

Market Review

July 25, 2011

Sector

Non-Life & Life

Additional Information

2011 Special Report:

Takaful – Market Review

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Rating Implications of Recent Unrest in the MENA Region

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Criteria:

Assessing Country Risk

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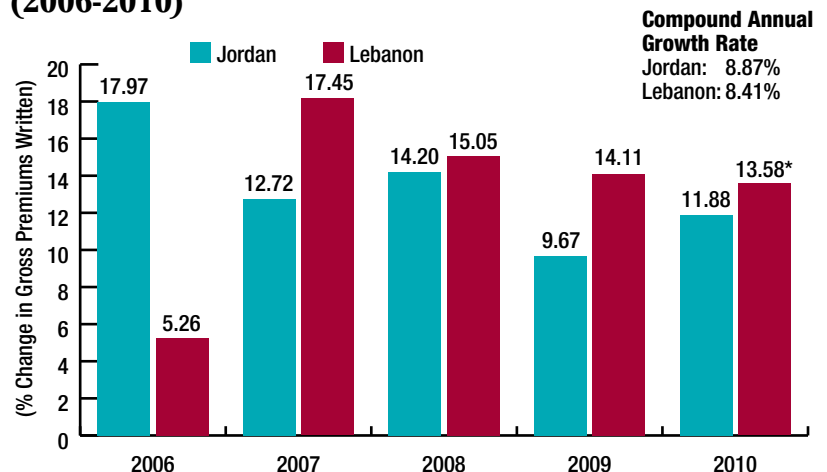
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Jordan and Lebanon Lead Growth In Levant Region's Insurance Markets

Jordan and Lebanon are the main emerging insurance markets of the Levant – a region encompassing the countries of the Eastern Mediterranean – with open doors for foreign ownership of domestic companies, and new compulsory covers for certain risks. They have low insurance penetration but potential to grow as their economies expand, marked more by agriculture and tourism than the oil and construction industries that drive other Arab economies.

- Both countries are home to companies that dominate, posing a challenge to small insurers to grow and prosper.
- Common challenges for insurers in the region include intense competition, volatile investment portfolios and overall instability in the Arab world, although both Lebanon's and Jordan's insurance markets have remained dynamic.
- Jordan's insurers tend to serve the domestic market, whereas several Lebanese insurers have regional networks, but A.M. Best believes both markets are well placed to grow and mature further.
- Lebanon has the highest rate of insurance penetration in the Middle East and North Africa region, with the exception of Israel.
- Jordan's insurance market is among the smallest in the Middle East and is dominated by non-life business, reflecting compulsory lines.

Jordan & Lebanon – Gross Premium Written Growth (2006-2010)



* 2010 data for Lebanon are estimated.

Sources: Insurance Commission (Jordan) Financial Report 2010 and Insurance Control Commission (Lebanon)



Platforms of Promise in the Levant

The insurance markets of Jordan and Lebanon share many similar characteristics, as the main emerging markets of the Levant – a region encompassing the countries of the Eastern Mediterranean.

Both countries have well-developed insurance markets that permit 100% foreign ownership of domestic companies, and regulators have introduced compulsory covers for certain risks.

They are, however, still viewed as emerging markets with low insurance penetration but potential for growth, reflecting economic expansion. The drivers for insurance demand differ from other Arab countries, as the Jordanian and Lebanese economies rely more on agriculture and tourism, as opposed to oil and construction. Lebanon is benefiting from a period of relative political stability, while new compulsory covers should increase premium volume in Jordan.

This potential growth is supported by domestic insurance expertise, as both markets have established sound insurance sectors with a large number of professionals. Many market participants have a good depth of skills, and Jordan and Lebanon therefore supply local talent to Middle Eastern markets.

Although the combined market share of the top companies is not high for the region, in both countries there are companies that dominate, making it more challenging for

small insurers to grow their businesses and achieve technical profits. Market conditions theoretically pave the way for consolidation, as markets are not only open to foreign investment but are also crowded. However, as insurers are often family owned, genuine merger opportunities are limited because families are reluctant to relinquish control of their enterprises.

