

## Attorneys' Liability Assurance Society (Bermuda) Ltd. And Attorneys' Liability Assurance Society Inc. RRG

**Primary Credit Analyst:**

Taoufik Gharib, New York (1) 212-438-7253; taoufik\_gharib@standardandpoors.com

**Secondary Credit Analyst:**

Kyle Leung, New York (1) 212-438-2031; kyle\_leung@standardandpoors.com

### Table Of Contents

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Major Rating Factors

Rationale

Outlook

Competitive Position: A Leader In The Lawyers' Professional Liability  
Niche Market Because Of Strong Loss Prevention And Superior Service

Management And Corporate Strategy: Benefits From A Strong And  
Experienced Management Team

Enterprise Risk Management: Adequate With Strong Risk Controls,  
Supported By A Robust Loss Prevention Program

Accounting

Operating Performance: Consistently Strong Operating Results

Investments And Liquidity: Aggressive Strategy, With Significant Equities  
And Alternative Investments

Capitalization: Very Strong, Supported By Strong Earnings And  
Investment Recovery

## Table Of Contents (cont.)

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Financial Flexibility: Strong Despite Nonpublic Status That Limits Access To Capital Markets

Related Criteria And Research

# Attorneys' Liability Assurance Society (Bermuda) Ltd. And Attorneys' Liability Assurance Society Inc. RRG

## Major Rating Factors

### Strengths:

- Strong competitive position supported by loyal owners/insureds.
- Strong and experienced management team.
- Conservative underwriting that contributes to strong and consistent profitability.
- Very strong capital adequacy.

### Weaknesses:

- Monoline business profile subject to the vagaries of the attorneys' professional liability niche market.
- Significant investment risk, albeit reduced from historical levels.
- High reinsurance reliance for excess limits.

## Rationale

The insurer financial strength ratings on Bermuda-based Attorneys' Liability Assurance Society (Bermuda) Ltd. and its Vermont-based subsidiary, Attorneys' Liability Assurance Society Inc. RRG (collectively referred to as ALAS or the company), reflect ALAS' strong competitive position supported by loyal owners/insureds, a strong and experienced management team, conservative underwriting that contributes to consistently strong profitability, and very strong capital adequacy. Offsetting these positive factors are ALAS' monoline business profile subject to a single industry's vagaries, significant investment risk, albeit reduced from historical levels, and high reinsurance reliance for excess limits.

In May 2010, Standard & Poor's Ratings Services downgraded ALAS to 'A+'. We lowered our rating to reflect our view that ALAS' monoline business model limits the company's strategic flexibility, which we no longer view as commensurate with the former rating. Despite its well-established competitive position in the attorneys' professional liability niche market, the company is concentrated in one line of business--subjecting it to the vagaries of this market segment. ALAS' business profile has not deteriorated, but we view its concentrated position as less favorable than its more diverse peers'.

The rating action also reflects our view that ALAS still has an aggressive investment strategy, even though it reduced its maximum allowed exposure to equities and alternative investments to 25% of total invested assets in 2009 from 38% previously. These investments constituted 24% of the investment portfolio at fiscal year-end 2009 (23% in the first quarter, which ended on Feb. 28, 2010). We view this allocation as high and considerably above that of other Bermudian (re)insurers, which could exacerbate earnings and capital volatility. However, the company's very strong risk-adjusted capitalization and overall well-diversified invested assets are mitigating factors to the significant--though reduced from historical levels--investment risk.

**Operating Companies Covered By This Report**

**Financial Strength Rating**

*Local Currency*

A+/Stable/--

Amid the current economic conditions, ALAS faces a potential reduction in the number of insured lawyers because members could reduce headcounts or even close their practices, although ALAS had no firm dissolutions in 2009 and had only one dissolution in the past three years. Conditions have improved somewhat for large firms in 2010 from a year ago, although large law firms are focusing on operating expenses. Inevitably, this may draw attention to lawyers' professional liability insurance, which is one of the largest costs in a law firm's budget. We expect ALAS to face greater competition from the commercial marketplace, even though firm loyalty remains strong, as its high renewal rates demonstrate.

Reinsurance utilization remained high in 2009, at 29%, but has declined from 40% in 2005 as a result of management retaining more risk on its books, supported by the strength of members' net worth. ALAS depends heavily on reinsurance for the excess layers of its capacity and for the supplemental coverage that it offers to policyholders. ALAS continues to receive strong support from reinsurers, with its excess programs often oversubscribed. However, a reduction in the capacity available to the company could hinder its ability to continue offering high limits to its members.

On the positive side, ALAS has a strong competitive position in its lawyers' professional liability niche market. The company's loyal owners/insureds, as well as its strong loss prevention through its disciplined underwriting and claims management expertise, support its competitive position. ALAS is the leading provider of lawyers' professional liability insurance in the U.S. focused on medium to large law firms. As of Jan. 1, 2010, ALAS' market share of law firms with 35 or more attorneys was 22% based on the number of insured firms and 32% based on the number of insured attorneys. Its competitive strength in member services, claims management, and loss prevention, as well as its uniquely qualified management team contribute to a sustainable competitive advantage.

