

# Best's Rating Report



NAVIGATORS INSURANCE COMPANY

NAVIGATORS INSURANCE COMPANY

A

NAVIGATORS SPECIALTY INSURANCE COMPANY

A

New York, New York



A

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# Best's Rating Report

## Ultimate Parent: The Navigators Group, Inc

### NAVIGATORS INSURANCE COMPANY

New York, NY

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#### BEST'S FINANCIAL STRENGTH RATING

Based on our opinion of the consolidated Financial Strength of the company and its insurance subsidiaries, the company is assigned a Best's Financial Strength Rating of A (Excellent). The company's Financial Size Category is Class X.

#### RATING RATIONALE

The following text is derived from the report of Navigators Insurance Group.

**Rating Rationale:** The rating reflects Navigators Insurance Group's leading position as a global provider of insurance to the marine sector, the group's well-diversified book of business, its modest net windstorm exposure, management's conservative approach to underwriting and claims handling in addition to the group's solid level of capitalization and profitability. These positive factors are somewhat offset by the group's elevated ceded reinsurance leverage and its rapid growth in relatively new lines of business seen in recent years, some of which have proved unprofitable. The rating outlook reflects A.M. Best's expectation that the group will continue to maintain its solid level of capitalization and operating performance, generating strong earnings throughout market cycles.

The positive rating factors are derived from favorable historical operating performance which, together with capital-raising initiatives, has supported growth and enhanced overall capitalization. The strong operating performance, as evidenced by excellent returns on both revenue and surplus, has been driven by underwriting profitability produced by the group's highly tenured underwriting staff and their specialty expertise built up as one of the largest marine insurers in the world. The group's firm commitments to underwriting excellence in terms of risk selection, contract terms and conditions and pricing discipline, have been hallmarks in the generation of annual loss ratios that have outperformed the average posted by its industry peers. Such discipline and expertise, which have been critical to profitability in the severity-driven ocean marine, casualty and energy lines, are a reflection of the strong risk management culture that has always been a part of the Navigators Insurance Group.

Somewhat mitigating the elevated ceded reinsurance leverage is the relatively high credit quality of Navigators' reinsurers as well as the presence of letters of credit provided by some reinsurers. The group's high ceded leverage is emblematic of its risk management approach wherein the majority of its Gulf Coast wind exposure and portions of its new business are ceded. Following large Gulf Coast storm losses, the group has significantly pared back its gross limits in recent years, effectively mitigating this exposure on a net basis. In addition, financial flexibility is afforded through the publicly traded parent, The Navigators Group Inc. (NASDAQ: NAVG).

While over 30% of Navigators' gross premium writings are still in the marine sector, diversification of risk is achieved as its remaining premiums are spread across a diverse product line, including general liability coverage for small general and artisan contractors, professional liability, and specialty coverages. While the group continues to expand both its product lines and geographic spread of risk, management remains focused on underwriting profitability. Some of its non-core lines have incurred increased loss experience that led management to refine its coverage terms.

**Best's Financial Strength Rating: A**

**Outlook: Stable**

#### FIVE YEAR RATING HISTORY

Date	Best's FSR	Date	Best's FSR
06/22/10	A	01/02/07	A g
05/27/09	A g	10/10/05	A g
03/28/08	A g	06/29/05	A g

#### KEY FINANCIAL INDICATORS (\$000)

Period Ending	Statutory Data							
	Direct Premiums Written	Net Premiums Written	Pretax Operating Income	Net Income	Total Admitted Assets	Policyholders' Surplus		
2005	304,357	267,745	30,486	16,937	1,065,658	356,484		
2006	389,817	376,179	75,098	45,426	1,361,849	524,188		
2007	490,595	478,019	98,519	64,914	1,594,942	578,668		
2008	562,243	472,689	97,669	31,952	1,687,014	581,166		
2009	562,248	477,673	70,365	42,938	1,789,140	645,820		
Period Ending	Profitability			Leverage			Liquidity	
	Comb. Ratio	Inv. Yield (%)	Pretax ROR (%)	NA Inv Lev	NPW to PHS	Net Lev.	Overall Liq. (%)	Oper. Cash-flow (%)
2005	94.7	3.6	13.3	5.7	0.8	2.6	157.5	168.0
2006	86.3	4.0	22.8	7.1	0.7	2.3	166.1	169.0
2007	87.2	4.0	22.2	11.7	0.8	2.5	160.3	160.0
2008	90.6	4.0	21.1	8.9	0.8	2.7	155.8	157.2
2009	98.0	3.9	14.7	9.7	0.7	2.5	160.4	118.7
5-Yr	91.3	3.9	19.1	...	...	...	...	...

(\* Data reflected within all tables of this report has been compiled from the company-filed statutory statement. Within several financial tables of this report, this company is compared against the Commercial Casualty Composite.

#### BUSINESS REVIEW

The following text is derived from the report of Navigators Insurance Group.

Navigators Insurance Group (Navigators), through its lead operating unit, Navigators Insurance Company, specializes in underwriting marine and energy, specialty lines and professional liability business. Navigators Specialty Insurance Company underwrites property/casualty business on a non-admitted basis for those types of risks requiring greater flexibility in rating or policy terms and conditions. The group's multi-channel distribution platform utilizes global, national and regional brokers as well as wholesalers.

Navigators has a long-standing reputation for expertise in the marine and energy sector, the group's largest segment, which includes property and excess liability coverages for marine-related business, offshore energy risks, related transportation and cargo exposures as well as a modest amount of business written in other facets of the marine and energy field.

Specialty operations have underwritten general liability coverages for small general and artisan contractors since 1995, mostly in California, and represent a "post-Montrose" book of business with tight terms and conditions in place to limit or avoid significant construction defect claims. Coverages are generally written on a non-admitted basis and have included construction wrap-up products since 2005. Approximately 50% of the specialty group's gross writings represent construction risks, with excess casualty generating roughly 15% of this segment. Excess casualty risks are diversified among a large number of industry groups. The remaining portion of the specialty gross premiums includes personal umbrella (which has gone into run-off), primary casualty and commercial middle market accounts. The group also writes professional director and officer coverages to a variety of market niches including lawyers, architects and a variety of public and private companies. This coverage is largely offered to small and mid-size companies as opposed to Fortune 1000 companies. The group also enters specialty niche lines which management believes can produce profitable underwriting results. It recently discontinued writing personal umbrella coverages due to unfavorable loss experience.

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## 2009 BUSINESS PRODUCTION AND PROFITABILITY (\$000)

Product Line	—Premiums Written—		% of Total NPW	Pure Loss Ratio	Loss & LAE Res.
	Direct	Net			
Ocean Marine.....	198,477	185,338	38.8	59.6	242,626
Oth Liab Occur.....	175,656	143,294	30.0	24.5	364,776
Oth Liab CM.....	119,580	87,057	18.2	69.7	113,176
Inland Marine.....	25,841	24,134	5.1	44.6	7,022
Com'l MultiPeril.....	12,768	11,670	2.4	94.5	43,534
Comm'l Auto Liab.....	11,711	10,866	2.3	103.1	10,739
All Other.....	18,215	15,313	3.2	69.5	25,402
Totals.....	562,248	477,673	100.0	50.7	807,275

**Geographical breakdown of direct premium writings (\$000):** California, \$120,530 (21.4%); New York, \$49,411 (8.8%); New Jersey, \$25,151 (4.5%); Texas, \$24,762 (4.4%); Washington, \$23,444 (4.2%); 48 other jurisdictions, \$189,115 (33.6%); Aggregate Alien, \$129,835 (23.1%).

### FINANCIAL PERFORMANCE

The following text is derived from the report of Navigators Insurance Group.

**Overall Earnings:** Navigators has generated strong pre-tax operating performance over the majority of the last five years, producing pre-tax returns on revenue and equity that exceed the results produced by the commercial casualty industry composite while after-tax return measures largely reflect this composite. Increasing levels of both underwriting profits and investment income over a five-year period have been key drivers behind operating earnings. Total return measures were negatively impacted in 2008 by significant realized capital losses, which were impacted by impairment losses recorded for accounting purposes. Positive unrealized capital gains boosted total return measures in 2009.