Common challenges for insurers in the region include intense competition and volatile investment portfolios. The instability in the Arab world has to an extent impacted the insurance sector, although both Lebanon's and Jordan's insurance markets have remained dynamic.

The two markets also contrast considerably in a range of aspects. For example Jordan's insurers tend to serve the country's domestic market, whereas several Lebanese insurers have regional networks. A.M. Best's Country Risk Tiers for each country reflect different economic and political challenges.

However, both markets are at an exciting stage of development, and A.M. Best believes they are well positioned to grow and mature further.

Lebanon's Strong Growth

Lebanon's insurance market has grown significantly in recent years and is double the size of Jordan's. In 2010, total premiums reached LBP 1.75 trillion (USD 1.16 billion), with growth of the non-life sector particularly strong (see **Exhibit 1**).

The market has experienced continuous growth from the end of the '90s, but it has only enjoyed such buoyancy over the past few years, having been unsettled in 2005 by political instability and security issues. From 2007 to 2010, total gross premiums written recorded double-digit year-on-year growth ranging from 13.6% to 17.5% as domestic tensions eased. A period of relative stability after the truce between Israel and Hezbollah in 2006 has also bolstered foreign investors' confidence.

The country's economic growth has picked up substantially since 2005. Banks have also increased their offering of mortgage

Exhibit 1 Lebanon – Key Insurance Market Statistics (2008-2010)

Indicator	2008	2009	2010 (Estimated)
Population (Millions)	3.808	3.857*	3.908
Gross Domestic Product (LBP Billions)	45,346.00	52,650.00	59,165.94
Change in Real GDP (%)	9.30	8.50	7.50
Insurance Penetration (Life) %	0.94	0.85	0.91
Insurance Penetration (Non-Life) %	2.04	2.08	2.05
Insurance Penetration (Total) %	2.98	2.93	2.96
Insurance Premium (Life) (LBP Millions)	426,734.62	445,136.41	535,941.75
Insurance Premium (Non-life) (LBP Millions)	923,632.63	1,095,742.39	1,214,170.25
Insurance Premium (Total) (LBP Millions)	1,350,352.23	1,540,863.75	1,750,112.00
Change in Premium Volume (Total) %	15.05	14.11	13.58

* IMF estimate

Sources: International Monetary Fund, World Economic Outlook Database, April 2011; Insurance Control Commission (Lebanon); 2010 insurance figures reported in *Al-Bayan* business magazine.

and motor loans, resulting in greater demand for insurance products. There is also a sense of optimism currently surrounding the new Lebanese government, which was formed in mid-June 2011.

While Lebanon’s insurance market is small compared with those in the United Arab Emirates (UAE), Iran and Saudi Arabia, it has traditionally been a key insurance centre in the Middle East. Unlike those in Jordan, Lebanese insurers have served the regional market.

Lebanon has the highest rate of insurance penetration in the Middle East and North Africa (MENA) region, with the exception of Israel. Total insurance premium as a percentage of GDP has remained steady at around 3%. Compulsory insurance for workers’ compensation and motor insurance for bodily injury and civil liability has also aided growth in premiums.

Diverse Challenges for A Large Number of Insurers

The insurance market has been driven in part by strong economic growth, though this has waned in recent years. Gross domestic product (GDP) increased by an estimated 7.5% in 2010 but is forecasted to expand by a more modest 2.5% in 2011. To date, Lebanon has not suffered any major impact from the recent troubles in the MENA region; however, a slowdown in economic development represents a challenge for the large number of insurers in Lebanon.

Under A.M. Best’s country risk rating methodology, countries are placed into one of five tiers, ranging from “CRT-1” (Country Risk Tier 1), denoting a stable environment with the least proportion of risk, to “CRT-5” (Country Risk Tier 5) for countries posing the greatest risk. Lebanon falls into the CRT-5 category, while the majority of other MENA countries have CRT-3 and CRT-4 tiers.

A.M. Best considers Lebanon to be among the riskiest countries for insurers operating in the MENA region, with high levels of economic and political risk and very high levels of financial system risk. GDP growth is still very high compared with that of mature global insurance markets, although domestic political tensions between the

Lebanese government and Hezbollah have caused growth in GDP to slow down compared with previous years. It is difficult for the economy to gain momentum with the constant threat of instability and regional violence. Government debt is high – currently 150% of GDP.

