

Composite

AFRICAN REINSURANCE CORPORATION

Plot 1679, Karimu Kotun Street, Victoria Island, P.M.B 12765, Lagos, Nigeria

AMB#: 83411

AIIN#: AA-6940015

BEST'S RATING

Based on our opinion of the company's Financial Strength, it is assigned a Best's Rating of A- (Excellent). The company's Financial Size Category is Class VIII.

RATING RATIONALE

Rating Rationale: The rating of African Reinsurance Corporation (Africa Re) reflects the company's improving risk-adjusted capitalisation, robust operating results and its recognised position in the African reinsurance market. The outlook has been revised to stable from negative due to improved risk-adjusted capitalisation.

Improving risk-adjusted capitalisation -- A.M. Best believes that Africa Re's risk-adjusted capitalisation is likely to remain solid during 2006 and 2007 mainly due to expected single digit growth in net written premium during the next two years. The improvement in the company's risk-adjusted capitalisation in 2005 was largely due to increased paid-up capital (from USD 86.5 million in 2004 to USD 100 million at year-end 2005) and stable net written premium during that year. In A.M. Best's opinion, the company's risk-adjusted capitalisation also benefits from the continuing increase in overall retained earnings and the company's requirement to transfer 50% of net profit to general reserves (which A.M. Best regards as equity).

Robust operating results -- A.M. Best forecasts that Africa Re's current and prospective operating performance is expected to be robust with pre-tax profits to be approximately USD 21-23 million in each of the next two years (which is consistent with the year-end 2005 result of USD 20.6 million). A.M. Best believes that Africa Re's overall earnings will remain largely reliant on investment income as underwriting performance is forecast to remain modest and with a combined ratio of approximately 97-98% in 2006 and 2007. This is consistent with the 2005 result of 97.3%. There was a significant increase in the combined ratio in 2005 (from 87.8% in 2004) as a result of a deterioration in the loss ratio from 60.4% to 70.1%. This occurred due to both the company's prudent reserving methodology, associated with its adoption of annual accounting in 2005, and some adverse large loss experience in the same year. A.M. Best forecasts that net investment returns (including realised and unrealised gains and losses) will remain in line with the 2005 level of 5.9%.

Recognised position in the African reinsurance market -- Geographically, the company mainly operates through a widespread network of regional offices in Africa. A.M. Best forecasts that Africa Re's consolidated gross written premium is likely to be approximately USD 310 million at year-end 2006, compared to USD 330 million in the previous year (and which included late reported premium income of USD 20 million). In 2007, A.M. Best forecasts that the company's

consolidated gross written premium is likely to increase to approximately USD 330 million, primarily by means of developing existing business lines.

Best's Rating: A-

Outlook: Stable

FIVE YEAR RATING HISTORY

| <u>Date</u> | <u>Best's Rating</u> |
|-------------|----------------------|
| 07/13/06 | A- |
| 05/26/05 | A- |
| 06/21/04 | A- |
| 10/21/03 | A- |

BUSINESS REVIEW

In A.M. Best's opinion, African Reinsurance Corporation (Africa Re) has a recognised business profile in the African reinsurance market, where it continues to lead many reinsurance treaties in the region (particularly fire and engineering) and benefits from the close proximity of its branch offices to its cedants.

Currently, 5% of all treaty business in member states must be offered to Africa Re, with a refusal option on the part of Africa Re if particular risks are undesirable in terms of the company's portfolio mix. In A.M. Best's opinion, the significance of the compulsory cession has decreased over recent years, with A.M. Best expecting compulsory cession to account for approximately 10% of the total portfolio at the end of 2006, compared to a figure of 27% in 2002.

A.M. Best forecasts that the company's consolidated gross written premium is likely to reduce to approximately USD 310 million in 2006 and increase to approximately USD 330 million 2007 (consistent with the 2005 level of USD 330 million). The expected reduction in premium income in 2006 is due to the inclusion of late booked premiums (approximately USD 20 million from Angola) at year-end 2005, while the subsequent expected increase in 2007 is primarily due to the development of existing business lines. The company's non-African business is likely to continue to contribute approximately 5% of consolidated gross premium income during the next two years, consistent with the 2005 level. In 2005, gross written premium was split between fire and accident book business (which includes engineering and petrochemical risks) (87%), marine and aviation (10%) and life (3%). A.M. Best does not expect significant changes to the composition of the business portfolio.