Earnings since 2004 have been profitable, driven by underwriting results and boosted by consistently higher levels of net investment income. Otherwise solid results in 2005 and 2008 were somewhat offset by Gulf Coast storm losses. After such losses, the group has largely restricted its storm loss exposure by significantly curtailing its available Gulf Coast wind limits. The group's conservative operating strategies, high-quality investment portfolio, stringent underwriting guidelines and strong industry knowledge (particularly within its market niche) are expected to afford the group continued earnings momentum.

### PROFITABILITY ANALYSIS

Period Ending	Company				Industry Composite			
	Pretax ROR (%)	Return on PHS	Comb. Ratio	Oper. Ratio	Pretax ROR (%)	Return on PHS	Comb. Ratio	Oper. Ratio
2005	13.3	6.1	94.7	82.4	8.1	7.8	105.1	91.0
2006	22.8	11.7	86.3	73.4	19.2	19.3	94.3	79.5
2007	22.2	11.3	87.2	75.5	21.1	15.7	94.5	78.1
2008	21.1	5.6	90.6	78.2	17.3	-0.9	98.8	83.1
2009	14.7	9.3	98.0	85.5	15.2	11.8	99.8	84.8
5-Yr	19.1	8.9	91.3	78.9	16.3	10.7	98.4	83.2

**Underwriting Income:** The group's five-and ten-year average combined ratios have outperformed its commercial casualty peers by wide margins. Such results are largely due to the group's disciplined underwriting approach leading to underwriting earnings in each of the past five years. Underwriting fell in 2009 from the prior year as the level of reserve redundancies fell significantly from the prior year with redundancies of over \$40 million in 2008 versus somewhat less than \$10 million in 2009. Although overall reserve development was favorable, its specialty liability line incurred over \$35 million in adverse development that has prompted management to either discontinue writing specific niches or to restrict coverages available under such writings.

Despite hurricane losses in both 2005 and 2008, the combined ratio remained below 100. In light of such storm losses, the group imposed policy restrictions on its marine policies including lower policy limits and limiting its business interruption coverages, as well as significantly restricting its available Gulf of Mexico net wind aggregates. While the group's marine and energy rates have largely held up since 2006 (despite soft market conditions), gross written premiums remained largely flat on strong policy retention.

Although rates on its other lines of business have remained subject to competitive market conditions since 2006, overall premium volume grew as the company expanded its product offerings and grew existing lines of business. Premium growth has also been achieved by hiring individuals with existing contacts and underwriting expertise, and then matching new programs with the newly acquired skill sets. The majority of the non-marine premium growth is related to casualty niches; lines that are less susceptible to industry cycles. The group will also write opportunistic programs largely through an established distribution source.

### UNDERWRITING EXPERIENCE

Period Ending	Net Undrw Income (\$000)	—Loss Ratios—			—Expense Ratios—			Div. Pol.	Comb. Ratio
		Pure Loss	LAE	Loss & LAE	Net Comm.	Other Exp.	Total Exp.		
2005	1,885	52.4	15.1	67.5	11.2	16.1	27.2	...	94.7
2006	32,135	40.9	17.3	58.2	12.4	15.8	28.1	...	86.3
2007	46,393	47.3	10.6	57.9	12.6	16.7	29.4	...	87.2
2008	40,471	45.5	14.0	59.5	12.2	18.9	31.1	...	90.6
2009	10,083	50.7	12.9	63.6	13.2	21.2	34.4	...	98.0
5-Yr	...	47.2	13.6	60.9	12.4	18.0	30.4	...	91.3

**Investment Income:** Over the long term, the group's conservative investment strategy has produced a five-year average yield on invested assets that is somewhat below that of the commercial casualty composite. Due to the depressed interest rate environment experienced in recent years, management strategically cut back on the duration of its assets, staying short term while rates remained low, seeking to remain flexible to take advantage of rising rates once the market turned. Ultimately, duration has remained largely constant over the five-year period and moderately below its peer composite. Navigators' high-quality, actively managed investment portfolio is spread across U.S. Treasury securities, municipal, mortgage and asset-backed bonds and corporate issues. The employed strategy has produced favorable levels of investment income on an annual basis with modest realized capital gains (with the exception of 2008) generated over the years from its small equity portfolio. Increasing levels of cash flow have helped the group produce generally higher levels of investment earnings since 2004. Further boosting cash flow is the increased premium volume since 2005 on increased product offerings as well as \$220 million of capital contributions from the parent during 2005 and 2006. The group incurred significant realized losses on its common stock portfolio in 2008, which was impacted by impairment losses recorded for accounting purposes. Although the group continued to incur realized capital losses on its equity portfolio in 2009, unrealized capital gains on its stock portfolio contributed to surplus growth on the year.

### INVESTMENT INCOME ANALYSIS (\$000)

Period Ending	Company						Industry Composite	
	Net Inv. Income	Realized Capital Gains	Unrealized Capital Gains	Inv. Inc. Growth (%)	Inv. Yield (%)	Total Return (%)	Inv. Growth (%)	Inv. Yield (%)
2005	28,376	1,025	1,090	29.7	3.6	3.9	19.9	4.9
2006	42,441	-153	6,156	49.6	4.0	4.6	9.5	4.9
2007	52,269	1,431	-2,330	23.2	4.0	4.0	10.3	5.0
2008	57,684	-35,490	494	10.4	4.0	1.6	-4.7	4.8
2009	59,768	-9,930	13,907	3.6	3.9	4.2	-10.6	4.3
5-Yr	...	...	...	18.7	3.9	3.5	3.7	4.8

### INVESTMENT PORTFOLIO ANALYSIS

Asset Class	2009 Inv. Assets (\$000)	—% of Invested Assets—		Annual % Change
		2009	2008	
Long-term bonds.....	1,349,377	84.8	83.7	5.5
Stocks.....	62,610	3.9	3.4	20.9
Affiliated Investments.....	117,705	7.4	7.5	3.4
Other Inv Assets.....	61,855	3.9	5.4	-25.4
Total.....	1,591,547	100.0	100.0	4.2

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## 2009 BOND PORTFOLIO ANALYSIS

Asset Class	% of Total Bonds	Mkt. Val to Stmt Val (%)	Avg. Maturity (Yrs)	Class 1-2 (%)	Class 3-6 (%)	Struc. Secur. (%)	Struc. Secur. (% of PHS)
Governments .....	15.3	2.6	4.5	100.0	...	...	...
States, terr & poss...	21.4	4.3	7.3	100.0	...	...	...
Special Revenue.....	41.3	3.5	6.4	100.0	...	4.5	3.9
Corporates.....	22.0	0.5	5.9	100.0	...	35.0	16.0
Total all bonds..	100.0	2.9	6.2	100.0	...	9.5	19.9

## CAPITALIZATION

The following text is derived from the report of Navigators Insurance Group.

**Capital Generation:** Navigators has historically generated capital internally in the past five years. Significant surplus growth has been derived from capital contributions from the publicly traded parent, The Navigators Group, Inc. (Navigators Inc.). In September 2005, a \$250 million multipurpose shelf registration was filed with and approved by the SEC. This shelf was refreshed in 2009 under nearly identical terms. The shelf includes the option to issue debt securities, common and preferred shares as well as depositary shares. In the fourth quarter of 2005, Navigators Inc. drew down on a portion of its initial shelf through an equity offering that led to a \$120 million contribution to its domestic insurance subsidiary. In April of 2006, the parent again accessed its shelf and issued a \$125 million debt offering of which \$100 million was contributed to Navigators Insurance Company. The \$125 million senior notes mature on May 1, 2016, and pay interest at a rate of 7% annually. The additional capital contributions in 2005 and 2006 have provided the operating group with a solid level of capitalization as measured by Best's Capital Adequacy Ratio (BCAR). Further, consolidated financial leverage is a very low 12.5% (debt-to-total-capital), and interest coverage ratios more than support the group's current rating level. As a result, the group has ample financial flexibility.

Surplus growth in 2007 remained strong on favorable underwriting and investment earnings. Surplus remained unchanged in 2008 despite pre-tax operating income that was largely unchanged from the prior year. Offsetting surplus growth was realized capital losses, dividends and an increase in non-admitted assets. Growth in 2009 followed continued favorable operating results, unrealized capital gains and increases in deferred tax assets.

