STANDARD & POOR'S

INSURER CREDIT REPORT

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R.V.I. Guaranty Co. Ltd.

RATING A/Stable/— (STRONG)

An insurer rated 'A' has STRONG financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings.

HOLDING COMPANY

None

GROUP MEMBERS

None

DOMICILE

Bermuda

LICENSED

Bermuda and Connecticut

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Rating description

STRONG

Rating explanation

An insurer rated 'A' has STRONG financial security characteristics, but is somewhat more likely to be affected by adverse business conditions than are insurers with higher ratings.

Major Rating Factors

Strengths:

- Strong market position;
- Experienced management team;
- Conservative investments and very strong liquidity; and
- Strong, but volatile, earnings.

Weaknesses:

- Changing risk profile, with increased real estate risks;
- Strong, but declining, capital adequacy (in part due to reserve strengthenings); and
- Concentrated client base.

Rationale

The insurer financial strength ratings on R.V.I. Guaranty Co. Ltd. and R.V.I. America Insurance Co. (collectively RVI) are based on the company's strong but volatile earnings, leadership position within the residual value insurance market, experienced management team, conservative investments, and very strong liquidity. RVI's capital adequacy has declined to strong from extremely strong levels because of adverse development of its passenger vehicle reserves and increased exposure. Standard & Poor's Ratings Services expects RVI to maintain excess capital to compensate for its net income and reserve volatility. In contrast, negative factors that affect the rating on RVI are its changing risk profile, including exposure to larger real estate risks. Lastly, RVI maintains a concentrated client base.

RVI's quality of capital was inconsistent with the rating and expectations were that the subscription receivable from CNA Financial Corp.'s subsidiary for $50.7 million was expected to be converted to some form of hard capital by year-end 2005. On Dec. 12, 2005, CNA Financial Corp.'s subsidiary, which previously owned 50% of RVI, sold its ownership of RVI to Quantum Industrial Partners (QIP), RVI's other 50% shareholder. The result is that QIP now owns 100% of RVI. QIP's original 50% ownership remains in the form of soft capital support through a Bermuda trust, with a market value of $51 million. RVI is the beneficial owner of the Bermuda trust certificates. The Bermuda trust consists of a promissory note as well as U.S. Treasury strips and notes valued at $25 million and $26 million, respectively. The promissory note is fully collateralized with cash and valued at $29 million at year-end 2004, therefore, Standard & Poor's applies full credit for the original QIP capital commitment. The transaction, which closed December 2005 with QIP issuing another promissory note in the amount of $51 million, is fully collateralized by cash.

Outlook

The outlook is stable. RVI is expected to maintain a combined ratio of nearly 90% and a capital adequacy ratio (CAR) of nearly 150% to compensate for potential volatility. The CAR now applies 100% credit for unearned premiums (UPR) (previously it applied 50% credit). In addition, RVI has experienced further deterioration of reserves related to its passenger vehicle asset class (related to the 1999 and 2000 accident years). Standard & Poor's expects further deterioration will not be significant (as the vast majority of vehicles from those years are off risk), but if it is, the rating will be reviewed and the outlook could be revised to negative. Due to RVI's increasing risk profile, limited scale, and concentrated client base, a positive outlook is not likely.

Competitive Position

Table 1

R.V.I. Guaranty Co. Ltd.—Selected Statistics*					
			—Year ended Dec. 31—		
(Mil. $)	***2004***	***2003***	***2002***	***2001***	***2000***
Total net revenue	47.6	30.3	24.2	17.3	14.4
Net income (after tax)	6.7	5.6	(0.1)	7.9	8.8
Combined ratio (%)	99.0	105.9	136.4	87.1	80.8
Return on assets (%)	2.2 2.0.		0.3	3.0	3.8
Total assets	299.4	282.6	320.3	274.3	256.7
Stockholders' equity	43.7	35.7	115.7	116.7	111.2
Operating leverage (x)	1.6	1.4	0.4	0.3	0.3

*Consolidated GAAP basis.

Table 2

R.V.I. Guaranty Co. Ltd.—Business Statistics*					
			—Year ended Dec. 31—		
(Mil. $)	***2004***	***2003***	***2002***	***2001***	***2000***
Commercial equipment	17.7	14.4	13.3	12.6	10.2
Real estate	12.0	8.9	6.6	11.0	11.3
Passenger vehicle	38.8	27.4	22.0	8.9	15.3
Total net premiums written	68.5	50.7	41.9	32.5	36.8
Total change in net premiums written (%)	35.1	20.9	28.7	(11.5)	85.2

*Consolidated GAAP basis.

RVI's competitive position is strong based on its leading market position, successful business model, and brand equity; these attributes are offset by the group's monoline risk profile, concentration among key insureds, and increased risk profile.