Competition is among the most significant challenges facing the market. Currently, 52 international and local insurers are operating in the country. The number of insurers has consolidated marginally in recent years, falling from 61 in 2001, although the market is still overcrowded.

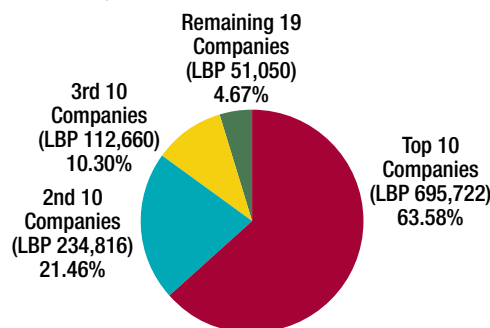
Insurers generally tend to be local; many are family businesses or controlled by an individual or a small group of investors. This tight ownership structure can restrict opportunities for consolidation.

There were 49 insurers writing non-life business at the end of 2009, making it difficult for smaller companies to expand premium volume and increase market share.

Exhibit 2 shows that the top 20 companies controlled 85% of the non-life market. Higher capital requirements may contribute to consolidation, although most company owners are likely to have the resources for heightened requirements (see **Regulatory Change Anticipated**, page 4).

Intense competition is also fuelling higher acquisition costs. Many brokers justify increased commission rates to attract certain types of risk, but this at the same time results in commission rates that are higher than in markets in the Gulf.

Exhibit 2
Lebanon – Non-Life – Market Shares by Premiums (2009)
(LBP Millions)



Note: Figures may not add due to rounding.
Source: Insurance Control Commission (Lebanon)

Recent acquisition activity needs to be seen within the context of increasing geographical reach, rather than an intention to grow specifically in the Lebanese market. In December 2010, Zurich Financial Services Group accelerated the expansion of its operations in the Middle East through the acquisition of Compagnie Libanaise D'Assurances, which has branch operations in the UAE, Kuwait and Oman.

However, while an outside investor can appreciate the opportunities Lebanon offers to access other regional markets and the technical expertise and talent of staff employed by domestic insurers, A.M. Best does not anticipate international companies establishing offices in Lebanon. Offsetting factors include a small population of 4 million (less than Saudi Arabia or the UAE but greater than other Gulf countries, including Qatar and Oman), political instability and a highly competitive operating environment.

Regulatory Change Anticipated

The insurance regulatory environment has been challenging, owing in part to insurance companies' resistance to changes from Lebanon's Insurance Control Commission (ICC). This has included legal challenges being brought by industry body Association des Compagnies d'Assurances au Liban (ACAL) to prevent the introduction of regulatory changes.

As the ICC is part of the Ministry of Economy and Trade, it is perceived to face challenges enforcing regulation, with permission required from the government to

take action against companies. For these reasons, a report on the insurance sector in the MENA region issued by the World Bank in November 2010 viewed Lebanon as having had "an unregulated market for over 60 years." It said Lebanon's insurance legislation was "very outdated and the supervisor has had to cope with a hostile sector in trying to introduce a modern risk based approach."

However, there has been some regulatory intervention, notably the withdrawal of non-life insurer American Underwriters Group Co.'s license in 2010. The ICC said this "was motivated by several factors: financial, administrative as well as market conduct ones."

The Amended Law 94 of 16 June 1999 increased the minimum capital requirement (MCR) from LBP 300 million to LBP 2.25 billion (USD 1.5 million) and introduced a solvency margin of 10% of gross premiums. Minimum capitalisation is expected to be further increased, possibly to LBP 15 billion (USD 10 million). Additional pressure on companies to increase their capital requirements could act as an incentive for industry consolidation, or the transfer or sale of books of business among insurers.

With the recently formed government, there are hopes that the insurance market will change as the government examines a range of issues, including social security and life assurance.

