

Brit Insurance Limited

Full Rating Report

Ratings

Brit Insurance Limited
Insurer Financial Strength Rating A

Brit Insurance Holdings N.V.
Long-Term Foreign-Currency IDR Subordinated BBB+
BB+

Outlooks

Brit Insurance Limited Insurer Financial Strength Rating Stable
Brit Insurance Holdings N.V. Stable

Financial Data

Brit Insurance Limited		
(GBPm)	31 Dec 10	31 Dec 09
Total assets	1,873	1,960
Total adjusted equity	448	461
Gross written premium	634	798
Net income	31	43
ROAE (%)	6.9	9.0
Combined ratio (%) ^a	101.8	100.0
^a Fitch-calculated combined ratio		

Key Rating Drivers

Resilient Financial Performance: The rating of Brit Insurance Limited (BIL) reflects the resilient financial performance of Brit Insurance Group (Brit Insurance). The group reported overall profit before tax for H111 of GBP6.8m (H110: GBP77.5m), despite incurring substantial catastrophe-related losses, and its underlying attritional loss ratio improved by 3.5 percentage points to 58.6%. For 2010, Brit Insurance reported PBT of GBP116.4m, in line with the previous year.

Strong Capital Adequacy: Group capital adequacy, as assessed by Fitch Ratings, remains strong, and although it has weakened somewhat following the heightened large claims activity in the first half of 2011, it remains commensurate with the current rating level.

New Ownership: Following Brit Insurance's change of ownership on 9 March 2011, Fitch continues to monitor its profile, specifically checking that consolidated group adjusted leverage is maintained below 30% (Year-end 2010: 14.8%) and that the risk-adjusted capitalisation, as calculated by Fitch, remains at a level at least commensurate with the current ratings.

Operational Improvements: Fitch views positively actions taken by management to streamline Brit Insurance's operations and reduce costs following the change in ownership, with underlying management expenses falling by 11.8% to GBP75.4m in H111. In addition, Fitch understands that Brit Insurance intends to outsource a number of its non-core back- and middle-office functions, excluding underwriting authorities. The agency currently has a credit-neutral view on this, although this could develop into a positive rating driver if it improves the group's profitability.

Balanced Operating Platform: BIL operates through three strategic business units (SBU) shared with the wider Brit Insurance Group: Brit UK, Brit Global Markets (Brit GM) and Brit Reinsurance (Brit Re), all of which contribute materially to both the top and the bottom line. Fitch believes that the three platforms offer a certain level of diversity, which should provide some stability through more turbulent parts of the operating cycle.

What Could Trigger a Rating Action

Capital and Leverage: Key triggers for a rating downgrade include failure to maintain consolidated group leverage and capitalisation at levels at least commensurate with the current ratings.

Strategic Change: A change to a more aggressive strategy resulting in a significant loss of insurance business arising from the change in ownership would also be viewed negatively.

Imminent Upgrade Unlikely: Fitch views a rating upgrade as unlikely in the near term given the expected weakening in the insurer's underwriting performance in 2011 and the low interest rate environment. Over the longer term, key triggers for a rating upgrade would be a marked and sustained improvement in earnings, coupled with capitalisation commensurate with a better-than-current rating level.

Related Research

[UK Non-Life Insurance – Profitability: Capital is Both the Problem and the Solution](#)

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Peer Analysis

Figure 1
Peer Comparison

2010	IFS ^a	Outlook	GWP (GBPm)	COR ^b (%)	PBT (GBPm)	PBT/GWP (%)
Hiscox Insurance Company Limited	A	Stable	1,433	89.3	211	14.7
Brit Insurance Limited ^c	A	Stable	1,530	97.1	116	7.6
Royal & Sun Alliance Insurance Plc	A	Stable	8,448	96.4	474	5.6
Lloyd's of London	A+	Stable	22,592	93.3	2,195	9.7

^a Insurer Financial Strength Rating of main operating company of each group

^b COR = Combined ratio (published)

^c For comparative purposes, we have included the published financial data for Brit Insurance Holdings N.V., although Brit Insurance Limited is the main operating company Fitch rates

^d Worldwide. UK only: GWP GBP4,405m, COR 96%, PBT GBP457m

Source: Companies' accounts, Fitch

BIL's closest peer is Hiscox Insurance Company Limited. For comparison purposes, the peer comparison table (Figure 1) also includes credit metrics for Royal & Sun Alliance Insurance Plc although the latter is among the largest general insurance players in the UK with a global presence and larger customer bases than BIL. The Lloyd's market (Lloyd's of London), in which Brit Insurance participates as managing agent and capital provider through Syndicate 2987, is also included in the analysis.

