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**Research Update:**

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

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## Rationale

On Oct. 10, 2008, Standard & Poor's Ratings Services affirmed its 'A-' counterparty credit rating on XL Capital Ltd. (NYSE:XL) and its 'A+' counterparty credit and financial strength ratings on XL's core operating insurance subsidiaries. The outlook on all of these companies remains negative.

The affirmation follows XL's recent announcements of a \$1.0 billion-\$1.2 billion decline in value of its investment portfolio in the third quarter of 2008 and a \$195 million-\$270 million net loss in the third quarter because of losses related to Hurricanes Ike and Gustav.

Although these developments hurt third-quarter earnings, XL raised \$2.875 billion through the issuance of new common shares and equity unit securities in July 2008. The company earmarked a substantial proportion of the proceeds for the closing of an agreement with Syncora Holdings Ltd. (SCA) terminating certain reinsurance and other obligations, which will result in a \$1.4 billion-\$1.5 billion third-quarter charge, but it retained the remainder of the net capital raise (\$1.1 billion). The capital retention offset our previously communicated concern regarding the heightened potential for investment declines and impairments. Pro forma Sept. 30, 2008, capital adequacy is strong and incorporates both the market valuation of XL's investment portfolio and expected Hurricane Ike and Gustav losses that, though material, were within our expectations.

The counterparty credit rating on XL reflects the company's strong global market presence, strong interest and fixed-charge coverage, and diversified earnings stream. Somewhat offsetting these strengths are a track record of inconsistent earnings performance; material, though reduced, exposure to large catastrophic losses; susceptibility to further declines in the investment portfolio; and business-integration challenges borne from the relatively rapid building of a very strong and diversified global competitive position.

## Outlook

The negative outlook reflects the potential for further declines in the investment portfolio and our concerns about the adequacy of XL's enterprise risk management (ERM). The material declines in the investment portfolio and the costs of resolving the situation with SCA is just the latest in a series of material charges in connection with several issues over a number of years. In addition, we believe XL's need to access the financial markets twice in the past three years to address such issues has hurt the company's financial flexibility. However, we believe that management is proactively addressing its shortfalls in ERM practices, especially strategic and operational risk management. Moreover, we believe there is adequate management, at least with

respect to its core insurance-related risks.

We expect XL to produce a strong, steady earnings stream from its ongoing core operations at a level equal to that of similarly rated peers, despite soft market pressures. An accident-year and calendar-year combined ratio of less than 100% and a pretax return on revenue (excluding realized gains or losses) of 15% will result from continued pricing discipline and operating performance, absent an unusually severe catastrophe year. Furthermore, 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 (excluding noncash and unusual charges) will approach 5.5x in 2008 and 2009.

The rating also assumes that the objective of exploring strategic opportunities related to the life reinsurance operations is to enhance management focus in the core property and casualty businesses. If, in the next two years, ERM continues to develop and no negative surprises arise that dampen consolidated results, we could revise the outlook to stable. However, if there is inadequate progress related to XL's ERM, if more unexpected adverse events occur, or if the company does not meet our financial tolerance levels, a downgrade would most likely result.

## Ratings List

### Ratings Affirmed

XL Capital Ltd.

X.L America Inc.

Nac Re Corp.

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.

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 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.

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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/--
XL Insurance (Bermuda) Ltd.	
Financial Enhancement Rating	
Local Currency	A+/--/--
XL Insurance Co. Ltd.	
Counterparty Credit Rating	
Local Currency	A+/Negative/--
XL Capital Ltd.	
Senior Unsecured (4 issues)	A-
Junior Subordinated (1 issue)	BBB
Preferred Stock (3 issues)	BBB
Mangrove Bay Pass-Through Trust	
Preference Stock (1 issue)	BBB
Premium Asset Trust Certificates 2004-9	
Senior Secured (1 issue)	A+
Stoneheath Re	
Preferred Stock (1 issue)	BBB
XL Capital Finance (Europe) plc	
Senior Unsecured (1 issue)	A-
XLLIAC Global Funding	
Senior Secured (2 issues)	A+

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