A.M. Best's *Introduction to...*

Insurance Ratings – MENA, South & Central Asia

Contents

VASILIS KATSIPIS
General Manager,
Market Development
MENA, South & Central Asia

The emerging markets of Middle East, North Africa (MENA) and South and Central Asia (SCA) continue to provide great growth potential. Favourable demographics, good GDP growth and a low level of insurance penetration are the main drivers for the long-term growth of insurance in the MENA SCA region.

However, growth rates for most of the markets remain subdued, when compared to pre-financial crisis levels. Financial performance has also deteriorated for many of the insurance companies in the market mainly as a result of intensified competition and reducing rates. Regulatory oversight of insurance companies is being strengthened, with several regulators taking new steps to enhance transparency and policyholder protection. Still, this is one area where the emerging markets lag significantly behind the more mature ones.

In this environment, an independent opinion of the strength of the market and its individual participants remains invaluable, and will continue to be fundamental. A Best's Credit Rating provides an authoritative third-party opinion, and helps demonstrate a company's relative ability to honour its obligations to policyholders.

A.M. Best is the oldest and most widely recognised insurance rating agency and the only international rating agency dedicated to the insurance and reinsurance sector, rating more than 3,500 companies in over 80 countries. A.M. Best's rating coverage has been constantly increasing in recent years, and A.M. Best is now the leading rating agency for the MENA SCA (re)insurance markets, rating local, regional and global insurers and reinsurers established in these markets.

The importance of the rating services provided by A.M. Best has been accentuated during the global financial uncertainty which has resulted in heightened sensitivity to credit quality. There is an increased value in having a secure Best's Credit Rating, particularly as our ratings are not derived from sovereign risk ratings which can skew assessments of companies in a particular country. Central to A.M. Best's rating methodology is the ability to differentiate levels of risk exposure among competing insurers in a given market. For this reason, rather than applying a blanket sovereign ceiling to all insurers in a country, A.M. Best uses a stress testing approach.

Our ratings are unique, with specific rating criteria applicable to segments of the market, including captives, takaful insurers, members of groups and new company formations. In 2012, A.M. Best also launched new services, including Best's Rating Evaluation Service (RES), which provides currently rated entities with a confidential opinion of the impact of hypothetical scenarios on a company's rating.

A.M. Best produces leading in-depth research, including special reports and briefings. Last year, to enhance accessibility, a number of market reports were published focusing on most of the MENA markets.

The insurance sector is facing a period of heightened uncertainty but remains paramount for the economic development of the region. A.M. Best looks forward to continuing to work with the industry in this challenging period.

A.M. Best at a Glance

A.M. Best is a leading provider of ratings, financial data and news with a specialist focus on the worldwide insurance industry. Best's Credit Ratings are recognized as the benchmark for assessing the financial strength of insurance-related organizations and the credit quality of their obligations.

- Established in the U.S. in 1899 and pioneered the concept of financial strength ratings in 1906
- Worldwide headquarters in New Jersey, U.S.; regional centres in London (serving Europe, Middle East and Africa), Hong Kong and Singapore (serving Asia Pacific and Oceania), and Mexico City (serving Latin America). Representative office located in Dubai (serving MENA, South & Central Asia)
- Full-service global ratings capabilities
- Over 3,500 ratings in over 80 countries worldwide
- Extensive marketing and publishing capability to promote corporate ratings in local and international markets

Market Coverage

Insurance-related companies operating in various markets, including:

- Property/casualty (non-life) insurers
- Life insurers and annuity writers
- Health insurers
- Reinsurers
- Mutual insurers and Protection & Indemnity (P&I) clubs
- Takaful, Retakaful and co-operative insurers
- Lloyd's and its syndicates
- New company formations ("start-ups")
- Alternative risk transfer (ART) vehicles (including captives, pools and risk-retention groups)
- Catastrophe bond issuers and other Insurance-Linked Securitisations (ILS)

Competitive Strengths

- Only international rating agency dedicated to the insurance industry
- World's leading provider of insurer Financial Strength Ratings (FSRs) by company coverage
- Foremost rating coverage of the global reinsurance segment
- Leading position in international (re)insurance hubs—including comprehensive coverage of Lloyd's/London market, Bermuda, Zurich, Singapore
- Leading rating agency for ART and captives coverage
- Key rating agency used by global broker security teams
- Data and research covering 16,000 (re)insurance companies worldwide
- Largest and most comprehensive insurance database providing unique insights by segment and line of business
- Published rating methodology on all key insurance industry segments

Research & News

- Publishers of frequent specialised reports on global insurance industry issues, including sector, company and geographic regional analysis. Extensive global insurance news delivery and resources

Best's Credit Ratings:
The Global Symbol of Financial Strength

RATING DEFINITIONS

Best's Financial Strength Ratings (FSRs) provide an opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations.

Best's Issuer Credit Ratings (ICRs) provide an opinion of an entity's ability to meet its ongoing senior financial obligations.

Best's Debt Ratings (DRs) provide an opinion as to the issuer's ability to meet its ongoing financial obligations to security holders when due.

A rating by A.M. Best is based on a comprehensive evaluation of an insurance company's financial strength, operating performance and business profile. A.M. Best also regularly publishes Impairment Studies, which evaluate rating performance over time.

BEST'S CREDIT RATING SCALES

Comparison of Financial Strength Rating (FSR) to Credit Market Scale

	FSR	ICR/DR	
Secure	A++	aaa aa+	Investment Grade
	A+	aa aa-	
	A	a+ a	
	A-	a-	
	B++	bbb+ bbb	
	B+	bbb-	

	FSR	ICR/DR	
Vulnerable	B	bb+ bb	Non-Investment Grade
	B-	bb-	
	C++	b+ b	
	C+	b-	
	C	ccc+ ccc	
	C-	ccc- cc	
	D	c	
	E, F	rs	

FSR = Financial Strength Rating
ICR = Issue Credit Rating
DR = Debt Rating

E = Under regulatory supervision
F = In liquidation

BestMark
for Secure-Rated Insurers

The *BestMark* provides a recognisable visual symbol of an insurer's financial strength.

The value of a Best's Credit Rating is enhanced by market penetration. Best's Credit Ratings reach:

- More than 150,000 insurance industry professionals via A.M. Best's publications (*BestWeek*®, *Best's Review*®, *BestDay*®, *BestWire*®)
- Thousands of financial professionals worldwide via news vendors such as Reuters, Dow Jones and NewsEdge
- More than 1,400,000 professionals who have registered to gain access to Best's Credit Ratings online

Best's Credit Ratings and related financial information provide powerful tools for insurance decision making and market research for insurance agents, brokers, risk managers, bankers, insurance executives, policyholders and consumers.

EFFECTIVE: APRIL 18, 2011

Best's Financial Strength Rating

A Best's Financial Strength Rating is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. It is based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile.

Our rating process incorporates specific methodologies designed to address the Property/Casualty (Non-Life) and Life/Health/HMO industry segments, as well as Non-U.S. insurance companies. A complete list of Best's Credit Rating Methodologies is available.

A Best's FSR opinion addresses the relative ability of an insurer to meet its ongoing insurance obligations. It is not a warranty of a company's financial strength and ability to meet its obligations to policyholders. View our Important Notice at **www.ambest.com/ratings/notice.asp for complete details.**

A.M. Best's rating system has a proven track record in indicating insurance companies that may, over time, encounter financial difficulties (see Best's Impairment Studies: Life/Health, Property/Casualty). As such, a Best's FSR is recognized worldwide as the benchmark for assessing and comparing insurers' financial strength. Such a benchmark is increasingly important to an international market that looks for a strong indication of stability in the face of widespread deregulation, mergers, acquisitions and other dynamic factors.

Why a Best's Financial Strength Rating Is Important

For insurance companies, a Best's FSR is a strategic tool that can enhance consumers' confidence in the organization's stability, as well as its attractiveness to investors. A rating also enhances an insurer's credibility with reinsurers - a valuable resource, particularly for insurers entering new markets.

Insurance professionals depend on a Best's FSR to assess the creditworthiness of an insurer's operations, to evaluate prospective reinsurance accounts, to compare company performance and financial condition, and more. A rating can influence an agent's selection of plans to market.

A rating also is an important factor in the consumer's decision-making process to purchase insurance. Today's insurance consumers are well aware of how regional, political and economic instabilities can affect a marginal company. A Best's FSR can provide consumers with the information necessary for an educated buying decision. In addition, A.M. Best offers a special *AMB Credit Report - Consumer*.

A.M. Best Company is committed to maintaining Best's FSRs as the definitive source for information on the financial condition and operating performance of insurance companies worldwide.

Understanding Best's Financial Strength Ratings

A Best's FSR can be assigned to an insurance company on an interactive or non-interactive basis. In both cases, the rating scale and descriptors are:

SECURE	VULNERABLE
A++, A+ (Superior)	B, B- (Fair)
A, A- (Excellent)	C++, C+ (Marginal)
B++, B+ (Good)	C, C- (Weak)
	D (Poor)
	E (Under Regulatory Supervision)
	F (In Liquidation)
	S (Suspended)

Rating Modifiers may be assigned to Financial Strength Ratings

MODIFIER	DESCRIPTOR	DEFINITION
u	Under Review	Indicates the rating may change in the near term, typically within six months. Generally is event driven, with positive, negative or developing implications.
pd	Public Data	Indicates rating assigned to insurer that chose not to participate in A.M. Best's interactive rating process (discontinued in 2010).
s	Syndicate	Indicates rating assigned to a Lloyd's syndicate.

In addition, Affiliation Codes may be added to identify companies whose assigned ratings include consideration of a group ("g"), pooling ("p") or reinsurance ("r") affiliation with other insurers.

Ratings from A to C also may be enhanced with a "++" (double plus), "+" (plus) or "-" (minus) to indicate whether credit quality is near the top or bottom of a category.

An Outlook is assigned to an interactive FSR to indicate its potential direction over an intermediate term, generally defined as 12 to 36 months. An Outlook can be:

OUTLOOK	DEFINITION
Positive	Indicates possible rating upgrade due to favorable financial/market trends relative to the current rating level.
Negative	Indicates possible rating downgrade due to unfavorable financial/market trends relative to the current rating level.
Stable	Indicates low likelihood of a rating change due to stable financial/market trends.

To enhance the usefulness of ratings, A.M. Best assigns each rated (A++ through D) insurance company a Financial Size Category (FSC). The FSC is based on adjusted policyholders' surplus (PHS) and is designed to provide a convenient indicator of the size of a company in terms of its statutory surplus and related accounts.

Many insurance buyers only want to consider buying insurance coverage from companies that they believe have sufficient financial capacity to provide the necessary policy limits to insure their risks. Although companies utilize reinsurance to reduce their net retention on the policy limits they underwrite, many buyers still feel more comfortable buying from companies perceived to have greater financial capacity.

Financial Size Category

CLASS	ADJ. PHS ($ MILLIONS)	CLASS	ADJ. PHS ($ MILLIONS)
I	Less than 1	IX	250 to 500
II	1 to 2	X	500 to 750
III	2 to 5	XI	750 to 1,000
IV	5 to 10	XII	1,000 to 1,250
V	10 to 25	XIII	1,250 to 1,500
VI	25 to 50	XIV	1,500 to 2,000
VII	50 to 100	XV	2,000 or greater
VIII	100 to 250		

Not Rated Designation

The Not Rated (NR) designation is assigned to companies that are not rated by A.M. Best.

