

Review of Independent Analyses of Demotech Financial Stability Ratings®

Michael A. Cohen
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Michael Cohen's experience includes the New Jersey Department of banking and Insurance as well as eight years at A. M. Best, with many of them as the Vice President of a rating group. His current clientele includes the Federal Home Loan Banks.

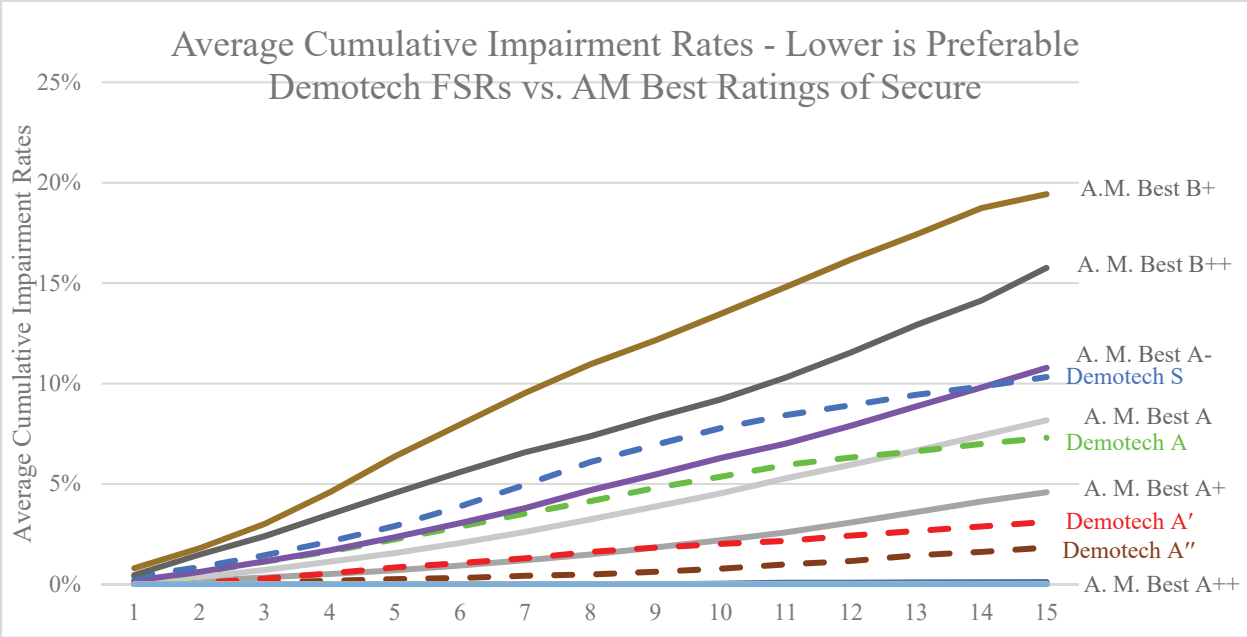
Cohen prepared a review of the examination and report that had been prepared by Drs. Cole, McCullough, He, Barth, Klein and Voss. His review as a summary of his education and expertise follows. Conclusions excerpted from the report include:

His observations underscore our ability to be the first to review and rate independent, regional and specialty insurers while referencing the importance of reinsurance in the review and analysis of smaller insurers. The three major factors that differentiate our approach are:

1. "Unlike other rating agencies, Demotech calibrates its opinion [rating assignment] to the likelihood of an insurer having positive surplus 18 months out."
2. "Second, Demotech does not view an insurer's size as an explicit rating factor." [Affirming the determination in the Kaminski report.]
3. "Third, Demotech recognizes, whereas some other rating agencies do not, that extensive usage of quality reinsurance has a positive impact on an insurer's financial security and conservative risk management."
4. Cohen concluded "I believe these differences have resulted in Demotech's opinion having the highest level of predictability of insurer "staying power" at respective rating levels."
5. In his assessment of Demotech FSRs versus AM Best Secure ratings, Cohen also observed:

"Note that carriers rated S by Demotech, one level below their A, have consistently lower average cumulative impairment rates than insurers assigned an A. M. Best rating of B++." [Recall the more conservative static pool standard imposed on us by Barth and Klein.]

Cohen's closing: "In conclusion, it is my opinion that the major factors discussed above in conjunction with Demotech's unique approach to ratings have resulted in lower average cumulative impairment rates; i.e., greater carrier "staying power," at comparable rating levels."



As excerpted from the previously cited report by Barth and Klein.



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I am the Founder and Principal of Cohen Strategic Consulting. The major focus of my consulting is assisting insurance companies in succeeding with the rating agencies. I spent several years as the head of A. M. Best's Life Insurance Rating Group, the last 4 of my 8 years at that rating agency. Since the inception of my consulting firm in 2009, I have advised over 100 clients on a broad range of issues in their pursuit of obtaining higher credit ratings. Over the past 20+ years, I have gained considerable familiarity with all of the major rating agencies' methodologies as well as a thorough understanding of the insurer strategic, operational, and financial characteristics that drive increased financial strength, which leads to enhanced claims paying ability and higher rating assignments.

