# SEMINOLE COUNTY GOVERNMENT
# AGENDA MEMORANDUM

**SUBJECT:** Protest Hearing concerning RFP-600209-07/BJC-Employee Benefits.

**DEPARTMENT:** Administrative Services **DIVISION:** Purchasing and Contracts

**AUTHORIZED BY:** Frank Raymond **CONTACT:** Ray Hooper **EXT:** 7111

**MOTION/RECOMMENDATION:**

To accept or reject the original contract award of RFP-600209-07/BJC; Employee Benefits to Professional Insurance Company (PIC) for both Voluntary Cancer and Short Term Disability Insurance.

Based upon a protest filed on 9/17/2007 on behalf of KMG America Corp.Inc., the Board can uphold the current award decision to Professional Insurance Company (PIC) or revoke the contract award to PIC and award to KMG America Corp. Inc. based upon the results of this hearing.

County-wide Ray Hooper

## BACKGROUND:

On 9/11/2007, the Board awarded RFP-600209-07/BJC; Employee Benefits to Professional Insurance Company (PIC) for both Voluntary Cancer and Short Term Disability Insurance. On 9/17/2007, staff received a protest concerning this award. According to Section 8.1540 of the Administrative Code, upon receipt of the written protest, the Purchasing and Contracts Manager shall schedule a hearing before the BCC. The protester shall be given an opportunity to show why the award of the contract by the BCC should be modified.

The backup contains all the protest support documentation that was provided in the protest letter.

## ATTACHMENTS:

1. Protest Documentation

**Additionally Reviewed By:**

☑ County Attorney Review ( Ann Colby )

September 17, 2007

Mr. Ray Hooper
Purchasing and Contracts Manager
Seminole County -Purchasing and Procurements Department
1101 E. First Street
Sanford, FL 32771

RE: RFP-600209-07/BJC - Employee Benefits: Group Medical Benefits, Voluntary Dental, Voluntary Cancer Plan, Voluntary Short Term Disability, COBRA Administration, FSA Administration

Dear Mr. Hooper,

In accordance with Seminole County Administrative Code 8.15, Purchasing Policy, Section VII Protests, Appeals and Remedies; we are submitting a formal protest of the reversal of the recommendation submitted by the Risk Management Committee to the Board of County Commissioners at the Seminole County Commissioners meeting on September 11, 2007 at 1:00 pm in the County Commissioners Chambers.

We respectfully request the BOCC reopen the item from the September 11, 2007 Commission meeting regarding the award of the Voluntary Cancer Plan and the Voluntary Short Term Disability to the current in force carrier PIC.

A letter dated August 21, 2007 from Mr. Doug Murdock on behalf of Professional Insurance Company (PIC) discussing the financial status of KMG America seemed to have an impact on the Commissions' decision. His illustration includes some facts, but he has presented them in a way that is very misleading, or has left things out all together.

Mr. Murdock discusses company A.M. Best & Company ratings. He may not be working with all of the correct and updated information, so we would like to further clarify.

A.M. Best & Company has affirmed the Financial Strength Ratings (FSR) of A- (Excellent) of Kanawha Insurance Company. A.M. Best has also affirmed the Issuer Credit Ratings (ICR) of "bbb-" of Kanawha's parent holding company, KMG America Corporation. The rating of bbb- as shown in Mr. Murdock's exhibit (attached) is not the financial strength rate (shown in all caps "A-") but is the issuer credit rating (shown in lower case "bbb"). The bbb credit rating shows "Adequate" Investment Grade. Mr. Murdock is confusing his terms of the financial strength rating (FSR) and the issuer credit rating (ICR) and may intentionally be using this to mislead the Commissioners. Comparing the FSR and the ICR is not an apples to apples comparison.

Another piece of information he neglected to illustrate is the fact that KMG America was recently purchased by Humana whose current A.M. Best FSR rating is A- (Excellent).

Mr. Murdock states that KMG America may be a significant financial risk, but apparently Humana felt it was a good investment to add this company to their portfolio, so KMG America is not in the financial straights as Mr. Murdock would have you believe.

In Mr. Murdock's Financial Strength Comparison exhibit he is comparing Sun Life Financial with KMG America. Shouldn't that be a comparison of either PIC with KMG or Sun Life Financial with Humana? Again, there seems to be the intent to mislead.

The agents who would be servicing this account is Nelson Benefits Group from Lutz, FL. They have been the brokers of record for the dental plan since 1995 and have serviced that plan without complaint from County or employees.

Lastly, in item 8 of Mr. Murdock's letter he mentions how he is now updating PIC proposal language to remove a one-on-one enrollment requirement. As we all know this proposal was due to Seminole County on July 6, 2007 by 2:00 PM and no changes to proposals are allowed after submittal. Isn't this the reason you were not able to have self funded medical alternatives to discuss? In addition, Mr. Murdock presenting a seventeen (17) page document to county representatives after the recommendation without forwarding a copy to representatives of KMG or Ms. Andria Herr is clearly outside the accepted bid process and demonstrates the intention to secure an unfair advantage.

Most of the arguments raised in the letter were addressed at the Commission meeting. The question of financial strength of KMG America appears to have been the deciding factor.

This should not be the deciding factor. The County or the County's employees are NOT at financial risk by doing business with KMG and was a gross exaggeration of the facts to lead the County Commissioners down this path. The final vote of 3 to 2 is indicative should be evidence of this. Financial viability and strength of KMG America is backed up by Humana with an A.M. Best & Company FSR rating of A-. PIC's financial strength is backed up by Sun Life Financial, a Canadian company who purchased PIC in June of this year. Sun Life also has an A.M. Best & Company of A-.

For the benefit of the County Commissioners we have included a PDF from the AM Best Company which fully explains the categories and financial strength rating methodology demonstrating an insurer's ability to meet its obligations to policyholders. KMG meets the test and poses <u>no risk</u> to county employees or to the county itself with regard to solvency and the ability to pay claims. (A summary page of the **Guide to Best's Financial Strength Ratings** is attached as Exhibit 1).

This bid process should be fair and equitable to all parties involved and some of the statements made by Mr. Murdock seem to be purposely misleading the reader.

With regard to the Cancer and Short Term Disability products presented by KMG, there are distinct benefit advantages to the employees of Seminole County when compared to the existing benefit plans offered through PIC. These advantages were recognized by the Insurance Committee thus the recommendation was made to select KMG but ultimately abandon due to the negative influence presented by Mr. Murdock.

The bottom line is simply this. The Seminole County employees and their financial security at claim time is reliant upon, and subject to judgments made by empowered persons entrusted to make the best decisions on their behalf. Don't we owe it to the employees and their families to revisit this critically important issue especially since new light has been shed upon the situation?

We look forward to your consideration and thank you for your time.

Sincerely yours

Mark D. Gebhardt
Mark.Gebhardt@gmail.com
E.M. Pete Nelson
petenelson@nelsonbenefitsgroup.com
KMG America

# EXHIBIT 1

**Guide to Best's Financial Strength Ratings**
Effective July 23, 2007

**Best's Financial Strength Rating** is an independent opinion, based on a comprehensive quantitative and company's balance sheet strength, operating performance and business profile.

**Our rating process** incorporates specific methodologies designed to address the Property/Casualty (Non-Life/Health/HMO industry segments as well as Non-U.S. and U.K. domiciled insurance companies.

A complete list of Best's Rating Methodologies covering topics such as **Insurance Groups, Issuer Credit and Debt Ratings, BCAR** (Best's Capital Adequacy Ratio) are continually fine-tuned to reflect ever-changing industry, regulatory and legal developments. Please note that Best's Financial Strength Ratings are **not a warranty** of a company's financial strength and ability to meet its obligations to policyholders. View our entire notice for complete details.

**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 Modifiers and Affiliation Codes may also be associated with these ratings. The following list outlines our rating scale and associated descriptions.

| Secure | Vulnerable |
|---|---|
| **A++, A+** (Superior) | **B, B-** (Fair) |
| **A, A-** (Excellent) | **C++, C+** (Marginal) |
| **B++, B+**(Good) | **C, C-** (Weak) |
| | **D** (Poor) |
| | **E** (Under Regulatory Supervision) |
| | **F** (In Liquidation) |
| | **S** (Rating Suspended) |

**Not Rated Categories (NR)** are assigned to companies reported on by A.M. Best, but not assigned a Best's Rating. The five categories and descriptions are listed below.

| |
|---|
| **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 |

Please put this link in your browser to view complete details re: AM Best Rating standards:

http://www.ambest.com/ratings/guide.asp?l=1&Menu=Ratings+Definitions,Financial+Strength

## Best's Rating and Report Updates for KANAWHA INSURANCE COMPANY

**Best's Rating of A- (Excellent)**
**Financial Size Category of VII ($50 Million to $100 Million)**

Rating Category (Excellent): Assigned to companies that have, in our opinion, an excellent ability to meet their ongoing obligations to policyholders. A.M. Best assigns each letter rated (A++ through D) insurance company a **Financial Size Category (FSC)**, which is designed to provide a convenient indicator of the size of a company based on reported policyholders' surplus and conditional or reserve funds.

The objective of **Best's rating system** is to provide an opinion of an insurer's financial strength and ability to meet ongoing obligations to policyholders. Our opinions are derived from the evaluation of a company's balance sheet strength, operating performance and business profile as compared to Best's quantitative and qualitative standards. View our **Best's Rating System and Procedures** for more information.

While Best's Ratings reflect our **opinion** of a company's financial strength and ability to meet its ongoing obligations to policyholders, they are **not a warranty**, nor are they a recommendation of a specific policy form, contract, rate or claim practice. View our **entire notice** for complete details.

**Note:** The above information reflects the most recent Best's Rating for this company, which may have been released subsequent to the creation of the following Best's Company Report.

**Best's Company Reports** provide detailed business overview, extensive financial data and analytical commentary, product and geographic information, company history, as well as the rationale supporting the financial strength rating assigned by A.M. Best. These reports are updated on a regular basis based on input and analysis performed throughout the year.

**Best Company Report Revision Date - 09/14/2007 ***

The **Report Revision Date *** represents the last significant material change made to this report. Other non-material changes may have been made to this report subsequent to this date, but are not reflected in the report revision date. The Best Company Report below was created based on the following dates.

| Rating and Commentary [1] | Financial [2] | General Information [3] |
|---|---|---|
| **Best's Rating: 09/11/2007** | **Time Period: 2nd Quarter - 2007** | **Corporate Structure: N/A** |
| **Rating Rationale: 09/11/2007** | **Last Updated: 08/18/2007** | **States Licensed: 03/21/2007** |
| **Report Commentary : 09/14/2007** | **Status: Quality Cross Checked** | **Officers and Directors: 04/12/2007** |

***Note:** The **Rating and Commentary** [1] date outlines the most recent updates to the Company's Rating, Rationale, and Report Commentary for key rating and business changes. Report commentary may include significant changes to Business Review, Financial Performance/Earnings, Capitalization, Investment/Liquidity, or Reinsurance sections of the report. The **Financial** [2] date reflects the current status of the financial tables found within the body of the Company Report, including whether the data was loaded as received or had been run through our quality control cross-check process. The **General Information** [3] date covers key areas that may have changed such as corporate structure, states licensed or officers and directors.

## Best's Company Report for KANAWHA INSURANCE COMPANY

**Group Affiliation: KMG America**

**210 South White Street, Lancaster, South Carolina, United States 29720**

**Mailing Address: P.O. Box 610, Lancaster, South Carolina, United States 29721-0610**
**Web: www.kanawha.com**

**Tel:** 803-283-5300 **Fax:** 803-283-5313
**AMB#:** 06604 **NAIC#:** 65110
**FEIN#:** 57-0380426

Report Revision Date: 09/14/2007

# BEST'S RATING

Based on our opinion of the company's Financial Strength, it is assigned a Best's Rating of A- (Excellent). The company's Financial Size Category is Class VII.

# RATING RATIONALE

**Rating Rationale:** The rating of Kanawha Insurance Company (Kanawha) reflects the company's growing presence in its market niche, maintenance of an adequate level of capital and surplus, and the company's announcement that it has signed a definitive agreement to be purchased by Humana, Inc. Offsetting factors include the company's continued unfavorable statutory operating results, its current lack of critical mass, and the challenges of diversifying its book of business.

Historically, Kanawha sales had been primarily in the southeastern US region in the worksite and senior health insurance markets. However, since becoming a subsidiary of KMG America, it has focused its operations on group benefits and worksite products. In addition to its insurance operations, a subsidiary, Kanawha HealthCare Solutions operates as a third-party administrator. The company's overall risk-adjusted capital remains at an adequate level based on its business and investment risks. Its parent company continues its commitment of support, which has enhanced the company's capital position. KMG America has made sizeable capital contributions since acquiring Kanawha to support its growing operations. Humana's proposed acquisition would provide financial support, allow the company to focus on the worksite market by expanding its sales force and to address its non-core product lines more quickly.

Previously, Kanawha experienced statutory strain, primarily from the significant amount of new business written in its prior emphasized businesses. With the change in ownership late in 2004, the company has been incurring a sizeable amount of expenses related to its changing strategy. During 2005 (the company sold the agency on October, 2005 and ceased actively underwriting new long term care policies after December 31, 2005), the company discontinued sales of the long-term care business, as a result of low sales and lack of strategic fit; however, it will maintain the existing block of business. In 2006, KMG America reallocated a large portion of its corporate expenses to Kanawha. This resulted in increased statutory losses at Kanawha in the near term, but would directly offset through reduced losses at KMG America and would have no impact to the GAAP consolidated entity. Kanawha's increased statutory losses have been funded through capital infusions from the holding company to preserve Kanawha's capital position. A.M. Best expects Kanawha's earnings performance will remain inhibited in the near term as it will take some time to attain critical mass in the group and voluntary market. A.M. Best also believes the acquisition will assist Kanawha in achieving its sales goals and desired business mix as the company expands nationally entering new territories. However, the company will continue to have the challenges of managing its still sizeable run-off long-term care business.

**Best's Rating: A-** **Outlook: Negative**

# FIVE YEAR RATING HISTORY

| Date | Best's Rating |
|---|---|
| 09/11/07 | A- |
| 03/29/07 | A- |
| 02/07/06 | A- |
| 12/22/04 | A- |
| 08/05/04 | A- |
| 05/28/04 | A- |
| 04/15/03 | A- |

# KEY FINANCIAL INDICATORS (in thousands of dollars)

| | | Total Capital | | | | |
|---|---|---|---|---|---|---|
| Year | Assets | Capital Surplus Funds | Condit'l Reserve Funds | Net Premiums Written | Net Invest Income | Net Income |
| 2001 | 479,124 | 72,125 | 3,925 | 86,287 | 29,530 | 6,077 |
| 2002 | 494,524 | 67,232 | 3,382 | 98,538 | 26,944 | -2,960 |
| 2003 | 492,580 | 66,808 | 731 | 106,617 | 26,552 | -1,372 |
| 2004 | 539,002 | 83,708 | 963 | 102,911 | 24,611 | -1,745 |
| 2005 | 575,243 | 85,063 | 3,650 | 107,900 | 27,599 | -8,887 |
| 2006 | 608,840 | 72,284 | 4,671 | 129,389 | 30,835 | -14,718 |
| 06/2006 | 591,531 | 74,022 | 4,371 | 60,877 | 15,196 | -6,975 |
| 06/2007 | 644,325 | 70,812 | 5,004 | 83,370 | 16,525 | -12,050 |

# CORPORATE STRUCTURE

| AMB # | COMPANY NAME | DOMICILE | %OWN |
|---|---|---|---|
| 51491 | *KMG America Inc* | VA | |
| 06604 | Kanawha Insurance Company | SC | 100.00 |

# BUSINESS REVIEW

KMG America Corporation (KMG America) is a holding company incorporated under the laws of the Commonwealth of Virginia. KMG America commenced operations shortly before it completed its initial public offering of common stock on December 21, 2004, and its shares trade on the New York Stock Exchange under the symbol "KMA." Concurrently with the completion of its initial public offering, KMG America completed its acquisition of Kanawha Insurance Company (Kanawha) and its subsidiaries, which are KMG America's primary operating subsidiaries that underwrite and administer life and health employee benefit products which are marketed nationally. The corporate headquarters is located in Minnetonka, MN, with operations in Lancaster, SC. There are two national sales centers, one in Boston, MA, and the other in Orange County, CA, along with approximately 14 sales offices located throughout the United States to market regionally and give KMG America a strong national group and voluntary worksite presence.

