

Rating New Company Formations

In recent years, regulatory and tax issues, as well as market dislocations, have contributed to the formation of new insurance and reinsurance companies. As a result, growing numbers of brokers, agents, lenders, capital market participants and corporate clients are seeking financial information about these new entities. To meet this demand, A.M. Best Co. provides ratings on these new organizations and other risk-assuming vehicles using methodology outlined in this report.

A.M. Best's interactive rating process for insurance companies involves numerous quantitative and qualitative factors that are grouped into three categories: balance sheet strength, operating performance and business profile. A.M. Best's methodology for rating new company formations uses the same assessments of balance sheet strength and business profile as it does for established companies receiving traditional rating assignments.

Since, however, these new companies have yet to demonstrate a track record of operating performance, A.M. Best applies an additional set of quantitative and qualitative standards to the initial rating to reflect the extra uncertainty. In particular, initial and prospective risk-adjusted capital levels typically will need to be well above the assigned initial rating level throughout the development phase of the company, even after factoring in conservative earnings and investments returns. Extensive conversations with, and an assessment of, management are central to this process.

These criteria might apply partially or not at all to some newly organized, nontraditional insurance entities, such as virtual companies and special purpose vehicles.

Criteria for Proceeding with the Rating Assignment

For A.M. Best to proceed with an initial rating assignment, certain conditions must be fulfilled:

Questions regarding A.M. Best's methodology for rating new insurance company formations can be directed to Matthew Mosher, group vice president in the property/casualty division.

- Initial financing in place or expected to be executed concurrently with the initial rating assignment.

- Stress-tested capitalization, which conservatively supports the assigned rating throughout the business plan.

- Management's demonstration of a successful track record of operating performance relevant to the new venture's core business. Experience with organizing new insurance ventures also is factored into the process.

- A clearly defined, three-to-five-year business plan that all principals are in accord with and are well qualified and capable of implementing. The plan includes:

- Policy statements on underwriting criteria, investment guidelines and risk management;

- A thorough description of the products offered, pricing standards and the company's distribution and market strategy; and

- Financial projections, along with the underlying quantitative and qualitative assumptions and the anticipated utilization of capital.

- Experienced management and the appropriate staff and operational infrastructure in place (or adequately provided by third parties) to support initial activities and meet regulatory and rating agency scrutiny.

- Management, board members, strategic investors, investment bankers, actuaries and other advisers available for discussions with A.M. Best and to provide comprehensive disclosure of requested information.

- A follow-up process in place to measure the effectiveness of the initial business plan and to monitor the company's strategic and financial development.

New Company Rating Process

The objective of Best's Financial Strength Rating (FSR) is to provide an opinion as to an insurer's ability to meet its obligations to policyholders. In assigning a FSR to an established company, A.M. Best looks at balance sheet strength, operating performance and business profile, which is analogous to a review of a new



company's initial and prospective capital, sponsorship, business plans, management and operational controls.

The rating analysis of established and new entities is both quantitative and qualitative. Evaluation of key financial ratios is integrated with a qualitative evaluation of the company's operating plans and philosophies to gain a comprehensive understanding of the company's initial standing and its future prospects.

As with the traditional Best's FSR process, start-up entities are viewed within the context of the particular country risks to which they are exposed. Under these circumstances, A.M. Best utilizes its Country Risk Methodology, whereby countries are classified into one of five tiers reflecting the various economic and political risks that can affect an insurer's financial strength. The country risk tier is one factor, among many, in the rating process, and while it affects the rating, it is not necessarily a ceiling on the rating.

Best's rating system applies the same rigorous criteria to all insurers, new or established, offering a means of directly comparing insurers regardless of longevity or country of domicile. However, because a new company rating opinion must consider a greater degree of uncertainty, A.M. Best is conservative in its initial rating assignment.

