

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2005

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_ to \_\_\_\_

Commission file number 1-10804

**XL CAPITAL LTD**

(Exact name of registrant as specified in its charter)

CAYMAN ISLANDS  
(State or other jurisdiction of  
incorporation or organization)

98-0191089  
(I.R.S. Employer  
Identification No.)

**XL House, One Bermudiana Road, Hamilton, Bermuda HM 11**  
(Address of principal executive offices and zip code)

**(441) 292-8515**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 2, 2005, there were 140,399,600 outstanding Class A Ordinary Shares, \$0.01 par value per share, of the registrant.

**XL CAPITAL LTD**

**INDEX TO FORM 10-Q**

	<b>Page No</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements:	
Consolidated Balance Sheets as at June 30, 2005 (Unaudited) and December 31, 2004	3
Consolidated Statements of Income for the Three Months Ended June 30, 2005 and 2004 (Unaudited) and the Six Months Ended June 30, 2005 and 2004 (Unaudited)	5
Consolidated Statements of Comprehensive Income for the Three Months Ended June 30, 2005 and 2004 (Unaudited) and the Six Months Ended June 30, 2005 and 2004 (Unaudited)	6

	Consolidated Statements of Shareholders' Equity for the Six Months Ended June 30, 2005 and 2004 (Unaudited)	7
	Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2005 and 2004 (Unaudited)	8
	Notes to Unaudited Consolidated Financial Statements	9
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	27
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	57
Item 4.	Controls and Procedures	62
<b>PART II. OTHER INFORMATION</b>		
Item 1.	Legal Proceedings	63
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	64
Item 4.	Submission of Matters to a Vote of Security Holders	64
Item 5.	Other Information	65
Item 6.	Exhibits	65
	Signatures	67

**PART I — FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**XL CAPITAL LTD**  
**CONSOLIDATED BALANCE SHEETS**  
(U.S. dollars in thousands, except share amounts)

	(Unaudited)	
	June 30,	December 31,
	2005	2004
<b>ASSETS</b>		
Investments:		
Fixed maturities at fair value (amortized cost: 2005, \$27,762,444; 2004, \$24,452,348)	\$28,524,432	\$25,100,194
Equity securities, at fair value (cost: 2005, \$766,896; 2004, \$778,117)	918,740	962,920
Short-term investments, at fair value (amortized cost: 2005, \$2,007,761; 2004, \$1,738,845)	2,005,731	1,760,714
Total investments available for sale	31,448,903	27,823,828
Investments in affiliates	2,044,085	1,936,852
Other investments	262,292	305,160
Total investments	33,755,280	30,065,840
Cash and cash equivalents	2,467,775	2,304,303
Accrued investment income	353,110	326,510
Deferred acquisition costs	947,905	845,422
Prepaid reinsurance premiums	1,103,229	992,260
Premiums receivable	4,442,750	3,838,228
Reinsurance balances receivable	957,904	1,095,739
Unpaid losses and loss expenses recoverable	6,464,019	6,971,356
Goodwill and other intangible assets	1,820,148	1,827,782
Deferred tax asset, net	201,700	288,599
Other assets	811,078	689,430
Total assets	\$53,324,898	\$49,245,469
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		

## Liabilities:

Unpaid losses and loss expenses	\$19,775,410	\$19,837,669
Deposit liabilities	7,336,323	5,974,726
Future policy benefit reserves	5,749,285	4,335,056
Unearned premiums	6,064,286	5,191,368
Notes payable and debt	2,721,916	2,721,431
Reinsurance balances payable	1,460,842	1,565,689
Net payable for investments purchased	150,842	273,535
Other liabilities	1,622,918	1,533,860
Minority interest	71,400	73,440
Total liabilities	\$44,953,222	\$41,506,774