A.M. Best does not expect the company's life business to grow materially. This is due to both the underdeveloped life market in Africa generally and Africa Re's decision to cease underwriting life business in South Africa (due to the cost associated with its small life portfolio).

Despite writing business in over 50 African countries, approximately 40% of gross premium income emanates from South Africa as this country's insurance industry provides approximately 80% of total premium income in Africa. In 2003 and 2004, Africa Re has been able to report aggressive growth in this region (from 16% of gross premium income in 2002) that has been partly attributable to the devaluation of the US Dollar against the South African Rand, as well as the first-time recognition of pipeline premiums (premiums written but not advised by the insured) into the accounts. The company's move from a three year funded basis to an annual accounting basis (in accordance with International Financial Reporting Standards) in 2005 resulted in the inclusion of pipeline premiums in respect of prior years in the 2003-05 accounts. Africa Re also increased its presence in the South African reinsurance market through the incorporation of a locally registered subsidiary in 2004.

During the next two years, A.M. Best expects broker-derived business to remain in line with the 2005 level of 57%. This large proportion is mainly due to the company's South African business, where brokers provide most of the business. Africa Re's inwards business is currently very reliant on a small number of cedants operating in a concentrated geographical region. However, A.M. Best does not regard this as unusual as it is common for reinsurers in emerging markets to be mainly reliant on business from a few large cedants. In 2005, the continent's top 25 ceding companies continued to account for approximately 50% of Africa Re's gross written premium. A.M. Best does not expect this to change as no material changes are expected in the company's business profile.

FINANCIAL PERFORMANCE

Overall Earnings: A.M. Best believes that Africa Re's financial performance is likely to remain solid with pre-tax profit expected to be within the range of USD 21-23 million in 2006 and 2007 (consistent with the year-end 2005 result of USD 20.6 million). In A.M. Best's opinion, Africa Re's overall earnings are expected to remain mainly dependent on investment income as underwriting performance is forecast to remain modest and with a combined ratio of approximately 97-98% in 2006 and 2007 (consistent with the 2005 ratio of 97.3%). A.M. Best forecasts that the company's investment returns (including realised and unrealised gains and losses) will remain in line with the 2005 level of 5.9% as 75% of its total investments are in cash and short-term deposits.

In A.M. Best's opinion, Africa Re's return on equity (ROE), the ratio of profit after tax to capital and surplus, in 2006 and 2007 is likely to remain in line with the 2005 level of 12.1%.

Underwriting Income: A.M. Best believes that Africa Re's underwriting performance is likely to remain modest with a high combined ratio of approximately 97-98% in 2006 and 2007 (consistent with the 2005 ratio of 97.3%). The company's loss ratio deteriorated significantly from 60.4% in 2004 to 70.1% in 2005 due to its prudent reserving strategy (that led to increases in reserves in 2005) and some adverse large loss experience during the same year. The change in the reserving strategy is partly due to the adoption of annual accounting for the first time in 2005 (previously, Africa Re reported on a three year funded accounting basis). A.M. Best expects Africa Re's expense ratio during the next two years to remain in line with the 2005 level of 27.2% which is mainly driven by acquisition costs.

For the life business (which represented 3% of overall net written premium in 2005), A.M. Best anticipates technical profits to increase to approximately USD 0.40-0.50 million (compared to USD 0.25 million in 2005), due to a slight increase in premium income.

Investment Income: A.M. Best forecasts that net investment returns, including realised and unrealised gains and losses, are likely to remain modest and to be in line with the 2005 level of 5.9%. In A.M. Best's opinion, the company's investment portfolio benefits from the rising level of interest rates in the United States. This is mainly due to Africa Re's conservative investment strategy, which is geared towards cash and short-term deposits (approximately 75% of total investments in 2005). Approximately 55% of these deposits are invested in US and European banks, with the remainder held in regional banks. In A.M. Best's opinion, this somewhat reduces the investment risk. The company aims to revise its investment strategy to accommodate higher proportions of investment in fixed income securities and less in fixed term cash deposits.