Company Profile

Ownership Structure

BIL's new ownership structure is shown in Figure 2. The previous ultimate holding company, Netherlands-domiciled Brit Insurance Holdings N.V., is now owned by Achilles Netherlands Holdings BV (Achilles). Achilles is a wholly owned subsidiary of Achilles Holdings 2 S.à r.l (AH2), and AH2 is a wholly owned subsidiary of Achilles Holdings 1 S.à r.l (AH1), both of which are domiciled in Luxembourg. AH1 is controlled by CVC Capital Partners Ltd (CVC) and Apollo Management VII, L.P. (Apollo), although certain members of management also hold shares in AH1 and AH2.

Underwriting activities are conducted through two principal risk-taking entities: BIL and Syndicate 2987 at Lloyd's (under the management of Brit Syndicates Ltd (BSL)).

BIL is a UK-based commercial insurer and reinsurer writing a diversified book of business, including London market and other international business, UK regional business and reinsurance. Brit Insurance allocates business between BIL and Syndicate 2987, focusing on the most efficient use of capital, but also considering licensing and business fit. Following the change in ownership, the group intends to migrate some of its business away from BIL onto its Lloyd's platform to benefit from a more efficient use of capital. BIL is primarily used for UK and European direct business, and the syndicate for international and US business. Reinsurance business is written by both entities.

The group has demonstrated consistent commitment to BIL through capital injections as the business has grown, shared management and processes, and a catastrophe swap agreement between BIL and BSL. The catastrophe swap agreement was introduced for the 2011 year of account and replaces an equalisation agreement that had been in place since 2004. The swap provides some geographical diversification for BIL as it swaps some Euro exposure for US windstorm exposure, with the total value of indemnity swapped at GBP25m.

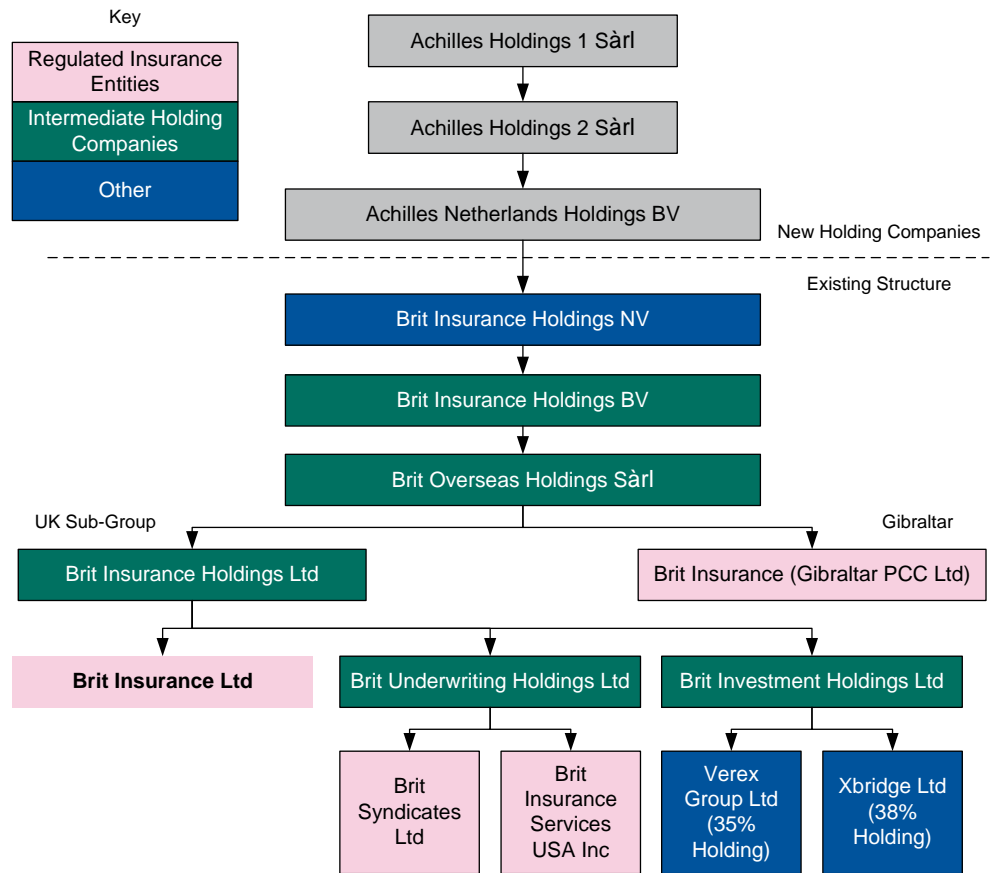
BIL's senior management team consists of seasoned professionals with proven track records in the insurance marketplace, and Fitch views positively the shared management between BIL and BSL, as it ensures that BIL's interests are fully represented at the highest level within the group.

Related Criteria

[Insurance Rating Methodology](#)

Figure 2

Structure Diagram



Source: Transaction documents

Corporate governance is viewed as strong, and the board of the group convenes several committees entrusted with various responsibilities. Since 2006, Brit Insurance has employed a senior independent director whose key role is to liaise with major shareholders and monitor the performance of the chairman. All senior directors participate in the working committees, and this ensures a high level of communication and input into group strategies.

