

Canadian Public Data Ratings, Property/Casualty

A.M. Best Co. has been assigning Public Data Ratings (PDRs) to Canadian property and casualty companies since 2000. While the Canadian property and casualty industry generally has been more stable than the U.S. industry, there still have been issues that have challenged the financial strength of individual companies. Most notable have been the Quebec ice storm of 1998, the automobile crisis of 2001-03 and, to a lesser extent, the Eastern blackout and Kelona wild fires of 2003, as well as the severe summer storm activity across Canada in 2004 and 2005. Without the recent hard market cycle, these catastrophes certainly would have had a more adverse impact on profitability and financial strength. Considerable earthquake risk for companies in British Columbia and Quebec, as well as the potential for additional severe weather-related losses due to global climate change, also pose a real threat and challenge to most Canadian property and casualty insurers.

Additionally, some Canadian companies have expanded into the United States through either acquisition or organic growth. While this can be beneficial because of improved geographic diversification, there are added risks due to greater legal complexities, and the potential for increased catastrophe-related losses also must be taken into consideration. This was evidenced in 2005, as some Canadian companies were impacted by the U.S. Gulf Coast hurricane losses.

Canadian reinsurance buyers are well aware of the credibility of a Best's Rating. Financial Strength Ratings (FSRs) are an integral part of the reinsurance purchasing process, as Canadian insurers more often than not insist on highly rated reinsurers on their property catastrophe treaties for surplus protection. Likewise, independent commercial lines brokers will insist on a primary company having

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a specific A.M. Best rating before placing their risks with the carrier.

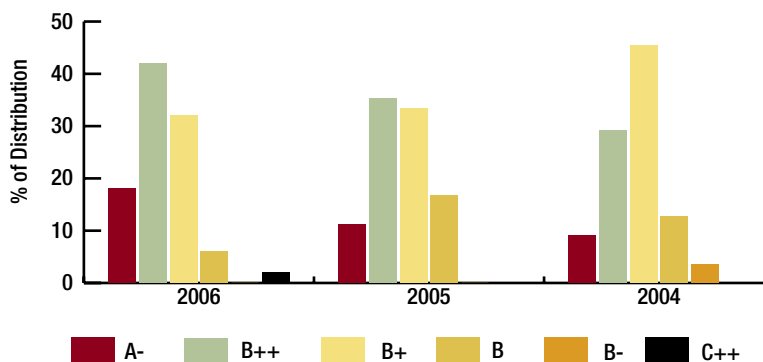
Canadian Property and Casualty Insurance Company Rating Criteria

A PDR is an A.M. Best opinion of the financial strength of an insurer. It is expressed using the same rating scale and definitions as A.M. Best's interactive ratings of long-term financial strength; however, a "pd" rating modifier is applied to ensure that the user is aware of the more limited information basis for the rating. The assignment of Best's Public Data Ratings ("pd" modifier) incorporates analysis of balance-sheet strength, operating performance and business profile. In addition, it considers mix of business, geographic concentration, market environment, underwriting cycle and trend analysis. However, the analysis does not involve discussions with company management. Currently, A.M. Best assigns PDRs to 50 Canadian property and casualty companies.

The graph below displays the most recent three-year trend of the Canadian PDR ratings.

In contrast, an interactive A.M. Best rating is produced at the request of the property and casualty company. The interactive rating process includes annual, detailed interviews with senior management and other representatives of the company. A.M. Best is afforded access to nonpublic data and other information such as, but not limited to: business plans and earnings forecasts;

Canadian PD Companies P/C Ratings Distribution



Source: A.M. Best Co.



reinsurance protection; actuarial analysis; reserving methodologies; and catastrophe modeling. Detailed analysis on these additional aspects of a company allows for a more comprehensive rating process and gives a clearer understanding of the company's actual financial strength. There are currently interactive ratings on nearly 60 Canadian property and casualty companies.