In addition to modest debt service, profits from the domestic insurance companies have been utilized to further the group's expansion overseas, primarily in London. From a group perspective, the standard is to provide dividends that are less than or equal to 50% of net statutory income. This standard was exceeded in 2008 as dividends approached 60% of net statutory income and fell slightly in 2009 but higher than its historical 50%.

## CAPITAL GENERATION ANALYSIS (\$000)

Period Ending	Source of Surplus Growth					PHS Growth (%)
	Pretax Operating Income	Total Inv. Gains	Net Contrib. Capital	Other, Net of Tax	Change in PHS	
2005	30,486	2,115	117,000	-28,679	120,922	51.3
2006	75,098	6,004	100,000	-13,397	167,704	47.0
2007	98,519	-900	-8,000	-35,139	54,480	10.4
2008	97,669	-34,996	-20,000	-40,175	2,499	0.4
2009	70,365	3,977	-25,000	15,312	64,654	11.1
5-Yr	372,136	-23,800	164,000	-102,078	410,259	...

**Overall Capitalization:** Navigators' risk-adjusted capitalization is solid, as measured by Best's Capital Adequacy Ratio (BCAR) and more than supports its current rating. With the significant increase in surplus since 2005 from capital contributions and retained earnings, underwriting leverage and capitalization have improved to conservative levels.

The group has significantly reduced its Gulf Coast wind exposure by reducing its gross limits and laying off the majority of risk to third party reinsurers. While the sum of net limits reached over \$200 million at year-end 2008, net offered limits fell to less than \$10 million by the end of the third quarter in 2009. This shift followed a number of large gross incurred Gulf Coast catastrophe losses in 2008 of \$114 million on Hurricane Ike and Gustav losses. Nonetheless, net losses including reinstatement premiums from these two events were \$29 million as the majority of its catastrophe exposure is

ceded to third-party reinsurers, and as such, the group's catastrophe exposure was largely reduced to credit risk on the year. This strategy was adopted in light of the adverse impact of Hurricanes Katrina and Rita in 2005 that led management to mitigate its catastrophe exposure through the purchase of additional reinsurance, reductions in aggregate exposures and more stringent underwriting guidelines. Prior to 2006, loss limits of up to \$65 million were available to its insureds on policies exposed to storm losses. Current maximum available limits on such policies are (on a gross basis) less than \$10 million for both property damage and business interruption on a combined basis. Further, the company offers business interruption coverage on a limited basis.

## QUALITY OF SURPLUS (\$000)

Period Ending	Year-End PHS	% of PHS			—Dividend Requirements—		
		Cap. Stock/Contrib. Cap.	Other	Unassigned Surplus	Stock-holder Divs	Div. To POI (%)	Div. To Net Inc. (%)
2005	356,484	74.7	...	25.3	-3,000	9.8	17.7
2006	524,188	69.8	...	30.2	...	...	...
2007	578,668	63.3	...	36.7	-8,000	8.1	12.3
2008	581,166	63.0	...	37.0	-20,000	20.5	62.6
2009	645,820	56.7	1.5	41.8	-25,000	35.5	58.2

**Underwriting Leverage:** Gross underwriting leverage remains at a reasonable level and largely reflects its peer group norms. While ceded leverage is somewhat elevated as a result of the extensive utilization of reinsurance to mitigate exposure risks, credit risk is mitigated through the use of a diversified group of highly rated reinsurers and letters of credit received from foreign reinsurers. Although premiums and liabilities, both net and gross, have grown rapidly in recent years, surplus growth has been even stronger resulting in decreasing leverage measures.

## LEVERAGE ANALYSIS

Period Ending	Company				Industry Composite			
	NPW to PHS	Res. to PHS	Net Lev.	Gross Lev.	NPW to PHS	Res. to PHS	Net Lev.	Gross Lev.
2005	0.8	1.2	2.6	5.3	1.0	1.8	3.7	4.9
2006	0.7	1.0	2.3	4.2	0.9	1.6	3.3	4.3
2007	0.8	1.1	2.5	4.3	0.8	1.5	3.0	3.9
2008	0.8	1.3	2.7	4.5	0.9	1.6	3.3	4.3
2009	0.7	1.2	2.5	4.0	0.7	1.4	2.9	3.7

Current BCAR: 243.5

## PREMIUM COMPOSITION & GROWTH ANALYSIS

Period Ending	—DPW—		—GPW—		—NPW—		—NPE—	
	(\$000)	(% Chg)	(\$000)	(% Chg)	(\$000)	(% Chg)	(\$000)	(% Chg)
2005	304,357	26.5	529,681	15.7	267,745	25.8	230,046	0.6
2006	389,817	28.1	672,846	27.0	376,179	40.5	329,723	43.3
2007	490,595	25.9	774,346	15.1	478,019	27.1	443,456	34.5
2008	562,243	14.6	762,190	-1.6	472,689	-1.1	463,297	4.5
2009	562,248	0.0	730,776	-4.1	477,673	1.1	479,121	3.4
5-Yr CAGR	...	18.5	...	9.8	...	17.6	...	15.9
5-Yr Chg	...	133.7	...	59.7	...	124.5	...	109.4

**Reserve Quality:** While loss reserves generally developed favorably during 2009, the level of favorable development was markedly less than seen in prior calendar years. Adverse loss development on prior accident years was recorded on various elements of the group's diversified product offerings, including marine liability, middle market commercial auto and general liability, as well as its "Public Company D&O" liability and lawyers liability under its professional liability programs. A number of corrective actions have been implemented which are expected to minimize future development.

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## LOSS & ALAE RESERVE DEVELOP.: CALENDAR YEAR (\$000)

Calendar Year	Orig. Loss Reserves	Developed Thru '09	Develop. to Orig. (%)	Develop. to PHS (%)	Develop. to NPE (%)	Unpaid Reserves @12/09	Unpaid Res. to Develop. (%)
2004	344,460	276,363	-19.8	-28.9	120.8	69,815	25.3
2005	382,191	286,342	-25.1	-26.9	124.5	102,949	36.0
2006	467,762	361,997	-22.6	-20.2	109.8	161,572	44.6
2007	584,438	527,356	-9.8	-9.9	118.9	304,104	57.7
2008	690,675	682,581	-1.2	-1.4	147.3	499,182	73.1
2009	747,069	747,069	...	...	155.9	747,069	100.0

## LOSS & ALAE RESERVE DEVELOP.: ACCIDENT YEAR (\$000)

Accident Year	Orig. Loss Reserves	Developed Thru '09	Develop. to Orig. (%)	Unpaid Reserves @12/09	Acc. Yr Loss Ratio	Acc. Yr Comb Ratio
2004	131,407	99,338	-24.4	16,205	51.5	76.0
2005	136,127	98,352	-27.7	33,134	52.6	79.8
2006	178,270	145,846	-18.2	58,623	52.4	80.5
2007	243,976	257,187	5.4	142,532	69.4	98.8
2008	264,636	270,818	2.3	195,078	70.4	101.5
2009	247,887	247,887	...	247,887	64.2	98.6

## ASBESTOS & ENVIRONMENTAL (A&E) RESERVE ANALYSIS

Year	Company				Industry Composite				
	Net A&E Reserve (\$000)	Reserve Retention (%)	Net IBNR Mix (%)	Survival Ratio (3yr)	Comb Ratio Impact (1 yr)	Comb Ratio Impact (3 yr)	Survival Ratio (3yr)	Comb Ratio Impact (1 yr)	Comb Ratio Impact (3 yr)
2005	30,372	53.4	25.4	...	0.2	...	...	1.0	...
2006	21,381	57.5	36.0	...	0.1	...	...	0.5	...
2007	16,716	72.1	41.9	2.9	0.4	0.3	8.5	0.7	0.7
2008	16,683	76.6	45.9	3.1	0.1	0.2	7.4	0.3	0.5
2009	16,763	75.7	45.6	7.6	0.0	0.1	7.7	0.6	0.5

**Reinsurance Utilization:** Significant dependence on reinsurance is maintained as the group writes high gross limits, consistent with that of typical commercial marine and energy insurers. Following the group's Katrina loss in 2005, management made a decision to limit its Gulf Coast wind exposure, effectively reducing its gross catastrophe exposure from this book of business. This strategy was tested in 2008 with both Hurricane Ike and Gustav with the group incurring \$114 million in gross losses. However, net losses including reinstatement premiums from both catastrophes were \$29 million or less than 1% of surplus. In 2009, the group further reduced its net Gulf exposure, issuing total net limits of less than \$10 million.

