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Sirius International Insurance Corp.

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Sirius International Insurance Corp.

Major Rating Factors

Strengths:

- Historically strong operating performance.
- Very strong capitalization.
- Improving competitive position as a member of the White Mountains Insurance Group Ltd.

Weaknesses:

- Potential volatility of underwriting results through group reinsurance agreements.

Holding Company: White Mountains Insurance Group Ltd.
Counterparty Credit Rating
Local Currency
BBB-/Stable/--
Operating Company Covered By This Report
Financial Strength Rating
Local Currency
A-/Stable/--

Rationale

The ratings on Stockholm-based reinsurer Sirius International Insurance Corp. (Sirius) reflect its core status as a member of the Bermuda-based White Mountains Re Group Ltd. (WMRe, core operating entities rated A-/Stable/--).As a core entity of WMRe, the ratings and outlook on Sirius would be affected by any change in the ratings or outlook on WMRe. Standard & Poor's Ratings Services considers the company's operations as a significant strength for the ratings on WMRe.

On a stand-alone basis, the key rating factors include Sirius' very strong capitalization, historically strong operating performance, and its improved competitive position as a member of the Bermuda-based White Mountains Insurance Group Ltd (WM group; BBB-/Stable/--). The ratings are constrained, however, by enhanced volatility through assumed reinsurance agreements with other parts of WMRe and the WM group, and the integration of White Mountains Re Bermuda Ltd. (WMRe Bermuda) into Sirius. We consider these developments as having the potential to dilute the strong and consistent operating performance of Sirius' core operations.

We consider Sirius to be core to WMRe, reflecting the breadth of the company's financial and operational integration within the group and ultimately within the WM group, as illustrated by the demonstrable fungibility of capital and risk within the group. In 2009, 45% of group premiums consisted of quota shares from other WM group entities--Esurance Insurance Co. and White Mountains Reinsurance Company of America (WMRe America). This proportion shrank to 32% in the first half of 2010, as the Esurance cession declined. In our opinion, it will further reduce in 2011 when the amount of WMRe America business taken is also expected to decline. Sirius' integration of WMRe Bermuda in February 2010 will in part offset the 2010-2011 reduction in premiums implied by the quota share reductions. However, these strategic developments highlight the potential volatility of business and results reported under the Sirius banner.

The enhanced resulting volatility and potential concentration of catastrophe risk deriving from the Bermudan business integration and intra-group quota shares is recognized by WMRe and the WM group. In 2009, $200 million was injected into Sirius by its parent group to counteract the potential volatility. Overall, we regard Sirius' capitalization as very strong, underpinned by its very strong risk-based capital adequacy according to Standard & Poor's proprietary model.

We view Sirius' historical operating performance as strong. Its combined ratio has outperformed the reinsurance market average each year since 1997, returning an operating profit in every year save 2001. 2009 saw the second-best result in the group's history, both in terms of profitability (Swedish krona [SEK] 1.57 billion) and combined ratio (86%). In the first quarter of 2010, Sirius suffered disproportionately from the Chilean earthquake. However, in 2010, good results elsewhere reduced the first half combined ratio to 102%, with the prospect of technical profitability over the year given favorable catastrophe experience in the second half of the year.

Outlook

The stable outlook on Sirius reflects the stable outlook on WMRe overall and the other core entities of WMRe. As a core subsidiary of WMRe, the ratings on the company will move in tandem with those on the parent.

Subject to normal loss experience in the fourth quarter of 2010, we expect Sirius' net combined ratio to recover from the earthquake-inspired shock of early 2010 and to be below 98% for the year as a whole. Looking forward, we would expect the 2011 combined ratio to be in the low 90s as performance and catastrophe experience revert to recent norms. We expect Sirius to maintain its very strong capitalization.

We view Sirius as a rating strength to the group and we expect this to continue over the rating horizon. A positive rating action would be most likely if the positives of Sirius' stand-alone position were considered to outweigh the drag factors of the remainder of the WM group. A negative rating action would most likely be driven by a sustained downturn in operating performance or competitive position, or a significant deterioration in risk-based capital adequacy. Such a deterioration is most likely to derive from demands for capital from elsewhere in the WM group, or from the WM group making further use of the Sirius balance sheet to buttress its other businesses.

