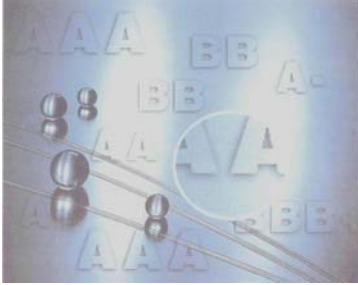


INSURANCE RATING METHODOLOGY



INTRODUCTION

Insurer Financial Strength (IFS) rating of a non-life insurer assesses the financial strength of the company and its capacity to meet obligations to policyholders on a timely basis. The financial strength rating is assigned to the company itself, and no liabilities or obligations of the insurer are specifically rated unless otherwise stated. The financial strength rating does not address the willingness of management to honor company obligations, nor does the rating address the quality of a company's claims handling services. In the context of the financial strength rating, the timeliness of payments is considered relative to both contract and/or policy terms and also recognizes the possibility of acceptable delays caused by circumstances unique to the insurance industry, including claims reviews, fraud investigations and coverage disputes.

METHODOLOGY

PACRA's analyses incorporate an evaluation of the rated company's current financial position as well as an assessment of how the financial position may change in the future. Our ratings methodology includes an assessment of both quantitative and qualitative factors based on in-depth discussions with senior management. The evaluation of financial strength and credit quality centres on the ability of the company to meet all of its obligations.

PACRA's rating methodology focuses on the following five areas of analysis:

- Industry Review
- Operational Review
- Organizational Review
- Management Review
- Financial Review

INDUSTRY REVIEW

The starting point for PACRA's ratings is a thorough understanding of the industry in which the insurer operates. One of PACRA's goals is to judge the extent industry dynamics can impact the ratings levels that individual insurers operating in a given industry segment can achieve. PACRA also uses its industry analysis to allow it to make better judgements on the unique attributes of individual insurers by being able to understand them on a relative as well as absolute basis. PACRA's specific evaluation of the non-life insurance industry focuses on:

- Level of competition in specific sectors, and how variable competition has been over time
- The basis for competitive advantage in the sector
- Barriers to entry and threats of new products
- The potential "tail" of losses and ability to make accurate pricing decisions, as well as exposure to large unexpected losses
- Regulatory, legal and accounting environment and framework

The primary function of PACRA is to evaluate the capacity and willingness of an entity / issuer to honor its financial obligations. Our ratings reflect an independent, professional and impartial assessment of the risks associated with a particular instrument or an entity.

PACRA's comprehensive offerings include instrument and entity credit ratings, insurer financial strength ratings, fund ratings, asset manager ratings and real estate gradings.

PACRA's opinion is not a recommendation to purchase, sell or hold a security, in as much as it does not comment on the security's market price or suitability for a particular investor.

July 2005

Rating Methodology

PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA shall owe no liability whatsoever to any loss or damage caused by or resulting from any error in such information. None of the information in this document may be copied or otherwise reproduced, stored or disseminated in whole or in part in any form or by any means whatsoever by any person without PACRA's written consent. Our reports and ratings constitute opinions, not recommendations to buy or to sell.

OPERATIONAL REVIEW

PACRA's operational review focuses on a given company's unique competitive strengths and weaknesses, operating strategies, and business mix. PACRA's analysis focuses on both the historical and current business position, and how it is expected to change over time.

PACRA believes that its operational analysis is among the most critical parts of its ratings review. Companies that have strong balance sheets and acceptable risk exposures can provide near-term financial strength. However, for high levels of credit quality and financial strength to be maintained over the long-term, the company must exhibit favourable operating characteristics. Included in PACRA's operational review is an evaluation of:

- Underwriting expertise and market knowledge
- Distribution capabilities and mix
- Classes of business and changes in mix
- Market share and growth
- Brand name recognition and franchise value
- Expense efficiencies and operational scale
- Product and geographical mix
- Administrative and technological capabilities

The operational review includes a significant degree of qualitative judgement. There is a delicate balance that needs to be maintained between attaining growth and market share, and maintaining underwriting discipline. PACRA places underwriting expertise and market knowledge as the most important operational attributes of a highly rated non-life insurer.

ORGANIZATIONAL REVIEW

PACRA factors in the influence of the owners on the company and the extent of financial support they would extend in case of any emergency. Moreover, PACRA also assesses the credibility, market reputation and experience in the relevant field of the owners.