ALAS benefits from a strong and experienced management team--many members of management have been with the company for more than 15 years. In addition, ALAS employs experienced attorneys, many of whom joined the company following careers in the partnership ranks of member firms. The staff's background allows for close ongoing working relationships with ALAS' members.

The company carefully underwrites prospective members before admission. New applicants are subject to on-site underwriting reviews and significant scrutiny before acceptance. All renewing firms are required to file a comprehensive renewal application, which ALAS reviews in detail. Disciplined underwriting contributes to consistently strong earnings and further strengthens the capital base.

ALAS consistently delivers strong operating performance, leading to the return of excess profits to its policyholders in the form of premium credits--totaling \$205 million--in six of the past seven years. Excluding the premium credit expense, ALAS' average return on revenue (ROR) and combined ratio were 36.2% and 75.7%, respectively, over the past five years. When factoring in the premium credit expense, the company still reported a strong five-year average ROR and combined ratio of 26.2% and 87.6%, respectively. Operating performance remained strong in the first quarter of 2010. The company reported a combined ratio of 45.6%, an ROR of 62.0%, and EBITDA of \$45 million. These results are appropriate since ALAS is not compelled to increase earnings given its mutual profile.

ALAS' capitalization is very strong at the current rating. Given the uncertainty of loss-reserve estimates for the long-tailed lawyers' professional liability business and the potential for investment losses amid the current market conditions, the very strong capital provides a cushion for ALAS. The company's capital base consists of only members' net worth and increased 41% to \$724 million as of fiscal year-end 2009 (\$741 million as of Feb. 28,

2010) because of strong operating results and investment market recovery.

## Outlook

The stable outlook reflects our view that ALAS' competitive position, supported by its loyal client base, will remain strong. Its superior underwriting, loss prevention, and claims-management practices should continue to generate profitability, which will sustain the very strong levels of capital underlying the rating.

ALAS operates in a mature industry where the number of potential new members is limited, and it will need to continuously defend its market position in an increasingly competitive commercial market. Even with an increase in competition in 2009, ALAS had a 99% renewal rate in 2010--the sixth straight year it has reported a renewal rate of either 99% or 100%. Despite premium rates remaining flat during the 2010 renewal period, gross premiums could decline by 5% to 10% because of a decrease in the number of insured attorneys. With lower premiums, increased competition from commercial carriers, and the possibility of less favorable development on prior-year loss reserves, underwriting results could weaken somewhat in 2010. Nevertheless, we expect the company to report an underwriting profit, although the accident-year combined ratio could reach 100%, with the possibility that claims frequency could rise.

We are unlikely to raise the ratings in the next 24 months because of the company's concentrated business profile. Conversely, the ratings could come under pressure if ALAS were to experience an unexpected deterioration in its competitive position because of a significant reduction in members, or if it incurs material unfavorable reserve development or suffers a significant investment loss.

## Competitive Position: A Leader In The Lawyers' Professional Liability Niche Market Because Of Strong Loss Prevention And Superior Service

ALAS has a strong competitive position in its lawyers' professional liability niche market because of its strong loss prevention and other services provided to its policyholders/owners, as well as its strong underwriting discipline and claims management expertise. The company is the leading provider in the U.S. of lawyers' professional liability insurance focused on medium-to-large law firms. Despite ALAS' strength in the lawyers' professional liability market, we view its traditional single line concentration as a significant risk to the company because it subjects the company to the vagaries of this market segment.

**Table 1**

Attorneys' Liability Assurance Society (Bermuda) Ltd./Business Statistics							
	--Three months ended Feb. 28--		--Year ended Nov. 30--				
	2010	2009	2009	2008	2007	2006	2005
Gross premiums written (mil. \$)	334.4	354.6	355.9	386.9	396.0	370.0	363.1
Growth (%)	(5.7)	(7.5)	(8.0)	(2.3)	7.0	1.9	(15.8)
Net premiums written (mil. \$)	225.6	238.9	254.1	282.6	233.0	236.3	217.7
Growth (%)	(5.6)	(3.7)	(10.1)	21.3	(1.4)	8.5	(1.8)
Reinsurance utilization (%)	32.5	32.6	28.6	26.9	41.2	36.1	40.1

**Table 1**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Business Statistics (cont.)</b>							
<b>Net premiums by line of business</b>							
Lawyers' professional liability (%)	N.A.	N.A.	99.4	99.5	99.5	99.6	99.4
Combined management and employment practice liability (%)	N.A.	N.A.	0.4	0.3	0.2	0.0	0.0
Employment practices liability (%)	N.A.	N.A.	0.2	0.1	0.3	0.4	0.4
Management liability (%)	N.A.	N.A.	0.0	0.1	0.1	0.0	0.2

N.A.--Not available.