Key Rating Factors

The analytical components of A.M. Best's interactive rating process for new insurers involve numerous quantitative and qualitative factors that can be grouped into the two evaluative categories of balance sheet strength and business profile. Since new companies lack a measurable track record of operating performance, A.M. Best applies a stringent set of qualitative (due diligence) standards to the initial rating. These are grouped into a third evaluative category of operational controls.

1. Balance Sheet Strength

A. Capitalization

A.M. Best's assessment of the strength and quality of a company's balance sheet is the underpinning of any FSR. In reviewing initial and prospective capitalization and leverage, A.M. Best begins with the capital requirements of the relevant regulatory authorities.

This is followed by a rigorous capital analysis using Best's Capital Adequacy Ratio (BCAR) to assess the capital that is necessary to support the new venture's operations over a period of time and that is appropriate for the types of business written.

The new company should demonstrate that it can support the execution of its business plan while maintaining risk-adjusted capital adequacy at levels well above the assigned rating level for at least three to five years. The degree of additional capital needed will reflect the risk profile of the business. A higher level of capitalization might be required if the business is subject, for instance, to low-occurrence but high-severity events. A.M. Best also will stress test the pace at which the company expects to utilize its capital. The capital required at all rating levels will reflect the greater risks inherent in a start-up venture compared with an established company's continuing operations.

A.M. Best Co. Methodology

March 2004

PUBLISHER, PRESIDENT AND CHAIRMAN
Arthur Snyder

EXECUTIVE VICE PRESIDENT/CHIEF OPERATING OFFICER
Arthur Snyder III

EXECUTIVE VICE PRESIDENT/CHIEF RATING OFFICER
Larry G. Mayewski

EXECUTIVE VICE PRESIDENT/CHIEF INFORMATION OFFICER
Paul C. Tinnirello

SENIOR VICE PRESIDENT
Shaun Flynn, International

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

Copyright © 2004 by A.M. Best Company, Inc., Ambest Road, Oldwick, New Jersey 08858. ALL RIGHTS RESERVED. No part of this report or document may be distributed in any electronic form or by any means, or stored in a database or retrieval system, without the prior written permission of the A.M. Best Company. For additional details, see Terms of Use available at the A.M. Best Company Web site <http://www.ambest.com>.

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

Copies are available through Customer Service: (908) 439-2200, ext. 5557. This report is also available online at <http://www.ambest.com/ratings/methodology.html>.



The Insurance Information Source

The process includes an evaluation of the company's financial stability and flexibility. The level, quality and permanence of capital, including potential distributions of initial investor capital, are evaluated, taking into consideration the company's appetite for risk, the structure of its assets, its dependence on reinsurance and its liquidity needs. Key factors reviewed include:

- Initial capital commitment.
- Stress-tested capitalization based on the BCAR model under various scenarios, which conservatively support the assigned rating throughout the operating plan.
- Capital structure—equity and debt financing.
- Use of reinsurance, credit facilities and other forms of contingent capital financing.
- Quality and diversity of assets.
- Regulatory considerations.
- Targeted risk-adjusted capital under the BCAR model.
- Investor expectations, including earnings and dividends.
- Capital generation anticipated from core business activities.
- Pricing targets.
- Expected reserving levels (conservative or aggressive).
- Investment strategy for reserves and capital. The investment strategy should be consistent with the mix of business, financial plans, liquidity needs and capitalization. Since investment management is important to preserving capital, A.M. Best will review the quality and diversification of assets and the reputation and experience of the investment managers.
- Expertise and processes for managing assets, liabilities and other forms of enterprise risk.

B. Sponsorship and Investors

A new company's sponsors and/or strategic investors can significantly affect its success in meeting its objectives. Their experience and commitment to the company over the near and long term, including any potential exit strategies, are key considerations in the rating process.

A.M. Best might give credit in the rating where the sponsor is a rated organization that provides turnkey capability to a new company that, in turn, supports the sponsor's core business.