See accompanying Notes to Unaudited Consolidated Financial Statements

3

**XL CAPITAL LTD**  
**CONSOLIDATED BALANCE SHEETS**  
(U.S. dollars in thousands, except share amounts)

	(Unaudited)	
	June 30, 2005	December 31, 2004
Commitments and Contingencies		
Shareholders' Equity:		
Series A preference ordinary shares, 9,200,000 authorized, par value \$0.01 Issued and outstanding: 2005 and 2004, 9,200,000	\$ 92	\$ 92
Series B preference ordinary shares, 11,500,000 authorized, par value \$0.01 Issued and outstanding: 2005 and 2004, 11,500,000	115	115
Series C preference ordinary shares, 20,000,000 authorized, par value \$0.01 Issued and outstanding 2005 and 2004, nil.	—	—
Class A ordinary shares, 999,990,000 authorized, par value \$0.01 Issued and outstanding: 2005, 140,389,078; 2004, 138,932,481	1,404	1,389
Additional paid in capital	4,053,051	3,950,175
Accumulated other comprehensive income	589,601	460,273
Deferred compensation	(107,115)	(69,988)
Retained earnings	3,834,528	3,396,639
Total shareholders' equity	\$ 8,371,676	\$ 7,738,695
Total liabilities and shareholders' equity	\$53,324,898	\$49,245,469

See accompanying Notes to Unaudited Consolidated Financial Statements

4

**XL CAPITAL LTD**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(U.S. dollars in thousands, except per share amounts)

	(Unaudited)		(Unaudited)	
	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Revenues:				
Net premiums earned	\$3,712,768	\$2,870,115	\$5,612,203	\$4,602,917

Net investment income	367,401	240,426	675,606	479,493
Net realized gains on investments	90,055	8,763	150,726	124,100
Net realized and unrealized (losses) gains on derivative instruments	(47,941)	30,874	(2,763)	38,641
Net (loss) income from investment affiliates	(10,774)	7,969	59,738	71,462
Fee (loss) income and other	(3,048)	8,152	14,112	15,059
<b>Total revenues</b>	<b>\$4,108,461</b>	<b>\$3,166,299</b>	<b>\$6,509,622</b>	<b>\$5,331,672</b>
Expenses:				
Net losses and loss expenses incurred	\$1,261,707	1,096,840	\$2,404,768	2,084,098
Claims and policy benefits	2,020,664	1,010,131	2,146,291	1,125,407
Acquisition costs	310,988	347,408	605,382	624,678
Operating expenses	248,950	247,716	496,106	493,016
Exchange (gains) losses	(10,693)	15,913	229	5,189
Interest expense	97,766	59,120	186,052	109,370
Amortization of intangible assets	3,043	3,257	5,836	6,514
<b>Total expenses</b>	<b>\$3,932,425</b>	<b>\$2,780,385</b>	<b>\$5,844,664</b>	<b>\$4,448,272</b>
<b>Income before minority interest, income tax and equity in net (income) of insurance and financial affiliates</b>	<b>\$ 176,036</b>	<b>\$ 385,914</b>	<b>\$ 664,958</b>	<b>\$ 883,400</b>
Minority interest in net income of subsidiary	2,079	2,284	4,354	6,944
Income tax	41,776	32,266	94,650	68,151
Net (income) from operating affiliates	(13,794)	(22,320)	(33,046)	(27,628)
<b>Net income</b>	<b>145,975</b>	<b>373,684</b>	<b>599,000</b>	<b>835,933</b>
Preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
<b>Net income available to ordinary shareholders</b>	<b>\$ 135,895</b>	<b>\$ 363,604</b>	<b>\$ 578,840</b>	<b>\$ 815,773</b>
Weighted average ordinary shares and ordinary share equivalents outstanding — basic	138,948	137,655	138,488	137,568
Weighted average ordinary shares and ordinary share equivalents outstanding — diluted	140,404	138,741	139,841	138,648
Earnings per ordinary share and ordinary share equivalent — basic	\$ 0.98	\$ 2.64	\$ 4.18	\$ 5.93
Earnings per ordinary share and ordinary share equivalent — diluted	\$ 0.97	\$ 2.62	\$ 4.14	\$ 5.88

See accompanying Notes to Unaudited Consolidated Financial Statements

**XL CAPITAL LTD**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(U.S. dollars in thousands)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2005	2004	2005	2004
Net income	\$145,975	\$373,684	\$599,000	\$835,933
Change in net unrealized appreciation of investments, net of tax	390,751	(585,146)	49,693	(469,941)
Change in derivative loss	157	—	313	—
Foreign currency translation adjustments, net	61,252	(17,817)	79,322	8,765
<b>Comprehensive income (loss)</b>	<b>\$598,135</b>	<b>\$(229,279)</b>	<b>\$728,328</b>	<b>\$374,757</b>