Kanawha, domiciled in South Carolina, is licensed to write life and accident and health insurance in 46 states, the District of Columbia, and as a reinsurer, in New York. In addition to the insurance operations, Kanawha has one wholly-owned subsidiary, Kanawha HealthCare Solutions. KMG America has eliminated Kanawha Marketing Group, a subsidiary of Kanawha HealthCare Solutions, as of the end of 2006. This was done to simplify intercompany transactions and lower expenses.

Effective September 1, 2006, the company entered into a reinsurance arrangement with Columbian Life Insurance Company (CLIC) and Columbian Mutual Life Insurance Company (CMLIC), which are affiliates of each other. Under the arrangement, Kanawha reinsures 100% of the risk of a block of voluntary term life insurance and universal life insurance policies from these companies. In addition, CLIC and CMLIC assigned key trademarks to Kanawha for these insurance policies and their marketing brand, "UNIQ Benefit Solutions."

Distribution of the company's worksite products are through the KMG America Sales Division, the Career Sales Organization and the Kanawha HealthCare Solutions marketing group. Primary products include worksite group and voluntary life insurance, short and long-term disability, dental, indemnity health, stop loss, accident, and critical illness and claims administration services. After extensive analysis, the company has discontinued the sales of new long-term care policies, however, it will maintain the existing block of business.

The company targets medium to large employers that utilize benefit consultants/brokers to design and place their benefit plans. Through an integrated and coordinated sales organization, a wide suite of products can be sold to an employer through one primary sales contact.

Kanawha HealthCare Solutions, Inc. is the administrative and managed care division of Kanawha focused on growing the company's ERISA plan administration business. The division continues to maintain an accredited medical management/utilization review program as well as a proprietary managed care network primarily in North and South Carolina. In addition, the administrative services division provides administrative services to several large insurance companies. It maintains more than 150,000 ASO members under administration and more than 250,000 lives administered through other outsourced relationships. KHS has contracted with several large companies to provide the back room functionality to administer a Health Reimbursement Account (HRA) product.

On September 7, 2007, Humana Inc. announced it signed a definitive agreement to purchase KMG America for approximately $187.7 million (including estimated assumed debt of approximately $50 million) to be financed through a combination of cash and debt. The transaction is expected to close in the first quarter of 2008, pending regulatory approval.

## PREMIUM AND RESERVE ANALYSIS

| Direct Premiums (000) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Ordinary life | 14,061 | 14,177 | 14,251 | 14,314 | 14,600 |
| Group life | 4,517 | 2,156 | 1,793 | 1,936 | 2,031 |
| Individual annuities | 66 | 60 | 127 | 2,759 | 1,357 |
| Group annuities | 66 | 1 | ... | 0 | -8 |
| Individual A&H | 90,908 | 93,508 | 92,260 | 88,568 | 78,913 |

| | | | | | |
|---|---|---|---|---|---|
| Group A&H | 37,756 | 10,718 | 4,880 | 4,494 | 2,853 |
| Total | 147,376 | 120,620 | 113,311 | 112,072 | 99,746 |

| Reins Assumed Prems (000) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Ordinary life | -3,344 | -2,675 | -2,833 | -1,438 | -1,093 |
| Group life | 3,494 | 4 | 7 | 14 | 64 |
| Credit life | 0 | 0 | 2 | 1 | 2 |
| Individual annuities | 33 | 36 | 42 | 73 | 101 |
| Individual A&H | 5,171 | 5,797 | 6,440 | 7,014 | 7,645 |
| Credit A&H | ... | ... | 0 | 0 | 1 |
| Group A&H | 876 | 901 | 889 | 904 | 1,020 |
| Total | 6,230 | 4,064 | 4,548 | 6,568 | 7,741 |

| Reins Ceded Prems (000) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Ordinary life | 1,160 | 896 | 818 | 768 | 818 |
| Group life | 294 | 261 | 350 | 479 | 527 |
| Credit life | 0 | ... | 0 | 0 | 0 |
| Individual annuities | 99 | 97 | 264 | 1 | 5 |
| Individual A&H | 14,926 | 14,263 | 13,211 | 10,476 | 7,244 |
| Credit A&H | ... | ... | 0 | 0 | 0 |
| Group A&H | 7,739 | 1,267 | 304 | 297 | 354 |
| Total | 24,217 | 16,783 | 14,948 | 12,022 | 8,949 |

| Net Premiums & Deposits (000) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Ordinary life | 10,138 | 11,364 | 11,264 | 12,800 | 13,468 |
| Group life | 7,718 | 1,899 | 1,450 | 1,471 | 1,568 |
| Credit life | 0 | 0 | 1 | 1 | 2 |
| Individual annuities | 0 | 87 | -36 | 2,974 | 1,669 |
| Group annuities | 66 | 1 | 2 | 0 | -7 |
| Individual A&H | 81,153 | 85,042 | 85,489 | 85,105 | 79,314 |
| Credit A&H | ... | ... | 0 | 0 | 1 |
| Group A&H | 30,893 | 10,352 | 5,466 | 5,101 | 3,519 |
| Total | 129,968 | 108,746 | 103,637 | 107,453 | 99,534 |
| Deposits (incl. above) | 580 | 846 | 726 | 835 | 996 |

| General Account Reserve Distribution (000) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Ordinary life | 217,205 | 224,381 | 229,525 | 235,271 | 241,118 |
| Group life | 11,434 | 9,018 | 9,670 | 9,916 | 10,393 |
| Credit life | 4 | 9 | 19 | 46 | 89 |
| Individual annuities | 974 | 1,017 | 1,099 | 1,145 | 14,623 |
| Group annuities | 4,808 | 4,922 | 5,166 | 5,355 | 5,586 |
| Deposit type contracts | 7,139 | 7,208 | 7,000 | 6,743 | 7,012 |

| | | | | | |
|---|---|---|---|---|---|
| Individual A&H | 226,243 | 187,998 | 151,141 | 119,731 | 95,075 |
| Credit A&H | 3 | 4 | 7 | 21 | 21 |
| Group A&H | 5,121 | 733 | 419 | 246 | 155 |
| Total | 472,930 | 435,291 | 404,048 | 378,474 | 374,073 |

**Current Year Geographic Direct Premium Distribution ($000):** South Carolina, $25,886 (17.8%); North Carolina, $22,189 (15.2%); Florida, $18,283 (12.5%); Texas, $9,610 (6.6%); California, $7,329 (5.0%); other jurisdictions, $62,393 (42.8%).

# EARNINGS

Kanawha has reported negative statutory financial results over the past five years. The operating losses have been the result of new business expansion and, more recently, the reallocation of KMG's expenses to Kanawha, as well as weakness in the medical stop-loss business. Previously, investment income had been declining, however, the investment efforts over the past several quarters have reversed the trend. Previously, Kanawha had been growing its worksite and long-term care segments. This produced statutory strain from the sizeable amount of new business and the ramp up of the long-term care and employee benefits product lines, although the company recently discontinued selling new long-term care policies. More recently, the individual accident and health products have incurred increased claims and increases in reserves, combined with higher general expenses, as the company expands geographically.

## PROFITABILITY TESTS

| Year | Ben Paid to NPW & Dep | Comm & Exp to NPW & Dep | NOG to Tot Assets | NOG to Tot Rev | Operating Return on Equity | Net Yield | Total Return |
|---|---|---|---|---|---|---|---|
| 2002 | 62.4 | 44.6 | 0.0 | 0.0 | 0.1 | 5.84 | 5.13 |
| 2003 | 66.6 | 40.0 | -0.3 | -1.0 | -2.0 | 5.67 | 4.84 |
| 2004 | 66.8 | 38.7 | -0.5 | -2.1 | -3.7 | 5.01 | 5.14 |
| 2005 | 66.4 | 38.7 | -1.6 | -6.3 | -10.5 | 5.25 | 6.08 |
| 2006 | 67.3 | 44.9 | -2.5 | -8.9 | -18.9 | 5.55 | 6.82 |
| 06/2006 | 70.6 | 46.0 | -1.2 | -8.6 | -8.6 | 2.75 | 3.79 |
| 06/2007 | 75.3 | 40.0 | -1.9 | -11.7 | -16.8 | 2.77 | 2.92 |

## PROFITABILITY ANALYSIS

| Net Operating Gain (000) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Ordinary life | 1,240 | 1,090 | 1,657 | 1,597 | 1,943 |
| Group life | 305 | 919 | 203 | 400 | 493 |
| Credit life | 3 | 16 | 4 | 25 | 66 |
| Supplementary contracts | -1 | -1 | 0 | 11 | 8 |
| Individual annuities | -27 | -49 | -78 | 80 | 137 |
| Group annuities | -163 | -406 | 114 | 65 | 147 |
| Individual A&H | -7,078 | -10,897 | -4,254 | -3,551 | -3,051 |
| Credit A&H | 1 | -4 | 2 | -16 | 149 |

| | | | | | |
|---|---|---|---|---|---|
| Group A&H | -6,883 | 444 | -432 | 17 | 151 |
| Other | -2,254 | ... | ... | ... | ... |
| Total | -14,857 | -8,887 | -2,784 | -1,372 | 42 |

### ACCIDENT & HEALTH STATISTICS

| Year | Net Premiums Written | Net Premiums Earned | Loss Ratio | Exp. Ratio | Under-writing Results |
|---|---|---|---|---|---|
| 2002 | 83,273 | 82,361 | 70.1 | 41.3 | -9,707 |
| 2003 | 90,479 | 89,334 | 77.7 | 37.0 | -13,395 |
| 2004 | 91,368 | 91,047 | 85.9 | 34.1 | -18,181 |
| 2005 | 94,756 | 95,333 | 91.6 | 34.7 | -24,616 |
| 2006 | 112,143 | 112,337 | 93.6 | 36.6 | -33,628 |
| **Current Year Experience:** | | | | | |
| Group | 30,900 | 30,854 | 78.6 | 56.5 | -10,855 |
| Credit | ... | 1 | -99.9 | ... | 1 |
| Guaranteed renew | 68,390 | 68,786 | 104.7 | 28.3 | -22,285 |
| Non-renew, S.R. | 12,853 | 12,697 | 70.0 | 33.4 | -485 |
| Other accident | ... | ... | ... | ... | -2 |
| Other | ... | ... | ... | ... | -3 |

# CAPITALIZATION

Kanawha maintains an appropriate level of risk-based capitalization for its present business being conducted and investment profile. After the acquisition by KMG America, Kanawha received a $24.7 million capital contribution from the holding company. While the surplus level has decreased over the year as a result of a sizeable net loss and a change in asset valuation reserve, the holding company is positioned to contribute additional capital to fund the anticipated operating losses of the insurance company over the near term. KMG America made additional $10 million and $15 million capital contributions to Kanawha during 2005 and 2006, respectively. During the second quarter of 2007, $18 million in surplus notes added to Kanawha's surplus position to help offset the sizeable loss.

To partially finance the acquisition of Kanawha, KMG America made a $15 million subordinated promissory note payable to the seller. On December 21, 2006, KMG American entered into a $15 million unsecured revolving credit facility with Wachovia Bank and paid off the original promissory note at a significant discount. The credit agreement currently has an outstanding balance of $14 million, with an initial interest rate of 6.6%, and matures on December 31, 2007. In addition, the organization recently issued $35 million in trust preferreds. The additional capital will be used to help fund future premium growth.

### LEVERAGE TESTS

| Year | C&S to Liabilities | Surplus Relief | Reins Leverage | NPW & Dep to Capital | Change in NPW & Dep | Change in Capital |
|---|---|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| 2002 | 16.7 | 5.2 | 60.9 | 1.4 | 14.4 | -7.1 |
| 2003 | 15.9 | 7.4 | 89.2 | 1.6 | 8.0 | -4.4 |
| 2004 | 18.6 | 5.8 | 80.4 | 1.2 | -3.6 | 25.4 |
| 2005 | 18.2 | 5.1 | 93.1 | 1.2 | 4.9 | 4.8 |
| 2006 | 14.5 | 6.1 | 133.3 | 1.7 | 19.5 | -13.3 |
| 06/2006 | 15.3 | 3.0 | XX | 0.8 | 13.1 | -11.6 |
| 06/2007 | 13.3 | 2.9 | XX | 1.1 | 36.9 | -1.5 |

2006 BCAR: 164

### SOURCES OF CAPITAL GROWTH
### (in thousands of dollars)

| Year | Net Gain | Realized Capital Gains | Unrealized Capital Gains | Change AVR | Other Changes | Change in C&S |
|---|---|---|---|---|---|---|
| 2002 | 42 | -3,003 | -546 | 543 | -1,929 | -4,892 |
| 2003 | -1,372 | ... | -4,409 | 2,651 | 2,705 | -425 |
| 2004 | -2,784 | 1,039 | -2,711 | -233 | 21,590 | 16,900 |
| 2005 | -8,887 | 0 | 3,405 | -2,686 | 9,524 | 1,355 |
| 2006 | -14,857 | 140 | 6,076 | -1,021 | -3,117 | -12,779 |
| 06/2006 | -6,842 | -134 | 5,201 | XX | XX | XX |
| 06/2007 | -12,020 | -30 | 436 | XX | XX | XX |

### CAPITAL TRENDS
### (in thousands of dollars)

| Year | Year end C&S | Surplus Notes | Stock-holder Divs | Policy-holder Divs | Asset Valuation Reserve | Interest Maintenance Reserve |
|---|---|---|---|---|---|---|
| 2002 | 67,232 | ... | 1,750 | 2,216 | 3,382 | 4,142 |
| 2003 | 66,808 | ... | 1,750 | 2,036 | 731 | 9,211 |
| 2004 | 83,708 | ... | ... | 2,267 | 963 | 11,509 |
| 2005 | 85,063 | ... | ... | 2,162 | 3,650 | 10,927 |
| 2006 | 72,284 | ... | ... | 1,342 | 4,671 | 9,951 |
| 06/2006 | 74,022 | XX | ... | 562 | 4,371 | 10,485 |
| 06/2007 | 70,812 | XX | ... | 872 | 5,004 | 9,353 |

# INVESTMENTS AND LIQUIDITY

Kanawha utilizes an outside investment advisor to manage its investment portfolio. The company maintains a conservative investment portfolio comprised of more than four-fifths of its invested assets in investment grade bonds and mortgaged-backed securities. The remainder consists of modest amounts of cash and short-term investments, equities, mortgage loans, real estate and policy loans. Kanawha's equity holdings include 100% of the stock of its subsidiary, Kanawha HealthCare

Solutions, Inc., some preferred equities, mutual funds (employee deferred compensation arrangement), and various other holdings. The investment in mortgage loans consists primarily of first mortgage liens on single family residences.