If the sponsor also provides financial guarantees or reinsurance support that is acceptable to A.M. Best, this too might enhance the rating level. A more conservative rating approach is required of situations where investors are looking to make a quick return because of prevailing favorable market conditions, as short-term adversity could lead them to withdraw support. In these situations, regulatory controls on paid-up capital, and the likely underlying attractiveness of the operation to future capital providers, are especially important. Expected dividend policy is a key part of the initial rating analysis, and any subsequent increase in the scale or early introduction of dividends compared with the initial plan will be a negative factor in the rating.

A.M. Best also considers the competitive advantages that a sponsor might provide to a new company. Also assessed are the new company's expected benefits to the sponsor's core business, as this gives an indication of the sponsor's likely long-term commitment to the new company. It is also important to understand the return investors expect and the reasonableness of these expectations relative to the new company's business plan and existing market conditions.

The strength of the sponsor/new company relationship is evaluated through the following factors:

- Type of sponsor or investor—strategic/financial;
- Level of financial and operational commitment;
- Investors' return expectations (reasonableness, timeliness, exit strategies);
- Linkage or synergies with an existing insurance or noninsurance organization, such as a mutually beneficial long-term relationship with the sponsor;
- Strategic/operational support (distribution, markets); and
- Additional financial support (capital contributions, financial guarantees and reinsurance agreements).

In certain circumstances, A.M. Best might find it appropriate to use its Insurance Group Rating Methodology for certain companies that are considered core or strategically important to their sponsors that are rated interactively.

2. Business Profile

A. Business Plan and Strategy

A clearly defined business plan is essential. The success of the company depends on management's ability to effectively implement the business plan while remaining responsive to changing conditions. The business plan and financial targets serve as a benchmark against which A.M. Best will measure the success of the company in the first few years. Some of the areas A.M. Best explores include:

- Targeted lines of business that are consistent with the expertise and track record of management and, if relevant, the company's strategic investors or its parent company;
- Pricing targets and financial plans that are compatible with expected returns and capital protection and generation; and
- Whether the new company is set up to serve an appropriate business purpose or as a means to reduce taxable obligations.

Key factors in A.M. Best's evaluation include:

- Well-defined three-to-five-year business plan;
- Target classes of business;
- Competitive environment and the characteristics that will differentiate the company;
- Distribution relationships;
- Pricing methodologies and monitoring practices;
- Return expectations vs. market realities;
- Defined risk-management and underwriting policy statements;
- Investment strategies, both long-term and short-term; and
- Projected financial results, including balance sheet, income statement, cash flows and capital obligations.

B. Management

A.M. Best looks at the depth of the senior management in terms of its track record in critical functional areas, such as underwriting and claims management; financial, investment and risk management; information technology; and marketing, sales and distribution. As part of the review of management, A.M. Best examines:

- Experience in managing other operations through start-up and changing business conditions.
- Financial and operational risk tolerance.
- Consistency of the business plan and investment strategy with that of sponsors or investors and market realities.

- Alignment of incentive compensation plans, employment contracts and management investments with the attainment of the company's long-term financial and strategic goals, shareholder value and policyholder security.

- Ability of management to attract key personnel, establish sound business practices, and develop formal monitoring processes and the appropriate infrastructure and operating controls to support its operations.

- Succession plans, especially if the founding management is in place only to develop the initial business plan.

3. Operational Controls

Operational controls are important indicators of management's ability and commitment to the quality and longevity of a new company. These controls should be linked to the monitoring and fulfillment of the business plan. Operational controls also are the means by which the new company's growth is managed and provide a large measure of risk management. As part of the review of operational controls, A.M. Best examines:

- Whether statements on investment, risk-management, underwriting and accounting policy are defined clearly, and whether those statements are consistent with the company's business plan, capitalization and management's appetite for risk.
- The company's valuation methodology for establishing reserves.
- Its monitoring of catastrophic exposures and modeling techniques used.
- The controls to monitor the new company's distribution relationships, due diligence, productivity, revenue tracking and expense controls.