ALAS is the premier lawyers' professional liability insurer for the larger law firms in the U.S., offering a claims-made, broad-form professional liability policy to law firms with 35 or more attorneys. Its membership is concentrated in the larger firms, with about 46% of its attorneys in firms with more than 500 attorneys. The number of firms with more than 500 attorneys constitutes only 13% of the total member firms. It is the segment where ALAS faces the most intense price competition from the commercial market on the upper coverage layers. ALAS has a strong market share in the lawyers' professional liability segment. As of Jan. 1, 2010, its market share of law firms with 35 or more attorneys was 22% based on the number of insured firms and 32% based on the number of insured attorneys. ALAS has a total of 81 insured firms and more than 41,000 lawyers in the top 200 U.S.-based law firms, as ranked by total revenue by American Lawyer magazine.

ALAS is in a mature industry sector. The number of member firms decreased to 235 at the beginning of 2010 from 237 at the beginning of 2009. The number of insured attorneys declined 5% year over year to 60,042 attorneys at the beginning of 2010. The decrease resulted entirely from staff reductions at member firms. The two firms that nonrenewed voluntarily on Jan. 1, 2010, had a total of 385 lawyers. However, these departures were outweighed by an increase of 412 lawyers to the overall ALAS census because of one new firm and other groups of lawyers that joined insured firms through mergers and lateral acquisitions in 2009. ALAS has about 3,700 insured attorneys outside of the U.S., and about 36% of those are in London. ALAS currently has no plans to admit law firms based outside the U.S., but rather it currently offers its coverage in foreign markets to U.S.-based firms that have foreign offices.

**Table 2**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Change In Member Firms In 2009</b>	
<b>Change in number of firms</b>	<b>Reason for change</b>
1	New firms admitted into ALAS
(2)	Voluntary nonrenewal
(1)	Merger between two ALAS member firms
(2)	Net additions (subtractions) of member firms

The company underwrites based on a preferred risk standard, and once a law firm becomes a member, ALAS maintains loyalty throughout the underwriting cycle by offering coverage that other carriers exclude (e.g., punitive damages) as well as by providing superior service. Services include proactive claims management and making a wide variety of loss prevention and industry information available during on-site firm reviews and presentations, Web casts, conferences, DVDs, and written material distributed directly to members and appearing on the members' only section of the ALAS Inc. Web site. Additional services include premerger reviews that ALAS offers to its member firms.

As for its premium rates, ALAS provides unitary pricing among members. Overall rates can change over time to reflect changes in projected costs and claims trends. However, the board of directors of ALAS Inc. must approve any rate changes. In the past five years, ALAS firms benefited from stable or declining rates. Rates remained stable in 2010 following a decrease in the previous year (7.5% for the first \$20 million of coverage and 15% for coverage in excess of \$20 million) because of favorable claims trends.

ALAS is strong in its niche, but it depends on a single industry and product line. ALAS' competitors often compete on price, whereas ALAS competes more on service quality. By providing superior service, retention of firms is consistently high (at 95% or greater), with only two firms voluntarily nonrenewing during the January 2010 renewal period (its January 2006, 2007, and 2009 renewals each resulted in the voluntary renewal of 100% of its members). Since there are about 190,000 lawyers in law firms of the size ALAS targets, a competitor seeking market share gains could conceivably take a material volume of business away from ALAS. However, the company benefits from loyal owners/insureds and very high retention through market cycles since its inception nearly 30 years ago. Therefore, the possibility of a major departure of its insureds seems unlikely.

ALAS continues to see some of its members increase their limit levels--three firms increased their limits during the January 2010 renewal period. However, three firms also chose to reduce their limits. Policy limits have been capped at \$75 million per occurrence and \$150 million in the aggregate for ALAS' lawyers' professional liability coverage, and the company uses reinsurance so that it is able to offer limits this high. Although ALAS does not offer any limits above this amount, it does assist members in finding higher levels of coverage when necessary through a recommended broker, Beecher Carlson. Only one member firm--out of 14 that purchased the maximum limit offered by ALAS--took advantage of this program in 2009 by purchasing excess coverage.

In addition to writing lawyers' professional liability coverage, ALAS offers employment practices liability, management liability, and combined employment practices and management liability insurance coverage. Although premiums in these lines are relatively small compared with its lawyers' professional liability coverage, these programs have increased steadily in recent years, and the number of lawyers insured under these policies increased by 10% during 2009. As of Jan. 1, 2010, 67 firms with approximately 27,500 lawyers, or 46% of the overall ALAS census, participate in these programs.

### **Prospective**

We believe management will continue to focus on sustaining ALAS' competitive position by maintaining a high level of service, which is a major strength to the rating and contributes to the company's consistently strong earnings and insured firm retention. A challenge for ALAS is its focus on a single market--the lawyers' professional liability market. ALAS will continue to face competition from traditional commercial carriers that might offer lower premium rates, higher limits, or multiyear contracts.

## **Management And Corporate Strategy: Benefits From A Strong And Experienced Management Team**

ALAS is focused on providing stable capacity to its members through market cycles. Operational management is a strength to the rating, emphasizing disciplined underwriting, claims management, and loss prevention.

Management works closely with very active boards of directors through 11 active board committees in key operational areas, including reinsurance, member services and underwriting, investments, loss prevention, claims,

audit, budget, and enterprise risk management (ERM). The boards of directors are representative of member firms by geographic base and firm size. A significant amount of work is done in committees in which all board members are welcome to participate.