Key Events

On 9 March 2011, Brit Insurance was acquired by Achilles, a holding company majority-owned by funds managed by Apollo and funds advised by CVC. Fitch will closely monitor the post-acquisition profile of the group and assess the likely rating implication of any significant changes in the business strategy or financial profile of the existing group. At this time, the agency expects the financial and strategic profile of the group to remain commensurate with BIL's 'A' rating.

On 10 October 2011, Brit Insurance announced that its Chief Executive, Dane Douetil, would step down with effect from 27 October 2011. Mr Douetil will be replaced by Mark Cloutier who has over 35 years of experience in the insurance and reinsurance industry and has recently been working as an advisor to Brit in developing the group's strategy. Fitch will monitor this development closely and will over time determine what implications this change in management will have for the future profile of Brit Insurance as well as any risks that may materialise as a result of the relatively short transition period. Fitch will assess any change in strategy as part of its ongoing evaluation of the insurer's credit quality, and will take appropriate rating action as necessary.

Products, Target Markets and Distribution Channels

Brit Insurance underwrites through three SBUs: Brit GM, Brit Re and Brit UK. Each SBU underwrites through both regulated underwriting platforms, BIL and BSL. BIL wrote 41.4% of Brit Insurance’s business in 2010 (2009: 47.0%), with the balance written by BSL, which had a capacity of GBP745m in 2010 (this was increased to GBP760m in 2011).

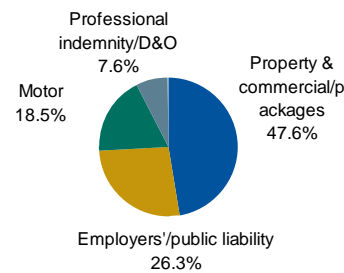
BIL is primarily a commercial writer that also writes reinsurance and participates in several niche markets, especially specialised private motor and household insurance for mid-net-worth individuals, through the Brit UK unit, although the private motor account was substantially reduced in 2010. BIL’s commercial lines portfolio is predominantly targeted at small to medium-sized enterprises, and the company avoids large multinational risks as part of a strategy to minimise extreme losses and volatility within the underwriting result. BIL generates business via intermediaries, with the majority sourced through the professional broker market, largely based in London.

In 2010, BIL’s portfolio of business by class consisted of reinsurance (20%), property insurance (31%), third-party liability (17%), motor (13%), legal expenses (15%) and other (7%). One of the group’s objectives is to maintain a balance of long- and short-tail risks. In addition, Brit Insurance aims to diversify through a range of uncorrelated risks to avoid undue exposure to pricing pressure in individual classes or to large claims arising from single events in specific classes of business.

Brit Insurance’s geographical spread of risks has diversified in the last few years, although the gross written premiums (GWP) split by geography in 2010 was largely unchanged from the previous year, being: the UK 34.2% (2009: 29.0%); the US 22.5% (24.5%); Europe 5.5% (7.6%); and other, including worldwide, 37.8% (38.9%). BIL has “passport” licences to write in all European Economic Area member states and Gibraltar.

Figure 3

Brit UK: Business Classes



Source: Fitch

Brit UK

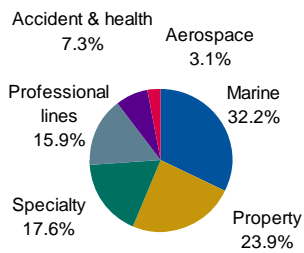
The UK business remained the largest contributor to BIL in 2010, with 60.9% of GWP (2009: 51.0%). The SBU is focused on providing a range of insurance products to small and mid-market enterprises with turnover of up to GBP300m, while the niche personal lines business is aimed at mid- to high-net-worth individuals. Product lines written, shown in Figure 3, have a diversified range of risk tails.

The SBU’s business is produced via brokers, with small commercial risks and personal lines being handled electronically. The company has widened its regional representation in the UK, and the branch network now serves around 300 brokers in nine outlets. Brit UK continues to develop its online trading capability, and Brit Lite, focused on micro-SME business (premiums below GBP2,000), has grown to represent 12% of the SBU’s portfolio in 2010 since its formation in 2007.

Current challenging market conditions have led Brit UK to reposition some underperforming business and exit others. In 2010, it withdrew from the municipal market following weak pricing, and it has reduced its exposure to Private Motor in order to focus on the more attractive Commercial Motor book. In 2010, the aggregate Motor insurance portfolio represented 18.5% of Brit UK’s GWP (2009: 25.3%). Fitch views Brit UK’s focus on selective underwriting as positive as the market remains competitive, although the agency continues to believe that its distribution strategy, centred on the establishment of regional offices, is likely to result in a higher expense base than for some competitors with more centralised underwriting and administration functions, which may place a further strain on profitability in the medium term.