**XL CAPITAL LTD**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2005	2004
<b>Series A and B Preference Ordinary Shares:</b>		
Balance — beginning of year	\$ 207	\$ 207
Issue of shares	—	—
Balance — end of period	\$ 207	\$ 207
<b>Class A Ordinary Shares:</b>		
Balance — beginning of year	\$ 1,389	\$ 1,373
Issue of shares	8	5
Exercise of stock options	8	5
Repurchase of shares	(1)	—
Balance — end of period	\$ 1,404	\$ 1,383
<b>Additional Paid in Capital:</b>		
Balance — beginning of year	\$3,950,175	\$3,949,421
Issue of shares	60,306	43,445
Stock option expense	9,685	6,000
Exercise of stock options	34,515	16,746
Repurchase of shares	(1,630)	(1,631)
Equity units/debt value	—	(112,301)
Balance — end of period	\$4,053,051	\$3,901,680
<b>Accumulated Other Comprehensive Income:</b>		
Balance — beginning of year	\$ 460,273	\$ 490,195
Net change in unrealized gains (losses) on investment portfolio, net of tax	46,715	(476,724)
Net change in unrealized gains on investment portfolio of affiliates	2,978	6,783
Derivative Loss on Cashflow Hedge	313	—
Currency translation adjustments	79,322	8,765
Balance — end of period	\$ 589,601	\$ 29,019
<b>Deferred Compensation:</b>		
Balance — beginning of year	\$ (69,988)	\$ (46,124)
Issue of restricted shares	(57,604)	(43,103)
Amortization	20,477	12,218
Balance — end of period	\$ (107,115)	\$ (77,009)
<b>Retained Earnings:</b>		
Balance — beginning of year	\$3,396,639	\$2,541,843
Net income	599,000	835,933
Dividends on Series A and B preference ordinary shares	(20,160)	(20,160)
Dividends on Class A ordinary shares	(138,186)	(135,278)
Repurchase of ordinary shares	(2,765)	(1,046)

Balance — end of period	\$3,834,528	\$3,221,292
<b>Total Shareholders' Equity</b>	<b>\$8,371,676</b>	<b>\$7,076,572</b>

See accompanying Notes to Unaudited Consolidated Financial Statements

**XL CAPITAL LTD**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(U.S. dollars in thousands)

	(Unaudited)	
	Six Months Ended June 30,	
	2005	2004
<b>Cash flows provided by operating activities:</b>		
Net income	\$ 599,000	\$ 835,933
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Net realized gains on investments	(150,726)	(124,100)
Net realized and unrealized gains on derivative instruments	2,763	(53,737)
Amortization of premiums on fixed maturities	30,380	43,147
Net income from investment, insurance and financial affiliates	(92,784)	(99,090)
Amortization of deferred compensation	20,477	12,218
Accretion of convertible debt	485	12,882
Accretion of deposit liabilities	105,219	53,904
Unpaid losses and loss expenses	(62,259)	502,507
Future policy benefit reserves	1,414,229	875,705
Unearned premiums	872,918	1,233,412
Premiums receivable	(604,522)	(1,150,047)
Unpaid losses and loss expenses recoverable	507,337	(53,815)
Prepaid reinsurance premiums	(110,969)	(44,134)
Reinsurance balances receivable	137,835	57,011
Deferred acquisition costs	(102,483)	(209,150)
Reinsurance balances payable	(104,847)	102,486
Deferred tax asset	86,899	2,503
Other assets	(90,027)	(61,316)
Other	172,125	35,102
Total adjustments	2,032,050	1,135,488
Net cash provided by operating activities	\$ 2,631,050	\$ 1,971,421
<b>Cash flows used in investing activities:</b>		
Proceeds from sale of fixed maturities and short-term investments	\$11,209,810	\$13,800,883
Proceeds from redemption of fixed maturities and short-term investments	646,697	2,482,888
Proceeds from sale of equity securities	555,622	252,333
Purchases of fixed maturities and short-term investments	(15,407,239)	(19,328,808)
Purchases of equity securities	(555,142)	(284,308)
Investments in affiliates, net of dividends received	2,292	(1,322)
Other investments	16,300	(1,632)
Net cash used in investing activities	\$ (3,531,660)	\$ (3,079,966)
<b>Cash flows provided by financing activities:</b>		
Proceeds from exercise of stock options and issuance of common shares	40,446	16,751
Repurchase of shares	(4,396)	(2,676)