CAPITALIZATION

Overall Capitalization: A.M. Best believes that Africa Re's risk-adjusted capitalisation is likely to remain solid during 2006 and 2007 mainly due to expected single digit growth in net written premium during the next two years. Risk-adjusted capitalisation improved in 2005 due to lower than anticipated growth in net written premium (which led to a reduced credit risk). In addition, Africa Re's paid-up capital increased to USD 100 million in 2005, from USD 86.5 million in 2004, as additional capital was raised from its shareholders.

In A.M. Best's opinion, the company's risk-adjusted capitalisation benefits from the company's requirement to transfer 50% of net profit to general reserves (and which A.M. Best regards as equity). Furthermore, the company's risk-adjusted capitalisation also benefits from the continuing increase in overall retained earnings. In A.M. Best's opinion, Africa Re's ability to attract "AAA" rated supranational investors indicates the strong level of international support for the company.

Reserve Quality: In A.M. Best's opinion, the company's requirement from 2005 to estimate losses after a 12 month period rather than a 36 month period is likely to increase the volatility of reserves. This volatility is mitigated by Africa Re's prudent reserving strategy for both its non-life and life business. In line with the change in accounting systems from a three year accounting basis to annual accounting, Africa Re's gross provisions for outstanding claims increased significantly from USD 51.8 million in 2004 to USD 192.8 million in 2005. At the same time, unearned premium reserves reduced from USD 202 million in 2004 to USD 71 million in 2005. A.M. Best regards the company's move to annual accounting as a progression towards more transparent reserve calculations.

LIQUIDITY

Overall Liquidity: In A.M. Best's opinion Africa Re's liquidity ratio is solid and expected to be at the 2005 level of 99.2% during the next two years as the majority of total investments (75% in 2005) are held in cash and short-term deposits. The remaining investments are split between

bonds (13%), listed shares (6%) real estate (5%) and unlisted shares (1%). In 2005, the liquidity ratio increased from 71.3% at year-end 2004 as paid-up capital was increased from USD 86.5 million in 2004 to USD 100 million in 2005. While A.M. Best does not expect any material changes to the composition of the investment portfolio, the company intends to increase the portion of its bond portfolio during the next two years. The average maturity of the bond portfolio is two to five years, and this, in A.M. Best's opinion, is in line with the average duration of the company's corresponding liabilities.

**Source of Information: Company Annual Report
Summarized Accounts as of December 31, 2005**

MANAGEMENT

In A.M. Best's opinion, Africa Re benefits from an experienced management team with longstanding and wide-ranging knowledge of global (and in particular, African) insurance and reinsurance markets. The company's corporate governance is extensive, using very good management information systems to maintain control over the regional office network throughout the African continent.

A.M. Best regards the company's move to an annual accounting basis in accordance with IFRS (from a three year accounting basis) as a progression towards compliance with international regulations. Although unregulated outside of South Africa, Africa Re benefits from a supervisory board of independent directors, a significant number of which are heads of their national insurance regulatory bodies. In addition, the African Development Bank, International Financial Corporation and Deutsche Investitions und Entwicklungsgesellschaft each hold a permanent board position and the company is subject to regular internal audits which are submitted to the audit and risks committee of the board of directors at Africa Re.

REINSURANCE

A.M. Best believes that Africa Re's retrocession programme is very good, both in its structure and in the security of the companies used. Africa Re purchases retrocession cover through a comprehensive excess of loss programme. Excess of loss cover is bought separately for property, casualty, marine and aviation accounts from reinsurers who generally have a rating in the "A" range. Despite decreasing prices in the retrocession market for marine, accident and aviation, A.M. Best does not expect Africa Re to increase its outward reinsurance as the African continent has a relatively low exposure to catastrophes and generally has low insured values.

In A.M. Best's opinion, the anticipated increase in 2006 in the net retention of non-life premiums to 92% (from 89% in 2005) is unlikely to impact the company's net earnings as the company is not exposed to large risks. In 2007, A.M. Best does not expect any changes to the net retention level of premiums.

