

Assigning Public Data Ratings To U.K. Companies

The purpose of this report is to provide transparency regarding A.M. Best Co.'s criteria for assigning Public Data Ratings (PDRs) to both life and non-life companies in the United Kingdom. A.M. Best's analytical leadership in the U.K. insurance market is demonstrated by its extensive coverage of companies on an interactive basis. Nevertheless, the focus of its interactive ratings, commissioned by companies in the United Kingdom, tends to be operations that underwrite business in the international market. In order to meet the need from interested parties in a wider range of companies, including a broader spectrum of companies that underwrite solely in United Kingdom, A.M. Best assigns PDRs to certain insurers.

Rating Criteria

A Public Data Rating is an A.M. Best opinion of the financial strength of an insurer. The PDRs are expressed using the same rating scale and definitions as A.M. Best's interactive ratings of long-term financial strength but have a "pd" rating modifier applied to ensure the user is aware of the more limited information basis for the rating. In common with interactive ratings, the assignment of Best's PDRs incorporates analysis of balance-sheet strength, operating performance and business profile. However, the analysis does not generally involve interaction with company management. A wide range of public documents and disclosures may be used as part of the analytical process for assigning PDRs.

In contrast, an interactive A.M. Best rating is produced at the request of an insurer. The rating process includes detailed interviews of senior management and, typically, access to non-public data and other information. Analysis on issues that typically would have limited distribution in the public domain plays a sig-

nificant part in the interactive rating analysis (e.g., detailed information on management strategy, earnings forecasts, reinsurance protections and reserving methodology).

The Rating Process for PDRs in the United Kingdom

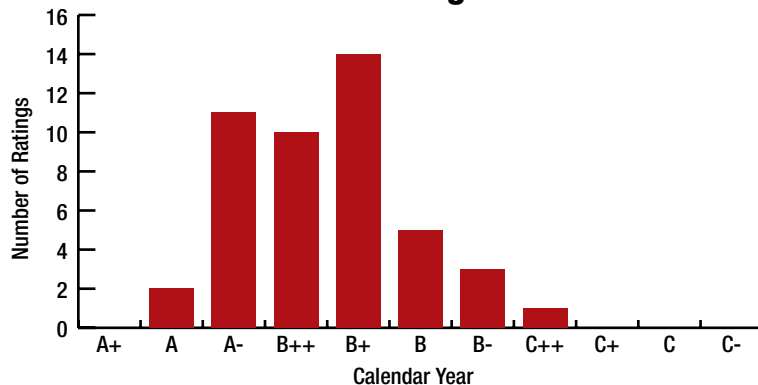
A.M. Best uses both financial statements and returns filed with the U.K. regulator, the Financial Services Authority (FSA), in its analysis. Annual financial statements are the primary source for the quantitative analysis of financial ratios, and A.M. Best evaluates the five most recent years of a company's financial performance. A.M. Best will not assign PDRs to companies with less than three years of data.

Similar to A.M. Best's interactive ratings, the analysis for U.K. PDRs has three distinct sections: balance-sheet strength, operating performance and business profile. Whilst the assignment of any PDR allows for a significant element of judgment, the following weighting provides a broad indication of the relative importance of these factors:

Balance-Sheet Strength	60%
Operating Performance	30%
Business Profile	10%

A.M. Best's database has financial statements for approximately 190 U.K. life insurance companies and 475 U.K. non-life companies (based on 2005 year-end financial statements). By

U.K. PDRs - 2006 Final Ratings



This report was written by Miles Trotter and Vasilis Katsipis, assistant general managers, analytics, at A.M. Best Europe Ltd.



utilizing A.M. Best's database, selected financial data and ratios are reviewed to provide performance benchmarks.

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. A critical measure of balance-sheet strength is the adequacy of an insurer's capital and surplus to support its financial and operating practices. The net required capital to support these practices and the company's other risk exposures—primarily related to product mix and underwriting—are evaluated using Best's Capital Adequacy Ratio (BCAR). The BCAR is the principal means used to assess balance-sheet strength for U.K. PDRs. This stresses the importance of a company's capital position to support its operations and unexpected risks.

Best's Capital Adequacy Ratio (BCAR)

The Universal BCAR model used for the U.K. PDRs is a hybrid of A.M. Best's Property/Casualty and Life/Health BCAR models. A.M. Best's universal 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 statistical independence of the individual components. A company's adjusted surplus is divided by its net required capital, after the covariance adjustment, to determine its BCAR. Companies deemed to have "adequate" balance-sheet strength normally generate a BCAR score of more than 100%. However, the level of capital required to support a given rating level varies by company, depending on its operating performance and, to a lesser extent, its business profile.

