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Additional Information**Criteria:**

A.M. Best's Liquidity Model for U.S. Life Insurers

A.M. Best's Perspective on Operating Leverage

Insurance Holding Company and Debt Ratings

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A.M. Best will consider feedback from any interested party prior to publishing its methodology. Written comments can be submitted by e-mail to methodology.commentary@ambest.com, no later than Jan. 2, 2012.

This criteria report can be found at www.ambest.com/ratings/methodology

Analyzing Commercial Paper Programs

Commercial paper is defined as a short-term, negotiable, unsecured promissory note, generally issued for the purpose of meeting a corporation's current cash liquidity needs. It often is seen as a prudent source of funding when matched with the operating needs of a corporation, providing a diversified and cost-effective source of funding compared with bank loans.

Although large, highly rated issuers can access the commercial paper market directly, commercial paper often is issued through dealers that specialize in buying commercial paper from issuers and then selling it to investors. The dealer market primarily consists of large securities firms, often affiliated with bank holding companies. There is no real secondary market for commercial paper, but dealers generally will make a market in paper that they have helped issue. On its website, the Federal Reserve publishes the previous day's average rates on commercial paper for different types of issuers and for varying maturities (www.federalreserve.gov).

Most commercial paper is exempt from registration with the Securities and Exchange Commission (SEC), as its maturity rarely exceeds 270 days. The majority of commercial paper has a maturity of 30 days or less. Commercial paper is considered a money market security and generally is issued on a discount basis (actual/360). Insurers generally issue commercial paper to finance premiums and cover other operating expenses.

The two main risks with commercial paper are the credit risk of the issuing entity and rollover risk, or the inability of the issuer to fund maturing commercial paper with ongoing issuances. Commercial paper generally is considered a low-risk security, as it typically is issued only by highly rated entities for short maturities. A lesser risk is interest rate risk, although this is minimized by the short maturity profile of the paper.

Credit Risk

Because commercial paper is backed only by confidence in the issuer's promise to pay, only firms with widely recognized credit strengths are able to sell commercial paper in the money market at a reasonable price. A.M. Best's analytical process for commercial paper includes an analysis of a company's capacity to generate cash – including an assessment of the variety, availability and stability of alternative sources of liquidity – to service its short-term obligations. The analysis focuses on all short-term debt obligations, i.e., those with a term of one year or less.

A.M. Best's analysis of short-term creditworthiness includes a careful assessment of a company's asset-liability profile, generally viewed as holding company sources and uses. This includes an assessment of operating cash flow and the availability of other assets; the issuer's liability structure, such as the maturity schedule



for short-term and other obligations; and the correlation to market risk. The purpose of the liquidity analysis is to compare the funding needs of all obligations likely to come due over the short term with probable near-term cash resources. In this evaluation, outstanding commercial paper is a component of near-term obligations, while committed bank credit facilities or unfunded commercial paper programs are viewed as a component of accessible near-term sources of cash.

The short maturities of commercial paper programs imply special risks and greater urgency in responding to rapid changes in economic conditions. Over time, commercial paper issuance costs, for example, can increase based on market conditions. In the extreme, such as during the 2008/2009 financial crisis, sudden and rapid declines in operating performance and deterioration in the credit markets can lead to bankruptcy or distressed restructurings of commercial paper issuers and an inability to roll existing paper, regardless of their historical market share, profitability or financial leverage. A.M. Best's analysis applies both qualitative and quantitative factors in determining sources and uses to protect an insurer's liquidity needs. An issuer-by-issuer approach is vital, entailing a careful review of sources and uses of liquidity; near-term market conditions; and contingency plans in the event of adverse events.

While commercial paper may have an initial maturity as long as 270 days, many issuers utilize 30-day-and-under maturity ranges. Due to the short maturity of this security, issuers continually must refinance outstanding commercial paper. An individual issuer may repay maturing paper from funds generated from operations or from alternative sources of liquidity. However, the bulk of maturing paper is repaid through the sale of new paper (i.e., the issuer rolls the maturing paper).

