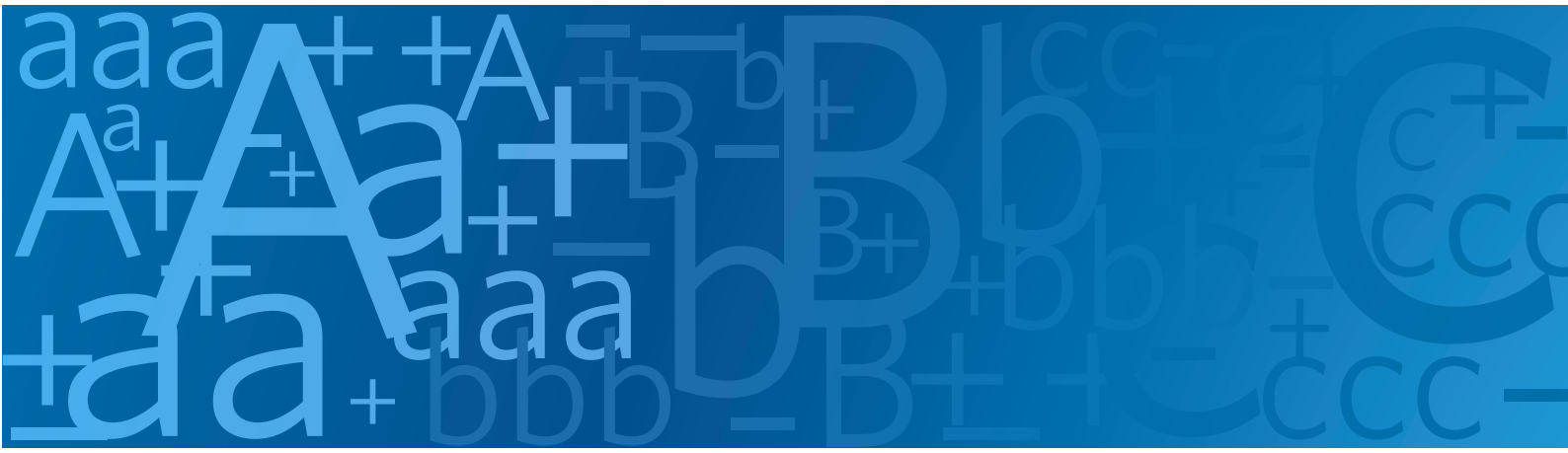
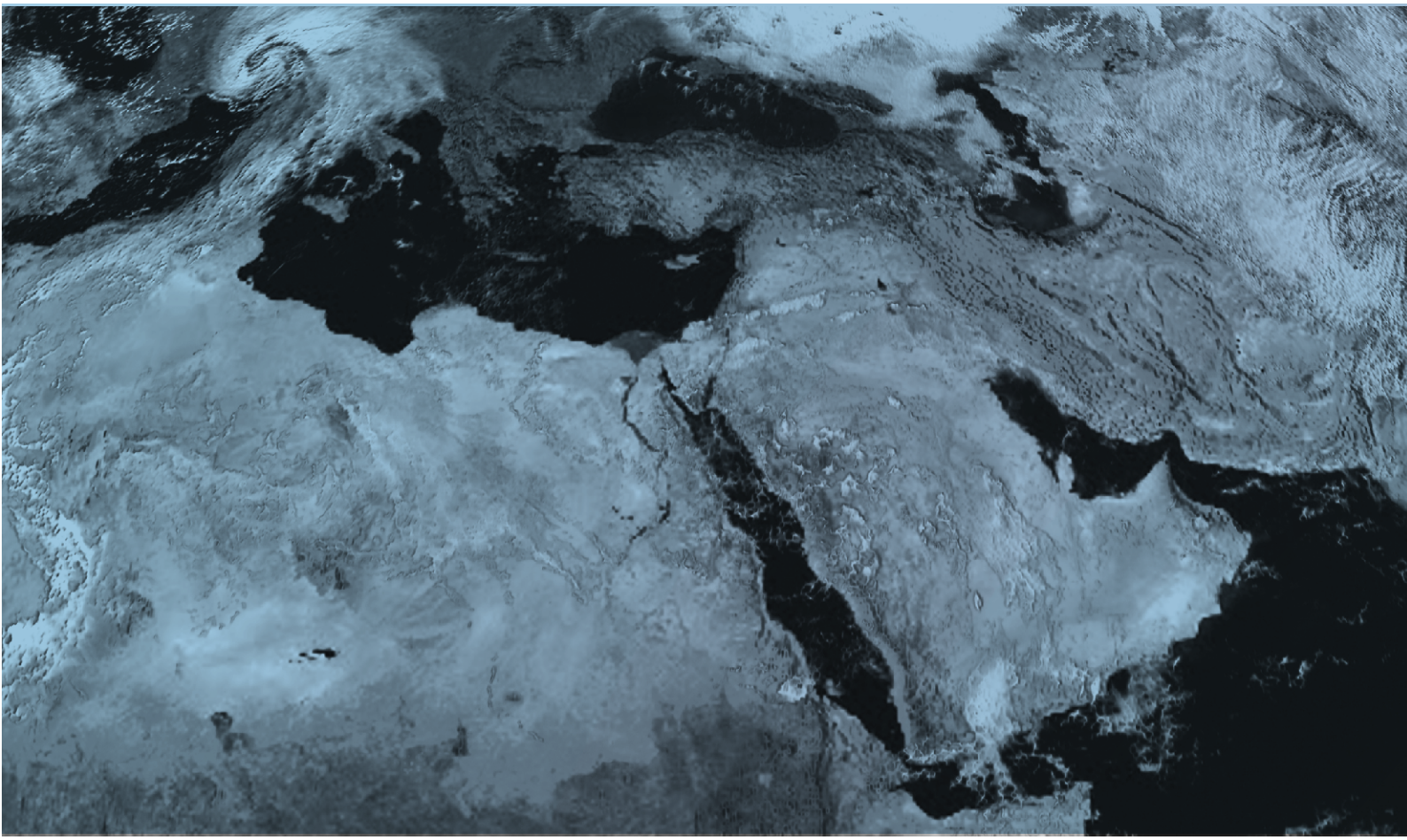
2018

A.M. Best's Introduction to
Insurance Ratings – MENA, South & Central Asia





A.M. BEST®

A.M. Best's Introduction to Insurance Ratings – MENA, South & Central Asia

Source: A.M. Best Rating Services, Inc.

Contents

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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, regional political instability and reduced commodity prices have meant that growth rates for most of the markets remain subdued. Financial performance is volatile for many of the insurance companies in the market mainly as a result of intensified competition and reducing rates. Regulatory oversight of insurance companies continues to be strengthened, with several regulators taking new steps to enhance transparency and policyholder protection. Still, this is one area where the emerging markets continue to lag 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 90 countries. A.M. Best's rating coverage has been constantly increasing in recent years, and A.M. Best has for several years been 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 addition, A.M. Best offers a series of 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, and Best's Rating Assessment Service (RAS) which provides an opinion on an insurer's rating prospects were it to enter into an interactive rating relationship with A.M. Best.

A.M. Best produces leading in-depth research, including special reports and briefings.

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 recognised as the benchmark for assessing the financial strength of insurance-related organisations 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
- More than 3,500 ratings in over 90 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 (re)insurance in the emerging markets of MENA and South & Central Asia
- Leading rating agency for ART and captives coverage
- Key rating agency used by global broker security teams
- Data and research covering 17,000 (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 Ratings: The Global Symbol of Financial Strength

Rating Definitions

Best's Issuer Credit Rating (ICR) An independent opinion of an entity's ability to meet its ongoing **financial** obligations and can be issued on either a long- or short-term basis.

Best's Financial Strength Rating (FSR) An independent opinion of an insurer's financial strength and ability to meet its ongoing **insurance** policy and contract obligations.

Best's Issue Rating (IR) An independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis.

Best's National Scale Rating (NSR) A relative measure of creditworthiness in a specific local jurisdiction that is issued on a long-term basis and derived exclusively by mapping the NSR from a corresponding global Issuer Credit Rating (ICR) using a transition chart.

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

Translation of Issuer Credit Ratings to Financial Strength Ratings

Long-Term ICR	FSR
aaa, aa+	A++
aa, aa-	A+
a+, a	A
a-	A-
bbb+, bbb	B++
bbb-	B+
bb+, bb	B
bb-	B-
b+, b	C++
b-	C+
ccc+, ccc	C
ccc-, cc	C-
c	D

ICR = Issuer Credit Rating
FSR = Financial Strength Rating

Note: D is used for non-insurers and securities.
The rating symbols A++, A+, A, A-, B++, B+ are registered certification marks of A.M. Best Rating Services.

BestMark for 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 a million 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.

The Rating Process, Step by Step

An A.M. Best Market Development contact 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.

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 Management 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 management meeting is a critical component in A.M. Best's analytical process, adequate preparation by the company is imperative.

During management 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. The number of participants involved in the meeting can vary depending on the size and structure of the company.

Companies are encouraged to select a rating agency liaison person who 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 management 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 unauthorised 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 management 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

Non-Life Insurance Rating Meeting Agenda

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 Programmes
- 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

Life Insurance Rating Meeting Agenda

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

Capitalisation

- Capitalisation (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 upon an insurer's scope of operations, size and risk complexity. In some cases, a separate ERM meeting may be required.