MANAGEMENT REVIEW

One of the most difficult, yet critical aspects of PACRA's rating process is the level of confidence we

develop in the management team and its stated strategies. PACRA has found that the ability of management to establish a "performance-based" culture, and have in place an appropriate risk/reward system, is a key determinant to overall success. Our specific evaluation of management focuses on the following:

- Strategic vision
- Appetite for risk
- Credibility and track record for meeting expectations
- Controls and risk management capabilities
- Depth, breadth, and succession plans
- Accomplishments of key executives

FINANCIAL REVIEW

PACRA's financial review includes the calculation of numerous financial ratios and other quantitative measurements. These are evaluated based on industry norms, specific rating benchmarks, prior time periods and expectations developed by PACRA specific to the rated entity. Though the financial review is largely a quantitative exercise, the interpretation of the results and weighing them into the final rating includes significant elements of subjectivity and qualitative judgment

In addition to the published financial statements PACRA examines the management reports, evaluations and company projections. The financial review is broken into seven main segments:

- Underwriting quality
- Profitability
- Investments
- Reinsurance utilization
- Reserves and Capital adequacy
- Liquidity

UNDERWRITING QUALITY

The evaluation of underwriting quality, especially for insurers in higher risk classes of business, is the first part of the financial review and in many ways the most important. PACRA's goal is to judge the overall health of the book of business, and management's



understanding of its risks and ability to control them. Key areas considered include:

- Underwriting expertise in each class of business
- Pricing credibility
- Pricing flexibility given competitive and regulatory environment
- Exposure to large losses
- Balance of premium growth and underwriting discipline
- Controls over any third party underwriters, such as managing general agents
- Claims management and expertise
- Expense efficiencies, and impact of ceding commissions on expense ratios

PACRA measures underwriting performance using two common ratios – the loss ratio and the expense ratio. To properly interpret these ratios, PACRA considers the company’s business mix, pricing strategy, accounting practices, distribution approach and reserving approach. PACRA examines these ratios for the company as a whole, and by each category. PACRA also looks at underwriting results both before and after the impact of ceded reinsurance. The combination of the loss and expense ratios is referred to as the combined ratio. A combined ratio below 100% translates into an underwriting profit, and above 100% represents an underwriting loss. PACRA also evaluates underwriting quality in the context of growth in premiums and revenues. PACRA tries to understand how premium growth is influenced by changes in pricing versus growth in exposures. PACRA generally prefers to see reasonably steady and even growth trends, and is concerned by both excessive growth and negative growth. Growth is evaluated in the context of market conditions and strategic initiatives of the insurer.

PROFITABILITY

The focus of PACRA’s analysis of profitability is to understand the sources of profits, the level of profits on both an absolute and relative basis, and potential variability in profitability. Profits for non-life insurers are sourced from two primary functional areas -- underwriting and investment income. As indicated above, profits from underwriting are generated when

operating revenues (generally premiums) exceed the sum of losses and administrative expenses. The underwriting margin, and its volatility, generally correlates with the level of risk that is being assumed.

Profits derived from investments can take the form of interest, dividends and capital gains and can vary as to their taxable nature. The level of investment earnings is dictated by the investment allocation strategy and the quality of management. Like underwriting income, investment returns and their volatility are also correlated with the level of risk assumed. PACRA measures overall profitability (underwriting and investing) by calculating the company’s operating ratio. To further understand the quality of earnings, PACRA evaluates the diversification of earnings, as earnings that are well diversified tend to be less volatile. PACRA also calculates the following standard profitability ratios: return on assets (ROA) and return on equity (ROE).

PACRA is very careful in interpreting the ROE and ROA ratios, since they are influenced by not only overall profitability levels, but also the degree of operating and financial leverage. PACRA also emphasizes on the stability and growth pattern, on a YoY basis, of the underwriting profits and other supporting sources of income.

INVESTMENTS/LIQUIDITY

PACRA’s analysis of the investment portfolio focuses on credit risk, market risk, liquidity and historical performance. As part of PACRA’s analysis, the company’s investment guidelines and management controls are also evaluated to understand how the investment portfolio may change over time. PACRA examines credit risk by looking at the company’s exposure to higher risk investments relative to the total investment portfolio and capital base. Overall diversification of the investment portfolio by major asset class and industry sector is also evaluated to identify any concentration issues.