## LIQUIDITY TESTS

| Year | Operating Cash Flow ($000) | Quick Liquidity | Current Liquidity | Non-Inv Grade Bonds to Capital | Delnq & Foreclsd Mtg to Capital | Mtg & Cred Ten Lns & RE to Cap | Affil Invest to Capital |
|---|---|---|---|---|---|---|---|
| 2002 | 17,080 | 60.6 | 69.3 | 25.3 | 0.4 | 82.9 | 16.8 |
| 2003 | -640 | 60.4 | 70.6 | 17.6 | 1.2 | 55.6 | 15.7 |
| 2004 | 33,608 | 71.9 | 80.4 | 10.4 | 0.1 | 33.6 | 12.3 |
| 2005 | 23,959 | 66.8 | 77.2 | 12.4 | 0.4 | 25.2 | 15.5 |
| 2006 | 29,475 | 63.5 | 75.3 | 14.9 | 0.2 | 24.5 | 15.9 |
| 06/2006 | 6,692 | XX | XX | 14.8 | 0.1 | 26.0 | XX |
| 06/2007 | 32,944 | XX | XX | 13.5 | ... | 23.1 | XX |

## INVESTMENT YIELDS

| Year | Net Yield | Bonds | Stocks | Mort-gages | Cash & Short Term | Real Estate Gross | Real Estate Net | Invest. Exp. Ratio |
|---|---|---|---|---|---|---|---|---|
| 2002 | 5.84 | 6.20 | 4.22 | 7.75 | 1.69 | 16.01 | 10.18 | 6.40 |
| 2003 | 5.67 | 5.84 | 6.10 | 7.03 | 0.78 | 14.81 | -3.44 | 7.10 |
| 2004 | 5.01 | 5.93 | 6.10 | 7.23 | 0.36 | 14.36 | -3.32 | 12.80 |
| 2005 | 5.25 | 5.68 | 2.60 | 6.83 | 2.35 | 14.03 | -4.18 | 5.18 |
| 2006 | 5.55 | 5.82 | 6.64 | 7.13 | 1.94 | 14.18 | -5.61 | 6.12 |

## INVESTMENT DATA

Current Year Distribution of Bonds By Maturity

| | Years 0-1 | 1-5 | 5-10 | 10-20 | 20- | Yrs-Avg Maturity |
|---|---|---|---|---|---|---|
| Government | 1.1 | 1.9 | 2.5 | 0.7 | 0.9 | 8 |
| Gov't Agencies & Muni | 0.1 | 0.5 | 1.5 | 9.9 | 5.6 | 17 |
| Public Utilities | 0.0 | 0.0 | 0.4 | 0.1 | 0.0 | 9 |
| Industrial & Misc | 4.1 | 9.7 | 25.4 | 19.0 | 16.7 | 12 |
| Total | 5.2 | 12.2 | 29.7 | 29.6 | 23.2 | 13 |

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Bonds (000) | 491,143 | 469,192 | 381,141 | 376,970 | 331,664 |
| US Government | 6.7 | 9.0 | 13.4 | 15.0 | 20.1 |
| Foreign Government | 0.4 | 0.4 | ... | ... | ... |
| Foreign - All Other | 9.1 | 4.0 | ... | ... | 0.3 |
| State/Special Revenue - US | 17.5 | 17.7 | 23.8 | 19.8 | 18.7 |
| Public Utilities - US | 0.4 | 0.1 | 3.4 | 3.4 | 4.0 |

| | | | | | |
|---|---|---|---|---|---|
| Industrial & Misc - US | 65.8 | 68.7 | 59.4 | 61.7 | 57.0 |
| Private Issues | 4.6 | 4.9 | 2.6 | 3.3 | 4.1 |
| Public Issues | 95.4 | 95.1 | 97.4 | 96.7 | 95.9 |

| Bond Quality (%) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Class 1 | 79.3 | 79.7 | 83.6 | 79.9 | 78.8 |
| Class 2 | 18.3 | 18.0 | 14.1 | 17.0 | 15.8 |
| Class 3 | 0.6 | 1.4 | 1.8 | 2.7 | 3.0 |
| Class 4 | 1.2 | 0.9 | 0.5 | 0.4 | 0.9 |
| Class 5 | 0.6 | 0.0 | 0.0 | ... | 1.5 |
| Class 6 | 0.0 | 0.0 | 0.0 | 0.0 | ... |

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Mortgages (000) | 12,766 | 16,381 | 22,382 | 31,631 | 53,045 |
| Commercial | 8.2 | 10.0 | 8.5 | 6.6 | 10.1 |
| Residential | 91.8 | 90.0 | 91.5 | 93.4 | 89.9 |

| Mortgage Quality (%) | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| 90 Days Delinquent | 1.0 | 2.4 | ... | 0.6 | 0.5 |
| In Process of Foreclosure | ... | ... | ... | 1.9 | ... |
| Total Delinquencies | 1.0 | 2.4 | ... | 2.5 | 0.5 |

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Real Estate (000) | 6,126 | 5,977 | 6,047 | 5,902 | 5,491 |
| Property Occupied by Co | 100.0 | 100.0 | 98.7 | 100.0 | 100.0 |
| Property Held for Sale | ... | ... | 1.3 | ... | ... |

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Stocks (000) | 28,777 | 10,113 | 11,428 | 23,743 | 37,516 |
| Unaffiliated Common | 0.0 | 0.1 | 0.3 | 11.9 | 46.4 |
| Affiliated Common | 21.2 | 77.2 | 38.6 | 19.9 | 17.0 |
| Unaffiliated Preferred | 78.8 | 22.7 | 61.1 | 68.2 | 36.6 |

| | 2006 | 2005 | 2004 | 2003 | 2002 |
|---|---|---|---|---|---|
| Other Inv Assets (000) | 43,761 | 46,349 | 99,579 | 37,498 | 48,544 |
| Cash | 45.5 | 40.5 | 69.8 | 25.5 | 46.1 |
| Short-Term | ... | ... | ... | ... | 0.2 |
| Schedule BA Assets | 12.8 | 12.0 | 5.2 | 13.3 | 0.1 |
| All Other | 41.7 | 47.6 | 25.0 | 61.2 | 53.6 |

# HISTORY

**Date Incorporated:** 05/22/1958 **Date Commenced:** 12/01/1958
**Domicile:** SC

**Mergers:** Central Reassurance Corporation, South Carolina, 1998; National Term Life Insurance Company, South Carolina, 1999.

**Reinsurances:** In 1988, the company entered into an agreement to assume all the traditional life insurance policies of the Investment Life and Trust Company, South Carolina. In 1990, the company assumed all of the individual accident and health policies of the Professional Investors Life Insurance Company, Oklahoma, and a portion of the individual accident and health policies of the Life Insurance Company of Virginia. In 1993, the company assumed all of the individual life policies of The National Term Life Insurance Company, Indianapolis, Indiana.

# OFFICERS

Chairman of the Board and Chief Executive Officer, Stanley D. Johnson; President and Chief Operating Officer, R. Dale Vaughan; Executive Vice President, Treasurer and Chief Financial Officer, Robert E. Matthews; Executive Vice President and Chief Actuary, Peter V. Susi; Senior Vice Presidents, Alfred L. Ferguson (Risk Management), Thomas J. Gibb (Marketing), Thomas D. Sass (Risk Management & Underwriting); Vice President and Chief Compliance Officer, Pamela P. Gillespie; Vice Presidents, Nancy K. Arfsten (Accounting), Kitty L. Eargle (Underwriting), Ronald P. Groover (Corporate Services), Jim Mark B. Gutierrez (Actuarial), Richard J. Hyclak (Actuarial), Debra P. Jaillette (Human Resources), Sylvia H. Knight (Corporate Communications & Marketing), Johnny D. McGee (Career Agencies), Shawn D. Parks (Actuarial), Debbie R. Paskoff (Accounting), Russell Piepenbring (Claims and Customer Service), May S. Rhea (Excess Risk).

# DIRECTORS

Scott H. DeLong III, Stanley D. Johnson, Kenneth U. Kuk, R. Dale Vaughan.

# REINSURANCE

The majority of its ordinary life cessions were placed with The Lincoln National Life Insurance Company, Fort Wayne, IN, under yearly renewable term and coinsurance agreements. Group life business is ceded primarily with Munich American Reinsurance Corporation, Atlanta, GA. Long-term care contracts are ceded to Employers Reinsurance Corporation, General & Cologne Life Reinsurance, and Munich American Reassurance Co. under quota share arrangements.

# REGULATORY

An examination of the financial condition was made as of December 31, 2002 by the Insurance Department of South Carolina. The 2006 annual independent audit of the company was conducted by Ernst & Young, LLP. The annual statement of actuarial opinion is provided by Peter Susi.

**Territory:** The company is licensed in the District of Columbia, AL, AZ, AR, CA, CO, CT, DE, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, MD, MA, MI, MN, MS, MO, MT, NE, NV, NJ, NM, NC, ND, OH, OK, OR, PA, RI, SC, SD, TN, TX, UT, VT, VA, WA, WV, WI and WY. The company is also licensed as a reinsurer only in NY.

**Reserve basis:** (Current ordinary business): 1980 CSO 4%, 4 1/2% and 5%; CRVM valuation. (Current credit business:) 1958 CSO 3%; Net Level valuation.

# FINANCIAL INFORMATION

## BALANCE SHEET - December 31, 2006
## (in thousands of dollars)

| Assets | | Liabilities | |
|---|---|---|---|
| *Total bonds | 491,143 | +Net policy reserves | 465,792 |
| *Total preferred stocks | 22,667 | Policy claims | 11,736 |
| *Total common stocks | 6,109 | Deposit type contracts | 7,139 |
| Mortgage loans | 12,766 | Payable on reins | 20,561 |
| Real estate | 6,126 | Interest maint reserve | 9,951 |
| Contract loans | 18,163 | Comm taxes expenses | 1,887 |
| Cash & short-term inv | 19,896 | Asset val reserve | 4,671 |
| Prems and consids due | 7,810 | Other liabilities | 14,821 |
| Accrued invest income | 6,489 | Total Liabilities | 536,557 |
| Other assets | 17,672 | Common stock | 4,624 |
| | | Paid in & contrib surpl | 65,579 |
| | | Unassigned surplus | 2,080 |
| Assets | 608,840 | Total | 608,840 |

*Securities are reported on the bases prescribed by the National Association of Insurance Commissioners. + Analysis of reserves; Life $174,674; annuities $5,782; accidental death benefits $55; disability active lives $9,805; disability disabled lives $43,496; miscellaneous reserves $614; accident & health $231,367.

## SUMMARY OF OPERATIONS
## (in thousands of dollars)

| | | | |
|---|---|---|---|
| Premiums: | | Death benefits | 14,938 |
| Ordinary life | 9,558 | Matured endowments | 204 |
| Individual annuities | 0 | Annuity benefits | 737 |
| Credit life | 0 | Disability benefits | 4,169 |
| Group life | 7,718 | Surrender benefits | 5,185 |
| Group annuities | 66 | Acc & health benefits | 62,263 |
| Acc & health group | 30,893 | Int on policy funds | -15 |
| Acc & health other | 81,153 | Supplementary contracts | 1 |
| Total premiums | 129,389 | Incr life reserves | -4,922 |
| Net investment income | 30,835 | Incr a & h reserves | 42,631 |
| Amort interest maint res | 1,044 | Commissions | 23,045 |
| Comm & exp reins ceded | 4,398 | Comm exp reins assumed | 956 |
| Mgt and/or service fee | 609 | Insur taxes lic & fees | 3,333 |
| | | General ins expenses | 35,363 |
| Total | 166,274 | Total | 187,887 |

| | |
|---|---|
| Gain from operations before FIT & div to policyholders | -21,613 |
| Dividends to policyholders: life | 1,331 |
| Dividends to policyholders: accident & health | 11 |
| Gains from operations after dividends to policyholders | -22,956 |
| Federal income taxes incurred | -8,098 |
| Net gain from operations after FIT and dividends | -14,857 |

## CASH FLOW ANALYSIS
## (in thousands of dollars)

| Funds Provided | | Funds Applied | |
|---|---|---|---|
| Gross cash from oper | 163,151 | Benefits paid | 81,469 |
| Long-term bond proceeds | 52,255 | Comm, taxes, expenses | 61,875 |
| Stock proceeds | 9,281 | Long-term bonds acquired | 85,785 |
| Capital surplus paid in | 15,000 | Other cash applied | 19,444 |
| Other cash provided | 10,025 | Incr cash & short-term | 1,138 |
| Total | 249,711 | Total | 249,711 |

## INTERIM BALANCE SHEET
## (in thousands of dollars)

| Assets | 03/31/2007 | 06/30/2007 | |
|---|---|---|---|
| Total bonds | 505,098 | 522,999 | ... |
| Total preferred stocks | 25,715 | 34,636 | ... |
| Total common stocks | 6,284 | 6,546 | ... |
| Mortgage loans | 12,326 | 11,470 | ... |
| Real estate | 6,070 | 6,039 | ... |
| Contract loans | 17,954 | 17,848 | ... |
| Cash & short-term inv | 10,072 | 10,101 | ... |
| Accrued invest income | 6,684 | 6,682 | ... |
| Other assets | 27,781 | 28,005 | ... |
| Assets | 617,984 | 644,325 | |

| Liabilities | 03/31/2007 | 06/30/2007 | |
|---|---|---|---|
| Net policy reserves | 474,214 | 487,825 | ... |
| Policy claims | 20,742 | 23,547 | ... |
| Payable on reins | 21,821 | 23,736 | ... |
| Interest maint reserve | 9,690 | 9,353 | ... |
| Comm taxes expenses | 2,713 | 1,963 | ... |
| Asset val reserve | 4,804 | 5,004 | ... |
| Other liabilities | 23,370 | 22,087 | ... |
| Total liabilities | 557,355 | 573,513 | |
| Common stock | 4,624 | 4,624 | ... |
| Surplus notes | ... | 18,000 | ... |
| Paid in & contrib surpl | 65,579 | 65,579 | ... |
| Unassigned surplus | -9,575 | -17,391 | ... |
| Total | 617,984 | 644,325 | |

## INTERIM SUMMARY OF OPERATIONS

| | Period Ended 06/30/2007 | Period Ended 06/30/2006 | Increase/ (Decrease) |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Prems & ann consid | 83,370 | 60,877 | 22,493 |
| Total premiums | 83,370 | 60,877 | 22,493 |
| Net investment income | 16,525 | 15,196 | 1,329 |
| Amort interest main res | 509 | 792 | -284 |
| Comm & exp reins ceded | 2,052 | 2,248 | -196 |
| Other income | 216 | 113 | 103 |
| Total | 102,672 | 79,227 | 23,445 |
| Death benefits | 7,885 | 9,374 | -1,490 |
| Matured endowments | 96 | 113 | -18 |
| Annuity benefits | 367 | 372 | -5 |
| Surrender benefits | 2,273 | 2,374 | -101 |
| Disability and A&H ben | 52,130 | 30,741 | 21,389 |
| Int on policy funds | 4 | 6 | -2 |
| Supplementary contracts | 0 | -2 | 2 |
| Change in reserves | 22,051 | 15,996 | 6,055 |
| Commissions | 13,262 | 12,033 | 1,228 |
| Comm exp reins assumed | 511 | 185 | 327 |
| Insur taxes lic & fees | 3,448 | 1,600 | 1,848 |
| General ins expenses | 18,142 | 16,425 | 1,717 |
| Total | 120,169 | 89,219 | 30,950 |
| Gain from operations before FIT & div to policyholders | -17,496 | -9,991 | -7,505 |
| Dividends to policyholders | 872 | 562 | 310 |
| Gain from operations after dividends to policyholders | -18,368 | -10,554 | -7,815 |
| Federal income taxes incurred | -6,348 | -3,712 | -2,636 |
| Net gain from operations after FIT and dividends | -12,020 | -6,842 | -5,179 |