Usage of Best's Credit Ratings

Best's Credit Ratings are proprietary and may not be reproduced without permission from A.M. Best. A company assigned a Best's Credit Rating should review the Guide to Proper Use at www.ambest.com/ratings/guidetouse.pdf, which outlines the acceptable parameters of the use of these ratings.

All queries regarding the use of proprietary information or to obtain a licensing agreement or a letter of consent should be directed to:

A.M. Best Company, Office of Intellectual Property, Ambest Road, Oldwick, New Jersey 08858

Phone: +1 (908) 439-2200, extension 5644 or e-mail James.Peavy@ambest.com.

Go to www.ambest.com/about/legal.html to view our Legal and Licensing information for details on the use of A.M. Best trademarks, logos and service marks.

Best's Credit Ratings: The Rating Process

An A.M. Best Market Development Manager can help get you started by answering your questions and supplying the information necessary to make an informed decision about obtaining a Best's Credit Rating.

Upon determination of rating feasibility, a rating fee will be quoted. If accepted, a contract will be issued for signature, and when returned, and fee paid, the company will be assigned a rating analyst for the process to begin.

STEP 1	STEP 2	STEP 3	STEP 4	STEP 5	STEP 6
Rating Engagement and Contract	Compiling Information	Rating Management Meeting	A.M. Best's Analysis & Decision	Rating Communication & Dissemination	Monitoring Best's Credit Rating

The Rating Process, Step by Step

Preliminary Discussions on Rating Objectives, Benefits and Scope of Analysis:
Discussions resulting in the company requesting to enter the rating process.

STEP 1: Rating Engagement and Contract:
Once a contract is signed and returned, the company is assigned a rating analyst, and the interactive rating process commences.

STEP 2: Compiling Information:
The rating assessment begins with the compilation of detailed public and proprietary financial information, including annual and quarterly financial statements, regulatory filings, certified actuarial and loss-reserve reports, investment detail and guidelines, reinsurance transactions, annual business plans and Best's Supplemental Rating Questionnaire.

STEP 3: Rating Management Meeting:
A.M. Best analysts meet with senior management and technical staff of the company that has applied for a rating (typically in the applicant company's head office).

STEP 4: A.M. Best's Analysis and Decision:
A rating recommendation is arrived at from the analysis and is taken to the Rating Committee for review and final determination.

STEP 5: Rating Communication and Dissemination:

- The rating is communicated to the rated entity.
- Once the rating is accepted by the rated entity, it is published immediately.

STEP 6: Monitoring Best's Credit Rating:

- The company is continuously monitored after the rating has been accepted.
- Open dialogue with A.M. Best's analytical team is fundamental for the ongoing maintenance of the company's rating, which will be formally reviewed, at least annually.

The typical duration of the rating process from signed contracts to announcement of assigned ratings is approximately three to four months.

Preparing for a Rating Meeting

Meeting with the management of a company is an integral part of A.M. Best's interactive rating process. Management meetings enable our rating analysts to review with the company factors that may affect its rating, including strategic goals, financial objectives and management practices.

It is during these interactive meetings that a company typically will share information that may be extremely sensitive or proprietary in nature. As a rating meeting is a critical component in A.M. Best's analytical process, adequate preparation by the company is imperative.

During rating meetings, companies should be prepared to provide and discuss, in detail, a broad range of information that can vary depending on the company and the industry in which they operate. The A.M. Best analyst typically provides a meeting agenda, outlining discussion topics that will guide the preparation effort.

Information Requirements

The primary source of the information is each company's annual and quarterly (if available) financial statements, as filed with the regulatory agency of the state, province or country in which the company is domiciled.

For a company new to the process, it is important to go through the history and business review issues, as well as the operating performance and overall capital position. For companies that are more familiar with the process, it is more important to focus on changes that have occurred since the last meeting. When there is a transaction pending or significant change in operating strategy and business plan, the focus of the meeting will be on such items.

A.M. Best expects all information submitted by a company to be accurate and complete. Furthermore, A.M. Best expects that any information relevant to the rating process will be submitted on a timely basis.
Key executives should be present to discuss their areas of responsibility, including strategy, distribution, underwriting, reserving, investments, claims and overall financial results and projections. Depending on the size of the company, this can involve anywhere from one to six individuals.

Companies are encouraged to select a rating agency liaison that knows the company well and can respond to ongoing inquiries promptly. This is particularly important with significant events or transactions for which a company should provide advance notification, giving A.M. Best an opportunity to evaluate the effects of the transaction on the company's operations.

Information provided to A.M. Best by a company during a rating meeting may be extremely sensitive and/or proprietary. A.M. Best analysts are held to the highest standards of ethical and professional conduct in handling such information. A.M. Best has established policies and procedures to prevent unauthorized disclosure of confidential information and ratings prior to release. A.M. Best allows the use of confidential information only for purposes related to its rating activities or in accordance with any confidentiality agreements with the rated company.

Four Key Elements

Key elements to maintaining a mutually successful relationship with A.M. Best are:

1. Honest and open dialogue. Make sure that the person you select as your rating agency liaison knows your company well and can manage the relationship with A.M. Best in a positive and productive manner. Discussions concerning your company's positives and negatives should always be frank. Expect the same from A.M. Best.

2. Full and timely disclosure of company information and plans. This includes your company's vision, mission and strategy, as well as financial statements and projections, rationales and details of any transactions and sales results.

3. Full preparation for rating meetings. In general, you should be prepared to discuss, in detail, a broad range of information, including corporate overview, strategic plan, business lines, financial overview, investments, operations and technology. All information should be compiled and disseminated for review prior to the meeting. For any meeting to be successful, your key executives must be present and be prepared for the discussion.

4. Advance notification of significant transactions. Advance notification, including background information, of significant transactions should be provided. This gives A.M. Best analysts an opportunity to evaluate the effects of the transaction on your company's operations before reacting to public inquiries. All such information is considered proprietary and will be held in the strictest confidence by A.M. Best.

Sample Meeting Agendas

Non-Life Insurance

In order to make your rating meeting as complete and comprehensive as possible, A.M. Best's analytical team has prepared a sample non-life meeting agenda, detailing the areas that will be discussed in the initial interactive rating meeting.

Organisation Structure

- Ownership and Membership Requirements
- Overview of Corporate Structure
- Management and Board of Directors
- Corporate Governance
- Mission Statement
- Management's Perspective on Key Risks
- Risk Management Framework—
  Roles, Responsibilities & Oversight
- Board Involvement
- Systems/Internal Controls

Capital Structure

- (Holding Company & Operating Company)
- Composition
- Capital Management Strategy
- Capital Adequacy
- Financial Leverage/Debt Service
- Financial Guarantees
- Sources & Uses (5 Years)
- Cash & Liquidity

Underwriting

- Product Offering(s)
- Geographic Footprint
- Limits Profile
- Base Rate & Overall Pricing Changes
- Retention
- Cycle Management Strategy
- Price Monitoring/Internal Controls
- Expansion Initiatives
- External Risk Factors

Marketing and Business Production

- Distribution Sources
- Diversification
- Business Strategies; Short and Long Term
- Growth Strategies and Targets

Claims and Loss Reserves

- Severity and Frequency Trends
- Claims Administration (Internal/Third Party)
- New Potential Claim Emergence
- Loss Reserves (Actuarial Report)—Carried vs. Indicated
- Management's Perspective of Reserve Adequacy
- Asbestos & Environmental Reserve Analysis (if Applicable

Reinsurance/Pooling

- Pro-Rata/Per Risk Excess of Loss
- Catastrophic Reinsurance Programs
- Loss Portfolio Transfers/Aggregate Stop Loss
  (Contracts)
- Inter-Company Reinsurance/Pooling Agreements
- Credit Risk
- Net Retention

Investments

- Strategy & Guidelines
- Composition
- Credit Risk—Potential Bond Issuer Default
- Capital Market Risk—Equities/Interest Rates
- Investment Manager(s)

Financial Data

- Statutory Financial Statement(s)
- Consolidated GAAP Holding Company Financial
  Statement(s) (Audited if Available)
- Long-Range Pro-Forma Financials—
  Income Statement & Balance Sheet

Catastrophe Management Framework

- Natural & Man-Made Catastrophe Exposure Analysis
- Catastrophe Model(s) Used
- Probable Maximum Loss (PML)/Tail Risk Analysis
- Risk Aggregation/Mapping/Geocoding

Enterprise Risk Management*

- ERM Framework
- Risk Correlation
- Modeling Capabilities—Economic Capital/DFA/RAROC
- Risk Tolerance/Risk Management Objectives

Other

- Regulatory
- Legislative
- Judicial

* A.M. Best's expectation of a company's ERM capabilities will vary depending on an insurer's scope of operations, size and risk complexity. In some cases, a separate ERM meeting may be required.

Sample Meeting Agendas

Life Insurance/Annuities

In order to make your rating experience as complete and comprehensive as possible, A.M. Best's analytical team has prepared a sample life meeting agenda, detailing the areas that will be discussed in the initial interactive rating meeting.

Overview

- Management Structure
- Mergers & Acquisition/Disposition Strategy
- Parental/Shareholder Expectations
- Assessment of Business Environment
- Regulatory Issues
  (Relevant to Your Core Marketplace Areas)
- Overall Strategy and Expansion Plans

Business Discussion by Main Product Line (Individual Insurance, Group Insurance and Investment Products)

- Competitive Market Position
- Sales Performance by Product Line
- Distribution Channels
- Agent Productivity
- New Products

Additional Discussions for Investment Products

- Separate Accounts Performance/Segregated Funds Performance (U.S. and Canada)
- Review of Separate Account/Segregated Fund Guarantees
- Spread Analysis

Additional Discussions for Group Insurance

- Growth Opportunities, Including Updates on the Company's Target Levels for New Business
- Customer Service
- Impact of Renewal Rating Actions on Profitability and Persistency as Well as Impact of Changes in Valuation Assumptions

Investments

- Balance Sheet Composition
- Investment Strategy
- Management/Performance of Portfolio
- Asset/Liability Management
- Discussion of Liquidity

Financial Performance

- Profitability by Product Line or Business Unit (Mortality, Morbidity, Expenses vs. Assumptions)
- Projected Two-Three Year Business Plan
- Budgets, Investment in Technology
- Embedded Value Analysis (European Companies)
- External/Internal Actuarial Reviews

Capitalization

- Capitalization (Targeted Levels, Statutory Coverage, Access to Capital, ROE Targets)
- Dividend Policy
- Holding Company and Corporate Overview (Leverage, Coverage, Cash at Holdco, Consolidating Statements)
- Reinsurance Agreements

Enterprise Risk Management*

- ERM Framework
- Risk Correlation
- Modeling Capabilities—Economic Capital/DFA/RAROC
- Risk Tolerance
- Risk Management Objectives
  (i.e., front-end [i.e., product design], back-end [i.e., hedging, reinsurance, etc.])

* A.M. Best's expectation of a company's ERM capabilities will vary depending on an insurer's scope of operations, size and risk complexity. In some cases, a separate ERM meeting may be required.