The model is populated using data from company financial statements and regulatory returns as appropriate. If there are shortcomings in the data available from public sources, then conservative assumptions and estimates are made.

While A.M. Best's analysis of capital adequacy begins with a BCAR assessment, several other quantitative factors play a

significant part in the rating, including:

Ratios and Tests

Change in net premiums written (NPW): A secure company should demonstrate an ability to support controlled business growth with quality surplus growth from strong internal capital generation.

Net leverage: This ratio measures the combination of a company's net exposure to pricing errors in its current underwriting and errors of estimation in its net liabilities in relation to capital and surplus.

Ceded reinsurance leverage: This ratio measures the company's dependence on the security provided by its reinsurers and its potential exposure to adjustments in this reinsurance.

Gross leverage: This ratio measures a company's gross exposure to pricing errors in its current book of business; to errors

A.M. Best Co.

Methodology

May 21, 2007

PUBLISHER, PRESIDENT AND CHAIRMAN
Arthur Snyder

EXECUTIVE VICE PRESIDENT/CHIEF OPERATING OFFICER
Arthur Snyder III

EXECUTIVE VICE PRESIDENT/CHIEF RATING OFFICER
Larry G. Mayewski

EXECUTIVE VICE PRESIDENT/CHIEF INFORMATION OFFICER
Paul C. Tinnirello

GROUP VICE PRESIDENTS
Manfred Nowacki, Life/Health
Matthew Mosher, Property/Casualty

PRODUCTION
Thomas Dawson IV, Associate Editor
Angel Negron, Designer

Copyright © 2007 by A.M. Best Company, Inc., Ambest Road, Oldwick, New Jersey 08858. ALL RIGHTS RESERVED. No part of this report or document may be distributed in any electronic form or by any means, or stored in a database or retrieval system, without the prior written permission of the A.M. Best Company. For additional details, see Terms of Use available at the A.M. Best Company Web site www.ambest.com.

Best's Ratings reflect the A.M. Best Company's opinion 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. These ratings are not a warranty of an insurer's current or future ability to meet its contractual obligations, nor are they a recommendation to buy, sell or hold any security. Further, any and all information herein is provided "as is," without warranty of any kind, expressed or implied. A.M. Best Company receives compensation for its interactive financial strength ratings, from the insurance companies it rates. In compliance with the Securities Act of 1933, A.M. Best also discloses that it receives rating fees from most issuers of the debt securities it rates. Those fees fall within a range of \$ 7,500 to \$ 500,000.

Copies are available through Customer Service: (908) 439-2200, Ext. 5577. The report is also available online at www.ambest.com/ratings/methodology.html.

For press inquiries or to contact the authors, please contact James Peavy at (908) 439-2200, ext. 5644.



estimating its liabilities; and to its reinsurers.

Diversification of invested assets: If full information is available, the quality and diversification of invested assets are evaluated to assess the risk of default and the potential impact on surplus if the sale of these assets occurred unexpectedly. The better the liquidity, diversification and/or quality of the assets, the less uncertainty there is in the value to be realised upon the sale and the less likelihood there is of default. Particular attention is paid to large, single investments that exceed 10% of a company's total capital and to affiliated investments.

Quick liquidity: This ratio measures the proportion of net liabilities covered by cash and investments that can be converted quickly to cash. This ratio may indicate a company's ability to settle its outstanding liabilities without prematurely selling long-term investments or the need to borrow money.

Debt to capital: This ratio shows a company's total debt to its total capital and surplus. In this ratio, debt is defined as loans and notes payable on both a current and a long-term basis.

Ratios and Tests for Life Insurers Only

Change in New Business Premiums: This is a more accurate measure for evaluating a life insurer's ability to grow than pure NPW growth.

Realistic Capital Margin (RCM) Cover: Where publicly available, the RCM coverage of a life insurer's realistic liabilities is a good indicator of its financial strength, especially for companies with significant liabilities emanating from participatory products.

Value of In-Force Business: This is used to measure the profit-generation ability of the business already accepted by a life insurer.

Ratios and Tests for Non-Life Insurers Only

Underwriting leverage (net premiums written to capital and surplus): This test measures the leverage associated with the level of premiums compared with the total capital and surplus of the company. It measures the company's exposure to pricing errors in its current book of business.