Best's Credit Rating Methodology (BCRM)

Best's Credit Ratings (BCRs)

A.M. Best assigns various types of BCRs to a wide variety of insurance organisations, from single legal entity insurers to complex, multinational enterprises with diversified operations.

Best's Credit Rating Scale

Translation of Issuer Credit Ratings to Financial Strength Ratings

Long-Term ICR	FSR
aaa, aa+	A++
aa, aa-	A+
a+, a	A
a-	A-
bbb+, bbb	B++
bbb-	B+
bb+, bb	B
bb-	B-
b+, b	C++
b-	C+
ccc+, ccc	C
ccc-, cc	C-
c	D

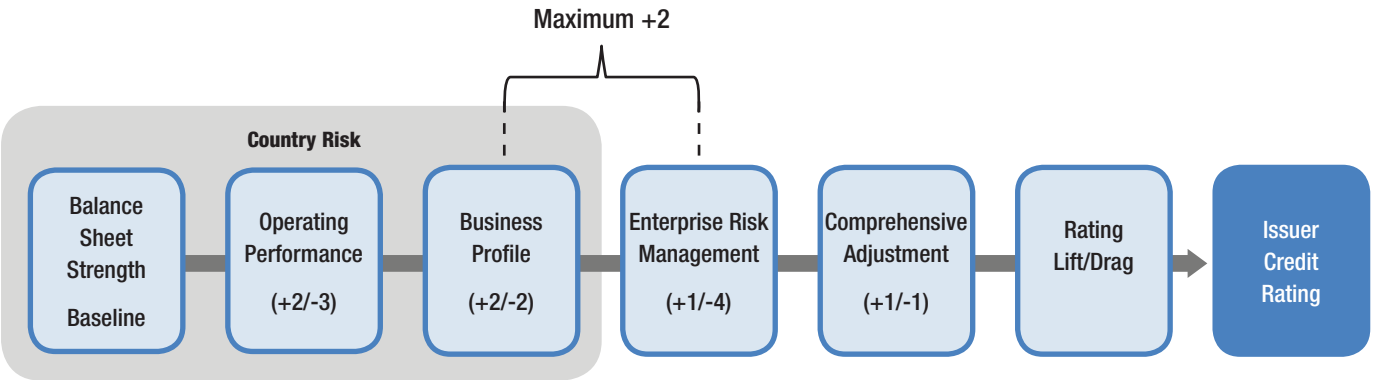
BCRs Include

- **Issuer Credit Rating (ICR):** An independent opinion of an entity's ability to meet its ongoing financial obligations that can be issued on either a long- or short-term basis.
- **Financial Strength Rating (FSR):** An independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations.
- **Issue Credit Rating (IR):** An independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis. When assigned to a specific issue, an IR is an opinion of the ability of the issuer/obligor to meet the ongoing financial obligations to security holders when due.

Best's Credit Rating Methodology (BCRM)

Best's Credit Rating Methodology (BCRM) provides a comprehensive explanation of A.M. Best's rating process. Key rating factors — including an insurer's balance sheet strength, operating performance, business profile, and enterprise risk management (ERM) — are qualitatively and quantitatively evaluated during the rating process. The foundational building blocks of A.M. Best's rating approach are outlined below.

A.M. Best's Rating Process



Balance Sheet Strength

A.M. Best's rating analysis is an interactive process that begins with an evaluation of the company's balance sheet strength. This evaluation includes a three-part analysis focusing on the following areas:

1. The insurance rating unit (the insurer)
2. The financial flexibility and risks associated with the insurer's holding company and/or ownership structure
3. The impact of country risk on the insurer's balance sheet strength

Baseline Balance Sheet Strength Assessment

Balance Sheet Strength Assessment Factors	
BCAR	Liquidity
Quality and appropriateness of reinsurance programmes	Quality of capital
Quality and diversification of assets	Internal economic capital models
Financial and operating leverage	

Best's Capital Adequacy Ratio (BCAR)

The measurement of the insurer's capital adequacy is key to the balance sheet assessment. A.M. Best uses its Best's Capital Adequacy Ratio (BCAR) to differentiate an insurer's balance sheet strength and determine whether its capitalisation is appropriate for its risk profile. The BCAR evaluates many of the insurer's balance sheet risks simultaneously, generates an estimate of the capital needed to support those risks at different confidence intervals, and compares it with the insurer's available capital.

BCAR Assessment

VaR Confidence Level (%)	BCAR	BCAR Assessment
99.6	> 25 at 99.6	Strongest
99.6	> 10 at 99.6 & ≤ 25 at 99.6	Very Strong
99.5	> 0 at 99.5 & ≤ 10 at 99.6	Strong
99	> 0 at 99 & ≤ 0 at 99.5	Adequate
95	> 0 at 95 & ≤ 0 at 99	Weak
95	≤ 0 at 95	Very Weak

Baseline Balance Sheet Strength Assessment

The assessments of the insurance company (Part 1) and its holding company (Part 2) result in the company's "Combined Balance Sheet Strength Assessment". A.M. Best arrives at a company's baseline balance sheet strength assessment by incorporating country risk (Part 3). The baseline is selected for the company from the various options in the Overall Balance Sheet Assessment chart and is determined through analytical judgment and rating committee review.

The Insurance Rating Unit:

Assessment	Key Characteristics
Strongest	The rating unit has the strongest BCAR score with a demonstrated pattern of stability. Its quality of capital and ALM are also the strongest. It has an appropriate and diverse reinsurance programme. Any additional analytical factors are in line with an assessment of strongest.
Very Strong	The rating unit has a very strong BCAR score with a demonstrated pattern of stability. Its quality of capital and ALM are also very strong. It has an appropriate and diverse reinsurance programme. Any additional analytical factors are in line with an assessment of very strong.
Strong	The rating unit has a strong BCAR score with a demonstrated pattern of stability. Its quality of capital and ALM are also strong. It has an appropriate and diverse reinsurance programme. Any additional analytical factors are in line with an assessment of strong.
Adequate	The rating unit has an adequate BCAR score that has been reltively stable. Its quality of capital and ALM are adequate. It has an appropriate reinsurance programme. Any additional analytical factors are in line with an assessment of adequate.
Weak	The rating unit has a weak BCAR score with a demonstrated pattern of volatility. Its quality of capital and ALM are weak. Its reinsurance programme is weak. Any additional analytical factors are in line with an assessment of weak.
Very Weak	The rating unit has a very weak BCAR score with a demonstrated pattern of volatility. Its quality of capital and ALM are very weak. Its reinsurance programme is very weak. Any additional analytical factors are in line with an assessment of very weak.

Holding Company

This analysis involves a review of the impact of the holding company and/or affiliates on the rating unit (the insurer). A.M. Best considers financial flexibility (including the Holding Company's BCAR score), liquidity, financial leverage, interest coverage, dividend requirements, and cash sources and uses (including unregulated non-insurance subsidiaries) to determine the effect on the lead rating unit.

Impact of Holding Company on Balance Sheet Strength Assessment

Assessment	Key Characteristics
Positive	The consolidated BCAR score is more than adequate. Financial flexibility, liquidity, and access to capital markets are high. Financial leverage is low on both an adjusted and unadjusted basis. Interest coverage is more than adequate.
Neutral	The consolidated BCAR score is adequate. Financial flexibility, liquidity, and access to capital markets are adequate. Financial leverage is acceptable on both an adjusted and unadjusted basis. Interest coverage is adequate.
Negative	The consolidated BCAR score is inadequate. Financial flexibility, liquidity, and access to capital markets are low. Financial leverage is high on either an adjusted and unadjusted basis. Interest coverage is inadequate.
Very Negative	The consolidated BCAR score is inadequate. Financial flexibility, liquidity, and access to capital markets are very low. Financial leverage is very high on either an adjusted and unadjusted basis. Interest coverage is inadequate.

Once the holding company analysis is completed, the result is integrated with the balance sheet strength assessment of the lead rating unit.

Combined Balance Sheet Strength Assessment

Lead Rating Unit	Holding Company: Positive	Neutral	Negative	Very Negative
Strongest	Strongest	Strongest	Very Strong	Adequate
Very Strong	Strongest	Very Strong	Strong	Weak
Strong	Very Strong	Strong	Adequate	Very Weak
Adequate	Strong	Adequate	Weak	Very Weak
Weak	Adequate	Weak	Very Weak	Very Weak
Very Weak	Weak	Very Weak	Very Weak	Very Weak

Country Risk

Country risk and its assessment is incorporated into the analysis of balance sheet strength, operating performance, and business profile. A.M. Best defines country risk as the risk that country-specific factors will adversely affect an insurer's ability to meet its financial obligations.

Overall Balance Sheet Assessment

Combined Balance Sheet Assessment (Rating Unit/Holding Company)	Country Risk Tier: CRT-1	CRT-2	CRT-3	CRT-4	CRT-5
Strongest	a+/a	a+/a	a/a-	a-/bbb+	bbb+/bbb
Very Strong	a/a-	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-
Strong	a-/bbb+	a-/bbb+	bbb+/bbb/ bbb-	bbb/bbb-/bb+	bbb-/bb+/bb
Adequate	bbb+/bbb/ bbb-	bbb+/bbb/bbb-	bbb-/bb+/bb	bb+/bb/bb-	bb/bb-/b+
Weak	bb+/bb/bb-	bb+/bb/bb-	bb-/b+/b	b+/b/b-	b/b-/ccc+
Very Weak	b+ and below	b+ and below	b- and below	ccc+ and below	ccc and below

Operating Performance

The second building block of A.M. Best's rating process is operating performance. This analysis can result in an increase, decrease, or no change to the baseline assessment. Possible adjustments range from +2 notches to -3 notches.