Dividends paid	(158,348)	(155,438)
Proceeds from notes payable and issuance of equity units	—	671,360
Deposit liabilities	1,259,848	682,338
Net cashflow on securities lending	(71,834)	—
Net cash provided by financing activities	1,065,716	1,330,192
Effects of exchange rate changes on foreign currency cash	(1,634)	1,586
Increase in cash and cash equivalents	163,472	341,757
<b>Cash and cash equivalents — beginning of period</b>	<b>2,304,303</b>	<b>2,829,627</b>
<b>Cash and cash equivalents — end of period</b>	<b>\$ 2,467,775</b>	<b>\$ 3,052,860</b>

See accompanying Notes to Unaudited Consolidated Financial Statements

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Preparation and Consolidation**

These unaudited consolidated financial statements include the accounts of the Company and all of its subsidiaries and have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, these unaudited financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and results of operations as at the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year. All significant inter-company accounts and transactions have been eliminated. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from these estimates.

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation. There was no effect on net income from this change in presentation.

Unless the context otherwise indicates, references herein to the Company include XL Capital Ltd and its consolidated subsidiaries.

**2. Significant Accounting Policies**

(a) Derivatives

For all periods reported herein, the Company amended the presentation of certain credit derivative transactions (described below) in the consolidated statements of income to include certain components of the change in fair value in “gross premiums written”, “net premiums earned” and “net losses and loss expenses incurred”, and in the consolidated balance sheet, certain components of the fair value in “unearned premiums” and “unpaid losses and loss expenses.” Previously, the change in fair value of all of the Company’s derivative transactions was reflected in one line item under “net realized and unrealized gains (losses) on derivative instruments”, and the fair value had been reflected in “other assets” and “other liabilities.” There was no effect on net income as a result of this change in presentation and prior period results have been reclassified to reflect this presentation. This change in presentation is applicable only to credit default swaps issued by the Company that are investment grade and that the Company intends, and has the ability, to hold to maturity. This change in presentation is principally applicable to credit default swaps issued by the Company’s financial guaranty insurance subsidiaries and is consistent with practices in the financial guaranty insurance industry for reporting the results of such instruments.

(b) Stock-Based compensation

Effective January 1, 2003, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards (“FAS”) No. 123 *Accounting for Stock-Based Compensation* (“FAS 123”), as amended by FAS No. 148 *Accounting for Stock-Based Compensation — Transition and Disclosure* (“FAS 148”), under the prospective method for options granted subsequent to January 1, 2003. Prior to 2003, the Company accounted for options under the disclosure-only provisions of FAS 123 and no stock-based employee compensation cost was included in net income as all options granted had an exercise price equal to the market value of the Company’s ordinary shares on the date of the grant. Awards under the Company’s plans vest over periods ranging from three to four years. If the fair value based method had been applied to all awards since the original effective date of FAS 123, the cost related to employee stock-based compensation included in the determination of net income would have been higher. The following table illustrates the net effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested awards in each period:

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**2. Significant Accounting Policies (Continued)**

(U.S. dollars in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Net income available to ordinary shareholders — as reported	\$135,895	\$363,604	\$578,840	\$815,773
Add: Stock-based employee compensation expense included in reported net income, net of related tax	5,508	3,601	9,685	6,000
Deduct: Total stock-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects	(6,189)	(10,665)	(14,318)	(21,757)
Pro forma net income available to ordinary shareholders	\$135,214	\$356,540	\$574,207	\$800,016
Earnings per ordinary share:				
Basic — as reported	\$ 0.98	\$ 2.64	\$ 4.18	\$ 5.93
Basic — pro forma	\$ 0.97	\$ 2.59	\$ 4.15	\$ 5.82
Diluted — as reported	\$ 0.97	\$ 2.62	\$ 4.14	\$ 5.88
Diluted — pro forma	\$ 0.96	\$ 2.57	\$ 4.11	\$ 5.77

### 3. Recent Accounting Pronouncements

Statement of Position (“SOP”) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor’s initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. SOP 03-3 limits the yield that may be accreted (accretable yield) to the excess of the investor’s estimate of undiscounted expected principal, interest, and other cash flows (cash flows expected at acquisition to be collected) over the investor’s initial investment in the debt security. SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. The adoption of SOP 03-3 did not have a material effect on the Company’s financial condition or results of operations.

