Review & Preview
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European Non-Life Sector Faces Further Economic Uncertainty

Operating Fundamentals for Most Companies Remain Strong.

The Eurozone financial crisis continues to be among the most significant challenges facing insurers, although capital is strong for the European primary insurance market.

In the past year, A.M. Best has continued to stress the balance sheets of insurers for a possible further deterioration in the investment environment in Europe. A.M. Best has taken negative rating actions on several European insurers. Downgrades have been attributed primarily to companies' exposures to Italian and Spanish sovereign debt and Eurozone financial institutions.

Despite balance sheet concerns, operating fundamentals for most companies remain strong. In the context of extreme global catastrophe losses in 2011, reported earnings were robust and have remained so in 2012. Primary European insurers appear able to withstand a significant amount of continued deterioration and volatility, although if conditions were to worsen to a level beyond stress test assumptions, further negative rating actions may be necessary.

The operating environment for Eurozone insurers differs markedly, although those based in certain countries display notable characteristics. A.M. Best notes:

• The German non-life insurance sector enjoyed growth in 2011 and is expected to show resilience in 2012. Given the low interest rate environment, insurers have been lifting rates and are adjusting investment portfolios to concentrate on sectors offering higher yields.

• French insurers posted improved profitability in 2011, owing in part to a benign year for natural catastrophes. Non-life gross premiums written (GPW) set a record in 2011, although underwriting discipline is paramount given the challenging macroeconomic environment.

• Italian insurers are focusing on achieving technical profitability and have implemented rate increases, given the volatile investment environment. In 2011, rate rises continued for motor third-party liability risks, although a sharp decline in new car registrations has offset strong growth in motor premiums.

• Spain's fragile economic and financial conditions have resulted in suppressed demand for non-life insurance, although the insurance market remains profitable. The reduction in economic activity has also resulted in a fall in claims activity.

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Contents

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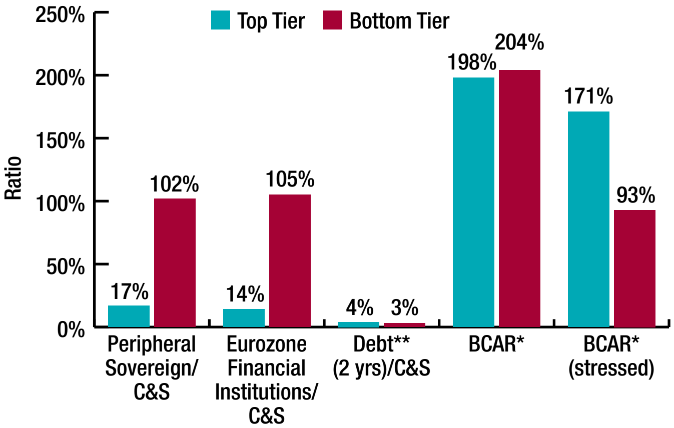
Exhibit 1
Eurozone – A.M. Best's Stress Test (December 2011)
Average ratios for top tier and bottom tier insurance groups, based on third-quarter 2011 data.



* Best's Capital Adequacy Ratio
** Senior or subordinated debt due in less than 2 years.
Source: A.M. Best research

A.M. Best's Stress Testing – December 2011

A.M. Best has been actively monitoring the financial crisis and its effects on European insurers. In December 2011, A.M. Best ran stress tests as economic and investment market conditions in the Eurozone had deteriorated rapidly. There was a heightened level of credit and liquidity risk for insurers operating within Eurozone countries.

The tests were based on third-quarter 2011 financial data for all insurers and reinsurers domiciled in the Eurozone or with significant business operations in the region, and were based on A.M. Best's own capital model, Best's Capital Adequacy Ratio (BCAR). Common features were identified for companies, which were grouped into two tiers – the top tier for companies with the least amount of exposure to uncertainty within the Eurozone, and the bottom tier for those facing the most exposure.

As **Exhibit 1** shows, sharp contrasts became evident between the two groups. While both tiers had very strong levels of capitalisation, on a stressed basis, risk-adjusted capitalisation of companies with the largest exposure to troubled Eurozone assets was affected much more negatively. Under the scenario of further deterioration of Eurozone investments, the bottom tier did not have sufficient capital to support their stated risks.

Rating actions were consequently taken on individual group members to reflect risks created by uncertainties within the Eurozone, and their impact on risk-adjusted capitalisation – especially on a stressed basis – as well as future operating performance and market position. Rating actions were driven by companies' exposure to investments in several peripheral Eurozone economies.

Primary insurers exhibited the highest strain on risk-adjusted capitalisation, particularly those with significant operations in Italy and Spain, and those with life and annuity operations, owing to high asset leverage, rich guarantees and options, and concerns over asset-liability matching.

In contrast, European reinsurers had very little Eurozone exposure, as they had de-risked their balance sheets and maintained a very conservative investment risk profile. Healthy capitalisation and good underwriting discipline resulted in very few negative rating actions for European reinsurers.

A.M. Best's Stress Testing – June 2012

Further stress testing was conducted in early June 2012, based on full-year 2011 results. A.M. Best updated its view on Eurozone exposure based on market conditions, incorporating additional risks from Italy and Spain and a revised stress test that was centred on a severe downward scenario for the Eurozone. This involved stress-testing the balance sheets of companies against their exposure to Eurozone debt, equities, real estate and corporate bonds.

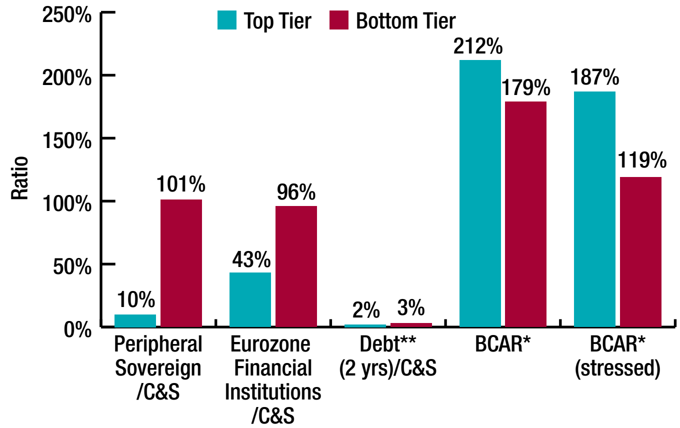
Exhibit 2 shows that the amount of peripheral sovereign debt in relation to capital and surplus did not alter dramatically from the stress testing in December 2011. This indicates it has been difficult for companies to change their debt exposures.

However, companies were sufficiently capitalised in the June 2012 test, with the bottom tier posting a significant improvement in its BCAR scoring under a stressed scenario. Companies had benefited from fairly good earnings and, where possible, had reduced equity and real estate investments and increased their cash balances. This indicated some stability, improved margins and greater protection of the balance sheet, so few rating adjustments were taken.

Exhibit 2

Eurozone – A.M. Best's Stress Test (June 2012)

Average ratios for top tier and bottom tier insurance groups, based on year-end 2011 data.



* Best's Capital Adequacy Ratio

** Senior or subordinated debt due in less than 2 years.

Source: A.M. Best research

At the time of June's stress testing, A.M. Best expected the challenging recessionary environment, stagnated growth in gross domestic product (GDP) and severe market turbulence in Europe's major economies would continue over the near to medium term. Volatile financial markets were expected to remain, resulting in poor investment returns and extremely low current investment yields in "safe haven" securities.