A.M. Best views operating performance as a leading indicator of future balance sheet strength and long-term financial stability. A company's profitability affects its ability to generate earnings, and profitable insurance operations are essential for a company to operate as a going concern. In general, more diversity in earnings streams leads to greater stability in operating performance. A.M. Best's analysis of operating performance focuses on the stability, diversity, and sustainability of the company's earnings sources and the interplay between earnings and liabilities.

Operating Performance Assessment

Assessment	Notches	Key Characteristics
Very Strong	+2	Historical operating performance is exceptionally strong and consistent. Trends are positive and prospective operating performance is expected to be exceptionally strong. Volatility of key metrics is low.
Strong	+1	Historical operating performance is strong and consistent. Trends are neutral/slightly positive and prospective operating performance is expected to be strong. Volatility of key metrics is low to moderate.
Adequate	0	Historical operating performance and trends are neutral. Prospective operating performance is expected to be neutral. Volatility of key metrics is moderate.
Marginal	-1	Historical operating trends have been inconsistent. Trends are neutral/slightly negative with some uncertainty in prospective operating performance. Volatility of key metrics is moderate to high.
Weak	-2	Historical operating performance is poor. Trends are slightly negative and prospective operating performance is expected to be poor. Volatility of key metrics is high.
Very Weak	-3	Historical operating performance is very poor. Trends are negative and prospective operating performance is expected to be very poor. Volatility of key metrics is very high.

Business Profile

Business profile is the third building block in A.M. Best's rating process and is a highly qualitative component of A.M. Best's rating evaluation. Business profile may ultimately affect an insurer's current and future operating performance and, in turn, its long-term financial strength and ability to meet its obligations to policyholders. Possible adjustments for business profile range from +2 notches to -2 notches.

The business profile review includes evaluation of the following factors:

- Market position
- Degree of competition
- Distribution channels
- Pricing sophistication and data quality
- Management quality
- Product/Geographic concentration
- Product risk
- Regulatory, event, market, and country risks

Business Profile Assessment

Assessment	Notches	Key Characteristics
Very Favourable	+2	The company's market leadership position is unquestionable, demonstrated, and defensible with high brand recognition. Distribution is seen as a competitive advantage; business lines are non-correlated and generally lower risk. Its management capabilities and data management are very strong.
Favourable	+1	The company is a market leader with strong business trends and good control over distribution. It has diversified operations in key markets that have high to moderate barriers to entry with low competition. It has a strong management team that is able to meet projections and utilise data effectively.
Neutral	0	The company is not a market leader, but is viewed as competitive in chosen markets. It has some concentration and/or limited control of distribution. It has moderate product risk but limited severity and frequency loss. Its use of technology is evolving and its business spread of risk is adequate
Limited	-1	The company has a lack of diversification in geographic and/or product lines; its control over distribution is limited and undifferentiated. It faces high/increasing competition with low barriers to entry and elevated product risk. Management is unable to utilise data effectively or consistently in business decisions.
Very Limited	-2	The company faces high competition and low barriers to entry. It has high concentration in commodity or higher-risk products with very limited geographic diversity. It has weak data management. Country risk may factor into its elevated business profile risks.

Enterprise Risk Management (ERM)

ERM is the fourth building block in the rating process. The impact of ERM on an insurer's rating is based on understanding the development and implementation of an insurer's risk management framework as well as the insurer's risk management capability relative to its risk profile. The framework and the risk evaluations include the following sub-assessments:

Framework Evaluation	Risk Evaluation
Risk identification and reporting Risk appetite and tolerance Stress testing Risk management and controls Governance and risk culture	Product & Underwriting Reserving Concentration Reinsurance Liquidity & Capital management Investments Legislative/Regulatory/Judicial/Economic Operational

Enterprise Risk Management Assessment

Assessment	Notches	Key Characteristics
Very Strong	+1	The insurer's ERM framework is sophisticated, time/stress-tested and embedded across the enterprise. Risk management capabilities are superior and are suitable for the risk profile of the company.
Appropriate	0	The insurer's ERM framework is well-developed and/or adequate given the size and complexity of its operations. Risk management capabilities are very good and are well aligned with the risk profile of the company.
Marginal	-1	The insurer's ERM framework is well-developed; however, certain key elements of the framework are not yet in place or have proven inadequate given the complexity of its operations. Some risk management capabilities are not aligned with the risk profile of the company.
Weak	-2	The insurer's ERM framework is emerging and management is exploring the development of formal risk protocols. Risk management capabilities are insufficient given the risk profile of the company.
Very Weak	-3/4	There is limited evidence of a formal ERM framework in place. Severe deficiencies in risk management capabilities relative to the risk profile of the company are evident.

If a rating unit is practicing sound risk management and executing its strategy effectively, the results will be evident in successful performance over the long term. Possible adjustments for ERM range from +1 notch to -4 notches.

Companies with complex global business profiles have a need for a robust and comprehensive ERM programme. In many cases, the complexities and demands of these companies' "Very Favourable" business profiles require an equally "Very Strong" ERM. Acknowledging this interaction, and the limited impact that these two highly qualitative building blocks may have on credit strength, the combined impact between business profile and ERM will be restricted to a maximum of "+2" notches. This calculation would only affect those companies that have both a "Very Favourable" business profile assessment and a "Very Strong" ERM assessment.

Comprehensive Adjustment

A comprehensive adjustment may be applied in the rating process when the company being reviewed has an uncommon strength or weakness that exceeds (or is less than) what has been captured through the rating process up to this point. A comprehensive adjustment can increase or decrease the assessment by a maximum of 1 notch. The vast majority of ratings will not require a comprehensive adjustment.

Assessment	Notches	Key Characteristics
Positive	+1	The company has uncommon strengths that exceed what has been captured throughout the rating process.
None	0	The company's strengths and weaknesses have been accurately captured throughout the rating process
Negative	-1	The company has uncommon weaknesses that exceed what has been captured throughout the rating process.

Rating Lift/Drag

In this step, the company may be afforded lift (or drag) based on factors such as integration, strategic importance, and contribution to the overall enterprise. The amount of lift or drag assigned depends on the specific circumstances of the insurer. Only companies designated "non-lead rating units" are eligible for lift/drag. For further details on lead and non-lead rating units, please visit http://www3.ambest.com/ambv/ratingmethodology/.

The Credit Rating Process

The typical duration from signed contract to ratings announcement is generally about three to four months. Each interactively-rated entity is assigned to a rating analyst, who manages the ongoing interaction with company management and conducts the fundamental credit analysis as described in A.M. Best's rating criteria.

BCRs are initially determined and periodically updated through a defined rating committee process. The rating committee itself consists of analytical staff and is generally chaired by senior rating officers. The committee approach ensures rating consistency across different business segments and maintains the integrity of the rating process (described briefly below).

1. **Compile Information**
   The assigned analyst collects public and proprietary financial information and data to develop a tailored meeting agenda.
2. **Perform Analysis**
   A.M. Best incorporates a host of qualitative and quantitative measures to evaluate the organisations' financial health.
3. **Determine Best's Credit Rating**
   The A.M. Best Rating Committee ensures rating consistency and maintains the integrity of the rating process and methodology.
4. **Disseminate Best's Credit Rating**
   Best's Credit Ratings are distributed via the A.M. Best website, press releases, and a number of print and digital publications.
5. **Monitor Best's Credit Rating**
   A.M. Best regularly monitors the rating by continually analysing the organisation's creditworthiness.

Sample Information Inputs

Private		Public
• Capital structure • Investment and credit guidelines • Reinsurance guidelines • Exposure to catastrophes • Enterprise risk management (ERM) • Internal capital models	• Meeting with key executives • Business plans and projections • Supplemental rating questionnaire (SRQ) • Actuarial memorandum • Loss provision reports • Cash-flow stress testing	• Financial statements • Reports to shareholders • Public records • Regulatory reports and disclosure notes • Audit reports • Compliance and ethical conduct reports

Characteristics of Highly Rated Insurers

- Superior and stable risk-adjusted capitalisation
- Strong, predictable, and sustainable operating profitability
- Competitive advantage in branding, customer experience, investments, and/or underwriting
- Competitive market position leading to pricing power in core business lines
- Strong and stable operating cash flows, with books of business demonstrating favourable retention trends
- Diversified earnings and revenue streams Effective use of technology/data analytics
- Product design with flexibility/risk-sharing features to effectively react to changing market environments
- Market-leading distribution system
- Comprehensive and proactive enterprise risk management
- Consistency of key metrics compared with peers
- Long-term, well-developed business strategy that has been tested over time
- Strong management team
- Key operations in stable regulatory environments

This overview document provides a quick look at the components of Best's Credit Rating Methodology (BCRM) and rating process. For more information related to the complete BCRM, including various comprehensive criteria procedures applicable to aspects of the insurance and reinsurance industry globally, please visit the Best's Credit Rating Methodology section of our website at http://www3.ambest.com/ambv/.

Criteria: Evaluating Country Risk

The following criteria procedure should be read in conjunction with *Best's Credit Rating Methodology (BCRM)* and all other related BCRM-associated criteria procedures. The BCRM provides a comprehensive explanation of A.M. Best Rating Services' rating process.

