

Ratings Review  
January 24, 2019

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**Changes in  
balance sheet  
strength have  
been a key  
driver for  
rating actions**

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## CIS Insurers Navigate Geopolitical Instability and Regulatory Changes

Insurers in the Commonwealth of Independent States (CIS) face volatile operating environments and geopolitical instability in the region. In particular, the fresh round of sanctions introduced by western countries against Russia in 2018 has caused further uncertainty with regard to the region's prospective insurance development, in view of Russia's significant economic presence there. Whilst the overall economy for the CIS improved in 2018 compared to prior years, in which it was adversely affected by the low oil prices and financial sector reforms, challenges for the insurance sector remain.

AM Best rates a number of companies based in Kazakhstan, Russia and Azerbaijan and monitors insurance and economic trends in these and other CIS countries. AM Best notes that insurers in the region are contending with an evolving regulatory environment, limited investment options and currency fluctuations. As local regulators make progress towards risk-oriented supervision, companies are faced with additional costs and operational hurdles adjusting to the new regimes. This process can be especially difficult, given that the enterprise risk management (ERM) practices in the region are still emerging.

The insurance markets in the CIS are generally small, with very low penetration rates. For example, in Russia, gross written premium as a percentage of gross domestic product was only 1.4% in 2017, according to the Swiss Re Institute's sigma report. Government and legislative influence on product design, pricing, distribution, and even ownership of companies is often significant in these marketplaces, and (re)insurers are therefore subject to heightened political and regulatory risk. However, AM Best notes that some local regulators are taking steps towards gradual liberalisation of insurance tariffs, as is the case with compulsory motor third-party liability (MTPL) business in Russia.

Investment options are generally limited as capital markets are relatively underdeveloped in these countries, compared to western economies. Consequently, credit quality tends to be weak and local (re)insurers' investment portfolios can be concentrated, including in affiliated assets. On a positive note, portfolios are usually weighted towards conservative asset classes, such as fixed-income securities and bank deposits.

AM Best notes that some companies have a policy of holding foreign currency assets to hedge against currency devaluations and high inflation – factors that can have a negative impact on their technical results. Despite significant foreign exchange gains recorded by some market participants in recent periods, AM Best is cautious about this strategy, particularly in view of the limited risk controls around asset/liability management in the region.

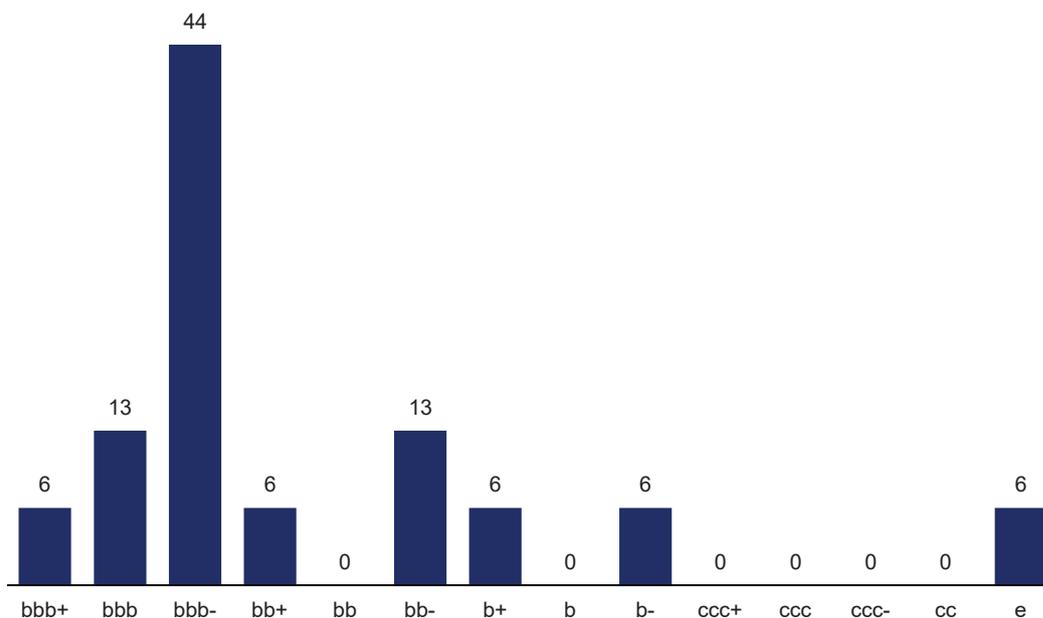
In AM Best's view, regulatory developments can be both positive and negative. There are some attempts by regulators to improve capital standards and underwriting controls. For example, the Kazakh insurance regulator, the National Bank of Kazakhstan (NBK), has been focusing its attention in recent years on insurers' capital adequacy, the quality of reinsurance protection, maximum and minimum underwriting limits, as well as the quality and diversification of investment holdings. Measures have also been taken to improve ERM standards in Kazakhstan.