In December 2004, the Financial Accounting Standards Board (“FASB”) issued FAS No. 123 (Revised), *Share-Based Payments* (“FAS 123 (Revised)”), which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based at their fair values. This statement will be effective for the first fiscal year beginning after June 15, 2005. The Company adopted the fair-value-based method of accounting for share-based payments effective January 1, 2003 using the prospective method described in FAS 148. FAS 123 (Revised) must be applied not only to new awards but to previously granted awards that are not fully vested on the effective date. Had the Company adopted FAS 123 (Revised) in prior periods, the impact of that standard would have approximated the impact of FAS 123 as described in the disclosure of pro forma net income and earnings per share in Note 2 (b) – Stock-Based compensation above.

In March 2005, the FASB issued FASB Staff Position (“FSP”) FIN 46(R)-5, *Implicit Variable Interests Under FASB Interpretation No. 46(R)*, which requires an enterprise to consider whether it holds an implicit variable interest in a Variable Interest Entity (“VIE”) and what effect this may have on the calculation of expected losses and residual returns of the VIE and the determination of which party, if any, is considered the primary beneficiary of the VIE. This statement was effective for the first reporting period beginning after March 3, 2005 and did not have a material impact on the Company’s financial condition or results of operations.

10

## XL CAPITAL LTD NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

### 3. Recent Accounting Pronouncements (continued)

In May 2005, the FASB issued FAS 154, *Accounting Changes and Error Corrections*, which changes the requirements for the accounting for and reporting of a change in accounting principle. This Statement applies to all voluntary changes in accounting principles and changes the requirements for accounting for, and reporting of, a change in accounting principle. This Statement will be effective for fiscal years beginning after December 15, 2005.

In June 2005, the FASB ratified the Emerging Issues Task Force (“EITF”) Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*. The EITF reached a consensus that a sole general partner is presumed to control a limited partnership (or similar entity) and should consolidate the limited partnership unless (1) the limited partners possess substantive kick-out rights or (2) the limited partners possess substantive participating rights similar to the rights described in EITF Issue No. 96-16, *Investor’s Accounting for an Investee When the Investor has a majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. This issue was effective for all new and modified agreements, upon the FASB’s ratification in June 2005. For pre-existing agreements that are not modified, the consensus is effective as of the beginning of the first fiscal reporting period beginning after December 15, 2005 and is not expected to have a material impact on the Company’s financial condition or results of operations.

The Company is aware of the SEC’s recent review of the loss reserving practices of the financial guaranty industry. The Company recognizes that there is diversity in practice among financial guaranty insurers and reinsurers with respect to their accounting policies. Current accounting literature, specifically FASB Statement of Financial Accounting Standards No. 60 *Accounting and Reporting by Insurance Enterprises* (“FAS 60”) does not specifically address the unique characteristics of financial guaranty insurance contracts. During June 2005, the FASB undertook a project to review this matter and provide guidance for the accounting for financial guaranty insurance contracts under which it will consider claims liability recognition, premium recognition, and the related amortization of deferred policy acquisition costs. The Company will continue its loss reserving methodology as noted in Note 2(k) of the Company’s Form 10-K for the year ended December 31, 2004, until further guidance is provided by the SEC or FASB.

#### 4. Segment Information

The Company is organized into three operating segments — Insurance, Reinsurance and Financial Products and Services — in addition to a Corporate segment that includes the general investment and financing operations of the Company. General, life and annuity and financial operations are disclosed separately by segment. General operations include property and casualty lines of business.

The Company evaluates the performance of each segment based on underwriting results for general operations, net income from life and annuity operations and contribution from financial operations. Other items of revenue and expenditure of the Company are not evaluated at the segment level. In addition, the Company does not allocate assets by segment for its general operations. Investment assets related to the Company's life and annuity and financial operations are held in separately identified portfolios. Net investment income from these assets is included in net income from life and annuity operations and contribution from financial operations, respectively.

In January 2005, following changes in certain executive management responsibilities, the Company changed the reporting segments under which certain business units are reported in order to reflect these changes in responsibilities.

- Results of business structured by XL Financial Solutions Ltd (“XLFS”) are now included entirely within the Financial Products and Services segment whereas previously this unit was reported in all three segments, depending on the nature of individual contracts.