Corporate Profile: Sirius Leads The International Business Of WMRe

Sirius is a core member of WMRe--WM group's reinsurance operations. Sirius is the hub of WMRe's international business, focusing on property (biased towards European risks and the largest line, comprising 50% of total premiums), accident and health, and aviation. Credit, marine (nonenergy), and contingency lines are also written across Europe, the U.S., and Asia; the latter being a possible area for growth. The business transferred in from the former WMRe Bermuda is predominantly U.S. catastrophe excess of loss cover.

Sirius' intra-group assumed reinsurance agreements with Esurance (U.S. personal auto risks) and WMRe America (property risks) are expected to reduce in significance for the Sirius group over 2010-2011. While business from these sources comprised 45% of net premiums in 2009, they are expected to fall to 32% in 2010. The Esurance cession declined to $69 million (17% of net premiums) in the first half of 2010, from $319 million in 2009 (42%). The two intra-group cession treaties were modestly profitable for Sirius in 2008-2009, but both showed losses in the first half of 2010, WMRe having been affected by losses from the Chilean earthquake.

Competitive Position: Strong, Enhanced By White Mountains Insurance Group Ltd.

Table 1

Sirius International Insurance Corp. Competitive Position

(Mil. SEK)	2009	2008	2007	2006	2005
Total revenue	7,241.0	6,245.0	6,978.0	6,355.0	5,558.6
P/C: Gross premium written	8,630.0	6,683.0	6,652.0	7,987.0	5,570.4
P/C: Annual change in gross premium written (%)	29.1	0.5	(16.7)	43.4	(3.4)
P/C: Net premium written	6,957.0	5,602.0	5,810.0	7,257.0	4,877.2

P/C--Property and casualty. SEK--Swedish krona.

Sirius' competitive position has historically been good. Business has been very stable with a remarkable 90% of business lines written in 2002-2003 still being with the group in 2010 (although many U.S. lines were transferred within the WMRe and only recently returned). Sirius' economies of scale, diversification, and access to business have been enhanced as a result of its membership of the WM group and WMRe.

Total premium volume oscillated widely over 2008-2010 mainly because of the integration of WMRe Bermuda, but also due to the downscaling of the intra-group quota shares. The core Sirius business was largely stable. Of its own business, Sirius leads on 56% of its portfolio by premium. The focus of Sirius' book is on short- to medium-tail lines, while 75% of premiums are nonproportional.

Management does not prioritize growing the core Sirius book in the current pricing environment, but is keen to retain the company's presence and relative position in markets in which it operates. Should premium or loss rates deteriorate in a sector, Sirius' inclination is to take out greater retrocession cover rather than withdraw completely.

Sirius continues to maintain a well-diversified portfolio, both in terms of the classes of business that it writes and its geographical spread. Business is written out of branches in London, Liege, Hamburg, Zurich, Bermuda, Singapore, and Copenhagen, in addition to Stockholm. Broker-channel business constitutes about 85% of gross premium income (excluding intra-group business) and the remainder consists of business written directly.

Prospective

We expect the shrinkage of the intra-group quota shares to drive a reduction in total net premiums of about 10% in 2010, compared with 2009. We expect a further, possibly more modest reduction for 2011. We anticipate that property will remain the dominant business line within Sirius' own business, representing over half of total premiums in financial-year 2010 (excluding intra-group business). In light of past stability, we expect little change to the business mix, with accident, health, and aviation remaining the second- and third-largest classes, respectively.

We view the strong competitive position of Sirius' own business as a positive ratings factor. We also regard the relative decline in the significance of intra-group quota shares as positive, given that their profitability had been moderate. We continue, however, to remain cautious in assessing the impact of the former WMRe Bermuda business on the Sirius group.

Management And Corporate Strategy: Experienced Management Team Is A Positive Ratings Factor

Standard & Poor's considers Sirius' management team to be a marginally positive factor for the ratings. The ongoing close involvement of the executive team from WMRe should enable local management to meet the challenges posed by the continuing uplift in Sirius' risk appetite. The management team intends to enhance the level of diversification to improve the balance of its portfolio.