A.M. Best recognised that short-term steps had been taken to reduce the level of risk in the Eurozone in 2012. They included the Long Term Refinancing Operation implemented by the European Central Bank (ECB) from December 2011 through March 2012, which provided EUR 1 trillion of temporary liquidity to the European banking sector, and the restructuring of Greek debt in February.

However, at the time of the June downgrades, A.M. Best said it had a negative view of the overall market environment for European insurers. The underlying conditions that created the weak economic performance across the Eurozone – notably heightened debt to GDP ratios and sluggish economies – remained.

Negative Outlook Remains for European Insurers

Since A.M. Best conducted its stress testing in June 2012, there have been few negative rating actions. This is a consequence of the strong operating fundamentals of these companies, with insurers reporting solid underwriting performance. In many cases, these carriers hold top-five positions in their key markets. Furthermore, their market strength is emphasised by a multi-platform distribution system that generates strong business retention and a competitive advantage in their core markets.

These European insurers often benefit from a global business platform. While they may be experiencing economic strain in key markets, they have diversified books of business and associated investment portfolios backing these businesses.

Investment exposure related to peripheral Eurozone sovereign debt and financial institution investments is on a par with catastrophe exposure as the greatest current risk to balance sheets. Consequently, a number of insurers, predominantly based in peripheral Eurozone countries, remain on negative outlook.

In 2012, economic conditions continue to deteriorate in the Eurozone, and previous projections of economic recovery have proved to be optimistic. There is the possibility that Greece may withdraw from the Eurozone in 2013, and concern remains regarding the contagion effect of a Greek exit, particularly with regard to Ireland, Portugal, Spain and Italy.

In September 2012, Mario Draghi, president of the European Central Bank (ECB), unveiled details of a new bond-buying programme aimed at easing the Eurozone's debt crisis. While A.M. Best recognises the ECB's pledge to purchase in the secondary market unlimited amounts of Eurozone sovereign debt, within certain conditions, was a new frontier, these actions alone will not solve the problems facing Europe. While it can provide breathing space, volatility is expected to continue until a lasting solution to the crisis is found.

In September 2012, Germany's Constitutional Court also reached a critical decision in support of the Eurozone by permitting the establishment of the European Stability Mechanism (ESM), provided Germany's liabilities were limited to EUR 190 billion.

Despite the ECB's actions, there are a number of ongoing pressures on ratings. The negative economic conditions can dampen top-line growth, while moral hazard may result in higher theft and fraudulent claims. These factors could have a negative impact on the profit and loss accounts of insurers over time.

European insurers are attempting, where possible, to increase rates, and underwriting margins are passable based on current pricing. Reserving levels are showing stability, with modest reverse releases benefitting returns.

A.M. Best's greatest concern for European primary insurers is the sudden impact macroeconomic conditions can have on an insurer's balance sheet. Scenarios that could place a company under severe pressure include the write-down of a large European country's sovereign debt, or the exit of a current member of the Eurozone and the expected contagion effects of such an action. A.M. Best currently believes both of these scenarios are unlikely, but they could have extremely damaging consequences for the sector if they were to occur.

There are additional risks regarding the ability of the ECB to fully implement its bond-buying programme, given that the plan may face political resistance. While short-term relief may be provided, fundamental long-term concerns that have contributed to the Eurozone crisis – such as the lack of competitiveness of southern European countries versus those in the north – have not been addressed. A.M. Best therefore retains its negative view on the European insurance sector, as structural issues of the Eurozone do not appear likely to be resolved anytime soon. A.M. Best continues to hold discussions with insurers and will closely monitor their investment portfolios, as well as the legislative actions that are crucial to solving the crisis.

German Non-Life Insurers' Focus on Rates Improves Profitability

The German non-life insurance market has proved to be resilient, as it continued to enjoy growth in 2011 and is expected to remain robust in 2012.

In 2011, the sector recorded its strongest annual percentage increase in premiums since 2003. The primary contributor to such growth was motor business, with motor gross premiums written (GPW) increasing by an estimated 3.6% in 2011 as rates were lifted after years of inadequate pricing.

Insurers have also been able to increase rates for liability insurance. After the global financial crisis, it appears that insurers are evaluating risks more closely before underwriting. Pricing for most other property/casualty (P/C) risks has been stable.

Non-life insurers are increasingly focusing on underwriting profitability as the low interest rate environment in Germany continues to suppress investment income. Additionally, insurers are adjusting their investment portfolios to take account of this new reality, concentrating on sectors that offer higher yields.

Motor Market Drives Non-Life Insurance Growth

The German non-life insurance market expanded by 2.5% to reach EUR 56.6 billion of premium income in 2011 (see **Exhibit 4**). This reflected Germany's continued economic recovery since 2009, with gross domestic product (GDP) increasing by 3.1% in 2011, although the International Monetary Fund predicts GDP will grow at a slower rate, expanding by just 0.6% in 2012 and by 1.5% in 2013. Germany's economic upturn has been supported by a decline in unemployment and low inflation, which is forecast

Exhibit 3
Germany Non-Life – Top 20 Insurers (2009-2011)
(EUR Thousands)

		Gross Premiums Written			Gross Combined Ratio (%)		
Rank	Company	2009	2010	2011	2009	2010	2011
1	Allianz Versicherungs-AG	EUR 9,100,348	EUR 8,943,094	EUR 8,906,456	97.9	104.2	105.4
2	AXA Versicherung AG	3,258,686	3,176,351	3,544,571	98.6	105.6	103.4
3	R+V Allgemeine Versicherung AG	2,604,750	2,716,359	3,023,753	104.6	105.5	102.3
4	Allianz Global Corporate & Specialty AG	2,338,663	2,408,614	2,725,443	84.3	90.5	97.2
5	HDI-Gerling Industrie Versicherung AG	2,523,548	2,529,877	2,720,547	107.8	100.3	109.8
6	ERGO Versicherung AG	1,676,390	2,643,064	2,711,532	95.8	95.3	94.4
7	Generali Versicherung AG	1,690,410	1,623,888	1,596,909	96.4	97.7	96.7
8	LVM Landwirtschaftlicher Versicherungs	1,389,557	1,458,399	1,553,328	99.1	103.1	96.4
9	R+V Versicherung AG	1,146,733	1,371,189	1,492,356	100.1	102.4	106.6
10	Gothaer Allgemeine Versicherung AG	1,400,400	1,402,370	1,426,021	98.9	100.6	97.2
11	Wuerttembergische Versicherung AG	1,304,758	1,324,110	1,379,816	91.8	98.8	92.5
12	VHV Allgemeine Versicherung AG	1,264,793	1,373,671	1,372,433	103.9	102.3	102.3
13	HUK-COBURG Haftpflicht-Unterstuetzungs	1,299,109	1,319,392	1,363,568	94.3	100.1	102.6
14	HUK-COBURG-Allgemeine Versicherung AG	1,121,797	1,168,984	1,248,488	91.4	96.3	98.1
15	SV SparkassenVersicherung Gebaeudevers	1,201,832	1,201,210	1,232,613	105.2	101.5	97.7
16	AachenMuenchener Versicherung AG	1,020,231	1,029,609	1,074,030	94.1	91.2	91.2
17	Bayerischer Versicherungsverband Versicherung	977,694	1,026,060	1,058,561	108.7	108.9	106.9
18	Westfaelische Provinzial Versicherung	1,017,757	1,027,338	1,039,749	92.4	96.5	94.3
19	DEVK Allgemeine Versicherungs AG	896,143	951,679	995,232	101.0	100.9	98.4
20	Landschaftliche Brandkasse Hannover	954,041	960,457	989,128	94.6	101.4	98.1