## ORDINARY LIFE STATISTICS

| Year | Ord. Lapse Ratio % | Average Ord. Policy (in dollars) Issued | In Force | Avg. Prem ($/M) | 1st Yr Prem / Total Prem | 1st Yr Comm / 1st Yr Prem | Gen. Exp. / Policies In Force |
|---|---|---|---|---|---|---|---|
| 2002 | 11.3 | 36,350 | 11,983 | 8.21 | 10.2 | 57.9 | 50.55 |
| 2003 | 11.8 | 42,316 | 12,537 | 7.96 | 9.9 | 97.5 | 43.76 |
| 2004 | 12.9 | 48,592 | 13,172 | 7.13 | 11.9 | 99.3 | 41.71 |
| 2005 | 12.1 | 43,798 | 13,648 | 7.35 | 12.5 | 97.0 | 44.72 |
| 2006 | 12.1 | 45,312 | 14,654 | 6.73 | 13.7 | 71.5 | 36.08 |

| Year | # Policies Issued (000) | # Policies in Force (000) | First Year Premium (000) | Gen'l Exp/ Reserves (%) | Return on Reserves (%) |
|---|---|---|---|---|---|

| | | | | | |
|---|---|---|---|---|---|
| 2002 | 5 | 137 | 1,490 | 2.80 | 0.78 |
| 2003 | 5 | 129 | 1,412 | 2.33 | 0.66 |
| 2004 | 5 | 121 | 1,703 | 2.14 | 0.70 |
| 2005 | 4 | 115 | 1,773 | 2.21 | 0.47 |
| 2006 | 5 | 109 | 1,925 | 1.75 | 0.55 |

## NEW LIFE BUSINESS ISSUED
## (in thousands of dollars)

| Year | Whole Life & Endow | Term | Credit | Group | Indus-trial | Total Insurance Issued | Non-Par (%) | Par (%) |
|---|---|---|---|---|---|---|---|---|
| 2001 | 66,854 | 122,856 | ... | 389,802 | ... | 579,512 | 97 | 3 |
| 2002 | 57,897 | 109,856 | ... | 53,671 | ... | 221,424 | 89 | 11 |
| 2003 | 53,938 | 145,749 | ... | 33,614 | ... | 233,301 | 90 | 10 |
| 2004 | 55,060 | 174,438 | ... | 16,807 | ... | 246,305 | 93 | 7 |
| 2005 | 61,984 | 133,487 | ... | 114,863 | ... | 310,334 | 95 | 5 |
| 2006 | 61,816 | 176,481 | ... | 1,065,636 | ... | 1,303,933 | 99 | 1 |

## LIFE INSURANCE IN FORCE
## (in thousands of dollars)

| Year | Whole Life Endow & Adds | Term | Credit | Group | Industrial | Total Insurance In Force |
|---|---|---|---|---|---|---|
| 2001 | 762,589 | 937,332 | 7,194 | 2,761,481 | ... | 4,468,596 |
| 2002 | 737,438 | 906,933 | 3,480 | 2,773,458 | ... | 4,421,309 |
| 2003 | 707,543 | 910,098 | 1,908 | 2,724,051 | ... | 4,343,600 |
| 2004 | 686,779 | 913,550 | 940 | 2,682,481 | ... | 4,283,750 |
| 2005 | 552,654 | 1,011,462 | 470 | 3,426,794 | ... | 4,991,380 |
| 2006 | 527,224 | 1,066,359 | 246 | 4,562,741 | ... | 6,156,570 |

KMG AMERICA

12600 Whitewater Drive, Suite 150
Minnetonka, MN 55343
952-930-4802

# MEMO

To: KMG America Distributors

From: Kenneth Kuk, Chairman, President and CEO of KMG America Corporation

Re: KMG America to be acquired by Humana Inc.

KMG America (NYSE:KMA) announced today that it has signed a definitive merger agreement to be acquired by Humana Inc., (NYSE:HUM). Humana is based in Louisville, Kentucky and is one of the nation's largest publicly traded health benefits companies. The convergence of KMG America and Humana will combine Humana's market presence, brand and financial strength with KMG America's demonstrated expertise in ancillary group and voluntary benefit products.

We are excited about what the merger with Humana will mean for both organizations, our producers and our customers. In looking for a strategic partner, we wanted a company that would protect our financial strength and ratings and also had a strong interest in our products, services, customers, distributors and associates. We believe our affiliation with Humana meets those objectives and predict this will be a win-win for all involved...including you.

The primary message we want to relay is "business as usual, but better." KMG America will continue to market under our current name and brand as we transition to being part of the Humana family. We will retain our original strategy of selling core and voluntary benefits through a single point of contact. We anticipate leveraging the Humana brand and taking advantage of cross-selling opportunities over time. This merger will not involve a complex systems or organizational integration with Humana. Therefore, you should experience no disruption with your contacts, administration or processes.

We want to thank you for your loyalty and support, especially over the last several months. Now, with the power of Humana behind us, we will be a stronger force as we offer quality core and voluntary benefits to employers nationwide.

The merger is subject to approval by KMG America shareholders and various regulatory bodies, which we expect to be completed before the end of 2007. We will communicate with you as the process evolves.

In closing, Humana has a strong history of leading change by providing consumers with innovative health and benefit solutions. We are happy to be joining their family of companies.

Kenneth Kuk

KMG AMERICA

## Additional Information and Where to Find It

KMG America plans to file with the Securities and Exchange Commission (the "SEC") and mail to its shareholders a proxy statement in connection with the special meeting of the KMG America shareholders that will be held to consider the proposed merger (the "Merger Proxy Statement") and KMG America may file other documents regarding the proposed transaction with the SEC. **BEFORE MAKING ANY VOTING OR INVESTMENT DECISION, INVESTORS AND SHAREHOLDERS ARE URGED TO READ THE MERGER PROXY STATEMENT AND ANY OTHER RELEVANT DOCUMENTS CAREFULLY AND IN THEIR ENTIRETY, WHEN THEY BECOME AVAILABLE, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED MERGER.** When available, shareholders may obtain a free copy of the Merger Proxy Statement and other documents that KMG America files with the SEC at the SEC's website, at www.sec.gov. The Merger Proxy Statement and other documents filed with the SEC may also be obtained free of charge from KMG America, at www.kmgamerica.com, or by directing a request to KMG America Corporation, 12600 Whitewater Drive, Suite 150, Minnetonka, Minnesota 55343, Attention: General Counsel.

**Participants in the Solicitation**

KMG America, its directors and named executive officers may be deemed to be participants in the solicitation of proxies from its shareholders in connection with the proposed transaction. Information regarding the interests of such directors and executive officers is included in KMG America's proxy statement filed with the SEC on March 30, 2007, and information concerning such individuals will be included in the proxy statement relating to the proposed merger, when it becomes available. To the extent such individuals' holdings of KMG America's securities have changed since the amounts printed in the proxy statement dated March 30, 2007, such changes have been reflected on Forms 3, 4 and 5 filed with the SEC and will be reflected in the Merger Proxy Statement.

**Cautionary Statement Regarding Forward-Looking Statements**

Certain statements in this letter are forward-looking as defined by the Private Securities Litigation Reform Act of 1995. These include statements as to the expected timing, completion and effects of the proposed merger. Such forward-looking statements are based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions the accurate prediction of which may be difficult and involve the assessment of events beyond the control of KMG America. Due to known and unknown risks, actual results may differ materially from expectations or projections. KMG America does not undertake any obligations to update any forward-looking statement, whether written or oral, relating to matters discussed in this letter.

The following factors, among others, could cause actual results to differ materially from those described in the forward-looking statements: the shareholders of KMG America may not approve and adopt the merger agreement and the transactions contemplated by the merger agreement at the special shareholders meeting; the parties may be unable to obtain governmental and regulatory approvals required for the merger; required governmental or regulatory approvals may delay the merger or result in the imposition of conditions that could cause the parties to abandon the merger; the parties may be unable to complete the merger because, among other reasons, conditions to the closing of the merger may not be satisfied or waived; or other factors that may be referred to in KMG America's reports filed with or furnished to the Securities and Exchange Commission from time to time. There can be no assurance that other factors not currently anticipated by KMG America will not materially and adversely affect future events. Viewers of this letter are cautioned to consider these risks and uncertainties and not to place undue reliance on the forward-looking statements.

Humana Inc.
500 West Main Street
P.O. Box 1438
Louisville, KY 40201-1438
http://www.humana.com

**news** release

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# Humana Announces Intent to Acquire KMG America

***Acquisition to further expand Humana's product portfolio***

LOUISVILLE, Kentucky — September 7, 2007 — Humana Inc. (NYSE: HUM) today announced it has signed a definitive agreement to purchase KMG America Corporation ("KMG") (NYSE: KMA), a group and voluntary insurance benefits and third-party administration company based in Minnetonka, Minnesota, for cash consideration of $6.20 for each outstanding share of KMG, representing a premium of approximately 36 percent over the average closing price of KMG shares for the past 60 trading days. The total transaction price of approximately $187.7 million (including estimated assumed debt of approximately $50 million) will be financed through a combination of cash and debt.

KMG offers life and health insurance products and services to approximately 1.1 million group and individual members nationwide, including stand-alone stop-loss insurance through group employers for approximately 473,000 members and third-party claims administration and medical management services for approximately 131,000 self-insured members. KMG's revenues for the year ended December 31, 2006 approximated $181 million.

Humana Inc.
500 West Main Street
P.O. Box 1438
Louisville, KY 40201-1438
http://www.humana.com



"KMG's capabilities in voluntary products will complement our major medical offerings in both the employer group and individual product lines," said Michael B. McCallister, Humana's president and chief executive officer. "In addition, KMG's approach to both marketing and product distribution fit well with Humana's focus on the consumer. We are looking forward to having KMG as part of our organization."

"KMG America has managed a rigorous strategic alternative review process and could not be more excited about joining the Humana family of companies," said Kenneth U. Kuk, chairman of the board, president, and chief executive officer of KMG. "Our shareholders, producers, and associates will benefit from this affiliation. I feel we have accomplished the objectives we stated when we announced this effort in May 2007."

The transaction is not expected to impact Humana's guidance for 2007 diluted earnings per common share, with accretion of $0.04 to $0.05 per share expected in 2008.

The transaction was unanimously approved by the boards of directors of Humana and KMG. The transaction is subject to customary closing conditions, including the approval by KMG shareholders and the receipt of governmental and regulatory approvals, including the approval of the South Carolina Department of Insurance, and the expiration of all waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. KMG expects to schedule a special meeting of shareholders during the fourth quarter of 2007 to vote on the transaction. The transaction is anticipated to be completed in the first quarter of 2008.

Humana Cautionary Statement

This news release contains statements and earnings guidance points that are forward-looking. The forward-looking items herein are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking items may be significantly impacted by certain risks and uncertainties described in the company's Form 10-K for the year ended December 31, 2006, its Form 10-Qs for the periods ended March 31, 2007 and June 30, 2007 and Form 8-Ks filed during 2007, as filed with the Securities and Exchange Commission.

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Louisville, KY 40201-1438
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**news release**

About Humana

Humana Inc., headquartered in Louisville, Kentucky, is one of the nation's largest publicly traded health benefits companies, with approximately 11.3 million medical members. Humana offers a diversified portfolio of health insurance products and related services – through traditional and consumer-choice plans – to employer groups, government-sponsored plans, and individuals.

Over its 46-year history, Humana has consistently seized opportunities to meet changing customer needs. Today, the company is a leader in consumer engagement, providing guidance that leads to lower costs and a better health plan experience throughout its diversified customer portfolio.

More information regarding Humana is available to investors via the Investor Relations page of the company's web site at http://www.humana.com, including copies of:

- Annual reports to stockholders;
- Securities and Exchange Commission filings;
- Most recent investor conference presentations;
- Quarterly earnings news releases;
- Replays of most recent earnings release conference calls;
- Calendar of events (includes upcoming earnings conference call dates and times, as well as planned interaction with research analysts and institutional investors);
- Corporate Governance Information.

KMG America – Additional Information and Where to Find It

KMG America plans to file with the Securities and Exchange Commission (the "SEC") and mail to its shareholders a proxy statement in connection with the special meeting of the KMG America shareholders that will be held to consider the proposed merger (the "Merger Proxy Statement") and KMG America may file other documents regarding the proposed transaction with the SEC. Before making any voting or investment decision, investors and shareholders are urged to read the Merger Proxy Statement and any other relevant documents carefully and in their entirety, when they become available, because they will contain important information about the proposed merger. When available, shareholders may obtain a free copy of the Merger Proxy Statement and other documents that KMG America files with the SEC at the SEC's website, at www.sec.gov. The Merger Proxy Statement and other documents filed with the SEC

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may also be obtained free of charge from KMG America, at www.kmgamerica.com, or by directing a request to KMG America Corporation, 12600 Whitewater Drive, Suite 150, Minnetonka, Minnesota 55343, Attention: General Counsel.

Participants in the KMG America Solicitation

KMG America, its directors and named executive officers may be deemed to be participants in the solicitation of proxies from its shareholders in connection with the proposed transaction. Information regarding the interests of such directors and executive officers is included in KMG America's proxy statement filed with the SEC on March 30, 2007, and information concerning such individuals will be included in the proxy statement relating to the proposed merger, when it becomes available. To the extent such individuals' holdings of KMG America's securities have changed since the amounts printed in the proxy statement dated March 30, 2007, such changes have been reflected on Forms 3, 4 and 5 filed with the SEC and will be reflected in the Merger Proxy Statement.

KMG America Cautionary Statement Regarding Forward-Looking Statements

Certain statements in this news release are forward-looking as defined by the Private Securities Litigation Reform Act of 1995. These include statements as to the expected timing, completion and effects of the proposed merger. Such forward-looking statements are based on facts and conditions as they exist at the time such statements are made as well as predictions as to future facts and conditions the accurate prediction of which may be difficult and involve the assessment of events beyond the control of KMG America. Due to known and unknown risks, actual results may differ materially from expectations or projections. KMG America does not undertake any obligations to update any forward-looking statement, whether written or oral, relating to matters discussed in this news release.

The following factors, among others, could cause actual results to differ materially from those described in the forward-looking statements: the shareholders of KMG America may not approve and adopt the merger agreement and the transactions contemplated by the merger agreement at the special shareholders meeting; the parties may be unable to obtain governmental and regulatory approvals required for the merger; required governmental or regulatory approvals may delay the merger or result in the imposition of conditions that could cause the parties to abandon the merger; the parties may be unable to complete the merger because, among other reasons, conditions to the closing of the merger may not be satisfied or waived; or other factors

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that may be referred to in KMG America's reports filed with or furnished to the Securities and Exchange Commission from time to time. There can be no assurance that other factors not currently anticipated by KMG America will not materially and adversely affect future events. Viewers of this news release are cautioned to consider these risks and uncertainties and not to place undue reliance on the forward-looking statements.

# PREFACE

## 2007 EDITION

## OVERVIEW OF BEST'S RATING SYSTEM AND PROCEDURES


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## SECTION I

### INTRODUCTION

Founded in 1899, A.M. Best Company is the oldest and most widely recognized rating agency dedicated to the insurance industry. Best's Ratings, which indicate the financial strength of insurance companies, cover: property/casualty, life, annuity, health, health maintenance organizations (HMOs), reinsurance, and title insurance companies. A.M. Best provides the most comprehensive insurance ratings coverage of any rating agency, with reports and ratings maintained on nearly 7,500 insurance entities world-wide, in approximately 65 countries. A.M. Best is also a well-known and highly regarded source of information and commentary on global insurance trends and issues through a host of other products and services.

A.M. Best's Company's Mission Statement is "To perform a constructive and objective role in serving the insurance marketplace as a source of reliable information and ratings dedicated to encouraging a financially strong industry through the prevention and detection of insurer insolvency." We believe that this proactive role is vital to encourage prudent management of insurance companies and to improve the industry's financial strength for the benefit of policyholders.

Best's Ratings and related financial information provide powerful tools for insurance decision-making and market research for insurance agents, brokers, risk managers, pension managers, employee benefits administrators, investment bankers, insurance executives, policyholders and consumers.

In 1900, A.M. Best first published what became known as *Best's Insurance Reports®—Property/Casualty Edition* which reported on 850 property/casualty insurers operating in the United States. This was soon followed by its companion volume, *Best's Insurance Reports®—Life/Health Edition*, which was published in 1906 reporting on 95 legal reserve life insurers in the United States. Over the better part of a century, these two annual publications have represented the most comprehensive source of financial information on domestic insurers.