A.M. Best's Monitoring Process

Maintaining a rating on a new company also requires significant ongoing surveillance by A.M. Best, over and above that already required when rating established operations. In assigning an initial rating, A.M. Best and the company agree on a formal plan to monitor the company's strategic and financial development. This plan usually entails quarterly reviews with management and other principals on the company's progress toward its stated objectives. Any changes in strategy are discussed and considered in the ongoing rating evaluation.

As with the initial rating, A.M. Best requires detailed disclosure in monitoring the rating. Companies are asked to provide all information necessary for continuing analysis. This generally includes annual and quarterly statements, reviews of risk management, revisions of business plans and documentation on insurance written.

GUIDE TO BEST'S FINANCIAL STRENGTH RATINGS							
A Best's Rating is an independent opinion, based on a comprehensive quantitative and qualitative evaluation, of a company's balance sheet strength, operating performance and business profile. Best's Ratings are not a warranty of a company's financial strength and ability to meet its obligations to policyholders.							
Financial Strength Ratings							
A Best's Financial Strength Rating (FSR) is an opinion of an insurer's ability to meet its obligations to policyholders.							
	Rating	Descriptor	Definition				
Secure	A++, A+	Superior	Assigned to companies that have, in our opinion, a superior ability to meet their ongoing obligations to policyholders.				
	A, A-	Excellent	Assigned to companies that have, in our opinion, an excellent ability to meet their ongoing obligations to policyholders.				
	B++, B+	Very Good	Assigned to companies that have, in our opinion, a good ability to meet their ongoing obligations to policyholders.				
Vulnerable	B, B-	Fair	Assigned to companies that have, in our opinion, a fair ability to meet their current obligations to policyholders, but are financially vulnerable to adverse changes in underwriting and economic conditions.				
	C++, C+	Marginal	Assigned to companies that have, in our opinion, a marginal ability to meet their current obligations to policyholders, but are financially vulnerable to adverse changes in underwriting and economic conditions.				
	C, C-	Weak	Assigned to companies that have, in our opinion, a weak ability to meet their current obligations to policyholders, but are financially very vulnerable to adverse changes in underwriting and economic conditions.				
	D	Poor	Assigned to companies that have, in our opinion, a poor ability to meet their current obligations to policyholders and are financially extremely vulnerable to adverse changes in underwriting and economic conditions.				
	E	Under Regulatory Supervision	Assigned to companies (and possibly their subsidiaries/affiliates) that have been placed by an insurance regulatory authority under a significant form of supervision, control or restraint whereby they are no longer allowed to conduct normal ongoing insurance operations. This would include conservatorship or rehabilitation, but does not include liquidation. It may also be assigned to companies issued cease and desist orders by regulators outside their home state or country.				
	F	In Liquidation	Assigned to companies that have been placed under an order of liquidation by a court of law or whose owners have voluntarily agreed to liquidate the company. Note: Companies that voluntarily liquidate or dissolve their charters are generally not insolvent.				
	S	Suspended	Assigned to companies that have experienced sudden and significant events affecting their balance sheet strength or operating performance and whose rating implications cannot be evaluated due to a lack of timely or adequate information.				
Rating Modifiers and Affiliation Codes							
A rating modifier can be assigned to indicate that a Best's Rating may be subject to near-term change (under review), that a company did not subscribe to Best's interactive rating process (public data) and that the rating is assigned to a syndicate operating at Lloyd's. Affiliation codes (g, p, and r) are added to Best's Ratings to identify companies whose assigned ratings are based on group, pooling or reinsurance affiliation with other insurers.							
	Modifier	Descriptor	Definition				
Rating Modifiers	u	Under Review	A modifier that generally is event-driven (positive, negative or developing) and is assigned to a company whose Best's Rating opinion is under review and may be subject to change in the near-term, generally defined as six months.				
	pd	Public Data	Assigned to insurers that do not subscribe to Best's interactive rating process. Best's "pd" Ratings reflect qualitative and quantitative analyses using public data and information.				
	s	Syndicate	Assigned to syndicates operating at Lloyd's.				
Affiliation Codes		g	Group	p	Pooled	r	Reinsured
Not Rated Categories (NR)							
Assigned to companies reported on by A.M. Best, but not assigned a Best's Rating. The five categories are:							
NR-1: Insufficient Data.		NR-2: Insufficient Size and/or Operating Experience.			NR-3: Rating Procedure Inapplicable.		
NR-4: Company Request.		NR-5: Not Formally Followed.					
Rating Outlook							
Best's interactive Ratings (A++ to D) are assigned a Rating Outlook that indicates the potential direction of a company's rating for an intermediate period, generally defined as the next 12 to 36 months. Rating Outlooks, which appear in the rating rationale section of the company's <i>Best's Company Report</i> , are as follows:							
Positive	Indicates a company's financial/market trends are favorable, relative to its current rating level and, if continued, the company has a good possibility of having its rating upgraded.						
Negative	Indicates a company is experiencing unfavorable financial/market trends, relative to its current rating level and, if continued, the company has a good possibility of having its rating downgraded.						
Stable	Indicates a company is experiencing stable financial/market trends and there is a low likelihood that its rating will change in the near term.						
Best's Ratings are distributed via press release and/or the A.M. Best Web site at www.ambest.com , and are published in the <i>Rating Monitor</i> section of <i>BestWeek</i> ®. Best's Ratings are proprietary and may not be reproduced without permission.							
Copyright © 2004 by A.M. Best Company, Inc.							Version 011304

