

## Philadelphia Indemnity Insurance Co. And Philadelphia Insurance Co.

**Operating Companies Covered  
By This Report**

Financial Strength Rating

**Local Currency**

AA-/Negative/—

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### **Major Rating Factors**

#### **Strengths:**

- Strategic importance of Philadelphia Indemnity Insurance Co. and Philadelphia Insurance Co. to Tokio Marine & Nichido Fire Insurance Co. Ltd.
- Strong competitive position as a specialty underwriter.
- Strong operating performance.
- Strong capitalization, with no debt outstanding.

#### **Weaknesses:**

- Aggressive growth strategy, featuring new product introductions in a difficult insurance cycle.
- Key-men risk.
- Relatively high gross catastrophe exposure.

### **Rationale**

The counterparty credit and financial strength ratings on Philadelphia Indemnity Insurance Co. and its sister company, Philadelphia Insurance Co., are based on their strategic importance to Tokio Marine & Nichido Fire Insurance Co. Ltd. (TMNF; AA/Negative/A-1+), and therefore receive an uplift in the ratings. According to Standard & Poor's Ratings Services' criteria, the ratings on these entities are capped at one notch below the ratings on core group members. The companies' stand-alone characteristics include their strong competitive position, strong operating performance, and strong capitalization. Offsetting these strengths are the companies' aggressive growth strategy (including the introduction of new products in a

difficult insurance cycle), key-men risk, and relatively high gross property catastrophe exposure.

The GAAP financial data in this report includes the following companies: Philadelphia Indemnity Insurance Co., Philadelphia Insurance Co., Liberty American Select Insurance Co., and Liberty American Insurance Co. (collectively referred to as PHLY).

On July 23, 2008, Tokio Marine Holdings Inc. (Tokio Marine; the parent company of TMNF) and Philadelphia Consolidated Holding Corp. (Philadelphia Consolidated; the parent company of PHLY) entered into an agreement under which Tokio Marine would acquire all outstanding shares of Philadelphia Consolidated for \$61.50 per share in cash, a 73% premium to Philadelphia Consolidated's closing price of \$35.50. The total transaction value was approximately \$4.73 billion, and the sale was completed on Dec. 1, 2008.

Tokio Marine's acquisition of PHLY was consistent with its long-term strategy of expanding revenues and profits from international markets. Given its limited growth potential in the domestic Japanese nonlife insurance market, Tokio Marine has been pursuing an international expansion strategy to achieve business growth and strengthen profitability. The PHLY acquisition will play a vital and strategic role in the group's strategy, enabling it to establish a significant presence in the U.S., the world's largest insurance market. The acquisition also will enable Tokio Marine to create a well-balanced global portfolio, including domestic, developed, and emerging markets. Therefore, we view PHLY as a strategically important subsidiary of TMNF.

PHLY constitutes a significant proportion of Tokio Marine's pro forma consolidated position. As of year-end 2008, PHLY accounted for about 7% of the group's pro forma net premiums written and about 11% of its pro forma capital position. More importantly, its net income represented about 39% of the group's pro forma total.

PHLY has a strong competitive position as a specialty insurer with an underwriting focus on value-added coverage and services for select markets. The company has translated this competitive advantage into strong underwriting results, as it targets niches (such as nonprofit and religious organizations) with specialized areas of expertise. This enables PHLY to offer customized coverage and solutions rather than competing solely on price. The company also benefits from a diverse multichannel distribution platform with a national footprint.

PHLY's operating performance has been consistently strong, with an average combined ratio of 79.9% over the past five years (2004-2008). In the first nine months of 2009, its underwriting performance remained strong, although it declined from the prior-year period. Adjusting the operating metrics to exclude merger-related items (refer to the Accounting section, below), the company had a combined ratio of 88.8% and pretax operating income of \$263 million, compared with 84.5% and \$274 million, respectively, in the prior-year period. Results were hampered by \$47 million of catastrophe losses resulting from a number of small events, a higher-than-expected frequency of losses across its commercial package products, and declining premium rates (a 1.7% average rate decrease during the first nine months of 2009). However, this was partially offset by \$34 million of favorable reserve development. PHLY continues to generate robust earnings that have supported its very strong and redundant risk-adjusted capital base (which includes an estimated property catastrophe charge incorporating its net aggregate probable maximum loss based on the one-in-250-year return period).

In the past five years, the company has been growing its top line aggressively. Gross premiums written (GPW) increased at a 13% compound annual growth rate, reaching \$1.89 billion in 2008

versus \$1.17 billion in 2004. Similarly, in the first nine months of 2009, GPW rose 8% year-over year, to \$1.56 billion. To implement its growth strategy, PHLY is relying on its experienced management team and strong relationships with its key agents to generate new business opportunities. PHLY added a significant number of new products and wrote a significant amount of new business, including about \$350 million of GPW during the first nine months of 2009 (22% of GPW). The company does extensive research prior to introducing a new product and focuses on the coverage needs within each niche. However, PHLY has a short track record in some of these new businesses, and its ability to execute an overall profitable growth strategy—especially in a challenging environment—remains somewhat unproven and risky.