Published: April 2, 2014

Understanding Universal BCAR

Additional Information

Criteria:
Understanding BCAR for U.S. Property/Casualty Insurers

Understanding BCAR for U.S. and Canadian Life/Health Insurers

A.M. Best's Perspective on Operating Leverage

Analyzing Contingent Capital Facilities

The Treatment of Terrorism Risk in the Rating Evaluation

Risk Management and the Rating Process for Insurance Companies

Assessing the Tail Risk of Sidecars

Catastrophe Analysis in A.M. Best Ratings

Equity Credit for Hybrid Securities

Insurance Holding Company and Debt Ratings

Rating Members of Insurance Groups

Evaluating U.S. Surplus Notes

2011 Best's Briefing:
Catastrophe Models and the Rating Process FAQ

Analytical Contact

Thomas Mount, Oldwick
+1 (908) 439-2200 Ext. 5155
Thomas.Mount@ambest.com

The purpose of this report is to document the existing criteria and methodology related to A.M. Best Co.'s Universal BCAR model, which is used in the evaluation of balance sheet strength for those companies that do not file U.S. or Canadian statutory statements. The Universal BCAR model can also be used in the evaluation of balance sheet strength at the insurance holding company level, regardless of domicile or accounting standard. In addition, the model can also be used to evaluate the prospective balance sheet strength of start-up insurers based on their proposed business plans.

Introduction

The objective of A.M. Best Co.'s financial strength ratings is to provide an opinion of an insurer's financial strength and ability to meet ongoing obligataions to policyholders. The assignment of an interactive rating is derived from an in-depth evaluation of a company's balance sheet strength, operating performance and business profile as compared with A.M. Best's quantitative and qualitative standards.

Balance Sheet Strength

In determining a company's ability to meet its current and ongoing obligations to policyholders, the most important area to evaluate is its balance sheet strength, since it is the foundation for policyholder security. Performance then determines how that balance sheet strength will be enhanced, maintained or eroded over time. Balance sheet strength measures the exposure of a company's capital to its operating and financial practices. An analysis of a company's underwriting, financial and asset leverage is very important in assessing its overall balance sheet strength.

Underwriting leverage is generated from current premium writings, reinsurance recoverables and loss reserves. In order to assess whether a company's underwriting leverage is prudent, a number of factors unique to the company are taken into account, including type of business written, quality and appropriateness of its reinsurance program, and adequacy of loss reserves.

Financial leverage is created through debt or debt-like instruments (including financial reinsurance) and is reviewed in conjunction with a company's underwriting leverage. An analysis of financial leverage is conducted at both the operating company and holding company levels, since debt at either level could place a call on the insurer's earnings and strain its cash flow, leading to financial instability.

Asset leverage measures the exposure of a company's capital to investment, interest rate and credit risks. The volatility and credit quality of the investment portfolio, recoverables and agents balances determine the potential impact of asset leverage on the company's balance sheet strength.

A company's underwriting, financial and asset leverage also are subjected to an evaluation by Best's Capital Adequacy Ratio (BCAR), which allows for an integrated review of these leverage areas. The universal BCAR model calculates the Net Required Capital to support the financial risks of the company associated with the exposure of assets and underwriting to adverse economic and market conditions, and compares this required capital to economic capital. Some of the stress tests within BCAR include above-normal catastrophes, a decline in equity markets and a rise in interest rates. This integrated stress evaluation permits a more discerning view of a company's balance sheet strength relative to its operating risks.

A company's BCAR result is extremely useful in evaluating its balance sheet strength, but BCAR is only one component of that analysis. In addition, balance sheet strength is only one component of the overall financial strength rating, which also includes operating performance and business profile. BCAR establishes a guideline for risk-adjusted capital to support a rating, but other factors driving expectations of future balance sheet strength drive the rating as well. All of these factors are important to the overall rating process.

Overview of BCAR

A.M. Best's capital formula uses a risk-based capital approach whereby net required capital is calculated to support three broad risk categories: investment risk, credit risk and underwriting risk. A.M. Best's capital adequacy formula also contains an adjustment for covariance, reflecting the assumed statistical independence of the individual components. A company's adjusted capital is divided by its net required capital, after the covariance adjustment, to determine its BCAR.

Investment Risk

Investment risk includes three main risk components: fixed-income securities, equities and interest rate. Capital charges are applied to different asset classes based on the risk of default, illiquidity and market-value declines in both equity and fixed-income securities. Additionally, higher capital charges are ascribed to affiliated investment holdings, real estate, below-investment-grade bonds and nonaffiliated, privately traded common and preferred shares because of the illiquid nature of the asset and/or the potential volatility of the reported value.

The levels of liquidity and volatility in a country's capital markets are an important part of A.M. Best's analysis. The influence of market liquidity and volatility on the financial system and the broad macro economy are captured in A.M. Best's Country Risk Methodology. These risks include, but are not limited to, sharper and more frequent business cycles caused by more volatile consumption and investment, and increased uncertainty concerning access to capital. The greater the degree of market volatility, the more difficult the operating environment for insurers.

These country-specific risk factors also can have a direct impact on an insurer's risk-adjusted capital. At the company level, illiquidity and volatility will depress an asset's valuation, and in extreme scenarios, severely limit access to cash. The potential for market illiquidity and volatility to increase the risk within an insurance company's invested assets or diminish financial flexibility is captured through country-specific risk charges, based on the origin of the asset, within A.M. Best's Universal BCAR model.

In some instances, some or all of the risk associated with a particular asset may be borne by the policyholder. In those situations, the investment risk to the insurance company may be reduced.

A.M. Best's capital model incorporates an interest-rate risk component that considers the decline in market value of a company's fixed-income portfolio as a result of rising interest rates. The interest rate risk calculation will reflect the fact that companies writing life and annuity products will have an exposure to disintermediation and cash-flow mismatch risks, whereas a company writing property/casualty products will have an interest-rate risk exposure when a shock event occurs. Interest rate risk for annuity writers will vary based on the type of products offered and the source of that business.

Investment risks are typically the main drivers of a life and annuity insurer's capital requirements.

Credit Risk

Capital charges are applied to different receivable balances to reflect third-party default risk. Credit risk factors are ascribed to recoverables from all reinsurers, including affiliates. Required capital for credit risk may be modified after taking into account acceptable collateral offsets for reinsurance balances; the quality of the reinsurers that participate in the company's reinsurance program; and the company's dependence on its reinsurance program. Also included in the credit risk component are charges for premium balances receivable; accrued retrospective premiums; deposits in pools and associations; funds held by ceding insurers; and other, miscellaneous receivables.

Underwriting Risk

This category encompasses the risks associated with net loss and loss-adjustment expense reserves, net premiums written and net unearned premiums. The reserve component requires capital based on the risk inherent in a company's loss and loss-adjustment expense reserves, adjusted for A.M. Best's assessment of its reserve equity. Reserve equity is a function of the estimated reserve deficiency, the payout pattern of the reserves and the discount rate, which is currently 4% in BCAR. The net premiums written component is a forward-looking component and requires capital based on the pricing risk inherent in a company's expected book of business for the upcoming year. The unearned premium component reflects the exposure to pricing risk on premium that was written in the past but is still unearned as of the current evaluation dateand can be a material exposure for long duration contracts.

Long duration property/casualty contracts are defined as contracts having terms in force for more than 13 months and for which the insurer cannot cancel or increase the premium during the life of the contract. Long duration unearned premiums will be included on the loss reserve page and other adjustments will be made in an effort to capture other risks associated with writing long duration contracts. In the case of a contractual liability policy (CLIP), where the insurer guarantees the liabilities of another entity for a fee, the underlying unearned premium that is being guaranteed will be added to the loss reserve page instead of the unearned CLIP premium.

Exhibit 1
Available Capital Components:

Reported Capital

Equity Adjustments:
- Unearned Premiums
- Assets
- Loss Reserves
- Reinsurance

Debt Adjustments:
- Debt/Hybrid Securities
- Debt-Service Requirements

Other Adjustments:
- Potential Catastrophe Losses (Net of Reins.)
- Future Operating Losses
- Future Dividends
- Contingent Capital
- Contingent Reserves
- Value in Force (Life Business)
- Deferred Acquisition Costs
- Goodwill
- Other Intangible Assets

Required capital for the underwriting risk components may be increased to reflect an additional surcharge for "excessive" exposure growth. In addition, there is credit for a well-diversified book of business, but this credit is minimized for those companies that maintain small books of many lines of business and may not necessarily have expertise in each of them. For those composite companies that write both property/casualty and life insurance, the amount of diversification credit may be increased to reflect the additional benefits from diversifying across insurance sectors.

For life and health insurers, underwriting risks are divided into mortality risks, longevity risks and morbidity risks. Mortality risks are based on volume of life insurance in force, net of reserves and reinsurance, with risk charges grading lower for higher amounts at risk. Longevity risks are present in annuities and certain types of pension plans, as plan participants are living longer than expected when payment amounts originally were determined. Morbidity risks vary by line of business and therefore warrant different charges. Generally, health care lines of business with long-tail risks (disability, long-term care) will have higher premium risk charges than shorter tail risks (medical, critical illness).

For property/casualty insurers, underwriting risk is typically the largest risk category and usually accounts for two-thirds of a company's gross required capital.

Required Capital

Collectively, the investment, credit and underwriting risk components generate more than 99% of a company's gross required capital, with the business risk component generating minimal capital requirements for off-balance-sheet items. Off-balance-sheet items include items such as noncontrolled assets, guarantees for affiliates, contingent liabilities, pension obligations and other post-employment/retirement obligations. A company's gross required capital, which is the sum of the capital required to support all of its risk components, reflects the amount of capital needed to support all of those risks if they were to develop simultaneously. However, these individual components then are subjected to a covariance calculation within the BCAR formula to account for the assumed statistical independence of these components. This covariance adjustment essentially says that it is unlikely that all of the individual risk components will develop simultaneously, and this adjustment generally reduces a company's overall required capital.

A.M. Best recognizes the distortions caused by the "square root rule" covariance adjustment, whereby the more capital-intensive risk components are disproportionately accentuated while the less capital-intensive risk components are diminished in their relative contribution to net required capital. Nevertheless, by using other distinct capital measures, A.M. Best can counterbalance this apparent shortcoming.

Determination of Available Capital

A.M. Best makes a number of adjustments to a company's reported capital within its universal capital model to provide a more economic and comparable basis for evaluating capital adequacy. Different accounting methods and regulatory requirements across the world require numerous adjustments to a company's reported capital. Goodwill and other intangible assets are eliminated. Pre-event catastrophe reserves are removed from the loss reserves and moved into available capital on a tax-effected basis. Adjustments for any embedded value in unearned premium reserves, loss reserves and fixed-income securities are made if the company has not already reflected these in its reported capital. Further adjustments are made to capital to reflect other non-balance sheet risks, including catastrophe exposures and debt-service requirements.

A.M. Best's capital model emphasizes permanent capital and consequently will reduce a company's reported surplus for encumbered capital, which includes surplus notes and future debt-service requirements of an affiliated holding company. This reduction, in whole or in part, depends on the magnitude of, and dependence an insurance group has on, debt-like instruments and their associated repayment features.

On a qualitative basis, issues such as where the debt is held vs. where the cash is used; the existence of other sources of income to offset the cost of debt; fixed-charge coverage; and the overall level of debt relative to the organization's total capital all are considered. For example, when debt is issued at the holding company but the cash is held at the operating insurance company, even though the cash is given full credit in the BCAR analysis of the operating company, the actual rating of the operating company could be limited by the evaluation of the financial leverage and earnings coverage at the holding company.