Source: BestLink® – Global Statement File

Exhibit 4
Germany Non-Life & Life – Key Market Statistics (2007-2011)

Indicator	2007	2008	2009	2010	2011
Population (Millions)	82.26	82.12	81.88	81.76	81.78
Gross Domestic Product (EUR Billions)	2,428.50	2,473.80	2,374.50	2,476.80	2,570.80
Change in Real GDP (%)	3.39	0.81	-5.08	3.56	3.06
Inflation (%)	3.12	1.13	0.84	1.85	2.27
Unemployment Rate (%)	8.78	7.60	7.74	7.06	5.98
Insurance Penetration (%)					
Life	3.25	3.22	3.59	3.65	3.38
Health	1.21	1.23	1.33	1.34	1.35
Non-Life	2.24	2.21	2.30	2.23	2.20
Total	**6.71**	**6.65**	**7.22**	**7.22**	**6.93**
Insurance Premiums Written (EUR Billions)					
Life	78.97	79.59	85.25	90.35	86.80
Health	29.46	30.33	31.47	33.27	34.68
Non-Life	54.50	54.62	54.70	55.22	56.62
Total	**162.93**	**164.54**	**171.42**	**178.84**	**178.10**
Change in Total Premium Volume (%)	0.61	0.99	4.18	4.36	-0.41

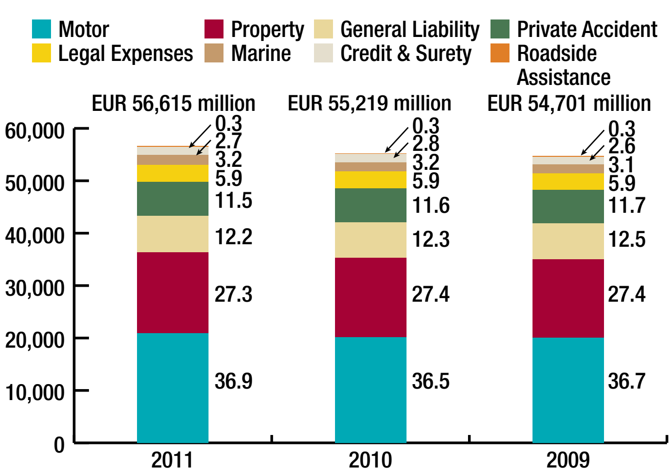
Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Gesamtverband der Deutschen Versicherungswirtschaft

to decline to 1.9% in 2012 from 2.3% in 2011. However, weakening global demand for German exports and the continued uncertainties regarding the Eurozone sovereign debt crisis may dampen economic growth prospects.

Motor insurance underpinned the growth in non-life premiums in 2011 as the sector strengthened rates. According to data from the German insurance trade association, Gesamtverband der Deutschen Versicherungswirtschaft (GDV), in 2011 GPW for motor risks was EUR 20.9 billion (36.9% of total non-life premium in 2011), compared with EUR 20.2 billion a year earlier (see **Exhibit 5**).

In some cases, insurers were able to push through rate increases of as much as 10% for motor third-party liability after years of inadequate rates. Rates for motor fleets were also increased, while some insurers cancelled policies that were attracting high losses. It is worth noting that the motor fleet insurance market in Germany is unique in comparison with other European markets, as insurers are able to increase rates in some instances – or even cancel policies – midway through the year.

Exhibit 5
Germany Non-Life – Gross Premiums Written By Line of Business With Market Shares (2009-2011)
(%)



Source: Gesamtverband der Deutschen Versicherungswirtschaft

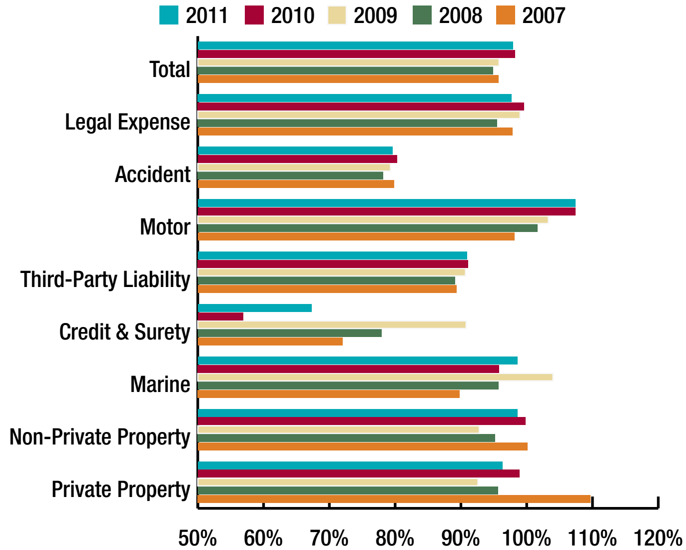
Motor rate rises are expected to continue throughout 2012, although claims remain high. Despite rate increases, motor business remains unprofitable, and in 2011 this class of business incurred the greatest losses. **Exhibit 6** shows combined ratios have been increasing for motor, reaching 107.4% in 2010 and 2011. The motor market remains very competitive, and motor physical damage claims were high in 2011 after flooding at the beginning of the year and heavy regional hailstorms during the summer.

Other Non-Life Rates Remain Stable

As was the case with motor, virtually all other lines of business enjoyed increases in GPW in 2011. The exception was credit and surety, for which premium income remained stable (see **Exhibit 5**). In 2011, credit and surety was among the smallest classes of business, accounting for just 2.7% of total non-life premium. Nevertheless, as **Exhibit 6** shows, it proved to be the most profitable sector with a combined ratio of 67.3%.

Exhibit 6

German Non-Life – Combined Ratios By Line of Business (2007-2011)



Source: Gesamtverband der Deutschen Versicherungswirtschaft

Property, which is the second largest line of business – accounting for 27.3% of non-life premium in 2011 – experienced 2.1% growth in GPW (see **Exhibit 5**). In comparison, property GPW grew by 1.2% in 2010. Although rates for private home insurance remain under pressure, particularly for non-catastrophe-exposed risks, insurers are attempting to reduce limits and increase rates for catastrophe-exposed commercial property risks. Combined ratios for both private property insurance and commercial business improved by 2.6 and 1.2 percentage points, respectively, in 2011 (see **Exhibit 6**).

A greater focus on achieving underwriting profitability and understanding risks underwritten was apparent for liability lines, particularly for directors' and officers' insurance and policies for financial institutions. While rates have remained fairly flat in 2011 and 2012 for these lines of business, insurers have been requesting more detailed information before committing to underwriting such risks. In view of recent events, a notable trend has been the reduction in capacity for complex accounts or those with a poor loss history.