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A. Market Description

Country risk is the risk that factors specific to a country could adversely affect the ability of an insurer operating in that country to meet its financial obligations. A.M. Best evaluates and incorporates country risk into all of its credit ratings, which entails identifying the various risks in a country that could directly or indirectly affect an insurance company. These risks are divided into three main categories: economic risk, political risk, and financial system risk; financial system risk is further divided into insurance risk and non-insurance financial system risk.

An evaluation of country risk is not directly comparable to a sovereign debt rating, which entails an evaluation of the ability and willingness of a government to service its debt obligations. Country risk analysis does consider the finances and policies of a sovereign government, but the final determination is not guided solely by these factors; thus, country risk evaluation is not tied to a sovereign debt rating.

A.M. Best's country risk evaluation entails both a data-driven assessment to score the level of risk in a given country and a qualitative determination of country-specific conditions affecting an insurer's operating environment. Countries are placed into one of five tiers, ranging from Country Risk Tier 1 (CRT-1), for countries with a stable environment that poses the least amount of risk, to Country Risk Tier 5 (CRT-5) for those that pose the most risk and, therefore, the greatest challenge to an insurer's financial stability, strength, and performance.

As country risk increases (as measured by a higher Country Risk Tier), the distribution of ratings generally migrates down the rating scale. This same relationship effectively applies to any significant category of risk an insurer faces, i.e., greater risk exposure will pressure financial stability.

Key elements of country risk can be managed or mitigated, effectively diminishing the impact on an insurer's rating. Country risk in and of itself is not equivalent to a ceiling or cap on insurer ratings, but just one of many factors in the rating process.

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.

B. Elements of Country Risk

The three risk categories in A.M. Best's country risk analysis are economic risk, political risk and financial system risk. Economic risk is the risk that fundamental weaknesses in a country's economy will adversely affect an insurer. A.M. Best's assessment of economic risk takes into account the state of the domestic economy, government finances, and international transactions, as well as prospects for growth and stability.

Political risk is the risk that governmental or bureaucratic inefficiencies, societal tensions, an inadequate legal system, or international tensions will adversely affect an insurer. Political risk takes into account 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 (non-insurance) system risk the risk that financial volatility may be present due to inadequate reporting standards, weak banking systems or asset markets, or poor regulatory structure which can adversely affect an insurer. This type of risk encompasses a country's banking system, accounting standards, financial market development, and government finances, as well as the financial system's vulnerability to external or internal volatility. A.M. Best's analysis references Basel II & III, World Bank Insolvency Principles, and international accounting standards, as well as the performance of banks, equity indices, and fixed-income securities.

Insurance risk, a distinct subsection of financial system risk, is the risk that the level of development of a country's insurance industry, as well as public awareness, transparency and effectiveness of regulation, reporting standards, and regulatory sophistication could contribute to financial volatility and compromise an insurer's ability to pay claims. A.M. Best's assessment of insurance risk is based heavily on the Insurance Core Principles (ICP) of the International Association of Insurance Supervisors (IAIS), using a sizable subset of the 28 ICPs divided 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.

C. Calculation of Country Risk

The country risk determination begins with running a Country Risk Assessment to generate a score consisting of the weighted average for the three risk categories. The score is then squared, to represent the non•linear relationship between the score and the actual country risk in the country. Exhibit C.1 shows how the Country Risk Score is calculated.

Exhibit C.1: Calculation of the Country Risk Score

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

Where: I_E = Economic risk

I_P = Political risk

I_{FSi} = Financial system risk (insurance component)

I_{FSni} = Financial system risk (non-insurance component)

ω = Weight applied to each category of risk

In special circumstances—for instance, for a domicile with a particularly strong relationship with another (such as Guernsey and the United Kingdom)—an additional calculation is used to incorporate the influence of larger domicile on the stability of the smaller one.

The country risk score provides a baseline assessment. A higher country risk score indicates a riskier environment, and a lower country risk score, a less risky environment. However, the Country Risk Group also evaluates additional qualitative factors that could influence the overall score or one particular category of risk.

D. Country Risk Tiers

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

CRT-1: The country is characterised by a predictable and transparent political environment, legal system and business infrastructure, a sophisticated financial system regulation with deep capital markets, and a mature insurance industry.

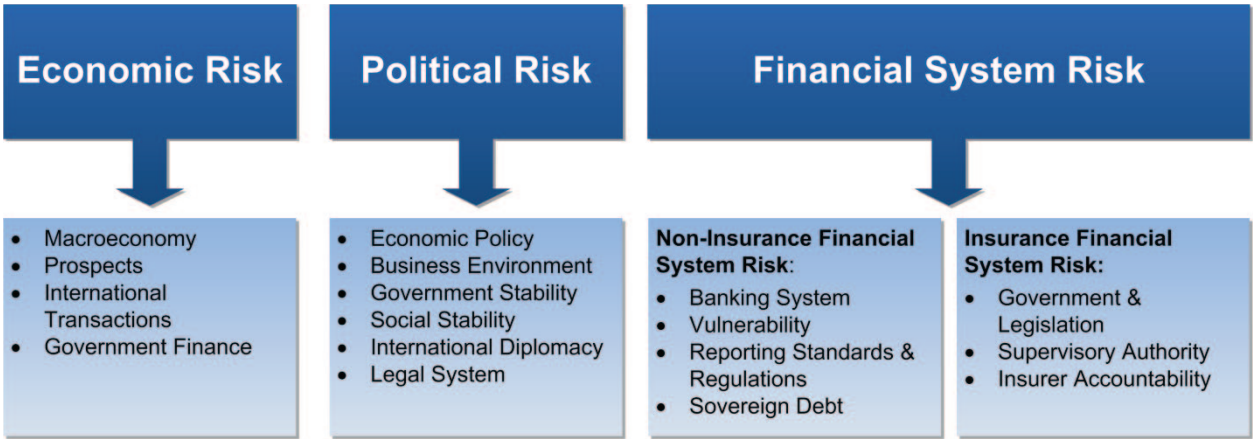
CRT-2: The country is characterised by a predictable and transparent political environment, legal system and business infrastructure, sufficient financial system regulation, and a mature insurance industry.

CRT-3: The country is characterised by a developing political environment, legal system, business infrastructure, capital market, and insurance regulatory structure.

CRT-4: The country is characterised by a relatively unpredictable and political, legal, and business environment, with an underdeveloped capital market, and a partially to fully inadequate insurance regulatory structure.

CRT-5: The country is characterised by an unpredictable and opaque political, legal, and business environment, with weak rule of law, lower human development and social instability, a limited, illiquid, or nonexistent capital market, and a nascent insurance industry.

Exhibit D.1: Components of Country Risk



E. Annual and Event-Driven Reviews

Each CRT is reviewed annually, although the Country Risk Group continually monitors world events and developments and assesses their potential impact on tier assignments. This process is facilitated by a country watch list, which identifies nations experiencing a significant increase in economic, political, or financial volatility that have the potential to impact a country's CRT.

Moving up or down the scale outside the annual review cycle is unusual, as the CRTs are designed to remain stable through the business cycle. Recent developments are factored into the analysis of country risk, but they are seldom significant enough to warrant an off-cycle change in the tier assignment. CRT changes are thus infrequent. However, in the event of a change in the CRT, ratings on the companies domiciled in that country will be subject to review.

Criteria: Rating Takaful (Shari'a Compliant) Companies

The following criteria procedure should be read in conjunction with *Best's Credit Rating Methodology (BCRM)* and all other related BCRM-associated criteria procedures. The BCRM provides a comprehensive explanation of A.M. Best Rating Services' rating process.

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Outline

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A. Market Overview

Despite many similarities between takaful (Shari'a compliant insurance) companies and conventional insurance companies, takaful companies have distinctive features that need to be highlighted within the A.M. Best rating process.

As part of its corporate governance framework, a takaful company must establish a Shari'a board that provides oversight and sets the rules and principles governing its activities, ensuring that it operates within Shari'a principles. A.M. Best does not specifically comment on a takaful company's degree of compliance with Shari'a. A.M. Best does discuss items such as the following:

- The organisation'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**.

Principles of Takaful

Takaful includes both general (non-life) and family (life) products. The family product line includes life and health insurance covers, as well as education, accident, and travel medical plans. The existence of takaful companies in recent times is a result of the commonly accepted incompatibility between Islamic beliefs and the conventional insurance model.

Takaful is essentially a cooperative risk-sharing programme 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 (pooling system to guarantee against loss or damage). As a result, takaful 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, which is 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 company evaluates the risk of potential loss and establishes a contribution (premium) base appropriate for that aggregated risk to protect the pool from undue losses. However, unlike the risk-based premium paid by a policyholder in a traditional insurance model (where each insured pays a rate commensurate with specific rating factors), each takaful participant shares equally in supporting the pool in recognition of the underlying principle of mutual cooperation.

Similarly, the takaful company's reinsurance cover should also be based on the 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 particular conditions and limitations.

Takaful Models & Structures

There is not one preferred operating model for takaful companies. 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 currently three primary operating models: the Al Mudharabah model, the Al Wakalah model, and the Waqf model.

Ta' aw uni Concept

The Ta'awuni concept (cooperative insurance) practices the approach of pure Mudharabah in daily transactions by encouraging the Islamic values of brotherhood, unity, solidarity, and mutual cooperation. In the pure Mudharabah approach, the takaful company and the participant share the direct investment income, while the participant is entitled to 100% of the residual surplus in the policyholders' fund, 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 or combine them in a hybrid model.