A significant portion of the group's reinsurance program is placed with foreign reinsurers, primarily in the London market. The majority of reinsurance balances with unauthorized carriers is covered by letters of credit, which partially mitigate associated credit risk exposure.

## CEDED REINSURANCE ANALYSIS (\$000)

Period Ending	Company				Industry Composite			
	Ceded Reins. Total	Bus. Ret. (%)	Reins. to Recov. to PHS (%)	Ceded Reins. to PHS (%)	Bus. Ret. (%)	Reins. to Recov. to PHS (%)	Ceded Reins. to PHS (%)	
2005	946,914	50.5	192.1	265.6	82.9	92.7	124.3	
2006	1,022,582	55.9	138.5	195.1	81.7	73.3	100.9	
2007	1,034,377	61.7	127.5	178.8	82.9	64.3	89.4	
2008	1,065,233	62.0	133.5	183.3	82.6	71.4	98.9	
2009	1,005,054	65.4	116.4	155.6	81.4	62.7	86.9	

## 2009 REINSURANCE RECOVERABLES (\$000)

	Paid & Unpaid Losses	IBNR	Unearned Premiums	Other Recov*	Total Reins Recov
Foreign Affiliates.....	126	186	...	...	312
US Insurers.....	211,459	278,619	97,141	-4,697	582,520
Pools/Associations.....	31	26	...	...	58
Other Non-US.....	93,430	54,322	23,041	-1,729	169,062
Total (ex US Affils).....	305,046	333,153	120,182	-6,426	751,952
Grand Total.....	305,045	333,151	120,181	-6,426	751,952

\* Includes Commissions less Funds Withheld

## INVESTMENT LEVERAGE ANALYSIS (% OF PHS)

Period Ending	Company						Industry Composite	
	Class 3-6 Bonds	Real Estate/ Mtg.	Other Invested Assets	Common Stocks	Non-Affil. Inv. Lev.	Affil. Inv.	Class 3-6 Bonds	Common Stocks
2005	...	...	...	5.7	5.7	29.0	7.0	15.8
2006	...	...	...	7.1	7.1	20.4	6.2	16.1
2007	0.0	...	...	11.6	11.7	19.3	5.9	15.1
2008	0.0	...	...	8.9	8.9	19.6	5.5	9.5
2009	...	...	...	9.7	9.7	18.2	6.0	8.6

## LIQUIDITY

The following text is derived from the report of Navigators Insurance Group.

**Overall Liquidity:** The company maintains a very sound liquidity position with quick and current liquidity ratios above industry averages. Positive underwriting and operating cash flows have been produced over the past five years, enhancing the group's invested asset and liquidity position. Cash flow has been significantly enhanced in recent years due to the dramatic increase in premiums written. The group's asset portfolio, though largely invested in government, corporate and municipal bonds, allocates enough into cash and short-term securities to supply sound liquidity. Paid losses in 2009 doubled from the prior year due to heavy storm loss activity from Hurricanes Ike and Gustav, lowering underwriting and operating cash flows on the year.

## LIQUIDITY ANALYSIS

Period Ending	Company			Industry Composite				
	Quick Liq. (%)	Current Liq. (%)	Overall Liq. (%)	Gross Agents Bal. to PHS (%)	Quick Liq. (%)	Current Liq. (%)	Overall Liq. (%)	Gross Agents Bal. to PHS (%)
2005	29.0	124.1	157.5	12.0	20.6	102.2	137.6	11.8
2006	28.6	135.3	166.1	5.8	23.8	108.8	141.6	11.7
2007	26.2	131.4	160.3	6.6	21.9	111.3	145.1	10.1
2008	21.6	130.6	155.8	5.5	19.1	104.7	141.3	11.8
2009	27.9	132.1	160.4	6.3	21.3	110.7	146.6	9.3

## CASH FLOW ANALYSIS (\$000)

Period Ending	Company			Industry Composite			
	Underw Cash Flow	Oper. Cash Flow	Net Cash Flow	Underw Cash Flow (%)	Oper. Cash Flow (%)	Underw Cash Flow (%)	Oper. Cash Flow (%)
2005	131,984	142,946	20,874	169.0	168.0	114.9	128.4
2006	152,050	172,598	740	167.4	169.0	113.4	125.7
2007	184,994	194,990	-21,452	166.1	160.0	112.1	122.6
2008	155,681	187,366	6,219	152.4	157.2	100.4	112.4
2009	41,096	82,539	-36,591	109.9	118.7	99.1	110.7

## HISTORY

The company was incorporated under the laws of New York on July 16, 1981. Active underwriting operations began on March 10, 1983. At December 31, 2009, paid-in capital of \$366.1 million consisted of 100 shares of common stock at a par of \$50,000 per share and \$361.1 million of contributed surplus. All authorized shares are outstanding.

## MANAGEMENT

All outstanding capital stock is held by The Navigators Group, Inc., a publicly traded holding company (NASDAQ: NAVG), approximately 20% of which is owned by Terence N. Deeks and family.

The affairs of the company are under the direction of Navigators Management Company, Inc., which is reimbursed for its expenses. Terence N. Deeks serves as Chairman of the Board of The Navigators Group, Inc. Mr. Deeks has been active in the insurance industry in various executive capacities since the mid-1950s. Stanley A. Galanski serves as President and CEO of The Navigators Group, Inc. and as President, CEO and Chairman of Navigators Insurance Company. Mr. Galanski has been active in the insurance industry since 1980.

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**Officers:** Chairman, President and Chief Executive Officer, Stanley A. Galanski; Senior Vice President and Chief Financial Officer, Francis W. McDonnell; Senior Vice President, Chief Underwriting Officer and Chief Risk Officer, Henry C. Bassett, Jr.; Senior Vice President and General Counsel, Bruce J. Byrnes; Senior Vice President, Richard S. Eisdorfer; Vice President and Treasurer, Thomas C. Connolly; Vice Presidents, Ramona L. Eisman (Claims), Paul C. Kluga (Reinsurance), Daniel P. Reale (IT), Jeff L. Saunders (Underwriting); Secretary, Emily B. Miner.

**Directors:** Henry C. Bassett, Jr., Michael L. Civisca, Christopher C. Duca, Richard S. Eisdorfer, Stanley A. Galanski (Chairman), Paul V. Hennessy, Noel Higgitt, Christopher A. Johnson, Russell J. Johnson, John W. Jones, Francis W. McDonnell, Gregory D. Olson, Richard C. F. Rea, Jeff L. Saunders.

## REGULATORY

An examination of the financial condition is being made as of December 31, 2009 by the Insurance Department of New York. The 2009 annual independent audit of the company was conducted by KPMG, LLP. The annual statement of actuarial opinion is provided by Claus S. Metzner, FSA, FCAS, MAAA, Milliman USA.

**Territory:** The company is licensed in the District of Columbia, Puerto Rico and all states. It also operates on a surplus lines or non-admitted basis in U.S. Virgin Islands. This company is also licensed in the United Kingdom.

## REINSURANCE

The following text is derived from the report of Navigators Insurance Group.

Navigators Insurance maintains proportional and non-proportional reinsurance with U.S. domestic reinsurers, Lloyd's of London, and other international companies. Quota share contracts for most marine lines were eliminated in 2009, but remain in place for 80% of the primary liability, 64% of the Gulf of Mexico wind exposure and 100% of its war business. Excess of loss contracts provide up to \$50 million of protection per risk on marine and offshore energy business.

The marine and the offshore energy excess of loss program (excluding Gulf of Mexico wind exposures) attaches at \$5 million per risk. The company maintains catastrophe layers to protect against catastrophic events and retains a pre-tax maximum of \$25 million in aggregate for Gulf of Mexico wind exposure, which is much smaller on a PML basis.