Profitability Improves

The German non-life insurance market posted an improved total combined ratio of 97.9% in 2011 (see **Exhibit 6**). In comparison, 2010's combined ratio was 98.2%, although this was a particularly poor year for losses, with freezing weather conditions at both the beginning and end of the year resulting in increased attritional claims, as well as claims resulting from windstorm Xynthia. **Exhibit 7** shows the claims ratio in 2010 reached 80.3%, improving to 79.4% in 2011. Nevertheless, 2011's total loss ratio was higher than those from 2007 to 2009.

A.M. Best believes the non-life insurance sector is conservatively invested, with the current weak investment environment forc-

Exhibit 7

Germany Non-Life – Claims Ratios By Line (2007-2011)

(%)

	2007	2008	2009	2010	2011
Private Property	82.0	68.0	64.3	69.6	67.7
Non-Private Property	80.4	75.0	72.1	78.0	78.0
Marine	68.6	68.1	65.5	64.0	67.7
Credit & Surety	51.9	70.9	76.7	43.1	47.5
Third-Party Liability	64.5	67.0	67.5	69.5	66.9
Motor	91.8	96.0	97.0	99.6	98.1
Accident	56.9	57.1	58.2	60.2	60.2
Legal Expense	70.7	71.2	75.0	71.9	70.6
Total	**78.6**	**78.8**	**78.5**	**80.3**	**79.4**

Source: Gesamtverband der Deutschen Versicherungswirtschaft ing insurers to focus on profitable underwriting as the yields on German government bonds remain at historic lows. German motor insurers registered investment returns in 2011 of EUR 1.9 billion, compared with EUR 3.1 billion in 1999. The average return on investment for motor insurers was 3.5% in 2011, down from 4.3% in 2010 and 7.3% in 2002.

As the low interest rate environment is likely to persist, some of the larger insurers are investing more actively in corporate bonds and commercial real estate financing projects as they seek better yields. At the end of 2011, property investments accounted for EUR 5.5 billion out of a EUR 138.0 billion investment portfolio. Data from the German insurance regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), show that in 2010, direct investments in property and property funds represented EUR 5.1 billion out of EUR 138.0 billion of total investments. According to figures from BaFin, property investments have been relatively stable, representing 3.7% to 3.8% of total investments from 2007 to 2010, increasing to 4.0% at the end of 2011.

BaFin noted in its second-quarter 2012 report that German insurers are increasingly investing in infrastructure projects (including renewable energies). *BaFinQuarterly* explained that insurers were attracted by the long-term nature of these investments, which normally generate attractive yields.

German Insurers Well Placed, but Uncertainties Remain

Overall, A.M. Best believes non-life German insurers are robust, with companies anticipating a modest increase in premium in 2012. Provided there are no major catastrophes for the remainder of the year, the sector should be well positioned to post an improved combined ratio. In the first half of 2012, it appears motor rate increases have been sustained, although combined ratios are expected to remain in excess of 100%, reflecting years of competitive pricing.

Offsetting factors for premium growth include the cautious income expectations of private households. The growing use of comparison portals over the past few years has increased competition and places further downward pressure on prices. In particular, aggregators are growing in popularity for personal lines such as motor, where margins are already tight. Consequently, the market share of tied agents has been reducing for these lines of business.

Insurers additionally faced a number of major loss events in 2012, including a long period of freezing weather at the beginning of the year that caused burst water pipes. Floods in January also resulted in property claims, as well as motor damage.

The German financial system has not directly experienced the economic crisis that has affected the southern European countries, although it is not immune. On the whole, capitalisation for the sector is strong, with companies having a long tradition of conservative reserving. However, continuing turbulence in investment markets and the weakening macroeconomic outlook for Germany may put strains on insurer capitalisation going forward.

France's Non-Life Sector Resilient Despite Economic Difficulties

The French insurance market has experienced significant volatility during the past few years, although the non-life sector continues to grow.

While the life market contracted in 2011, gross premium written (GPW) for non-life insurers continued to increase. The non-life sector benefited from a harder market, with rates for motor lines in particular lifted to improve profitability.

A benign year for natural catastrophes in 2011, compared with 2010, also supported the non-life market. The sector posted improved profitability levels in 2011 and is maintaining a solvency margin well above the regulatory required amount.

Despite rates being forecast to modestly increase, insurers could face strain on their overall profitability. Maintaining underwriting discipline is paramount, given the challenging macroeconomic environment that has resulted in continued low investment returns.

Market Overview

The economic slowdown in France has had a negative impact on the country's overall insurance market (including life insurance), with total GPW growing by a modest 3.4% in 2010 and falling 8% in 2011 (see **Exhibit 8**). France's gross domestic product (GDP) grew by 1.7% in 2011, although this is forecast to fall to no more than 0.5% in 2012. Unemployment is projected to remain relatively high at 9.9% in 2012.

Data from the insurance association, Fédération Française des Sociétés d'Assurances (FFSA), shows GPW for the non-life segment increased 4.6% to an estimated EUR 47.9 billion in 2011. This is a record level for the non-life market, with rate increases mainly accounting for the increased premiums.

Virtually every line of business – with the exception of commercial property, which remained static – contributed to non-life growth (see **Exhibit 9**). Motor, the largest line of business at 40% of non-life GPW, experienced a near 4% increase in premiums to EUR 19 billion. The

Exhibit 8

France Non-Life & Life – Key Market Statistics (2007-2011)

Indicator	2007	2008	2009	2010	2011
Population (Millions)	61.97	62.30	62.64	62.80	63.09
Gross Domestic Product (EUR Billions)	1,887.28	1,931.46	1,889.66	1,931.40	1,995.34
Change in Real GDP (%)	2.23%	-0.20%	-2.63%	1.38%	1.72%
Inflation (%)	1.61%	3.16%	0.10%	1.74%	2.29%
Unemployment Rate (%)	8.37%	7.81%	9.50%	9.80%	9.68%
Insurance Penetration (%)					
Life & Health	8.05%	7.17%	8.19%	8.32%	7.12%
Non-Life	2.31%	2.31%	2.38%	2.37%	2.40%
Total	**10.36%**	**9.48%**	**10.57%**	**10.69%**	**9.52%**
Insurance Premiums Written (EUR Billions)					
Life & Health	152.00	138.40	154.70	160.60	142.10*
Non-Life	43.60	44.70	45.00	45.80	47.90*
Total	**195.60**	**183.10**	**199.70**	**206.40**	**190.00***
Change in Premium Volume (Total) %	-0.76%	-6.39%	9.07%	3.36%	-7.95%

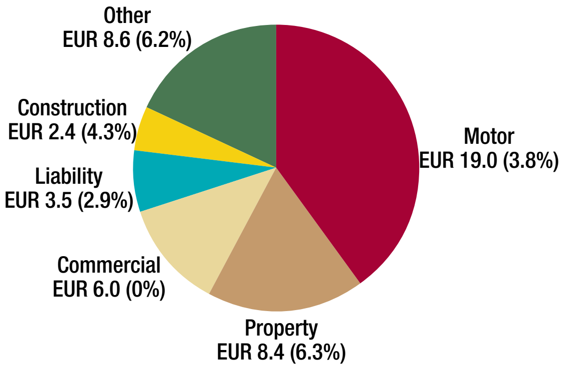
*Estimated

Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Fédération Française des Sociétés d'Assurances

Exhibit 9

France – Non-Life Insurance: Gross Premiums Written by Line of Business and Percentage Growth (2011)

(EUR Billions)



Numbers in parentheses show year-on-year change in GPW.
Source: Fédération Française des Sociétés d' Assurances, A.M. Best research.

second-largest class of business, household property, enjoyed a 6% uplift in GPW to EUR 8.4 billion.