The company has a strong and experienced management team consisting of financially motivated owners/managers. The top three executive positions (chairman, CEO, and chief operating officer) prior to the acquisition had been held by the Maguire family, which constitutes a key-men risk. James Maguire Jr., president and CEO, became chairman following the retirement of James Maguire (the founder of PHLY) effective Jan. 1, 2010. Nevertheless, the prior three executives had owned about 20% of Philadelphia Consolidated's common shares prior to its acquisition by Tokio Marine. Given their financial payouts, there are concerns about their long-term plans with the company. However, as a mitigating factor, TMNF has retained PHLY's executive management team through three-year employment contracts (set to expire Jan. 1, 2012) and retention bonuses vested over time. In addition, PHLY's top five executives invested about \$23 million in Tokio Marine's common stock.

PHLY's gross property catastrophe exposure is high compared with its capital base. However, as a mitigating factor, the company has a good reinsurance program in place that significantly reduces its net exposure. To minimize the counterparty credit risk, PHLY's reinsurance structure is well diversified among highly rated carriers.

### ***Outlook***

The outlook on PHLY is negative, reflecting the negative outlook on its parent, TMNF. Standard & Poor's revised the outlook on TMNF to negative following the outlook revision on the long-term sovereign credit ratings on Japan (AA/Negative/A-1+) to negative from stable. (See Standard & Poor's article entitled "Outlooks On Three Japanese Insurers To Negative Following Sovereign Outlook Revision," published Jan. 26, 2010, on RatingsDirect.)

Standard & Poor's expects PHLY's GPW to grow by about 5% to 10% in 2009 and by about 5% in 2010. We are somewhat concerned about the company's growth in a weak pricing environment, which could affect its operating results. Nevertheless, we expect PHLY's competitive position to remain strong, and we anticipate that the company will continue to emphasize underwriting discipline. PHLY should generate strong underwriting results in 2009 and 2010, in line with its historical results. We believe that the company will report an adjusted combined ratio (excluding merger-related items) of about 88% in 2009, despite the soft pricing environment.

In our opinion, PHLY's capitalization is likely to remain strong, redundant, and supportive of the ratings in 2009 and 2010. We expect TMNF to support PHLY's capitalization and financial flexibility, if necessary, and believe PHLY will maintain its strategically important status within TMNF. As a result, the ratings and outlook on PHLY should move in tandem with those on TMNF.

If PHLY is successfully integrated, establishes itself as a cornerstone within the group, and materially contributes to the group's turnover and earnings during the next two to three years, we might decide to

view PHLY as core to TMNF. If that were to happen, we would then align the ratings on PHLY with those on the other core group members. Alternatively, we could lower the ratings on PHLY if its operating performance were to deteriorate significantly, thereby affecting its financial profile.

***Competitive Position: Focused On Value-Added Coverage In Niche Markets***

PHLY has a strong competitive position as a specialty underwriter with a focus on value-added coverage and services for select markets. The company has successfully translated its competitive advantage into strong underwriting results, as it targets niches with specialized areas of expertise. This enables PHLY to compete by offering customized coverage and solutions rather than competing solely on price.

Table 1

<b>Philadelphia Consolidated Holding Corp./Business Statistics</b>							
	—Nine months ended Sept. 30—		—Year ended Dec. 31—				
<i>(Mil. \$)</i>	2009	2008	2008	2007	2006	2005	2004
Gross premiums written	1,556.3	1,442.2	1,891.7	1,692.2	1,493.2	1,264.9	1,171.3
Growth (%)	7.9	11.2	11.8	13.3	18.0	8.0	29.3
Net premiums written	1,442.5	1,301.0	1,695.2	1,459.6	1,282.9	1,110.8	914.5
Growth (%)	10.9	16.2	16.1	13.8	15.5	21.5	51.8
Reinsurance utilization (%)	7.3	9.8	10.4	13.7	14.1	12.2	21.9
<b><i>Gross premiums by line of business (% of total):</i></b>							
Human services and auto	40.2	N.A.	38.7	40.5	43.3	49.1	55.4
Public services and sports and recreation	24.2	N.A.	21.3	18.8	16.6	12.2	10.6
Property	18.8	N.A.	22.5	22.9	18.9	15.7	10.9
Specialty/professional	15.0	N.A.	14.4	14.1	14.4	14.8	13.2
All other	1.7	N.A.	3.1	3.6	6.8	8.1	9.9
Total	100.0	N.A.	100.0	100.0	100.0	100.0	100.0

N.A.—Not available.

PHLY targets various niche markets, primarily nonprofit and religious organizations (e.g., Habitat for Humanity, the YMCA, and churches), where its average premium per policy is less than \$10,000. The company underwrites mostly commercial lines (83% of the first nine months of 2009 GPW), and the remainder of its premium profile consists of specialty and professional lines (15%) and all other (2%). The company exited all of its Florida’s personal line policies (e.g., homeowners and rental homes) in the summer of 2009 to reduce its catastrophic wind exposure.