Formula Drivers

A company's gross capital requirement within A.M. Best's capital model is generated primarily from its investment, credit and underwriting risks. A company that maintains a more aggressive investment portfolio, is heavily concentrated in one asset or sector, or is heavily dependent on pyramided capital likely will generate a lower BCAR value. Companies that have excessive exposure to third-party credit risk or are heavily dependent on reinsurance likely will generate lower BCAR scores. The amount of required capital generated from the underwriting risk components is largely a function of the company's mix of business, amount of available capital, growth in exposure, stability of loss development, profitability, loss-reserve adequacy and length of claims payout. All other things being equal, the absolute BCAR score of a company will be lower because of higher capital requirements associated with greater indicated reserve deficiencies, as well as unstable or unprofitable business.

Exhibit 2
BCAR Guidelines

BCAR	Implied Balance Sheet Strength
Secure:	
175	A++
160	A+
145	A
130	A-
115	B++
100	B+
Vulnerable:	
90	B
80	B-
70	C++
60	C+
50	C
40	C-
<40	D

In addition, the model can be adjusted in response to various market issues. Some examples of the issues that can impact capitalization include rate changes, the stage of the underwriting cycle, changing reinsurance products and reinsurance dependence. The ability of the model to respond to these market issues makes it a robust tool that assists in the evaluation of the company's balance sheet strength.

The basis of risk measurement for some of the key drivers of required capital in the universal BCAR model is expected policyholder deficit. A.M. Best adopted the concept of expected policyholder deficit to better calibrate the model's loss-reserve and premium-risk factors, as well as other risk factors in the model. The concept of expected policyholder deficit allows risk charges to be calibrated to a specific level of insolvency risk and also takes into consideration the expected cost, or severity, of insolvency.

BCAR Is an Absolute Measure

The universal BCAR model produces an absolute score, which is the ratio of the company's adjusted capital to its own net required capital. This company-specific capital ratio indicates whether its capital strength aligns with A.M. Best's "Secure" or "Vulnerable" rating categories and is based on the specific risk profile of a company's operations. A BCAR score below 100% would be considered vulnerable. Given strong, stable operating performance, sound risk management, high quality capital and strong financial flexibility, Exhibit 2 provides a reasonable guide for the BCAR levels needed to support A.M. Best's Financial Strength Ratings.

Additional Stress Testing

A.M. Best also will stress a company's BCAR score for a second catastrophic event according to the procedures outlined in its criteria report titled Catastrophe Analysis in A.M. Best Ratings and its criteria report titled The Treatment of Terrorism Risk in the Rating Evaluation. The testing will incorporate natural catastrophes and/or man-made events such as terrorism to monitor how sensitive a company's balance sheet strength is to a second catastrophic event. For casualty writers, an estimate of a casualty shock loss may be used in the analysis of balance sheet strength. Additional stresses may be employed when insurers accumulate large amounts of higher risk investments.

Conclusion

The tools to allocate capital and understand capital strength continue to evolve. These tools often vary in theory, purpose and outcome. It is important to remember that, while they can add significant value, they are only tools. A.M. Best's proprietary universal BCAR is one of those tools that look at capital needs well above financial solvency. A.M. Best will continue to enhance BCAR going forward to improve its accuracy in measuring balance sheet and operating risk.

BCAR is important to A.M. Best's evaluation of both absolute and relative capital strength. Consistent with standards embedded within the universal BCAR model, A.M. Best would expect that well-managed and highly rated companies will maintain capitalization levels in excess of the risk-adjusted amounts indicated by the published guidelines to support their current ratings.

A.M. Best is quick to caution, however, that although BCAR is an important tool in the rating process, it isn't sufficient to serve as the sole basis of a rating assignment. BCAR, like other quantitative measures, has some limitations and doesn't necessarily work for all companies. Consequently, capital adequacy should be viewed within the overall context of the operating and strategic issues surrounding a company. Business profile and operating performance are important rating considerations in evaluating a company's long-term financial strength and viability as well as the quality of the capital that supports the BCAR result. In addition, any holding company considerations also will play a key role in evaluating the financial strength of an insurance company.

In closing, A.M. Best believes that well-managed and highly rated insurers will continue to focus on the fundamentals of building future economic value and financial stability, rather than on managing one, albeit important, component of A.M. Best's rating evaluation.

PUBLISHED: MAY 2, 2012

Evaluating Country Risk

Additional Information

Criteria:
Understanding Universal BCAR

Risk Management and the Rating Process for Insurance Companies

Rating Members of Insurance Groups

Analytical Contacts

Edward Easop, Oldwick
+1 (908) 439-2200 Ext. 5781
Edward.Easop@ambest.com

Andrea Keenan, Oldwick
+1 (908) 439-2200 Ext. 5084
Andrea.Keenan@ambest.com

James Gillard, Oldwick
+1 (908) 439-2200 Ext. 5818
James.Gillard@ambest.com

A.M. Best defines country risk as the risk that country-specific factors could adversely affect an insurer's ability to meet its financial obligations. Country risk is evaluated and factored into all A.M. Best ratings. As part of evaluating country risk, A.M. Best identifies the various factors within a country that may directly or indirectly affect an insurance company. In doing so, A.M. Best separates the risks into three main categories: economic risk, political risk and financial system risk. Given A.M. Best's particular focus on the insurance industry, financial system risk is further divided into two sections: insurance risk and non-insurance financial system risk.

A.M. Best's evaluation of country risk is not directly comparable to a sovereign debt rating, which evaluates the ability and willingness of a government to service its debt obligations. Though country risk analysis does consider the finances and policies of a sovereign government, the final determination is not guided by this sole purpose. Additionally, A.M. Best's country risk evaluation does not impose a ceiling on ratings in a given domicile.

A.M. Best's approach to country risk analysis employs a data-driven model that scores the level of risk present in a given country, plus a qualitative determination of country-specific conditions that affect the operating environment for an insurer. Countries are placed into one of five tiers, ranging from "CRT-1" (Country Risk Tier 1), denoting a stable environment with the least amount of risk, to "CRT-5" (Country Risk Tier 5) for countries that pose the most risk and, therefore, the greatest challenge to an insurer's financial stability, strength and performance. The conceptual relationship between the relative level of country risk and the rating of an insurer is depicted in **Exhibit 1** at right.

Exhibit 1
Relationship Between Ratings and CRTs

Above Average Rating
Average Rating
Below Average Rating

CRT-1	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-
CRT-2	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-
CRT-3	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-
CRT-4	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-
CRT-5	aaa	aa+	aa	aa-	a+	a	a-	bbb+	bbb	bbb-	bb+	bb	bb-	b+	b	b-

In short, as country risk increases (measured by a higher assigned tier), the distribution of ratings migrates down the rating scale. This same relationship effectively applies to any significant category of risk an insurer faces, i.e. higher risk exposure pressures financial stability.

Key elements of country risk can be managed or mitigated, effectively reducing the impact on an insurer's rating. As a result, it is possible for an insurer in any country to achieve A.M. Best's highest Financial Strength Rating (FSR). Country risk is not a ceiling or cap on insurer ratings; it is one of many rating factors.

Country Risk Tier (CRT) assignments are reviewed annually, though significant events and developments are tracked continuously and may cause an interim change to a country's tier assignment. CRTs are evaluations of the current conditions in a country, but they are designed to remain stable through the business cycle. Therefore, political and industry outlooks as well as economic forecasts are integrated into the analysis.

Elements of Country Risk

The three risk categories in A.M. Best's country risk analysis – economic risk, political risk and financial system risk – will be defined below, and some of the key variables used will be discussed (see **Exhibit 2**).

Economic risk is the likelihood that fundamental weaknesses in a country's economy will cause adverse developments for an insurer. A.M. Best's determination of economic risk evaluates the state of the domestic economy, government finances and international transactions, as well as prospects for growth and stability.

Political risk is the likelihood that governmental or bureaucratic inefficiencies, societal tensions, an inadequate legal system or international tensions will cause adverse developments for an insurer. Political risk comprises the stability of a government and society; the effectiveness of international diplomatic relationships; the reliability and integrity of the legal system and business infrastructure; the efficiency of the government bureaucracy; and the appropriateness and effectiveness of the government's economic policies.

Financial system risk (non-insurance) is the risk that financial volatility may erupt due to inadequate reporting standards, weak banking systems or asset markets or poor regulatory structure. Non-insurance financial system risk considers a country's banking system, accounting standards and government finances, and it assesses how vulnerable the financial system is to external or internal volatility. Basel II, World Bank Insolvency Principles and International Accounting Standards all are referenced in the analysis, as are the performances of banks, equity indices and fixed-income securities.

Exhibit 2
Components of Country Risk Analysis

Economic Risk	Macroeconomy
	Prospects
	International Transactions
	Government Finance
Political Risk	Economic Policy
	Business Environment
	Government Stability
	Social Stability
	International Diplomacy
	Legal System
Financial System Risk	**Non-Insurance Financial System Risk:**
	Banking System
	Vulnerability
	Reporting Standards & Regulations
	Sovereign Debt
	Insurance Financial System Risk:
	Government & Legislation
	Supervisory Authority
	Insurer Accountability

Insurance risk is the risk that the insurance industry's levels of development and public awareness; transparency and effectiveness of regulation; reporting standards; and regulatory sophistication will contribute to a volatile financial system and compromise an insurer's ability to pay claims. Insurance risk, which A.M. Best considers as a distinct subsection of financial system risk, is addressed separately because of the importance of and A.M. Best's specific focus on the industry. The determination is based heavily on the Insurance Core Principles (ICP) of the International Association of Insurance Supervisors (IAIS). A.M. Best employs a sizable subset of the 28 ICPs by organizing them into three categories: 1) government commitment to an open and well-regulated insurance industry; 2) adequacy of supervisory authority and its supporting infrastructure; and 3) insurer accountability.

Calculating Country Risk

The country risk determination begins with the running of the Country Risk Model to generate a "score." The score is a weighted average of the three risk categories. The score then is squared, representing the nonlinear relationship between the score and the actual country risk present in the country. The main equation for calculating the Country Risk Score is as follows:

$$\text{CR Score} = [\omega_E I_E + \omega_P I_P + \omega_{FS}(I_{FSi} + I_{FSni})]2$$

Where I_E = Economic Risk
I_P = Political Risk
I_{FSi} = Financial System Risk (insurance component)
IF_{Sni} = Financial System Risk (non-insurance component)
ω = weight applied to each category of risk

In special circumstances, such as where a given domicile has a particularly strong relationship with another – such as Guernsey with the United Kingdom – an additional calculation is added that integrates the larger domicile's influence on the stability of the smaller.

The country risk score provides a baseline of evaluation for each country. A country with a higher country risk score indicates a more risky environment as compared with a country that has a lower country risk score. After the model is run, the Country Risk Group evaluates additional qualitative factors that would influence the overall score, or one particular category of risk.

Country Risk Tiers

The assignment of CRTs to score ranges is based on A.M. Best's assertion that the risk in countries can be categorized loosely to provide a basis of comparison, provided that country-by-country differences are acknowledged. Therefore, CRTs can be classified, in a typical scenario, by the following:

CRT-1: Predictable and transparent political environment, legal system and business infrastructure; sophisticated financial system regulation with deep capital markets; mature insurance industry framework.

CRT-2: Predictable and transparent political environment, legal system and business infrastructure; sufficient financial system regulation; mature insurance industry framework.

CRT-3: Developing political environment, legal system and business infrastructure with developing capital markets; developing insurance regulatory structure.