Navigators' other lines of business are reinsured on either a quota share or excess of loss basis. Both construction and commercial middle market businesses are reinsured above the company's \$1,000,000 and \$500,000 retentions, respectively, on an excess of loss basis. The construction wrap program and primary casualty program are both subject to a 35% quota share. The excess casualty program is subject to a variable quota share between 60% and 80% and the personal umbrella program is reinsured at 50% on a quota share basis. A variable quota share is in place for the professional liability business with a maximum retention of \$7.2 million. Maximum retention under the inland marine program is \$2 million.

## BALANCE SHEET

### ADMITTED ASSETS (\$000)

	12/31/09	12/31/08	'09%	'08%
Bonds .....	1,349,377	1,278,922	75.4	75.8
Common stock .....	62,610	51,802	3.5	3.1
Cash & short-term invest .....	32,019	68,610	1.8	4.1
Real estate, offices .....	1,280	1,312	0.1	0.1
Other non-affil inv asset .....	15,014	137	0.8	0.0
Investments in affiliates .....	116,425	112,518	6.5	6.7
<b>Total invested assets.....</b>	<b>1,576,724</b>	<b>1,513,301</b>	<b>88.1</b>	<b>89.7</b>
Premium balances .....	91,323	78,167	5.1	4.6
Accrued interest .....	14,823	14,119	0.8	0.8
All other assets.....	106,270	81,427	5.9	4.8
<b>Total assets.....</b>	<b>1,789,140</b>	<b>1,687,014</b>	<b>100.0</b>	<b>100.0</b>

## LIABILITIES & SURPLUS (\$000)

	12/31/09	12/31/08	'09%	'08%
Loss & LAE reserves .....	807,275	749,060	45.1	44.4
Unearned premiums.....	214,616	216,065	12.0	12.8
Conditional reserve funds.....	27,869	23,201	1.6	1.4
All other liabilities .....	93,559	117,522	5.2	7.0
<b>Total liabilities.....</b>	<b>1,143,320</b>	<b>1,105,848</b>	<b>63.9</b>	<b>65.6</b>
Capital & assigned surplus.....	376,073	366,122	21.0	21.7
Unassigned surplus.....	269,747	215,044	15.1	12.7
<b>Total policyholders' surplus.....</b>	<b>645,820</b>	<b>581,166</b>	<b>36.1</b>	<b>34.4</b>
<b>Total liabilities &amp; surplus.....</b>	<b>1,789,140</b>	<b>1,687,014</b>	<b>100.0</b>	<b>100.0</b>

## SUMMARY OF 2009 OPERATIONS (\$000)

Statement of Income	12/31/09	Funds Provided from Operations	12/31/09
Premiums earned.....	479,121	Premiums collected.....	458,045
		Benefit & loss related pmts	195,544
Losses incurred .....	242,947		
LAE incurred .....	61,725	LAE & undrw expenses paid	221,404
Undrw expenses incurred	164,367		
Net underwriting income	10,083	Undrw cash flow .....	41,096
Net investment income....	59,768	Investment income.....	64,248
Other income/expense ...	514	Other income/expense ...	514
		Pre-tax cash operations	105,959
Pre-tax oper income ...	70,365		
Realized capital gains.....	-9,930	Income taxes pd (recov)...	23,320
Income taxes incurred .....	17,497	Net oper cash flow.....	82,539
Net income.....	42,938		

# Best's Rating Report

## Ultimate Parent: The Navigators Group, Inc

### NAVIGATORS SPECIALTY INSURANCE COMPANY

New York, NY

Reckson Executive Park, 6 International Drive, Rye Brook, NY 10573

Web: www.navg.com

Tel: 914-934-8999

AMB#: 010761

Ultimate Parent#: 058430

Fax: 914-934-2355

NAIC#: 36056

FEIN#: 13-3536448

#### BEST'S FINANCIAL STRENGTH RATING

Based on our opinion of the company's Financial Strength and relationship with an affiliated reinsurer, which reinsures virtually all of the company's business, the company is assigned the Best's Financial Strength Rating of its affiliated reinsurer, Navigators Insurance Company, which is A (Excellent). The company is assigned the Financial Size Category of Class X, which is the Financial Size Category of its affiliated reinsurer.

#### RATING RATIONALE

The following text is derived from the report of Navigators Insurance Group.

**Rating Rationale:** The rating reflects Navigators Insurance Group's leading position as a global provider of insurance to the marine sector, the group's well-diversified book of business, its modest net windstorm exposure, management's conservative approach to underwriting and claims handling in addition to the group's solid level of capitalization and profitability. These positive factors are somewhat offset by the group's elevated ceded reinsurance leverage and its rapid growth in relatively new lines of business seen in recent years, some of which have proved unprofitable. The rating outlook reflects A.M. Best's expectation that the group will continue to maintain its solid level of capitalization and operating performance, generating strong earnings throughout market cycles.

The positive rating factors are derived from favorable historical operating performance which, together with capital-raising initiatives, has supported growth and enhanced overall capitalization. The strong operating performance, as evidenced by excellent returns on both revenue and surplus, has been driven by underwriting profitability produced by the group's highly tenured underwriting staff and their specialty expertise built up as one of the largest marine insurers in the world. The group's firm commitments to underwriting excellence in terms of risk selection, contract terms and conditions and pricing discipline, have been hallmarks in the generation of annual loss ratios that have outperformed the average posted by its industry peers. Such discipline and expertise, which have been critical to profitability in the severity-driven ocean marine, casualty and energy lines, are a reflection of the strong risk management culture that has always been a part of the Navigators Insurance Group.

Somewhat mitigating the elevated ceded reinsurance leverage is the relatively high credit quality of Navigators' reinsurers as well as the presence of letters of credit provided by some reinsurers. The group's high ceded leverage is emblematic of its risk management approach wherein the majority of its Gulf Coast wind exposure and portions of its new business are ceded. Following large Gulf Coast storm losses, the group has significantly pared back its gross limits in recent years, effectively mitigating this exposure on a net basis. In addition, financial flexibility is afforded through the publicly traded parent, The Navigators Group Inc. (NASDAQ: NAVG).

While over 30% of Navigators' gross premium writings are still in the marine sector, diversification of risk is achieved as its remaining premiums are spread across a diverse product line, including general liability coverage for small general and artisan contractors, professional liability, and specialty coverages. While the group continues to expand both its product lines and geographic spread of risk, management remains focused on underwriting profitability. Some of its non-core lines have incurred increased loss experience that led management to refine its coverage terms.

**Best's Financial Strength Rating: A r**

**Outlook: Stable**

#### FIVE YEAR RATING HISTORY

Date	Best's FSR	Date	Best's FSR
06/22/10	A r	01/02/07	A r
05/27/09	A r	10/10/05	A r
03/28/08	A r	06/29/05	A r

#### KEY FINANCIAL INDICATORS (\$000)

Period Ending	Statutory Data							
	Direct Premiums Written	Net Premiums Written	Pretax Operating Income	Net Income	Total Admitted Assets	Policyholders' Surplus		
2005	176,414	...	2,706	1,788	124,452	103,483		
2006	231,718	...	5,126	3,311	134,343	106,773		
2007	233,005	...	5,493	3,610	127,551	110,407		
2008	149,141	...	5,585	2,001	126,417	112,518		
2009	109,617	...	5,364	1,611	125,653	116,425		
	Profitability		Leverage		Liquidity			
Period Ending	Comb. Ratio	Inv. Yield (%)	Pretax ROR (%)	NA Inv Lev	NPW to PHS	Net Lev.	Overall Liq. (%)	Oper. Cash-flow (%)
2005	...	3.5	...	...	...	0.2	593.5	236.1
2006	...	4.9	...	...	...	0.3	487.3	277.7
2007	...	5.2	...	...	...	0.2	744.0	246.8
2008	...	5.1	...	...	...	0.1	909.5	999.9
2009	...	4.8	...	...	...	0.1	999.9	153.6
5-Yr	...	4.7	...	...	...	...	...	...

(\* ) Data reflected within all tables of this report has been compiled from the company-filed statutory statement. Within several financial tables of this report, this company is compared against the Surplus Lines Composite.