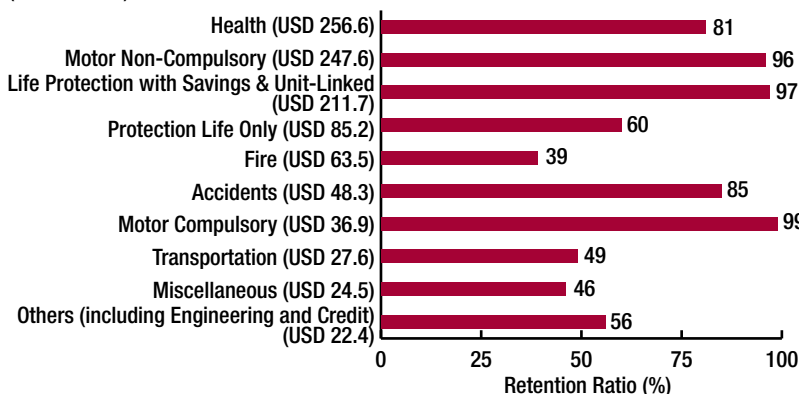
Reinsurance Purchase Reflects Strong Personal Lines

Insurers in Lebanon cede less business compared with other insurance markets in the Middle East, including Jordan, with 82% of total premiums retained in 2009.

This in part reflects the high levels of retention for compulsory motor (99%) and non-compulsory motor (96%). Motor is the largest line of business in Lebanon, representing 28% of total premiums in 2009. Health, the second biggest risk, contributed a quarter of total premiums and had an 81% retention level (see **Exhibit 3**).

While life insurance penetration is low compared with more mature insurance markets at 0.9% of GDP, again this is higher in Lebanon than in other countries

Exhibit 3
Lebanon – Retention Ratios and Gross Written Premiums by Line of Business (2009)
 (USD Millions)



Source: Insurance Control Commission, Annual Report 2009

of the region, including Jordan. The life protection market represented less than a third (29%) of total premiums in 2009, and 97% of these risks were retained, as they tend to be less volatile.

With the exclusion of personal lines and life risks, reinsurance is in line with other Middle Eastern markets. However, there are few engineering insurance contracts in Lebanon, reflecting the absence of petroleum risk and a slowdown of construction and development in recent years. In line with insurers in other MENA markets, most Lebanese insurers are unable to sustain a major loss for commercial risks and consequently rely on reinsurance.

Companies purchase reinsurance in Lebanon much as they do in the rest of the Middle East. They seek protection in particular on a facultative basis for volatile and large risks – for example, engineering, marine and transport, aviation, fire and accident. Business is reinsured on a bundled basis, particularly for marine, engineering and fire risks. Quota share surplus reinsurance is also commonly used.

Greater confidence regarding risk exposure and more restrictive proportional reinsurance terms would cause retentions to increase. At the same time, the appeal of increased reinsurance commissions from the cession of such risks is high, even for companies that can afford to retain some larger risks.

Jordan – Growing From a Small Base

Jordan's insurance market is among the smallest in the Middle East, with total premiums reaching JOD 408.6 million (USD 576.3 million) in 2010. The non-life market is almost 10 times the size of the life sector, with gross premiums written (GPW) of JOD 370.6 million. This reflects compulsory lines of business, including workers' compensation, motor third-party liability (MTPL) insurance for bodily injury, and public liability insurance for hotels and restaurants.

While the market is small, with insurance premium as a percentage of GDP a modest 2.1% in 2010, it is growing significantly, driven by personal lines. **Exhibit 4** shows total premiums increased 11.9% in 2010. This was driven by motor – the largest class of business

at 43.2% of total GPW in 2010 – expanding by 17.8% after a price restructuring enabled insurers to increase rates. Medical insurance, which represented 23% of total GPW, enjoyed a 14.5% increase in premiums and is expected to experience further demand.

Personal lines are forecasted to see further growth as Jordan's economy expands. In 2009 and 2010, the pace of economic development slowed, but GDP is predicted to grow by 3.3% in 2011.

The introduction of additional compulsory insurance from the Insurance Commission will help generate momentum. Recent, new regulation makes fire and earthquake insurance compulsory for industrial and commercial government entities next year.

Compulsory medical cover for employees and their families in private-sector institutions and earthquake cover for residential units remain under consideration.

