A.M. BEST

METHODOLOGY AUGUST, 2001

Insurance Groups

A.M. Best's Perspective

Rapid transformation is a hallmark of today's insurance industry. Global business dynamics are reducing the number of insurers, intensifying competition and creating increasingly complex insurance organizations.

From A.M. Best's perspective, success requires a strong business profile and a high degree of strategic and operational agility. These characteristics combined with solid balance sheet strength will inevitably return more value to stakeholders and better position companies to capitalize on opportunities. For individual companies within a group the implicit or explicit support of a parent or affiliate can affect an insurer's financial strength and perception of parental commitment, which are paramount rating considerations.

Determining the degree of intragroup support can be difficult, however. Affinity between companies can vary dramatically, as can the overall legal structure of any group of insurance companies. For example, the kieretsu in Japan and the chaebol in South Korea have no legal binds, but member companies possess strong implicit intragroup support. Furthermore, demands for sustainable returns can make even short-term adversity a reason for management to reverse its commitment to a particular line of business or to an affiliate within its group.

Group Ratings

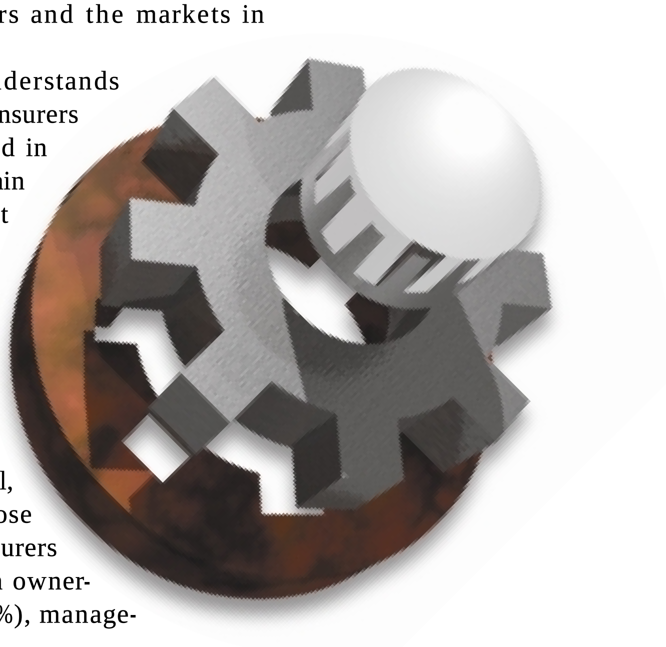
A.M. Best's Group Rating methodology is a systematic, yet flexible approach to the analytical model for assessing today's insurance groups. Our model incorporates individual company characteristics that can impact the financial strength of the group. It also is dynamic, incorporating continual monitoring to evaluate the impact of any strategic alterations to the role or viability of a group's subsidiaries.

In developing its group rating methodology, A.M. Best looked beyond historical contractual links, such as intercompany pooling and reinsurance agreements, and established measures for assigning group ratings to affiliates that are deemed to be strategically or financially important to the insurance enterprise. These criteria are linked to the three general rating components that comprise the foundation of A.M. Best's analytical process—**balance sheet strength, operating performance and business profile**.

Flexibility was favored over a more rigid approach, recognizing the need to address new organizational or legal structures that may arise in the future. A more flexible, yet comprehensive analytical process is also more dynamic and better suited to the sophisticated approach that managements utilize in operating their insurance groups.

A.M. Best views the strategic role of a group's individual units and their financial contributions to their group along a continuum with respect to its expectations for assigned ratings. For the most part, these are subjective judgments that can only be made by interacting with management to gain a complete understanding of the organization, its individual members and the markets in which they operate.

While A.M. Best understands that no two groups of insurers operate or are managed in the same fashion, certain factors must be present for group rating consideration. Eligibility for a group rating is not an option, but rather, a decision made by A.M. Best based on whether these factors are present. In general, eligible groups are those where two or more insurers operate under common ownership (in excess of 50%), manage-



ment, strategy, or other substantial form of corporate governance or functional area of operations (i.e., shared board of directors, pooling arrangements, distribution).