#### BUSINESS REVIEW

The following text is derived from the report of Navigators Insurance Group.

Navigators Insurance Group (Navigators), through its lead operating unit, Navigators Insurance Company, specializes in underwriting marine and energy, specialty lines and professional liability business. Navigators Specialty Insurance Company underwrites property/casualty business on a non-admitted basis for those types of risks requiring greater flexibility in rating or policy terms and conditions. The group's multi-channel distribution platform utilizes global, national and regional brokers as well as wholesalers.

Navigators has a long-standing reputation for expertise in the marine and energy sector, the group's largest segment, which includes property and excess liability coverages for marine-related business, offshore energy risks, related transportation and cargo exposures as well as a modest amount of business written in other facets of the marine and energy field.

Specialty operations have underwritten general liability coverages for small general and artisan contractors since 1995, mostly in California, and represent a "post-Montrose" book of business with tight terms and conditions in place to limit or avoid significant construction defect claims. Coverages are generally written on a non-admitted basis and have included construction wrap-up products since 2005. Approximately 50% of the specialty group's gross writings represent construction risks, with excess casualty generating roughly 15% of this segment. Excess casualty risks are diversified among a large number of industry groups. The remaining portion of the specialty gross premiums includes personal umbrella (which has gone into run-off), primary casualty and commercial middle market accounts. The group also writes professional director and officer coverages to a variety of market niches including lawyers, architects and a variety of public and private companies. This coverage is largely offered to small and mid-size companies as opposed to Fortune 1000 companies. The group also enters specialty niche lines which management believes can produce profitable underwriting results. It recently discontinued writing personal umbrella coverages due to unfavorable loss experience.

**Direct Premium Writings By Product Lines:** Direct Premiums written at the last year end totaled (\$000) \$109,617, and were distributed as follows: Oth Liab Occur, \$77,591; Oth Liab CM, \$27,473; Inland Marine, \$2,826; All Other, \$1,729.

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**Geographical breakdown of direct premium writings (\$000):** California, \$51,800 (47.3%); Texas, \$6,939 (6.3%); Florida, \$5,772 (5.3%); New Jersey, \$4,250 (3.9%); Louisiana, \$3,790 (3.5%); 45 other jurisdictions, \$37,015 (33.8%); Aggregate Alien, \$52 (0.0%).

## FINANCIAL PERFORMANCE

The following text is derived from the report of Navigators Insurance Group.

**Overall Earnings:** Navigators has generated strong pre-tax operating performance over the majority of the last five years, producing pre-tax returns on revenue and equity that exceed the results produced by the commercial casualty industry composite while after-tax return measures largely reflect this composite. Increasing levels of both underwriting profits and investment income over a five-year period have been key drivers behind operating earnings. Total return measures were negatively impacted in 2008 by significant realized capital losses, which were impacted by impairment losses recorded for accounting purposes. Positive unrealized capital gains boosted total return measures in 2009.

Earnings since 2004 have been profitable, driven by underwriting results and boosted by consistently higher levels of net investment income. Otherwise solid results in 2005 and 2008 were somewhat offset by Gulf Coast storm losses. After such losses, the group has largely restricted its storm loss exposure by significantly curtailing its available Gulf Coast wind limits. The group's conservative operating strategies, high-quality investment portfolio, stringent underwriting guidelines and strong industry knowledge (particularly within its market niche) are expected to afford the group continued earnings momentum.

## PROFITABILITY ANALYSIS

Period Ending	Company				Industry Composite			
	Pretax ROR (%)	Return on PHS	Comb. Ratio	Oper. Ratio	Pretax ROR (%)	Return on PHS	Comb. Ratio	Oper. Ratio
2005	...	2.4	...	...	18.7	12.0	93.7	80.5
2006	...	3.1	...	...	33.0	18.3	80.7	65.8
2007	...	3.3	...	...	38.7	17.6	79.4	62.2
2008	...	1.6	...	...	24.3	-0.1	95.0	76.2
2009	...	1.3	...	...	26.0	12.4	94.4	74.4
5-Yr	...	2.3	...	...	28.5	11.8	88.1	71.4

**Underwriting Income:** The group's five-and ten-year average combined ratios have outperformed its commercial casualty peers by wide margins. Such results are largely due to the group's disciplined underwriting approach leading to underwriting earnings in each of the past five years. Underwriting fell in 2009 from the prior year as the level of reserve redundancies fell significantly from the prior year with redundancies of over \$40 million in 2008 versus somewhat less than \$10 million in 2009. Although overall reserve development was favorable, its specialty liability line incurred over \$35 million in adverse development that has prompted management to either discontinue writing specific niches or to restrict coverages available under such writings.

Despite hurricane losses in both 2005 and 2008, the combined ratio remained below 100. In light of such storm losses, the group imposed policy restrictions on its marine policies including lower policy limits and limiting its business interruption coverages, as well as significantly restricting its available Gulf of Mexico net wind aggregates. While the group's marine and energy rates have largely held up since 2006 (despite soft market conditions), gross written premiums remained largely flat on strong policy retention. Although rates on its other lines of business have remained subject to competitive market conditions since 2006, overall premium volume grew as the company expanded its product offerings and grew existing lines of business. Premium growth has also been achieved by hiring individuals with existing contacts and underwriting expertise, and then matching new programs with the newly acquired skill sets. The majority of the non-marine premium growth is related to casualty niches; lines that are less susceptible to industry cycles. The group will also write opportunistic programs largely through an established distribution source.

**Investment Income:** Over the long term, the group's conservative investment strategy has produced a five-year average yield on invested assets that is somewhat below that of the commercial casualty composite. Due to the depressed interest rate environment experienced in recent years, management strategically cut back on the duration of its assets, staying short term while rates remained low, seeking to remain flexible to take advantage of rising rates once the market turned. Ultimately, duration has remained largely constant over the five-year period and moderately below its peer composite. Navigators' high-quality, actively managed investment portfolio is spread across U.S. Treasury securities, municipal, mortgage and asset-backed bonds and corporate issues. The employed strategy has produced favorable levels of investment income on an annual basis with modest realized capital gains (with the exception of 2008) generated over the years from its small equity portfolio. Increasing levels of cash flow have helped the group produce generally higher levels of investment earnings since 2004. Further boosting cash flow is the increased premium volume since 2005 on increased product offerings as well as \$220 million of capital contributions from the parent during 2005 and 2006. The group incurred significant realized losses on its common stock portfolio in 2008, which was impacted by impairment losses recorded for accounting purposes. Although the group continued to incur realized capital losses on its equity portfolio in 2009, unrealized capital gains on its stock portfolio contributed to surplus growth on the year.

## INVESTMENT INCOME ANALYSIS (\$000)

Period Ending	Company						Industry Composite	
	Net Inv. Income	Realized Capital Gains	Unrealized Capital Gains	Inv. Inc. Growth (%)	Inv. Yield (%)	Total Return (%)	Inv. Growth (%)	Inv. Yield (%)
2005	2,706	59	104	21.2	3.5	3.7	18.9	3.8
2006	5,126	-29	-22	89.4	4.9	4.9	28.5	4.3
2007	5,493	-61	24	7.2	5.2	5.1	13.9	4.4
2008	5,585	-1,600	-168	1.7	5.1	3.4	3.5	4.4
2009	5,364	-1,902	-157	-4.0	4.8	2.9	-7.3	4.0
5-Yr	...	...	...	14.8	4.7	4.0	9.2	4.2

## INVESTMENT PORTFOLIO ANALYSIS

Asset Class	2009 Inv. Assets (\$000)	—% of Invested Assets—		Annual % Change
		2009	2008	
Long-term bonds .....	113,488	97.9	94.0	5.5
Other Inv Assets .....	2,407	2.1	6.0	-65.1
Total .....	115,895	100.0	100.0	1.2

## 2009 BOND PORTFOLIO ANALYSIS

Asset Class	% of Total Bonds	Mkt. Val to Stmt Val (%)	Avg. Maturity (Yrs)	Class 1-2 (%)	Class 3-6 (%)	Struc. Secur. (%)	Struc. Secur. (% of PHS)
States, terr & poss..	0.0	-6.1	14.0	100.0	...	...	...
Special Revenue .....	35.0	3.9	4.8	100.0	...	1.2	0.4
Corporates .....	32.9	-0.1	6.5	100.0	...	40.1	12.8
Total all bonds..	100.0	2.0	5.4	100.0	...	13.6	13.2

## CAPITALIZATION

The following text is derived from the report of Navigators Insurance Group.

