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Best's
Methodology and Criteria

Best's National Scale Ratings



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Best's National Scale Ratings

Outline

- A. Introduction
- B. Country Risk and Best's National Scale Ratings
- C. Constructing Best's National Scale Mappings
- D. Best's National Scale Ratings in the Rating Process

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

A. Introduction

A Best's Issuer Credit Rating (ICR) is a global rating that is an independent opinion of an entity's ability to meet its ongoing financial obligations. This allows for the comparison of (re)insurers across all countries by using the same credit rating scale. By contrast, a Best's National Scale Rating (NSR) is a relative opinion of a (re)insurance company's financial strength within a single country. The unique features of an NSR and the analysis associated with its assignment are discussed within this criteria procedure.

All (re)insurers that are assigned an NSR are first assigned an ICR. Since an NSR provides a relative opinion of financial strength among (re)insurers within a single country, an NSR assigned to a (re)insurer in one country is not comparable to an NSR assigned to a (re)insurer in another country. Therefore, global impairment statistics cannot be directly compared to impaired companies on a national scale. However, since an ICR is assigned as the basis for the NSR, impairment rates can be inferred.

NSRs were created to address the concern that country-specific limiting factors the industry faces—including economic, political, and financial system risks, and other insurance industry factors—can create less differentiation and result in: 1) using only a particular section of the rating scale and 2) ratings that are grouped closely together. NSRs allow for increased differentiation among (re)insurers operating in a single country.

NSRs are offered in select countries that have sufficient available market data. These countries tend to be in Best's Country Risk Tiers (CRT) 3 through to 5, although an NSR can be assigned in any CRT.



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B. Country Risk and Best's National Scale Ratings

Country risk is the risk that factors specific to a country could adversely affect the ability of a (re)insurer operating in that country to meet its financial obligations. Country risk, along with industry-related risks, has an impact on the financial strength of the overall insurance industry in a specific country. Since an NSR is a relative measure of a (re)insurer's financial strength within a country, the macro-level risks that impact all (re)insurers operating in the country—such as limited access to secure investable assets and limited industry maturity and/or regulation—are no longer rating differentiators, as (re)insurers are typically subject to the same country risks.

As stated previously, the assignment of an NSR is derived from the (re)insurer's ICR, which incorporates country risk. Therefore, the NSR captures the extent to which a particular (re)insurer can mitigate and manage its country risk exposures. A company that manages its country risk exposure better would be relatively stronger and would have a higher NSR, all else being equal.

C. Constructing Best's National Scale Mappings

NSRs are constructed individually based on the financial characteristics of (re)insurers that are domiciled in that country, although two different countries may have the same national scale mapping. As the degree of country risk increases, the distribution of ratings moves further away from the top end of the ICR scale. The strength of the insurance market participants and the creditworthiness of governments are assessed to arrive at the Best's National Scale Mapping for each country. Public data is used to analyze the active (re)insurance companies domiciled within the country to determine the distribution of financial strength.

The evaluation of the distribution of financial strength in a country is assessed through nine individual factors based on financial reports:

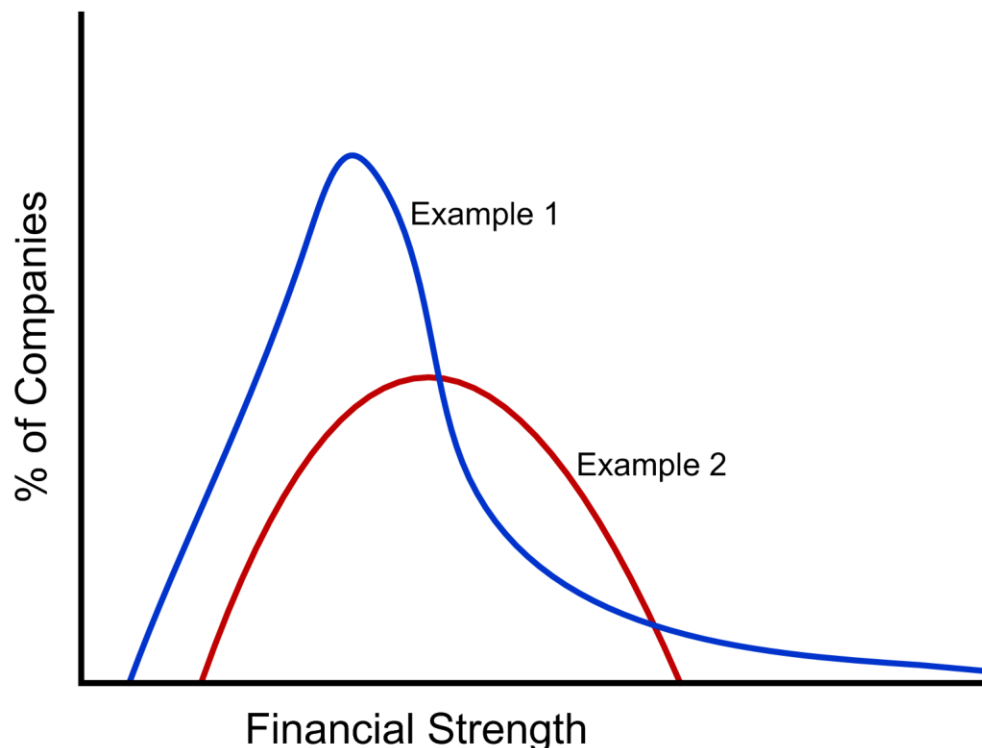
1. Capital and Surplus
2. Liquidity Ratio
3. Gross Underwriting Leverage Ratio
4. Gross Insurance Revenue
5. Return on Equity
6. Return on Assets
7. Retention Ratio
8. Combined Ratio
9. Total Assets