Group Analysis

The assignment of group ratings involves a top-down, bottom-up analysis of the parent organization and each subsidiary. This analysis provides a reference point for the Best's Ratings assigned to the different subsidiaries. As with all Best's Ratings, the application of Group Rating is intended to have predictive value as well as historical context. This involves factoring into the rating the business prospects of the operating entities and any plans by management for further integration or sale of a unit, using a minimum time horizon of 12-to-24 months.

Determining Subsidiary Classifications

Insurers eligible for a Group Rating fall into one of three subsidiary classifications: ***core, strategic or ancillary***. A.M. Best uses these classifications to determine the extent to which a company's rating may be affected by its group affiliation. A core unit receives the same rating as their parent or that of the company with which they maintain the greatest degree of affiliation, based on the consolidation strength and capability of the group. Strategic subsidiaries are assigned ratings based on 1) their stand-alone strength and capabilities, and 2) the benefit they receive by being a member of a larger group.

Key Criteria

The extent to which Best's Ratings on individual companies are affected by their affiliation with an insurance enterprise depends on the:

- Role that the individual company plays in the group's strategy.
- Contributions of the company to the ongoing success and viability of the organization.
- Level of integration and identity the company maintains with other members of the group.
- Demonstrated support and commitment of

Best's Rating Analysis

Best's Ratings provide an opinion of an insurer's ability to meet long-term obligations to its policyholders. Best's Ratings are based on an analysis of an insurance company on both a quantitative and qualitative basis. Key performance ratios are integrated with a subjective evaluation of the company's operating plans and philosophies. This analysis goes beyond the numbers to arrive at a comprehensive understanding of where that company stands and where it is going.

The analysis requires a high level of disclosure. Companies are asked to provide annual statements, including detailed information about the operations, reserving, environmental and catastrophe exposures, as well as supplemental information, captured via proprietary rating forms, that we feel is necessary for a thorough and adequate analysis. In addition, rating meetings are conducted with individual companies, typically on an annual basis. These meetings involve senior officers of the company and provide analysts with an understanding of the company's strategy and future direction.

Analysts' rating recommendations are approved and modified through a specific committee process including an executive committee of A.M. Best senior officers. A.M. Best continually monitors current developments (i.e., reviewing public documents, news items, the Internet, etc.) to evaluate potential impact on an assigned rating. Significant company developments will initiate discussions with management and can result in rating modifications.

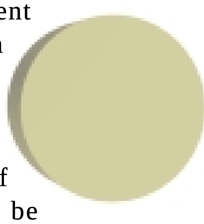
Because A.M. Best's rating system subjects all insurers to the same rigorous criteria, the ratings offer a means of directly comparing insurers, regardless of their country of domicile. This consistent approach, as well as A.M. Best's uncompromised reputation for third-party neutrality, has led to the acceptance of Best's Ratings as a reliable benchmark on a global scale. Such a benchmark is increasingly vital to an international market that demands proof of financial strength and stability in the face of widespread deregulation, mergers, acquisitions and other dynamic factors.

For insurance companies, Best's Ratings are a strategic tool that can enhance the confidence of consumers, brokers and risk managers in the stability of the organization, as well as its attractiveness to investors, particularly pension funds. For insurers in search of capital to leverage growth opportunities, a rating satisfies many of the investment community's needs for comprehensive financial data covering historical and current financial performance. It also enhances credibility with reinsurers - a valuable resource, particularly for insurers entering new markets.

the group's senior management to its operating subsidiaries.

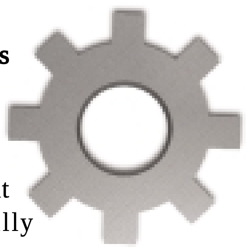
- Operational performance of the company relative to the expectations of the organization and the markets in which it operates.

Core Subsidiaries are most likely to receive the same rating as the parent concern, or that of an appropriate company within the group. Startups, newly formed units and foreign branches of insurance enterprises may be considered as core subsidiaries under select circumstances. Core subsidiaries are:



- Integral to the group's strategy and critical to its ongoing success and viability.
- Fully integrated into the group's operations and usually carry the group name.
- Well established in their particular markets.
- Material contributors to the business profile, operating performance, balance sheet strength or other relevant business activities of the group.