**Capital Generation:** Navigators has historically generated capital internally in the past five years. Significant surplus growth has been derived from capital contributions from the publicly traded parent, The Navigators Group, Inc. (Navigators Inc.). In September 2005, a \$250 million multipurpose shelf registration was filed with and approved by the SEC. This shelf was refreshed in 2009 under nearly identical terms. The shelf includes the option to issue debt securities, common and preferred shares as well as depositary shares. In the fourth quarter of 2005, Navigators Inc. drew down on a portion of its initial shelf through an equity offering that led to a \$120 million contribution to its domestic insurance subsidiary. In April of 2006, the parent again accessed its shelf and issued a \$125 million debt offering of which \$100 million was contributed to Navigators Insurance Company. The \$125 million senior notes mature on May 1, 2016, and pay interest at a rate of 7% annually. The

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additional capital contributions in 2005 and 2006 have provided the operating group with a solid level of capitalization as measured by Best's Capital Adequacy Ratio (BCAR). Further, consolidated financial leverage is a very low 12.5% (debt-to-total-capital), and interest coverage ratios more than support the group's current rating level. As a result, the group has ample financial flexibility.

Surplus growth in 2007 remained strong on favorable underwriting and investment earnings. Surplus remained unchanged in 2008 despite pre-tax operating income that was largely unchanged from the prior year. Offsetting surplus growth was realized capital losses, dividends and an increase in non-admitted assets. Growth in 2009 followed continued favorable operating results, unrealized capital gains and increases in deferred tax assets.

In addition to modest debt service, profits from the domestic insurance companies have been utilized to further the group's expansion overseas, primarily in London. From a group perspective, the standard is to provide dividends that are less than or equal to 50% of net statutory income. This standard was exceeded in 2008 as dividends approached 60% of net statutory income and fell slightly in 2009 but higher than its historical 50%.

## CAPITAL GENERATION ANALYSIS (\$000)

Period Ending	Source of Surplus Growth					Change in PHS	PHS Growth (%)
	Pretax Operating Income	Total Inv. Gains	Net Contrib. Capital	Other, Net of Tax	Change in PHS		
2005	2,706	163	50,000	-977	51,892	100.6	
2006	5,126	-51	...	-1,785	3,290	3.2	
2007	5,493	-37	...	-1,822	3,634	3.4	
2008	5,585	-1,768	...	-1,706	2,111	1.9	
2009	5,364	-2,058	...	601	3,907	3.5	
5-Yr	24,273	-3,752	50,000	-5,689	64,833	...	

**Overall Capitalization:** Navigators' risk-adjusted capitalization is solid, as measured by Best's Capital Adequacy Ratio (BCAR) and more than supports its current rating. With the significant increase in surplus since 2005 from capital contributions and retained earnings, underwriting leverage and capitalization have improved to conservative levels.

The group has significantly reduced its Gulf Coast wind exposure by reducing its gross limits and laying off the majority of risk to third party reinsurers. While the sum of net limits reached over \$200 million at year-end 2008, net offered limits fell to less than \$10 million by the end of the third quarter in 2009. This shift followed a number of large gross incurred Gulf Coast catastrophe losses in 2008 of \$114 million on Hurricane Ike and Gustav losses. Nonetheless, net losses including reinstatement premiums from these two events were \$29 million as the majority of its catastrophe exposure is ceded to third-party reinsurers, and as such, the group's catastrophe exposure was largely reduced to credit risk on the year. This strategy was adopted in light of the adverse impact of Hurricanes Katrina and Rita in 2005 that led management to mitigate its catastrophe exposure through the purchase of additional reinsurance, reductions in aggregate exposures and more stringent underwriting guidelines. Prior to 2006, loss limits of up to \$65 million were available to its insureds on policies exposed to storm losses. Current maximum available limits on such policies are (on a gross basis) less than \$10 million for both property damage and business interruption on a combined basis. Further, the company offers business interruption coverage on a limited basis.

## QUALITY OF SURPLUS (\$000)

Period Ending	Year-End PHS	% of PHS			—Dividend Requirements—		
		Cap. Stock/Contrib.	Other	Unassigned Surplus	Stockholder Divs	Div. To POI (%)	Div. To Net Inc. (%)
2005	103,483	87.9	...	12.1	...	...	...
2006	106,773	85.2	...	14.8	...	...	...
2007	110,407	82.4	...	17.6	...	...	...
2008	112,518	80.9	...	19.1	...	...	...
2009	116,425	78.2	...	21.8	...	...	...

**Underwriting Leverage:** Gross underwriting leverage remains at a reasonable level and largely reflects its peer group norms. While ceded leverage is somewhat elevated as a result of the extensive utilization of reinsurance to mitigate exposure risks, credit risk is mitigated through the use of a diversified group of highly rated reinsurers and letters of credit received from foreign reinsurers. Although premiums and liabilities, both net and gross, have grown rapidly in recent years, surplus growth has been even stronger resulting in decreasing leverage measures.

## LEVERAGE ANALYSIS

Period Ending	Company				Industry Composite			
	NPW to PHS	Res. to PHS	Net Lev.	Gross Lev.	NPW to PHS	Res. to PHS	Net Lev.	Gross Lev.
2005	...	...	0.2	0.2	0.6	1.0	2.3	3.8
2006	...	...	0.3	0.3	0.6	1.0	2.3	3.5
2007	...	...	0.2	0.2	0.5	0.9	2.0	2.9
2008	...	...	0.1	0.1	0.5	1.0	2.0	3.0
2009	...	...	0.1	0.1	0.4	0.9	1.7	2.6

Current BCAR: 243.5

## PREMIUM COMPOSITION & GROWTH ANALYSIS

Period Ending	—DPW—		—GPW—		—NPW—		—NPE—	
	(\$000)	(% Chg)	(\$000)	(% Chg)	(\$000)	(% Chg)	(\$000)	(% Chg)
2005	176,414	25.3	176,414	25.3	...	...	...	...
2006	231,718	31.3	231,718	31.3	...	...	...	...
2007	233,005	0.6	233,005	0.6	...	...	...	...
2008	149,141	-36.0	149,141	-36.0	...	...	...	...
2009	109,617	-26.5	109,617	-26.5	...	...	...	...
5-Yr CAGR	...	-4.9	...	-4.9	...	...	...	...
5-Yr Chg	...	-22.1	...	-22.1	...	...	...	...

**Reserve Quality:** While loss reserves generally developed favorably during 2009, the level of favorable development was markedly less than seen in prior calendar years. Adverse loss development on prior accident years was recorded on various elements of the group's diversified product offerings, including marine liability, middle market commercial auto and general liability, as well as its "Public Company D&O" liability and lawyers liability under its professional liability programs. A number of corrective actions have been implemented which are expected to minimize future development.

**Reinsurance Utilization:** Significant dependence on reinsurance is maintained as the group writes high gross limits, consistent with that of typical commercial marine and energy insurers. Following the group's Katrina loss in 2005, management made a decision to limit its Gulf Coast wind exposure, effectively reducing its gross catastrophe exposure from this book of business. This strategy was tested in 2008 with both Hurricane Ike and Gustav with the group incurring \$114 million in gross losses. However, net losses including reinstatement premiums from both catastrophes were \$29 million or less than 1% of surplus. In 2009, the group further reduced its net Gulf exposure, issuing total net limits of less than \$10 million.

A significant portion of the group's reinsurance program is placed with foreign reinsurers, primarily in the London market. The majority of reinsurance balances with unauthorized carriers is covered by letters of credit, which partially mitigate associated credit risk exposure.

## 2009 REINSURANCE RECOVERABLES (\$000)

	Paid & Unpaid Losses	IBNR	Unearned Premiums	Other Recov*	Total Reins Recov
US Affiliates.....	88,928	282,089	52,859	...	423,876
Grand Total.....	88,928	282,089	52,859	...	423,876

\* Includes Commissions less Funds Withheld

## LIQUIDITY

The following text is derived from the report of Navigators Insurance Group.