Through its commercial multiperil package policies, the company offers its producers and policyholders a convenient product. These package policies provide a combination of liability, property, and automobile coverage with limits up to \$1 million for casualty, \$125 million for property, and umbrella limits on an optional basis up to \$15 million. Its ability to provide professional/management liability and general liability coverage in one policy is advantageous. PHLY has written a significant amount of its GPW through its commercial multiperil package policies, including \$839 million during the first nine months of 2009.

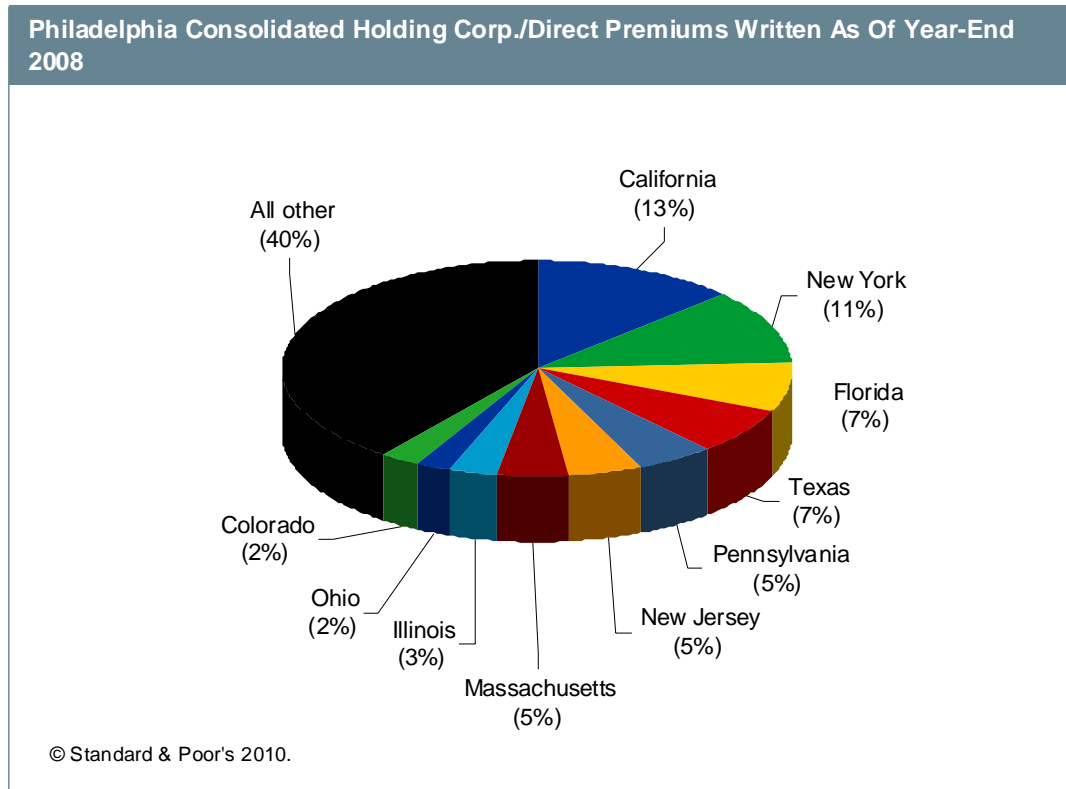
In its specialty and professional lines, PHLY provides professional and excess liability (errors and omissions) coverage mainly to accountants, marketing consultants, and claims adjusters. Specialty lines

also include directors' and officers' liability coverage for nonprofit and private companies written on a claims-made basis, with \$1 million in limits.

PHLY's competitive position benefits from a diverse multichannel distribution system that includes a select group of 268 preferred agents, a broader group of 930 Firemark producers, and a network of more than 13,000 independent producers. These producers complement PHLY's existing 49 regional and field offices across the U.S. The preferred agents are eligible for profit sharing based on their achievement of minimum premium production thresholds and profitability results. The amount of profit sharing may not be known until the final contractual loss evaluation, which may be 6.5 years after the contract-year business was written. Moreover, the company has given Firemark producers the opportunity to become preferred agents. In addition to independent producers, the company sources its business through wholesalers and the Internet.

PHLY has a geographically diversified book of business, with the top five states accounting for 43% of 2008 direct premiums written. The company has reduced its Florida writings, as it has exited the personal lines segment.

Chart 1



In the past five years (2004-2008), the company has been growing its top line aggressively. Its GPW grew at a 13% compound annual rate, to \$1.89 billion in 2008, from \$1.17 million in 2004. Similarly, its net premiums written (NPW) increased 17%, to \$1.70 billion, from \$915 million. PHLY has continued to add a significant number of new products and to write a significant amount of new business, including about \$350 million of GPW during the first nine months of 2009. Strong premium growth occurred despite softening rates across all business lines (a 1.7% average rate decrease during

this period). The company's strategy has produced strong earnings thus far, but it has a short track record in some of these new businesses. In addition, its ability to execute an overall profitable growth strategy, especially in a difficult insurance cycle, remains somewhat untested.