### Operational management

ALAS benefits from strong and disciplined underwriting. There is no traditional outside marketing to attract new members, but rather the company relies on referrals from existing members or other contacts within the lawyers' community. The company benefits from having member firms located throughout the U.S. and operating in almost all major cities, allowing it to obtain information on the quality and reputation of applicant firms.

New applicants are subject to significant underwriting scrutiny before acceptance into ALAS, and an on-site loss prevention review is the final step in evaluating attitudes and approaches to risk management. The underwriting philosophy uses the size-of-firm threshold (a minimum of 35 attorneys), historical claims experience, and reputation to focus membership growth on preferred-risk firms. Of the three applicants requesting membership in 2009, two were given offers to join, of which one accepted, but one declined and stayed in the commercial market.

Once a member joins ALAS, loyalty between ALAS and the insured law firm is generally very high, though poor claims experience that goes uncorrected can cause ALAS to decline a member's renewal. The preferred-risk committee, composed of members of senior management, conducts semiannual sessions to review claims experience, the attitude of the firm management, and the firm's participation in loss-prevention activities, in order to identify firms that warrant closer scrutiny. Actions of the preferred-risk committee include risk-mitigation discussions, audits, increased insured retention, or, ultimately, nonrenewals. Involuntary nonrenewals are infrequent but do occur, with a total of 20 since 1992, including one firm that was asked to leave as recently as January 2008. ALAS did not have any involuntary nonrenewals in 2009.

ALAS' mutual structure contributes to the quality of its loss prevention because the member firms are willing to share information, concerns, and ideas. Each firm benefits from the combined expertise of ALAS and its member firms, and ALAS frequently makes loss-prevention presentations to its members. Furthermore, ALAS performs loss-prevention reviews of member firms, where it gains knowledge of their policies and procedures, learns about best practices, and also provides suggestions for improvement. However, in the current weak macroeconomic conditions, claims frequency could rise. The company's claims frequency (excluding those without merit) increased to 7.4 per 1,000 attorneys in 2009 from 6.4 in 2007, a rate that remains below that of a decade ago.

**Table 3**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Real Claims* Reported And Loss And Combined Ratios</b>									
	<b>--Year ended Nov. 30--</b>								
	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Real claims reported*	468	441	376	377	345	406	389	417	N.A.
Real claims per 1,000 attorneys*	7.4	7.2	6.4	6.8	6.5	7.6	7.2	7.8	9.4
Loss ratio (%)	59.0	56.6	44.0	68.7	72.5	65.0	75.2	91.6	110.9
Combined ratio (%)	87.7	71.2	78.3	98.9	102.1	97.7	115.5	118.9	145.6

\*Real claims are all claims other than those without merit. N.A.--Not available.

The company has strong claims handling and encourages members to report matters early, before a circumstance becomes a claim, so it can assist in resolving problems before experiencing substantial costs. There is close

cooperation between the insured, its defense counsel, and ALAS' claims department. When it is clear that a claim should be settled, ALAS provides assistance in the settlement process. ALAS also supports cases that go to trial in which member firms did nothing wrong or the claimant has unreasonably high settlement demands. Of the eight cases tried in 2009, seven resulted in no liability, and one resulted in a verdict far below the lowest settlement demands made by the claimant.

### Financial management

As a member-owned entity, the company does not seek to make a large profit, but rather it focuses on preserving its financial strength to readily pay claims and to offer premium rates that are appropriate for its expenses. As such, it does not strive to increase earnings, and when the company makes a profit in excess of the amount deemed appropriate for growth in net worth, it returns the excess to its policyholders through premium credits or cash distributions. ALAS returned capital to its members in 2009 through a \$35 million premium credit and a \$31 million cash distribution pursuant to the company's bylaws in respect of the members' subpart F tax liability.



## Enterprise Risk Management: Adequate With Strong Risk Controls, Supported By A Robust Loss Prevention Program

We view ALAS' ERM as adequate with strong risk controls based on its expertise in the lawyers' professional liability niche market, with particular strength in underwriting and loss prevention. The company has a strong risk-management culture in which management oversees all major risks and puts an emphasis on risk management.

In addition, the board of directors' ERM committee supports the ERM construct. The purpose of the committee is to provide oversight and authority regarding ALAS' risk-management framework, including significant policies, procedures, and practices employed to manage various types of strategic, operational, financial, and reputational risks.

The ERM committee consists of the chairs of other board committees, but generally meetings are open to all directors, who typically attend. Senior management and the board of directors' committee have successfully monitored and adequately managed each of the company's risks, and the ERM committee brings together the analysis of all risks the company is facing and determines how they interrelate. The committee provides a forum to discuss risk from a holistic perspective. In addition, it gives directors and management an opportunity to brainstorm about the risks ALAS is facing, as well as potential emerging risks. Management and the board members' extensive knowledge of the lawyers' professional market provide insight for potential emerging risks.