GUIDE TO BEST'S DEBT RATINGS

A Best's Rating is an independent opinion, based on a comprehensive quantitative and qualitative evaluation, of a company's balance sheet strength, operating performance and business profile. Best's Ratings are not a warranty of a company's ability to meet its financial obligations.

Long-Term Credit Ratings

A **Best's Long-Term Debt Rating** (issue credit rating) is an opinion as to the issuer's ability to meet its financial obligations to security holders when due. These ratings are assigned to debt and preferred stock issues.

	Rating	Descriptor	Definition
Investment Grade	aaa	Exceptional	Assigned to issues, where the issuer has, in our opinion, an exceptional ability to meet the terms of the obligation.
	aa	Very Strong	Assigned to issues, where the issuer has, in our opinion, a very strong ability to meet the terms of the obligation.
	a	Strong	Assigned to issues, where the issuer has, in our opinion, a strong ability to meet the terms of the obligation.
	bbb	Adequate	Assigned to issues, where the issuer has, in our opinion, an adequate ability to meet the terms of the obligation; however, is more susceptible to changes in economic or other conditions.
Non-Investment Grade	bb	Speculative	Assigned to issues, where the issuer has, in our opinion, speculative credit characteristics, generally due to a moderate margin of principal and interest payment protection and vulnerability to economic changes.
	b	Very Speculative	Assigned to issues, where the issuer has, in our opinion, very speculative credit characteristics, generally due to a modest margin of principal and interest payment protection and extreme vulnerability to economic changes.
	ccc, cc, c	Extremely Speculative	Assigned to issues, where the issuer has, in our opinion, extremely speculative credit characteristics, generally due to a minimal margin of principal and interest payment protection and/or limited ability to withstand adverse changes in economic or other conditions.
	d	In Default	In default on payment of principal, interest or other terms and conditions. The rating also is utilized when a bankruptcy petition, or similar action, has been filed.

A.M. Best's Long-Term Credit Rating scale also is used when assigning a **Best's Long-Term Issuer Credit Rating (ICR)**, which is an opinion as to the ability of the rated entity to meet its senior-most obligations.