CRT-4: Relatively unpredictable and non-transparent political, legal and business environment with underdeveloped capital markets; partially to fully inadequate regulatory structure.

CRT-5: Unpredictable and opaque political, legal and business environment with limited or nonexistent capital markets; low human development and social instability; nascent insurance industry.

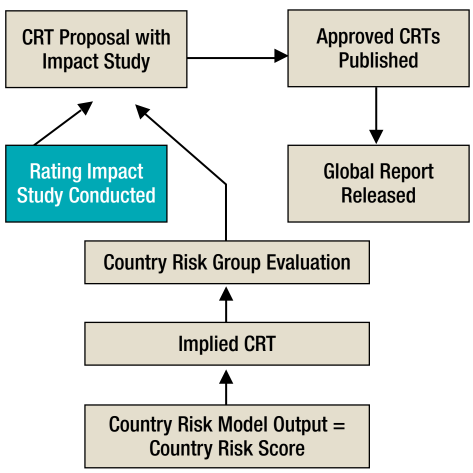
Countries with characteristics of a stable insurance industry environment are highly correlated with those countries that are economically large, stable, diverse and efficiently regulated, with stable political regimes supported by a strong and credible legal system.

Annual and Event-Driven Reviews

Each country that is assigned a Country Risk Tier is reviewed annually. This review includes the model-driven score, the qualitative analysis, a rating impact study and the committee process each year. During the interim period, the Country Risk Group continually monitors world events and developments and assesses their potential impact on tier assignments. This process is facilitated through the maintenance of a watch list that identifies countries that are experiencing a significantly increased level of volatility that has the potential to impact the CRT.

It is unusual for a country to be moved up or down the scale outside of the annual review cycle, as the CRTs are designed to remain stable through the business cycle and are not subject to frequent upgrades or downgrades. Therefore, while recent developments are factored into the analysis of country risk, they often are not significant enough to warrant an off-cycle change in the tier assignment. In the event of a change in CRT, the ratings of the companies domiciled in that country will be subject to review.

Exhibit 3
Country Risk Evaluation Process



Applying Country Risk to Ratings

A.M. Best's ratings are independent opinions based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile. Country risk is one of many factors considered in evaluating a company according to these three characteristics. The level of consideration given to country risk (i.e. the potential impact on the determination of a rating for a company) is determined on a case-by-case basis for each insurer, based on its financial strength, position in the market and ability to mitigate or manage its exposure to country risk.

A.M. Best's Country Risk analysis seeks to identify those aspects of a country that may create a difficult or unpredictable environment for an insurer. For example, a poorly regulated banking system, poorly executed monetary policy or illiquid equity market could leave a financial system more prone to collapse. On average, most companies

Exhibit 4
Incorporating Country Risk

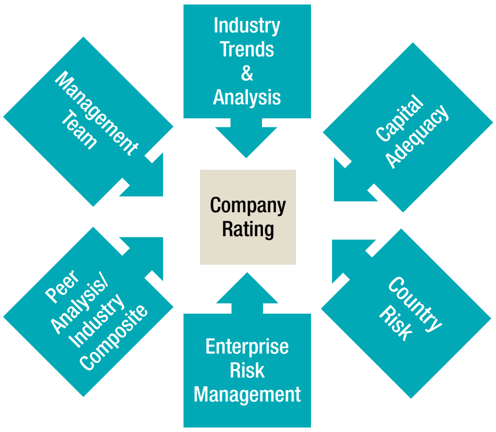


Exhibit 5
Rating Translation
Financial Strength Ratings (FSR) and Issuer Credit Ratings (ICR)

Secure — Investment Grade

FSR	ICR
A++	aaa aa+
A+	aa aa-
A	a+ a
A-	a-
B++	bbb+ bbb
B+	bbb-

Vulnerable — Non-Investment Grade

FSR	ICR
B	bb+ bb
B-	bb-
C++	b+ b
C+	b-
C	ccc+ ccc
C-	ccc- cc

in CRT-1 or CRT-2 countries would not be impacted adversely by their operating environments (i.e. country risk). In CRT-3, CRT-4 and CRT-5, there is an increasing probability that environmental factors will affect a company's ability to fulfill policyholder obligations.

A.M. Best employs neither a notching process nor a ceiling in applying country risk to ratings. Country risk is one of many factors that are integrated into a Best's Rating. The integration of country risk into a rating outcome is comparable to the integration of other components of the rating analysis such as enterprise risk management (ERM); senior management discipline and track record; capital management; and competitive market position, among others (see **Exhibit 4**). Analysts are able to ascertain during the rating process whether an insurer is subject to country risk issues. To aid analysts in this process, the Country Risk Group offers internal briefings and mapping guides that serve as benchmarks when comparing insurers across countries and regions.

PUBLISHED: JANUARY 10, 2012

Rating Takaful (Shari'a Compliant) Insurance Companies

Additional Information

Criteria:
Rating European Mutual Insurers

Understanding Universal BCAR

A.M. Best's Perspective on Operating Leverage

Risk Management and the Rating Process for Insurance Companies

Assessing Country Risk

Rating Members of Insurance Groups

Analytical Contacts

Carlos Wong-Fupuy, London
+(44) 20-7397-0287
Carlos.Wong-Fupuy@ambest.com

Mahesh Mistry, London
+(44) 20-7397-0325
Mahesh.Mistry@ambest.com

Moungmo Lee, Hong Kong
+(852) 2827-3402
Moungmo.Lee@ambest.com

This report highlights the main issues arising when applying A.M. Best's rating methodology to takaful insurance companies. Takaful insurance (or insurance compliant with Islamic beliefs) is clearly on the rise, particularly in the Middle East and Malaysia, and despite their many similarities with conventional mutual operating structures, A.M. Best believes there are distinctive issues with these companies that need to be highlighted. However, it is important to mention that the main principles on which A.M. Best's financial strength methodology are based remain unchanged, regardless of the type of company being analysed.

As is discussed later, each takaful company must establish a Shari'a board that sets the basic rules and principles governing the takaful company's activities, and ensuring that it operates within Islamic Shari'a principles. A.M. Best will not specifically comment on takaful companies' degree of compliance with Shari'a. However, as part of the interactive rating evaluation, A.M. Best will discuss items such as: the organization's corporate and management structure; the type of takaful business model employed; corporate governance and the role of the Shari'a board; and the insurer's performance versus key strategic and financial objectives. For further information on the breadth and depth of the rating evaluation, please refer to Appendix 1 – Sample Takaful Meeting Agenda.

The discussion that follows includes: a review of some of the key principles of takaful; how these principles are incorporated into a takaful company's business model; and how A.M. Best's rating methodologies are applied in the assessment of these organizations.

Principles of Takaful

The first takaful insurer was established in Sudan in 1979, and the market now has grown to comprise roughly 200 companies, including "windows" (operations affiliated with conventional insurers). Takaful includes both general (non-life) and family (life) products. The family product line includes life and health insurance plans, as well as education, accident and travel medical plans. The surge of takaful companies in recent times is a response to the commonly accepted incompatibility between Islamic beliefs and the conventional insurance model.

Takaful insurance is essentially a cooperative risk-sharing program established for the well-being of the community. The purpose of this system is not to generate profit, but to uphold the Islamic principle of Al-Takaful – "bear ye one another's burden." As a result, takaful insurance is based on the concept of mutual cooperation, solidarity and brotherhood. Takaful participants contribute (donate) to help protect one another against the impact of unpredicted risk and catastrophe, whereas in the conventional insurance model, policyholders pay premiums to protect themselves, or their interests, from some form of risk.

Other Islamic beliefs or principles that takaful operations intend to address are the avoidance of both uncertainty, particularly in terms of the amount and timing of claim payments to be made; and excessive profit (seen as usury), be it in the form of payments received in the event of death, or any form of financial interest (e.g., bond coupon payments).

Underwriting and actuarial techniques apply in a similar manner as under conventional insurance, in that the takaful insurer evaluates the risk of potential loss and establishes a contribution (premium) base appropriate for that aggregate risk to protect the pool from undue losses. However, unlike the risk-based premium paid by a policyholder in a conventional insurance model (where each insured pays a rate commensurate with the assumed level of risk), each takaful participant shares equally in supporting the pool in recognition of the underlying principle of mutual cooperation.

As to reinsurance, it also should be based on the takaful pooling concept. The reinsurer should act primarily as a risk manager (retakaful operator) and should not profit excessively from the underwriting results. However, because of the relative lack of capacity and quality of true retakaful carriers, reinsurance with conventional reinsurers may be permitted under certain specified conditions and limitations.

Takaful Models & Structures

For takaful programs to be financially sound over the long term, as well as to provide incentive to takaful insurers to develop and promulgate these programs to provide Muslims with alternatives to conventional insurance, these operators to some degree must be rewarded through profits in a more traditional sense. However, profits are not the end goal of the operation.

Muslims believe there is unity in diversity, so there is not one preferred operating model for takaful insurers. Shari'a scholars generally agree on certain fundamental components that are required to be an accepted takaful company; however, operational differences are tolerated as long as there is no contradiction to any essential religious tenets. There are now three primary operating models.

Ta'awuni Model

The Ta'awuni model (cooperative insurance) practices the concept of pure Mudharabah in daily transactions, where it encourages the Islamic values of brotherhood, unity, solidarity and mutual cooperation. In the pure Mudharabah concept, the takaful company and the participant share the direct investment income, while the participant is entitled to 100% of the surplus, with no deduction made prior to the distribution.

From the Ta'awuni concept, there are two basic models, Al Mudharabah and Al Wakalah. In reality, there are many variations of these basic models, but these variations fundamentally follow one of these two conceptual frameworks.

Al Mudharabah. This is a modified profit- and loss-sharing model. The participant and the takaful insurer share the surplus. The sharing of such profit (surplus) differs based on a ratio mutually agreed between the contracting parties. Generally, these risk-sharing arrangements allow the takaful insurer to share in the underwriting results from operations, as well as the favourable performance returns on invested premiums.

Al Wakalah. This is a fee-based model. Cooperative risk-sharing occurs among participants where a takaful insurer simply earns a fee for services (as a Wakeel, or "Agent") and does not participate or share in any underwriting results. The insurer's fee may include a fund management fee and a performance incentive fee.

Waqf Model

Unlike the Al Mudharabah and Al Wakalah models, Waqf operates as a social/governmental enterprise, and programs are operated on a nonprofit basis. Under the Waqf model, the surplus or profit is not owned directly by either the insurer or the participants, and there is no mechanism to distribute the surplus funds. In effect, the insurer retains the surplus funds to support the participant community.

This model, with a single surplus fund, is most like a conventional mutual insurance model. As such, it is rated in a very similar manner to conventional mutuals. For further information on the rating dynamics of mutual insurance companies, please see A.M. Best's "Rating European Mutual Insurance Companies."

The remainder of the report will highlight the unique elements of takaful companies following the Ta'awuni model, and how these factors are incorporated in the rating analysis.

Main Characteristics of Takaful Companies

Takaful insurers have certain unique characteristics that recognize the key principles of Al-Takaful and fundamental Islamic beliefs.

The establishment of two separate funds: A takaful (or policyholders') fund and an operator's (or shareholders') fund. The takaful fund operates under pure cooperative principles, in a very similar way to conventional mutual insurance entities. Underwriting deficits and surpluses are accrued over time within this fund, to which the operator has no direct recourse. As a result, the takaful fund effectively is ring-fenced and protected from default of the operator's fund. Management expenses and seed capital are borne by the operator's fund, where the main income takes the form of either a predefined management fee (to cover costs) or a share of investment returns and underwriting results (or a combination of both).