Strategic Subsidiaries share many core subsidiary characteristics, but differ in their degree of affinity. A strategic unit does not automatically receive a group's rating; however, their standalone ratings usually benefit from their group affiliations. Strategic subsidiaries are:



- Important to the group's strategy.
- Typically operate on a more standalone basis, and are reasonably well established in their markets.
- Integrated to some degree with one or more affiliates within the group, but may not possess the group's name or share common identity.
- Important contributors to the business profile, operating performance, balance sheet strength or other relevant business activities of the group.

Ancillary Subsidiaries usually are viewed as being opportunistic in nature. Ancillary units will rarely carry a rating equal to that of the parent concern or other group members. Ancillary subsidiaries are:

- Incidental to the group's overall strategy and can be readily sold.
- Minimally integrated with the group and typically have their own distinct identity.
- Stand-alone entities that garner little explicit or implicit support from their group.
- Insignificant contributors to the group's performance.

Group Rating Continuum

An insurance subsidiary's placement on this continuum is determined by its correlation with the key criteria below.

Classification	Core	Strategic	Ancillary
Correlation	High	Moderate	Immaterial

- Consistency with organization's management, customers & business strategy
- Integration with parent's operations/distribution network
- Presence in target markets
- Standalone viability
- Strength of historical & expected performance
- Contribution to group's current/future business, earnings & revenue
- Performance level against parent's expectations
- Performance level against peers
- Standalone capital adequacy
- Degree of implicit & explicit organizational financial support
- Peer group comparability
- Level of other organizational support (e.g., reinsurance, pooling)

Group Rating Application

Application of Best's Group Rating criteria to specific companies is a complex process that involves a high degree of qualitative judgement. Companies falling into the relatively clear-cut classifications of core or ancillary represent a minority of the companies rated. The vast majority of companies will, to one degree or another, fall into the strategic classification.

The following case study provides an example of the differences between a core and strategic subsidiary.

Subsidiary Classification: Parent
Financial Size Category: Class XIV
Best's Rating: A based on excellent balance sheet strength, operating performance and business profile on a consolidated basis.

Global Insurance Company, Ltd.

Assets: £13.8 billion/USD 23.7 billion
Gross Premium: £700 million/USD 1.2 billion

A large U.K. composite insurer, with policyholders' surplus of $1.8 billion, is seeking to expand its operations. Its primary global operations are focused on property/casualty insurance. It was assigned an A (Excellent) Best's Rating and a financial size category of Class XIV. Below is an overview of the legal entities:

Subsidiary Classification: Core
Financial Size Category: Class XIV
Best's Rating: A g assigned a group rating due to its high integration with the parent, and its material contributions to the group's business profile and operating performance.

Global Insurance Property/Casualty-Commercial Lines

Global Insurance P/C is the group's flagship operation. It is well established in its markets, where it writes a full complement of commercial property/casualty business under the group's name throughout most of the world. In these markets, Global Insurance P/C's performance is excellent in an absolute sense and relative to its peers.

The countries it operates in and its products are consistent with the parent company, and are considered critical to the group's ongoing success and viability. Its operations are fully integrated with the group, and it contributes materially to the business profile, operating performance and balance sheet strength of the group. Substantial capital contributions in past years are clear evidence of explicit parental support.

Subsidiary Classification: Strategic
Financial Size Category: Class III
Best's Rating: B++ represents a two-notch benefit due to explicit parental capital and reinsurance support, and strategic importance.

Global Insurance Unlimited-Developing Country Property/Casualty Start-up

Global Insurance Unlimited represents a new, but important long-term commitment to a new market that is strategically important to the group. The subsidiary is thinly capitalized with a relatively low business profile, with earnings under competitive pressure; however, its growth and earnings potential are high. It is expected that Global Insurance Unlimited will meet the parent company's financial return expectations within three years.

As Global Insurance Unlimited develops critical mass and begins to generate acceptable returns, it would most likely be viewed as a core subsidiary and receive the group's rating.

Subsidiary Classification: Strategic
Financial Size Category: Class V
Best's Rating: B++ represent a one-notch benefit due to parental capital support that provides it with greater financial flexibility and market presence.