RVI insures against significant declines in an asset's future value. RVI's liability limit is generally the difference between the market value of an insured asset (as defined in the insurance contract) and its insured value on a specific future date.

RVI's risk portfolio targets four main asset classes (passenger vehicle, commercial equipment (including aircraft), and real estate). At year-end 2004, maximum liability was allocated 68% passenger vehicle, 20% commercial equipment, and 12% real estate. The average policy/asset term for passenger vehicle, commercial equipment, and real estate risks are one to five years, eight to 10 years, and 20 years, respectively. The average duration for all asset sectors is about nine years. Accordingly, RVI defers a significant amount of its premium related to its commercial equipment and real estate product lines (UPR measured $165 million at year-end 2004). The net written and earned premium amounts are currently more heavily weighted with passenger vehicle business, but the future earnings from the commercial equipment and real estate related unearned premium will provide stability in earned premium in years where premium volume is not as strong.

Expenditure management is key to RVI's earnings capacity and has been consistently improving since 1996. In 1996, the expense ratio measured 108%, but has decreased steadily, to 54.4% in 2002 and 37.5% in 2004. Integrated operations, hired intellect, and updated technology have all helped improve accountability and operational efficiency. In addition, premium volume of $68 million in 2004, an increase from $11 million in 1997 and $33 million in 2001, has outpaced expense increases. Because of the large UPR balance, however, the expense ratio is not as relevant to RVI as it is to traditional insurance companies.

Since the most recent peak in January 2001, according to the BLS Used Car CPI, used car prices dropped 18.6% on a cumulative basis through June 2004. This significantly affected RVI's business underwritten in 1999 and 2000 as the leases insured by RVI during those years experienced greater declines in value than expected. The drop in prices was a result of several factors: high used vehicle supply, high new-vehicle incentives, and cheap new vehicle financing. The events of Sept. 11, 2001, also had an impact. At a time when lack of consumer confidence had frozen new- and used-vehicle demand, vehicle manufacturers decided to enter uncharted waters with a new wave of 0% financing programs contributing to the drop in used vehicle prices.

The health of the economy is a significant factor in new- and used-vehicle demand. RVI's forecast models employ several factors, one of which is to quantify the impact of economic cycles. The output from these models is one of the factors utilized in determining the insured limits that will be offered to clients. RVI is one of the only residual value insurers to prepare its own forecast of the value of every new and one-year-used vehicle. This guidebook is a significant factor in determining the insured value it would offer to its clients.

In 2004, RVI's real estate business began to shift from many small risks to a few small risks and a few large risks (such as trophy buildings). As competition exited the real estate residual value insurance business, RVI expanded its underwriting guidelines to be more appropriate for the major markets. The square-foot values in the underwriting guidelines were set on a national rather than a market-by-market basis. RVI's real estate underwriting guidelines now allow for prudent levels of square foot values in the major markets. The company has written three such policies in Boston, San Francisco, and Washington, D.C. RVI has raised premium levels for these transactions and expects to aggregate exposure and reinsure as appropriate. Standard & Poor's is concerned about RVI's expansion into greater risks with its current capital base. Any loss related to these greater risks would significantly affect RVI's financial strength; however, this real estate product growth initiative will not result in a near-term liquidity shortfall. When these risks mature, RVI is expected to have a significantly larger capital base to withstand potential losses in its real estate portfolio.

Prospective

RVI's competitive position is expected to remain strong, supported by the company's leading market share position. Products offered are linked based on the demand of each individual client's financial and risk management strategies, and client concentrations are expected to remain. With the changes in RVI's risk tolerance, the company now has a higher risk profile. Such risks are compensated for by exponentially higher premium rates. The company has now moved toward providing significant amounts of asset protection and away from primarily favorable accounting treatment. The higher risk profile is expected to remain.

Management And Corporate Strategy

Standard & Poor's considers RVI's management marginally positive for the rating. Technical expertise and efficient asset valuation have maintained the group's position as a leader in its respective niche markets.

Operational management

The company employs stringent underwriting guidelines and relies on many sources of data, such as comprehensive and up-to-date databases of historical asset prices, including internally developed databases to accurately forecast the residual value of an asset. RVI guarantees only residual values that are at a discount to projected future market values while assuming zero inflation. In most cases, in underwriting new policies, RVI assumes only the risk that properly maintained assets will be worth less than their insured values and the lessor retains all other risks associated with the normal course of business, including credit risk. Surveillance includes continual reestimation of future market values for the insured portfolio, client risk tolerance, and demand, with corresponding policy language that includes strict equipment/asset return conditions. For passenger vehicles, surveillance of a transaction's performance is conducted quarterly with econometric modeling methods. Econometric modeling has also been incorporated into management's underwriting process. For real estate assets, regional indexes are used to update current values and identify properties in need of closer monitoring. For commercial equipment and aircraft, market information is reviewed for indications of reduction in value and updated asset forecasts are obtained as necessary. Management underwrites asset risk, not credit risk, and has the option to purchase the insured asset and manage for recovery to mitigate against claims.