Solidarity principle and equal surplus distribution: Given the fact that the takaful fund is seen as a pool of risks managed under solidarity principles, it is not meant to accumulate surpluses at levels excessively higher than those strictly needed to protect the fund from volatile results and to support further growth. Likewise, any fees or profit shares received by the operator should be just sufficient to cover management and capital costs while keeping the company running as an ongoing concern.

In case of financial distress for the takaful fund, the operator is committed to provide it with an interest-free loan, Qard' Hasan, for however long it is deemed necessary – providing an additional layer of financial security to the participants. The Qard' Hasan is likely to be limited to the available capital in the operator's fund or a prescribed limit.

The surplus distribution structure is expected to be managed carefully and in a balanced way, so that neither policyholders nor operator make excessive profits at the expense of the other party.

Restricted investments: Shari'a compliance refers not only to the operational structure of the company, but also to its investment policy. Takaful companies must avoid investing in traditional fixed-income securities (due to the coupon interest payment attached). Instead, they are allowed to invest in sukuk (or Islamic bonds, where coupon payments take the form of a profit share on a particular enterprise). Moreover, investments in stocks (in principle allowed) should avoid the financing of non-Islamic activities (such as alcohol or gambling).

In practice, these restrictions often translate into an excessive concentration in stocks (due to the relative scarcity of sukuk), lower than average credit ratings (increased counterparty exposure) and high geographical concentration.

Establishment of a Shari'a board: An essential component in a takaful company's corporate governance is the establishment of a Shari'a board, in addition to the conventional board of directors. The Shari'a board is made up of recognised

Retakaful Capacity and Financial Security Issues

Reinsurance following the same applicable Islamic principles as takaful insurance is known as retakaful. Reinsurance of takaful business through retakaful companies has been somewhat controversial within the Islamic insurance marketplace, as the growth of direct takaful writers has far outpaced the available capacity of retakaful. In addition, from a financial strength perspective, there have been ongoing concerns over the placement of reinsurance with lower or non-rated retakaful companies, as opposed to higher rated conventional reinsurers. As a result, takaful insurers in effect face issues with both retakaful capacity and financial security.

This has caused takaful companies to develop alternate strategies, including reinsuring on a conventional basis, contrary to the preference of seeking retakaful support. In recognition of this market reality, the Shari'a scholars have allowed takaful companies to seek support from conventional reinsurers under confined conditions. However, the preference still is to utilize retakaful companies whenever possible. Another manner in which takaful insurers have addressed the issue of retakaful capacity is to co-insure (a form of reinsurance) each other's direct takaful writings to reduce the heavy reliance on conventional reinsurance support.

The shortage of retakaful capacity may inhibit the growth of the takaful industry; however, A.M. Best has observed that the issue of retakaful capacity has begun to ease recently as an increasing number of new retakaful companies are being established in response to the market demands. As part of the rating evaluation, as with any insurer, A.M. Best will review the takaful insurer's reinsurance program and the quality and diversity of its reinsurance providers, including the exposure to counterparty credit risk.

Islamic scholars, who ensure the company's operational model, profit distribution policies, product design and investment guidelines comply with Islamic principles.

The global shortage of recognised Islamic scholars in the insurance arena and lack of consensus in terms of what constitutes Shari'a compliance is, in A.M. Best's view, a challenge for more rapid development of the industry. Having said this, the emergence of some inter-regional and government-supported initiatives in this respect, as well as the participation of individual scholars in more than one Shari'a board, are positive signs of a gradual but slow trend toward convergence.

Analysing a Takaful Company

As with conventional mutual insurance companies, takaful insurers have certain limiting features inherent to their business model, such as a relative lack of financial flexibility compared with stock companies, or increased concentration risk compared with broadly diversified insurers. This section discusses some unique elements of takaful insurers and how these are assessed in the rating process.

Two Separate Funds – a Two-Stage Risk-Based Capital Approach

Given that one of the key characteristics of a takaful operation is the existence of two separate funds (the takaful fund and the operator's fund), the starting point for assessing the financial strength of a particular insurance company is to apply Best's Capital Adequacy Ratio (BCAR) proprietary model to the takaful fund in a way very similar to a mutual company.

This first-tier analysis compares the takaful fund's surplus to the capital required to support the fund's obligations to participants, per the BCAR model. The BCAR ratio for the takaful fund, as well as an analysis of the trends in the ratio and other key metrics, is the primary driver of A.M. Best's assessment of the takaful company's balance sheet strength.

A second-tier capital assessment also is performed on the operator's fund. The second-tier analysis compares the surplus position of the operator's fund to the capital required to support the fund's obligations, per the BCAR model.

An operator's fund with much higher financial strength than its corresponding takaful fund normally will enhance the capitalisation assessment in respect of the whole insurance operation, reflecting the increased financial strength provided to the takaful fund's participants. This enhanced financial strength stems from the operator's obligation to provide an interest-free loan (Qard' Hasan) to the takaful or policyholders' fund in situations of financial distress. In cases where such a loan has been made to the takaful fund, the loan will be considered part of the takaful fund's capital base. Additionally, in circumstances where the potential Qard' Hasan (dependent on strength of regulation) is not sufficient to bring the takaful fund to a suitable capital adequacy level, consideration will be given for shareholders' commitment to the takaful fund, such as ring fencing assets in favor of policyholders.

This consolidated view of capital, in effect combining the takaful and operator's fund for analytical purposes, is particularly important in the assessment of takaful insurers in the early years of operation. Currently, it is not uncommon for the operator's fund to be in a stronger relative position, given the relatively short track record of most companies with the resulting low level of surpluses, if any, accumulated at a takaful fund level.

An operator's fund with a weaker financial strength position may not detract from the overall analysis significantly, since the operator's fund cannot access the takaful fund surplus. However, in all cases, regardless of which fund is in a stronger relative position, it also is important to note that this two-tier analysis is supplemented further by a comparison of the capital accumulation trends in each of the separate funds to ensure an appropriate balance in the surplus distribution and fee structure.

Main Drivers of Balance Sheet Strength in a Takaful Company

Given the comparatively restricted investment policy of a typical takaful company; its consequent higher levels of counterparty risk; geographical concentration; and higher than average proportion of stock holdings, capital requirements in many cases are significantly larger than for a conventional company of a similar size.

The limited classes of invested assets long have been a barrier to the growth of the takaful industry, as well as a limitation on the development of more long-term products, due to the difficulty in addressing asset-liability management issues. The current situation has improved as the capital markets in Islamic countries have begun to mature and more Shari'a-compliant investment products are available in the market. However, demand is still higher than supply, resulting in increased expense for such investment products.

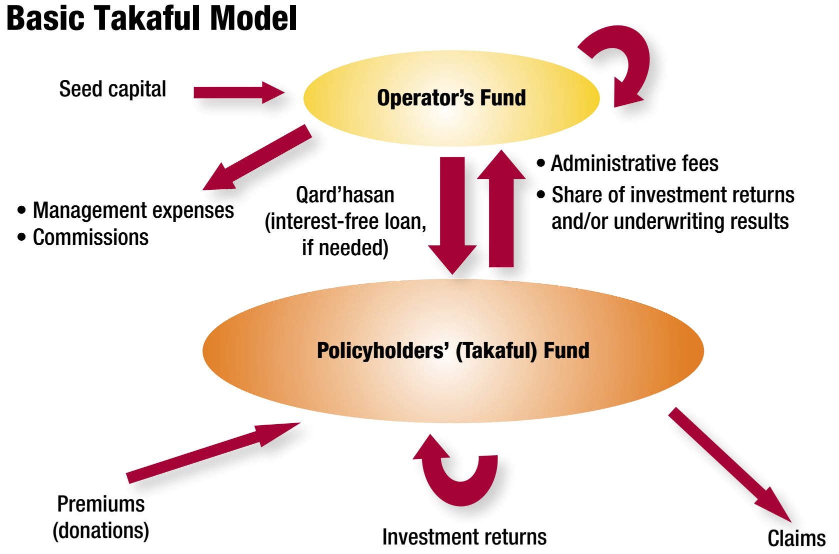
In terms of insurance risk borne by takaful companies, the currently moderate exposures and relative specialisation on domestic and small to medium-sized corporate lines should be expected to keep the capital requirements (as per the BCAR model) modest. These factors, nonetheless, easily can be more than offset by rapid growth of business and excessive concentration in a few product lines, with resulting pressures on capital needs.

An essential feature of all takaful models is participants' sharing of the underwriting surpluses/deficits. Accurately determining the surplus/deficit is, therefore, fundamental to the accounting process. Setting aside a reserve for contingencies always raises the question as to which policyholders own it, i.e. the participants that helped set it up or later generations. This is relevant because the significance of the reserve in the initial years of takaful operations is likely to be substantially greater than in subsequent years. This effectively will result in earlier participants paying to stabilize underwriting results for later participants.

Despite the possible inequity in a pure sense, the building up of a contingency reserve is desirable to enable stability in underwriting results and make it practical to expand the size of the risk pool (as there will be limits to what amounts the takaful operator will be able to provide as Qard' Hasan in case of deficits). A.M. Best considers contingency reserves as part of the capital and surplus of a company when assessing balance sheet strength.

As with conventional insurance operations, an important driving factor in the rating decision for a takaful company is its degree of financial flexibility (i.e. the company's ability to raise equity capital). As with mutual companies, the capital available normally would be expected to reflect significant surpluses accrued over the years within the takaful fund. This component of the analysis is focused mainly on the operator because of the mutual nature of the takaful fund and its inherent lack of financial flexibility. The assessment normally involves a detailed analysis of the ownership structure (and shareholders' solvency) and the record of equity or debt issues. Furthermore, consideration needs to be given for shareholders' capital commitment to the takaful fund.

Exhibit 1
Basic Takaful Model



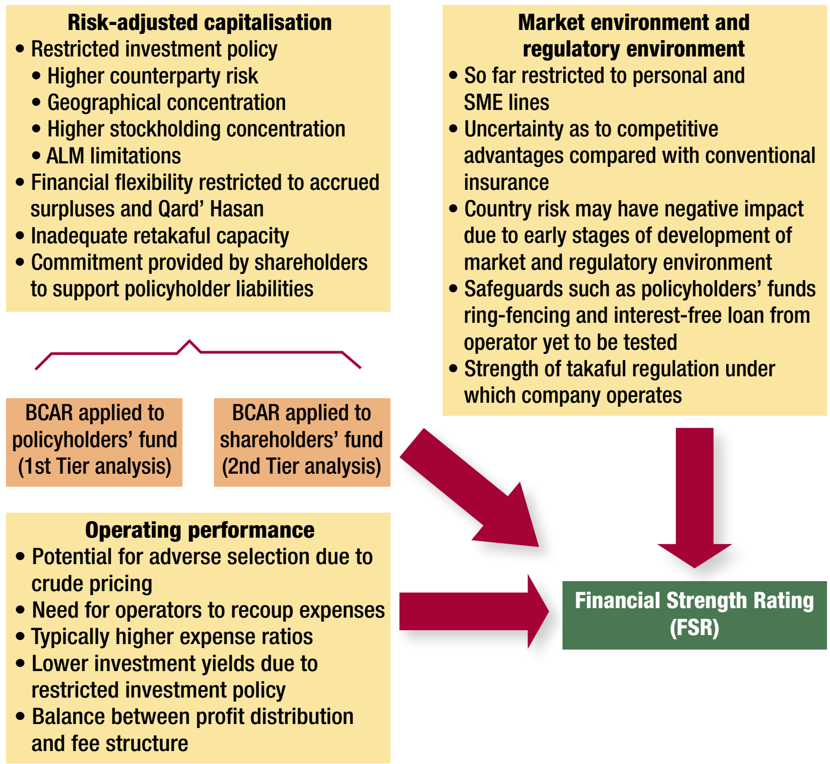
A.M. Best monitors carefully the quality of the reinsurance program to assess a takaful company's balance sheet protection through reinsurance. This is particularly relevant given the previously mentioned restricted retakaful capacity (and virtual nonexistence of retro-takaful), which may force direct insurers to compromise the security of their insureds.