The constant need to refinance creates a risk for both the issuer and the investor. As previously noted, an adverse turn of events may make it extremely expensive, if not impossible, for the issuer to roll maturing paper. To reduce the risk to the investor, issuers enhance their commer-

cial paper programs with committed bank lines of credit. However, the supply of traditional bank credit facilities can ebb and flow with the credit markets and financial conditions of even the largest banks. In addition, an issuer's financial condition may deteriorate to a point where a bank may invoke a material adverse change clause in its credit agreement and cancel its commitment to lend precisely when needed most. Other enhancements can be in the form of a standby letter of credit (LOC) or parental guarantees.

Methodology

A.M. Best's analysis of overall liquidity risk incorporates all of the issuer's near-term claims on cash, both direct and contingent. At the issuer level, a detailed quantitative and qualitative review of sources and uses of liquidity, market conditions and contingency plans is necessary, since the issuer's ability to generate immediate and near-term cash flow can vary significantly among industry sectors and from company to company.

Properly understanding relevant issues, such as the short-term funding risk of an insurer, requires an in-depth dialogue between A.M. Best's analytical team and senior management of the rated entity. This analysis generally focuses on commercial paper issued at the corporate or holding company level.

A.M. Best's ratings of commercial paper provide an opinion of the issuer's ability to meet short-term financial obligations to security holders when due. In A.M. Best's view, the inability or unwillingness of an issuer to repay a commercial paper note in full on the date due constitutes a default.

In evaluating an issuer's liquidity risk, the issuer's potential near-term obligations are considered and compared with all likely near-term sources of cash. The analysis of an issuer's short-term creditworthiness begins with a careful assessment of its liability structure, including an array of maturing obligations over the short term, the maturity profile/liquidity of any invested assets held at the issuer level, and the exposure of the assets and liabilities to market risk. The purpose of the assessment is to determine the magnitude of commercial paper utilized

in the capital structure and other potential short-term obligations that the company's alternative liquidity arrangements may be required to fund. As previously stated, outstanding commercial paper is a component of near-term obligations, while bank credit facilities are viewed as a component of the potential near-term sources of cash.

Issuer Analysis

A.M. Best's analysis begins with a critical evaluation of an issuer's sources and uses of cash. To assess the company's ability to meet both operating needs and debt obligations, a variety of plausible stress scenarios are analyzed. Next, contingency funding plans for a sustained period of stress, caused by either company-specific concerns or capital or general market disruptions, are examined. In the case of an operating company issuer, general disruptions could be event driven, such as large catastrophic claims following an earthquake or hurricane; a "run on the bank" following a credit event; or declines in investment portfolio valuations due to volatile securities markets. Capital market disruptions usually are related to broader systemic dislocations such as the recent financial crisis, when an issuer's ability to roll commercial paper was nonexistent. Tightening or absolute capital market seizures can lead to a contagion effect, which can create difficulties for issuers at all rating levels. During times of systemic financial stress in which market downturns can exceed the most severe downside projections, A.M. Best anticipates that virtually all commercial paper programs, although backed by committed bank lines of credit or other, alternative sources of liquidity, will be shut down, with no new issuance.

In instances where the commercial paper program exceeds committed back-up, A.M. Best must be highly confident that sufficient alternative sources of liquidity would be available in a stress scenario. Access to alternative liquidity usually occurs with larger, highly rated issuers that have considerable financial flexibility. In these cases, analytical principles that are emphasized include the matching of cash flows for short-term assets and liabilities;

the quality of assets with intrinsically high cash flows; and the availability of financial and other assets that can be monetized quickly at close to par. In the case of government support in an emergency situation, A.M. Best also will factor this source of liquidity into its analysis. This is what happened in the fall of 2008 when the Federal Reserve announced plans to purchase commercial paper directly from highly rated issuers through the Commercial Paper Funding Facility.

A.M. Best notes that property and casualty risk characteristics are largely uncorrelated with market risk, as short-term concerns over liquidity likely would be triggered by a catastrophic loss event. Property/casualty insurers generally make more use of contingent financing arrangements to protect against such event-driven stresses. Life insurance companies, particularly annuity writers, have a higher correlation with market movements, as their products carry equity and interest rate risks. In either case, the ability to readily access alternative sources of short-term funding is crucial in determining a company's short-term debt rating.