Market risk is evaluated to identify potential changes in asset valuation due to a change in market conditions and the interest rate environment. Historical investment performance is evaluated to determine how well the company’s investment strategies are executed. PACRA

examines the company's investment yield, total return, duration and maturity structure, and historical default experience. Volatility of investment valuations is considered in the context of both book value and underlying market (liquidation) values.

REINSURANCE UTILIZATION

In assessing an insurer's use of reinsurance, PACRA's goal is to determine if capital is adequately protected from large loss exposures, and to judge if the ceding company's overall operating risks have been reduced or heightened. In the traditional sense, reinsurance is used as a defensive tool to lay off risks that the ceding company does not want to expose to its earnings or capital. When reinsurance is used defensively, PACRA's goal is to gain comfort that:

- Sufficient amounts and types of reinsurance are being purchased to limit net loss exposures given the unique characteristics of the book
- Reinsurance is available when needed
- The cost of purchasing reinsurance does not excessively drive down the ceding company's profitability to inadequate levels, and weaken its competitive pricing posture
- The financial strength of reinsurers is strong, limiting the risk of uncollectible balances due to insolvency of the reinsurer.
- Exposure to possible collection disputes with troubled or healthy reinsurers is not excessive

Reinsurance can also be used aggressively and potentially add to risk. In such cases, PACRA examines why the reinsurance approach is being used, and stresses what would happen if the programme developed adversely. Examples of aggressive use of reinsurance include excessive cessions under quotashare treaties simply to earn ceding commissions, and use of finite or other financial reinsurance that "smooths results" rather than transfer risk as the *core* part of the reinsurance programme.

RESERVES AND CAPITAL ADEQUACY

Reserve adequacy is a critical part of the financial review, and a demonstrated ability to maintain an adequate reserve position is a crucial characteristic for a highly rated insurer. While the analysis of reserve adequacy includes a robust quantitative element, much

of PACRA's reserve review is qualitative in nature. Accordingly, our review focuses on the following:

- Historical track record in establishing adequate reserves
- Management's reserving targets
- Key reserving assumptions
- General market and competitive pricing environment, and propensity of management to carry weaker reserves during down cycles
- Use of discounting, financial reinsurance or accounting techniques that reduce carried reserves
- Comparison of company loss development trends relative to industry and peers

There is significant overlap in PACRA's qualitative analysis of underwriting quality and reserve adequacy, as PACRA believes the two generally go hand in hand. Most insurers with lax underwriting standards will also have ineffective reserving standards, and vice versa. Inadequate reserving can thus result in poor pricing decisions on current and future business. PACRA's evaluation of capital adequacy and profitability are also closely linked with its assessment of reserve adequacy.

IFS analysis involves detailed evaluation of a company's solvency. PACRA assesses the level of capital in relation to underwriting business and reinsurance by calculating the premium solvency ratio and adequacy of the loss reserve is measured through reserve solvency ratio. Moreover, solvency ratio (calculated according to statutory standards) is also evaluated. These analyses help in establishing the extent of the company's capacity to meet its obligations both in absolute and relative terms.

Future capital needs based on business growth and other factors are also considered in PACRA's analysis. Financial flexibility, or the company's ability to access internal and external capital sources, is an important ratings factor. In good times, the ability to access capital to support growth while maintaining capital adequacy is critical to maximising the franchise value. In bad times, maintaining the confidence of the capital markets and lenders can prove critical in allowing a company to avoid problems such as an inability to refinance maturing debt. Financial flexibility is derived first from the overall quality and reputation of the



company as reflected in all of the ratings factors discussed throughout this report. However, financial flexibility is also strongly linked to the company's financial leverage, debt service coverage and liquidity.

LIQUIDITY

In short-tail insurance sectors, liquidity is particularly important. PACRA judges liquidity based on the marketability of the investments. The manner in which the company values its assets on the balance sheet is also closely examined.

PACRA evaluates trends in operating and underwriting cash flows to judge liquidity at the operating company level. PACRA also considers cash flows in the context of future levels of investment income generated by a shrinking or growing portfolio. Off balance sheet sources of liquidity, including committed and uncommitted lines of credit, asset securitization and other funding arrangements, are also considered.



GLOSSARY OF TERMS

The following is a glossary of key insurance terms commonly used in our quantitative analysis.

Underwriting provisions: The sum of provision for outstanding claims, provision for unearned premium and commission income unearned.

Provision for outstanding claims: The liability representing the estimate of the claims intimated or assessed before the end of the accounting year.