The 2007 Property/Casualty and Life/Health Editions of *Best's Insurance Reports®—United States & Canada* contain approximately 3,100 and 2,000 insurance companies, respectively, representing virtually all active insurers operating in the United States. In addition, the 2007 editions contain Canadian property/casualty, Canadian life and reports on United States, European, and Canadian branches.

In 1984, A.M. Best embarked on completing global coverage of the insurance industry with the publication of *Best's Insurance Reports®—Non-US Edition*, which currently reports, in CD-ROM format, on approximately 4,600 international property/casualty and life/health companies.

In 1999, A.M. Best expanded its rating assignments to include debt and structured finance. The issuance of securities ratings for insurers and insurance holding companies is a natural extension of our expertise in providing financial strength ratings and reports on insurance organizations to investors, analysts and policyholders. Best's extended focus on the insurance industry provides the basis for rating opinions in the credit markets that is unmatched in terms of an in-depth understanding of underlying insurance business fundamentals, risks and future prospects. This focus also serves as the foundation for which ratings are issued to other risk bearing institutions and entities, including captive insurers and alternative risk transfer facilities.

Within the insurance segment, Best now assigns ratings to debt securities, surplus notes, preferred stock and hybrid debt instruments, commercial paper, collateralized debt obligations, insurance-based liability or asset-backed securitizations and monetizations, risk-linked securities, structured financing programs, closed block securities, and institutional investment products.

In addition to our rating products and services, A.M. Best also publishes a host of other complementary products that are an extension of our knowledge of the industry. Some of these products include *Best's Aggregates and Averages* (industry-wide aggregate totals), *Best's Underwriting Guide* (an underwriter's guide to assessing over 500 commercial risks), and *Best's Loss Control Manual* (a safety engineer's guide to assessing insurance exposures and requirements). These products add to the understanding of the complexities of the insurance industry and enhance our rating evaluations as well as the value and scope of information we provide our subscribers.

A.M. Best currently provides over 50 publications and services to meet the needs of our customers who require timely, accurate and comprehensive information on this dynamic industry. A.M. Best is dedicated to providing our subscribers with the most useful and up-to-date information and ratings available in the insurance industry.

While Best's Financial Strength Ratings reflect our **opinion** as to a company's financial strength and ability to meet its ongoing obligations to policyholders, they are **not a warranty**, nor are they a recommendation of a specific policy form, contract, rate or claim practice.

## SECTION II

### SOURCES OF INFORMATION

The primary source of the information presented in this publication is each insurance company's official annual and quarterly (if available) financial statements as filed with the regulator of the state, province or country in which the company is domiciled. In the United States, most of these financial statements are prepared in accordance with statutory accounting requirements established by the National Association of Insurance Commissioners (NAIC) and administered by the respective states. Within some of the Canadian company presentations, portions of the Canadian data are provided by OSFI and Beyond 20/20 Inc., Ottawa, Canada.

Our comprehensive review of a company's financial strength is supplemented by publicly available documents, such as Securities and Exchange Commission (SEC) filings in the United States, Generally Accepted Accounting Principles (GAAP) or International Accounting Standards (IAS) financial statements. Other sources of information may include audit reports prepared by certified public accountants or actuaries, loss reserve reports prepared by loss reserve specialists, confidential documents provided by company management, our proprietary Background and Supplemental Rating Questionnaires, and annual business plans.

While the information contained in our reports is obtained from sources believed to be reliable, its accuracy is not guaranteed. We do not audit company financial records or statements and, therefore, cannot attest as to their accuracy.

Consequently, no representations or warranties are made or given as to the accuracy or completeness of the information presented herein, and no responsibility can be accepted for any error, omission or inaccuracy in our reports. Caution should be used in the interpretation and comparison of the information shown due to the differences which may exist between companies' financial reporting standards, insurance operations, and parent/subsidiary relationship.

## SECTION III

### OBJECTIVE OF BEST'S RATING SYSTEM

**Financial Strength Ratings**

The objective of Best's Financial Strength Rating system is to provide an opinion as to an insurer's financial strength and ability to meet its ongoing obligations to policyholders. The assigned rating is derived from an in-depth evaluation of a company's balance sheet strength, operating performance and business profile, as compared to Best's quantitative and qualitative standards. An important component of the evaluation process requires an interactive exchange of information with the insurance company's management.

As shown in the accompanying table, Best's Financial Strength Ratings range from our highest, A++ (Superior), to our lowest, F (In Liquidation). Companies that subscribe to our interactive rating service are assigned a Best's

Rating (A++ to F). Best may assign Best's Public Data Ratings (noted by the "pd" subscript), to other European insurers, as well as to U.S. Health Maintenance Organizations (HMOs) that do not subscribe to our interactive rating process. These Public Data Ratings will be assigned where, in Best's opinion, ratings are needed due to market demand.

**Type of Rating Opinions**

| | Best's Ratings | |
|---|---|---|
| | Interactive | Public Data |
| Rating Scale | A++ to F | A++ pd to D pd |
| Evaluation | Quan. & Qual. | Quan. & Qual. |
| Interaction with Mgmt. | Yes | No |
| Sufficient Exp. & Size | Yes | Yes |

Best's Financial Strength Rating opinions are divided into two broad categories — Secure and Vulnerable. This delineation provides our subscribers with a gauge of how A.M. Best views a company's ability to meet its obligations to policyholders. Based on *Best's Insolvency Studies*, Secure rated companies have experienced a very low failure frequency, which is significantly lower than Vulnerable rated companies (and companies unrated or not followed by A.M. Best). Hence the justification for the two categories.

In Best's opinion, the highest rated Secure companies have a very strong ability to meet their ongoing obligations to policyholders, while the lowest rated Secure companies have a good ability. The time frame for the ability of Secure companies to meet their current and ongoing obligations to policyholders varies. The higher a company's Secure rating, the greater its ability to withstand adverse changes in underwriting and economic conditions over longer periods of time. The time frame in which Vulnerable companies are expected to meet their obligations also varies. "Fair," "Marginal" and "Weak" rated companies may only have a current ability to pay claims, while companies rated "Poor," "Under Regulatory Supervision" and "In Liquidation" may not have an ability to fully meet their current obligations to policyholders.

## Issuer Credit Ratings and Debt Ratings

A.M Best also assigns Issuer Credit Ratings and Debt Ratings to insurance operating companies and holding companies. While our annual publications include only Financial Strength Ratings, Issuer Credit Ratings and Debt Ratings can be found along with Financial Strength Ratings on the A.M. Best website, www.ambest.com.

A Best's Long-Term Issuer Credit Rating is an opinion as to the ability of the issuer to meet its ongoing senior financial obligations. These ratings are assigned to insurance companies, holding companies, or other legal entities authorized to issue financial obligations.

A Best's Short-Term Issuer Credit Rating is an opinion as to the ability of the issuer to meet its senior financial commitments on obligations maturing in generally less than one year.

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

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

# SECTION IV

## BEST'S RATING SCALE

The Best's Financial Strength Rating scale is comprised of 16 individual ratings grouped into 10 categories, consisting of three **Secure** categories of "Superior," "Excellent" and "Good" and seven **Vulnerable** categories of "Fair," "Marginal," "Weak," "Poor," "Under Regulatory Supervision," "In Liquidation" and "Rating Suspended."

### Financial Strength Ratings

### Secure

**A++ and A+ (Superior)**
Assigned to companies that have, in our opinion, a superior ability to meet their ongoing obligations to policyholders.

**A and A- (Excellent)**
Assigned to companies that have, in our opinion, an excellent ability to meet their ongoing obligations to policyholders.

**B++ and B+ (Good)**
Assigned to companies that have, in our opinion, a good ability to meet their ongoing obligations to policyholders.

### Vulnerable

**B and B- (Fair)**
Assigned to companies that have, in our opinion, a fair ability to meet their ongoing obligations to policyholders, but are financially vulnerable to adverse changes in underwriting and economic conditions.

**C++ and C+ (Marginal)**
Assigned to companies that have, in our opinion, a marginal ability to meet their ongoing obligations to policyholders, but are financially vulnerable to adverse changes in underwriting and economic conditions.

**C and C- (Weak)**
Assigned to companies that have, in our opinion, a weak ability to meet their ongoing obligations to policyholders, but are financially very vulnerable to adverse changes in underwriting and economic conditions.

**D (Poor)**
Assigned to companies that in our opinion, may not have an ability to meet their ongoing 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 (Rating Suspended)**
Assigned to rated companies that have experienced sudden and significant events affecting their balance sheet strength or operating performance whereby the rating implications cannot be evaluated due to a lack of timely or adequate information.

**Long-Term Issuer Credit Ratings and Long-Term Debt Ratings**

Best's Long-Term Issuer Credit Rating and Long-Term Debt Rating scale is comprised of 22 individual ratings grouped into 8 categories, consisting of four **Investment Grade** categories of "Exceptional," "Very Strong," "Strong" and "Adequate" and four **Non-Investment Grade** categories of "Speculative," "Very Speculative," "Extremely Speculative" and "In Default."

**Investment Grade**

**aaa** **(Exceptional)**

**aa+** and **aa** and **aa-** **(Very Strong)**

**a+** and **a** and **a-** **(Strong)**

**bbb+** and **bbb** and **bbb-** **(Adequate)**

**Non-Investment Grade**

**bb+** and **bb** and **bb-** **(Speculative)**

**b+** and **b** and **b-** **(Very Speculative)**

**ccc+** and **ccc** and **ccc-** and **cc** and **c** **(Extremely Speculative)**

**d** **(In Default)**

While the above definitions apply to entities which do not issue insurance obligations, A.M. Best also assigns Issuer Credit Ratings to all rated insurance companies. In addition, it should also be noted that A.M. Best assigns Issuer Credit Ratings to publicly-traded holding companies, where a significant portion of cash flow is provided by insurance operations. The definitions applied to insurance companies that are assigned an Issuer Credit Rating are as follows: (aaa) - Exceptional; (aa) - Superior; (a) - Excellent; (bbb) - Good; (bb) - Fair; (b) - Marginal; (ccc,cc) - Weak; (c) - Poor; (rs) - Regulatory Supervision/Liquidation.

**Short-Term Issuer Credit Ratings and Short-Term Debt Ratings**

Best's Short-Term Issuer Credit Rating and Short-Term Debt Rating scale is comprised of 6 individual ratings grouped into 6 categories, consisting of four **Investment Grade** categories of "Strongest," "Outstanding," "Satisfactory" and "Adequate" and two **Non-Investment Grade** categories of "Speculative" and "In Default."

**Investment Grade**

**AMB-1+** **(Strongest)**

**AMB-1** **(Outstanding)**

**AMB-2** **(Satisfactory)**

**AMB-3** **(Adequate)**

**Non-Investment Grade**

**AMB-4** **(Speculative)**

**d** **(In Default)**

## SECTION V

### RELEASE OF FINANCIAL STRENGTH RATINGS

Best's Financial Strength Rating opinions are formally evaluated at least once every 12 months. The annual review is based on comprehensive information provided to A.M. Best, which includes annual and quarterly (if available) financial statutory statements filed with regulators and SEC filings (if applicable), together with other publicly available financial statements prepared under GAAP or IAS standards and confidential documents including Best's Supplemental Rating Questionnaires (for interactive Best's Ratings).

With our interactive Best's Ratings, analysts maintain rating contact with company managements throughout the year and monitor each company's performance. Ratings are continually re-evaluated for changes that might arise during the year, or in conjunction with our ongoing dialogue with company managements.

Ratings are reviewed and released throughout the year following a formal annual review, including upgrades, downgrades, affirmations, new assignments or ratings placed under review (see section X, Affiliation Codes and Rating Modifiers). In addition, all ratings are reviewed following the receipt of the annual statutory and GAAP financial statements, as well as quarterly filings to ensure there have been no material changes since the last formal rating review. Moreover, due to event-driven circumstances, rating actions may be released outside of the scheduled formal review process. Situations such as mergers or acquisitions, dramatic changes in financial information, legislative/regulatory actions or current events are examples of occasions that may instigate a rating action or change. Best's Ratings are updated and are released immediately through *Best's Internet Service* via www.ambest.com — A.M. Best's Web Site. Rating upgrades and downgrades, as well as initial ratings are also released through *Best's Ratings Monitor*, our most timely and complete release of ratings in print. Selected rating changes and new ratings are published on a monthly basis in *Best's Review*®, the monthly magazine. Finally, updated *Best's Credit Reports* are available shortly after the publication of a company's updated rating assignment and following the review of the company's annual statutory statement.

### Rating Outlooks

A rating outlook indicates the potential future direction of a company's rating over an intermediate period, generally defined as the next 12 to 36 months. Outlook indications can be positive, negative or stable. A *positive* outlook is placed on a company's rating if its financial and market trends are favorable, relative to its current rating level, and if they continue, the company has a good possibility of having its rating upgraded. In contrast, a *negative* outlook is placed on a company's rating that is experiencing unfavorable financial and market trends, relative to its current rating level, and if they continue, the company has a good possibility of having its rating downgraded. A *stable* outlook is placed on a company's rating to indicate that it is experiencing stable financial and market trends, and that there is a low likelihood that its rating will change in the near-term. Rating outlooks appear immediately following the rating rationale section of the company's *Best's Credit Report*.

### Rating History

To enable the reader to track trends, *Best's Insurance Reports* contains a Five Year History section and *Best's Key Rating Guide* presents the five latest rating events.

# SECTION VI

## ASSIGNMENT OF BEST'S RATINGS

The assignment of an interactive Best's Financial Strength Rating (A++ to F) involves a comprehensive quantitative and qualitative analysis of a company's **balance sheet strength**, **operating performance** and **business profile**.

For our interactive Best's Financial Strength Ratings, we believe this balanced approach of evaluating a company on both quantitative and qualitative levels provides a better insight of a company and results in a more discerning and credible rating opinion. We believe our more refined rating process has significantly improved the predictive value of our ratings in identifying financially secure or vulnerable insurance companies over time.

Risk Management is an important aspect of any insurance company operation. Enterprise Risk Management (ERM) has grown in importance as companies look to consider the correlation of many risks that they have historically managed independently, or deal with emerging risk issues inherent in many of today's more sophisticated product offerings.

The analysis of ERM is an integral part of the rating analysis and discussions with all rated companies. A company's risk management capabilities are considered in the qualitative assessment of all three rating areas, Balance Sheet Strength, Operating Performance, and Business Profile.

The interpretation of quantitative measurements involves the incorporation of more qualitative considerations into the process that may impact prospective financial strength. Our quantitative evaluation is based on an analysis of each company's reported financial performance, utilizing over 100 key financial tests and supporting data. These tests, which underlie our evaluation of balance sheet strength and operating performance, vary in importance depending upon a company's characteristics.

In assigning a Best's Financial Strength Rating, additional consideration is given to balance sheet strength for those companies that are exposed to shorter tail liabilities (less than 2-3 years) or those companies maintaining extremely strong balance sheet strength. Companies exposed to short-tail liabilities face fewer unknown losses, reducing long-term risk. Alternatively, those companies exposed to long-tail liabilities (over 7 years) face greater uncertainty and risk and more importance is placed on operating performance which will need to be strong to sustain or enhance balance sheet strength over the long term. Those companies with an extremely strong balance sheet are given additional consideration while improving their weak profitability.

A company's quantitative results are compared with industry composites as established by A.M. Best. Composite standards are based on the performance of many insurance companies with comparable business mix and organizational structure. In addition, industry composite benchmarks are adjusted from time to time for systemic changes in underwriting, economic and regulatory market conditions to ensure the most effective and appropriate analysis.

For many insurance groups, Best's quantitative evaluation is based on a consolidated approach applied to an insurance group or pool, recognizing the importance of inter-company arrangements that financially link individual insurers by investment, pooling, or reinsurance agreements. Such arrangements are common in the property/casualty industry.