Operating Performance Issues In a Takaful Company

In principle, any fees paid to the operator on average should be lower than the difference between premiums and claims. In other words, as long as the takaful fund continues to generate surpluses in the long term, there should be no major reason for concern. Having satisfied this condition, at a second level of analysis, A.M. Best believes that to ensure the ongoing existence of the whole insurance operation, it is important as well that the operator at least can cover its expenses from the fees received from the policyholders' fund. For companies to achieve more secure ratings, it is important that the takaful fund generates profits and that there is a suitable balance of profit distribution between shareholders and policyholders, in addition to appropriate management fees to generate surpluses.

During the past few years, takaful companies (particularly in the Middle East) have shown higher expense ratios than their conventional counterparts. The main driver is relatively high management charges and fees to the takaful fund, resulting in low surplus accumulation. However, some companies are adopting prudent fee structures and surplus accumulation to assure a suitable balance of profit distribution and charges is maintained. A.M. Best would expect the current gap to narrow in coming years as takaful business volumes continue to expand rapidly. In addition, A.M. Best expects that over time, the issue of higher expense ratios will be somewhat mitigated by higher customer loyalty and policy persistency driven by the participants' belief in the principles of takaful.

Exhibit 2
Analysing a Takaful Company



As for investment returns, given takaful companies' constraints in asset management, higher concentration in shares and in a particular geographical region, and increased counterparty credit risk, A.M. Best expects, takaful funds on average to yield lower risk-adjusted returns, experiencing higher volatility and credit defaults. Despite the continuous growth in the supply of Islamic securities, A.M. Best believes the investment opportunities are bound to remain limited for years to come.

Market Environment and Country Risk

Despite the continued impressive growth of the takaful sector overall, rapid growth has not been experienced in all product lines, as the expansion of general or non-life business has outpaced that of the family or life product line. In addition, the typical size of a takaful company remains smaller than that of a conventional insurer. Takaful insurers tend to be smaller, in part due to their relative lack of operating experience (takaful insurers have only been in existence since 1979), and the more limited operating profile of takaful insurers when compared with conventional insurers that have diverse operating platforms and more than a century of operating history.

Going forward, A.M. Best believes the main opportunities and challenges for the sector overall are the development of more robust life insurance platforms, and compulsory lines such as motor third-party liability and health within the non-life business (in particular countries). A growth area within the corporate product line is medium-sized business risk products within the energy and construction sectors, which continue to expand. In general, retention levels for corporate product lines have been improving gradually, providing a more stable base for growth, although the largest risks still are expected to be ceded to the international markets.

A.M. Best believes it is not yet clear whether takaful companies offer any competitive advantage within this market environment. It is debatable whether there is actually an untapped demand (especially in family/life insurance business) due strictly to religious beliefs – and whether this can be unlocked easily through the offer of takaful products.

A material component of the rating process focuses on the market position of the company – its diversification in terms of client base, business lines and distribution network. In particular for takaful companies based in the Middle East, all these factors are related closely to A.M. Best's country risk assessment. The early stage of development of complementary sectors or activities (e.g. Islamic bonds, bancassurance or Internet distribution and retakaful capacity) often may have a negative impact on the final rating assigned.

Regulatory Environment and Risk Management

Regulation is extremely important in A.M. Best's assessment of takaful companies. The strength of regulation varies significantly among jurisdictions, and the protection to policyholders is somewhat unclear. While regulation of takaful companies has developed and improved in recent years, there remains an inherent lack of transparency in certain jurisdictions, particularly concerning the liabilities on winding up a takaful company. Where regulation is deemed to be weak or unclear, benefit can be given for additional commitments to the takaful fund from shareholders in favor of policyholders, such as ring-fenced assets which will be made explicit in A.M. Best's analysis of a company. Additionally, A.M. Best will consider the role of the Shari'a board within the organization and any potential differences with regulators on winding up a company.

Moreover, in A.M. Best's opinion, some of the regulatory safeguards (e.g., ring-fencing of assets within the takaful fund, interest-free loans from operators in case of solvency difficulties, etc.) are yet to be tested. The development of the Islamic insurance industry, including the regulatory environment, needs to keep pace with the rest of the financial industry in the region (especially banking).

In A.M. Best's view, a robust regulatory regime is crucial for the development of a risk management culture. A.M. Best believes that given their constraints, takaful companies need to develop and demonstrate that they can apply an adequate risk-based approach to investment management (because of the reduced investment opportunities); capital adequacy and reserving (given the need for building up surpluses in the long term, especially for family/life business); and pricing/adverse selection control (given the restrictions on charging extra risk premiums for policyholders representing a greater risk of loss than the aggregate participant pool).

Overall, one of the unique challenges facing takaful companies – and A.M. Best as it endeavours to assess their financial strength – is the need to ensure that the objectives set by their Shari'a boards are consistent with key performance indicators based on conventional sound financial and risk management. That includes establishing processes to address all material risks, despite the challenges presented by the limited capacity of retakaful, and concentration risks presented by restrictive investment guidelines and the limited geographic diversity of the current takaful marketplace.

Rating Takaful Windows and Takaful Subsidiaries

There has been an increasing use of takaful windows and takaful subsidiaries as companies seek to widen their offering and service clients. While contributions from the takaful operations are currently small, volumes are increasing and becoming more prominent within conventional insurers' profiles. In addition to the takaful methodology herein, A.M. Best will also use Rating Members of Insurance Groups when rating takaful windows and subsidiaries.

PUBLISHED: FEBRUARY 24, 2011

Financial Strength Ratings and Sovereign Credit Risk FAQ

Sovereign creditworthiness has deteriorated significantly during the most recent economic cycle, as governments have used fiscal policy extensively to stimulate their respective economies. This fiscal stimulus has predictably led to higher deficits, larger government debts and in turn higher sovereign credit risk. This document addresses frequently asked questions about A.M. Best Co.'s handling of sovereign credit issues.

Does A.M. Best rate government debt (i.e. sovereign ratings)?

No. A.M. Best specializes in insurance ratings and does not issue a ratings opinion on the creditworthiness of sovereign governments.

Does A.M. Best place a sovereign ceiling on its insurer Financial Strength Ratings (FSRs)?

No. A.M. Best does not place a cap on its FSRs based on the sovereign credit rating of the country in which the rated entity is domiciled. Not placing a ceiling on the FSR of a company is based on two concepts. Firstly, A.M. Best believes it is possible that a company can be more financially secure than the government of the country in which it is domiciled. Secondly, A.M. Best believes that a sovereign default in a given country, while clearly creating a more difficult operating environment, would not necessarily lead to an insurance company in the domicile failing to meet its policyholder obligations.

Does A.M. Best factor sovereign credit risk in its rating process?

Yes. A.M Best does incorporate sovereign credit risk in its rating process. Firstly, since insurers tend to hold a high proportion of domestic sovereign bonds, the investment position of the insurer is evaluated carefully. Risk charging of assets based on, among other things, the credit quality of the asset is included in the analytical process. In addition, the concentration of an investment portfolio is assessed to determine how exposed the insurer is to any one entity, including the sovereign.

Secondly, A.M. Best incorporates country risk into all of its ratings. A.M. Best's country risk analysis incorporates the degree of economic, political and financial system (both insurance and non-insurance) risk. The creditworthiness of a government is factored into the evaluation of country risk in a given domicile. (For more information on A.M. Best's country risk analysis, please see Evaluating Country Risk on page 19.)

Does a change (upgrade/downgrade) in a government's sovereign credit rating change its Country Risk Tier?

Not necessarily. A.M. Best categorizes countries into one of five Country Risk Tiers (CRTs). Given that A.M. Best's view of country risk is less stratified than the standard credit market scale, it would not be possible for there to be a one-to-one correspondence between movements in CRTs and movements in sovereign credit ratings.

Sovereign credit risk is one input into the Country Risk Model. The CRT incorporates political, economic and financial system (both insurance and non-insurance) risk; and while the government's creditworthiness is factored into the model, it is only one of many indicators. In addition to the change in sovereign credit quality, the cause of the improvement/deterioration is examined, be it rising debt, a slowing economy or political upheaval. These underlying factors, which are often the basis for a decline in sovereign credit quality, are captured in the analysis and more directly influence the tier assignment.

Does a government's sovereign credit rating downgrade impact an insurer's Financial Strength Rating?

It depends. Sovereign ratings on their own are not a driver of an insurer's financial strength rating. However, as issues arise with sovereign debt, analysts identify those companies impacted by the issues, including the credit risk of the sovereign government considering any rating downgrades, potential liquidity concerns and any potential change in the operating environment of the country. Additionally, as the credit quality of sovereign debt changes, it is incorporated in the evaluation of the domicile's country risk. Beyond the worsening sovereign credit quality, the cause of the deterioration is examined be it rising debt, a slowing economy or political upheaval. The different impacts of specific company issues and overarching country risk are incorporated into the ratings process on a company-by-company basis.

Therefore, it is possible that a sovereign credit rating downgrade could lead to the downgrade of an insurer's FSR, regardless of whether it is currently rated above or below the sovereign. While a downgrade of sovereign debt does increase country risk and could impact a company's rating, most downgrades of a company rating are triggered by an increase in company-specific risks.

GUIDE TO BEST'S FINANCIAL STRENGTH RATINGS

A Best's Financial Strength Rating is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. The rating is based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile.

Best's Financial Strength Ratings

	Rating	Descriptor	Definition
Secure	A++, A+	Superior	Assigned to companies that have, in our opinion, a superior ability to meet their ongoing insurance obligations.
	A, A-	Excellent	Assigned to companies that have, in our opinion, an excellent ability to meet their ongoing insurance obligations.
	B++, B+	Good	Assigned to companies that have, in our opinion, a good ability to meet their ongoing insurance obligations.
Vulnerable	B, B-	Fair	Assigned to companies that have, in our opinion, a fair ability to meet their ongoing insurance obligations. Financial strength is vulnerable to adverse changes in underwriting and economic conditions.
	C++, C+	Marginal	Assigned to companies that have, in our opinion, a marginal ability to meet their ongoing insurance obligations. Financial strength is vulnerable to adverse changes in underwriting and economic conditions.
	C, C-	Weak	Assigned to companies that have, in our opinion, a weak ability to meet their ongoing insurance obligations. Financial strength is very vulnerable to adverse changes in underwriting and economic conditions.
	D	Poor	Assigned to companies that have, in our opinion, a poor ability to meet their ongoing insurance obligations. Financial strength is extremely vulnerable to adverse changes in underwriting and economic conditions.
	E	Under Regulatory Supervision	Assigned to companies (and possibly their subsidiaries/affiliates) that are publicly placed under a significant form of regulatory supervision, control or restraint - including cease and desist orders, conservatorship or rehabilitation, but not liquidation - that prevents conduct of normal, ongoing insurance operations.
	F	In Liquidation	Assigned to companies that are publicly placed in liquidation by a court of law or by a forced liquidation.
	S	Suspended	Assigned to rated companies when sudden and significant events impact operations and rating implications cannot be evaluated due to a lack of timely or adequate information; or in cases where continued maintenance of the previously published rating opinion is in violation of evolving regulatory requirements.