***Prospective***

We expect the company's GPW to increase by about 5% to 10% in 2009 and by about 5% in 2010. We are somewhat concerned about PHLY's organic growth strategy amid a soft pricing environment, as this could affect its operating results. Nevertheless, we expect the company's competitive position to remain strong, and we believe PHLY will continue to emphasize underwriting discipline.

***Management And Corporate Strategy: Likely To Remain Relatively Unchanged Following The Acquisition***

The company has a strong and experienced management team consisting of financially motivated owners/managers. The top three executive positions (chairman, CEO, and chief operating officer) within PHLY are held by the Maguire family. Effective Jan. 1, 2010, James Maguire Jr., president and CEO, became chairman following the retirement of James Maguire (PHLY's founder). The previous top three executives had collectively owned approximately 20% of Philadelphia Consolidated's common shares prior to its acquisition by Tokio Marine. Given their financial payouts, there are some concerns about their long-term plans with the company. However, in the short term, the executive management team will continue to manage PHLY after signing three-year employment contracts (set to expire Jan. 1, 2012), receiving retention bonuses, and investing \$23 million in Tokio Marine common stock.

PHLY's strategy is to generate underwriting profits through sound risk selection and pricing discipline. The company differentiates itself by seeking to create value-added coverage and service features not found in typical property and casualty policies. It focuses on coverage enhancements where premiums may be small but have a minimal amount of exposure. Furthermore, the company continues to focus on product development, with the introduction of about three new products per year. PHLY has established a committee focused on researching new products and current market conditions, and it tests products on a limited basis before rolling them out nationwide. We expect the company's short-term strategy to remain relatively unchanged following the acquisition.

***Operational management***

PHLY maintains a local presence, to more effectively serve its producers and to be closer to its customer base. The company operates through 13 regional offices and 36 field offices throughout the country, which allows it to adapt its marketing and underwriting strategies to local conditions and build value-added relationships with its customers and producers.

The company focuses its operations on underwriting profitability. The claims management team investigates reported claims at an early stage, services insureds, and reduces fraud. PHLY offers a quick turnaround for policy issuance and a timely claims response. The company also closely monitors its systems, records, and databases to swiftly react to positive or negative developments. PHLY produces detailed profitability reports on a monthly basis as part of its process of reviewing and analyzing its book of business. PHLY continues to invest in its technology platform, with the goal of being a Web-based company with lower expenses and to improve its processes and customer service.

***Financial management***

PHLY focuses on maximizing its long-term aftertax total return, with an objective of earning a 15% return on equity and a combined ratio below 90% over the insurance cycle. To support its growth strategy, PHLY has historically retained most of its earnings.

***Enterprise Risk Management: Adequate, As PHLY Learns The Risk Management Framework Of Tokio Marine***

We view PHLY's enterprise risk management (ERM) as adequate, as the company learns the processes and risk-management framework of Tokio Marine. We believe that PHLY has appropriate controls to manage, monitor, and assess its risks. The company has a formalized ERM framework and process under the direction of its chief actuarial officer/chief risk officer. PHLY has created a risk register for both its operational and financial risks. In addition, the company has ranked its various risks and has developed dashboards to monitor its top 10 risks.

We view PHLY's ERM culture as adequate. The company has an ERM committee that consists of the CEO, chief financial officer, chief operating officer, chief information officer, chief actuarial officer/chief risk officer, and director of internal audit. The ERM committee recommends strategies, communicates internal guidelines, supervises risk analyses, and reports to the board of directors. However, the business units remain the risk owners. In addition to the ERM committee, PHLY holds executive and management meetings on a regular basis, in which the members discuss (among other things) the current market environment, underwriting, and reinsurance.

We believe that PHLY has adequate controls to manage its underwriting risks. Senior management has defined underwriting and catastrophe risk appetite and has conveyed this across the enterprise. The company has established a segregation of duties between those responsible for making risk decisions and those responsible for measuring risk. The company actively reviews its agents through its real-time information system and ties compensation of its agents and executive management to underwriting performance. Furthermore, PHLY regularly reviews market conditions by analyzing pricing and loss trends.

Following the company's acquisition by Tokio Marine, there has been constant communication between PHLY and Tokio Marine and its various subsidiaries. The two companies are learning about each other (the markets each participates in, various operational processes, information systems, risk tolerances, etc.) through quarterly board meetings, a joint strategic committee, a chief risk officer roundtable, and various other meetings. We view the integration risk as marginal, given that PHLY will continue to operate as a stand-alone entity with minimal overlap with TMNF. Nevertheless, PHLY has worked with Tokio Marine to achieve a small amount of back-office synergies.

The company has enhanced its ERM framework, with a focus on dynamic financial analysis. It provides guidance for capital and asset allocation and for evaluating growth and underwriting strategies. PHLY has worked with Tokio Marine to understand the parent company's internal capital model and framework.