The assignment of Best's Public Data Ratings ("pd" subscript) also incorporates analysis of balance sheet strength, operating performance and business profile. However, the analysis does not generally involve interaction with company management.

In some instances, Best's Financial Strength Ratings are assigned to newly formed companies or companies that do not meet our minimum size requirements, that maintain strategic affiliations with other rated companies, or have demonstrated long histories of relatively stable operating performance. Best's Ratings are also assigned to companies that have achieved or will likely achieve significant market share or acquired seasoned books of business. In general, Best's Financial Strength Ratings may be assigned to new companies with experienced management and credible business plans. In all cases, these companies comply with Best's request for supplemental information and/or meetings with management.

Over the years, regulatory and tax issues, in addition to market dislocations, have resulted in a wave of newly created insurance and reinsurance companies. A.M. Best has actively responded to the growing market demand by agents, brokers, lenders, capital markets participants and corporate clients for information on newly formed insurance and reinsurance entities. The start-ups rated by A.M. Best are subject to the same assessment of balance sheet strength and business profile as established companies receiving an interactive rating assignment. However, because these new entities have yet to demonstrate a track record in operating performance, Best also applies a stringent set of qualitative standards upon which initial ratings may be issued.

Some of the more specific considerations utilized by A.M. Best in assigning ratings to start-up insurers / reinsurers are broken down into four critical areas: management, sponsorship, strategy, and capitalization. However, in addition to these factors, certain conditions must be present, transcending all other rating considerations for Best to proceed with an initial rating assignment.

- Initial financing either must be in place or must be expected to be executed concurrent to the initial rating assignment.
- Appropriate management, staff and operational infrastructure must be available to support initial activities.
- A formal plan to follow-up on the execution of the initial business plan, along with a formal process to monitor the company's strategic and financial development, must be agreed to by A.M. Best and company management.

## Parent / Subsidiary Relationships

The implicit or explicit support of a parent or affiliate can affect an insurer's financial strength and therefore its Best's Rating. The assessment of support involves a top-down, bottom-up analysis of the parent organization and each subsidiary. This analysis enables A.M. Best to classify a company in one of three categories from which its stand-alone rating will receive: full rating uplift, partial rating uplift or no rating uplift.

- Subsidiaries that receive full rating uplift and the rating of their parent or that of the company with which they maintain the greatest degree of affiliation, are viewed as integral to the group's strategy and critical to its ongoing success and viability. These subsidiaries are fully integrated into the group's operations, usually carry the group name and are well established in their particular markets. Additionally, the operating performance and stand-alone capitalization of the subsidiary is comparable to that of its parent and has historically contributed to the financial strength of the parent.
- Subsidiaries that receive partial rating uplift share many of the same characteristics as a subsidiary receiving full rating uplift, but differ in their degree of affinity. Such subsidiaries do not receive the parent's/affiliates rating, however, their stand-alone ratings usually benefits from their group affiliations.
- Subsidiaries receiving no rating uplift are usually viewed as being opportunistic in nature. These subsidiaries carry a rating based on an evaluation of their stand-alone financial strength and receive no benefit of potential support from the group as they are incidental to the group's overall strategy and

are insignificant contributors to the group's operating performance.

# SECTION VII

## BALANCE SHEET STRENGTH

In determining a company's ability to meet its current and ongoing obligations to policyholders, the most important area to evaluate is its balance sheet strength. An analysis of a company's **underwriting, financial, operating** and **asset leverage** is very important in assessing its overall balance sheet strength.

Balance sheet strength measures the exposure of a company's surplus to its operating and financial practices. A highly leveraged, or poorly capitalized company can show a high return on surplus, but may be exposed to a high risk of instability. A conservative level of leverage or capitalization enables an insurer to better withstand catastrophes, unexpected losses and adverse changes in underwriting results, fluctuating investment returns or investment losses, and changes in regulatory or economic conditions.

**Underwriting leverage** is generated from four sources: current premium writings, annuity deposits, reinsurance and loss or policy reserves. A.M. Best reviews these forms of leverage to analyze changes in trends and magnitudes. To measure a company's exposure to pricing errors in its book of business, we review the ratio of gross and net premiums written to capital. To measure the company's credit exposure and dependence on reinsurance, we review the credit quality of a company's reinsurers and ratio of reinsurance premiums and reserves ceded and related reinsurance recoverables to surplus. To measure the company's exposure to unpaid obligations, unearned premiums and exposure to reserving errors, we analyze the ratio of net liabilities to surplus.

In order to assess whether or not a company's underwriting leverage is prudent, a number of factors unique to the company are taken into consideration. These factors include: type of business written, spread of risk, quality and appropriateness of its reinsurance program, quality and diversification of assets, and adequacy of loss reserves.

A.M. Best reviews a company's **financial leverage** in conjunction with its underwriting leverage in forming an overall opinion of a company's balance sheet strength. Financial leverage through debt, or debt-like instruments (including financial reinsurance) may place a call on an insurers earnings and strain its cash flow. Similar to underwriting leverage, excessive financial leverage at the operating or holding company can lead to financial instability. As such, the analysis is conducted both at the operating company and holding company levels, if applicable.

To supplement its assessment of financial leverage, A.M. Best also reviews a company's **operating leverage**. A.M. Best broadly defines operating leverage as debt (or debt-like instruments) used to fund a specific pool of matched assets. Cash flows from the pool of assets are expected to be sufficient to fund the interest and principal payments associated with the obligations, substantially reducing the potential call on insurer's earnings and cash flow. As such, for analytical purposes, generally debt obligations viewed by A.M. Best as operating leverage would be excluded from the calculation of financial leverage.

A.M. Best also evaluates **asset leverage**, which measures the exposure of a company's surplus to investment, interest rate and credit risks. Investment and interest rate risks measure the credit quality and volatility associated with the company's investment portfolio and the potential impact on its balance sheet strength.

A company's underwriting, financial and asset leverage is also subjected to an evaluation by Best's Capital Adequacy Ratio (BCAR) which calculates the Net Required Capital to support the financial risks of the company associated with the exposure of its investments, assets and underwriting to adverse economic and market conditions such as a rise in interest rates, decline in the equity markets and above normal catastrophes. This integrated stress analysis evaluation permits a more discerning view of a company's relative balance sheet strength relative to its operating risks. A company's BCAR result is useful in determining a company's balance sheet strength.

A.M. Best takes a consolidated approach to insurance groups and assigns a common BCAR result to multiple member companies that are linked together through inter-company pooling or reinsurance arrangements.

### CAPITALIZATION TESTS FOR LIFE COMPANIES

• **Change in Net Premiums Written (NPW) and Deposits:** The annual percentage change in net premiums written and deposits. This test is a measure of growth in underwriting commitments.

• **NPW and Deposits to Total Capital:** Net premiums written and deposits related to capital and surplus funds, including AVR. This reflects the leverage, after reinsurance assumed and ceded, of the company's current volume of net business in relation to its capital and surplus. This test measures the company's exposure to pricing errors in its current book of business.

• **Capital & Surplus to Liabilities:** The ratio of capital and surplus (including AVR) to total liabilities (excluding AVR). This test measures the relationship of capital and surplus to the company's unpaid obligations after reinsurance assumed and ceded. It reflects the extent to which the company has leveraged its capital and surplus base. On an individual company basis, this ratio will vary due to differences in product mix, balance sheet quality and spread of insurance risk.

• **Surplus Relief:** The relationship of commissions and expense allowances on reinsurance ceded to capital and surplus funds. The use of surplus relief can be the result of "surplus strain", a term used to describe any insurance transaction wherein the funds collected are not sufficient under statutory accounting guidelines to cover the liabilities established.

• **Reinsurance Leverage:** The relationship of total reserves ceded plus commissions and expenses due on reinsurance ceded plus experience rating and other refunds due from reinsurers, plus amounts recoverable from reinsurers to total capital and surplus.

• **Change in Capital:** The annual percentage change in the sum of current year capital and surplus, plus AVR, plus voluntary investment reserves, over the prior year's sum.

CAPITALIZATION TESTS FOR HEALTH COMPANIES

• **Liabilities to Assets:** The ratio of total liabilities to total assets. This test measures the proportion of liabilities covered by a company's asset base.

• **Net Premiums Written to Capital:** The ratio of premiums to total capital & surplus. This test measures the leverage associated with the level of premiums compared to the total capital & surplus of the company. The higher the number, the more leveraged the company.

• **Debt to Capital & Surplus:** The ratio of a company's total debt to its total capital & surplus. In this ratio, debt is defined as loans and notes payable on both a current and long term basis, as well as surplus notes.

• **Equity PMPM:** The ratio of capital & surplus to member months. This test measures the amount of capital & surplus spread over a company's membership base.

• **Capital & Surplus to Total Assets:** The ratio of total capital & surplus to total assets. This test measures the relationship of a company's asset base to its capital & surplus.

• **Months Reserves:** The ratio of a company's total capital & surplus to monthly average total expenses. This test provides a measure of the duration of a particular company's capital & surplus versus its expense commitments.

• **Best's Capital Adequacy Ratio (BCAR):** The BCAR Ratio compares an insurer's adjusted surplus relative to the required capital necessary to support its operating and investment risks. Companies deemed to have "adequate" balance sheet strength normally generate a BCAR score of over 100% and will usually carry a Secure Best's Rating. Companies deemed to have very strong balance sheet strength generate a BCAR score over 175%. The level of capital required to support a given rating level varies by company, depending on its operating performance and business profile.

Adjusted surplus is reported surplus plus/minus adjustments made to provide a more comparable basis for evaluating balance sheet strength. Such modifications include adjustments related to equity in unearned premiums, loss reserves, and assets. Certain off-balance sheet items are also deducted from reported surplus, such as encumbered capital, debt service requirements, potential catastrophe losses and future operating losses.

Net Required Capital is calculated as the necessary level of capital to support four broad risk categories, including: C1 (Credit Risk); C2 (Underwriting Risk); C3 (Interest Rate Risk); and C4 (Business Risk). Net Required Capital represents the arithmetic sum of capital required to support each of the risk categories reduced by a covariance adjustment. The covariance adjustment reduces a company's total capital requirement by recognizing that risks associated with many of the four categories are independent and do not occur at the same time.

Over two-thirds of a health company's net capital requirement is generated by its C1 (Credit Risk) and C2 (Underwriting Risk). The Underwriting Risk components are influenced by a company's business profile which includes distribution of premium by line and size.

## Capital Structure/Holding Company

Holding companies (if present) and their associated capital structures can have a significant impact on the overall financial strength of an insurance company subsidiary. Holding companies can provide subsidiaries with a level of financial flexibility, including capital infusions, access to capital markets, and in some cases, additional cash flow sources from other operations. Likewise, debt and other securities are typically obligations of a holding company which, depending on the magnitude of these obligations, can reduce the financial flexibility of the enterprise and potentially place a strain on future earnings and inhibit surplus growth at a subsidiary.

A.M. Best reviews both an insurer's capital structure and its holding company's capital structure to determine if it is sound and unencumbered. This review includes an assessment of the quality of capital with a focus on the amount, composition, and amortization schedule of intangible assets as well as the presence of surplus notes at the operating company.

A holding company can have various types of financial instruments, including debt securities, preferred stocks or other hybrid securities in its capital structure. For mutual companies, surplus notes can exist as a component of overall surplus. A.M. Best reviews the relative debt and equity characteristics of a particular capital security in determining overall financial leverage. Our review focuses on specific terms and features of securities, including the coupon and dividend rate, repayment terms and financial and other covenants. Insurance subsidiaries generally fund debt service and other obligations of their holding company through a combination of dividends, tax sharing payments and other expense allocation agreements with their holding company. As such, A.M. Best measures the extent to which an insurance company's earnings or the holding company's cash flow can cover interest and other fixed obligations.

Integral to an insurer's rating assignment is our assessment of a company's ability to meet the debt service and other obligations associated with its parent's capital structure and the risks that a capital structure imposes on a company.

Additionally, Best employs a top-down view of the total organization that includes a review of the non-insurance operations of a holding company, to determine their impact, if any, on the overall financial strength of the insurance operations.

## Quality and Appropriateness of Reinsurance Program

Reinsurance plays an essential role in the risk spreading process and provides insurers with varying degrees of financial stability. As a result, we evaluate a company's reinsurance program to determine its appropriateness and credit quality. A company's reinsurance program should be appropriate relative to its policy limits and underwriting risks, catastrophe exposures, business, financial capacity and credit quality of the reinsurers involved. In addition, a reinsurance program should involve time-risk transfer and include reinsurers of good credit quality, since in the event of a reinsurer's failure to respond to its share of a loss, the reinsured or counterparty would have to absorb a potentially large loss in its entirety.

To be considered adequate for catastrophe protection, a program needs to protect a property/casualty company from impairment or insolvency, from large shock-losses such as a 100-year wind storm, a 250-year earthquake, or its annual aggregate loss exposure. In addition, reinsurance should also provide protection from a series of smaller storm losses that do not trigger recovery from a traditional catastrophe reinsurance program. In addition to spreading risk, reinsurance can be utilized to leverage a company's surplus to enable it to write more business than would otherwise be possible.

For life/health companies, a reliable reinsurance program must consider sound risk management practices to provide the company with protection against adverse fluctuations in experience. Since these risk transfer agreements on an underlying policy or policies indemnify the company for insurance risks, prudent evaluation of the economic impact on a company's life, health, and annuity operations is critical. Incorporating reinsurance to manage a company's financial risk that includes mortality, morbidity, lapse or surrender, expense, and investment performance presents a competitive risk to a counterparty's future growth prospects and long-term viability. Therefore, the range of reinsurance business must be evaluated with the company's ability to manage its growth relative to demands for life and health insurance coverages under existing economic and regulatory environments.

An insurer's ability to meet its financial obligations can become overly dependent upon the performance of its reinsurers. A company can also become exposed to the state of reinsurance markets in general. A significant dependency on reinsurance can become problematic if a major reinsurer of the company becomes insolvent or disputes coverage for claims. It also can become a problem if general reinsurance rates, capacity, terms and conditions change dramatically following an industry event. The more a company is dependent upon reinsurance, the more vulnerable its underwriting capacity becomes to adverse changes in the reinsurance market. The greater this dependency, the greater our scrutiny of a company's reinsurance program to determine its appropriateness and credit quality and whether it is temporary or permanent in nature.

## Adequacy of Loss/Policy Reserves

An evaluation of the adequacy of an insurer's reported reserves is essential to an evaluation of its profitability, leverage (capitalization) and liquidity. Net income and policyholders' surplus are directly affected by changes in reported reserves. While we do not audit a company's reserves, we rely on the reserve adequacy opinions of certified actuaries (internal and third-party) to supplement our review.

For life/health companies, we review the valuation methodology, interest assumptions and degree of conservation in the establishment of life, health and annuity reserves. We also evaluate the degree of uncertainty in policy reserves, recognizing that they are only actuarial estimates of future events. If the degree of uncertainty exceeds any equity in the reserves, and is large in relation to net income and policyholders' surplus, our confidence declines in a company's reported profitability, liquidity, and leverage (capitalization).

## Quality and Diversification of Assets

The quality and diversification of assets contributes to a company's financial stability. Invested assets (principally bonds, common stocks, mortgages and real estate) are evaluated to assess the risk of default and the potential impact on surplus if the sale of these assets occurred unexpectedly. The better the liquidity, diversification and/or quality of the assets, the less uncertainty there is in the value to be realized upon their sale and the lesser the likelihood of default. Therefore, a review of a company's invested assets is performed to identify a lack of diversification among industries or geographic regions, with particular attention paid to large single investments that exceed 10% of a company's total capital. Companies that hold liquid, undiversified and/or speculative assets and have a significant underwriting exposure to volatile lines of business that are vulnerable to unfavorable changes in underwriting and/or economic conditions can jeopardize policyholders' surplus.

