NAICO AM Best Rating History

Using its own standards, A.M. Best Company rates insurance providers by conducting a quantitative and qualitative analysis of the provider's financial condition and operating performance. NAICO is currently rated B+ (Good). A.M. Best defines a B+ (Good) rating as follows: Rating assigned to companies that have a good ability to meet their ongoing obligations to policyholders.

As a company we would like to help clarify what National American Insurance Company's (NAICO) B+ VII AM Best rating means, and how it will relate to your company and your operations. A.M. Best assigns two types of ratings, financial strength ratings and debt ratings. Both are independent opinions, based on a comprehensive quantitative and qualitative evaluation of a company's balance sheet strength, operating performance and business profile. The main industry focus is on the financial strength ratings. Our current AM Best rating is B+ VII (Good), which is considered to be a <u>secure</u> rating with a "good" ability to meet our policyholder obligations.

We would like to illustrate the main reason why NAICO was given a B+ rating in lieu of our previous held A- rating. The initial cause of our downgrade stems from a prior reinsurance arrangement with Reliance Insurance Company (A rated at the time of our reinsurance purchase, now in liquidation). Our management had been reviewing the financial strength of Reliance and came to the conclusion that Reliance was going to be incapable of meeting its reinsurance obligations. We felt our best course of action was to have our contracts rescinded. Fortunately, we received a return of all of our reinsurance premiums; however, we also took back all of the premiums and losses we had originally anticipated transferring to Reliance, which created a leverage issue. AM Best measures insurance companies in three primary categories, *profitability, leverage and liquidity* and because of this increased liability and unanticipated premiums our leverage ratios became out of line with what AM Best considered acceptable for "A-" rated carriers. At the time, we felt like this was the best decision. We felt it would be best to get our return of premium to pay our losses in lieu of hoping to collect reinsurance recoverables owed by Reliance through a liquidation manager. We have since remedied our leverage issues and are considered to be very strong in regards to liquidity and leverage.

The primary factor that has prevented our return into the "A" category arose from a book of unprofitable construction business in south TX. From the period of 1997 until 2000 we had significant growth in construction business in South TX. This, coupled with an extremely soft market resulted in an under priced book of business. To make matters even worse, we later found that South TX was an extremely unfavorable venue. We had tremendous development in losses from the period of 1997 through 2001 primarily driven by South TX business. We began making corrective changes to our underwriting process in April of 2000 and have seen tremendous improvement in our underwriting results. Our primary focus has been to increase pricing and remove ourselves from unfavorable legal jurisdictions and undesirable classes of business. Because of these changes, beginning in 2000 we have seen very little development coming from our more recent accident years and waning loss development from the 1997-2001 periods.

To illustrate the progress we have made, in 2000 on a $197 million book of business we had approximately 8,000 open claims; compared to approximately 1,800 open claims today on a $121 million book of business. This correlates to a 39% reduction in premium, but an astonishing 78% reduction in open claims. We were receiving around 18,000 new claims per year on a $197 million book of business and we now receive approximately 3,500 new claims a year on a $121 million book of business. This correlates to a 39% reduction in premium, but an 81% reduction in claim frequency.

We are very confident that these past profitability problems are behind us and we see a very positive outlook regarding our future. We are currently attaining some of the most profitable results in the history of the company (see NAICO Financial Summaries). However, AM Best's view of the industry is predicting more prior year loss development and considerable softening in the market. AM Best would like us to continue to demonstrate profitable results by maintaining our underwriting discipline and by eliminating prior year loss development to be considered for an upgrade regarding our current AM Best rating.

It is also important to note that NAICO is still supported and trusted by some of the largest reinsurance companies in the world. They trust that NAICO has the ability to meet their obligations within their specific retentions.

Not only do NAICO customers have confidence in our financial stability, so do the industries that our customers embody. For example, NAICO has always been successful in obtaining support on their *"good"* B+ VII AM Best rating. They have many highly recognized industries that accept their paper. This list would contain names such as SBC, Love's Country Stores, PhillipsConoco, Chesapeake Energy, Devon Energy, Exxon Mobile, Hobby Lobby, Tyson, Albertson's, Koch Industries, and many more.

We are very confident if we are given the opportunity to obtain your business we can make any of your customers comfortable with our financial strength and stability (we would be glad to review NAICO's income statement and balance sheet at any time).

If you have any questions about our companies please do not hesitate to contact us and we would be glad to discuss.

NATIONAL AMERICAN INSURANCE COMPANY