***Accounting***

Following its acquisition by Tokio Marine, PHLY's assets and liabilities at Dec. 31, 2008, were marked to fair value under purchase accounting. As a result, the company recorded \$1.42 billion of intangible assets at year-end 2008. The intangible assets include policy renewals, preferred and independent agent

distribution channels, and trademarks. Furthermore, the deferred acquisition cost (DAC) was revalued to zero. The \$869 million increase in shareholders' equity in 2008 was a result of \$161 million of net income and the difference in the markup of assets and liabilities.

PHLY amortized each of its intangible assets based on an estimated useful life, and will continue to book amortization expense going forward. Since year-end 2008, the company's combined ratio has been affected by the amortization expense, which is reported in acquisition costs and other underwriting expense. To compare operating results with prior-year periods, we calculated adjusted operating metrics (expense and combined ratio, pretax operating income, underwriting income, and return on revenue {ROR}). The adjustments removed the amortization expenses of the intangible assets related to the acquisition, but added back the DAC amortization expense that would have occurred if DAC hadn't been eliminated at year-end 2008.

### **Operating Performance: Strong Results, Despite Declining Premium Rates**

PHLY generated a strong operating performance in 2008 and the first nine months of 2009, despite declining premium rates. The company benefited from strong underwriting, favorable reserve development, and an increase in net investment income.

Table 2

<b>Philadelphia Consolidated Holding Corp./Operating Statistics</b>							
<i>(Mil. \$)</i>	—Nine months ended Sept. 30—		—Year ended Dec. 31—				
	2009	2008	2008	2007	2006	2005	2004
Total revenue	1,451.1	1,284.4	1,727.6	1,500.0	1,263.6	1,041.8	818.1
Underwriting gain/(loss)	15.4	170.9	152.0	334.9	350.2	191.7	70.3
Adjusted underwriting gain/(loss)*	147.7	170.9	152.0	334.9	350.2	191.7	70.3
EBITDA	468.8	291.7	314.5	472.9	461.3	236.0	121.7
Pretax operating income (excluding realized capital gain/(loss))	130.4	274.3	289.8	455.7	444.5	231.2	118.2
Adjusted pretax operating income (excluding realized capital gain/(loss) *)	262.6	274.3	289.8	455.7	444.5	231.2	118.2
Net income	143.0	165.6	161.2	326.8	288.8	156.7	83.7
Return on revenue (%)	9.0	21.4	16.8	30.4	35.2	22.2	14.4
Adjusted return on revenue (%)*	18.1	21.4	16.8	30.4	35.2	22.2	14.4
Return on equity (%)	6.7	10.8	8.1	24.1	29.1	21.5	14.1
Return on assets (%)	2.5	3.8	3.2	8.7	9.1	5.8	3.8
Expense ratio (%)	41.3	29.4	32.1	30.0	28.9	27.0	27.8
Adjusted expense ratio (%)*	31.4	29.4	32.1	30.0	28.9	27.0	27.8
Loss ratio (%)	57.4	55.1	55.1	44.9	40.0	51.6	61.8
Combined ratio (%)	98.7	84.5	87.2	74.8	69.0	78.6	89.6
Adjusted combined ratio (%) *	88.8	84.5	87.2	74.8	69.0	78.6	89.6
Operating ratio (%)	9.7	23.8	21.0	33.7	38.9	27.9	16.0
Net investment income to net premiums earned (%)	8.3	8.3	8.2	8.5	7.8	6.5	5.6
<b>Cash flows</b>							
Net cash flow from operating activities	542.4	422.7	442.4	534.1	506.8	430.7	390.5
Net cash flow from investing activities	(369.3)	(480.8)	(705.4)	(562.9)	(492.9)	(549.1)	(264.6)

Table 2

<b>Philadelphia Consolidated Holding Corp./Operating Statistics (cont.'d)</b>							
<i>(Mil. \$)</i>	—Nine months ended Sept. 30—		—Year ended Dec. 31—				
	2009	2008	2008	2007	2006	2005	2004
Net cash flow from financing activities	(130.6)	103.8	226.7	26.5	20.3	(2.8)	(4.4)