Figure 4

GM: Business Classes



Source: Fitch

Brit Global Markets

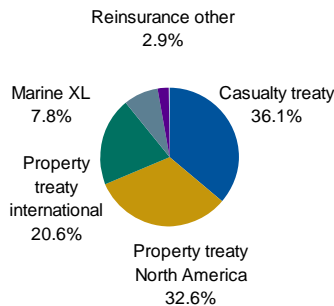
The Brit GM SBU remained the primary generator of Brit Insurance's business in 2010 at 50.9% of GWP (2009: 51.6%), although its 21.9% contribution to BIL's GWP was second to that of Brit UK at 60.9%.

Brit GM's broad product range is targeted at small and medium-sized enterprises as well as large corporate clients, with distribution through London market brokers and delegated authorities with selected coverholders who distribute products into local markets. Fitch views as positive that the majority of business written is short-tail, representing 66% of the portfolio in 2010 (2009: 70%), as this reduces Brit GM's exposure to inflation risk. Although the agency notes that a marginal shift towards long-tail business took place in 2010, this was mostly as a result of Brit GM's decision during the previous year to stop underwriting US Medical Expenses. Business lines underwritten are shown in Figure 4.

The SBU continued its policy of active portfolio management during 2010, exiting underperforming business and adjusting pricing for lines with adverse loss experience. The exit of US Medical Expenses was the most notable action of this process taken to date. Fitch continues to view this action positively and believes that the benefits will be reflected in future results.

Figure 5

Brit Re: Business Classes



Source: Fitch

Brit Reinsurance

In GWP terms, Brit Re remained the smallest contributor to both Brit Insurance (20.2%) and BIL (17.3%) in 2010. Brit Re writes a diverse range of predominantly short-tail reinsurance products that are 100% produced by brokers originating from worldwide markets. Business lines underwritten are shown in Figure 5.

Financial Analysis

Profitability

Fitch considers the ability of Brit Insurance to maintain a consistent level of profitable earnings in the near to medium term to be a key rating driver. Brit Insurance's 2010 earnings performance was ahead of Fitch's forecast, and the group remained profitable in the first half of 2011 despite incurring significant catastrophe losses. The agency believes that the delivery of improved underwriting results remains the driving factor in achieving a more stable level of profitability, in particular in the light of the low interest rate environment.

Brit Insurance reported a 9.8% decline in GWP to GBP1.5bn in 2010 (-10.4% at a constant rate of exchange), with PBT stable at GBP116.4m. Premium rates increased 1.0% (2009: 4.8%). The group combined ratio increased to 97.1%, or 97.6% including FX effects (2009: 94.0% and 95.6%), with a 2.4 percentage-point fall in the claims ratio being offset by a 4.4 percentage-point rise in the expense ratio. The claims costs movement reflected an increase in large losses offset by an improved attritional ratio, whereas the increased expense base was driven by a combination of premium reduction and higher commission and regulatory levies as a result of adjustments on prior year premiums. The group released GBP72.4m from prior-year reserves (2009: GBP81.2m).

Brit's Insurance's three SBUs provided a balanced contribution to GWP in 2010. Fitch maintains the view that the three SBUs will continue to provide a level of earnings stability through more turbulent parts of the operating cycle.

Figure 6

Brit Insurance: Gross Written Premiums Split

% of total	2006	2007	2008	2009	2010
Global markets	56.7	59.3	56.1	51.6	50.9
Reinsurance	20.9	19.0	18.7	21.5	20.2
UK	22.4	21.7	25.2	26.9	28.9

Source: Fitch

Figure 7

Brit Insurance: Profit Before Tax Split

% of total	2006	2007	2008	2009	2010
Global markets	52.2	61.7	46.4	34.8	40.2
Reinsurance	31.3	30.4	24.8	53.7	43.2
UK	16.5	7.9	28.8	11.5	16.6

Source: Fitch

The agency continues to monitor the quality of Brit Insurance's earnings, which have historically been heavily dependent on investment income and prior-year reserve releases. Notable points from the Breakdown of PBT table (Figure 8) include:

- a continued reliance on investment income – although the overall investment yield declined to 3.2% in 2010 (2009: 4.2%);
- a continued positive run-off from prior-year reserves, equivalent to 5.5% of net earned premiums in 2010 (2009: 5.4%); and
- the continued volatile contribution of foreign-exchange movements, both monetary and non-monetary, to bottom-line profitability.

Whilst net aggregate prior-year reserve releases remained stable as a proportion of net premiums earned in 2010, Fitch continues to question the long-term sustainability of this source of income in supporting calendar-year results.