ALAS has a defined risk appetite and has developed a risk register and dashboards to monitor its key risks. The company has documented correlations across different risk categories. It has assigned executives and a board committee to monitor each risk, and there is constant communication with the broader management team. In addition, there is strong cooperation between ALAS and its member firms in the sharing of information (i.e., reports of new regulations, court decisions, and novel situations that have arisen in their practice). ALAS has a capital model, and management is exploring how to expand its use to strengthen the ERM processes.

Outside its core strengths in underwriting and loss prevention, ALAS has adequate risk controls on reinsurance, loss reserves, and investments, which are managed appropriately. Nonetheless, ALAS' high reinsurance utilization and its above-industry-average exposure to equities and alternative investments present a risk. Investment controls are adequate as ALAS requires its investment managers to adhere to strict guidelines with regard to strategy, concentration limits, diversification, and liquidity requirements. However, a weakness to the ERM process is that the company does not robustly review investment correlation or concentration between investment managers or by industry. Given the company's focused strategy, underwriting risk (that is, pricing and reserving) and conditions in the lawyers' professional liability market are the most important risks to manage, and ALAS has a strong track record in these areas. The organization's risk profile does not warrant a complex ERM process, but management continues to focus on enhancing its ERM capabilities.

## Accounting

ALAS issues premium credits to members as a reduction of premium based on its underwriting and financial position. Premium credits are at the discretion of the board, and the company is not obligated to issue them. These premium credits are recorded as an expense on the income statement, but when we analyze ALAS' operating performance, we review profitability including and excluding premium credits because they are discretionary.

ALAS reviews its fixed-maturity and equity securities portfolio to evaluate the necessity of recording OTTI (other-than-temporary impairments). It screens bonds that are 90% below cost for 12 consecutive months, stocks that are 85% below cost for 12 consecutive months, and bonds and stocks that are 80% below cost for six consecutive months. In 2008, amid the market disruption, ALAS strengthened its screening process to include additional time horizons and various severity of unrealized losses. As part of its analysis, the company evaluates the current interest rate conditions, specific issuer information, and its ability and intent to hold a security until recovery before realizing impairment. ALAS has adequate liquidity to support its ability to hold onto depressed value

securities, as demonstrated by its strong operating cash flows. The company incurred \$33 million of OTTI through earnings in 2009.

## Operating Performance: Consistently Strong Operating Results

ALAS has consistently delivered strong operating performance, which has led the company to return excess profits to its policyholders in the form of premium credits.

**Table 4**

Attorneys' Liability Assurance Society (Bermuda) Ltd./Operating Statistics							
(Mil. \$)	--Three months ended Feb. 28--		--Year ended Nov. 30--				
	2010	2009	2009	2008	2007	2006	2005
Total revenue	72.5	77.0	304.9	328.8	278.6	279.2	255.1
EBITDA	45.0	51.2	81.8	129.6	97.3	47.2	33.2
EBITDA including realized gains	60.5	41.3	84.9	48.1	145.2	77.0	69.2
Net income	59.8	40.6	81.9	43.7	141.0	74.8	66.9
Return on average adjusted equity (%)*	38.5	28.3	13.2	7.4	23.8	15.7	16.4
Return on average equity (%)*	38.5	28.3	13.2	7.4	23.8	15.7	16.4
Return on average adjusted assets (%)*	12.8	8.0	5.3	2.7	8.4	5.0	4.9
Return on revenue (%)	62.0	66.4	26.8	39.4	34.9	16.9	13.0
Return on revenue including realized gains (%)	83.5	53.5	27.9	14.6	52.1	27.6	27.1
Administrative expense ratio (%)	12.2	9.9	24.1	9.6	28.7	25.5	23.9
Commissions expense ratio (%)	4.9	5.1	4.5	5.0	5.5	4.7	5.7
Expense ratio (%)	17.1	15.0	28.7	14.5	34.3	30.2	29.6
Loss ratio (%)	28.5	25.0	59.0	56.6	44.0	68.7	72.5
Combined ratio (%)	45.6	40.0	87.7	71.2	78.3	98.9	102.1
<b>Cash flows</b>							
Net cash flow from operating activities	135.3	191.6	152.4	143.7	125.7	67.7	54.9
Net cash flow from investing activities	(133.9)	(167.8)	(42.7)	152.6	(246.8)	(27.3)	(142.7)
Net cash flow from financing activities	(27.9)	(53.3)	(145.3)	(267.8)	61.2	(12.2)	102.1

\*Ratios for first-quarter 2010 and 2009 were annualized.

### Historical

Even with rate reduction in January 2008 (10% for the first \$20 million of coverage and 2.5% for coverage in excess of \$20 million), ALAS produced strong underwriting results, supported by \$67 million of favorable reserve development. However, net income declined by \$97 million (a 69% drop from the prior year) to \$44 million in 2008, despite no premium credits being paid for the year. The decrease resulted mainly from \$82 million of realized investment losses, including \$72 million of OTTI.

Operating performance improved significantly in 2007 from the prior year as ALAS generated strong earnings despite flat premium rates. Results benefited from \$103 million of favorable development from prior-year reserves, which improved the combined ratio by 44 percentage points. In 2006, the combined ratio improved to 98.9%, even with marginally decreasing rates and a slightly increasing per-claim severity. Although earnings in 2005 were strong, the combined ratio rose, partly because of a 15% rate cut during the year, which \$18 million of favorable reserve development partially offset.