The increases in non-life GPW are, in part, a result of higher rates. Insurers are exercising greater underwriting discipline, as the continued uncertainty in the Eurozone has resulted in historically low government bond yields. A.M. Best considers the need to focus on maintaining underwriting profitability to be paramount.

Some insurers began to lift rates in 2009 for certain personal lines of business. For years, the motor sector has suffered from unprofitable underwriting, given increasing damage repair and bodily injury costs. In 2011, motor insurers implemented rate increases of approximately 4%, and rates are expected to increase in line with inflation for medical costs and spare parts in 2012.

Natural hazards in 2010, including windstorm Xynthia in February, had an adverse impact on the property sector. As a result of the higher claim experience recorded in 2010, property rates for homeowners increased in 2011 and were expected to increase in 2012. The effects of the economic slowdown in France also started to affect this line of business, with theft claims increasing on the back of increased burglaries.

Rates for commercial and industrial risks have been relatively stable, reflecting competition for these classes. However, where rates are flat or soft, insurers are attempting to improve technical profitability by altering terms and conditions and ending multiyear contracts, particularly for property and large commercial risks. There is a greater focus on deductibles, limits, exposure and exclusions.

According to Groupement des Entreprises Mutuelles d'Assurance (GEMA), the mutual sector grew its non-life GPW by 5% to EUR 12.5 billion in 2011. Mutuals have not been immune from the challenging market conditions, whereby consumers are tightening their belts. However, the majority of mutuals sell directly to the policyholder, and these lower expense and acquisition costs, together with their specific ownership structure, have enabled mutuals to offer more competitive pricing. A.M. Best believes the increase in GPW reported by French mutuals has been driven by a desire to increase market share in a favourable rate environment. While technical profitability for mutuals remains acceptable, this will present a challenge for non-mutual insurers.

The momentum for rate increases appears to have continued in 2012, according to first-quarter data from the FFSA. In *Tableau de bord de l'assurance* May 2012, the association stated that the French non-life market grew by approximately 4% compared with the first quarter of 2011.

French Non-Life Insurers' Performance in 2011

As stated above, insurers are under increasing pressure to focus on underwriting profitability. The ongoing uncertainty within the Eurozone, together with the prospect of Solvency II, has led French insurers to de-risk their balance sheets, and insurers can no longer rely on investment returns. According to the FFSA, investment income for non-life insurers in 2011 fell to EUR 4.3 billion, down from EUR 6 billion in 2010. Before the global economic downturn, investment income reached EUR 7.6 billion (for 2006 and 2007).

In 2011, solvency and profitability levels for French non-life insurers were negatively affected by the difficult economic conditions. Nevertheless, results remained good. Data from the FFSA show capital and surplus in 2011 represented 62.3% (EUR 43.6 billion) of premiums. When including unrealised investment gains, this ratio reached 91%, which was down from the 103% reported in 2010 but exceeded 2008's level of 89.9%. Any deterioration in the Eurozone macroeconomic fundamentals is likely to have a negative effect on solvency, with the risk of increased credit spreads reducing insurers' unrealised gains.

The French non-life insurance sector has improved its underwriting profitability in the past two years. The sector's combined ratio improved in 2010 and 2011. It fell from 100.9% in 2009 to 98.4% in 2010, and to 94.5% in 2011 (see **Exhibit 10**). However, natural catastrophes remain among the most significant threats to this trend. Notable events have included severe flooding in Var in the summer of 2010. In December 2011, windstorm Joachim struck the north of France and was followed by windstorm Andrea, which caused damage in various areas of the country in January 2012.

The French government intends to pass legislation to reform the natural catastrophe insurance system, known as *Régime Cat Nat* (Nat Cat scheme). The reform will not bring any changes to the current articulation of the scheme, in which the French national reinsurer, Caisse Centrale de Réassurance (CCR), plays a major role, but it should ensure coverage is based on an exhaustive list of named perils. Rates will vary in relation to risk exposures for local authorities and companies above a certain size, with the aim to foster risk prevention. Under the current regime, there is a Nat Cat flat percentage surcharge for natural catastrophe risks on all property contracts, regardless of the property insured.

Mergers, Acquisitions and Overseas Expansion

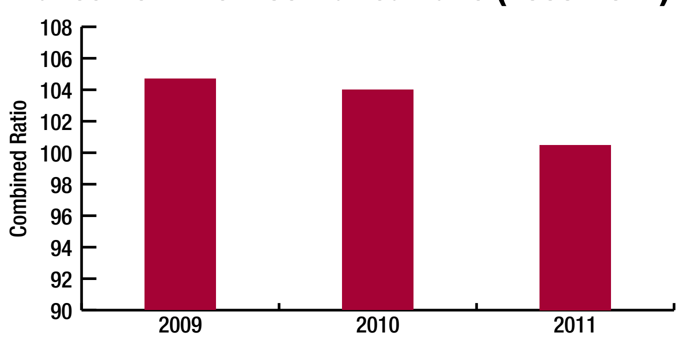
France's non-life insurance market has been subject to merger and acquisition (M&A) activity recently. Much of this has centred on Groupama, which has suffered financial difficulties, culminating in a EUR 3 billion investment write-down in 2011. Groupama has come under pressure to sell subsidiaries and investments after this hit to capitalisation, which resulted from high exposure to equities and sovereign debt within peripheral Eurozone countries.

Sales have included its Spanish subsidiary Groupama Seguros y Reaseguros to Grupo Catalana Occidente, and its property/casualty (P/C) brokerage business Gan Eurocourtage to Allianz France. In July 2012, Groupama announced its intention to sell its Polish insurance branch, Proama, to Generali PPF Holding.

A number of French insurers are attempting to grow outside of France, seeking risk diversification and faster growth through M&A deals. For example, Covéa acquired U.K. insurer Provident Insurance in June 2011. In April 2011, the French SGAM purchased an 81% stake in Banca Popolare di Milano's life operation, which controls BPM's P/C business, BPM Assicurazioni.

Exhibit 10

France Non-Life – Combined Ratio (2009-2011)



Source: Fédération Française des Sociétés d'Assurances

In addition to pursuing growth in other European countries, French insurers also see opportunities in emerging markets in Africa, given its relative proximity and common language. French insurers such as Axa, as part of a wider emerging markets strategy, are focusing on western African countries including Ghana, the Ivory Coast and Senegal, although they face competition from Moroccan insurers.

Conclusion

Technical profitability in the French market has improved considerably since 2009, when the overall market's combined ratio reached 104.7%. A combination of rate increases in 2011 and a more benign claims environment has driven the large improvement in technical profitability. A.M. Best expects rate increases to continue in 2012 and 2013, albeit at lower levels than those achieved in 2010 and 2011.

The sector has shown good underwriting discipline in what has been a challenging investment environment, which is unlikely to improve in the foreseeable future. Any deterioration in Eurozone macroeconomic fundamentals is likely to have a negative effect on the market's overall capitalisation. The effects of the economic slowdown have already had consequences for insurers, with an increase in burglaries noticeable for retail property lines of business. However, as in other European countries, the slowdown may result in an overall reduction in claims as a result of reduced economic activity.