Best's Canadian Property And Casualty PDR Model

A.M. Best's database of statutory financial information has many years of financial statement data from approximately 220 Canadian property/casualty insurance companies, representing about 90% of the net premiums written in the country. Selected financial information is input into and ratios are loaded into the Canadian PC PDR Model to establish industry benchmarks. The Canadian PC PDR Model utilizes the publicly available statutory data that are either voluntarily submitted or purchased. The model is the primary source for the quantitative analysis used in assigning PDRs, and it 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 Best's interactive rating analysis, the Canadian PC PDR Model has three distinct sections: balance-sheet strength, operating performance and business profile. The model assigns the following weights to those sections:

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

Balance-Sheet Strength

As with interactive ratings, the foundation of all PDRs is based heavily on a company's balance-sheet strength. A critical measure of balance-sheet strength is the adequacy of the Canadian insurer's capital and surplus to support its asset, liability and underwriting risks. The Canadian PDR Model takes into account the Canadian version of Best's Capital Adequacy Ratio (BCAR) model, which will be discussed at length later in this report. Other factors include, but are not limited to, overall liquidity, surplus quality and changes in surplus. For all Canadian PDRs, A.M. Best then adjusts the BCAR downward by 15 points to add a degree of conservatism because of the lack of critical information that could be obtained through the interactive rating process.

Operating Performance

When assessing a company's operating performance for a PDR, the model incorporates the two-year average pretax return on equity (ROE), two-year underwriting ratio, investment yield and loss-development test. Furthermore, the five-year financial data are reviewed to analyze trends and compare them with the Canadian property and casualty industry.

Business Profile

When measuring business profile for a PDR, the model considers the business mix and geographic concentration of any new premium written. It should be noted that business profile is evaluated more thoroughly in the interactive rating process, and the strength of a company's business profile becomes an even greater consideration at the higher rating levels. The in-depth market knowledge of the Canadian analytical team plays an important

A.M. Best Co. Methodology

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role in assessing a PDR company's business profile. This includes line-of-business knowledge by province and territory, legal and governmental issues, weather factors and pricing trends in the specific segments.

Best's Capital Adequacy Ratio (BCAR)

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 the Canadian 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 are evaluated by Best's Capital Adequacy Ratio (BCAR). A BCAR is run on all Canadian PD and interactively rated companies.

A company's quantitative results are evaluated on their own merits and also are compared with industry composites as established by A.M. Best. Composite standards are based on the performance of other Canadian insurance companies with comparable business mix and organizational structure. These industry benchmarks are adjusted when needed to reflect changes in underwriting, economic and regulatory market conditions.

Balance-sheet strength is critical, 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 surplus 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 recoverable and loss reserves. 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.

Asset leverage measures the exposure of a

company's surplus to investment, interest rate and credit risks. The volatility and credit quality of the investment portfolio, reinsurance recoverables, agents' balances and other receivables determine the potential impact of asset leverage on the company's balance-sheet strength.

BCAR allows for an integrated review of these leverage areas. BCAR 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 it with economic capital. Some of the stress tests within BCAR include above-normal catastrophes, a decline in equity markets, a rise in interest rates, rapid premium growth and reserve inadequacies. This integrated stress evaluation permits a more discerning view of a company's balance-sheet strength relative to its operating risks.

Balance-sheet strength is only one, albeit significant, component of a PDR, which also includes operating performance and business profile.

Rating Distributions

The following section provides the distribution of Best's Financial Strength Public Data Ratings. A.M. Best wants to reiterate that the PDR model is formula driven, with little analyst interaction in arriving at a rating. A PDR is often more conservative than an interactive FSR, which emphasizes significant dialogue with company management and a substantial amount of supplemental financial, actuarial and risk-management information. In addition, Canadian companies generally manage to an MCT (Minimum Capital Test) score assigned by the Office of the Superintendent of Financial Institutions. The BCAR model, which feeds the PDR model, is more conservative than MCT, as it focuses on forward-looking, risk-adjusted capitalization rather than minimum capital requirements.

A.M. Best will continue to review and refine its Canadian PD Rating Methodology so as to provide the most accurate opinion of a company's financial strength based upon publicly available data.



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.

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