Al Mudharabah Model

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

Al Wakalah Model

This is a fee-based model. Cooperative risk-sharing occurs among participants where a takaful company 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, the Waqf model operates as a social/governmental enterprise, and programmes are operated on a nonprofit basis. Under the Waqf model, the surplus or profit is not owned directly by either the takaful company or the participants, and there is no mechanism to distribute the surplus funds. In effect, the takaful company retains the surplus funds to support the participant community. The Waqf model, with a single surplus fund, is most like a mutual insurance model.

The remainder of this criteria procedure will highlight the unique elements of takaful companies following the Ta'awuni model—since this is by far the most common amongst rated companies—and how these factors are incorporated in the rating analysis.

Takaful Windows and Subsidiaries

Conventional insurers may elect to use takaful windows—which are not, by definition, separate legal entities, but a ring-fenced fund within the larger company—or takaful subsidiaries in order to widen their offerings and service clients. These entities will be evaluated as part of the standard rating process.

Main Characteristics of Takaful Companies

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

Two Separate Funds

One significant characteristic of a takaful company is the existence of two separate funds, a takaful (or policyholders') fund and an operator's (or shareholders') fund. The takaful fund operates under pure cooperative principles. 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 is conceptually 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 (usually called a Wakalah fee) to cover costs or a share of investment returns (called a Mudharabah fee) 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 providing it with an interest-free loan (Qard' Hasan), for however long it is deemed necessary, thus 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 the operator makes 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, which are Islamic bonds where coupon payments take the form of a profit share on a particular enterprise. Moreover, investments in stocks, which are in principle allowed, should avoid financing 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 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 regarding what constitutes Shari'a compliance is, in A.M. Best's view, a challenge for a more rapid development of the industry. The emergence of some inter-regional and government-supported initiatives, 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.

A.M. Best's Rating Process

The building blocks of A.M. Best's rating process are outlined in **Exhibit A.1**.

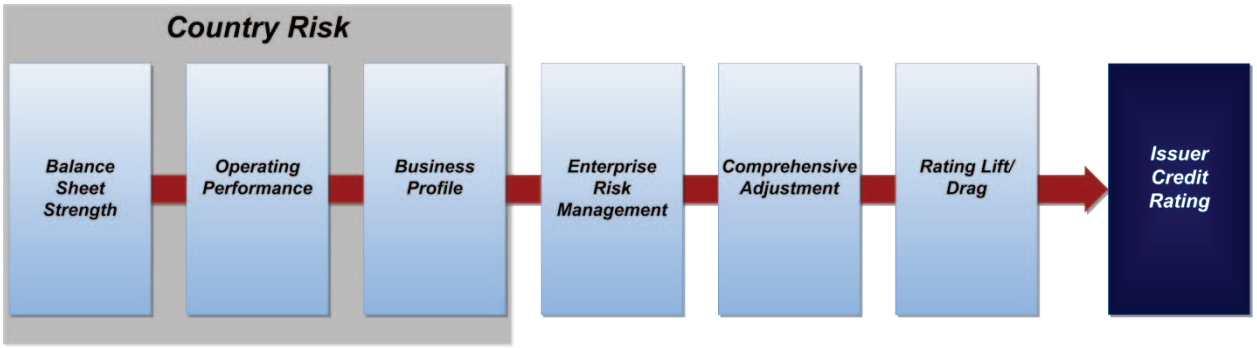


Exhibit A.2 details the possible assessment descriptors for the evaluations of balance sheet strength, operating performance, business profile, and enterprise risk management.

Exhibit A.2: BCRM Building Block Assessments

Balance Sheet Strength	Operating Performance	Business Profile	Enterprise Risk Management
Strongest	Very Strong	Very Favourable	Very Strong
Very Strong	Strong	Favourable	Appropriate
Strong	Adequate	Neutral	Marginal
Adequate	Marginal	Limited	Weak
Weak	Weak	Very Limited	Very Weak
Very Weak	Very Weak		

The specific considerations of takaful companies within the building block assessments are discussed in the following sections.

B. Balance Sheet Strength

Takaful companies 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 companies and how these are assessed in the rating process.

Two Separate Funds: A Two-Stage Risk-Based Capital Approach

The primary quantitative tool used to assess the financial strength of a takaful company is the Best's Capital Adequacy Ratio (BCAR).

Subject to regulatory enforceability as to the need for the shareholders' fund to support the policyholders' fund, the first-tier analysis of the takaful fund involves calculating its net required capital—the capital required to support the fund's obligations to participants at different confidence levels—and determining the capital it has available to support these risks. The BCAR ratios for the takaful fund, as well as an analysis of the trends in the ratios and other key metrics contribute to A.M. Best's assessment of the takaful company's balance sheet strength.

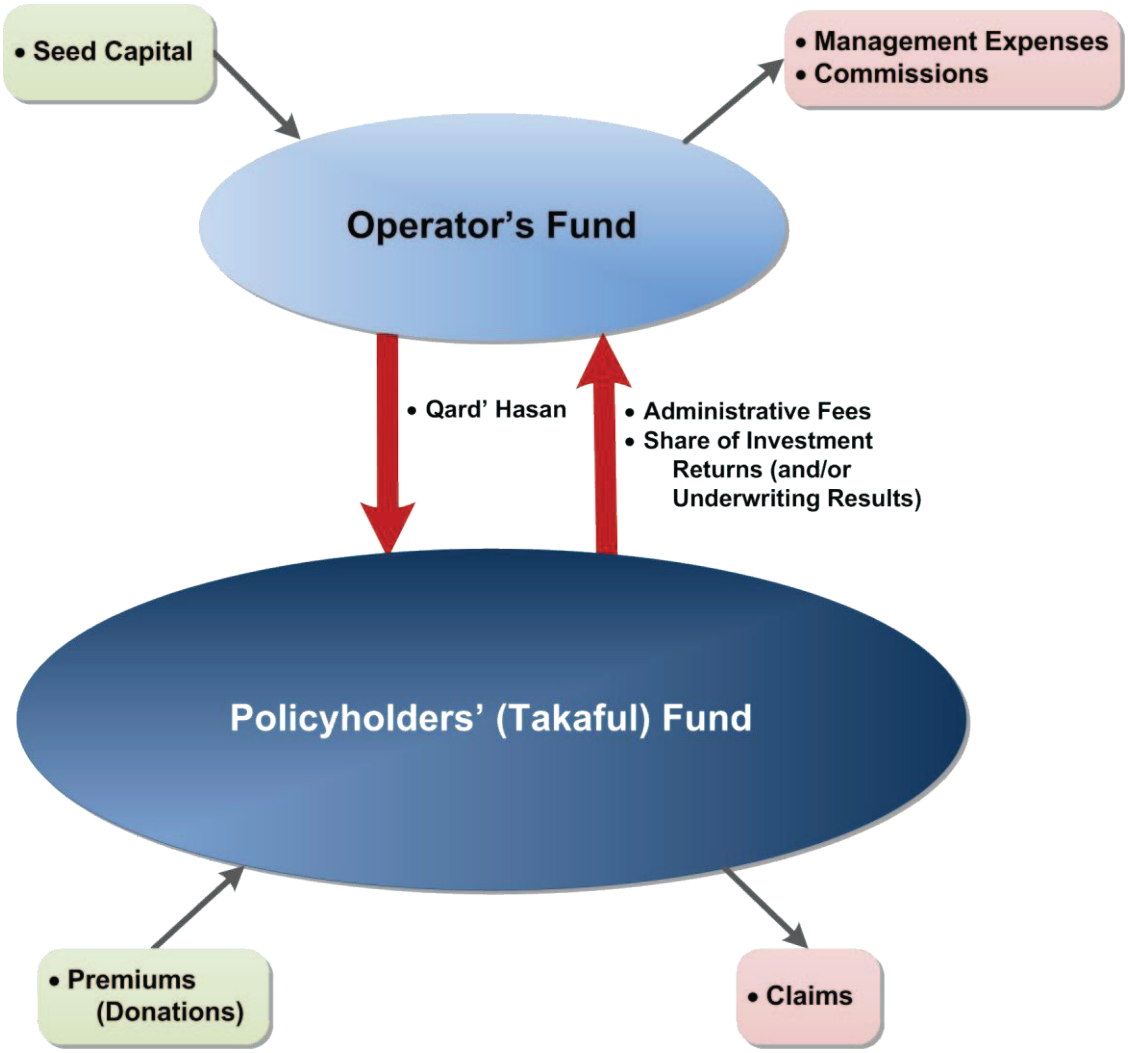
A second-tier capital assessment also is performed on a combined basis, including both the shareholders' fund and the operator's fund. The second-tier analysis uses the combined capital position of both funds to arrive at a determination of the capital available to support these risks at different confidence levels.

A combined position, (i.e., both takaful fund and operator's fund) with much higher financial flexibility than its corresponding takaful fund normally will enhance the balance sheet strength assessment with respect to the whole insurance operation, reflecting the increased financial strength provided to the takaful fund's participants. This enhanced balance sheet 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 cover policyholder obligations, consideration will be given for shareholders' commitment to the takaful fund, such as ring-fencing of assets in favour 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. For companies with a short track record, it is not uncommon for the operator's fund to be in a stronger relative position, as takaful companies tend to have low levels of accumulated surpluses.