Italy's Non-Life Insurance Sector Faces Shifting Landscape

The Italian non-life insurance market faces changes as the sector is subject to new legislation and industry consolidation, while the country's ongoing economic challenges constrain demand for coverage.

Insurers are focusing on achieving technical profitability after some challenging years and an increasingly volatile investment environment. In 2011, rate rises continued for motor third-party liability (MTPL) risks, although a sharp decline in new car registrations has offset strong growth in motor premiums.

Italy's weak economy will continue to result in lower household spending and cuts in government expenditures. The global financial crisis caused the gross domestic product (GDP) to contract by 5.49% in 2009, although the economy returned to modest growth in 2010 and 2011 (see **Exhibit 11**). However, uncertainties over Italy's sovereign debt remain, with the Eurozone crisis prompting forecasts that Italy's GDP will decline by 1.9% in 2012 and the country's unemployment rate will increase to 9.5%.

The insurance sector was exposed to high levels of suspected fraud and claims even before Italy's economic downturn, and these continue to impact loss ratios. However, the recently passed law *Cresci Italia* (Grow Italy) aims to help reduce fraud, as well as increase transparency and competition in the insurance industry.

A successful completion to the proposed four-way merger involving Unipol and Fondiaria-Sai is expected to create a rival to Assicurazioni Generali. The two companies will merge with Premafin and Milano Assicurazioni. With three major players set to dominate the market after the merger, with Allianz remaining the third-largest non-life insurer, the insurance industry is looking for stronger governance from a new insurance regulatory body to protect the interests of smaller participants. The three biggest insurers would control almost 60% of the non-life market, widening the gap between the key players and the smaller companies.

Motor Rate Rises Drive Non-Life Premium Growth

The Italian non-life insurance market returned to growth in 2011, with premium

Exhibit 11
Italy Non-Life & Life – Key Market Statistics (2007-2011)

Indicator	2007	2008	2009	2010	2011
Population (Millions)	59.13	59.62	60.05	60.34	60.63
Gross Domestic Product (EUR Billions)	1,554.20	1,575.14	1,519.70	1,553.17	1,580.22
Change in Real GDP (%)	1.68%	-1.16%	-5.49%	1.80%	0.43%
Inflation (%)	2.81%	2.35%	1.10%	2.09%	3.65%
Unemployment Rate (%)	6.12%	6.79%	7.79%	8.38%	8.37%
Insurance Penetration (%)					
Life	3.95%	3.46%	5.34%	5.80%	4.67%
Non-Life	2.42%	2.38%	2.41%	2.29%	2.30%
Total	**6.38%**	**5.84%**	**7.75%**	**8.09%**	**6.98%**
Insurance Premiums Written (EUR Billions)					
Life	61.44	54.56	81.12	90.11	73.87
Non-Life	37.65	37.45	36.68	35.61	36.36
Total	**99.09**	**92.01**	**117.80**	**125.72**	**110.23**
Change in Premium Volume (Total) %	-6.76%	-7.15%	28.03%	6.72%	-12.32%

Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Associazione Nazionale fra le Imprese Assicuratrici income rising 2.1% to EUR 36.4 billion, according to data from insurance trade association, the Associazione Nazionale fra le Imprese Assicuratrici (ANIA).

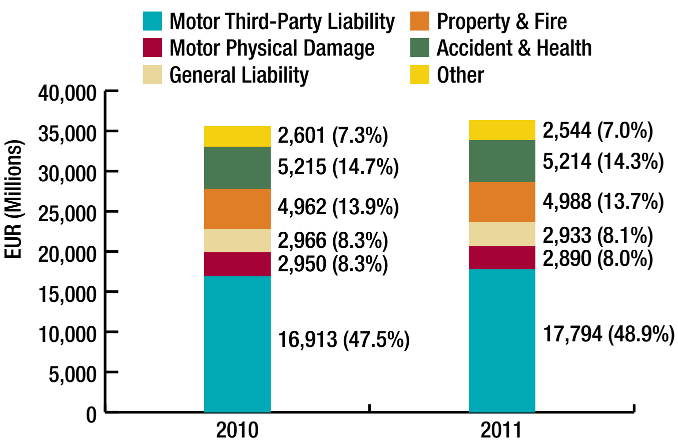
The motor segment, which accounted for 57% of non-life premiums in 2011, was the key contributor to renewed growth for the non-life sector, as premiums for MTPL and motor physical damage increased by 4.1% (see **Exhibit 12**).

Insurers began implementing tariff increases on MTPL insurance from the second half of 2010 to rebalance technical accounts on what has been an unprofitable line of business in recent years. Rates have been lifted by as much as 30%, and insurers have been attempting to increase prices in 2012, although to a lesser extent than in previous years.

More appropriate pricing for motor risks has contributed to an improvement in combined ratios for MTPL. This line of business has been unprofitable from a technical perspective, although the combined ratio improved from 106% in 2010 to 103% in 2011, having been as high as 108% in 2009 (see **Exhibit 13**).

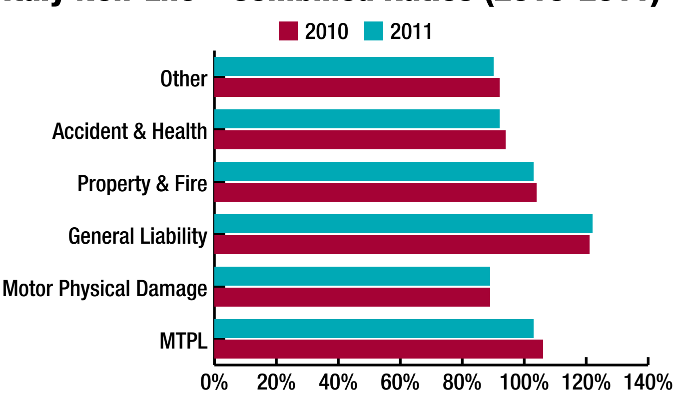
Other non-life risks, including medical malpractice, which has suffered from poor technical performance, have also been subject to major rate increases. However, there has not been a hardening across the whole of the non-life market because of the ongoing difficult economic situation and labour market in Italy. As **Exhibit 12** shows, gross premiums written (GPW) for general liability in fact fell in 2011. Insurers offering general liability coverage have additionally faced increased competition from the Italian branches of foreign insurers. General liability business (including medical malpractice, professional liability, directors and officers, and employers liability) has been unprofitable, with the combined ratio for this class of risk reaching 122% in 2011 (see **Exhibit 13**).

Exhibit 12
Italy Non-Life – Gross Premiums Written By Line of Business (2010-2011)



NOTES:
Market share shown in parentheses.
Source: Associazione Nazionale fra le Imprese Assicuratrici

Exhibit 13
Italy Non-Life – Combined Ratios (2010-2011)



Source: Associazione Nazionale fra le Imprese Assicuratrici

Property rates were broadly flat in 2011, although these are expected to increase for commercial property covers after the earthquake activity and aftershocks in the Emilia-Romagna region of Italy in May 2012, which significantly damaged manufacturing facilities and consumer goods inventories. Catastrophe modelling firm EQECAT has estimated insured losses could reach EUR 700 million (USD 875 million).