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**Exhibit 1**  
**Best's Issuer Credit Rating – Commonwealth of Independent States – Distribution Dec. 31, 2018**  
 (%)



Notes: AM Best's nine Issuer Credit Rating categories from "aaa" to "ccc" include rating notches "+" or "-" to reflect gradation within the category. This provides an indication of whether credit quality is near the top or bottom of that category. For further details of how AM Best's Issuer Credit Rating Scale translates into its Financial Strength Ratings, please visit [www3.ambest.com/ambv/ratingmethodology/](http://www3.ambest.com/ambv/ratingmethodology/)  
 Source: AM Best data and research.

In general, the country's insurance regulation is evolving rapidly with certain rules being subject to frequent modification, which can lead to operational strains and earnings volatility as local companies continually adapt to changing requirements.

A feature that has been particularly apparent in the CIS countries has been industry consolidation. Mergers and acquisitions (M&As) have been driven in part by certain companies aiming to achieve the critical mass needed to operate efficiently, as well as in some instances, consolidation by banks, which own insurance companies. The typically high costs of sourcing insurance business in the CIS, combined with relatively high claims inflation, has put pressure on technical results. A number of companies have sought to achieve economies of scale through acquisitions in an attempt to reduce their operating expenses and improve profitability. At the same time, increased regulatory oversight has resulted in some companies voluntarily exiting the market, leading to higher industry concentration – especially amongst the largest players.

As of December 31, 2018, over a third of rated insurers in the CIS region had their AM Best Issuer Credit Ratings (ICRs) in the range of “bb+” and below (see **Exhibit 1**). These companies' ratings tend to be constrained by their marginal performance, deficiencies in ERM or relatively low levels of risk-adjusted capitalisation. In contrast, the higher-rated entities with ICRs of “bbb-” and above are characterised by features such as consistently good performance or established market positions.

Approximately half of rating actions in 2018 were affirmations (see **Exhibit 2**). This compares to Western Europe and the Middle East and North Africa (MENA) region where affirmations

respectively represented 89% and 77% of ratings in 2018.

Upgrades and downgrades were a relatively small part of the change in CIS ratings in 2018. An upgrade of the ratings of one company was based on sustained improvement in its risk-adjusted capitalisation. Meanwhile negative rating actions, which included rating downgrades and revisions of rating outlooks to negative, reflected factors such as deterioration of the companies' balance sheet strength and uncertainty regarding the sustainability of underwriting performance.

Under review rating actions comprised 18% of rating actions in 2018, highlighting the volatility that exists in these markets (see **Exhibit 3**). The reasons for moving to an under review

status included announced M&A transactions and the implications they may have on entities' risk-adjusted capitalisation and other rating factors. Additionally, AM Best issued comments on some entities in response to company-specific events, which were deemed material but were not expected to have an impact on the companies' ratings (see **Exhibit 4**).

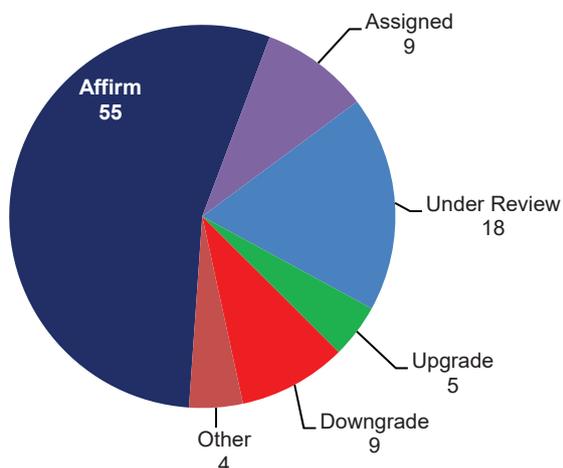
In the CIS, changes in balance sheet strength have been a key driver for rating actions as risk-adjusted capitalisation is susceptible to volatility due to local (re)insurers' exposure to high investment market risk and the small capital bases of some participants. In general, rating factors that had a negative impact on local companies' ratings in 2018 included rapid premium growth, susceptibility to changes in the operating environment and, in some cases, inconsistent business strategy.

**Conclusion**

Looking ahead, AM Best expects further market consolidation in the CIS, as companies seek to improve efficiency and strengthen their business profiles. Smaller players are likely to face challenges in sustaining their technical margins and capital strength in a difficult operating environment, whilst larger participants with established brands and good internal risk controls are more likely to withstand volatile market conditions and increased regulatory scrutiny.

At the same time, as regulation becomes stricter, AM Best expects gradual market standardisation and an overall improvement in risk management capabilities across the region. Over the longer term, this should increase local (re)insurers' resilience to adverse market fluctuations.

**Exhibit 2**  
**Commonwealth of Independent States – Best's Issuer Credit Rating Actions (2018)**  
 (%)



Source: AM Best data and research.