Ratings from "aa" to "ccc" may be enhanced with a "+" (plus) or "-" (minus) to indicate whether credit quality is near the top or bottom of a category. A company's Long-Term Credit Rating also may be assigned an Under Review modifier ("u") that generally is event-driven (positive, negative or developing) and indicates that the company's Best's Rating opinion is under review and may be subject to near-term change. Ratings shown as *(italicized)* denote indicative shelf ratings. Ratings may also be assigned a Public Data modifier ("pd") which indicates that a company does not subscribe to A. M. Best's interactive rating process.

Short-Term Credit Ratings

A **Best's Short-Term Debt Rating** is an opinion as to the issuer's ability to meet its obligations having maturities generally less than one year, such as commercial paper.

	Rating	Descriptor	Definition
Investment Grade	AMB-1+	Strongest	Assigned to issues, where the issuer has, in our opinion, the strongest ability to repay short-term debt obligations.
	AMB-1	Outstanding	Assigned to issues, where the issuer has, in our opinion, an outstanding ability to repay short-term debt obligations.
	AMB-2	Satisfactory	Assigned to issues, where the issuer has, in our opinion, a satisfactory ability to repay short-term debt obligations.
	AMB-3	Adequate	Assigned to issues, where the issuer has, in our opinion, an adequate ability to repay short-term debt obligations; however, adverse economic conditions will likely lead to a reduced capacity to meet its financial commitments on short-term debt obligations.
Non-Investment Grade			
	AMB-4	Speculative	Assigned to issues, where the issuer has, in our opinion, speculative credit characteristics and is vulnerable to economic or other external changes, which could have a marked impact on the company's ability to meet its commitments on short-term debt obligations.
	d	In Default	In default on payment of principal, interest or other terms and conditions. The rating also is utilized when a bankruptcy petition, or similar action, has been filed.

A.M. Best's Short-Term Credit Rating scale also is used when assigning a **Best's Short-Term Issuer Credit Rating (ICR)**, which is an opinion as to the ability of the rated entity to meet its senior financial commitments on obligations maturing in generally less than one year.

Rating Outlook

Best's Credit Ratings (aaa to c and AMB-1+ to AMB-4) are assigned a Rating Outlook that indicates the potential direction of a company's rating for an intermediate period, generally defined as the next 12 to 36 months. Rating Outlooks are as follows:

Positive	Indicates a company's financial/market trends are favorable, relative to its current rating level, and if continued, the company has a good possibility of having its rating upgraded.
Negative	Indicates a company is experiencing unfavorable financial/market trends, relative to its current rating level, and if continued, the company has a good possibility of having its rating downgraded.
Stable	Indicates a company is experiencing stable financial/market trends and that there is a low likelihood that its rating will change in the near term.

Best's Ratings are distributed via press release and/or the A.M. Best Web site at www.ambest.com, and are published in the *Rating Monitor* section of *BestWeek*®. Best's Ratings are proprietary and may not be reproduced without permission.
Copyright © 2004 by A.M. Best Company, Inc.

Version 011304



The Insurance Information Source

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:

A.M. Best Company

Ambest Road
Oldwick, New Jersey 08858
Phone: (908) 439-2200
Fax: (908) 439-3296
<http://www.ambest.com>

A.M. Best Europe Ltd.

1 Minster Court, 11th Floor
Mincing Lane
London, England EC3R 7AA
Phone: 011-44-207-626-6264
Fax: 011-44-207-626-6265
www.ambest.co.uk

A.M. Best International Ltd.

A.M. Best House
264 Northfield Avenue
London, England W5 4UB
Phone: 011-44-208-579-1091
Fax: 011-44-208-566-1789
www.ambest.co.uk

A.M. Best Asia-Pacific Ltd.

Unit 5707 Central Plaza
18 Harbour Road
Wanchai, Hong Kong
Phone: 011-852-2824-1107
Fax: 011-852-2824-1833
www.ambest.com.hk