Liquidity Analysis

The starting point in liquidity analysis is assessing an insurer's potential internal and external liquidity. Although there have been few defaults among rated commercial paper issuers, an adverse turn of events might make it extremely expensive or even impossible for the issuer to roll over maturing paper. Investors also generally will limit the maturities they are willing to invest in, which magnifies the rollover risk. In addition, a company in distress quickly could lose access to external sources of liquidity, such as committed bank lines of credit, by violating covenants in the credit agreement. The purpose of the analysis is for A.M. Best to become comfortable that the issuer can smoothly accommodate the loss of confidence-sensitive funding under stress conditions without disrupting its basic operating plan.

Therefore, a thorough understanding of each issuer's liquidity profile should be considered in the context of immediacy, quality and diversity. The following

depicts, at a high level, the elements of A.M. Best's liquidity analysis:

- Discuss topics such as management's philosophy with regard to liquidity and financial flexibility and how short-term borrowings fit into an insurer's overall funding strategies.
- Determine the minimum required cash position to meet short-term liabilities.
- Evaluate operating cash flow, including premiums from in-force business and the degree of volatility of operations.
- Determine all short-term sources of financing available to the issuer (including the availability of subsidiary dividends) and review all short-term funding arrangements such as commercial paper programs, master note programs, money market bank loans and asset-securitization facilities.
- Evaluate the degree of dependence on and sources of liquidity.
- Consider the loyalty and financial strength of banking relationships and other backup arrangements, and review associated documents.
- Calculate the company's current and prospective interest coverage and cash coverage ratios to evaluate earnings coverage.
- Determine overall financial leverage and the ability to repay short-term debt with long-term obligations.
- Discuss stress scenarios and contingency plans should commercial paper and similar funding suddenly become unavailable.

Internal Sources of Liquidity

Cash on Hand

In evaluating an insurer's cash on hand, A.M. Best considers:

- Possible restriction due to minimum bank balance requirements.
- Possible complications related to cross-border repatriation, currency conversion, tax issues, regulatory concerns and sovereign risks.

Near-Term Cash Resources

In evaluating an insurer's near-term cash resources, A.M. Best considers:

- Liquidity of the investment portfolio by investment type. In stress market conditions, A.M. Best will assess a potential range of market values for readily liquid investments.
- Operating cash flow.
- Dividend capacity of subsidiaries (including non-insurance or nonregulated entities).
- Timing for conversion to cash/immediacy of availability.
- Alternative value scenarios for liquidity in a stress situation (i.e., mark-to-market).
- Strength, diversity and availability of cash flows with higher emphasis placed on unregulated near-term cash flows.
- Assets that may already be pledged or assets with springing liens or the need to post cash as additional collateral (i.e., derivatives used for hedging programs).

External Sources of Liquidity

Bank Credit Facilities

In assessing an insurer's bank credit facilities, A.M. Best considers both quantity and quality. Uncommitted credit facilities, bilateral lines of credit or facilities syndicated with very few banks may be more risky when the banking system is stressed. High levels of participation in a syndicated credit facility could lead to majority control by a few banks. This could work against a company in stressful situations when amendments or waivers are required to avoid default. However, in practical terms it may be easier to negotiate an amendment/waiver with fewer lenders than with more. The analysis also considers the financial strength of the lenders and relationship factors.

Borrowing options should include same-day funding, as adverse markets may cause the company to suddenly need same-day funds to roll over maturing commercial paper. Alternative liquidity is examined to ensure that swing lines – portions of a credit facility

that can be accessed on very short notice – are available for immediate coverage on commercial paper issued. A.M. Best seeks to become comfortable that the company has sufficient immediate liquidity to repay all commercial paper that comes due on any given day.

