

## Endurance Specialty Holdings Ltd.'s U.S. Operating Subsidiaries Assigned 'A' Ratings; Other Ratings Affirmed

### *Overview*

- Endurance American Insurance Co., American Merchants Casualty Co., American Agri-Business Insurance Co., and Endurance American Specialty Insurance Co. established an intercompany pooling arrangement in 2009.
- We view this intercompany pool as core to Endurance Specialty Holdings Ltd., essentially because of the pool's significance to the group.
- We are assigning our 'A' counterparty credit and financial strength ratings to the U.S. subsidiaries members of the pool. We are also affirming our existing ratings on Endurance Specialty Holdings and its operating subsidiaries.
- The stable outlook reflects our view that Endurance will generate strong operating results in 2009, supported by improved pricing for catastrophe exposed risks.

### *Rating Action*

On Oct. 6, 2009, Standard & Poor's Ratings Services assigned its 'A' counterparty credit and financial strength ratings to Endurance American Insurance Co. (EAIC), American Merchants Casualty Co. (AMCC), and American Agri-Business Insurance Co. (AABIC).

At the same time, we affirmed all our existing ratings on Bermuda-based Endurance Specialty Holdings Ltd. (NYSE:ENH; BBB+/Stable/—) and core subsidiaries. We refer to the holding company and all its operating subsidiaries as Endurance (see ratings list). The outlook is stable.

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### ***Rationale***

The ratings on EAIC, AMCC, AABIC, along with Endurance American Specialty Insurance Co., reflect their core status to the group. These four companies formed a pooling arrangement in 2009, to which they cede 100% of their gross premiums written. The pooling of the U.S. insurance entities is intended to better balance premiums with expenses incurred, effectively leverage capital, and efficiently purchase third-party reinsurance. Standard & Poor's views this intercompany pool as core to its parent, essentially because of its significance to Endurance. At year-end 2008, the intercompany pool constituted about 40% of the group's consolidated pro forma gross premiums written. In addition, these pooled entities benefit from substantial intercompany, third party, and U.S. government (through federal crop insurance program) reinsurance protection.

The ratings on Endurance reflect our opinion that the group has established a strong track record since it started its operation in 2001. We view the company's management team and corporate strategy as positive to the rating. Endurance has a strong and seasoned management team with a strategy focused on consistent underwriting profits through market cycles. The ratings are also based on the group's strong competitive position, robust operating performance with prudent reserve practices, very strong capitalization, and excellent enterprise risk management (ERM). Offsetting these strengths are the significant growth in a potentially volatile agriculture line of business and material exposure to property catastrophe risk.

Endurance has a strong competitive position as a specialty (re)insurer based on its global market presence, scale, and diversified insurance and reinsurance platforms. The company has a global and credible presence through its three main underwriting hubs in Bermuda, New York, and London. Since its creation, the company has been successful in developing its franchise organically and through several favorable acquisitions. Its competitive position has further improved based on the buildout of its admitted and nonadmitted platforms in the U.S. In addition, Endurance has created a competitive advantage within the areas of agricultural insurance, property catastrophe reinsurance, and hospital professional liability insurance (health care).

Endurance's operating performance is strong and stable, as demonstrated by its five-year (2004 to 2008) average combined ratio of 92.8% and a return on revenue (ROR) of 17.8%. With prudent and conservative reserving practices, the quality of earnings is solid, with modest volatility, which compares favorably vis-à-vis its Bermudian peers. In the first half of 2009, operating performance remained strong as Endurance reported EBITDA of \$238 million and a combined ratio of 90.8% compared with \$223 million and 86.9%, respectively, during the same period in 2008. Supporting results were \$75 million of favorable reserve development and \$51 million of mark-to-market gains on its alternative investments and high-yield loan funds.

Capitalization is very strong, including a net aggregate exposure property catastrophe (re)insurance charge to incorporate Endurance's probable maximum loss (PML) based on the 1-in-250-year return period. Property catastrophe exposure remains the principal risk as measured by Standard & Poor's risk-adjusted capital model. The company's stated objective is to limit its loss in a 1-in-100-year event to 25% of equity capital or less; this figure was about 20% as of July 1, 2009.