A weaker combined assessment may not detract from the overall analysis significantly, as long as the key assumption—that the operator's fund cannot access the takaful fund's surplus—holds. 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 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.

Exhibit B.1: Basic Takaful Model



Regulatory Concerns and Capital

The strength of regulation varies significantly among jurisdictions, and, without a solid track record the protection to policyholders is somewhat unclear. While regulation of takaful companies has 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, credit can be given for additional commitments to the takaful fund from shareholders in favour of policyholders, such as ring-fenced assets, or explicit policy wording regarding the ability of the operator to support the takaful fund through Qard' Hasan. Additionally, A.M. Best will consider the role of the Shari'a board within the organisation 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 evolution of the takaful sector in general, including the regulatory environment, needs to keep pace with the rest of the Islamic financial industry (especially banking).

Depending on the strength of the takaful regulatory environment, A.M. Best may focus only on the combined BCAR assessment, reflecting the degree of comfort regarding the level of shareholder support with respect to policyholder liabilities.

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 tend to be sources of negative pressure in the balance sheet strength assessment.

The narrow range of Shari'a-compliant investment opportunities available to takaful companies accounts for their visible concentration in particular asset classes. At the same time, these limited opportunities usually restrict the development of more long-term products, due to the difficulty in addressing asset-liability management issues. The current situation has shown some improvement as the capital markets in Islamic countries continue to develop and more Shari'a-compliant investment products become available in the market. However, demand is still higher than supply.

An essential feature of all takaful models is the 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 contributed in earlier years or later generations. This is relevant because 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 stabilise 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). As with conventional insurance operations, an important assessment factor is the takaful company's degree of financial flexibility, i.e., the company's ability to raise equity capital. The capital available typically 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 nature of the takaful fund and its inherent lack of financial flexibility. The assessment generally involves a detailed analysis of the ownership structure (and shareholders' solvency) and the record of equity or debt issues. The assessment also considers the shareholders' capital commitment to the takaful fund.

A.M. Best monitors carefully the quality of the reinsurance programme to assess a takaful company's degree of balance sheet protection. This is particularly relevant given the previously mentioned restricted retakaful capacity (and virtual nonexistence of retro-takaful), which may force direct takaful operators to utilise conventional reinsurance capacity.

C. Operating Performance

As noted, the purpose of the takaful system is not to generate profit. Thus, 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, A.M. Best believes that to ensure the ongoing existence of the whole takaful operation, it is important that the operator at least can cover its expenses from the fees received from the policyholders' fund. Additionally, the takaful fund should generate profits and there should be a suitable balance of profit distribution between shareholders and policyholders, along with appropriate management fees to generate surpluses. This is particularly the case for those takaful companies that would expect to receive an operating performance assessment of at least "Adequate".

Typically, takaful companies (particularly in the Middle East) show higher expense ratios than their conventional counterparts. As the sector matures, an appropriate balance should develop between fees that reflect the combined level of expenses plus cost of capital and the ability to build surpluses within the takaful fund.

Given takaful companies' constraints in asset management, higher concentration in certain investment classes and in a particular geographical region, combined with increased counterparty credit risk, A.M. Best expects takaful funds, on average, to yield lower risk-adjusted returns, and experience higher volatility and credit defaults. Despite the sustained growth in the supply of Islamic securities, A.M. Best believes the investment opportunities are bound to remain limited, especially within the Middle East, for years to come.

D. Business Profile

A material component of the rating process focuses on the business profile of the company, including its diversification with regard to its client base, business lines, and distribution network. The relatively early stage of development of sectors or activities complementary to takaful companies—e.g., Islamic bonds, bancassurance (selling insurance products through banks), internet distribution, and retakaful capacity—combined with the following factors may result in many cases in a business profile assessment of "Limited".

The typical size of a takaful company remains smaller than that of a conventional insurer. This is in part a result of takaful companies' relative lack of track record (takaful operators have only been in existence since 1979), and the more limited profile of takaful companies when compared with conventional insurers that have diverse operating platforms and a long running history.

A.M. Best believes it is not yet clear whether takaful companies offer a significant competitive advantage within the current 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 demand can be unlocked easily through the offer of takaful products.

E. Enterprise Risk Management (ERM)

Takaful-specific regulation is extremely important in A.M. Best's enterprise risk management (ERM) assessment of takaful companies. In A.M. Best's view, a robust regulatory regime is crucial for the advancement of enterprise risk management. A.M. Best also believes that, given their constraints, takaful companies need to demonstrate they can apply a sufficient risk-based approach to the following:

- 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).

A.M. Best acknowledges that takaful operations face an additional layer of complexity when developing a suitable ERM framework, given the existence of two separate funds.

Overall, one of the unique challenges facing takaful companies is ensuring that there is an appropriate balance between the objectives set by their Shari'a boards and the trends shown by their key financial performance indicators. This includes establishing processes to address all material risks, despite the challenges presented by the limited capacity of retakaful, along with the concentration risks presented by restrictive investment guidelines and the limited geographic diversity of the current takaful marketplace.

Appendix 1: Sample Takaful Meeting Agenda

Organisation Structure and Overview

- Ownership and Participant Requirements
- Overview of Corporate Structures
  - Takaful Model Employed
  - Relationship between Takaful Fund and Operator's Fund (Sharing of Profits)
- Management Structure and Board of Directors
  - Senior Management
  - Board of Directors (if applicable)
  - Shari'a Board
- Assessment of Business Environment
- Key Strategic Objectives and Financial Targets
  - Takaful Fund
  - Operator's Fund

Corporate Governance

- Mission Statement, Articles of Association and Policy Wording
- Management's Perspectives on Key Risks
- Risk Management Framework
  - Roles and Responsibilities
  - Corporate Oversight
  - Shari'a Compliance
- Board Involvement
- Systems and Internal Controls

Capital Structure

- Composition
  - Takaful Fund
  - Operator's Fund
- Capital Management Strategy
- Capital Adequacy
  - Takaful Fund
  - Operator's Fund
  - Qard' Hassan
- Sources and Uses of Capital
- Cash and Liquidity

Product Development and Underwriting

- Product Offerings
  - General (Non-life)
  - Family (Life and Health)
- Geographic Footprint
- Retention
- Cycle Management Strategy
- Price Monitoring and Controls
- Expansion Initiatives and New Products
- External Risk Factors

Marketing and Business Production

- Competitive Market Position
  - Within Takaful Market
  - Within Broader Insurance Market
- Distribution Sources
- Production by Line of Business
- Business Strategies
  - By Line of Business
  - Short Term
  - Long Term
- Growth Targets by Line of Business

Claims and Loss Reserves

- Severity and Frequency Trends (General)
- Mortality and Morbidity Trends (Family)
- Claims Administration
- New Potential Claim Emergence
- Loss Reserves
- Management's Perspective on Reserve Adequacy

Reinsurance

- Reinsurance Programme Overview
- Reinsurance Providers
  - Retakaful Providers
  - Commercial Providers
- Catastrophic Reinsurance Programmes
- Credit Risk Analysis
- Net Retention

Investments

- Balance Sheet Composition
- Investment Strategy and Guidelines
- Performance of Portfolio
  - Gross and Risk-Adjustment Yields
  - Performance versus Benchmarks
- Asset-Liability Management
- Credit Risk
- Concentration Risk
  - By Asset Type and Geographic
  - Availability of Shari'a Compliant Assets
- Capital Markets Risk

Financial Performance

- Balance of Earnings between the Funds
- Al Wakala Fees
- Profitability by Line of Business
  - Sources of Profits
  - Profit Sharing between Takaful and
  - Operator's Fund
  - Projections
- Operating Expenses Operator's Fund
  - Trends
  - Expense Management Initiatives
  - Reported Expenses vs. Reimbursement from Takaful Fund
  - Budgets
- Catastrophe Management Framework
- Natural and Man-Made Catastrophe Exposure

Analysis

- Catastrophe Models Used
- Probable Maximum Loss and Tail Risk Analysis
- Risk Aggregation and Mapping

Enterprise Risk Management (ERM)*

- ERM Framework
- Risk Correlation
- Modeling Capabilities
- Risk Tolerance and Risk Management Objectives

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

Appendix 2: Comparison of Basic Terms

	Takaful and Conventional Insurance
Accounts	Takaful participant contributions are credited into one of two accounts, depending upon the type of takaful firm and any predetermined risk-sharing or profit-sharing arrangements. The two accounts are described below. PA account (managed according to the al-Tabarru principle) – Funds that are ring-fenced to cover policyholders' claims only (i.e., operators or shareholders do not have access to this fund). PSA account (managed according to the al-Mudharabah principle) – Funds in which profit-sharing surpluses (between policyholders and shareholders, normally in fixed proportions) are accumulated. In a conventional insurance model, the paid premium for both general and life products is credited into what is commonly referred to as the general insurance account. For certain life products in which the policyholder maintains ownership and control of the assets, payments often are referred to as deposits and are placed in a segregated or separate account.
Bonus	Takaful contracts specify from the outset how the profits from takaful investments are to be shared between the operator and the participants. This is done in accordance with the principle of al-Mudharabah, and the share split typically is expressed in the form of a ratio as agreed between the participant and the operator – regardless of the amount of investment profit made during the year. Certain types of conventional insurance may offer some form of bonus or profits in general terms related to either investment or underwriting performance. This bonus may take the form of a dividend payment, an increase in insurance coverage, or lower premium payments. The conventional carrier can decide to give or not to give a bonus for any particular year, depending on the result of the investment and/or underwriting returns. The rate of bonus itself can vary from year to year and typically is at the discretion of the company's board of directors.
Claims	In a takaful policy, if the participant dies, or the covered risk occurs, the beneficiary(ies) may claim the policy value from the PSA, in addition to the accumulated account value from the PA. In cases where the participant survives at the maturity of the policy, or if the covered risk does not occur, his/her claim is confined to the account value available in the PA. In conventional insurance, when the policyholder dies or the covered risk occurs, the beneficiary(ies) may claim the whole amount named in the policy (often referred to as the face amount of a life policy), or the prescribed reimbursement for loss as defined in a general insurance policy. When a covered risk does not occur, the insured is not entitled to any reimbursement of premium or investment results in many forms of conventional insurance, such as term life insurance and typical personal general insurance. However, for certain types of investment-related products, the insured maintains the right to claim the policy value at maturity together with interest, if any.
Damages	In takaful, in compliance with the Islamic principles of mutual cooperation and shared responsibility, there is no justification to award unlimited or unreasonable damages related to any claim or dispute. Under the conventional insurance model, the local court system with jurisdiction in a particular matter (depending on the relevant statutes and laws in the jurisdiction) often is empowered to award unlimited punitive damages against the insurer.