Provision for unearned premium: Liability of an insurance company that represents the unearned part of gross premiums on all outstanding policies at the time of valuation.

Commission income unearned: A portion of commission received from reinsurers deferred to bring to account as revenue in accordance with the pattern of recognition of the reinsurance premiums to which they relate.

Premium deficiency reserve: A liability to meet the deficit where the unearned premium reserve for any class of business is not adequate to meet the expected future liability, after reinsurance, from claims and other expenses, expected to be incurred after the balance sheet date with respect to policies in that class of business in force at balance sheet date.

Deferred Commission expense: That proportion of commission expense deferred which is probable to give rise to premium revenue that will be recognized in subsequent reporting periods.

Net underwriting provisions: Underwriting provisions less reinsurance recoveries against outstanding claims, deferred commission expense and prepaid reinsurance premium ceded.

Gross Premium written (GPW): Premiums receivable under direct, facultative reinsurance contracts and under reinsurance treaties accepted (this includes amounts receivable net of retrocession in respect of outstanding claims and loss portfolios), less

rebates and refunds but before deductions in respect of reinsurance ceded in the financial year.

Net Premium revenue (NPR): Gross premium written adjusted for the opening and closing unearned premium reserves less reinsurance ceded adjusted for opening and closing prepaid reinsurance ceded.

Investment yield: Net investment income as a percentage of the average total investments.

Premium solvency ratio: Equity as a percentage of NPW.

Reserves solvency ratio: Net provision for outstanding claims as a percentage of equity.

Financial Base: The sum of net assets and net underwriting provisions.

INSURER FINANCIAL STRENGTH RATING SCALE AND DEFINITIONS

AAA - Exceptionally Strong. Insurers assigned this highest rating are viewed as possessing exceptionally strong capacity to meet policyholder and contract obligations. For such companies, risk factors are minimal and the impact of any adverse business and economic factors is expected to be extremely small.

AA - Very Strong. Insurers are viewed as possessing very strong capacity to meet policyholder and contract obligations. Risk factors are modest, and the impact of any adverse business and economic factors is expected to be very small.

A - Strong. Insurers are viewed as possessing strong capacity to meet policyholder and contract obligations. Risk factors are moderate, and the impact of any adverse business and economic factors is expected to be small.

BBB - Good. Insurers are viewed as possessing good capacity to meet policyholder and contract obligations. Risk factors are somewhat high, and the impact of any adverse business and economic factors is expected to be material, yet manageable.

BB - Moderately Weak. Insurers are viewed as moderately weak with an uncertain capacity to meet policyholder and contract obligations. Though positive factors are present, overall risk factors are high, and the impact of any adverse business and economic factors is expected to be significant.

B - Weak. Insurers are viewed as weak with a poor capacity to meet policyholder and contract obligations. Risk factors are very high, and the impact of any adverse business and economic factors is expected to be very significant.

CCC, CC, C - Very Weak. Insurers rated in any of these three categories are viewed as very weak with a very poor capacity to meet policyholder and contract obligations. Risk factors are extremely high, and the impact of any adverse business and economic factors is expected to be insurmountable. A 'CC' rating indicates that some form of insolvency or liquidity impairment appears probable. A 'C' rating signals that insolvency or a liquidity impairment appears imminent.

DDD, DD, D - Distressed. These ratings are assigned to insurers that have either failed to make payments on their obligations in a timely manner, are deemed to be insolvent, or have been subjected to some form of regulatory intervention. Within the DDD-D range, those companies rated 'DDD' have the highest prospects for resumption of business operations or, if liquidated or wound down, of having a vast majority of their obligations to policyholders and contractholders ultimately paid off, though on a delayed basis (with recoveries expected in the range of 90-100%). Those rated 'DD' show a much lower likelihood of ultimately paying off material amounts of their obligations in a liquidation or wind down scenario (in a range of 50-90%). Those rated 'D' are ultimately expected to have very limited liquid assets available to fund obligations, and therefore any ultimate payoffs would be quite modest (at under 50%).

Notes:

i)- "+" or "-" may be appended to a rating to indicate the relative position of a credit within the rating category. Such suffixes are not added to ratings in the "AAA" category or to ratings below the "CCC" category.

ii)- PACRA's IFS rating does not constitute any form of guarantee of the ability of the company to meet policyholders' obligations; nor does it constitute a recommendation to effect or discontinue any policy of insurance.