Having been retained to review independent analyses of Demotech Financial Stability Ratings®, including a study comparing Demotech to Moody's, S&P, A. M. Best, and Fitch, and having more than two decades of direct experience and interaction at A. M. Best, I am uniquely qualified to summarize the findings in the analyses as well as present my thoughts. I granted permission to Demotech to share this communication with you.

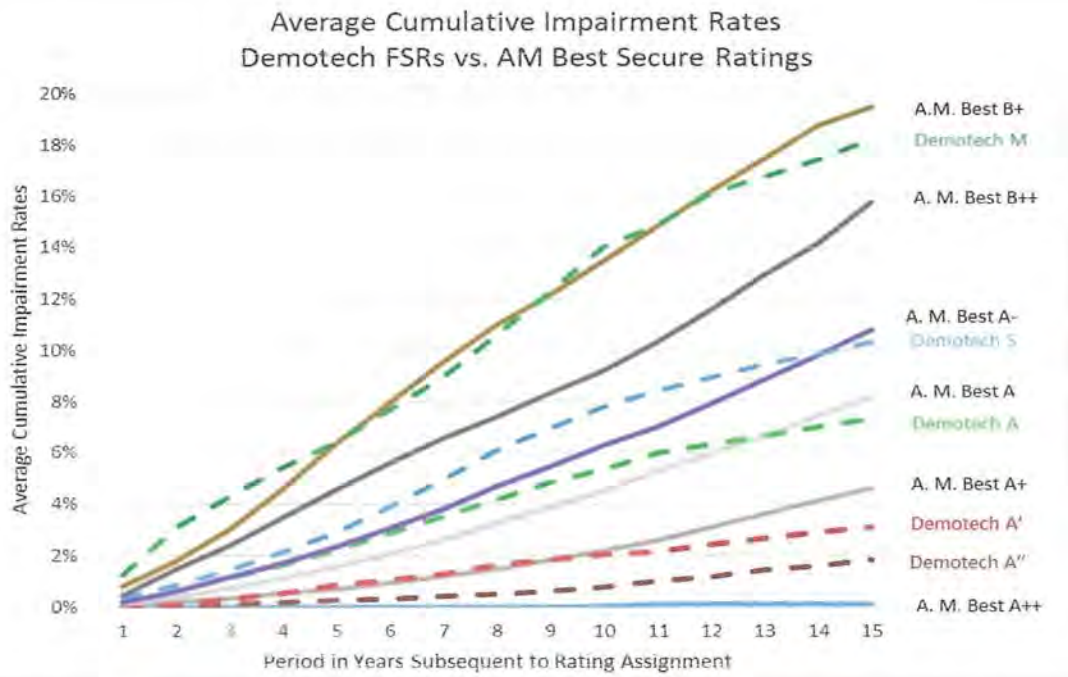
There are three major factors that differentiate Demotech's approach from that of the other rating agencies. I believe these differences have resulted in Demotech's opinion having the highest level of predictability of insurer "staying power" at respective rating levels.

Unlike other rating agencies, Demotech calibrates its opinion to the likelihood of an insurer having positive surplus 18 months out. Other rating agencies base their opinions on quantitative and qualitative reviews that are combined with comparisons of how an insurer under review stacks up to other insurers in the various rating categories. The other agencies use subjective adjectives to describe claims paying ability, i.e. "strongest", "very strong", "strong", "adequate", etc.

Second, Demotech does not view an insurer's size as an explicit rating factor. Their research indicated that when insurers with manageable operating leverage and a conservative investment strategy secure appropriate reinsurance, smaller size does not correlate with increased risk of potential impairment.

Third, Demotech recognizes, whereas some other ratings agencies do not, that extensive usage of quality reinsurance has a positive impact on an insurer's financial security and conservative risk management.

As Demotech's primary opinion focuses on the likelihood of an insurer having positive surplus 18 months out, their approach has led to greater predictability over longer periods of time as well. The following exhibit based upon Demotech's independently calculated and verified average cumulative impairment rates displays the relative level of impairments of all Demotech ratings versus ratings that A. M. Best describes as "Secure."



Demotech data is from a report by Drs. Barth and Klein, February 15, 2018.

A. M. Best data is from A. M. Best Co. - Impairment Rate and Rating Transition Study, October 31, 2017.

Note that carriers rated S by Demotech, one level below their A, have consistently lower average cumulative impairment rates than insurers assigned an A.M. Best rating of B++. Furthermore, in the fourteenth and fifteenth years after assignment of a rating, carriers rated S by Demotech begin to outlast those insurers rated A- by A. M. Best.

In conclusion, it is my opinion that the three major factors discussed above in conjunction with Demotech's unique approach to ratings have resulted in lower average cumulative impairment rates, i.e., greater carrier "staying power," at comparable rating levels.

Please feel free to contact me with your questions on the subject of insurer ratings.

Very truly yours,

Michael A. Cohen
Principal and Founder