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# Best's Rating Report

**Overall Liquidity:** The company maintains a very sound liquidity position with quick and current liquidity ratios above industry averages. Positive underwriting and operating cash flows have been produced over the past five years, enhancing the group's invested asset and liquidity position. Cash flow has been significantly enhanced in recent years due to the dramatic increase in premiums written. The group's asset portfolio, though largely invested in government, corporate and municipal bonds, allocates enough into cash and short-term securities to supply sound liquidity. Paid losses in 2009 doubled from the prior year due to heavy storm loss activity from Hurricanes Ike and Gustav, lowering underwriting and operating cash flows on the year.

## LIQUIDITY ANALYSIS

Period Ending	Company				Industry Composite			
	Quick Liq. (%)	Current Liq. (%)	Overall Liq. (%)	Gross Agents Bal. to PHS (%)	Quick Liq. (%)	Current Liq. (%)	Overall Liq. (%)	Gross Agents Bal. to PHS (%)
2005	999.9	999.9	593.5	18.3	32.3	132.9	158.1	13.5
2006	999.9	999.9	487.3	24.8	36.5	142.2	160.8	12.5
2007	999.9	999.9	744.0	15.1	33.5	148.5	167.8	10.6
2008	999.9	999.9	909.5	10.6	30.2	144.0	165.4	9.6
2009	999.9	999.9	999.9	7.7	35.0	152.4	172.5	8.7

## CASH FLOW ANALYSIS (\$000)

Period Ending	Company				Industry Composite			
	Underw Cash Flow	Oper. Cash Flow	Net Cash Flow	Underw Cash Flow (%)	Oper. Cash Flow (%)	Underw Cash Flow (%)	Oper. Cash Flow (%)	
2005	...	1,535	7,163	...	236.1	150.0	157.1	
2006	...	3,348	-14,646	...	277.7	157.6	159.5	
2007	...	3,315	8	...	246.8	146.7	144.4	
2008	...	5,304	4,757	...	999.9	121.6	133.1	
2009	...	1,878	-5,500	...	153.6	104.2	127.4	

## HISTORY

The company was incorporated under the laws of New York on December 1, 1988 as Pilot Insurance Company and began business on October 17, 1989. Active underwriting operations commenced in 1990 and, effective January 23, 1990, the company was renamed NIC Insurance Company. The current name was adopted on January 4, 2007. At December 31, 2009, paid-in capital of \$91.0 million consisted of 250 shares of common stock at \$20,000 par and \$86.0 million of contributed surplus. All authorized shares are outstanding.

## MANAGEMENT

All outstanding capital stock of Navigators Specialty Insurance Company is owned by Navigators Insurance Company, which in turn is owned by The Navigators Group, Inc., a holding company, approximately 20% of which is owned by Terence N. Deeks and family. The affairs of the Company are under the direction of Navigators Management Company, Inc. which is reimbursed for its services. Management is directed by the same executives who direct the affairs of the parent company and The Navigators Group, Inc.

**Officers:** Chairman, President and Chief Executive Officer, Stanley A. Galanski; Senior Vice President and Chief Financial Officer, Francis W. McDonnell; Senior Vice President, Chief Underwriting Officer and Chief Risk Officer, Henry C. Bassett, Jr.; Senior Vice President and General Counsel, Bruce Byrnes; Senior Vice President, Richard S. Eisdorfer; Vice President and Treasurer, Thomas C. Connolly; Vice Presidents, Ramona L. Eiseman (Claims), Paul C. Kluga (Reinsurance), Daniel P. Reale (IT), Jeff L. Saunders (Underwriting); Secretary, Emily B. Miner.

**Directors:** Henry C. Bassett, Jr., Michael L. Civasca, Christopher C. Duca, R. Scott Eisdorfer, Stanley A. Galanski (Chairman), Paul V. Hennessy, Noel Higgitt, Christopher A. Johnson, Russell J. Johnson, John W. Jones, Francis W. McDonnell, Gregory D. Olson, Richard C. F. Rea, Jeff L. Saunders.

## REGULATORY

An examination of the financial condition is being made as of December 31, 2009 by the Insurance Department of New York. The 2009 annual independent audit of the company was conducted by KPMG, LLP. The annual statement of actuarial opinion is provided by Claus S. Metzner, FSA, FCAS, MAAA, Milliman USA.

**Territory:** The company is licensed in New York. It also operates on a surplus lines or non-admitted basis in the District of Columbia, AL, AK, AZ, AR, CA, CO, CT, DE, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA, MI, MN, MS, MO, MT, NE, NV, NH, NJ, NM, NC, ND, OH, OK, OR, PA, RI, SC, SD, TN, TX, UT, VT, VA, WA, WV, WI and WY.

## REINSURANCE

Business is all ceded to Navigators Insurance Company.

## BALANCE SHEET

### ADMITTED ASSETS (\$000)

	12/31/09	12/31/08	'09%	'08%
Bonds .....	113,488	107,587	90.3	85.1
Cash & short-term invest .....	422	5,922	0.3	4.7
Other non-affil inv asset .....	969	10	0.8	0.0
Total invested assets .....	114,879	113,519	91.4	89.8
Premium balances .....	8,938	11,883	7.1	9.4
Accrued interest .....	1,016	960	0.8	0.8
All other assets .....	820	55	0.7	0.0
Total assets .....	125,653	126,417	100.0	100.0

### LIABILITIES & SURPLUS (\$000)

	12/31/09	12/31/08	'09%	'08%
All other liabilities .....	9,228	13,899	7.3	11.0
Total liabilities .....	9,228	13,899	7.3	11.0
Capital & assigned surplus .....	91,000	91,000	72.4	72.0
Unassigned surplus .....	25,425	21,518	20.2	17.0
Total policyholders' surplus .....	116,425	112,518	92.7	89.0
Total liabilities & surplus .....	125,653	126,417	100.0	100.0

## SUMMARY OF 2009 OPERATIONS (\$000)

Statement of Income	12/31/09	Funds Provided from Operations	12/31/09
Net investment income .....	5,364	Investment income .....	5,382
Pre-tax oper income ...	5,364	Pre-tax cash operations	5,382
Realized capital gains .....	-1,902		
Income taxes incurred .....	1,851	Income taxes pd (recov) ...	3,504
Net income .....	1,611	Net oper cash flow .....	1,878

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# Best's Rating Report

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## Why is this *Best's*<sup>®</sup> Rating Report important to you?

A Rating Report from the A.M. Best Company represents an independent opinion from the leading provider of insurer ratings of a company's financial strength and ability to meet its obligations to policyholders.

The A.M. Best Company is the oldest, most experienced rating agency in the world and has been reporting on the financial condition of insurance companies since 1899. The Financial Strength Rating **opinion** addresses the relative ability of an insurer to meet its ongoing insurance policy and contract obligations. The rating is not assigned to specific insurance policies or contracts and does not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. A Financial Strength Rating is **not a recommendation** to purchase, hold or terminate any insurance policy, contract or any other financial obligation issued by an insurer, nor does it address the suitability of any particular policy or contract for a specific purpose or purchaser.

The company information appearing in this pamphlet is an extract from the complete company report prepared by the A.M. Best Company.

A Best's Rating is assigned after an extensive quantitative and qualitative valuation of a company's financial strength, operating performance and market profile.

Best's Ratings are assigned according to the following scale:

### Secure Best's Ratings

A++ and A+ . . . . .	Superior
A and A- . . . . .	Excellent
B++ and B+ . . . . .	Good

### Vulnerable Best's Ratings

B and B- . . . . .	Fair
C++ and C+ . . . . .	Marginal
C and C- . . . . .	Weak
D . . . . .	Poor
E . . . . .	Under Regulatory Supervision
F . . . . .	In Liquidation
S . . . . .	Rating Suspended

For the latest **Best's Financial Strength Ratings** and *AMB Credit Reports* visit the A.M. Best web site at [www.ambest.com](http://www.ambest.com). You may also obtain *AMB Credit Reports* by calling our Customer Service department at +1-908-439-2200, ext. 5742. To expedite your request, please provide the company's identification number (AMB #).