11

---

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### 4. Segment Information (continued)

- Certain blocks of U.S.-based term life mortality reinsurance business previously included in the Financial Products and Services segment are now included in the Reinsurance segment as management of these contracts was transferred to the life reinsurance business units in order to centralize the Company's management of traditional mortality-based reinsurance business.
- Political risk insurance business units now report to executive management of the Financial Products and Services segment and, as such, earnings from this business are no longer reported in the Insurance segment but included with financial operations.
- All operations of business units within the Financial Products and Services segment, including municipal reinvestment contracts and funding agreements, are now reported under financial operations in order to consolidate businesses with similar operating characteristics and risks.
- Net investment income and net income from affiliates generated by assets and interest expense incurred on liabilities of the business units within the Financial Products and Services segment is reported under financial operations. This income and expense is included in financial operations as it relates to interest on portfolios of separately identified and managed assets and deposit liabilities.

Prior period comparative information has been re-presented to conform to the above noted changes. There was no change in net income as a result of this change in presentation.

12

---

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

#### 4. Segment Information (continued)

The following is an analysis of results by segment together with a reconciliation to net income:

**Three months ended June 30, 2005:**

**(U.S. dollars in thousands)**

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
<b>General Operations:</b>				
Net premiums earned	\$1,054,360	\$ 673,201	\$ —	\$1,727,561
Fee (loss) income and other	(2,916)	(463)	—	(3,379)
Net losses and loss expenses	676,374	568,154	—	1,244,528
Acquisition costs	119,032	149,049	—	268,081
Operating expenses (1)	140,261	38,153	—	178,414
Exchange (gains) losses	(34,104)	21,895	—	(12,209)
<b>Underwriting profit (loss)</b>	<b>\$ 149,881</b>	<b>\$ (104,513)</b>	<b>\$ —</b>	<b>\$ 45,368</b>
<b>Life and Annuity Operations:</b>				
Life premiums earned	\$ —	\$1,933,215	\$ —	\$1,933,215

Fee income and other	—	114	—	114
Claims and policy benefits	—	2,020,664	—	2,020,664
Acquisition costs	—	35,058	—	35,058
Operating expenses (1)	—	5,068	—	5,068
Exchange losses	—	403	—	403
Net investment income	—	71,963	—	71,963
Interest expense	—	—	—	—
<b>Net loss from life and annuity operations</b>	<b>\$ —</b>	<b>\$ (55,901)</b>	<b>\$ —</b>	<b>\$ (55,901)</b>

**Financial Operations:**

Net premiums earned			\$51,992	\$ 51,992
Fee income and other			217	217
Net losses and loss expenses			17,179	17,179
Acquisition costs			7,849	7,849
Operating expenses (1)			17,338	17,338
Exchange losses			1,113	1,113
<b>Underwriting profit</b>			<b>\$ 8,730</b>	<b>\$ 8,730</b>
Net investment income — financial guarantee			\$14,986	\$ 14,986
Net investment income — structured products			70,725	70,725
Interest expense — structured products			54,134	54,134
Operating expenses — structured products (1)			13,439	13,439
Net loss from financial and investment affiliates			(7,437)	(7,437)
Minority interest			2,300	2,300
Net results from derivatives (2)			17,487	17,487
<b>Contribution from financial operations</b>			<b>\$34,618</b>	<b>\$ 34,618</b>

See footnotes on following page.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)**

**Three months ended June 30, 2005 (continued):**

(U.S. dollars in thousands, except ratios)

(Unaudited)

	<b>Insurance</b>	<b>Reinsurance</b>	<b>Financial Products and Services</b>	<b>Total</b>
Net investment income — general operations				\$209,727
Net realized and unrealized gains on investments and derivative instruments (4)				24,627
Net income from operating affiliates				10,457
Interest expense (3)				43,632
Amortization of intangible assets				3,043
Corporate operating expenses				34,691
Minority interest				(221)
Income tax				41,776
<b>Net Income</b>				<b>\$145,975</b>
<b>General Operations:</b>				
Loss and loss expense ratio (5)	64.2%	84.4%		72.0%
Underwriting expense ratio (5)	24.5%	27.8%		25.9%
<b>Combined ratio (5)</b>	<b>88.7%</b>	<b>112.2%</b>		<b>97.9%</b>