Appendix 2: Comparison of Basic Terms Continued

Extra Risk Premiums	In takaful, generally, the contribution or premium rates imposed are fixed by the actuarial evaluation for the entire risk pool. No participant is charged a higher rate, or is discriminated against due to foreseeable extra risk. However, if a particular participant is considered to have an extraordinary risk profile and poses an undue strain on the mutual fund, the participant may have to increase his proportion of Tabarru, i.e. the contribution from his premium to the PSA. In other words, the participant's total contribution remains the same, but the portion that is credited to his/her PA would be less than it generally would have been. In conventional insurance, an extra premium typically is charged in addition to the normal amount against the policyholder where an extra risk is foreseeable. For example, in life insurance, an extra premium may be charged to reflect the higher mortality rates for smokers or people with highly dangerous and strenuous jobs, such as firefighters, miners, and so on. Similarly, in non-life insurance, an extra premium may be charged to reflect higher probable losses for a home located in a flood zone.
Guarantees	In takaful, the operator gives no contractual guarantees. The underlying principles of community, solidarity, and brotherhood create joint indemnity or risk sharing among the participants. In the conventional model, the insurer guarantees the payment of the benefit or claim within the stipulations of the contract.
Investments	In takaful, the funds must be invested in non-interest bearing assets where investment returns are generated through some form of profit sharing or appreciation. All investments must comply with the guidelines of Shari'a. As such, investment returns must not be driven by any unethical commercial activities that may be in conflict with Islamic beliefs. Under the conventional model, assets typically are invested in a variety of interest-bearing assets, such as fixed-income instruments, as well as in equity-related securities. Each company typically develops a set of investment guidelines considering domestic insurance regulation, the profile of the insurer's liability base, and the company's appetite for risk.
Premium	In takaful, fixed minimum contribution or premium rates are set and are the same for all participants, in deference to Islamic principles and beliefs. Under the conventional model, premiums paid by the policyholder vary based on the risk profile of the individual or corporate entity. For life policies, attained age when the policyholder first takes out a policy is one of the key elements of the pricing decision. The older the policyholder is at the time of contract, the higher the level of premium, reflecting the increased mortality rate as age increases. Similarly, for non-life auto policies, the safety features and relative repair cost of a vehicle are taken into account when determining premium rates.
Profits	In takaful, the proportion or split of any profits typically is prescribed in the contract; however, the amount of profits in total depends on the aggregate investment and underwriting performance for the period. In a conventional insurance policy, there generally is no provision for profit sharing, other than through the dividend or bonus schemes mentioned above.
Term of the Policy	All takaful policies have a fixed and definite term or period of maturity, e.g., 10, 15, 20 years, etc. This is in recognition of the Islamic principle of avoiding uncertainty (Garar). In conventional insurance, the term of a policy varies based on the type of policy. Some life insurance policies have a definite time period, such as temporary and endowment assurance policies, while others may have an indefinite period as long as the policyholder continues to make premium payments. As for general insurance, there typically is a term specified in the contract.

BEST'S FINANCIAL STRENGTH RATING GUIDE – (FSR)

A Best's Financial Strength Rating (FSR) is an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. An FSR is not assigned to specific insurance policies or contracts and does 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. An FSR 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 addition, an FSR may be displayed with a rating identifier, modifier or affiliation code that denotes a unique aspect of the opinion.

Best's Financial Strength Rating (FSR) Scale

Rating Categories	Rating Symbols	Rating Notches*	Category Definitions
Superior	A+	A++	Assigned to insurance companies that have, in our opinion, a superior ability to meet their ongoing insurance obligations.
Excellent	A	A-	Assigned to insurance companies that have, in our opinion, an excellent ability to meet their ongoing insurance obligations.
Good	B+	B++	Assigned to insurance companies that have, in our opinion, a good ability to meet their ongoing insurance obligations.
Fair	B	B-	Assigned to insurance 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.
Marginal	C+	C++	Assigned to insurance 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.
Weak	C	C-	Assigned to insurance 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.
Poor	D	-	Assigned to insurance 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.

* Each Best's Financial Strength Rating Category from "A+" to "C" includes a Rating Notch to reflect a gradation of financial strength within the category. A Rating Notch is expressed with either a second plus "+" or a minus "-".

Financial Strength Non-Rating Designations

Designation Symbols	Designation Definitions
E	Status assigned to insurance companies 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; an impaired insurer.
F	Status assigned to insurance companies that are publicly placed in liquidation by a court of law or by a forced liquidation; an impaired insurer.
S	Status assigned to rated insurance companies to suspend the outstanding FSR 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.
NR	Status assigned to insurance companies that are not rated; may include previously rated insurance companies or insurance companies that have never been rated by A.M. Best.

Rating Disclosure – Use and Limitations

A Best's Credit Rating (BCR) is a forward-looking independent and objective opinion regarding an insurer's, issuer's or financial obligation's relative creditworthiness. The opinion represents a comprehensive analysis consisting of a quantitative and qualitative evaluation of balance sheet strength, operating performance, business profile and enterprise risk management or, where appropriate, the specific nature and details of a security. Because a BCR is a forward-looking opinion as of the date it is released, it cannot be considered as a fact or guarantee of future credit quality and therefore cannot be described as accurate or inaccurate. A BCR is a relative measure of risk that implies credit quality and is assigned using a scale with a defined population of categories and notches. Entities or obligations assigned the same BCR symbol developed using the same scale, should not be viewed as completely identical in terms of credit quality. Alternatively, they are alike in category (or notches within a category), but given there is a prescribed progression of categories (and notches) used in assigning the ratings of a much larger population of entities or obligations, the categories (notches) cannot mirror the precise subtleties of risk that are inherent within similarly rated entities or obligations. While a BCR reflects the opinion of A.M. Best Rating Services, Inc. (A.M. Best) of relative creditworthiness, it is not an indicator or predictor of defined impairment or default probability with respect to any specific insurer, issuer or financial obligation. A BCR is not investment advice, nor should it be construed as a consulting or advisory service, as such; it is not intended to be utilized as a recommendation to purchase, hold or terminate any insurance policy, contract, security or any other financial obligation, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser. Users of a BCR should not rely on it in making any investment decision; however, if used, the BCR must be considered as only one factor. Users must make their own evaluation of each investment decision. A BCR opinion is provided on an "as is" basis without any expressed or implied warranty. In addition, a BCR may be changed, suspended or withdrawn at any time for any reason at the sole discretion of A.M. Best.

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BEST'S ISSUER CREDIT RATING GUIDE – (ICR)

A Best's Issuer Credit Rating (ICR) is an independent opinion of an entity's ability to meet its ongoing financial obligations and can be issued on either a long- or short-term basis. A long-term ICR is an opinion of an entity's ability to meet its ongoing senior financial obligations, while a short-term ICR is an opinion of an entity's ability to meet its ongoing financial obligations with original maturities generally less than one year. An ICR is an opinion regarding the relative future credit risk of an entity. Credit risk is the risk that an entity may not meet its contractual financial obligations as they come due. An ICR does not address any other risk. In addition, an ICR is not a recommendation to buy, sell or hold any securities, contracts or any other financial obligations, nor does it address the suitability of any particular financial obligation for a specific purpose or purchaser. An ICR may be displayed with a rating identifier or modifier that denotes a unique aspect of the opinion.