Documentation of credit facilities is reviewed carefully to determine how much flexibility a company is allowed within the provisions. These include:

- Covenants
- Material adverse change (MAC) clauses
- Events of default
- Cross-default and cross acceleration provisions
- Maturity date
- Conditions of funding
- Changes in control or management
- Renewal procedures for multi-year or 364-day revolving credits

Due consideration is given to contractually committed bank lines compared with an uncommitted credit facility such as advised and/or guidance facilities, which can be withdrawn by the lender at will. A.M. Best also places greater value on relationship-based, committed bank facilities than on transactional or arms-length arrangements, and factors the remaining duration into its assessment.

Letters of Credit (LOCs)

While the practice is not prevalent among insurers, companies occasionally may enhance their liquidity by issuing commercial paper backed by a LOC from a bank. To provide true liquidity, the LOC has to be an irrevocable and unconditional guarantee that will pay off all commercial paper at maturity in all cases. However, while the LOC provides current liquidity to the company, the bank – not the issuer – bears credit risk. In such cases, A.M. Best may rate the commercial paper program higher than the stand-alone debt rating because

of the credit enhancement from a bank of stronger credit quality.

Federal Home Loan Bank Borrowings

Many insurance operating companies have joined their local Federal Home Loan Bank (FHLB) networks through the investment in capital shares. In turn, the FHLB will allow the insurer to leverage this investment through the advancement of funds. This alternative access to liquidity generally provides insurance companies with a diversified source of funding, stopgap liquidity, support for match-funding programs and the ability to enhance yields through more robust liquidity management. Borrowed funds used for institutional match-funding programs generally are viewed by A.M. Best as operating leverage. Alternative uses are more likely than not to be treated as financial leverage.

Evaluating Cash Outflows

The analysis first considers the cash resources available to meet maturing commercial paper, particularly at peak borrowing periods. Then the analysis lists forthcoming claims on cash, including operating uses of cash; the maturity profile for servicing debt and other financial claims; claims that could become payable at the option of the creditor; and reasonably possible contingencies. A.M. Best also will factor in management's track record of reducing discretionary cash outflows in periods of increasing financial stress.

Potential Near-Term Claims on Cash

Direct Obligations

- Short-term debt
- Current portion of long-term debt
- Capitalized lease obligations
- Contingent obligations
- Funding arrangements (including the use of reverse repos)
- Financial and commodity derivatives contracts (including the posting of additional collateral)
- Off-balance-sheet financing obligations

- Potential litigation settlements or judgments
- Margin requirements

Other Claims on Cash

- Working capital
- Capital spending commitments or investment commitments
- Stock buybacks
- Dividends

Market or Rollover Risk

In normal times, commercial paper holds minimal reinvestment risk due to its short-term maturity profile. This is important to the investor, given the lack of a secondary trading market in this security. For the issuer, there is market or interest rate risk in that situations can arise – whether driven by the capital markets or by the issuer’s specific profile – when the cost to issue commercial paper can rise and increase the chance of liquidity concerns. At the extreme, markets can “freeze” suddenly because of a lack of confidence in the capital markets as a whole, or issues specifically relating to the issuer (issues related to an erosion in issuer confidence can be real or perceived), and totally eliminate the company’s ability to issue new commercial paper. In these times, companies must look to alternative sources of liquidity to generate needed short-term funding while concurrently deferring discretionary cash programs (i.e., share repurchase). A.M. Best’s analysis, therefore, must assess both a potential over-reliance on short-term funding, including an excessive dependence on commercial paper, and the overall liquidity maintained at the holding company to meet and exceed near-term obligations should stress scenarios arise.

A.M. Best’s Commercial Paper Rating Scale

The evaluation of an issuer’s commercial paper reflects A.M. Best’s opinion of the issuer’s overall credit quality. As a result, the analytical approach is very similar to that of assigning a long-term rating. However, the long-term rating will not fully determine a commercial paper rating because of the overlap in rating categories. In these

cases, further testing of liquidity and cash flows, together with other short-term credit-quality metrics, is necessary. **Exhibit 1** shows the linkage between a short-term and a long-term rating.