- (1) Operating expenses exclude corporate operating expenses, shown separately.
- (2) Includes net realized and unrealized losses on credit derivatives of \$(4.0) million, and gains on weather and energy derivatives of \$4.1 million and gains on structured financial derivatives of \$17.4 million.
- (3) Interest expense excludes interest expense related to life and annuity operations, shown separately.
- (4) This includes net realized gains on investments of \$90.1 million and net realized and unrealized losses on investment derivatives of \$65.4 million, but does not include unrealized appreciation or depreciation on investments, which are included in “accumulated other comprehensive income (loss)”.
- (5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)**

**Three months ended June 30, 2004:**

(U.S. dollars in thousands)

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
<b>General Operations:</b>				
Net premiums earned	\$1,103,585	\$ 722,630	\$ —	\$1,826,215
Fee income and other	5,457	68	—	5,525
Net losses and loss expenses	706,869	377,800	—	1,084,669
Acquisition costs	154,867	172,985	—	327,852
Operating expenses (1)	130,254	48,396	—	178,650
Exchange losses	10,419	7,632	—	18,051
<b>Underwriting profit</b>	<b>\$ 106,633</b>	<b>\$ 115,885</b>	<b>\$ —</b>	<b>\$ 222,518</b>
<b>Life and Annuity Operations:</b>				
Life premiums earned	\$ —	\$ 986,930	\$ —	\$ 986,930
Fee income and other	—	116	—	116
Claims and policy benefits	—	1,010,131	—	1,010,131
Acquisition costs	—	10,561	—	10,561
Operating expenses (1)	—	2,950	—	2,950
Exchange losses	—	125	—	125
Net investment income	—	45,486	—	45,486
Interest expense	—	(42)	—	(42)
<b>Net income from life and annuity operations</b>	<b>\$ —</b>	<b>\$ 8,807</b>	<b>\$ —</b>	<b>\$ 8,807</b>
<b>Financial Operations:</b>				
Net premiums earned			\$56,970	\$ 56,970
Fee income and other			2,511	2,511
Net losses and loss expenses			12,171	12,171
Acquisition costs			8,995	8,995
Operating expenses (1)			15,637	15,637
Exchange (gains)			(2,263)	(2,263)
<b>Underwriting profit</b>			<b>\$24,941</b>	<b>\$ 24,941</b>
Net investment income — financial guarantee			8,872	8,872
Net investment income — structured products			39,888	39,888
Interest expense — structured products			21,876	21,876
Operating expenses — structured products (1)			11,686	11,686
Net income from financial and investment affiliates			2,599	2,599
Minority interest			2,427	2,427
Net results from derivatives (2)			15,486	15,486
<b>Contribution from financial operations</b>			<b>\$55,797</b>	<b>\$ 55,797</b>

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)****Three months ended June 30, 2004 (continued):**

(U.S. dollars in thousands, except ratios)

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
Net investment income — general operations				\$146,180
Net realized and unrealized gains on investments and derivative instruments (4)				24,151
Net income from operating affiliates				27,690
Interest expense (3)				37,286
Amortization of intangible assets				3,257
Corporate operating expenses				38,793
Minority interest				(143)
Income tax				32,266
<b>Net Income</b>				<b>\$373,684</b>
<b>General Operations:</b>				
Loss and loss expense ratio (5)	64.1%	52.3%		59.4%
Underwriting expense ratio (5)	25.8%	30.6%		27.7%
Combined ratio (5)	89.9%	82.9%		87.1%

(1) Operating expenses exclude corporate operating expenses, shown separately.

(2) Includes net realized and unrealized gains on credit derivatives of \$15.3 million, and weather and energy derivatives of \$0.1 million.

(3) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(4) This includes net realized gains on investments of \$8.8 million and net realized and unrealized gains on investment derivatives of \$15.4 million, but does not include unrealized appreciation or depreciation on investments, which are included in “accumulated other comprehensive income (loss)”.