We consider Endurance's ERM to be excellent. Supporting this view are Endurance's excellent risk culture and risk governance, several examples of strong or excellent controls for the company's most significant risks, as well as an excellent process to integrate risk management with strategic management. No corporate-wide risk-tolerance levels were breached in the past year, and we consider

it highly unlikely that Endurance will experience losses outside its tolerances in the year ahead. The company has a robust process to identify and evaluate risk/reward trade-offs and consistently uses that process to optimize risk-adjusted returns.

Offsetting these strengths is the company's significant growth in a potentially volatile agriculture business. With the acquisition of ARMtech Insurance Services Inc. in late 2007, Endurance has further strengthened the competitive position of its specialty unit. As a result, agricultural insurance has become a significant source of premiums and a core product. ARMtech's combination of strong distribution, extensive agribusiness experience and client relationships, and an efficient operating model built on a sophisticated technology platform render this business a long-term franchise for Endurance. On the other hand, agricultural insurance can be volatile because of the increase in frequency and severity of weather vagaries and the volatility in commodity prices, but this downside risk is somewhat mitigated in the U.S. by the federal insurance program and third-party excess of loss reinsurance. As a result, the agriculture business should not exacerbate earnings' volatility because of Endurance's comprehensive reinsurance protection.

Endurance's aggregate PML for a 1-in-250-year event as a percentage of its available economic capital is relatively high vis-à-vis its peers. However, the company's very strong capital base and excellent ERM mitigate this risk. Risk modeling is an inherent part of the company's operating procedure. Endurance's internal model "Pegasus," which incorporates several sound practices, is the primary tool to measure and monitor its catastrophe risks. These approaches are on par with industry leaders in this area. Endurance's risk platform provides real-time or near-real-time perspectives on concentrations, aggregations, and risk interactions and real-time marginal return on capital tracked at the contract level. Zonal aggregates are closely tracked against defined limits. In sum, it produces a detailed risk dashboard that highlights aggregate and individual risk categories.

### ***Outlook***

The stable outlook reflects our view that Endurance will generate strong operating results in 2009 supported by improved pricing for catastrophe exposed risks. Given its diversified business mix in (re)insurance, conservative reserving, strong risk selection, and excellent ERM, Endurance should produce strong earnings and not be a negative outlier in an above-average catastrophe season, and its potential losses shouldn't be disproportional to a loss event. In 2009, we expect that Endurance will generate a combined ratio of 90%-95% and an ROR of about 15%.

Endurance should maintain its strong competitive position in the (re)insurance market, opportunistically expanding and contracting its various lines of business based on its excellent risk-management capabilities. In 2009, we expect the top line to decrease by about 5%-10% because Endurance exited the California workers' compensation business and sold the renewal rights of its U.K. property business, somewhat offset by rate increases in its catastrophe-exposed business.

We expect capital adequacy to remain very strong and supportive of the rating. Debt leverage will likely stay modest at less than 20% and interest coverage of at least 5x. Thus far, the company's operating results have been favorable, and clearly supported by its ERM. We expect this trend to continue. We also expect that Endurance will continue to seek best ERM practices, particularly as risks continue to grow in complexity and size. We could revise the outlook to positive if Endurance continues to generate strong and sustainable underwriting results on both a calendar and underwriting

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year basis. Alternatively, we could revise the outlook to negative if Endurance fails to meet the aforementioned expectations.

***Related Research***

- “ Group Methodology,” April 22, 2009

***Ratings List***

New Rating

American Agri Business Insurance Co.	
Endurance American Insurance Co.	
Counterparty Credit Rating	A/Stable/—
American Agri Business Insurance Co.	
American Merchants Casualty Co.	
Financial Strength Rating	A/Stable/—
American Merchants Casualty Co.	
Counterparty Credit Rating	A/Stable/—
Endurance American Insurance Co.	
Financial Strength Rating	A/Stable/—
Ratings Affirmed	
Endurance Specialty Holdings Ltd.	
Counterparty Credit Rating	BBB+/Stable/—
Endurance American Specialty Insurance Co.	
Endurance Worldwide Insurance Ltd.	
Endurance Specialty Insurance Ltd.	
Endurance Reinsurance Corp. of America	
Counterparty Credit Rating	A/Stable/—
Financial Strength Rating	A/Stable/—
Endurance Specialty Holdings Ltd.	
Senior Unsecured	BBB+
Preferred Stock	BBB-

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