Best's Long-Term Issuer Credit Rating (ICR) Scale

Rating Categories	Rating Symbols	Rating Notches*	Category Definitions
Exceptional	aaa	-	Assigned to entities that have, in our opinion, an exceptional ability to meet their ongoing senior financial obligations.
Superior	aa	aa+ / aa-	Assigned to entities that have, in our opinion, a superior ability to meet their ongoing senior financial obligations.
Excellent	a	a+ / a-	Assigned to entities that have, in our opinion, an excellent ability to meet their ongoing senior financial obligations.
Good	bbb	bbb+ / bbb-	Assigned to entities that have, in our opinion, a good ability to meet their ongoing senior financial obligations.
Fair	bb	bb+ / bb-	Assigned to entities that have, in our opinion, a fair ability to meet their ongoing senior financial obligations. Credit quality is vulnerable to adverse changes in industry and economic conditions.
Marginal	b	b+ / b-	Assigned to entities that have, in our opinion, a marginal ability to meet their ongoing senior financial obligations. Credit quality is vulnerable to adverse changes in industry and economic conditions.
Weak	ccc	ccc+ / ccc-	Assigned to entities that have, in our opinion, a weak ability to meet their ongoing senior financial obligations. Credit quality is vulnerable to adverse changes in industry and economic conditions.
Very Weak	cc	-	Assigned to entities that have, in our opinion, a very weak ability to meet their ongoing senior financial obligations. Credit quality is very vulnerable to adverse changes in industry and economic conditions.
Poor	c	-	Assigned to entities that have, in our opinion, a poor ability to meet their ongoing senior financial obligations. Credit quality is extremely vulnerable to adverse changes in industry and economic conditions.

** Best's Long-Term Issuer Credit Rating Categories from "aa" to "ccc" include Rating Notches to reflect a gradation within the category to indicate whether credit quality is near the top or bottom of a particular Rating Category. Rating Notches are expressed with a "+" (plus) or "-" (minus).*

Best's Short-Term Issuer Credit Rating (ICR) Scale

Rating Categories	Rating Symbols	Category Definitions
Strongest	AMB-1+	Assigned to entities that have, in our opinion, the strongest ability to repay their short-term financial obligations.
Outstanding	AMB-1	Assigned to entities that have, in our opinion, an outstanding ability to repay their short-term financial obligations.
Satisfactory	AMB-2	Assigned to entities that have, in our opinion, a satisfactory ability to repay their short-term financial obligations.
Adequate	AMB-3	Assigned to entities that have, in our opinion, an adequate ability to repay their short-term financial obligations; however, adverse industry or economic conditions likely will reduce their capacity to meet their financial commitments.
Questionable	AMB-4	Assigned to entities that have, in our opinion, questionable credit quality and are vulnerable to adverse economic or other external changes, which could have a marked impact on their ability to meet their financial commitments.

Long- and Short-Term Issuer Credit Non-Rating Designations

Designation Symbols	Designation Definitions
d	Status assigned to entities (excluding insurers) that are in default or when a bankruptcy petition or similar action has been filed and made public.
e	Status assigned to insurers 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 operations; an impaired entity.
f	Status assigned to insurers that are publicly placed in liquidation by a court of law or by a forced liquidation; an impaired entity.
s	Status assigned to rated entities to suspend the outstanding ICR 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.
nr	Status assigned to entities that are not rated; may include previously rated entities or entities that have never been rated by A.M. Best.

Rating Disclosure: Use and Limitations

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BEST'S ISSUE CREDIT RATING GUIDE – (IR)

A Best's Issue Credit Rating (IR) is an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis (obligations with original maturities generally less than one year). An IR assigned to a specific issue is an opinion of the ability to meet the ongoing financial obligations to security holders when due. As such, an IR is an opinion regarding the relative future credit risk. Credit risk is the risk that an issue may not meet its contractual financial obligations as they come due. The rating does not address any other risk, including, but not limited to, liquidity risk, market value risk or price volatility of rated obligations. The rating is not a recommendation to buy, sell or hold any securities, contracts or any other financial obligations, nor does it address the suitability of any particular financial obligation for a specific purpose or purchaser. In addition, an IR may be displayed with a rating identifier or other modifier that denotes a unique aspect of the opinion.

Best's Long-Term Issue Credit Rating (IR) Scale

Rating Categories	Rating Symbols	Rating Notches*	Category Definitions
Exceptional	aaa	-	Assigned to issues where, in our opinion, there is an exceptional ability to meet the terms of the obligation.
Superior	aa	aa+ / aa-	Assigned to issues where, in our opinion, there is a superior ability to meet the terms of the obligation.
Excellent	a	a+ / a-	Assigned to issues where, in our opinion, there is an excellent ability to meet the terms of the obligation.
Good	bbb	bbb+ / bbb-	Assigned to issues where, in our opinion, there is a good ability to meet the terms of the obligation; however, the issue is more susceptible to changes in economic or other conditions.
Fair	bb	bb+ / bb-	Assigned to issues where, in our opinion, fair credit characteristics exist, generally due to a moderate margin of principal and interest payment protection or other issue-specific concerns that may be exacerbated by a vulnerability to economic changes or other conditions.
Marginal	b	b+ / b-	Assigned to issues where, in our opinion, marginal credit characteristics exist, generally due to a modest margin of principal and interest payment protection or other issue-specific concerns that may be exacerbated by an enhanced vulnerability to economic changes or other conditions.
Weak	ccc	ccc+ / ccc-	Assigned to issues where, in our opinion, weak credit characteristics exist, generally due to a minimal margin of principal and interest payment protection or other issue-specific concerns that may be exacerbated by a limited ability to withstand adverse changes in economic or other conditions.
Very Weak	cc	-	Assigned to issues where, in our opinion, very weak credit characteristics exist, generally due to an extremely minimal margin of principal and interest payment protection or other issue-specific concerns that may be exacerbated by a limited ability to withstand adverse changes in economic or other conditions.
Poor	c	-	Assigned to issues where, in our opinion, poor credit characteristics exist, generally due to an extremely minimal margin of principal and interest payment protection or other issue-specific concerns that may be exacerbated by an extremely limited ability to withstand adverse changes in economic or other conditions.

** Best's Long-Term Issue Credit Rating Categories from "aa" to "ccc" include Rating Notches to reflect a gradation within the category to indicate whether credit quality is near the top or bottom of a particular Rating Category. Rating Notches are expressed with a "+" (plus) or "-" (minus).*

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Satisfactory	AMB-2	Assigned to issues where, in our opinion, a satisfactory ability to repay short-term debt obligations exists.
Adequate	AMB-3	Assigned to issues where, in our opinion, an adequate ability to repay short-term debt obligations exists; however, adverse economic conditions likely will reduce the capacity to meet financial commitments.
Questionable	AMB-4	Assigned to issues that, in our opinion, contain questionable credit characteristics and are vulnerable to adverse economic or other external changes, which could have a marked impact on the ability to meet financial commitments.

Long- and Short-Term Issue Credit Non-Rating Designations

Designation Symbols	Designation Definitions
d	Status 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 and made public; or where the issuing entity has been designated as impaired (e/f [Issuer Credit] or E/F [Financial Strength] designations) or in default (d [Issuer Credit] designation).
s	Status assigned to rated issues to suspend the outstanding IR when sudden and significant events have occurred 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.
nr	Status assigned to issues that are not rated; may include previously rated issues or issues that have never been rated by A.M. Best.

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BEST'S NATIONAL SCALE RATING GUIDE – (NSR)

A Best's National Scale Rating (NSR) is a relative measure of creditworthiness in a specific local jurisdiction that is issued on a long-term basis and derived exclusively by mapping the NSR from a corresponding global Issuer Credit Rating (ICR) using a transition chart. An NSR is only comparable to other NSRs within the same country, as denoted by the specific country code suffix (".XX") attached to each NSR, and not across countries; therefore, impairment statistics cannot be compared directly to a national rating. However, since the global rating is assigned as the base for the national rating, impairment rates can be inferred. In cases where one global ICR level maps to more than one NSR level, a rating committee will determine which level, in accordance with the mapping, is appropriate given the relative financial strength of the entity to meet senior financial obligations. For more information on the ICR to NSR mapping chart and other relevant information refer to "Best's Rating Methodology" available on the A.M. Best website. In addition, an NSR may be displayed with a rating identifier or modifier that denotes a unique aspect of the opinion.

Best's National Scale Rating (NSR) Scale

Rating Categories	Rating Symbols	Rating Notches*	Category Definitions
Exceptional	aaa.XX	-	Assigned to entities that have, in our opinion, an exceptional ability to meet their ongoing senior financial obligations relative to other national entities.
Superior	aa.XX	aa+.XX / aa-.XX	Assigned to entities that have, in our opinion, a superior ability to meet their ongoing senior financial obligations relative to other national entities.
Excellent	a.XX	a+.XX / a-.XX	Assigned to entities that have, in our opinion, an excellent ability to meet their ongoing senior financial obligations relative to other national entities.
Good	bbb.XX	bbb+.XX / bbb-.XX	Assigned to entities that have, in our opinion, a good ability to meet their ongoing senior financial obligations relative to other national entities.
Fair	bb.XX	bb+.XX / bb-.XX	Assigned to entities that have, in our opinion, a fair ability to meet their ongoing senior financial obligations relative to other national entities.
Marginal	b.XX	b+.XX / b-.XX	Assigned to entities that have, in our opinion, a marginal ability to meet their ongoing senior financial obligations relative to other national entities.
Weak	ccc.XX	ccc+.XX / ccc-.XX	Assigned to entities that have, in our opinion, a weak ability to meet their ongoing senior financial obligations relative to other national entities.
Very Weak	cc.XX	-	Assigned to entities that have, in our opinion, a very weak ability to meet their ongoing senior financial obligations relative to other national entities.
Poor	c.XX	-	Assigned to entities that have, in our opinion, a poor ability to meet their ongoing senior financial obligations relative to other national entities.

** Best's National Scale Rating Categories from "aa" to "ccc" include Rating Notches to reflect a gradation within the category to indicate whether credit quality is near the top or bottom of a particular Rating Category. Rating Notches are expressed with a "+" (plus) or "-" (minus).*

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