Operational management

Standard & Poor's considers Sirius to have a very capable and experienced management team, focused on profitability and the cautious development of successful business niches. We view the consistently market-beating technical results as evidence for this. Responsibility for the day-to-day operations at Sirius remains with the local management team although the executive team at both the WM group and WMRe will continue to provide additional strategic and operational oversight. The structure and underwriting management of the Bermudan business remains unchanged following the transfer to Sirius.

Financial management

Financial management is focused around achieving the group target of 12% return on capital employed. To this end, WMRe has strengthened financial management at Sirius. Sirus' underwriting team has therefore been encouraged to focus on ensuring that the pricing of each individual treaty enables the company to achieve the group target. Although catastrophe losses will inevitably vary, we expect Sirius to deliver an average combined ratio of 90% across the cycle. We regard these targets as attainable given recent Sirius' performance. In 2008-2009, an average return on capital of 16% was achieved.

Enterprise Risk Management: Adequate With Strong Risk Controls

Standard & Poor's considers the enterprise risk management (ERM) program of WMRe, and consequently Sirius, to be adequate, with strong risk controls. The ERM framework at Sirius level is robust and has been developed in alignment with the risk management practices prescribed by WMRe. We consider that further progress has been made in 2009-2010 in enhancing Sirius' strategic risk assessment and management, and in integrating risk assessment and capital and business planning. We have raised our assessment of Sirius' risk controls to "strong" from "adequate".

Under the auspices of WMRe and the WM group, Sirius has developed a comprehensive risk-management structure, in particular the developing of its emerging risk identification and management processes through a standing risk management committee. The committee undertakes "legal scouting" and evaluates the impact of risks considered by the chief risk officer and the World Economic Forum. Five risk registers are maintained and their outputs are considered by the Sirius risk management function, reporting ultimately to the WMRe risk management committee.

The Sirius risk management function's reports also feed into group-steering committees preparing for Solvency II and developing an economic risk capital model. The model is based around an economic scenario generator and takes into account catastrophe incidence, reserve development, underwriting exposures, market trends, investment performance scenarios, foreign exchange movements, and correlation factors between these key risks. The model allocates capital across the WMRe operations and sets return targets for each unit, including Sirius, which in turn guide underwriting and pricing.

Under the model, an average combined ratio of 88% is targeted, with only one year in 25 having a combined ratio of 105% or more. While Sirius' operating performance since 2006 has been strong and within these parameters, they remain exacting targets. The worst-case annual result out of 10,000 scenarios explored would be equivalent to Sirius suffering a 44% capital loss. The model remains a work-in-progress and will continue to be refined through 2011 as part of Solvency II preparations.

Catastrophe risk is identified as the greatest threat to the company, with the greatest modeled exposure reckoned to be European Windstorm, closely followed by New Madrid quake. The 1 in 250 year probable maximum loss is estimated at $285 million post-tax (equivalent to a combined ratio of 134%).By means of comparison, the 2005 Katrina loss was $94 million. Other significant risks are market-related, with an unusually high level of Forex risk, reflecting the potential USD/SEK volatility. Interest rate risk is low by comparison, asset and liability durations being closely matched.

Operating Performance: Historically Strong

Table 2

Sirius International Insurance Corp. Operating Performance

	2009	2008	2007	2006	2005
Return on equity (%)	14.2	8.8	7.5	9.1	7.8
Return on equity (adjusted) (%)	14.4	14.6	21.3	18.3	6.4
Earnings before interest and tax (EBIT)	1,579.0	829.0	895.0	1,132.0	689.1
Gross combined ratio (%)	77.3	130.3	86.8	81.3	102.8
P/C: Current year loss ratio (%)	60.6	62.8	57.7	51.6	69.4
P/C: Net loss ratio (%)	60.6	62.8	57.7	51.6	69.4
P/C: Net acquisition expense ratio (%)	19.0	19.6	26.7	28.3	27.6
P/C: Total net expense ratio (%)	25.6	24.1	30.7	32.7	32.1
P/C: Net combined ratio (%)	86.2	86.9	88.3	84.3	101.5
P/C: Gross loss ratio (%)	53.0	106.9	58.2	49.8	72.4

P/C--Property and casualty.