Figure 8

Brit Insurance: Breakdown of PBT

	2006	2007	2008	2009	2010
Accident-year result	92.6	3.4	-45.5	3.0	-35.5
Prior-year release	33.9	58.7	79.1	81.2	72.4
Calendar-year result	126.5	62.1	33.6	84.2	36.9
Investment return	110.5	137.4	7.4	137.4	113.4
Return on derivatives		-4.0	-11.7	0.7	-0.1
Disposals		7.1	4.5	4.2	-0.4
Finance costs	-14.9	-12.7	-5.9	-11.5	-14.0
Other expenses	-23.0	-35.3	-28.8	-39.5	-38.9
FX (losses)/gains	-14.7	30.8	89.5	-58.2	21.3
Other income	0.8	2.9	1.1	1.4	-
Associates	1.1	2.9	-0.5	-2.3	-1.8
Profit before tax	186.3	191.2	89.2	116.4	116.4

Source: Fitch

For H111, the group reported GWP and PBT of GWP845.3m and GBP6.8m, respectively (H110: GWP851.5m and GBP77.5m), despite incurring substantial catastrophe-related losses. The reported combined ratio, excluding FX effects, was 104.8% (H110: 96.5%) with a 15.5 percentage-point impact from catastrophe claims (H110: 7.1 percentage points). Prior-year reserve releases increased marginally to GBP43.1m (H110: GBP41.9m). Positively, the group reported an improvement in the attritional claims ratio of 3.5 percentage points to 58.6%, and underlying management expenses decreased by 11.8% to GBP74.5m. In the absence of further major catastrophe losses, Fitch expects Brit Insurance to remain profitable in 2011 and to benefit from improved underlying underwriting margins going forward.

Brit UK

Brit UK, BIL's largest SBU by GWP, continues to operate in challenging market conditions. Top-line GWP declined by 3.1% to GBP441.2m in 2010, and PBT improved only marginally to GBP14.3m (2009: GBP14.2m). The top line was driven by a withdrawal from the Municipal business as well as a significant reduction of the SBU's Private Motor book as a result of weak pricing. Rate increases across the SBU averaged 3.0% (2009: 3.7%), with Motor achieving the highest growth at 11.9%, although improvements were evident across all lines. Investment income allocated to Brit UK remained stable at GBP14.0m (2009: GBP13.3m), and the combined ratio of 99.8% was largely unchanged from 2009 (99.7%). The underwriting result

benefited from reserve releases of GBP39.0m, equivalent to 10.4 percentage points on the combined ratio (2009: GBP41.2m, or 11.4 percentage points).

Figure 9
Brit UK Selected Metrics

Metric	UK				
	2006	2007	2008	2009	2010
GWP (GBPm)	279.9	274	350.6	455.4	441.2
PBT (GBPm)	40.4	15.8	35.7	14.2	14.3
Claims ratio (%)	69.6	76.3	66.4	66.7	64.7
Expense ratio (%)	27.3	33.0	32.9	33.0	35.1
Combined ratio (%)	96.9	109.3	99.3	99.7	99.8
Reserve release (GBPm)	32.0	25.2	38.6	41.2	39.0

Source: Fitch

Whilst Brit UK is not the only UK non-life player to be faced with the spectre of strained profitability, Fitch believes that the regional office platform distributing SME business through brokers will make it more challenging for Brit UK to control and reduce its expense base. Despite this, steps being taken by senior management to manage the current insurance portfolio are viewed positively by Fitch, and the agency expects to see a marginal improvement in underwriting margins in the short to medium term.

Brit Global Markets

Figure 10
Brit Global Markets Selected Metrics

Metric	Global markets				
	2006	2007	2008	2009	2010
GWP (GBPm)	706.9	749.2	781.3	875.3	778.3
PBT (GBPm)	127.5	123.7	57.6	42.8	34.6
Claims ratio (%)	46.5	54.4	61.2	62.7	57.4
Expense ratio (%)	38.9	34.9	35.2	34.2	40.3
Combined ratio (%)	85.4	89.3	96.4	96.9	97.7
Reserve release (GBPm)	17.0	29.5	22.0	13.8	9.6

Source: Fitch

Brit GM's overall GWP in 2010 decreased by 11.1% to GBP778.3m (-11.8% at a constant rate of exchange), following the SBU's decision to withdraw from US Medical Expenses as well as its continued focus on selective underwriting. PBT fell 19.2% to GBP34.6m, driven mostly by reduced top-line revenue but also a 0.8 percentage-point increase in the combined ratio to 97.7% as well as a 2.0% decline in allocated investment return of GBP19.8m. The marginal weakening of the underwriting margin arose from an improved loss ratio of 57.4% (2009: 62.7%), offset by an increase in the expense ratio to 40.3% (2009: 34.2%). The former was driven by an increase in large claims compensated for by an improved attritional claims ratio and also benefited from reserve releases of GBP9.6m equivalent to 1.4 percentage point on the loss ratio (2009: GBP13.8m, 1.7 percentage points). The increased expense ratio was predominantly a result of reduced premiums and higher regulatory levies. Premium rates were on average flat across the portfolio (2009: 4.3% increase). Fitch maintains its expectation that continued management of the underwriting portfolio will lead to improved results.