## Liquidity

Liquidity measures a company's ability to meet its anticipated short- and long-term obligations to policyholders and other creditors. A company's liquidity depends upon the degree to which it can satisfy its financial obligations by holding cash and investments that are sound, diversified and liquid or through operating cash flow. A high degree of liquidity enables an insurer to meet unexpected needs for cash without the untimely sale of investments or fixed assets, which may result in substantial realized losses due to temporary market conditions and/or tax consequences.

To measure a company's ability to satisfy its financial obligations without having to resort to selling long-term investments or affiliated assets, we review a company's quick liquidity, which measures the amount of cash and quickly convertible investments that have a low exposure to fluctuations in market value. We also review current liquidity to measure the proportion of a company's total liabilities that are covered by cash and unaffiliated invested assets. Operational and net cash flows are reviewed since they, by themselves, can meet some liquidity needs provided cash flows are positive, large and stable relative to cash requirements. Finally, we evaluate the quality, market value and diversification of assets, particularly the exposure of large single investments relative to capital.

In order to measure a life insurer's potential vulnerability to all surrenderable liabilities, it is necessary to review the impact of asset and liability maturations under normal and stressed cycles in the event of a crisis of confidence. A loss of confidence in the financial strength of an insurer on the part of distributors or policyholders, which can lead to a "run on the bank", can be triggered by adverse changes in the company's financial strength, the economy, the financial markets and/or a company's media profile.

The immediate liquidity analysis begins with an assessment of a life insurer's liability structure and the withdrawal characteristics of its policies and contracts. Companies that maintain a significant concentration of immediately surrenderable liabilities, which may be subject to unexpected calls on their assets, require greater levels of short-term liquidity. As a result, an evaluation is made to determine how vulnerable a company is to a potential "run" and its ability to satisfy its obligations to policyholders in the event a "run" is triggered. Included in our review is the size of the contracts issued, applicable surrender charges or market value adjustments, withdrawal restrictions, the types of distribution systems utilized, financial incentives which may exist for the replacement of policies, the level of highly liquid assets maintained, the strength and trends of cash flows and individual company's media profiles.

A.M. Best's review of liquidity for U.S. life companies has been enhanced with the introduction of A.M. Best's Liquidity Model for U.S. Life Insurers. Using statutory data, the model quantitatively measures a company's short-term (30 days) and longer-term (six to twelve months) cash needs positions under stressed scenarios. The model allows for conservative, standardized comparisons to be calculated and determines whether a company's calculated liquidity is within the range of its peers relative to its size, type of business and A.M. Best rating. A.M. Best's initial analysis has focused on companies with a preponderance of interest sensitive liabilities.

### KEY LIQUIDITY TESTS FOR LIFE COMPANIES

• **Quick Liquidity:** The ratio of unaffiliated quick assets to liabilities. Quick assets include cash and short-term investments and a percentage of unaffiliated common stocks and unaffiliated public investment grade bonds. This test measures the proportion of liabilities (excluding AVR, conditional reserves and separate accounts) covered by cash and quickly convertible investments. It indicates a company's ability to meet its maturing obligations without requiring the sale of long-term investments or the borrowing of money.

• **Current Liquidity:** The ratio of unaffiliated invested assets, excluding mortgages and real estate, to liabilities. This test measures the proportion of liabilities (excluding AVR, conditional reserves and separate account liabilities) covered by cash and unaffiliated holdings, excluding mortgages and real estate.

• **Non-Investment Grade Bonds to Capital:** The sum of NAIC Classes three, four, five, and six bonds as a percentage of capital and surplus funds (including AVR). Please note that although Class three bonds are considered below investment grade, the NAIC has assigned these securities a description of "medium quality".

• **Delinquent & Foreclosed Mortgages to Capital:** The sum of long-term mortgages upon which interest is overdue more than three months, in process of foreclosure and foreclosed real estate as a percentage of capital and surplus funds (including AVR).

• **Mortgages & Credit Tenant Loans & Real Estate to Capital:** Mortgage loans and credit tenant loans and real estate (home office property, property held for income and property held for sale) as a percentage of capital and surplus funds (including AVR).

• **Affiliated Investments to Capital:** Affiliated investments (including home office property) as a percentage of capital and surplus funds (including AVR).

KEY LIQUIDITY TESTS FOR HEALTH COMPANIES

• **Current Liquidity:** The ratio of total current assets to total liabilities. The ratio shows a company's ability to pay its current obligations from short-term assets. This test measures the proportion of liabilities covered by cash, short-term investments and other short-term assets.

• **Overall Liquidity:** This ratio measures the proportion of total liabilities covered by a company's total assets, to reflect a company's ability to meet its maturing obligations.

• **Premium Receivable Turnover:** The ratio of premium receivables to commercial revenue. This ratio is expressed in months and measures the liquidity level of a company's total premium and fee for service revenue in light of its premium receivables for a specific period.

• **Cash and Assets to Claims & Payables:** The ratio of total cash, short-term investments and long-term investments to the sum of accounts payable and claims payable.

• **Claims to Net Premium Earned:** The ratio of total claims payable to net premiums earned.

• **Health Average Claims Payment Period (days):** The ratio of claims payable to total health expenses per year in days (365).

• **Total Health IBNR Pay Period (days):** The ratio of total incurred but not reported claims divided by total health expenses in days (365).

# SECTION VIII

## OPERATING PERFORMANCE

### Profitability

Profitable insurance operations are essential for a company to operate as an ongoing concern. For an insurer to remain viable in the marketplace, it must perpetuate a financially strong balance sheet for its policyholders. When evaluating operating performance, Best's analysis centers on the stability and sustainability of the company's sources of earnings in relation to the liabilities that are retained by the company. Since long-term balance sheet strength is generally driven by operating performance, greater importance is placed on operating performance when evaluating insurers writing long-duration business. Conversely, operating performance is weighted less heavily for those insurers writing predominantly short-duration business that also possess very strong capitalization and a stable business profile. A.M. Best reviews the components of a company's statutory earnings over the past five year period to make an evaluation of the sources of profits and the degree and trend of various profitability measures. Areas reviewed include underwriting, investments, capital gains/losses and total operating earnings, both before and after taxes. Profitability measures are easily distorted by operational changes; therefore, we review the mix and trends of premium volume, investment income, net income and surplus. Also important to evaluating profitability is the structure of the company (stock vs. mutual), the length and nature of its insurance liability risks and how these elements relate to the company's operating mission. The degree of volatility in a company's earnings and the impact that this could have on capitalization and balance sheet strength is of particular interest to A.M. Best.

To supplement our review of statutory profitability, A.M. Best analyzes the company's earnings on a GAAP basis, IAS basis, and any other regulatory or accounting reporting in order to understand the company's forms and measurements of profitability. This review generally extends beyond the scope of publicly traded companies, since an increasing number of non-public insurers also prepare, monitor and/or manage to GAAP, IAS or other forms of accounting reporting. Best recognizes that a proper assessment of an insurer's current and prospective profitability may involve a review of multiple accounting forms and results.

KEY PROFITABILITY TESTS FOR LIFE COMPANIES

• **Benefits Paid to NPW and Deposits:** Total benefits paid as a percentage of net premiums written and deposits. Benefits paid include death benefits, matured endowments, annuity benefits, accident and health benefits, disability and surrender benefits, group conversions, coupons and payments on supplementary contracts, interest on policy or contract funds and other miscellaneous benefits.

• **Commissions and Expenses to NPW and Deposits:** Commissions and expenses incurred as a percentage of net premiums written and deposits. Commissions and expenses include payments on both direct and assumed business, general insurance expenses, insurance taxes, licenses and fees, increase in loading and other miscellaneous expenses, and exclude commissions and expense allowances received on reinsurance ceded.

• **NOG to Total Assets:** Net operating gain (after taxes) as a percentage of the mean of current and prior year admitted assets. This test measures insurance earnings in relation to the company's total asset base.

• **NOG to Total Revenue:** Net operating gain (after taxes) as a percentage of total revenues. This test measures insurance earnings in relation to total funds provided from operations.

• **Operating Return on Equity:** Net operating gain (after taxes) as a percentage of the mean of current and prior year capital and surplus. This test measures insurance earnings in relation to the company's policyholders surplus base.

• **Net Yield:** Net investment income expressed as a percent of mean cash and invested assets plus accrued investment income minus borrowed money. This test does not reflect realized and unrealized capital gains or income taxes.

• **Total Return:** The net yield plus realized and unrealized capital gains and losses, minus transfers to IMR, plus amortization of IMR.

KEY PROFITABILITY TESTS FOR HEALTH COMPANIES

• **Benefits Paid to Net Premiums Written & Fee for Service:** Total medical and hospital or dental expenses as a percent of net premiums written and fee for service. Also included with net premiums written and fee for service are risk revenues and changes in unearned premium reserves.

• **Commissions and Expenses to Net Premiums Written & Fee for Service:** Total claims adjustment expense and general administrative expenses as a percentage of net premiums written and fee for service. Also included with net premiums written and fee for service are risk revenues and changes in unearned premium reserves.

• **NOG to Total Assets:** Net income excluding net realized capital gains (losses) as a percent of the average between prior year and current year assets. This test measures post-tax insurance earnings in relation to the mean of the company's current and prior year total admitted assets.

• **NOG to Revenue:** Net income excluding net realized capital gains (losses) as a percent of total revenue. This ratio measures post-tax earnings in relationship to total funds provided from operations.

• **Operating Return on Equity:** Net income excluding net realized capital gains (losses) as a percent of the average between prior year and current year capital and surplus. This test measures earnings in relation to the company's total capital and contingency reserve base.

• **Net Yield:** Net investment income as a percentage of the average between prior year and current year invested assets and accrued investment income less borrowed money. It does not reflect the impact of realized and unrealized capital gains or income taxes.

• **Total Return:** The net yield plus realized and unrealized capital gains and losses.

# SECTION IX

## BUSINESS PROFILE

**Business Profile Issues**

Business Profile can be an important component of Best's rating evaluation. The factors that comprise an insurer's business profile drive current and future operating performance and, in turn, can impact long-term financial strength and the company's ability to meet its obligations to policyholders.

Business Profile is influenced by the degree of risk inherent in the company's mix of business, an insurer's competitive market position and the depth and experience of its management. Lack of size or growth are not considered negative rating factors unless A.M. Best believes these issues have a negative influence on the company's prospective operating performance and balance sheet strength.

A.M. Best places greater emphasis on business profile issues for insurers writing long-duration business, such as life, retirement savings, casualty lines, and reinsurance where long-term financial strength is critical. Conversely, less business profile emphasis is placed on auto and property writers, as well as indemnity health insurers writing shorter duration contracts where short-to medium-term financial strength is of greater importance.

In addition, business profile issues increase in their importance at Best's highest rating levels. At the "Superior" level, insurers are expected to have strong balance sheets and adequate operating performance, and exhibit stable operating trends. What differentiates these companies is the strength of their business profile, which typically translates into defensible competitive advantages. This rating approach is consistent with the requirements of today's marketplace, which is concerned with an insurer's financial strength and market viability.

**Key Business Profile Issues**

• **Spread of Risk:** A company's book of business must be analyzed by line in terms of its geographic, product and distribution diversification. However, the size of a company, measured solely by its premium volume, cannot be used to judge its spread of risk.

Generally, large companies have a natural spread of risk. Similarly, a small company, which is conservatively managed, writes conservative lines of business and avoids a concentration of risk, can attain the same degree of stability in its book of business as that experienced by a large company, with the exception of regulatory or residual market risks.

For life/health companies, the mix of business must be evaluated with respect to the distribution and performance of the underlying assets, as well as a company's susceptibility to economic business cycles or regulatory pressures, such as minimum loss ratios, market conduct regulation or financial services and health care reform initiatives.

The geographic location and lines of business written by a company also determine its exposure or vulnerability to regulatory or residual market risks that exist within certain jurisdictions. In addition, the mix of business must also be carefully evaluated. Because the underwriting experience between lines of business varies dramatically, the underwriting risk profile of a company must be determined since high risk lines with volatile loss experience can impact the financial stability of an insurer, particularly one that is poorly capitalized and/or has poor liquidity.

• **Revenue Composition:** A by-line analysis of net premium volume is important to determine changes in the amount, type, geographic distribution, diversification and volatility of business written by a company, which can either have a beneficial or adverse effect on its prospective profitability. Underwriting income, investment income, capital gains, asset values and, consequently, surplus can be significantly affected by external changes in economic, regulatory, legal and financial market environments, as well as by natural and man-made catastrophes.

• **Competitive Market Position:** Analysis of an insurer's operating strategy and competitive advantages by line is essential to assess a company's ability to respond to competitive market challenges, economic volatility and regulatory change in relation to its book of business. Defensible and sustainable competitive advantages include; control over distribution, multiple distribution channels, a low-cost structure, effective utilization and leveraging of technology, superior service, strong franchise recognition, a captive market of insureds, easy and inexpensive access to capital, and underwriting expertise within the book of business.

• **Management:** The experience and depth of management are important determinants for achieving success. Because the insurance business is based on an underlying foundation of trust and fiscal responsibility, prudent management plays a more vital role than in most other industries.

Competitive pressures within virtually every insurance market segment have amplified the importance of management's ability to develop and execute defensible strategic plans. Best's understanding of the operating objectives of a company's management team play an important role in its qualitative evaluation of the current and future operating performance of a company. This is particularly true when a company is undergoing a restructuring to address operational issues, balance sheet problems or is actively raising capital.

• **Insurance Market Risk:** Insurance market risk reflects the potential financial volatility that is introduced by, and associated with, the segment(s) of the insurance industry and/or the financial services sphere within which an organization operates. Such risks may also be considered systematic risks and are generally common to all market participants (i.e., financial services reform, healthcare reform, expansion of alternative markets, and integration of healthcare providers). Insurance market risk can be biased either positively or negatively by a number of company-specific business factors.

• **Event Risk:** Event risk can encompass a variety of sudden or unexpected circumstances that may arise and can potentially impact an insurer's financial strength and its Best's Rating. When a sudden or unexpected event occurs, we evaluate the financial and market impact to the insurer. For example, the potential exists for major business and distribution disruption associated with significant litigation, the potential for a "run-on-the-bank" due to a loss of policyholder/distributor confidence, economic collapse or the enactment of significant legislation. In addition, constraints imposed by regulators in the form of mandated rate rollbacks, extraordinary assessments, and mandatory market lock-in arrangements in catastrophe-prone areas can adversely affect a company. Event risk may include changes in management, ownership, parental commitment, distribution, a legal ruling or regulatory development. Finally, event risks can also be influenced by potential regulatory or legislative reforms, economic conditions, interest rate levels, and financial market performance, as well as societal changes. For international companies, and domestic insurers operating abroad, political climates and sovereignty risks may also have a significant bearing on event risk.

# SECTION X

## AFFILIATION CODES AND RATING MODIFIERS

Affiliation Codes and Rating Modifiers are added to Best's Financial Strength Ratings to identify companies whose assigned rating is based on a Group (g), Pooling (p), or Reinsurance (r) affiliation with other insurers. In addition, a company's rating may be placed Under Review and be subject to a near-term change, as indicated by the "u" rating modifier. A Best's Financial Strength Rating may carry a "pd" rating modifier, indicating that the company did not subscribe to our interactive rating process. The "s" rating modifier is assigned to syndicates operating at Lloyds that have subscribed to our interactive rating process. These affiliation codes or modifiers appear as a lower-case suffix to the rating (i.e., A g, A u, A pd, etc.).

Insurers with affiliation codes (g, p, r) indicate that their rating is based on the consolidated performance of the company and its affiliation with one or more insurers, which collectively operate, in Best's opinion, as one coordinated insurance group and meets our criteria for the same rating.

Accordingly, the Financial Size Category (see Section XII) of these member companies usually equals that of the group.