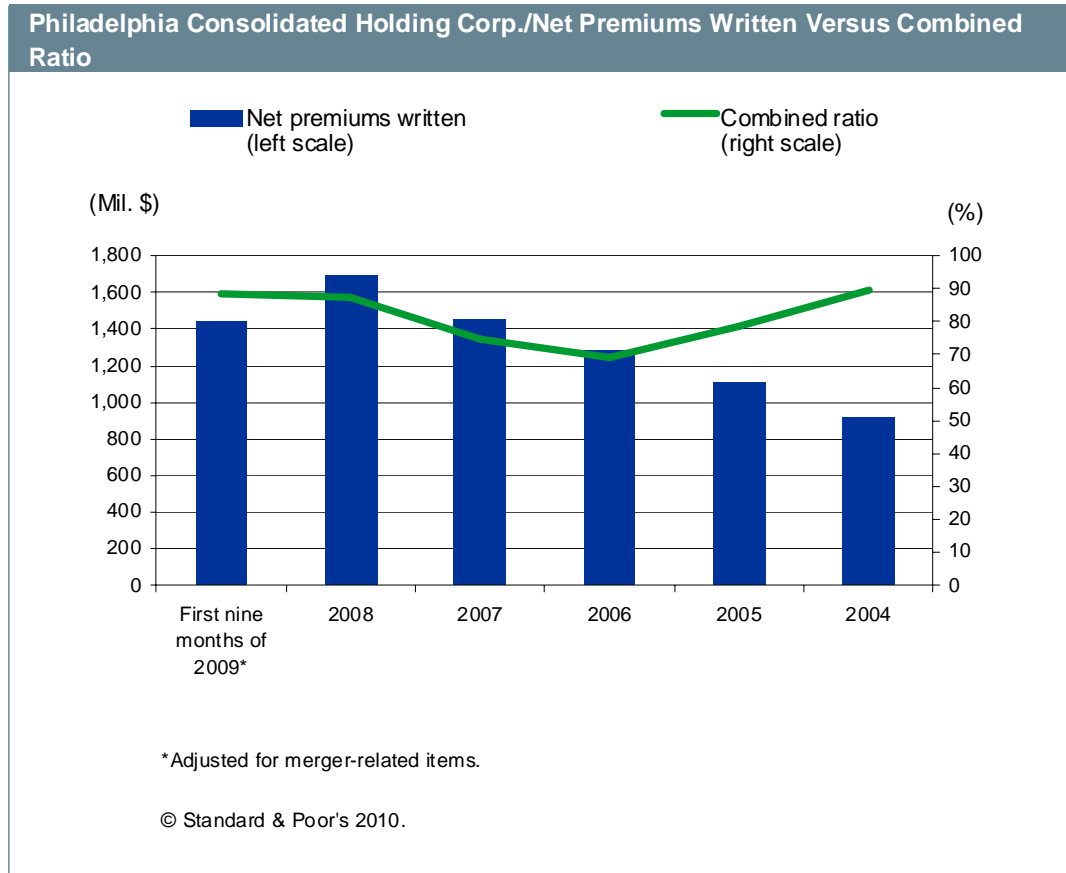
\*Following the acquisition of Philadelphia Consolidated Holding Corp. by Tokio Marine Holdings Inc., adjusted operating metrics were calculated following year-end 2008. The adjusted ratios are used to compare the current operating performance with 2008 and prior results. The adjustments removed the amortization of intangible assets, which is recorded under acquisition costs and other underwriting expenses. In addition, the amortization of deferred acquisition costs (DAC) that would have occurred if DAC were not written down to zero at year end 2008 was added back to acquisition costs and other underwriting expenses.

**Historical**

PHLY's pretax operating income declined in 2008, but its underwriting performance remained strong. The company generated pretax operating income of \$290 million and a combined ratio of 87.2%, compared with prior-year results of \$456 million and 74.8%, respectively. Underwriting results in 2008 were affected by \$22 million in net losses from Hurricane Ike (a \$120 million gross loss), \$21 million in losses from storms in the Midwest, and declining premium rates (year-to-date average rate decreases on renewed business of 4.8% for commercial and 2.3% for specialty lines). Profitability also was hurt by \$53 million of other-than-temporary impairment losses. In 2007, earnings benefited from a rise in net investment income because of an increase in invested assets and \$86 million in favorable reserve development, which improved the combined ratio by 6.2 percentage points.

PHLY's operating performance improved in 2006, with strong underwriting and favorable reserve development contributing to its strong combined ratio of 69.0% and an ROR of 35.2%. This compared favorably with a combined ratio of 78.6% and an ROR of 22.2% in 2005, as the company's 2005 results were hurt by \$25 million in hurricane catastrophe losses, \$4 million of reinstatement reinsurance premiums, and a \$6 million charge related to assessments from Citizen Property Insurance Corp. Net income in 2005 was also negatively affected by a \$26 million impairment charge for the write-down of goodwill from the acquisition of the company's personal lines segment in 1999. PHLY generated a combined ratio of 89.6% in 2004 despite \$35 million of adverse reserve development, \$47 million of hurricane catastrophe losses, and \$26 million of reinstatement premium expenses.

Chart 2



***Current performance***

During the first nine months of 2009, PHLY reported a combined ratio of 98.7% and pretax operating income of \$130 million. However, excluding the impact of purchase accounting items (refer to the Accounting section, above), PHLY generated a combined ratio of 88.8% and pretax operating income of \$263 million. The company’s operating performance remained strong, despite continued declining premium rates. Results were also hampered by \$47 million of catastrophe losses from a number of small events and a higher-than-expected loss frequency across commercial package products. This was partially offset by \$34 million of favorable reserve development and a 14% increase in net investment income because of a larger invested asset base.

***Prospective***

Despite the soft pricing, we expect PHLY’s operating performance to remain strong in 2009, with a combined ratio of about 88%. We believe that the company will continue to emphasize underwriting discipline and generate strong underwriting results in 2010, in line with historical results.

