considerations for Affirmative Cyber

Balance Sheet Strength	Operating Performance	Business Profile	Enterprise Risk Management
<ul style="list-style-type: none">• Risk-adjusted capitalization• Cyber modelling• Stress testing• Reinsurance• Reserve adequacy• Liquidity	<ul style="list-style-type: none">• Underwriting & earnings volatility• Business plans and assumptions• Track record	<ul style="list-style-type: none">• Product concentration risk• High product risk• Limits offered• Industries covered• Management expertise	<ul style="list-style-type: none">• Risk appetite & tolerances• Risk aggregation• Risk management capabilities• Stress testing

Incorporating Catastrophe Risk & Stress Testing Into the Ratings Process

Why Incorporating Catastrophe Risk & Stress Testing is Necessary?

Effectively managing exposure to catastrophe events is essential to protecting and preserving balance sheet strength

Catastrophes – both natural and man-made – can abruptly impair an insurer

Stress Testing allows AM Best to capture the uncertainties inherent in an insurer's operations and business plans



Catastrophe Risk

Rating Considerations

Aggregate exposure

Deterministic scenarios

Modelled PMLs

Management's view

Historical losses

Examples

Natural catastrophes

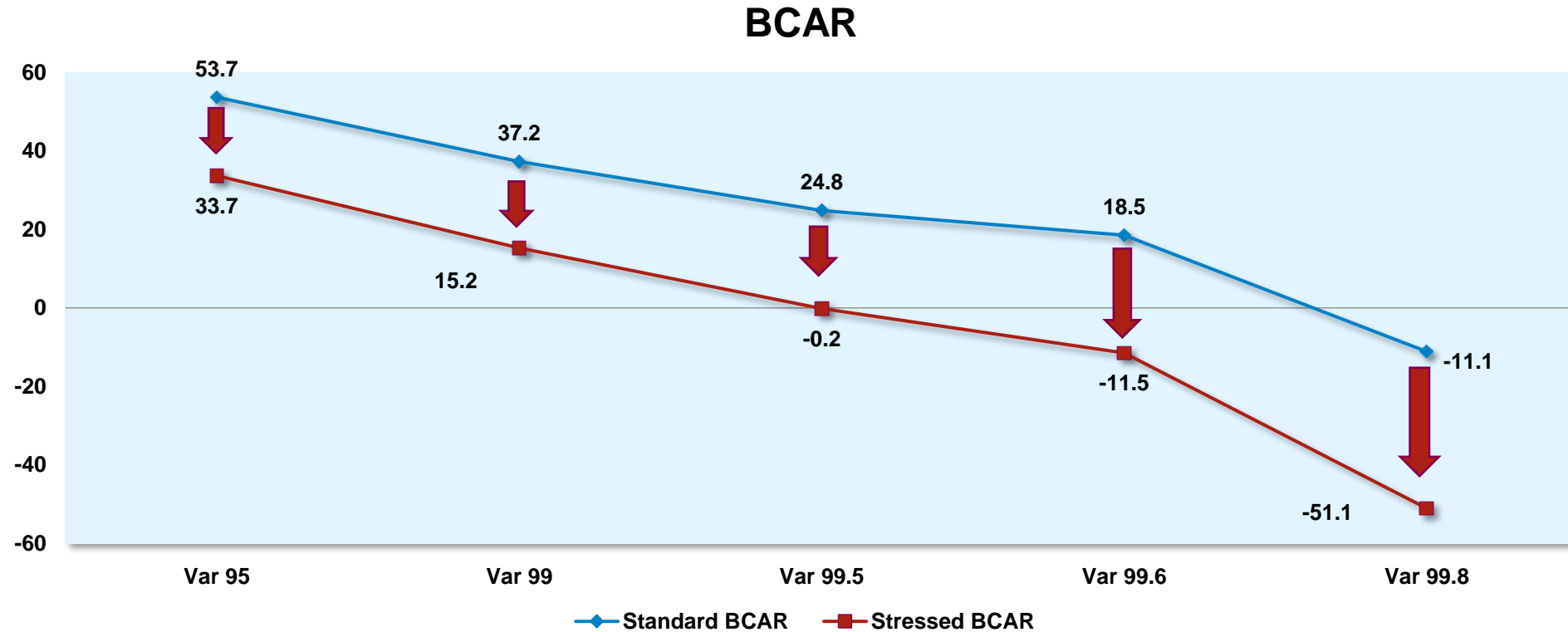
Terrorism exposure

Casualty clash

Cyber catastrophe

Stress Testing Risk Adjusted Capital

- Used in Balance Sheet Strength and ERM assessments
 - Natural catastrophe, terror, surety, pandemic, cyber, other



AM Best's Cyber Questionnaire

AM Best's Cyber Questionnaire

ERM & Cyber Strategy

- Nature of the portfolio
- Cyber risk appetite and underwriting strategy
- Reinsurance (traditional and non-traditional)
- Use of third parties

Profile & Performance

- Types of coverage offered
- Limits & retention levels
- Types of insureds & geographies
- Loss ratios, number of claims paid versus reported

Balance Sheet

- PMLs
- Deterministic scenarios
- Capital Stress

How Companies are Managing Cyber Risks

How Companies are Managing Cyber Risks

- Managing exposure through underwriting and risk transfer
 - Policy wording (i.e., war exclusions, addressing “silent” cyber)
 - Coverage terms and conditions
 - Utilizing vendor tools
 - Assessing aggregation risk
 - Risk transfer through cyber reinsurance treaties

- Cyber specialists: real-time exposure monitoring

- Cyber models continue to mature

- Data quality and consistency continue to improve

AM Best's Thoughts on a Government Backstop

Government Backstop – Potential Benefits & Challenges

Potential Benefits

- Avoids lengthy economic downturn and financial market volatility
- Promotes improved cyber hygiene and enhanced risk management capabilities
- Leads to greater take-up rates for cyber cover while attracting reinsurance capacity
- Promotes consistency in policy wording
- Broad definition of triggering events and clear certification process
- More permanent the backstop the better
- Program trigger designed to protect insurers of all size

Challenges & Possible Pitfalls

- Leads to lax cybersecurity by insureds
- Removes incentives of insurers to continue to push for stronger cyber hygiene
- Impedes the development of new or redesigned cyber insurance products and solutions
- Motivates threat actors to exploit vulnerabilities knowing the federal government will indemnify losses

Q&A

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