Financial management

Management targets a long-term net income growth rate of 15%-20%, but RVI's growth in net income has been very volatile (in large part due to its small scale).

Accounting

RVI's accounting practices are a neutral rating factor. A large portion of RVI's premium volume is subject to the lease accounting standards currently in place. The potential that a change in accounting standards will significantly affect RVI's premium volume and earnings remains a significant risk.

Residual-value insurance helps transactions meet a provision of financial accounting standards (FAS 13 and the new IAS-17, effective Jan 1, 2005 in the EU) that allows earlier recognition of lease income and permits off-balance-sheet accounting for asset securitizations. Residual-value insurance provides an indemnity that is limited to the difference between the fair market value of the asset and the insured value of that asset on the date of lease termination. An RVI guarantee is included as a third-party guarantee and enables a lease to qualify as a finance lease. Under FAS 13, lessors are able to accelerate earnings recognition if the aggregate present value of payments to be received from the lessee, plus payments from third-party guarantees, exceeds 90% of the asset's current fair market value. Under IAS-17, the same benefits are available if such payments equal "at least substantially all" of the asset's current fair market value.

RVI restated its 2003 financial statements due to a large number of reclassifications resulting principally from changes to Canadian GAAP:

- Foreign currency adjustments related to policies that would be settled in currencies other than the U.S. dollar, along with stock-based compensation changes, resulted in a decline in equity of less than $1 million.
- Promissory note reclassification from QIP, which had been presented as part of an investment in the Bermuda trust, is now presented as a reduction in capital stock, resulting in a decline in equity of $22 million.
- RVI was required to change its accounting for investments from amortized cost in 2003 from the straight-line method to the constant-yield method, reducing equity $7.7 million.

In summary, the restatement of financial statements now excludes about $81 million in soft capital from RVI's shareholders equity, thereby reducing equity from about $125 million to $44 million at year-end 2004, but there has been no change in the terms of the underlying capital instruments.

Operating Performance

Table 3

R.V.I. Guaranty Co. Ltd.—Operating Statistics*					
			—Year ended Dec. 31—		
(Mil. $)	***2004***	***2003***	***2002***	***2001***	***2000***
Total net revenues	47.6	30.3	24.2	17.3	14.4
Pretax operating income (excluding realized gains)	8.8	6.3	0.3	11.2	10.1
Return on revenue (including investment income) (%)	15.6	16.0	0.9	42.9	46.4
Return on equity (%)	15.3	15.7	0.0	6.9	8.1
Loss ratio (%)	61.5	55.7	82.0	18.6	16.7
Expense ratio (%)	37.5	50.2	54.4	68.5	64.1
Combined ratio (%)	99.0	105.9	136.4	87.1	80.8
Operating ratio (%)	20.5	23.4	1.8	63.6	70.0
Portfolio performance					
Net investment income	9.3	9.0	9.4	9.1	7.3
Net yield	4.4	4.5	4.7	5.2	5.1
Net capital gain or loss	0.0	0.1	0.0	0.3	0.0
Portfolio composition					
Cash and short-term investments (%)	12.1	9.7	8.5	4.6	12.7
Bonds (%)	87.1	89.9	91.2	95.2	86.7
Other (%)	0.8	0.4	0.3	0.1	0.7
Invested assets to total assets (%)	81.4	79.7	68.8	65.3	61.1
Average maturity of bond portfolio (years)	4.3	4.4	4.9	7.0	6.8

*Consolidated GAAP basis.

RVI’s operating performance is strong, but showed extreme volatility from 2002-2004.

Historical

RVI’s historical operating performance has been dominated by a very low loss ratio that averaged 26% between 1995 and 2001, while the expense ratio was significantly higher, averaging 88% during this period. RVI operating results were very strong in 2000 and 2001 with the combined ratio at 80.8% and 87.1%, respectively. The loss ratio in 2000 and 2001 was less than 20%, while the expense ratio was below historical levels. In 2002, RVI’s combined ratio increased substantially to 136.4% from 89% in 2001, as there was an accelerated decline in used passenger vehicle values that resulted in a reserve strengthening. This continued somewhat in 2003 with a 105.9% combined ratio and in 2004 with a 99% combined ratio.

Current performance

For the first six months of 2005, premium volume increased 8% on a gross basis from 2004, and net income increased to $8.5 million from $4.7 million in the same period due to lower passenger vehicle losses. The combined ratio measured 67% in the second quarter of 2005 compared with 83% in the second quarter of 2004. The loss ratio decreased to 20% in the second quarter of 2005 from 41% in second-quarter 2004, which was offset by an increase in the expense ratio. The expense ratio increased in part due to new business established at the beginning of 2005. Furthermore, RVI's net income increased to $12.6 million for the first nine months of 2005 compared with $6.5 million for the same period in 2004.