**Investments And Liquidity: More Conservative Following The Liquidation Of The Equity Portfolio**

PHLY's investment strategy is to generate relatively high levels of investment income and a competitive aftertax yield within duration and credit quality targets. The company uses external independent professional investment managers to manage its investment portfolio. The investment managers are bound by specific investment guidelines so the company can maintain an appropriate level of liquidity to satisfy the cash requirements of current operating and longer-term obligations, to adjust investment risk to offset or complement insurance risk based on total risk tolerance, and to meet insurance regulatory requirements.

Table 3

<b>Philadelphia Consolidated Holding Corp./Investment Statistics</b>							
	—Nine months ended Sept. 30—			—Year ended Dec. 31—			
<i>(Mil. \$)</i>	2009	2008	2008	2007	2006	2005	2004
Total invested assets	4,228.0	3,283.1	3,531.8	3,121.6	2,542.3	2,009.4	1,623.6
Change in total invested assets (%)	28.8	10.2	13.1	22.8	26.5	23.8	30.3
Net investment income	111.5	97.6	130.5	117.2	91.7	63.7	43.5
Net investment income to total revenue (%)	7.7	7.6	7.6	7.8	7.3	6.1	5.3
Net investment yield (%)	3.0	3.1	3.9	4.1	4.0	3.5	3.0
Realized capital gains/(losses)	39.4	(40.8)	(57.9)	29.6	(9.9)	9.6	0.8
Total investment yield (%)	4.0	1.8	2.2	5.2	3.6	4.0	3.1
<b>Portfolio composition (% of invested assets):</b>							
Bonds (%)	94.8	84.6	90.0	85.2	83.8	87.7	80.0
Common stocks (%)	2.5	10.7	8.1	11.4	12.0	8.6	7.9
Cash and cash equivalents (%)	2.7	4.6	2.0	3.4	4.3	3.7	12.0

With the company's strong operating performance and the recovery in the investment markets, PHLY's total invested assets increased 20%, to \$4.23 billion as of Sept. 30, 2009, compared with \$3.53 billion as of Dec. 31, 2008. The company had \$181 million of pretax unrealized gains that offset a \$6 million other-than-temporary impairment. The larger invested asset base increased investment income to \$112 million in the first nine months of 2009 (yielding a 4.0% total return, including realized capital gains), up 14% from the same period of the previous year.

PHLY's investment portfolio as of Sept. 30, 2009, consisted of \$4 billion of fixed maturities, representing 95% of the investment portfolio. The fixed-maturity portfolio, which consists primarily of municipal bonds (\$2.42 billion) and mortgage-backed securities (\$786 million, mostly agency securities), is highly rated, with an average credit rating of 'AA+'. The fixed-maturity portfolio is also well diversified, with no securities holdings in excess of 2% of shareholders' equity. The average duration of the fixed-income portfolio was 5.5 years, which exceeds the duration of the company's reserves. Nevertheless, because of PHLY's strong operating cash flows and net investment income, it is able to meet its claims-payment obligations. The remainder of the investment portfolio is split almost evenly between common stock and cash and cash equivalents. However, in the fourth quarter of 2009, PHLY completely liquidated its common stock holdings, given Tokio Marine's large common stock holdings.

PHLY's subprime and Alternative-A (Alt-A) investments are minimal. As of Sept. 30, 2009, the company owned 15 securities (totaling \$9 million) with subprime or Alt-A exposure. These securities are among the first to pay or are first cash flow tranches of their respective transactions. The subprime and Alt-A securities have a weighted average life of 1.6 years.

**Liquidity**

PHLY's liquidity is strong. A significant majority of its invested assets are readily exchangeable into cash, including \$112 million in cash and cash equivalents as of Sept. 30, 2009. In addition to its liquid investment portfolio, the company benefits from strong operating cash flow (it generated \$442 million in 2008 and \$542 million during the first nine months of 2009). In addition to payments for losses and loss-adjusted expenses, we expect that liquidity needs in 2010 will include deferred commission liability, other long-term contractual commitments, preferred agent profit sharing, and operating leases. We expect that PHLY will have adequate liquidity to meet its obligations based on its strong operating cash flows.

**Capitalization: Strong, Consisting Of Only Shareholders' Equity**

PHLY's capital adequacy is strong, as measured by Standard & Poor's risk-adjusted capital model, which includes an estimated net aggregate exposure property catastrophe charge to incorporate the company's probable maximum loss based on the one-in-250-year return period. The capital base consists of only shareholders' equity. With strong underwriting and unrealized investment gains, shareholders' equity increased to \$2.69 billion as of Sept. 30, 2009, from \$2.42 billion as of year-end 2008. Given the company's continued top-line growth in a softening insurance cycle and the uncertainty of loss-reserve estimates for PHLY's commercial lines, such a high level of capital adequacy provides additional cushion to the inherent risks.