Sirius' historical operating performance has been strong, reflecting the company's procyclical approach to underwriting. Over the past four completed years, the company reported an average net combined ratio of 86.4%.

2009 saw the second-best result in the group's history, both in terms of profitability (SEK1,578 million) and combined ratio (86%). In the first quarter of 2010, the group suffered significant losses from the Chilean earthquake due to its market share in Latin America. Gross losses are currently assessed at $100 million, and net at $50 million. In 2010, Sirius' net figure has not deteriorated since the first quarter; however it represents 42% of expected annual catastrophe losses for Sirius. While the Chilean loss was therefore significant, it is in the nature of the reinsurance business that there will be fluctuations. Although the Chilean loss will weigh on the 2010 result as a whole, the absence of other significant catastrophe losses in the second and third quarters of 2010 reduced the year-to-date combined ratios to 102% in the first half of the year, with the prospect of a sub-100% 12-month 2010 result, in the absence of further major losses in the second half of the year.

Prospective

Subject to normal loss experience, we expect Sirius' net combined ratio to remain below 95% over the rating horizon. We believe that the company will post a net underlying combined ratio of 98% for 2010. Consequently, we forecast that post-tax profit for the year will decrease to SEK700 million, from SEK1,302 million in 2009, due to declining premiums written through Sirius and the higher combined ratio from catastrophe losses.

Accounting: IFRS Reporting

Sirius reports in accordance with International Financial Reporting Standards (IFRS). Sirius' accounts are audited by PricewaterhouseCoopers Ltd. and have received a clean audit opinion in all recent years. Standard & Poor's does not have any concerns over the quality or nature of the company's accounting.

Investments: Conservative, With Low Volatility

Table 3

Sirius International Insurance Corp. Investments And Liquidity

(Mil. SEK)	2009	2008	2007	2006	2005
Common equity investments/capital (%)	19.4	23.9	31.1	16.6	24.8
Illiquid invested assets/total invested assets (%)	12.8	14.0	11.7	0.2	13.5
General account invested assets	17,030.0	15,086.0	14,240.0	14,870.0	15,669.4
Net investment yield (%)	2.3	2.9	6.5	3.0	3.9
Net investment yield including realized capital gains/(losses) (%)	0.3	5.6	4.3	(0.4)	8.6
Net investment yield including all capital gains/(losses) (%)	4.1	0.7	1.4	1.5	5.5
Cash & cash equivalents (%)	25.7	16.3	19.1	26.8	11.7
Investment grade bonds (%)	50.9	58.2	53.8	65.7	64.2
Common stock (%)	10.6	11.6	15.4	7.3	10.6
Investments in affiliates (%)	12.8	13.9	11.6	0.0	13.4

SEK--Swedish krona.

We consider Sirius' investment portfolio to be conservative and supportive of the rating. Policyholders' funds are matched to fixed interest investments with a weighted average credit rating of 'AA'. While shareholders' funds are matched by a wider range of assets, the traded equity portfolio is currently limited to 11% of total investments, while property investment is avoided. The only significant concentration risk is a 22% stakeholding in White Mountains Phoenix, WMRe America's ultimate holding company, which accounts for 13% of total investments.

WM group's wholly owned investment management subsidiary, White Mountains Advisors, sets the investment strategy and administers the investments for all the WM group companies. The targeted return on investment (ROI) is the 10-year Treasury rate plus 100 basis points, which we consider achievable within the context of the planned asset mix. The targeted ROI for 2010 represents a decline compared with actual results in 2009 (7.4%), when markets rebounded in the later part of the year. We do not expect the investment mix to change significantly, although there has been a modest movement from cash to fixed interest holdings over 2010.

Credit risk

In our view, the quality of the fixed-income portfolio is strong and credit risk is modest. In August 2010, 72% of Sirius' fixed-interest portfolio was invested in 'AAA' rated securities, 3% in the 'AA' category, 12% in the 'A' category, with the balance being held in the 'BBB category.