From Competitive to Investment Challenges

In common with other emerging markets, the operating environment for insurers in Jordan is challenging. Although there are fewer insurers than in neighbouring countries, including Lebanon, the 28 companies (one life, 10 non-life and 17 composite) compete largely on price. Some insurers do not attempt to reach new customers through offering innovative products, alternative distribution channels or improved service standards.

Arab Orient Insurance Co., which has an A.M. Best Financial Strength Rating (FSR) of B++, is the market leader, underwriting 13% of total

Exhibit 4

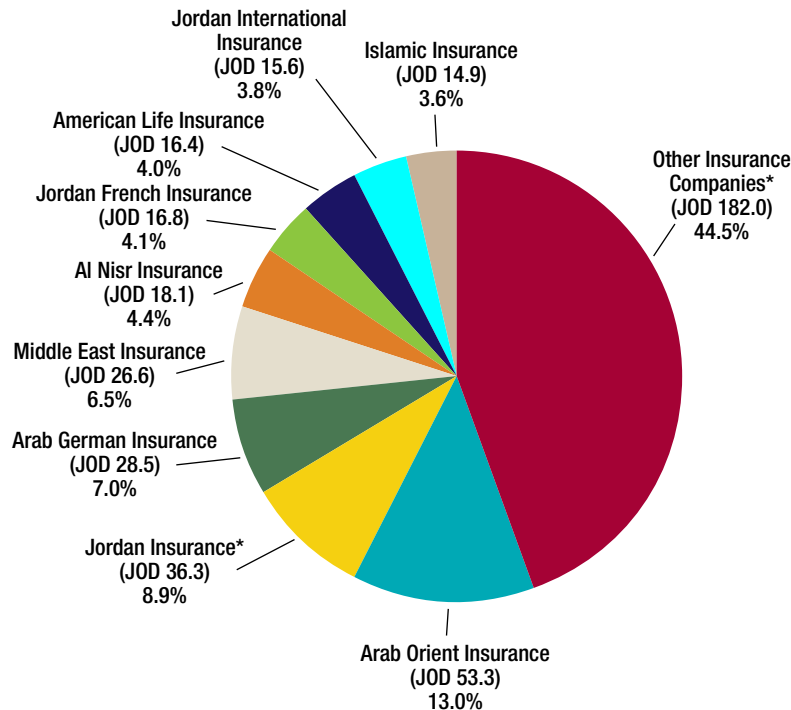
Jordan – Key Insurance Market Statistics (2008-2010)

Indicator	2008	2009	2010
Population (Millions)	5.85	5.98	6.117*
Gross Domestic Product (JOD Billions)	16.108	17.816	19.528
Change in Real GDP (%)	7.61	2.33	3.09
Insurance Penetration (Life) %	0.22	0.20	0.19
Insurance Penetration (Non-Life) %	1.84	1.85	1.9
Insurance Penetration (Total) %	2.07	2.05	2.09
Insurance Premium (Life) (JOD Millions)	35.9	34.9	38.0
Insurance Premium (Non-life) (JOD Millions)	297.1	330.3	370.6
Insurance Premium (Total) (JOD Millions)	333.0	365.2	408.6
Change in Premium Volume (Total) %	14.16	9.67	11.88

* IMF estimate

Sources: International Monetary Fund, World Economic Outlook Database, April 2011; Insurance Commission of Jordan annual reports

Exhibit 5
Jordan – Gross Premiums Written (2010)
 (JOD Millions)



* Gross Premiums Written exclude business outside Jordan.
 Note: Figures may not add due to rounding.
 Source: Insurance Commission (Jordan), Financial Report 2010.

GPW in Jordan in 2010. However, as **Exhibit 5** shows, the top five insurers control 39.8% of the total insurance market in Jordan.

In particular, it has been difficult to achieve profitability for motor risks as compulsory MTPL operates under a tariff structure, with insurers obliged to offer cover to everyone who requests protection. In the past year, insurers have been permitted to increase rates by up to 25%, based on an insured’s driving history. Even this has historically been proven inadequate to ensure profitability of compulsory MTPL for most Jordanian insurers.