Table 4

<b>Philadelphia Consolidated Holding Corp./Capital Adequacy And Flexibility Statistics</b>							
	<b>—Nine months ended Sept. 30—</b>			<b>—Year ended Dec. 31—</b>			
<b>(Mil. \$)</b>	<b>2009</b>	<b>2008</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
Shareholders' equity	2,692.0	1,606.8	2,416.0	1,547.5	1,167.3	816.5	644.2
Change in shareholders' equity (%)	67.5	11.1	56.1	32.6	43.0	26.8	18.1
Total capital	2,692.0	1,606.8	2,416.0	1,547.5	1,167.3	816.5	644.2
Change in total capital (%)	67.5	11.1	56.1	32.6	43.0	26.8	18.1
Operating leverage (%)	53.6	81.0	70.2	94.3	109.9	136.0	142.0
Common stock to equity (%)	3.9	21.9	11.8	23.0	26.0	21.2	19.9
Loss reserves/shareholders' equity (%)	76.0	107.9	78.6	92.5	109.9	152.6	154.7
Loss reserves to net premiums written (%)	141.9	133.3	112.0	98.1	100.0	112.2	109.0
Total reinsurance recoverable to shareholders' equity (%)	8.3	18.7	12.6	12.8	16.1	37.3	50.4
Interest expense	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest coverage (x)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Fixed-charge coverage (x)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Debt/capital (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

N.A.—Not applicable.

**Reserves**

We view the company's reserve position as adequate. The loss reserve balance of \$2.05 billion as of Sept. 30, 2009, is significant, and represented 76% of shareholders' equity. Because of PHLY's strong earnings, the loss reserves to shareholders' equity improved from 155% in 2004, when the company had recorded \$35 million of unfavorable reserve development (principally from its professional liability, general liability, and commercial automobile coverage).

During the past four years, the company has benefited from favorable reserve development, including \$37 million in 2008 and \$34 million through the first nine months of 2009. However, despite the reserve releases, the net incurred-but-not-reported reserves as a percentage of total net reserves remained flat at 56% at year-end 2008 and as of Sept. 30, 2009.

Table 5

<b>Philadelphia Consolidated Holding Corp./Reserve Development And Combined Ratio</b>							
	<i>—Nine months ended Sept. 30—</i>		<i>—Year ended Dec. 31—</i>				
	<i>2009</i>	<i>2008</i>	<i>2008</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>
Total (favorable)/unfavorable reserve development (mil. \$)	(33.6)	(36.6)	(36.6)	(85.8)	(91.4)	(29.9)	35.1
Accident year combined ratio (%)	101.2	87.6	89.5	81.1	76.8	81.7	85.1
Calendar year combined ratio (%)	98.7	84.5	87.2	74.8	69.0	78.6	89.6
Adjusted accident year combined ratio (%)*	91.3	87.6	89.5	81.1	76.8	81.7	85.1
Adjusted calendar year combined ratio (%)*	88.8	84.5	87.2	74.8	69.0	78.6	89.6

\*The adjusted ratios are used to compare the current operating performance with 2008 and prior results. The adjustments removed the amortization of intangible assets, which is recorded under acquisition costs and other underwriting expenses. In addition, the amortization of deferred acquisition costs (DAC) that would have occurred if DAC were not written down to zero at year end 2008 was added back to acquisition costs and other underwriting expenses.

**Reinsurance**

As its balance sheet has strengthened, PHLY has reduced the amount of reinsurance it has purchased, as demonstrated by the decline in its reinsurance utilization ratio to 10% in 2008 from 22% in 2004. In 2009, the company increased its retention on the lower working layers but bought more protection on the higher excess layers. The reinsurance recoverable balance represents a minor risk, as it constituted 8% of shareholders' equity at Sept. 30, 2009, compared with 50% at year-end 2004. To minimize its recoverability risk and manage its credit exposure, 93% of its net reinsurance recoverable balance is from carriers rated 'A-' or higher.

**Financial Flexibility: Strong, And Supported By The Current Ownership**

PHLY's financial flexibility is strong, as the company benefits from its ownership by Tokio Marine. The parent has a strong balance sheet and access to the capital markets. On a stand-alone basis, PHLY is a member of the Federal Home Loan Bank of Pittsburgh; and as a member, it has access to credit products. The company's borrowing capacity was \$899 million as of Sept. 30, 2009.

**Related Research**

- “Outlooks On Three Japanese Insurers To Negative Following Sovereign Outlook Revision,” Jan. 26, 2010
- “Tokio Marine & Nichido Fire Insurance Co. Ltd.,” June 29, 2009
- “Group Methodology,” April 22, 2009

<b>Ratings Detail (As Of 25-Feb-2010)*</b>	
<b>Operating Companies Covered By This Report</b>	
Philadelphia Indemnity Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Negative/—
Counterparty Credit Rating	
Local Currency	AA-/Negative/—
Philadelphia Insurance Co.	
Financial Strength Rating	
Local Currency	AA-/Negative/—
Issuer Credit Rating	
Local Currency	AA-/Negative/—
<b>Related Entities</b>	
Tokio Marine & Nichido Fire Insurance Co. Ltd.	
Financial Strength Rating	
Local Currency	AA/Negative/—
Issuer Credit Rating	
Local Currency	AA/Negative/A-1+
Commercial Paper	
Local Currency	A-1+
Senior Unsecured (3 Issues)	AA
<b>Domicile</b>	Pennsylvania

\*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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