Net technical reserves to capital and surplus: This ratio measures a company's exposure to errors of estimation in its loss

reserves. A higher ratio indicates a greater dependency on maintaining adequate reserves.

Operating Performance

When evaluating operating performance, Best's PDR analysis is focused on the stability and sustainability of the company's sources of earnings relative to the liabilities the company retains. A.M. Best reviews the components of a company's earnings over a five-year period to evaluate the sources of profits and the trends in various profitability measures. Areas reviewed include underwriting, investments, capital gains/losses and total operating earnings, both before and after taxes. The principal profitability tests analysed by A.M. Best as part of the PDR process are as follows:

Ratios and tests

Pretax return on revenue: This ratio measures a company's operating profitability and is calculated as pretax operating income divided by net premiums earned.

Yield on invested assets: This ratio measures the average return on a company's invested assets before capital gains/losses and income taxes.

Change in capital and surplus: This measures the annual change in a company's policyholder surplus derived from operating earnings, investment gains, net contributed capital and other, miscellaneous sources.

Return on capital and surplus: The purpose of this ratio is to measure a company's efficiency in using its surplus on a total return basis. "Total return" is the overall, after-tax profitability from underwriting and investment activities, including unrealised capital gains.

Ratios and Tests for Life Insurers Only

New Business Margins and New Business Value Added: These ratios are used to quantify the profitability of business written during the year.

Return on Embedded Value: This ratio is used to evaluate the profitability of the business accepted by a life insurer. It measures the returns as a proportion of a company's net asset value and the Present Value of Future Profits.

Technical Result as a Percentage of NPW: This measures the profitability of a life insurer on a statutory basis.

Ratios and Tests for Non-Life Insurers Only

Combined ratio: This is the most widely used measure of underwriting profitability, combining a company's loss ratio and expense ratio.

Operating ratio: The operating ratio measures a company's overall, pretax operational profitability from underwriting and investment activities. An operating ratio of less than 100 indicates a company is able to generate a profit from its core operations.

Business Profile

In the interactive rating process, business profile is an important component of A.M. Best's rating evaluation, and the strength of a company's business profile becomes an even greater consideration at the higher rating levels. However, business profile carries the lowest weighting in the PDR process because of the lack of insight A.M. Best has of the companies' business strategies. With no interaction with the management of companies for PDR ratings, it is more difficult to supplement financial data with the information needed to assess a company's profile. Business profile is influenced by the degree of risk inherent in a company's mix of business, an insurer's competitive market position, and the depth and experience of its management. These factors drive current and future performance and, in turn, can impact long-term financial strength and a

company's ability to meet its obligations to policyholders. As part of the PDR process, A.M. Best analyses a company's business mix as well as revenue growth trends. Nevertheless, there is inevitably less focus on likely future trends than with interactive ratings due to information constraints.

Rating Distribution

The chart on page 1 provides the distribution of Best's PDR ratings in the United Kingdom, both non-life and life. It should be noted that a public data rating may prove to be conservative because of the lack of insight into a company's operations and the business strategies it may be implementing. However, A.M. Best does not place an artificial ceiling on the level of the PDR that a company can achieve, although in practice the very highest, "Superior" A.M. Best ratings, are unlikely to be achieved. None of the U.K. companies assigned a PDR has a superior rating of A+ or A++.

In the United Kingdom, all companies are subject to the FSA's Individual Capital Adequacy Standards (ICAS) regime. A.M. Best believes that as a result of the FSA's initiative, the use of risk-based techniques to evaluate capital is more advanced in the United Kingdom than it is in other EU countries. The benefits of ICAS are reflected in the distribution of the U.K. PDRs, which is skewed heavily toward the "Secure" ratings of B+ and above.



Founded in 1899, A.M. Best Company is a full-service credit rating organization dedicated to serving the financial services industries, including the banking and insurance sectors. For more information, visit www.ambest.com or contact one of our offices:

A.M. Best Company
Ambest Road
Oldwick, New Jersey 08858
Phone: (908) 439-2200
Fax: (908) 439-3296
www.ambest.com

A.M. Best Europe Ltd.
12 Arthur Street, 6th Floor
London, UK EC4R 9AB
Phone: (44-20)-7626-6264
Fax: (44-20)-7-626-6265
www.ambest.co.uk

A.M. Best Asia-Pacific Ltd.
Unit 5707 Central Plaza
18 Harbour Road
Wanchai, Hong Kong
Phone: (852)-2827-3400
Fax: (852)-2824-1833
www.ambest.com.hk