The takaful, or Shari’a compliant market, has grown quickly, albeit from a low base. The three takaful operators collectively underwrote JOD 32.5 million of risks in 2010, representing 8% of total written premiums in Jordan. There is one operator writing family takaful business, despite this being considered to offer the greatest opportunity given low life penetration.

The strong growth of Islamic banking in Jordan points toward strong potential demand

for Shari’a products. Still, the growth is likely to be below that observed in the Gulf Cooperation Council (GCC) countries, as the practice of purchasing conventional insurance is better established in Jordan than in other Gulf markets, for example, Qatar, Oman or Kuwait.

In common with other insurers operating in many emerging markets, insurance companies in Jordan can have significant exposure to higher risk investment classes. Investment portfolios are heavily biased toward the real estate sector and equities, and they tend to lack regional diversification. Falls on the Amman Stock Exchange over the past year have resulted in investment portfolios experiencing capital losses, and total investments by Jordanian insurers declined by 2.2% to JOD 473.9 million in 2010. Reducing exposure to equities can provide insurers with a more diversified profile, more consistent returns on investment and greater stability in earnings.

Most Middle Eastern countries have suffered some political unrest in recent months, although activities in Jordan have not been as disruptive as those in neighbouring Arab countries. Unrest in the region has caused a slowdown in tourism, although public discontent in Jordan appears to have dissipated after governmental changes and various public reforms.

While the insurance market has suffered little direct impact from regional instability, uncertainty has affected insurers’ share prices and investment portfolios.

A.M. Best recognises Jordan as having relatively high levels of economic, political and financial system risk. It is categorised as a “CRT-4” (Country Risk Tier 4) country, as the economy is vulnerable to external shocks, and Jordan lacks natural resources and relies on trade. This is at the higher end of A.M. Best’s Country Risk analysis, with categories ranging from “CRT-1” to “CRT-5”.

Regulatory Change, Even at the Top

The Insurance Commission, which was created in late 1999, is on the cusp of entering a new stage in its evolution, as plans are under way to merge the insurance regulator with the Companies Control Directorate and create a specialised

department in the Ministry of Industry and Trade.

Jordan has to date had one of the region's more developed regulatory regimes. In recent years, it has taken significant steps to enhance its level of transparency and increase insurers' credibility with the use of International Financial Reporting Standards (IFRS).

Insurers use a modified U.S. risk-based capital (RBC) approach, and the Insurance Commission is considering updating this with an enhanced RBC regime following European Solvency II principles. However, while a standardised approach is used, the regulator believes companies are not ready for internal risk management models.

A company transacting business before 2005 has a minimum capital requirement (MCR) of JOD 4 million, or JOD 8 million for a composite. Under Regulation No. (73) of 2005, this increased to JOD 25 million for a company licensed after the act took effect. The Insurance Commission has no current plans to increase MCRs in the near future.

Heavy Reinsurance Use Set to Continue
Compared with international standards, overall retention was low in Jordan at 62%

for 2010, but this was in line with regional markets. Some insurers are reluctant to carry significant risk, owing to restraints on capitalisation. Others have little incentive to retain more risk against their balance sheets as they receive attractive commissions from reinsurers.

A domestic reinsurer would offer local expertise, but the market is too fragmented to enable a reinsurance start-up, which would face a MCR of JOD 100 million. Despite the absence of a domestic reinsurer, there is no shortage of reinsurance capacity, and foreign reinsurers are present in the market, owning stakes in local insurers.

Excess-of-loss tends to be reserved for motor – general and third-party liability – professional indemnity, workers' comp and employers' liability, while medical cover is purchased on a quota-share basis. These risks tend to be largely retained, with a small portion of motor reinsured to the local reinsurance pool, in which most companies participate.

Insurance companies in Jordan are unlikely to retain more risk in the very near future, as international reinsurers seeking geographical diversification continue to supply plentiful capacity. Overall retention is

Jordan's Aspirations to Become an Insurance Centre

In the past two years, Jordan's Insurance Commission has attempted to establish the country as a regional insurance centre in response to a Royal Guidance that aims to attract international insurers to domicile their businesses in the kingdom, and to expand to other insurance markets in the Arab region.