Brit Reinsurance

Despite a 15.0% fall in GWP in 2010 to GBP309.6m (-15.8% on a constant FX basis), the reinsurance portfolio remained stable in the year. The sharp fall in premiums written was predominantly due to a non-recurrence of positive changes on the re-estimation of prior-year premiums. Excluding this, underlying growth on a constant exchange basis was -1.1%. PBT fell by 43.7% to GBP37.2m, driven by a reduction in premiums and increased claims activity. Major claims accounted for GBP36.0m, equivalent to 14.4% of net earned premiums, and were mainly affected by earthquakes in Chile and New Zealand (2009: GBP12.0m, 4.0%). The

combined ratio also benefited from a GBP25.0m reserve release, equivalent to 10.0 percentage points (2009: GBP24.1m, 8.1 percentage points). Average premiums rates increased by just 0.4%. Although full-year results for 2011 are likely to be heavily hit by the extraordinary amount of catastrophe losses that the group incurred in the beginning of the year, the agency believes that the reinsurance segment will continue to generate sustainable earnings for the group.

Figure 11

Brit Reinsurance Selected Metrics

Metric	Reinsurance				
	2006	2007	2008	2009	2010
GWP (GBPm)	260.9	239.4	260.7	364.2	309.6
PBT (GBPm)	76.5	61.0	30.8	66.1	37.2
Claims ratio (%)	50.0	56.4	65.3	54.9	59.6
Expense ratio (%)	28.8	26.6	26.4	25.0	28.6
Combined ratio (%)	78.8	83.0	91.7	79.9	88.2
Reserve release (GBPm)	-12.0	4.2	20.1	24.1	25.0

Source: Fitch

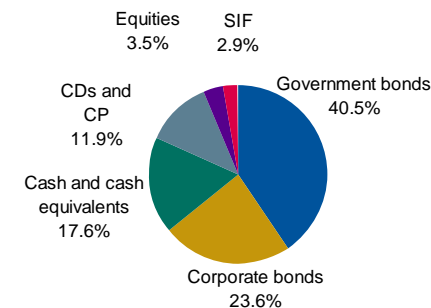
Investments and Liquidity

Brit Insurance pursues an active investment strategy with a very good-quality investment portfolio, and although a marginal shift towards riskier assets took place in 2010, the portfolio remains within Fitch's rating's tolerance. Total invested assets increased 2.0% to GBP3.5bn at end-2010 and generated investment income of GBP113.4m, equivalent to a 3.2% portfolio yield (2009: GBP137.4m, or 4.2%).

Brit Insurance actively de-risked its portfolio in 2009. In particular, it reduced its exposure to equity and hedge funds. Whilst Fitch views this positively, the agency continues to believe that one of Brit Insurance's main challenges in the near and possibly medium term will involve its ability to mitigate the earnings impact of reduced investment income caused by a combination of a lower-risk investment portfolio and generally lower investment returns in the current yield environment. Fitch does expect Brit Insurance to introduce some additional risk in its portfolio in 2011 by increasing its debt duration, and although the change is not expected to alter the agency's overall risk assessment, Fitch will continue to monitor closely Brit Insurance's investment strategy and the level of risk assumed within the portfolio.

Figure 12

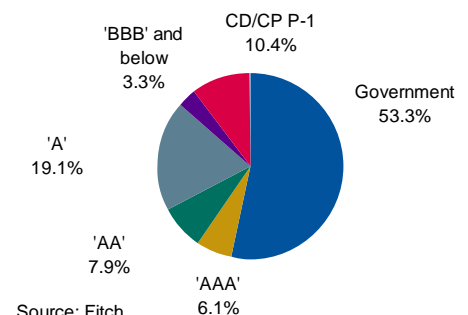
BIH Financial Investments - 2010



Source: Fitch

Figure 13

Debt Quality - 2010



Source: Fitch

The proportion of corporate investments rated at 'A' or below continued to rise in 2010 and amounted to 22.4% of the total debt portfolio at end-2010 (end-2009: 15.5%). The overall proportion of corporate bonds also rose to 23.6% of the total portfolio (2009: 20.8%), with 89.5% being rated 'A' or above (2009: 92.0%). Brit Insurance has limited exposure to peripheral European sovereigns, holding only GBP12.5m of Spanish and Italian debt and no exposure to Greece, Ireland or Portugal at end-2010. Brit Insurance continues to invest in a

range of specialised investment funds containing European covered bonds, asset-backed securities (ABS), US residential mortgage-backed securities (US RMBS) and collateralised mortgage-backed securities (CMBS).

