

February 11, 2009

**Research Update:**

# XL Capital Ltd. And Operating Companies Ratings Affirmed; Outlook Remains Negative

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## Rationale

On Feb. 11, 2009, Standard & Poor's Ratings Services affirmed its 'BBB+' counterparty credit rating on XL Capital Ltd. (NYSE:XL) and its 'A' counterparty credit and financial strength ratings on XL's core operating subsidiaries. The outlook on all of these companies remains negative.

The affirmation follows XL's announcement of a \$1.4 billion fourth-quarter 2008 loss. This loss consisted of \$1 billion in goodwill impairments and \$400 million of realized investment losses because of management's decision to sell non-impaired securities to reduce volatility in the investment portfolio. Notwithstanding the disappointment of another large reported loss following a \$1.6 billion loss in the third quarter of 2008, XL's underwriting performance continues to be strong and consistent with our expectations, thereby offsetting \$200 million of recognized other-than-temporary impairments and other realized investment losses (excluding the \$400 million realized loss due to management's decision to sell nonimpaired assets). We view the \$1 billion goodwill impairment as more of an accounting event because of our exclusion of goodwill in our assessment of capital and because this impairment is on a 1998 acquisition for which the current management team had no involvement.

The \$400 million realized loss, which stemmed from management's announced intent to dispose of certain higher-risk securities, introduces short-term execution risk. However, we consider it a positive rating factor over the long term because it reduces balance-sheet volatility while enhancing liquidity borne from the shortened duration. Furthermore, the \$400 million impairment charge has no impact on capital and financial leverage, which already incorporate the mark-to-market losses now being realized through income. The rating incorporates our expectation that XL will reposition its investments deliberately and in the context of market conditions rather than basing it on arbitrary guidelines.

The ratings are based on the group's strong global market presence, strong underlying underwriting performance, and diversified earnings stream. We consider XL's capitalization to be strong despite a quantitative calculation that was modestly below what we expect for the rating level when incorporating unrealized losses as of Dec. 31, 2008. Offsetting these strengths is a track record of inconsistent earnings performance, weakened financial flexibility, and susceptibility to further declines in the investment portfolio.

We believe perceived franchise issues borne from a string of material earnings and capital charges over the past several years continue to hurt XL's competitive position, though it is still strong. The rating incorporates the expectation that XL will sustain its business profile without compromising pricing or terms and conditions, with a marked decline in new premiums written

as XL continues to emphasize underwriting profitability.

## Outlook

We expect that the continued enhancement of XL's enterprise risk management (ERM)--especially strategic and operational risk--will materially reduce potential unexpected losses. Although additional realized losses in the investment portfolio are likely because of continued economic uncertainty, continued strong underwriting performance (accident-year and calendar-year combined ratios of less than 100% and returns on revenue, excluding realized investment losses, approaching 15%) will offset these losses. In 2009, financial leverage (debt plus preferreds, including hybrids) will be no more than 40% of total capital when reflecting the February 2009 conversion of \$745 million of senior notes into equity, and fixed-charge coverage will exceed 4.5x.

If, in the next two years, XL continues to develop its ERM, there are no additional investment losses that more than offset operating income, and no negative surprises arise that dampen consolidated results, we could revise the outlook to stable. However, if more unexpected adverse events occur (such as unexpected additional realized investment losses, large underwriting losses, or large operational risk), if the company does not meet our financial tolerance levels, or if there is inadequate progress related to ERM, we will most likely lower the ratings. A downgrade would also result if XL fails to sustain its underwriting guidelines in terms of pricing and terms and conditions.

## Ratings List

### Ratings Affirmed

XL Capital Ltd.

Counterparty Credit Rating

|                               |                  |
|-------------------------------|------------------|
| Local Currency                | BBB+/Negative/-- |
| Senior Unsecured (4 issues)   | BBB+             |
| Junior Subordinated (1 issue) | BBB-             |
| Preferred Stock (3 issues)    | BBB-             |
| Preference Stock (1 issue)    | BBB-             |

X.L America Inc.

Nac Re Corp.

Counterparty Credit Rating

|                |                  |
|----------------|------------------|
| Local Currency | BBB+/Negative/-- |
|----------------|------------------|

Greenwich Insurance Co.

XL Specialty Insurance Co.

XL Select Insurance Co.

XL Reinsurance America Inc.

XL Re Ltd.

XL Re Latin America Ltd.

XL Re Europe Ltd.

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|   |                |
|---|----------------|
| XL Life Insurance and Annuity Co.       |                |
| XL Insurance Switzerland                |                |
| XL Insurance Co. of New York Inc.       |                |
| XL Insurance America Inc.               |                |
| XL Insurance (Bermuda) Ltd.             |                |
| XL Europe Ltd.                          |                |
| Indian Harbor Insurance Co.             |                |
| Counterparty Credit Rating              |                |
| Local Currency                          | A/Negative/--  |
| Greenwich Insurance Co.                 |                |
| XL Specialty Insurance Co.              |                |
| XL Select Insurance Co.                 |                |
| XL Reinsurance America Inc.             |                |
| XL Re Ltd. - U.K.                       |                |
| XL Re Ltd.                              |                |
| XL Re Latin America Ltd.                |                |
| XL Re Europe Ltd.                       |                |
| XL Life Insurance and Annuity Co.       |                |
| XL Insurance Switzerland                |                |
| XL Insurance Co. of New York Inc.       |                |
| XL Insurance Co. Ltd.                   |                |
| XL Insurance America Inc.               |                |
| XL Insurance (Bermuda) Ltd.             |                |
| XL Europe Ltd.                          |                |
| Indian Harbor Insurance Co.             |                |
| Financial Strength Rating               |                |
| Local Currency                          | A/Negative/--  |
| Vitodurum Reinsurance Co.               |                |
| Counterparty Credit Rating              |                |
| Local Currency                          | BBB+/Stable/-- |
| Financial Strength Rating               |                |
| Local Currency                          | BBB+/Stable/-- |
| XL Insurance (Bermuda) Ltd.             |                |
| Financial Enhancement Rating            |                |
| Local Currency                          | A/--/--        |
| XL Insurance Co. Ltd.                   |                |
| Counterparty Credit Rating              |                |
| Local Currency                          | A/Negative/--  |
| Premium Asset Trust Certificates 2004-9 |                |
| Senior Secured (1 issue)                | A              |
| Stoneheath Re                           |                |
| Preferred Stock (1 issue)               | BBB-           |
| XL Capital Finance (Europe) plc         |                |

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Senior Unsecured (1 issue) BBB+

XLLIAC Global Funding

Senior Secured (2 issues) A

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