EQECAT'S estimate is particularly sensitive to the value of commercial facilities and their contents. The Emilia-Romagna region had low insurance penetration – estimated between 3% and 5% for commercial and industrial lines of business and 1% or less for residential lines – as many people expect the government to cover them in the event of a catastrophe. Market participants expect catastrophe-exposed risks to see rate rises of up to 20%, with changes being made to reinsurance renewal programmes.

The implications of the planned four-way merger involving Unipol and Fondiaria-Sai are unclear. Some market participants believe the deal, which has regulatory approval but still carries execution risk, could lead to reduced competition, particularly for motor risks. The merger will create the largest insurer to rival Assicurazioni Generali, which has been the clear market leader. Generali accounted for 17% of total premiums and 19% of non-life premiums in Italy in 2011.

Italy's Insurance Market Liberalised Under New Law

According to ANIA, the Italian non-life insurance sector had a solvency margin of 269% in 2011, down marginally from 288% in 2010. The trade association's data also show non-life insurers collectively posted an improved combined ratio in 2011 at 97.9%, compared with more than 100% in 2009 and 2010 (see **Exhibit 14**). This was a consequence of an improvement in the claims ratio, driven by motor rate increases, while expense ratios have broadly remained stable at between 24.1% and 24.7% during the past five years.

Cresci Italia, also known as Italy's "Liberalization" law, aims to stimulate competition and enhance transparency in the insurance market by targeting areas such as fraud and the insurance distribution network to improve prices for the consumer. Tied agents remain the key distribution channel for non-life business, accounting for 82% of premium in 2011. Under Article 34 of the law, companies and agents selling motor insurance must provide quotes from three different insurers.

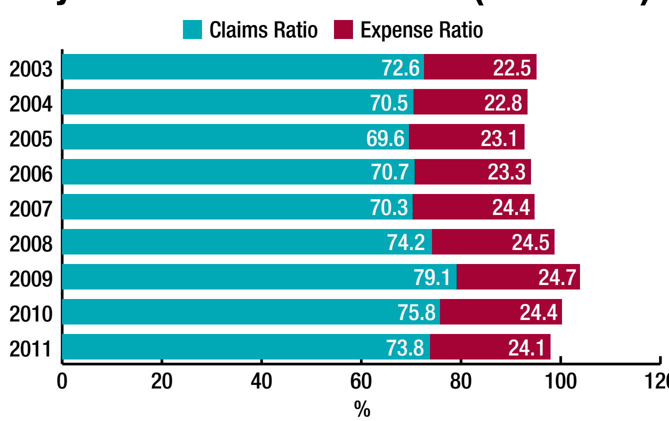
Article 34 is likely to be a positive development from a consumer standpoint, although it could create challenges for motor insurers, especially as they have been attempting to improve rates. However, insurers could benefit from other elements of the legislation, such as Article 32 on telematics. Discounts on premiums will be offered to motorists installing an electronic device ("black box") in their vehicles to monitor their driving.

Suspected fraudulent claims are a particular issue for motor insurers, notably in southern Italy. In recent years, the government has attempted to reduce fraud, and one of the key objectives of *Cresci Italia*, which was enacted in March 2012, is to continue this drive. For example, the new legislation stipulates a certified physician's signed document must be presented for minor bodily-injury claims. There are higher penalties for insurance fraud, and a new electronic system linked to databases is being introduced to replace paper insurance certificates and prevent the counterfeiting of these documents.

While *Cresci Italia* is likely to have an impact on the insurance market, the industry is looking to the insurance regulator to ensure that the wider details are enforced.

Exhibit 14

Italy Non-Life – Combined Ratio (2003-2011)



Source: Associazione Nazionale fra le Imprese Assicuratrici

The sector has been regulated by the Istituto per la Vigilanza sulle Assicurazioni Private e di Interesse Collettivo (ISVAP), although oversight of the insurance market is being reviewed as part of a government spending review. A new supervisory authority for the insurance industry will be created. The Istituto di Vigilanza sulle Assicurazioni (IVASS), will work closely with the Bank of Italy.

Challenging Times Ahead

The Italian non-life market is likely to face a number of challenges, including recent legislative changes and the impact of the current Eurozone crisis. Italian insurers have significant investments in Italian government bonds, which have suffered from rising yields on the back of concerns about the government deficit. A.M. Best does not expect these bonds to default, but in the unlikely event of a default or write-down, Italian non-life insurers would suffer severe strains on capitalisation. The slowdown in economic activity also presents a challenge by reducing demand for insurance products; however, this is offset by a likely fall in claims activity.

Despite these challenges, there remain some positives for the sector, with the rating environment improving in 2012 and the market expected to show an overall underwriting profit in 2013. The merger of Unipol and Fondiaria-Sai may also benefit the larger players in the market, with the reduction in competition likely to improve the rating environment. Government measures to tackle fraud and reduce the cost of small claims are also expected to have a positive impact on the industry.

Spanish Non-Life Insurance Sector Profitable, but Challenges Lie Ahead

The Spanish non-life insurance sector remained profitable in 2011, but growth remains challenging as it continues to face one of the bleakest economic environments since the 1930s.

Non-life insurers continue to benefit from solid distribution networks that encourage customer loyalty and ensure that the market continues to make underwriting profits. However, Spanish insurers could face deteriorating technical results as they compete on pricing. Insurers are under pressure to offer competitive rates, as the country's troubled economic position suppresses demand for cover and household spending remains under strain.

The fragile economic and financial conditions that Spain is experiencing have resulted in the non-life insurance market facing suppressed demand for insurance, with earned premiums falling 3.4% in 2010 (see **Exhibit 15**), according to figures released by the Dirección General de Seguros y Fondos de Pensiones (DGSFP). Data from the Spanish insurance regulator show that in 2011, non-life earned premium stabilised and increased a modest 0.6% to EUR 31.2 billion, with growth in property and funeral expenses business helping to offset decreases in motor and liability insurance.

Gross and net claims improved in 2011 (see **Exhibit 16**). Financial results as a percentage of net earned premiums (NEP) were sound at 4% but have been declining steadily since 2009.

A.M. Best remains concerned regarding the prospects for Spanish government bonds and financial institutions debt, which have been impacted negatively by Spain's economic and financial deterioration. Although A.M. Best does not expect Spanish government bonds to default, any material write-down would have a significant impact on the risk-adjusted capitalisation of the non-life sector.

Spain's gross domestic product (GDP) is forecast to contract by 1.83% in 2012, and unemployment has been increasing steadily, reaching an estimated 21.6% in 2011 (see **Exhibit 15**).

Losses have been subdued as a result of a slowdown in economic activity, which has helped the Spanish non-life insurance market to improve its profitability, with combined ratios falling from 93.8% in 2010 to 92% in 2011.