Market risk

We regard market risk within the portfolio arising from the equity exposure as acceptable. Sirius has clear limits on amounts to be invested locally and amounts to be invested in an individual security/issuer; the intra-group investment in White Mountains in Phoenix aside.

Exchange Risk

Exchange Rate risk is significant but managed and matched to underlying business. In August 2010, 36% of investments were held in U.S. dollars, 34% in Swedish krona, and 21% in euros. Less than half of the total solvency capital is held in U.S. dollars. An intra-group forex hedge is held with WmRe.

Liquidity: Very Strong, Supported By Surplus Capital

Liquidity is very strong, supported by the very strong capitalization held at Sirius. At financial year-end 2009, the ratio of liquid assets to technical reserves for the company was 188% (140% in December 2008). Underwriting cashflows of $187 million were generated in 2009.

Capitalization: Capital Adequacy Remains Resilient To Increased Operating Leverage And Equities

Table 4

Sirius International Insurance Corp. Capitalization

	2009	2008	2007	2006	2005
Liquidity ratio (x)	11.3	13.8	29.0	8.9	5.7
Invested assets/loss & unearned premium reserve (%)	216.0	188.8	203.5	169.7	178.0
Reinsurance utilization (%)	19.4	16.2	12.7	9.1	12.4
P/C: Net loss reserves/gross loss reserves (%)	60.5	56.8	82.4	85.8	83.8

P/C--Property and casualty.

Capitalization remains a key strength for the ratings, bolstered by the $200 million capital injections of 2009-2010. Standard & Poor's expects Sirius' capitalization to remain supportive of the current ratings.

Capital adequacy

On December 2010 projections, Sirius would enjoy a substantial surplus above the 'AA' level (according to Standard & Poor's capital model), and above its own 99.97% value-at-risk calculation. The internal model target, and our 'AA' capital model, both compare favorably to Sirius' estimated year-end 2010 capital of $1,821 million.

Sirius is enhancing its economic capital model ahead of Solvency II, which will guide its retrocession, catastrophe risk management, and capital allocation processes.

Reserves

Sirius has a track record of releasing reserves established in respect of old underwriting years. Reserves are reviewed quarterly as part of the audit process and receive an additional full external review every year. We consider it likely that reserve surpluses will continue to be released in coming years, although possibly at a lower level than they are currently.

Reinsurance

Sirius' reinsurance utilization ratio has been increasing in recent years (19.4% in 2009 compared with 9.4%-12.3% in 2005-2007). This is due in part to the lower retention assumed in the treaties renegotiated in the second quarter of 2010 following the Chilean earthquake losses. However, the long-term trend was upwards regardless of these renegotiations.

The composition of the reinsurance program is diverse, spread among securely-rated reinsurers. After declining over 2009, balances recoverable from reinsurers increased in the first half of 2010 to SEK7 billion (43% of gross recoverables).

We estimate Sirius's aggregate net probable maximum loss (PML) before reinstatement premiums, at a return period of 250 years, at about 16% of its regulatory capital at year-end 2009. A charge equating to the one-in-250-year PML ($285 million) has been included in our assessment of Sirius' capital adequacy.

Financial Flexibility: Strong, Driven By WMRe And WM group

In our view, Sirius' financial flexibility is strong and largely influenced by WmRe and WM group's capital-management strategies. Aside from the WmRe and WM group's overall capital flexibility, the company also uses internal and external reinsurance to manage its capital.

Ratings Detail (As Of December 14, 2010)*	
Holding Company: White Mountains Insurance Group Ltd.	
Issuer Credit Rating	
Local Currency	BBB-/Stable/--
Senior Unsecured (1 Issue)	BBB-
Operating Company Covered By This Report	
Sirius International Insurance Corp.	
Financial Strength Rating	
Local Currency	A-/Stable/--
Counterparty Credit Rating	
Local Currency	A-/Stable/--
Related Entities	
White Mountains Re Group Ltd.	
Issuer Credit Rating	
Local Currency	BBB-/Stable/--
Preference Stock (1 Issue)	BB
Senior Unsecured (1 Issue)	BBB-
Domicile	Sweden

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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