Exhibit 1

Short-Term Rating Matrix

Issuer Credit Rating	Short-Term Ratings			
aaa	AMB-1+			
aa+				
aa				
aa-				
a+				
a		AMB-1		
a-			AMB-2	
bbb+				AMB-3
bbb				
bbb-				
bb+				AMB-4
bb				
bb-				
b+				
b				
b-				
ccc+				
ccc				
ccc-				
cc				
c				
rs				

Source: A.M. Best Co.

AMB-1+

Cash, liquid assets and alternative sources of liquidity should be superior. Issuers accorded an AMB-1+ rating are distinguished by an exceptional ability to repay short-term debt obligations. Characteristics of this rating category include exceptional capital management, as well as significant liquidity and financial flexibility. Management’s strategy ensures strong earnings and sustainable operating trends. Financial management is conservative, with low debt-to-capital and excellent fixed-charge coverage ratios. Significant liquidity is available internally from a diverse earnings base, as well as from excess cash available on the company’s balance sheet. External sources of liquidity include committed bank lines of credit and access to cash through the capital markets.

AMB-1

Cash, liquid assets and alternative sources of liquidity should be excellent. Issuers rated AMB-1 exhibit a strong ability to repay short-term debt obligations. Most credit issues discussed in AMB-1+ will

be similar for AMB-1, with slightly lesser strengths. Issuers in this rating category will have a strong capability to service short-term debt. Fixed-charge coverage, liquidity and capital structure also are favorable. The issuer displays ready access to the capital markets and has significant alternative liquidity available to repay short-term debt obligations.

AMB-2

Cash, liquid assets and alternative sources of liquidity should be good. Issuers rated AMB-2 exhibit an acceptable ability to repay short-term debt obligations. While alternative liquidity remains adequate, companies in this category have more variability in earnings, cash flow and fixed-charge coverage. Companies at this rating level may not be able to rely consistently on the capital markets to fulfill liquidity needs. However, they maintain adequate alternative liquidity protection.

AMB-3

Cash, liquid assets and alternative sources of liquidity are deemed to be fair. However, these measures are prone to negative volatility due to market events. Even during favorable credit market conditions, investors' interest in this paper would be very limited.

AMB-4

Correlates to the non-investment-grade, long-term rating category. The commercial paper market will not accept issuers with this rating.

U.S. Commercial Paper Documentation

All U.S. commercial paper programs are exempt from SEC registration. Below are three types of programs, of which the first is most widely used by insurers.

3(a)(3)

- Maturities limited to 270 days.
- Proceeds must be utilized for current transactions.

4(2)/144A

- Does not limit maturities, but generally less than one year.
- There is no limit on the use of proceeds.

- Exemption based on the private placement nature of this note offering.

3(a)(2)

- This exemption is available for bank obligations, both direct and via a letter of credit (LOC).
- LOC-backed commercial paper that is issued by a corporation or institution and "guaranteed" by a commercial bank.
- LOC programs carry the credit rating of the LOC bank.
- The obligation of the LOC bank is irrevocable and unconditional, regardless of the issuer's financial condition.

Ongoing Monitoring And Surveillance

On a quarterly basis, A.M. Best requests and reviews a reconciliation of key ratios and triggers from the bank credit facility covenants. In addition, A.M. Best requests information on the authorized and outstanding amounts of the issuer's commercial paper program, and details on the backup facility coverage, including a listing of institutions providing backup facilities and the type of facility used. A.M. Best must assess other potential calls on backup facilities that would make them unavailable as a commercial paper backstop (i.e., facilities backstopping the issuance of LOCs). The analysis also should include a look at the trend in quarterly usage to determine seasonality or unusual patterns in outstandings. In addition, the ability to "clean up" or pay down outstandings from time to time also should be assessed.

Additionally, an increased use of commercial paper can result from an issuer's loss of access to longer term funding. This was evident in Japan during 2011 when several energy firms were suffering from the effects of the country's worst nuclear disaster. The cost of long-term financing became prohibitive to them, which increased their reliance on short-term financing, including commercial paper. The government, in this case through The Bank of Japan, stepped in by quadrupling its purchase of commercial paper to support the utility companies during the crisis.

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Methodology

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