



Interview with José Sanchez Crespo General Manager of AM Best Europe Ltd.

«The driving force behind a company is its quality»

AM Best's purpose has not changed since it was set up in 1899 in the USA. It is today the only rating agency exclusively specialised in offering insurance industry information and ratings. In order to do this, in addition to its home country, it has a presence in Canada, Hong Kong, and, for the last five years, in London, which is its base for the European market. José Sanchez Crespo heads the team in charge of setting ratings for European companies, and in this interview explains his work and the way he sees the market.



José Sanchez Crespo was born in Madrid on January 29, 1967. He has a degree in law awarded by the Universidad Autónoma of Madrid and an MBA that he studied in London. He is an associate member of the Institute of Risk Management of the United Kingdom. After completing his university studies he started to work as a lawyer in 1990. After forming part in Spain of a legal consulting group specialised in financial matters he decided to move to London where he set up residence. Here he specialised in insurance as a consultant for Tillinghast. He was later recruited by Standard & Poor's where he became the head of the insurance and financial services division. He then joined AM Best as general manager of the rating team.

Question: The financial rating awarded by rating agencies is becoming increasingly important, but what is a rating? How and where do these types of services arise? What differences are there between AM Best and other agencies like Moody's, Standard & Poor's or IBCA?

Answer: A rating is an opinion on a company's credit profile, not a product. It is an element of analysis. With regard to the history of rating agencies, they were all formed many years ago in

the United States and were associated with a certain sector in order to compile information, but with the years, and for commercial or economic reasons, they then moved on to specialise in credit analysis of the various sectors. When required, the information that has been obtained serves as the basis on which to give an opinion on the financial status of the companies. It is not necessary for the rating to be published, but in the North American market the whole world revolves around ratings and

many companies even have various of them.

Each company has its own criteria for making assessments. We are different because of our specialisation. We are the only rating agency specialised in one single sector and have been true to our roots since 1899. This specialisation in the insurance sector for more than a hundred years has brought us to the position where now we have around 700 professionals exclusively dedicated to the insurance industry, this gives us the advanta-



ge of having extremely reliable information available, above all in the North American market where AM Best is the leading company in the sector. Another important distinguishing aspect is that we are one of the few rating agencies to continue in private hands. This trueness to our roots, and the fact that there are no commercial pressures means that our ratings continue to be "an independent opinion".

Q: What is AM Best's working process in order to arrive at a rating?

A: Principally, it is important to form an opinion as to a company's capacity to meet its liabilities. The rating should be market-orientated and determine where the companies are and where they are going. In order to do this we base our opinions on various analyses which might be defined as a study of the market profile and product distribution; a study of economic profitability, differentiating between technical profitability and total profitability; a study of financial strength, encompassing capital, reserves, investments etc. In summary, we analyse various aspects, both qualitative and quantitative, and we try to understand the quality of the company's management team and the viability of its strategy, which in the end is the company's driving force.

Nobody wants to be needlessly evaluated. In the case of Europe, the ratings tend to be led by reinsurance and these are followed by insurers underwriting large risks. Risk managers and brokers want to know whom they are working with.

Q: With regard to solvency, what differences would you make between the European and the North American markets?

A: We should talk about a global market in reinsurance and insurance - even more so in the case of reinsurance - which uses similar parameters on both sides of the Atlantic. From my point of view, Europe is managing to develop on its own, and a very im-

portant role in this will be taken by the Basle agreements applied to insurance, which have become known as solvency II, which are based on the concept of *basic risk capital*, or, in other words, on how much capital is needed with respect to the risk (assets, underwriting, investments, management, etc) which has been accepted by the company. This new viewpoint will mobilise the whole industry, stimulating insurers to maintain assets that are appropriate to their activities. Until now one of the advantages of the North American market was the homogeneity of the accounting norms. The coming into force however of international accounting guidelines, NIC-IAS, will contribute to greater homogenisation and, in a few years, the market will be even more globalised. There can evidently not be total homogenisation because characteristics relating to each culture must be taken into account. There will be certain decisive elements, such as mortality rates for life insurance, which will be different for each country depending on various factors such as education, diet, cultural habits, etc. Homogenous accounting norms will be achieved in Europe in the same way that today there is a common currency. All this will contribute to the fact that the European market will take a more important role.

Q: Risks are changing, but so is society's perception of risk. Nowadays people are aware that in addition to property risks, financial risks can lead to drastic changes in their lives. How do you see this situation?

A: This is a very important matter, because society is facing the appearance of new risks and those that are considered traditional are changing in magnitude, with technology, with liabilities with respect to the activities of people or companies. There is a greater awareness of risks and prevention. There is no doubt however that not all countries are faced with the same risks, or at least they

do not do it with the same priority. A clear example of this would be the approach taken with regard to the prevention of some catastrophic risks, since the probability of hurricanes or earthquakes is very different depending on the country. There is a need to protect assets.