## Current performance

ALAS produced strong earnings in 2009, in spite of the rate reduction (7.5% for the first \$20 million of coverage and 15% for coverage in excess of \$20 million). During the fiscal year ended Nov. 30, 2009, the company generated EBITDA of \$82 million and a combined ratio of 87.7%. Operating results benefited from \$73 million of favorable reserve development--which improved the combined ratio by 29 percentage points--and a slight increase in net investment income. With the investment market recovery and lower OTTI, net income increased 87% year over year to \$82 million. The improvement occurred despite \$35 million of premium credit expense in 2009, compared with none in 2008.

**Table 5**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./ Financial Ratios Including And Excluding Premium Credit Expense</b>					
<b>--Year ended Nov. 30--</b>					
<b>(%)</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>Ratios including premium credit expense</b>					
Expense ratio	28.7	14.5	34.3	30.2	29.6
Loss ratio	59.0	56.6	44.0	68.7	72.5
Combined ratio	87.7	71.2	78.3	98.9	102.1
ROR	26.8	39.4	34.9	16.9	13.0
<b>Ratios excluding premium credit expense</b>					
Expense ratio	15.0	14.5	17.1	15.3	15.8
Loss ratio	59.0	56.6	44.0	68.7	72.5
Combined ratio	74.0	71.2	61.1	84.0	88.3
ROR	38.3	39.4	49.3	29.4	24.8

ALAS' operating performance remained strong in the first quarter of 2010. The company reported a combined ratio of 45.6%, an ROR of 62.0%, and EBITDA of \$45 million. Results benefitted from \$20 million of favorable reserve development, which improved the combined ratio by 32 percentage points.

## Prospective

We expect ALAS will remain up to speed with changing loss trends and will remain consistently profitable, with earnings at appropriate levels for a mutual company to sustain the very strong levels of capital underlying the rating. We expect underwriting results to weaken somewhat in 2010 because of possibly lower favorable development on prior-year loss reserves. Nevertheless, we expect the company to report an underwriting profit.

## Investments And Liquidity: Aggressive Strategy, With Significant Equities And Alternative Investments

ALAS has an aggressive investment strategy that includes a significant allocation to equities and alternative investments, which constituted about 24% of its total invested portfolio at fiscal year-end 2009 (23% in the first quarter, which ended on Feb. 28, 2010). In our opinion, this allocation is high and considerably above that of other Bermudian (re)insurers.

Given the recent market disruption, the company changed its investment policy by reducing its maximum allowed allocation to equities and alternative investments to 25% of the investment portfolio from 38%. We still view the

maximum allocation of 25% as aggressive. More importantly, the high concentration in equities and alternative investments could cause substantial volatility in the company's earnings and capital. The equity and alternative investments portfolio is significant--it represented 52% of members' net worth at the end of first-quarter 2010.

**Table 6**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Investment Statistics</b>							
<b>(Mil. \$)</b>	<b>--Three months ended Feb. 28--</b>		<b>--Year ended Nov. 30--</b>				
	<b>2010</b>	<b>2009</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Invested assets	1,672.0	1,478.6	1,576.7	1,310.6	1,444.4	1,279.5	1,162.9
Growth (%)	13.1	(6.5)	20.3	(9.3)	12.9	10.0	4.3
Net investment income	11.5	12.4	49.3	46.5	46.2	44.1	37.1
Realized capital gains/losses	15.6	(9.9)	3.1	(81.5)	47.9	29.8	36.0
Unrealized capital gains/losses	(10.2)	(0.4)	182.1	(154.8)	27.8	30.6	(9.3)
Net investment yield (%)*	2.9	3.2	3.4	3.4	3.4	3.6	3.3
Net investment yield including realized gains/(losses) (%)*	6.9	0.6	3.6	(2.5)	6.9	6.0	6.4
Net investment yield including realized and unrealized gains/(losses) (%)*	4.3	0.5	16.2	(13.8)	9.0	8.6	5.6
<b>Portfolio composition (% of invested assets)</b>							
Bonds (%)	75.6	76.8	72.9	69.7	58.7	56.6	61.0
Common stocks (%)¶	23.0	19.3	15.3	14.7	27.9	25.7	23.9
Alternative investments (%)¶	N.A.	N.A.	8.6	9.0	9.4	8.5	7.4
Cash and short-term investments (%)	1.5	3.9	3.2	6.6	4.0	9.2	7.7

N.A.--Not available. \*Ratios for first-quarter 2010 and 2009 were annualized. ¶Common stocks and alternative investments are combined in the common stock line for first-quarter 2010 and 2009.

ALAS maintains a large allocation to equities and hedge funds to achieve a higher investment yield. It uses the additional returns to offer competitive premium rates and to grow its capital base, which should give it greater flexibility to retain or cede risk. The company has maintained good investment income, overall well-diversified invested assets, and very strong capitalization. These are mitigating factors to its aggressive investment risk appetite.