**Affiliation Codes:**

**"g" Group Rating:** Assigned to the parent company of a group and is based on the consolidation of the parent company and its insurance subsidiaries where ownership or board control exceeds 50%.

The group rating is also assigned to certain subsidiaries based on the consolidation of the subsidiary and the parent. To qualify for full rating uplift, a subsidiary must be deemed integral to the group's business strategy, generally operates under common management and/or ownership, and serves as a strategic marketing or distribution arm of its parent. A stand-alone analysis is conducted on all insurance subsidiaries and comparable stand-alone operating performance and capitalization is expected to qualify for full rating uplift. In certain cases, group ratings are also assigned to sister companies owned by a common holding company.

**"p" Pooled Rating:** Assigned to members of an intercompany pool that effectively pool all their net business. The pooled rating is based on the consolidation of pool members and their subsidiaries. To qualify, a pool member must operate under common management and/or ownership (or substantial board control for mutual insurers) serve as a strategic affiliate to the group, and prorate all current and prior premiums, expenses and losses among the pool members in accordance with specified percentages that are comparable to the distribution of the policyholders' surplus of each member of the group. Other important features to the contract are the notice of termination and the treatment of run-off liabilities after termination.

Typically, all pool members are assigned the same rating and Financial Size Category, based on their consolidation. NOTE: Some of these pooling arrangements do not include joint and several liability clauses between the company members, but other clauses may be included to help to protect the rights to collect from other pool members.

**"r" Reinsured Rating:** Assigned to a company within a group that reinsures substantially all direct premiums written with an affiliated reinsurer. The rating is based on the consolidation of the company's reinsurer and its subsidiaries. To qualify, a company must operate under common management and/or ownership as its reinsurer. Other important features to the contract are the coverage of prior liabilities, notice of termination and the treatment of run-off liabilities after termination. Typically, reinsured affiliates are assigned the same rating and Financial Size Category as their reinsurer.

**Rating Modifiers:**

**"u" Under Review:** Assigned to companies whose rating is currently under review due to a recent event or abrupt change in its financial condition, which may have positive, developing, or negative rating implications. A rating placed under review with positive implications indicates that, based on information currently available, the rating will either be affirmed or upgraded once A.M. Best completes its assessment and removes the under review modifier. Conversely a rating placed under review with negative implications indicates that, based on information currently available, the rating will either be affirmed or downgraded once A.M. Best completes its assessment and removes the under review modifier. A rating placed under review with developing implications indicates that, based on information currently available, it is unclear how the recent event or abrupt change in financial condition will impact the rating.

A company's rating remains under review until A.M. Best is able to fully review the rating implications of the event before affirming, upgrading or downgrading the rating. Generally, a company's rating is placed Under Review for less than six months.

**"pd" Public Data Rating:** Assigned to Canadian, UK and other European insurers, and HMOs and health insurers (United States) that do not subscribe to our interactive rating process. Best's Public Data Ratings reflect both qualitative and quantitative analysis using publicly available data and other public information. Public Data Ratings will be assigned where in Best's view ratings are needed due to market demand. To maintain analytical integrity Public Data Ratings may be assigned to affiliated companies that do not voluntarily subscribe to a full interactive rating process.

**"s" Syndicate Rating:** Assigned to syndicates operating at Lloyds that meet our minimum size and operating experience requirements for a Best's Rating and subscribe to our interactive rating process.

RATING MODIFIER/AFFILIATION CODE DISTRIBUTION

Of the 1,160 individual total ratings assigned in Best's 2007 life/health publications, 626 or 54% were also assigned a Rating Modifier or Affiliation Code. Their distribution follows.

| RATING MODIFIER/ AFFILIATION CODE | NUMBER OF COMPANIES |
|---|---|
| g - Group | 470 |
| p - Pooled | 0 |
| r - Reinsured | 3 |
| pd- Public Data | 151 |
| s - Syndicate | 0 |
| u - Under Review | 10 |
| **Subtotal** | **634** |
| Dual Assignment | (8) |
| **Total Modifier/ Affiliation Code Ratings** | **626** |

# SECTION XI

## "NOT RATED" (NR) CATEGORIES

The current universe of rated life/health companies account for roughly 95% of the premium volume in the United States. However, A.M. Best also reports on 800 life/health companies that are not assigned a rating opinion. Because of their small size, Non-Rated (NR) insurers constitute only 5% of the industry's premium writings.

For (NR) companies, a condition exists that makes it difficult for A.M. Best to develop an opinion on the company's balance sheet strength and operating performance. Generally, these companies do not qualify for a Best's Rating because of their limited financial information, small level of surplus, lack of sufficient operating experience, or due to their dormant or run-off status.

Unrated companies are assigned to one of five "NR" categories.

**NR-1 (Insufficient Data)**
Assigned predominately to small companies for which A.M. Best does not have sufficient financial information required to assign rating opinions. The information contained in these limited reports is obtained from several sources, which include the individual companies, the National Association of Insurance Commissioners (NAIC) and other data providers. Data received from the NAIC, in some cases, is prior to the completion of its cross-checking and validation process.

**NR-2 (Insufficient Size and/or Operating Experience)**
Assigned to companies that do not meet A.M. Best's minimum size and/or operating experience requirements. To be eligible for a letter rating, a company must generally have a minimum of $2 million in policyholders' surplus to assure reasonable financial stability and have sufficient operating experience to adequately evaluate its financial performance, usually two to five years. General exceptions to these requirements include: companies that have financial or strategic affiliations with Best rated companies; companies that have demonstrated long histories of financial performance; companies that have achieved significant market positions; and newly formed companies with experienced management that have acquired seasoned books of business and/or developed credible business plans.

**NR-3 (Rating Procedure Inapplicable)**
Assigned to companies that are not rated by A.M. Best, because our normal rating procedures do not apply due to a company's unique or unusual business features. This category includes: companies that are in run-off with no active business writings, are effectively dormant, or underwrite financial or mortgage guaranty insurance. Exceptions to the assignment of the NR-3 designation include run-off companies that commenced run-off plans in the current year or inactive companies that have been structurally separated from active affiliates within group structures that pose potential credit, legal or market risks to the group's active companies.

**NR-4 (Company Request)**
Assigned to companies that are assigned a Best's Rating following a review of their financial performance, but request that the assigned letter rating not be published on their company. The NR-4 is assigned following the publication of a final letter rating opinion.

**NR-5 (Not Formally Followed)**
Assigned to insurers that are not formally evaluated for the purposes of assigning a rating opinion. It is also assigned retroactively to the rating history of traditional U.S. insurers when they provide prior year(s) financial information to A.M. Best and receive a Best's Rating or another NR designation in more recent years. Finally, it is assigned currently to those companies that historically had been rated, but no longer provide financial information to A.M. Best because they have been liquidated, dissolved, or merged out of existence.

# SECTION XII

## FINANCIAL SIZE CATEGORIES (FSC)

A.M. Best assigns a Financial Size Category (FSC) to each letter rated company. The FSC is designed to provide the subscriber with a convenient indicator of the size of a company in terms of its most recent cross-checked submission of year-end, first, second or third quarter statutory surplus and related accounts. Many insurance buyers consider buying insurance coverage from companies that they believe have the sufficient financial capacity to provide the necessary policy limits to insure their risks.

Best's Financial Size Category is based on reported policyholders' surplus plus conditional or technical reserve funds, such as the asset valuation reserve (AVR), other investment and operating contingency funds and miscellaneous voluntary reserves reported as liabilities in U.S. dollars.

The FSC is represented by Roman numerals ranging from Class I (the smallest) to Class XV (the largest). The distribution by FSC based upon individual companies is shown below.

## 2007 FINANCIAL SIZE CATEGORY (FSC) BY INDIVIDUAL COMPANIES

| Financial Size Category | Adjusted Policyholders' Surplus ($ Millions) | Number of Companies | Distribution Percentage | Distribution Cumulative |
|---|---|---|---|---|
| Class I | Less than 1 | 2 | 0.2 % | 0.2 % |
| Class II | 1 to 2 | 3 | 0.3 | 0.5 |
| Class III | 2 to 5 | 54 | 4.7 | 5.2 |
| Class IV | 5 to 10 | 90 | 7.8 | 13.0 |
| Class V | 10 to 25 | 166 | 14.4 | 27.4 |
| Class VI | 25 to 50 | 148 | 12.8 | 40.2 |
| Class VII | 50 to 100 | 119 | 10.3 | 50.5 |
| Class VIII | 100 to 250 | 144 | 12.5 | 63.0 |
| Class IX | 250 to 500 | 92 | 8.0 | 71.0 |
| Class X | 500 to 750 | 59 | 5.1 | 76.1 |
| Class XI | 750 to 1,000 | 36 | 3.1 | 79.2 |
| Class XII | 1,000 to 1,250 | 30 | 2.6 | 81.8 |
| Class XIII | 1,250 to 1,500 | 18 | 1.5 | 83.3 |
| Class XIV | 1,500 to 2,000 | 27 | 2.3 | 85.6 |
| Class XV | 2,000 or greater | 166 | 14.4 | 100.0 % |
| | Subtotal | 1,154 | | |
| E & F Rated Companies | | 6 | | |
| | Grand Total | 1,160 | | |

# SECTION XIII

## RATING DISTRIBUTIONS

The following section provides the distribution of Best's Financial Strength Ratings on both an individual company and rating unit basis as of July 17, 2007. In addition, this section provides the distribution of companies assigned to Not Rated (NR) Categories.

The term "rating unit" applies to either individual insurers or a consolidation of member companies. The rating unit forms the financial basis on which A.M. Best performs its rating evaluation. The financial results of rating units more accurately represent the way insurance groups operate and manage their businesses. Therefore, the rating distribution based on a Rating Unit basis is the more appropriate rating distribution to gauge A.M. Best's overall opinion of the financial health of the universe of insurance companies we rate.

## 2007 LIFE/HEALTH RATING DISTRIBUTION* BY INDIVIDUAL COMPANIES

| Best's Level | Rating Category | Number | Percent |
|---|---|---|---|
| | **Secure Ratings** | | |
| A++ | Superior | 56 | 4.8% |
| A+ | Superior | 152 | 13.1 |
| | **Subtotal** | **208** | **17.9** |
| A | Excellent | 224 | 19.3 |
| A- | Excellent | 279 | 24.0 |
| | **Subtotal** | **503** | **43.3** |
| B++ | Good | 144 | 12.4 |
| B+ | Good | 125 | 10.8 |
| | **Subtotal** | **269** | **23.2** |
| | **Total Secure Ratings** | **980** | **84.4%** |
| | **Vulnerable Ratings** | | |
| B | Fair | 49 | 4.2% |
| B- | Fair | 40 | 3.5 |
| | **Subtotal** | **89** | **7.7** |
| C++ | Marginal | 39 | 3.4 |
| C+ | Marginal | 28 | 2.4 |
| | **Subtotal** | **67** | **5.8** |
| C | Weak | 9 | 0.8 |
| C- | Weak | 7 | 0.6 |
| | **Subtotal** | **16** | **1.4** |
| D | Poor | 2 | 0.2 |
| E | Under Regulatory Supervision | 6 | 0.5 |
| F | In Liquidation | 0 | 0.0 |
| | **Subtotal** | **8** | **0.7** |
| | **Total Vulnerable Ratings** | **180** | **15.6%** |
| | **Total-Rating Opinions** | **1,160** | **100.0%** |
| | **No Rating Opinions** | | |
| NR-1 | Insufficient Data | 182 | 22.8% |
| NR-2 | Insufficient Size/ Operating Experience | 106 | 13.2 |
| NR-3 | Rating Procedure Inapplicable | 103 | 12.9 |
| NR-4 | Company Request | 7 | 0.9 |
| NR-5 | Not Formally Followed | 402 | 50.2 |
| | **Total-No Rating Opinions** | **800** | **100.0%** |
| | **Total Reported Companies** | **1,960** | |

*As of July 17, 2007

**2007 LIFE/HEALTH RATING DISTRIBUTION***
**BY RATING UNITS**

| Best's Level | Rating Category | Number | Percent |
|---|---|---|---|
| | **Secure Ratings** | | |
| A++ | Superior | 14 | 1.7% |
| A+ | Superior | 50 | 6.0 |
| | **Subtotal** | **64** | **7.7** |
| A | Excellent | 145 | 17.6 |
| A- | Excellent | 223 | 27.0 |
| | **Subtotal** | **368** | **44.6** |
| B++ | Good | 111 | 13.4 |
| B+ | Good | 112 | 13.6 |
| | **Subtotal** | **223** | **27.0** |
| | **Total Secure Ratings** | **655** | **79.3%** |
| | **Vulnerable Ratings** | | |
| B | Fair | 44 | 5.3% |
| B- | Fair | 39 | 4.7 |
| | **Subtotal** | **83** | **10.0** |
| C++ | Marginal | 37 | 4.5 |
| C+ | Marginal | 28 | 3.4 |
| | **Subtotal** | **65** | **7.9** |
| C | Weak | 9 | 1.1 |
| C- | Weak | 7 | 0.9 |
| | **Subtotal** | **16** | **2.0** |
| D | Poor | 1 | 0.1 |
| E | Under Regulatory Supervision | 6 | 0.7 |
| F | In Liquidation | 0 | 0.0 |
| | **Subtotal** | **7** | **0.8** |
| | **Total Vulnerable Ratings** | **171** | **20.7%** |
| | **Total-Rating Opinions** | **826** | **100.0%** |
| | **No Rating Opinions** | | |
| NR-1 | Insufficient Data | 182 | 22.8% |
| NR-2 | Insufficient Size/ Operating Experience | 106 | 13.2 |
| NR-3 | Rating Procedure Inapplicable | 103 | 12.9 |
| NR-4 | Company Request | 7 | 0.9 |
| NR-5 | Not Formally Followed | 402 | 50.2 |
| | **Total-No Rating Opinions** | **800** | **100.0%** |
| | **Total Reported Companies** | **1,626** | |

*As of July 17, 2007

# SECTION XIV

## DEFINITIONS

### ORGANIZATION TYPES

Insurance transactions are conducted primarily through four types of organizations—stock companies, mutual companies, fraternal societies and non-profit organizations. A brief description of the legal structure and function of each is as follows:

- **Stock Companies:** Stock companies are corporations, the financial ownership of which is comprised of capital stock which is divided into shares. Ultimate control of stock insurance companies is vested in the shareholders.

- **Mutual Companies:** Mutual companies are corporations without capital stock. Ultimate control of mutual insurance companies is vested in the policyholders.

- **Fraternal Societies:** Fraternal life insurance societies are purely mutual organizations and the major fraternal societies furnish life insurance benefits to their members on a basis essentially the same as that utilized by legal reserve life insurance companies. The fraternal life insurance society is characterized by its lodge system, a representative form of government and its fraternal or benevolent activities.

- **Non-Profit Organizations:** Insurance companies that have no individuals/organizations with an ownership interest. Control of these companies rests with the Board of Directors. Non-profit companies reported on by Best are typically health or dental insurers.

### DEFINITIONS OF LICENSES (FORMERLY STATES LICENSED)

In our reports we list the states, provinces, and territories in which a company is licensed or approved (where required) to do business. States have the authority to regulate insurance companies and have controlled insurance mainly through the licensing power. The license is a document that indicates an insurer has met the minimum requirements established by statute and is authorized to engage in the lines of business for which it has applied.

The importance of a company being licensed in a state determines not only the protection to the insured provided by the state's regulatory authorities to assist if a problem arises, but also the protection afforded the insured by the states guaranty fund laws which generally apply only to licensed insurers. Each state has its own statutes and there are a number of different licensing requirements.

In addition to licensed insurers, there are other specialty types of companies that exist in the field of insurance such as reinsurers. A reinsurer is a company that agrees to indemnify, for consideration, the ceding company against all or part of a loss that the latter may sustain under policies that it has issued. Reinsurers do not always have to be licensed and may operate on an approved basis in some states.