Prospective

Earnings are expected to remain strong with a combined ratio of nearly 90%, but due to the short-tail nature of passenger vehicle writings the volatility will remain a risk. RVI's risk profile has changed, and with the focus on short-tail passenger vehicle writings there is the potential for future losses to significantly affect net income.

Investments And Liquidity

RVI's investments and liquidity are very strong. The investment strategy is focused on the preservation of principal that yields modest but stable returns while maintaining a conservative investment strategy.

RVI's investment philosophy is to preserve and organically grow capital through after-tax investment income. The investment strategy is also focused on stability and the management of credit and cash flow risks.

At year-end 2004, 99% of RVI's invested assets were in fixed income securities and 1% was in preferred stock. The absence of common equities has been the traditional strategy for RVI, and this is expected to continue.

RVI's investment portfolio is allocated as follows: 42% municipal bonds, 17% each in corporate bonds and MBS, 16% in U.S. government, 7% in ABS, and 1% in preferred stock. On average, invested assets are of 'AA+' quality with a modified duration of 4.2 years.

RVI increased its cash amount to $30 million in 2004 from $19 million in 2002. RVI has no significant reinsurance receivables from reinsurers.

Prospective

Expectations are that RVI has sufficient fixed-income securities and cash to meet its near-term obligations. In general, because the majority of RVI's risks are long-term, the company is aware of payments well in advance, so near-term liquidity concerns are minimal.

Capitalization

Table 4

R.V.I. Guaranty Co. Ltd.—Capitalization Statistics*

	—Year ended Dec. 31—				
(Mil. $)	***2004***	***2003***	***2002***	***2001***	***2000***
Total assets	299.4	282.6	320.3	274.3	256.7
Stockholders' equity	43.7	35.7	115.7	116.7	111.2
Operating leverage (x)	1.6	1.4	0.4	0.3	0.3
Risk in force/shareholders' equity (x)	N.A.	101.8	100	90.1	73.2
Reinsurance utilization ratio (%)	3.4	17.4	7.7	5.5	23.7
Operating cash flow	20	38.8	38.4	24.6	28.9

*Consolidated GAAP basis. N.A.—Not available.

RVI's capital adequacy is strong but significantly lower than in prior years. RVI is expected to maintain higher capital adequacy to compensate for its volatile earnings and changing risk profile. Based on Standard & Poor's model, the CAR was nearly 150% at year-end 2004, including the trust preferred securities issued ($15 million) in November 2002. Before Standard & Poor's capital model was adjusted to apply 100% credit for UPR rather than 50%, RVI's CAR would have been 117%.

About 30% of RVI's sum insured amounts will mature in 2005 and 2006. The majority of these obligations are related to the passenger vehicle line of business, which has a 52-month average life. This near-term concentration of maturities is expected to be a continuous risk for RVI unless its writings of passenger vehicle risks decline, but this is not expected.

Generally, the company's standard reserving practice is to record 20% of net earned premiums annually. Where the ultimate-loss ratio is expected to exceed 20%, however, reserves are established based on that ultimate-loss ratio. Certain passenger vehicle contracts have ultimate loss expectations greater than 20%. Increases in ultimate-loss projections for the passenger vehicle line of business continued in 2004 due to adverse development on contracts for accident years 1999 and 2000. Standard & Poor's expects that further deterioration will be limited (as the vast majority of vehicles are off risk), but if this adverse development is significant the rating will be reviewed.

RVI's stockholders' equity has not grown significantly since 1997 when it measured $104 million and before the restatement when it measured $125 million at year-end 2004. Following the restatement, RVI's shareholders' equity increased to $56 million as of Sept. 30, 2005 from $44 million at year-end 2004.

Prospective

Capital adequacy should be maintained at about 150% to compensate for potential volatility. Standard & Poor's allows 100% credit in its capital model for RVI's UPR amount.

Financial Flexibility

RVI's financial flexibility is strong and consistent with the rating, but market acceptance and lack of knowledge about RVI's business model may limit RVI's financial flexibility. Furthermore, RVI's financial leverage has increased with its issuance of trust preferreds in November 2002. RVI might utilize more reinsurance to mitigate its changing risk profile, as the company has already placed quota share and excess of loss reinsurance.

Historically, RVI carried zero financial leverage, but in November 2002 trust preferreds were issued in the amount of $15 million, as part of a $350 million pool. The interest rate was 5.4% and the final maturity date is 2032. Debt plus preferreds to total capital now measures 26% in 2004, following the exclusion of the soft capital commitments. Interest coverage measured 12x.