## Exhibit 3

## Commonwealth of Independent States – AM Best Rating Actions (2018)

AMB #	Company Name	Domicile	Best's Long-Term Issuer Credit Rating (ICR)	Best's Financial Strength Rating (FSR)	Best's ICR & FSR Action	Best's ICR & FSR Outlook	Rating Effective Date
91215	Halyk-Kazakhinstrakh Ins Sub	Kazakhstan	bbb	B++	Affirm	Stable	18-Jan-18
92573	JSC Salem Insurance Company	Kazakhstan	ccc+ u	C	Under Review	Negative	19-Jan-18
91215	Halyk-Kazakhinstrakh Ins Sub	Kazakhstan	bbb u	B++ u	Under Review	Negative	6-Feb-18
93787	AzRe Reinsurance OJSC	Azerbaijan	bbb-	B+	Affirm	Stable	9-Feb-18
95015	PASHA Insurance OJSC	Azerbaijan	bbb-	B+	Affirm	Stable	23-Feb-18
92573	JSC Salem Insurance Company	Kazakhstan	e	E	Other	N/A	15-Mar-18
92524	Nomad Insurance Co JSC	Kazakhstan	b+	C++	Downgrade	Negative <sup>1</sup>	6-Apr-18
92322	Kommesk-Omir Insurance Co JSC	Kazakhstan	bb-	B-	Upgrade	Stable	18-Apr-18
90884	JSC Insurance Company Centras	Kazakhstan	b-	C+	Affirm	Stable	19-Apr-18
78919	Insurance Company of Gaz Industry SOGAZ	Russia	bbb u	B++ u	Under Review	Developing	1-Jun-18
93079	Standard Insurance Company JSC	Kazakhstan	b+	C++	Affirm	Stable	1-Jun-18
93079	Standard Insurance Company JSC	Kazakhstan	nr	NR	Withdraw	N/A	1-Jun-18
78331	Eurasia Insurance Company JSC	Kazakhstan	bbb+	B++	Affirm	Negative <sup>1</sup>	29-Jun-18
92467	Victoria Insurance Company JSC	Kazakhstan	bbb-	B+	Affirm	Negative	13-Jul-18
78871	Russian Reinsurance Co JSC	Russia	bb+	B	Assigned	Stable	10-Aug-18
91331	Halyk-Life, Life Insurance Sub	Kazakhstan	bbb- u	B+ u	Under Review	Developing	17-Aug-18
86892	Ingosstrakh Insurance Co PJSC	Russia	bbb-	B+	Affirm	Stable	24-Aug-18
90886	JSC IC Kazkommerts - Policy	Kazakhstan	nr	NR	Withdraw	N/A	7-Sep-18
93287	Nomad Life Ins Co JSC	Kazakhstan	bb-	B-	Affirm	Stable	5-Nov-18
93787	AzRe Reinsurance OJSC	Azerbaijan	bbb-	B+	Affirm	Stable	13-Dec-18
91215	Halyk-Kazakhinstrakh Ins Sub	Kazakhstan	bbb	B++	Affirm	Negative	14-Dec-18

Notes: 1: FSR Outlook: Stable

Source:  Best's Statement File - Global, AM Best data and research

## Exhibit 4

**Commonwealth of Independent States – AM Best-Rated Companies – Comments (2018)**

<b>AMB #</b>	<b>Company Name</b>	<b>Domicile</b>	<b>Date</b>	<b>AM Best Comment</b>
92322	Kommesk-Omir Insurance Co JSC	Kazakhstan	24-Jan-18	Ratings unchanged following Jan. 15, 2018 announcement of agreement with JSC Salem Insurance Co to acquire part of the latter's underwriting portfolio.
90886	JSC IC Kazkommerts - Policy	Kazakhstan	6-Feb-18	Ratings unchanged following Jan. 25, 2018 announcement by its sister company, Halyk-Kazakhinstrakh, Insurance Subsidiary Company of Halyk Bank of Kazakhstan, JSC of the latter's shareholder agreement to merge Kazkommerts-Policy into Kazakhinstrakh.
91215	Halyk-Kazakhinstrakh Ins Sub	Kazakhstan	7-Sep-18	Following the close of the merger transaction between Halyk-Kazakhinstrakh, Insurance Subsidiary Company of Halyk Bank of Kazakhstan, JSC and JSC IC Kazkommerts-Policy on Aug. 29, 2018, AM Best announced that it would evaluate the impact of the transaction on Kazakhinstrakh's Credit Rating fundamentals. This was completed on Dec. 14, 2018.

Source:  Best's Statement File - Global, AM Best data and research

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**Best's Issuer Credit Rating (ICR):** an independent opinion of an entity's ability to meet its ongoing financial obligations and can be issued on either a long- or short-term basis.

**Best's Issue Credit Rating (IR):** an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis (obligations with original maturities generally less than one year).

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