The industry average for each of these factors is calculated for the country being evaluated. Each (re)insurer operating within the country is evaluated based on distance from the industry average for each factor. This process is based on three-year averages, and the result is a country-specific distribution of financial strength. AM Best may use, where appropriate, other financial indicators or definitions subject to financial reporting requirements in that country.

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Countries can have different distributions of financial strength. A common distribution is a small number of market leaders that are relatively stronger than the rest of the market (Example 1). Another common distribution is a group of companies clustered around a similar ICR (Example 2). **Exhibit C.1** illustrates these two common distributions of financial strength.

Exhibit C.1: Examples of Financial Strength Distributions in Different Markets



An understanding of the shape of this distribution allows AM Best to efficiently spread out the ICR curve within a country. This allows for increased use of the national rating scale within that country, thus creating the greatest degree of differentiation among (re)insurers in the country.

This approach to the creation of NSRs is consistent with AM Best's belief that country factors, while clearly important and able to negatively affect a (re)insurer's ICR, should not act as a ceiling to companies on the ICR scale.

D. Best's National Scale Ratings in the Rating Process

As stated previously, the analysis of a (re)insurer begins with the assignment of an ICR. This ICR is then "mapped" to an NSR based on the Best's National Scale Mapping that has been developed for the (re)insurer's country of domicile. In cases where one ICR level maps to more than one NSR, a rating committee will decide which level, in accordance with the country-specific mapping, is appropriate given the relative financial strength of the (re)insurer. To denote the difference between an ICR and an NSR, the NSR will display a ".XX" where XX represents a two-letter country code. **Exhibit D.1** shows an illustrative example of a country-specific national scale mapping.

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Please refer to *Best's National Scale Mappings* for the country-specific national scale mappings applicable to this criteria procedure.

Changes to the Best's National Scale Rating

A (re)insurer's NSR can change for three primary reasons:

1. The analysis of the (re)insurer's financial strength leads to a change in that (re)insurer's ICR.
2. The country- and/or industry-specific characteristics lead to a change in the Best's National Scale Mapping for the country of domicile.
3. A change in the rating committee's assessment of the NSR, where an ICR corresponds to more than one NSR.

Exhibit D.1: Illustrative Example of a Best's National Scale Mapping

ICR	Country Name NSR
bbb or above	aaa.XX
bbb-	aa+.XX
bb+	aa.XX
bb	aa- to a+.XX
bb-	a.XX to a-.XX
b+	bbb+.XX
b	bbb.XX to bbb-.XX
b-	bb+.XX to bb.XX
ccc+	bb-.XX to b.XX
ccc	b-.XX to ccc+.XX
ccc-	ccc.XX
cc	ccc-.XX to cc.XX
c	c.XX

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Best's Financial Strength Rating (FSR): an independent opinion of an insurer's financial strength and ability to meet its ongoing insurance policy and contract obligations. An FSR is not assigned to specific insurance policies or contracts.

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

Best's Issue Credit Rating (IR): an independent opinion of credit quality assigned to issues that gauges the ability to meet the terms of the obligation and can be issued on a long- or short-term basis (obligations with original maturities generally less than one year).

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

Rating Disclosure: Use and Limitations

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