Jordan is considered to have advantages over other insurance markets as it offers insurance expertise with a well-educated and established workforce that does not depend on expatriate staff. At the same time, Jordan acts as a gateway to Iraq, even for other regional insurers.

The Insurance Commission would like the establishment of local reinsurers and is seeking to create an environment for captives, protected cell companies and special-purpose companies. However, no domestic reinsurer has yet been established in Jordan (see **Heavy Reinsurance Use Set to Continue**), and as is the case in most other Middle Eastern

insurance markets, there is little appetite for self-insurance through a captive as insurers continue to compete on pricing.

While companies may prefer Jordan's relative stability compared with countries such as Bahrain, it faces competition from some of its neighbours that enable insurers to set up regional centres with relative ease. Jordan has been unable to establish itself as the insurance hub for the Arab world.

A more competitive tax regime would enable Jordan to become a more attractive base for insurers. Joining the Gulf Cooperation Council could also increase interest and provide financial support for the country, although this would depend in part on the terms and conditions of membership.

To date, Jordanian insurers have tended to serve the local market. Of the country's 28 insurers, only two underwrote risks in branches outside of Jordan in 2010.

likely to increase as motor, medical and also life GPW rise.

Regulatory Change May Assist Life Market

In contrast to the non-life sector, there is a lack of awareness and communication with regard to life products, resulting in the sector experiencing marginal growth despite life products being among the most profitable lines of business. Life insurance penetration was a modest 0.19% of GDP in 2010, indicating low insurance awareness for life, which could work to takaful companies' advantage.

In 2010, life premiums grew by 9.1% to JOD 38 million, which was a slower pace than non-life (12.2%). In 2009, life volume was affected by the global financial downturn, which drove mortgage sales downward.

There is some movement to improve the products offered, with some insurers launching new education and retirement plans. However, greater awareness of insurance is needed.

The restructuring of the Social Security Law for 2010 is expected to improve interest in life products, as until now, social security has been considered as very generous. The new law caps the wage subject to contributions by employers. It is expected to provide life insurers with an opportunity to grow as Jordanians seek better provisions.

Ratings Activity In Lebanon & Jordan

A number of factors could affect Lebanese and Jordanian insurance companies' ratings. These include the increased regulatory capital requirements for Lebanon, the introduction of further compulsory insurances and volatile stock markets.

However, A.M. Best believes that of greater importance to companies' ratings in these markets is political stability in Jordan and Lebanon and their neighbouring countries, with the resulting impacts on their ability to operate and on economic growth.

Instability in the countries in which insurers operate could have a negative impact on both operating performance and the ability to attract business, as well as creating liquidity problems. (See Best's Briefing *Rating Implications of Recent Unrest in the MENA Region.*)

To date, the companies that A.M. Best rates in Lebanon and Jordan have had little or no exposure to neighbouring countries that have experienced unrest. A.M. Best currently does not anticipate any negative ratings actions in the near term. In Jordan, the three companies that A.M. Best rates have financial strength ratings (FSRs) with stable outlooks, while those rated in Lebanon have FSRs with positive outlooks (see **Exhibit 6**).

Exhibit 6

Jordan & Lebanon – A.M. Best Rated Companies

As of 5 July 2011.

Jordan

Company	FSR (Outlook)	Action	Date	ICR (Outlook)	Action	Date
Arab Orient Insurance Co.	B++ (Stable)	Affirmed	06/10/2011	bbb+ (Stable)	Upgraded	10/6/2011
Jordan Insurance Co. Plc.	B++ (Stable)	Affirmed	12/22/2010	bbb+ (Stable)	Upgraded	22/12/2010
Middle East Insurance Co. Plc	B++ (Stable)	Initial	9/27/2010	bbb (Stable)	Initial	27/09/2010

Lebanon

Company	FSR (Outlook)	Action	Date	ICR (Outlook)	Action	Date
Arab Reinsurance Co. S.A.L.	B+ (Positive)	Affirmed	11/11/2010	bbb- (Positive)	Affirmed	11/11/2010
Al Ittihad Al Watani Soc Gen Asr Proche	B+ (Positive)	Affirmed	12/23/2010	bbb- (Positive)	Affirmed	12/23/2010

Source: A.M. Best Co.

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