In 2009, invested assets increased by 20% to \$1.58 billion from \$1.31 billion in 2008 because of the investment market recovery. The company had \$182 million of unrealized gains, which \$33 million of OTTI partially offset. As a result, the company generated a total investment return of 16.2%, which is significantly higher than historical levels. Nevertheless, significant volatility remains in the portfolio.

**Table 7**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Select Peers' Investment Statistics</b>		
<b>(Re)insurers</b>	<b>Financial strength ratings on operating companies as of June 13, 2010</b>	<b>Common stock and alternative investments as of Dec. 31, 2009 (%)</b>
Oil Insurance Ltd.	A-/Stable/--	33.3
Attorneys' Liability Assurance Society (Bermuda) Ltd.	A+/Stable/--	23.9
RenaissanceRe Holdings Ltd.	AA-/Stable/--	14.7
Montpelier Re Holdings Ltd.	A-/Stable/--	9.5
Axis Capital Holdings Ltd.	A+/Stable/--	6.7

**Table 7**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Select Peers' Investment Statistics (cont.)</b>		
PartnerRe Ltd.	AA-/Negative/--	6.4
Everest Re Group Ltd.	A+/Stable/--	6.3
Endurance Specialty Holdings Ltd.	A/Stable/--	6.1
Alterra Capital Holdings Ltd.	A-/Stable/--	6.0
Arch Capital Group Ltd.	A/Positive/--	5.0
Allied World Assurance Co. Holdings Ltd.	A-/Stable/--	2.5
Aspen Insurance Holdings Ltd.	A/Stable/--	0.4

ALAS' investment portfolio, excluding its alternative investments, is highly liquid. External investment managers oversee the portfolio and follow investment-quality and liquidity guidelines that ALAS sets. The company uses an outside investment consultant to help identify and evaluate investment managers and to assist in the determination of appropriate asset allocation strategies.

The amount of credit risk the company takes in its fixed-income portfolio is conservative. The average credit rating of the fixed-income portfolio is 'AA+', and about 66% of the bonds are rated 'AAA'. The fixed-income portfolio's duration of 4.3 years is in line with the duration of the liabilities.

Operating cash flow is subject to some volatility because of the timing and frequency of large claims payments and receipt of reinsurance recoverables. Net operating cash flow has improved, increasing to \$152 million in 2009 from \$55 million in 2005, because of strong underwriting results. Standard & Poor's expects that operating cash flow will remain strong in 2010.

## Capitalization: Very Strong, Supported By Strong Earnings And Investment Recovery

ALAS' capitalization is very strong at the current rating. Given the uncertainty of loss-reserve estimates for the long-tailed lawyers' professional liability business and the potential for investment losses amid the currently weak economic conditions, such a high level of capital provides a cushion for ALAS.

**Table 8**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Capitalization Statistics</b>							
<b>(Mil. \$)</b>	<b>--Three months ended Feb. 28--</b>		<b>--Year ended Nov. 30--</b>				
	<b>2010</b>	<b>2009</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Total assets	2,298.4	2,187.2	1,993.9	1,834.3	2,254.0	2,036.4	2,010.2
Adjusted total assets	1,941.3	1,798.1	1,624.4	1,448.5	1,811.9	1,552.5	1,438.5
Members' net worth	741.3	503.1	724.3	512.8	662.7	524.0	426.4
Growth (%)	47.4	(21.8)	41.2	(22.6)	26.5	22.9	9.6
Total adjusted equity	741.3	503.1	724.3	512.8	662.7	524.0	426.4
Total capital	741.3	503.1	724.3	512.8	662.7	524.0	426.4
Investment leverage (%)	51.8	56.8	52.0	60.6	81.2	83.4	85.4
<b>Reinsurance and reserves</b>							
Reinsurance utilization (%)	32.5	32.6	28.6	26.9	41.2	36.1	40.1

**Table 8**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Capitalization Statistics (cont.)</b>							
Reinsurance recoverable to members' net worth (%)	48.2	77.3	51.0	75.2	66.7	92.4	134.1
Loss and loss adjustment expense reserves to members' net worth (%)	95.5	132.0	98.7	130.5	91.7	115.2	129.1
Loss and loss adjustment expense reserves to net premiums written (%)	313.9	278.0	281.4	236.8	260.8	255.4	252.9
Liquid assets/technical reserves (%)	N.A.	N.A.	193.3	169.9	203.5	183.7	184.0

N.A.--Not available.

The company's capital base consists of only members' net worth and has increased over the years because of strong earnings. Members' net worth increased 41% to \$724 million as of fiscal year-end 2009 (\$741 million on Feb. 28, 2010) from \$513 million the prior year. The \$182 million of unrealized investment gains and \$82 million of net income were mainly responsible for the increase. Consequently, risk-adjusted capitalization remains very strong at the current rating level.

Although ALAS returns to members their shares of capital if they leave the organization, the amount is payable over a seven-year period, and the aggregate amount payable to all former members is limited. This ensures that ALAS can further evaluate and adjust reserves for claims before the former member firm receives its share of net worth.