Figure 14

Debt Securities (Ex CDs and CPs) Duration

	31 Dec 10	31 Dec 09
GBP	1.8	1.2
USD	1.8	1.5
EUR	2.1	1.4
CAN	1.8	1.6

Source: Fitch

The inherent riskiness of the large corporate bond holding is somewhat mitigated by the short duration of the debt portfolio, although this increased somewhat in 2010. As mentioned above the duration is likely to continue to rise in 2011 as Brit Insurance tries to capitalise on higher returns available at the longer end of the yield curve.

Liquidity remained strong through 2010 despite a 37.2% fall in cash and cash equivalents to GBP623.4m following a shift from cash to debt holdings. The group predominantly invests in highly liquid bonds, minimising the impact on its financial flexibility. Fitch expects Brit Insurance to continue shifting its cash balance into low-risk fixed-income securities in order to make more efficient use of its capital. At year-end 2010 the cash balance included an amount of GBP150.1m (2009: GBP357.8m) not available for use by the group as it is held within the Lloyd's syndicates as Funds at Lloyd's.

The group's policy is to have access to sufficient liquidity at all times at the holding company and in each underwriting entity in order to manage a number of modelled events. These include a major catastrophe event, a material US dollar strengthening, a deterioration in forecast underwriting conditions and a significant deficiency in claims reserves.

In March 2011, the group increased its revolving credit facility by GBP25.0m to GBP200.0m with GBP70.0m and GBP17.0m drawn at 30 June 2011 and 25 July 2011, respectively. Fitch views negatively the continued use of the revolving loan facility, although the amount drawn has fallen significantly from GBP107.0m at end-2009.

Reinsurance Protection and Credit Quality

The structure of BIL's outward reinsurance programme for 2011 remains largely unchanged on recent years and includes the use of various excess-of-loss programmes in addition to industry loss warranty protection against US earthquakes. The quality of reinsurers remains high, with most rated 'A' and above, including Munich Reinsurance Company (IFS Rating: 'AA-'/Stable), Swiss Re and Lloyd's, and the group has long-standing relationships with them.

To protect its balance sheet from large losses, BIL seeks to diversify its portfolio geographically and purchases reinsurance and retrocessional protection to limit geographical loss aggregations.

The group also owns Brit Insurance (Gibraltar) PCC Limited (formerly Rockhampton), a Gibraltar-based protected cell company. One cell (100% owned by BIH) has written GBP11.1m (2009: GBP15.0m) of Brit Insurance's specific outwards risk XL reinsurance programme and also writes a 30% whole account quote share with BIL.

Reserve Adequacy and Development

Fitch believes that the underwriting reserves established by BIL have proven to be robust. Reserve releases have been a regular feature of the group's recent results, and in 2010, aggregate releases totalled GBP72.4m (end-2009: GBP81.2m; end-2008: GBP79.1m; end-

2007: GBP58.9m), with positive contributions from all three business units. Although this trend has continued in 2011, with total H111 releases of GBP43.1m (H110: GBP41.9m), Fitch continues to believe that Brit Insurance's ability to mitigate the impact of future poor underwriting years through the release of prior-year surpluses will be reduced in the near to medium term.

Reserves for BIL are set by the group reserving panel, taking into account the recommendations of internal and external actuaries and applying relevant loading factors. This mirrors the approach taken by the syndicate operations. The group has commissioned external actuarial reserve reviews, which confirm the existence of a modest surplus over best estimate in the level of reserves held.

Capitalisation

Fitch's capital assessment indicates that capitalisation at both group and BIL levels remains supportive of the rating level. The group's capital adequacy, as calculated by Fitch, strengthened in 2010, although it weakened somewhat in H111 as a consequence of the extraordinary catastrophe losses incurred in this period. Brit Insurance's capital also demonstrated a satisfactory level of resilience to Fitch's asset stress test.

For the purpose of calculation of capital adequacy, the equity credit assigned to the group's GBP135m Lower Tier 2 subordinated debt maturing 2030 has been changed to 100% (previously 25%) following the introduction of Fitch's new hybrid criteria on 11 July this year. As a dated deferrable debt hybrid security, under Fitch's criteria for assessing subordinated debt, this debt issue would not qualify for any equity credit. However, the agency believes that the current hybrid will continue to qualify as Tier 2 capital under the incoming Solvency II regime, and has therefore applied a regulatory override to its treatment. For the purpose of calculation of adjusted financial leverage, the instrument is treated as 100% debt (previously 75%). Please see "*Insurance Rating Methodology – Global Master Criteria*", dated 22 September 2011 and available at www.fitchresearch.com.

In light of the new ownership, Brit Insurance's capital strategy includes achieving annual ROE of 12% and maintaining sufficient regulatory capital to sustain BIL's target 'A' rating. The agency also understands that one of the group's strategic initiatives following its completed takeover will be to migrate some of its business from BIL to its Lloyd's platform in order to create a more efficient capital structure. Fitch considers the group's risk-adjusted capitalisation to be a key rating driver and will continue to closely monitor whether capital remains commensurate with the current rating.