Q: What role do the capital markets play?

A: The financial markets have been around for years, and advanced societies have learnt to use them in order to raise financing. The technical advances of the two last decades have been very great, and this has needed a large capital investment. The more advanced insurers are now turning to these markets to transfer capital.

Q: With the incursion of reinsurance in the capital markets through the application of ART (alternative risk transfer) formulas, could it not be that the very essence of a function is being lost a little since, with slight changes, it could also be carried out by other financial players?

A: The business which reinsurance carries out helps to support and understand the risk better on other economic and financial levels. Advice that is given for achieving an optimum protection, including the use of ART types of instruments, is a complementary service. A few years ago there was a *soft* market where the rates were far below what was technically prudent, below what should have been charged in order for the underwriting to be technically profitable. In this environment, the use of alternative solutions to transfer risks (ART) was not attractive from an economic point of view since there was such a high level of competition that reinsurers offered extremely low prices in order to attract business. But with the natural market concentration and raising of rates ART products begin to be attractive. It will be interesting to see the full extent of these initiatives taken by reinsurers,



brokers or even investment banks.

Q: How are these services being offered by rating agencies in Latin America developing and what rating is given to this market?

A: Submitting to an interactive rating is today a voluntary process. The companies that call us in are those that have a relatively stable situation. AM Best has assigned ratings to some ten companies in Latin American and has information available on 95% of the companies that operate in this market. An overall rating of the Latin American markets would however give a slightly distorted vision of reality, because it would be necessary for the majority of companies to submit themselves to rating in order to obtain an idea of the sector's solvency. It should be remembered that the rating does not only measure solvency but also other qualities, because then the companies must grow, in other words

you may have solvency but the company may still stagnate. The rating should establish present and future solvency, where they are going. With regard to this, I should remind you that the development of insurance business develops hand-in-hand with a country's economy.

Q: AM Best has its base for European operations in London, what is the status of this market which some professionals are beginning to compare with the Bermuda market?

A: There is a great disparity in opinions. For example the problems that Lloyd's has been faced with have given rise to a number of throwaway comments that have tarred the whole market. But Lloyd's is a market in itself, and as such has an effect on the London market. Lloyd's continues to be a point of reference for the insurance industry and is, in addition to this, carrying out far-reaching reforms, above all to guarantee its flexibility and ca-

capacity with regard to the future. The interactive rating for the Lloyd's market is A-, and nine months ago we launched a methodology to interactively analyse the syndicates. There are already approximately 10 that subscribe to our services.

Q: How would you assess the consequences of the WTC loss of September 11, 2001?

A: This subject has been written and talked about a lot. The losses associated with the WTC attacks have supposed enormous outflows of capital, the exact extent of which will still take some time to be known. But new capital has also arrived, approximately USD 11 billion (EUR 11.26 billion) has entered the Bermuda market, of this USD 9.6 billion (EUR 9.83 billion) has financed new companies without a past history or liabilities. All this means new capacity. The fact that the market is able to continue attracting capital is good news. ■

THE RISK OF GIVING AN OPINION

Q: Rating agencies take on a great responsibility when giving their opinions. The futures of many people are in their hands, what safety measures do they have in order to avoid making a mistake?

A: Rating agencies constantly have to give opinions. Of course, it is possible to make a mistake, but in order to avoid doing so it is necessary to have all the resources necessary so as to carry out a correct analysis. When an analyst has reached some conclusions he then presents these to a committee that then asks in-depth questions in order to minimise any possibility for error. If the opinion does not have a sufficiently firm base then the committee halts it.

Q: Have the opinions on which the ratings are based been affected by the crisis of confidence surrounding auditors?

A: Despite the fact that they are different activities, the model of a single company that carries out auditing and consulting is in a period of crisis and in fact there is a tendency to separate them, starting with brand image. The object of a rating is to analyse credit, credit solvency, both of insurers that have liabilities with their policyholders and of those that issue debts in the capital market. This is an opinion that may be affected by many factors. At the present time, after the scandals that started with the Enron case, there has been an increase of sensitivity towards risk and the quality of assets. There is a perception that the big players can also get caught out.

Q: What do the various letters that you use in order to rate the solvency of a company mean?

A: Rating agencies have an independent opinion on the probability that a company will not have sufficient capital in order to meet its liabilities, and this is shown by using a scale which in the case of AM Best goes from the highest safety rating of A++ to B+, which is the lowest rating, within certain set safety limits, there are then of course many other letters. Within this world of letters is the one known as AAA, or triple A, which is the scale used by the capital markets and which AM Best uses when referring to debts or an issue of debt, using the same language as is understood by the capital markets. When surveys have been carried out in the United States on the possibility of changing the scale, 89% of respondents indicate that the traditional scale employed by the AM Best is a confidence factor.