### Prospective

In 2010, we expect ALAS' capital adequacy to remain very strong and supportive of the rating. Any premium credits declared in 2010 will be based on profitability and capitalization levels.

### Reserves

ALAS has a record of conservative reserving. During the past five years, the company booked an accident-year combined ratio (excluding premium credit expense) of about 100%. On the other hand, it was able to generate favorable reserve development in fiscal years 2003 through 2009 (ended on Nov. 30), including \$73 million in 2009. The company tends to book a high accident-year combined ratio while realizing any reserve redundancies in subsequent years. However, the amount of favorable reserve development could diminish given that the incurred-but-not-evaluated reserves as a percentage of total reserves slightly declined, to 62% at fiscal year-end 2009 from 66% at the end of fiscal 2007.

**Table 9**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Reserve Development And Combined Ratio</b>							
	<b>--Three months ended Feb. 28--</b>		<b>--Year ended Nov. 30--</b>				
	<b>2010</b>	<b>2009</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
Favorable/unfavorable reserve development (mil. \$)	(19.7)	(36.0)	(72.9)	(67.4)	(103.2)	(31.7)	(18.3)
Initial accident-year combined ratio (%)	77.9	95.6	116.2	95.0	122.7	112.4	110.4
Fiscal-year combined ratio (%)	45.6	40.0	87.7	71.2	78.3	98.9	102.1
Initial accident-year combined ratio excluding premium credit expense (%)	77.9	95.6	102.5	95.0	105.5	97.5	96.7
Fiscal-year combined ratio excluding premium credit expense (%)	45.6	40.0	74.0	71.2	61.1	84.0	88.3

Estimates of loss reserves are subject to significant uncertainty and constitute a material risk to the company.

However, the strength of the capital base mitigates this risk. An outside actuarial firm reviews ALAS' reserve levels

annually. In addition, the company's in-house actuarial staff, which consists of three professionals, performs loss analysis studies quarterly. Claims frequency (measured as real claim frequency per 1,000 attorneys) and severity have been relatively stable in the past several years, but claims frequency increased slightly from 2007 to 2009. Nevertheless, the company has avoided severe losses--it reported only one claim in excess of \$20 million during fiscal 2009.

**Table 10**

<b>Attorneys' Liability Assurance Society (Bermuda) Ltd./Claims In Excess Of \$20 Million By Year Reported</b>							
	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Number of claims	1	1	0	1	1	1	2

### Reinsurance

Reinsurance utilization remained high in 2009, at 29%, but has declined from about 40% in 2005. Management has retained a greater degree of risk on its books since 2005, supported by its strong net worth and appropriate pricing levels.

ALAS retains most of the first \$20 million in exposures (the first \$15 million plus 60% of the \$5 million in excess of the \$15 million layer that is partially reinsured by a stop-loss reinsurance contract) and 7.5% of the \$55 million in excess of the \$20 million layer. The company relies heavily on reinsurers for the upper layers of capacity and for the management liability and employment practices liability coverage. ALAS continues to experience strong support from reinsurers. However, a reduction in the capacity available to the company could adversely affect its ability to offer the high limits currently offered to its insureds.

Reinsurance recoverables have been declining from historical levels, with a balance of \$369 million at fiscal year-end 2009 (\$357 million as of Feb. 28, 2010), compared with \$572 million at the end of fiscal 2005. The top 10 reinsurers represent about 90% of the total 2009 amount, but the recoverable balance is substantially collateralized, as ALAS benefits from \$353 million in letters of credit and \$129 million in trust funds as of fiscal year-end 2009. Therefore, the risk of nonrecovery is low.

## Financial Flexibility: Strong Despite Nonpublic Status That Limits Access To Capital Markets

ALAS has strong financial flexibility, supported by its loyal owners/insureds and its ability to make retrospective premium calls of up to 15% of annual premiums, if necessary. Although ALAS has the contractual ability to make retrospective premium calls from its member firms of up to \$216 million as of Nov. 30, 2009, it has never used the option and does not expect to exercise its contractual right. In addition, terminated members are subject to a withdrawal withholding of their net worth, and any payments to former members are paid over a seven-year period. Moreover, the aggregate amount that ALAS can pay to former member firms in one fiscal year is limited to 5% of its net worth.

Partially offsetting these strengths is the company's limited access to the capital markets because of its nonpublic status. However, ALAS has a \$100 million credit facility with its custodian, The Bank of New York Mellon, for liquidity-management purposes. As of Nov. 30, 2009, ALAS had no borrowings under this facility, and we expect that the company will use debt moderately.

## Related Criteria And Research

"Attorneys' Liability Assurance Society (Bermuda) Ltd. And Affiliate Ratings Lowered To 'A+'; Outlook Stable,"  
May 25, 2010

<b>Ratings Detail</b> (As Of June 16, 2010)*	
<b>Operating Companies Covered By This Report</b>	
<b>Attorneys' Liability Assurance Society (Bermuda) Ltd.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Counterparty Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Attorneys' Liability Assurance Society, Inc. RRG</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Domicile</b>	Bermuda

\*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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