Technology and innovation continue to change the world around us, creating both opportunities and new challenges for the (re)insurance industry. Advances in risk quantification such as predictive analytics and capital modeling, to name a few, are changing the way we underwrite, price and manage risk. Similarly, technology is allowing A.M. Best (Best's) to advance the analytics of risk supporting its assessment of balance sheet strength. Taking advantage of stochastic modeling technology, the evaluation of risk within Best's capital model is undergoing a fairly substantial overhaul to broaden the lens used to analyze risk relative to capital. The technology allows efficient production of multiple capital metrics adjusted for a range of risk levels rather than risk represented by just one data point, providing deeper insights into balance sheet strength, risk profile and risk appetite. The benefit of this overhaul will be a rating that provides greater differentiation among companies, a more informed dialogue around capital versus risk and a more concise measure of “excess” or “deficient” capital. This new lens on capital will significantly influence the way (re)insurers view, measure, communicate and possibly even manage risk.

As the only rating agency dedicated to the (re)insurance industry, Best’s maintains coverage on the widest spectrum of insurers and reinsurers and oftentimes serves as a catalyst for change across the industry. With over 4,000 ratings, modernizing the foundation of Best’s balance sheet strength evaluations will undoubtedly have broad industry and specific sector implications. Furthermore, for many insurers, the Best’s Capital Adequacy Ratio (BCAR) model represents one of the key considerations in capital management decisions and very often the most stringent capital hurdle faced. Understanding the changes and preparing for the transition are extremely crucial as decisions made today may have different capital consequences in the future. As the late, great, Yogi Berra once said, “The future ain’t what it used to be.” Never has that been a more appropriate statement.

For several years, Best's has been communicating plans to modernize its BCAR model, a key component in the overall determination of balance sheet strength within the rating process. This upcoming change represents arguably the most profound update to the model since its first introduction in the early 1990s. Using stochastic modeling to inform its views on potential risk outcomes, Best's is able to efficiently expand its views of capital adequacy to produce capital strength metrics at various confidence levels. The result will be five risk adjusted capital “scores” reflective of increasing degrees of modeling confidence, effectively creating a unique capital fingerprint for each company. This capital fingerprint, or “capital-print” will show the sustainability of capital across the spectrum of confidence levels, becoming a new standard in evaluating and communicating balance sheet strength. Higher rated companies will be expected to hold adequate levels of capital at higher confidence levels, but all companies will be evaluated to some degree across the whole “capital-print” spectrum.

The impact on the (re)insurance sector from the proposed BCAR changes will vary quite a bit by company and sector. For some companies, it will reinforce the strength of capital relative to risk, conservative capital management strategies and risk appetite. For others, it may have a more meaningful influence on strategic initiatives, reinsurance strategy, business plans or historical capital management practices. Universally, it will foster a review and adaptation of internal enterprise risk management (ERM) strategies, controls and procedures that have a direct or indirect link to BCAR. Some examples include:

- Capital management tools
- ERM documents
- Risk tolerance thresholds.

For companies in the early stages of ERM formalization, this change should be considered in the developmental plans, while recognizing its adoption is not immediate and the current BCAR model should still be considered the primary target benchmark. For companies further along in their ERM formalization, this change will need to be incorporated into those processes, ensuring the new view of capital remains consistent with formalized and approved risk management controls and procedures, for example, confirming previously developed net risk tolerance levels as still appropriate under Best’s new perspectives on capital relative to the company’s rating and profile.

No matter how this change affects your company, Guy Carpenter is uniquely positioned with the people, tools and innovative thinking necessary to help clients navigate and manage the uncertainty of a changing world, regardless of the source. With our integrated Rating Advisory, Capital Modeling and ERM suite of tools and services, Guy Carpenter offers customized solutions that help clients reach their short- and long-term goals regardless of the challenges faced.