Exhibit 15
Spain Non-Life & Life – Key Market Indicators (2009-2011)
(EUR Billions)

	2009	2010	2011
Population (Millions)	45.8	46.0	46.2
Gross Domestic Product	EUR 1,047.8	EUR 1,051.3	EUR 1,073.4
Change in Real GDP (%)	-3.7%	-0.1%	0.7%
Inflation (%)	0.9%	2.9%	2.4%
Unemployment Rate (%)	18.0%	20.1%	21.6%*
Insurance Premiums Earned			
Life	EUR 29.2	EUR 27.4	EUR 29.9
Non-Life	EUR 32.1	EUR 31.0	EUR 31.2
Total	**EUR 61.3**	**EUR 58.4**	**EUR 61.1**
Change in Premium Volume (Total) (%)	1.8%	-4.8%	4.6%

* Estimated
Sources: International Monetary Fund, World Economic Outlook Database, April 2012; Dirección General de Seguros y Fondos de Pensiones

Exhibit 16
Spain Non-Life – Profitability (2009-2011)

	2009	2010	2011
Retention (% of Gross Earned Premium)	85.9	85.2	88.6
Gross Claims (% of GEP)	70.7	70.9	68.4
Gross Expenses (% of GEP)	21.5	21.6	21.4
Net Claims (% of Net Earned Premium)	72.8	72.1	70.5
Net Combined Ratio (% of NEP)	93.9	93.8	92.0
Financial results (% of NEP)	4.9	4.6	4.0
Technical-Financial Result (% of NEP)	11.0	10.9	11.4

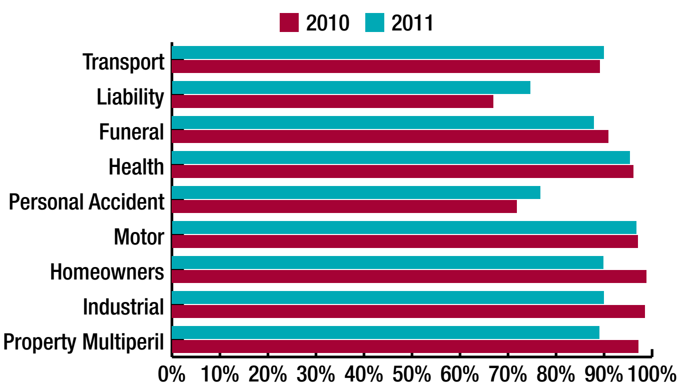
Source: Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones (ICEA); Fundación Mapfre

Combined ratios for property multiperil risks improved by 8 percentage points (see **Exhibit 17**) as a result of better claims experience during the year. Property premiums, which represented a fifth of total non-life gross premiums written (GPW) in 2011, showed good growth in rates, resulting in the sector's GPW increasing by 3.3% (see **Exhibit 18**). Homeowners GPW increased by 4.4%, although the number of policies grew by just 1%.

There was a slight drop in the combined ratio for motor risks (see **Exhibits 17** and **18**), which is the largest line of business, accounting for more than a third (36%) of non-life premium in 2011. The sluggish economy has driven new car sales to a 20-year low and reduced the number of insured vehicles, while policyholders have switched to more basic coverage. Furthermore, usage of vehicles has been constrained in recent years, resulting in lower claims.

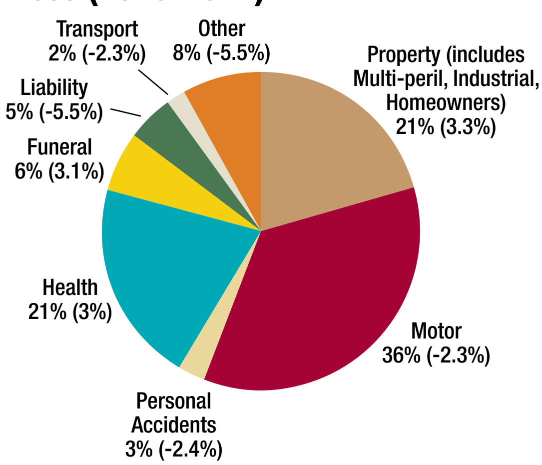
Premiums for health and funeral risks grew in 2011, largely as a result of modest rate increases. Funeral expenses coverage, which provides a guaranteed sum to pay for funeral services, is growing from a low base but is experiencing steady demand as consumers value the security of the product in challenging economic times. Funeral expenses are a historical feature of the Spanish insurance market. Originally conceived as a prepaid plan covering funeral expenses for the older generation, it has developed into a more complex insurance product that extends to family groups, offering add-on services such as legal assistance and travel coverage. Increasingly concentrated with a few niche players, it has been used successfully in cross-selling initiatives. Business volumes remain material and profitable.

Exhibit 17
Spain Non-Life – Combined Ratios (2010-2011)



*Estimated average of transport lines (i.e. cargo, marine, engineering, agriculture)
Source: Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones (ICEA); Fundación Mapfre.

Exhibit 18
Spain Non-Life – Market Share by Line of Business (2010-2011)



NOTE:
Numbers in parentheses show year-on-year percentage change in premiums in 2011 v. 2010
Source: A.M. Best calculation based on Investigación Cooperativa entre Entidades Aseguradoras y Fondos de Pensiones (ICEA); Fundación Mapfre

However, other lines of business are coming under pressure, notably liability, which has been impacted by softer pricing as well as new entrants into the market. With the market still remaining very profitable, this pricing trend is expected to continue.

Rates Remain Under Pressure

Rates across the Spanish market tend to be under pressure, reflecting the favourable loss history of the market and the competitive environment. There is excess capacity, with more than 100 non-life insurers in the Spanish market, while the 10 largest companies controlled 38% of the market in 2011. Competition in certain lines such as liability is aggressive; although insurers are struggling with low investment returns, the non-life market remains among the most profitable in Europe. While the economy is still depressed, claims levels are expected to remain stagnant, which will encourage companies to cut rates further. Companies are also well capitalised and solvency margins remain high, with the non-life market at 2.6 times the minimum regulatory requirement, although this has deteriorated from 3.4 times in 2010.

Spain's insurance market is experiencing structural changes through merger and acquisition (M&A) activity. In July 2011, Mutua Madrileña purchased a 50% stake in SegurCaixa Adeslas, the non-life insurance arm of CaixaBank, making it the largest health insurer in Spain. In June 2012, Grupo Catalana Occidente and INOCSA agreed to purchase Groupama Seguros y Reaseguros, the French mutual Groupama's Spanish subsidiary.

Although the bancassurance sector plays an important part in the distribution of life products, it is less prevalent in the non-life sector, accounting for just 8% of distribution in 2011. The bancassurance model faces a number of challenges in the coming years, particularly with the ongoing legal wrangling surrounding distribution agreements between insurers and recently merged *cajas* (savings banks), as well as the impact of the recent EUR 100 billion bank bailout. However, with life products expected to face fierce competition from banks, it is likely that banks will aggressively try to improve their presence in the profitable non-life market, putting further pressure on rates.

While Spain's non-life insurance market is profitable, the sector faces significant challenges in the event of further erosion of Spain's sovereign creditworthiness and continued negative developments regarding the Eurozone sovereign debt crisis.

A relaxation of underwriting discipline would result in pressure on technical results. Rates across most sectors have been cut to varying degrees, which is likely to impact results that to date have been good. The positive side for insurers is that claims activity should remain suppressed as the economy continues to suffer. However, while technical profitability remains good and insurers have ample capital, further significant competition cannot be discounted.

Despite the difficulties Spanish insurers face, they have proved to be resilient, as their top line and technical profits demonstrate. The main ongoing concern is capitalisation, which remains strong but has declined in recent years, and could be severely impacted in the unlikely event of a sovereign default.

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