Financial Leverage and Balance Sheet Quality

Brit Insurance's leverage fell to 14.8% at end-2010 (end-2009: 21.0%), driven by a 8.6% growth in retained earnings to GBP971.6m as well as a decrease of GBP69.4m to GBP35.4m in the balance outstanding on the revolving loan facility. The group has not accessed external debt markets since December 2005, when it raised GBP150.0m in Lower Tier 2 subordinated debt. The affirmation of the current rating is based on the expectation that post-acquisition gross adjusted leverage will be maintained below 30%.

Fitch continues to believe that Brit Insurance will be able to access the capital debt market when required, subject to capital markets operating in a normal fashion. The group's secured GBP200.0m revolving credit facility provides it with additional liquidity and increases capital management flexibility.

BIL maintains an adequate level of financial flexibility. Although the company is no longer listed, and therefore no longer has access to external equity funding, Fitch believes that capital could be provided by the new owners if required. The potential access to the Lloyd's Central Fund that derives from Syndicate 2987's membership at Lloyd's is also viewed positively from the

point of view of capital adequacy.

The funded status of group pension schemes improved to a surplus of GBP9.6m at end-2010 from a deficit of GBP4.1m at end-2009, with the movement being largely attributable to strong returns on assets as well as a GBP5.8m group contribution.

Debt-Servicing Capabilities

BIL has not directly issued debt, but Fitch believes that the parent company has adequate resources to service its outstanding obligations. Brit Insurance's cash flow is very strong, and the agency expects that it will consistently exceed the company's comparatively modest annual cash interest and dividend requirements by a healthy margin.

Figure 15
Brit Insurance Limited: Key Financials

(GBPm)	2005	2006	2007	2008	2009	2010
Balance sheet						
Capital	278.0	278.0	278.0	278.0	278.0	278.0
Claims equalisation reserve	6.8	9.6	22.5	30.5	33.5	39.3
Revaluation reserve	0.0	0.0	7.2	2.0	0.0	0.0
Profit & loss	94.2	146.8	166.5	169.9	149.5	130.9
Surplus	379	434.4	474.2	480.4	461.0	448.1
Net unearned premium	300.6	296.0	299.1	314.0	262.7	202.4
Claims reserve	600.4	699.7	902.1	1,024.8	1,090.6	1,006.3
Net technical reserves	901.0	995.7	1,201.2	1,338.8	1,353.3	1,208.6
Other liabilities	151.5	127.2	218.4	111.9	145.7	216.1
Total liabilities	1,052.4	1,122.9	1,419.6	1,450.7	1,499.0	1,424.7
Cash & deposits	447.9	348.9	374.6	645.3	596.2	626.6
Investments	496.0	703.7	1,032.9	929.6	1,023.1	918.1
Total investment assets	943.9	1,052.6	1,407.5	1,574.9	1,619.3	1,544.7
Insurance debtors	283.1	262.9	195.8	213.5	245.7	239.3
Unquoted investments	138.3	154.7	161.9	6.0	0.0	
Other assets	66.2	78.7	128.6	136.7	95.0	88.8
Total assets	1,431.5	1,557.3	1,893.8	1,931.1	1,960.0	1,872.8
Profit & loss account						
Gross premium written	656.6	610.9	616.3	674.2	797.9	633.7
Net premium written	545.1	495.5	533.3	523.1	592.0	398.0
Net premium earned	545.1	491.6	527.9	508.2	643.3	458.4
Net claims paid	194.6	208.4	209.5	332.4	308.6	329.2
Change in provision	231.9	110.5	166.7	2.4	112.4	-83.1
Net claims incurred	426.4	318.9	376.1	334.8	421.1	246.0
Change in equalisation provision	-2.9	-2.8	-12.9	-8.0	-3.0	-5.7
Change in other technical provisions	0.0	0.0	0.0	0.0	0.0	0.0
Commission expenses	99.2	103.3	114.4	116.2	159.5	143.0
Management expenses	39.1	50.2	53.6	57.1	66.6	79.9
Underwriting result	-22.5	16.3	-29.1	-5.0	-0.2	-8.4
Net investment income	35.0	43.2	52.7	104.1	50.9	46.8
Realised gains/(losses)	3.7	4.8	-13.8	-26.8	-8.6	-16.4
Unrealised gains/(losses)	17.0	7.0	10.8	-111.1	28.2	19.5
Other gains/losses	-2.3	-6.0	5.4	41.5	-12.5	0.1
(Loss)/profit before tax	30.9	65.3	26.0	2.7	57.7	41.5
Taxation	-6.7	-16.8	-7.7	0.7	-15.1	-10.1
(Loss)/profit after tax	24.2	48.4	18.3	3.4	42.6	31.4
Dividends	-20.0	0.0	0.0	0.0	-65.0	-50.0
Retained (loss)/profit for the year	4.2	48.4	18.3	3.4	-22.4	-18.6

Source: Fitch

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