Rating Modifiers

Modifier	Descriptor	Definition
u	Under Review	Indicates the rating may change in the near term, typically within six months. Generally is event driven, with positive, negative or developing implications.
pd	Public Data	Indicates rating assigned to insurer that chose not to participate in A.M. Best's interactive rating process. (Discontinued in 2010)
s	Syndicate	Indicates rating assigned to a Lloyd's syndicate.

Rating Outlooks

Indicates potential direction of a Best's Financial Strength Rating over an intermediate term, generally defined as 12 to 36 months.

Positive	Indicates possible rating upgrade due to favorable financial/market trends relative to the current rating level.
Negative	Indicates possible rating downgrade due to unfavorable financial/market trends relative to the current rating level.
Stable	Indicates low likelihood of a rating change due to stable financial/market trends.

Under Review Implications

Indicates the potential direction of a Best's Financial Strength Rating that is in Under Review status based on information currently available.

Positive	Indicates there is a reasonable likelihood the company's rating will be raised as a result of A.M. Best's analysis of a recent event.
Negative	Indicates there is a reasonable likelihood the company's rating will be lowered as a result of A.M. Best's analysis of a recent event.
Developing	Indicates there is uncertainty as to the final rating outcome, but there is a reasonable likelihood the company's rating will change as a result of A.M. Best's analysis of a recent event.

Not Rated Designation

NR: Assigned to companies that are not rated by A.M. Best.

Rating Disclosure

A Best's Financial Strength Rating opinion addresses the relative ability of an insurer to meet its ongoing insurance obligations. The ratings are not assigned to specific insurance policies or contracts and do not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. A Best's Financial Strength Rating is not a recommendation to purchase, hold or terminate any insurance policy, contract or any other financial obligation issued by an insurer, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser. In arriving at a rating decision, A.M. Best relies on third-party audited financial data and/or other information provided to it. While this information is believed to be reliable, A.M. Best does not independently verify the accuracy or reliability of the information. For additional details, see A.M. Best's *Terms of Use* at *www.ambest.com*.

Best's Financial Strength Ratings are distributed via press release and/or the A.M. Best website at *www.ambest.com* and are published in the *Best's Credit Rating Actions* section of *Best's Journal*™. Best's Financial Strength Ratings are proprietary and may not be reproduced without permission.
Copyright © 2014 by A.M. Best Company, Inc. **Version 102414**

GUIDE TO BEST'S DEBT AND ISSUER CREDIT RATINGS

A Best's Debt/Issuer Credit Rating is based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile and, where appropriate, the specific nature and details of a rated debt security.

Best's Long-Term Credit Ratings

A Best's Long-Term Debt Rating, assigned to specific issues such as debt and preferred stock, is an independent opinion of an issuer/entity's ability to meet its ongoing financial obligations to security holders when due.

	Rating	Descriptor	Definition
Investment Grade	aaa	Exceptional	Assigned to issues where, in our opinion, the issuer has an exceptional ability to meet the terms of the obligation.
	aa	Very Strong	Assigned to issues where, in our opinion, the issuer has a very strong ability to meet the terms of the obligation.
	a	Strong	Assigned to issues where, in our opinion, the issuer has a strong ability to meet the terms of the obligation.
	bbb	Adequate	Assigned to issues where, in our opinion, the issuer has an adequate ability to meet the terms of the obligation; however, the issue is more susceptible to changes in economic or other conditions.
Non-Investment Grade	bb	Speculative	Assigned to issues where, in our opinion, the issuer has speculative credit characteristics, generally due to a moderate margin of principal and interest payment protection and vulnerability to economic changes.
	b	Very Speculative	Assigned to issues where, in our opinion, the issuer has very speculative credit characteristics, generally due to a modest margin of principal and interest payment protection and extreme vulnerability to economic changes.
	ccc, cc, c	Extremely Speculative	Assigned to issues where, in our opinion, the issuer has extremely speculative credit characteristics, generally due to a minimal margin of principal and interest payment protection and/or limited ability to withstand adverse changes in economic or other conditions.
	d	In Default	Assigned to issues in default on payment of principal, interest or other terms and conditions, or when a bankruptcy petition or similar action has been filed.
	s	Suspended	Assigned to rated issues when sudden and significant events have affected the issuer's operations and rating implications cannot be evaluated due to a lack of timely or adequate information; or in cases where continued maintenance of the previously published rating opinion is in violation of evolving regulatory requirements.

A Best's Long-Term Issuer Credit Rating is an opinion of an issuer/entity's ability to meet its ongoing senior financial obligations.

Ratings from "aa" to "ccc" may be enhanced with a "+" (plus) or "-" (minus) to indicate whether credit quality is near the top or bottom of a category.

Best's Short-Term Credit Ratings

A Best's Short-Term Debt Rating is an opinion of an issuer/entity's ability to meet its financial obligations having original maturities of generally less than one year, such as commercial paper.

	Rating	Descriptor	Definition
Investment Grade	AMB-1+	Strongest	Assigned to issues where, in our opinion, the issuer has the strongest ability to repay short-term debt obligations.
	AMB-1	Outstanding	Assigned to issues where, in our opinion, the issuer has an outstanding ability to repay short-term debt obligations.
	AMB-2	Satisfactory	Assigned to issues where, in our opinion, the issuer has a satisfactory ability to repay short-term debt obligations.
	AMB-3	Adequate	Assigned to issues where, in our opinion, the issuer has an adequate ability to repay short-term debt obligations; however, adverse economic conditions likely will reduce the issuer's capacity to meet its financial commitments.
Non-Investment Grade	AMB-4	Speculative	Assigned to issues where, in our opinion, the issuer has speculative credit characteristics and is vulnerable to adverse economic or other external changes, which could have a marked impact on the issuer's ability to meet its financial commitments.
	d	In Default	Assigned to issues in default on payment of principal, interest or other terms and conditions, or when a bankruptcy petition or similar action has been filed.
	s	Suspended	Assigned to rated issues when sudden and significant events have affected the issuer's operations and rating implications cannot be evaluated due to a lack of timely or adequate information; or in cases where continued maintenance of the previously published rating opinion is in violation of evolving regulatory requirements.

A Best's Short-Term Issuer Credit Rating is an opinion of an issuer/entity's ability to meet its senior financial obligations having original maturities of generally less than one year.

Rating Modifiers

Both Best's Long- and Short-Term Credit Ratings can be assigned a modifier. Note: The public data modifier did not apply to Best's Short-Term Credit Ratings, which are only assigned on an interactive basis.

Modifier	Descriptor	Definition
u	Under Review	Indicates the rating may change in the near term, typically within six months. Generally is event driven, with positive, negative or developing implications.
pd	Public Data	Indicates rating assigned to an issuer that chose not to participate in A.M. Best's interactive rating process. (Discontinued in 2010)
i	Indicative	Indicates rating assigned is indicative.

Rating Outlooks

Indicates the potential direction of a Best's Credit Rating over an intermediate term, generally defined as 12 to 36 months.

Positive	Indicates possible rating upgrade due to favorable financial/market trends relative to the current rating level.
Negative	Indicates possible rating downgrade due to unfavorable financial/market trends relative to the current rating level.
Stable	Indicates low likelihood of a rating change due to stable financial/market trends.

Under Review Implications

Indicates the potential direction of a Best's Credit Rating that is in Under Review status based on information currently available.

Positive	Indicates there is a reasonable likelihood the credit rating will be raised as a result of A.M. Best's analysis of a recent event.
Negative	Indicates there is a reasonable likelihood the credit rating will be lowered as a result of A.M. Best's analysis of a recent event.
Developing	Indicates there is uncertainty as to the final rating outcome, but there is a reasonable likelihood the credit rating will change as a result of A.M. Best's analysis of a recent event.

Not Rated Designation

The Not Rated (NR) designation may be assigned to issuers or issues that are not rated.

Rating Disclosure

A Best's Debt/Issuer Credit Rating is an opinion regarding the relative future credit risk of an entity, a credit commitment or a debt or debt-like security. Credit risk is the risk that an entity may not meet its contractual, financial obligations as they come due. These credit ratings do not address any other risk, including but not limited to liquidity risk, market value risk or price volatility of rated securities. The rating is not a recommendation to buy, sell or hold any securities, insurance policies, contracts or any other financial obligations, nor does it address the suitability of any particular financial obligation for a specific purpose or purchaser. In arriving at a rating decision, A.M. Best relies on third-party audited financial data and/or other information provided to it. While this information is believed to be reliable, A.M. Best does not independently verify the accuracy or reliability of the information. For additional details, see A.M. Best's *Terms of Use* at *www.ambest.com*.

Best's Debt/Issuer Credit Ratings are distributed via press release and/or the A.M. Best website at *www.ambest.com* and are published in the *Best's Credit Rating Actions* section of *Best's Journal*™. Best's Credit Ratings are proprietary and may not be reproduced without permission.
Copyright © 2014 by A.M. Best Company, Inc. **Version 102414**

For more information about A.M. Best's ratings in the MENA, South and Central Asia region, please contact:

NICK CHARTERIS-BLACK

Managing Director, Market Development – EMEA
+44 (0)20 7397 0284
nick.charteris-black@ambest.com

VASILIS KATSIPIS

General Manager, Market Development –
MENA, South & Central Asia
+44 (0) 7731 782 882
vasilis.katsipis@ambest.com

A.M. Best Company is the world's oldest and most authoritative insurance rating and information source. For more information, visit www.ambest.com.

Copyright © 2015 by A.M. Best Company, Inc. ALL RIGHTS RESERVED.

A.M. Best Company, Inc.
Ambest Road
Oldwick, New Jersey 08858
Phone: +1 (908) 439-2200
ratings@ambest.com

A.M. Best Europe – Rating Services Ltd.
12 Arthur Street, 6th Floor
London, UK EC4R 9AB
Phone: +44 (0)20 7626-6264
europe.ratings@ambest.com

A.M. Best Asia-Pacific Ltd.
Unit 4004 Central Plaza
18 Harbour Road
Wanchai, Hong Kong
Phone: +852 2827-3400
asia.ratings@ambest.com

A.M. Best Asia-Pacific (Singapore) Pte. Ltd.
6 Battery Road , #40-02B
Singapore
Phone: +65 6589 8400
asia.ratings@ambest.com

A. M. Best MENA, South & Central Asia*
Office 102, Tower 2,
Currency House, DIFC
P.O. Box 506617, Dubai, UAE
Phone: +971 43 752 780
emea.ratings@ambest.com

*Regulated by the DFSA as a Representative Office

A.M. Best América Latina, S.A. de C.V. (Latin America)
Paseo de la Reforma 412, Piso 23
Col. Juárez, Del Cuauhtémoc
México, DF 06600
Phone: +52-55-5208-1264
americalatina@ambest.com

15.0394