Reinsurance Unlimited-Commercial Lines

The offshore domiciled Reinsurance Unlimited, a relatively new venture, provides finite and catastrophe reinsurance coverages. The parent considers this unit to be strategically opportunistic. There is little integration with the operations of the group, and its markets, products and customers differ from those of the group. The subsidiary has been a very profitable, fast growing operation.

Given current market conditions, Reinsurance Unlimited should continue to play a vital role in contributing to the group's overall profitability; however, an adverse change in market conditions may weaken the parental commitment, capital support and interest in owning Reinsurance Unlimited. Should this happen, its subsidiary classification would be changed to Ancillary.

Ongoing Commitment

The process by which A.M. Best evaluates the financial strength of insurance enterprises reflects the increasing complexity of the groups themselves. Our Group Rating methodology is both a macro- and micro-level analysis, to evaluate intragroup benefits while recognizing distinct individual elements. Furthermore, it also incorporates an analysis of other affiliated entities that can increasingly be noninsurance-related (e.g., banks, investment firms, brokers) and that can impact the insurance subsidiaries' risk profile and/or distribution.

As more insurers embrace change as the norm, the industry will increasingly witness dramatic and innovative transformations. This rapid pace of change will continue to present significant challenges and opportunities to insurers, as well as to the analytical rating process.

A.M. Best is committed to adapting its rating philosophy and methodology to this ever-changing landscape of industry, regulatory and legal developments, and to the individual operating approach each company's management employs. To that end, we pledge to managements to provide the most sophisticated, knowledgeable and analytically sound approach to assigning insurer financial strength ratings to their companies.

Financial Strength Ratings

Secure Ratings	
A++ and A+	Superior
A and A-	Excellent
B++ and B+	Very Good
Vulnerable Ratings	
B and B-	Fair
C++ and C+	Marginal
C and C-	Weak
D	Poor
E	Under Regulatory Supervision
F	In liquidation

A.M. Best's Group Rating Criteria Worksheet

Subsidiary Linkage With Groups

Group/Parent Name: XYZ Insurance Company
Group/Parent Rating: A

Company Name: XYZ Group
Current Company Rating: A–

Group Rating Classification: Core
Company Rating Impact: Upgrade to A

Capitalization	**Rank**	**Core Subsidiaries (9, 8 & 7)**	**Strategic Subsidiaries (6, 5 & 4)**	**Ancillary Subsidiaries (3, 2 & 1)**
Stand-Alone Capitalization	9	Prudently Capitalized	Adequately Capitalized	Modestly Capitalized
Parental Support — Explicit & Implicit	6	Strong	Modest	Limited or None
Comparability to Market — Peers	8	Above Market — Peers	Near Market — Peers	Below Market — Peers
Performance				
Future Expectations For Performance	6	Relatively Strong	Adequate	Relatively Weak
Consistency with Parent Expectations	6	Above Expectations	Near Expectations	Below Expectations
Strategic Linkage				
Historical Performance	7	Relatively Strong	Adequate	Relatively Weak
In Line with AMB Expectations	6	Above Expectations	Near Expectations	Below Expectations
Product	8	Very Compatible With "Mainstream" Business	Compatible With "Mainstream" Business	May Be Incompatible With "Mainstream" Business
Distribution	7	Share Distribution Network With Other Units	May Share Distribution Network With Other Units	Distribution Network Not Shared With Other Units
Common Corporate Identity	9	Carries the Same Name	May Carry Different Name	Carries Different Name
Materiality — Market Presence	8	Significant Earnings or Strong Presence	Material Earnings or Significant Presence	Immaterial Earnings or Modest Presence
Historical Track Record of Support	9	Strong Level of Historical Support	Significant Level of Historical Support	Limited or No Historical Support
Business Integration				
Communications & Technology	8			
Human Resources & Other Operations	7			
Investments	2	Managed by/Integrated with Parent/Affiliate	Coordinated with Parent/Affiliate with Parent/Affiliate	Done on Stand-Alone Basis
Marketing & Agency Support	8			
Underwriting & Pricing Activities	7			
TOTAL SCORE	**7**			

A.M. Best Co., established in 1899, is the world's oldest and most authoritative source of insurance company ratings. Best's Ratings are the definitive symbol signifying the financial strength and operating performance of insurance companies worldwide. For more information, visit A.M. Best's Web site at *http://www.ambest.com*, or contact one of our offices:

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