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)****Six months ended June 30, 2005:**

(U.S. dollars in thousands)

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
<b>General Operations:</b>				
Net premiums earned	\$2,136,878	\$1,356,952	\$ —	\$3,493,830
Fee (loss) income and other	1,011	(446)	—	565
Net losses and loss expenses	1,401,889	978,504	—	2,380,393
Acquisition costs	257,775	291,239	—	549,014
Operating expenses (1)	266,129	79,559	—	345,688
Exchange (gains) losses	(19,789)	18,281	—	(1,508)
<b>Underwriting profit (loss)</b>	<b>\$ 231,885</b>	<b>\$ (11,077)</b>	<b>\$ —</b>	<b>\$ 220,808</b>

<b>Life and Annuity Operations:</b>				
Life premiums earned	\$ —	\$2,014,686	\$ —	\$2,014,686
Fee income and other	—	179	—	179
Claims and policy benefits	—	2,146,291	—	2,146,291
Acquisition costs	—	41,409	—	41,409
Operating expenses (1)	—	9,251	—	9,251
Exchange losses	—	673	—	673
Net investment income	—	131,866	—	131,866
<b>Net loss from life and annuity operations</b>	<b>\$ —</b>	<b>\$ (50,893)</b>	<b>\$ —</b>	<b>\$ (50,893)</b>
<b>Financial Operations:</b>				
Net premiums earned			\$103,687	\$ 103,687
Fee income and other			13,368	13,368
Net losses and loss expenses			24,375	24,375
Acquisition costs			14,959	14,959
Operating expenses (1)			34,894	34,894
Exchange losses			1,064	1,064
<b>Underwriting profit</b>			<b>\$ 41,763</b>	<b>\$ 41,763</b>
Net investment income — financial guarantee			\$ 29,504	\$ 29,504
Net investment income — structured products			132,579	132,579
Interest expense — structured products			96,544	96,544
Operating expenses — structured products (1)			23,197	23,197
Net loss from financial and investment affiliates			(809)	(809)
Minority interest			4,575	4,575
Net results from derivatives (2)			33,565	33,565
<b>Contribution from financial operations</b>			<b>\$112,286</b>	<b>\$ 112,286</b>

See footnotes on following page.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)**

**Six months ended June 30, 2005 (continued):**

(U.S. dollars in thousands, except ratios)

(Unaudited)

	<b>Financial</b>			<b>Total</b>
	<b>Insurance</b>	<b>Reinsurance</b>	<b>Products and Services</b>	
Net investment income — general operations				\$381,657
Net realized and unrealized gains on investments and derivative instruments (4)				114,398
Net income from operating affiliates				93,593
Interest expense (3)				89,508
Amortization of intangible assets				5,836
Corporate operating expenses				83,076
Minority interest				(221)
Income tax				94,650
<b>Net Income</b>				<b>\$599,000</b>
<b>General Operations:</b>				
Loss and loss expense ratio (5)	65.6%	72.1%		68.1%
Underwriting expense ratio (5)	24.5%	27.3%		25.6%
Combined ratio (5)	90.1%	99.4%		93.7%

- (1) Operating expenses exclude corporate operating expenses, shown separately.
- (2) Includes net realized and unrealized gains on credit derivatives of \$6.2 million, weather and energy derivatives of \$10.2 million and gains on structured financial derivatives of \$17.2 million.
- (2) Interest expense excludes interest expense related to life and annuity operations, shown separately.
- (3) This includes net realized gains on investments of \$150.7 million, net realized and unrealized losses on investment derivatives of \$36.3 million, but does not include unrealized appreciation or depreciation on investments, which are included in “accumulated other comprehensive income (loss)”.
- (4) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)**

**Six months ended June 30, 2004:**

(U.S. dollars in thousands)

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services	Total
<b>General Operations:</b>				
Net premiums earned	\$1,982,106	\$1,437,355	\$ —	\$3,419,461
Fee income and other	7,616	139	—	7,755
Net losses and loss expenses	1,249,658	813,409	—	2,063,067
Acquisition costs	273,206	320,296	—	593,502
Operating expenses (1)	258,236	90,822	—	349,058
Exchange losses (gains)	12,057	(4,176)	—	7,881
<b>Underwriting profit</b>	<b>\$ 196,565</b>	<b>\$ 217,143</b>	<b>\$ —</b>	<b>\$ 413,708</b>
<b>Life and Annuity Operations:</b>				
Life premiums earned	\$ —	\$1,078,738	\$ —	\$1,078,738
Fee income and other	—	231	—	231
Claims and policy benefits	—	1,125,407	—	1,125,407
Acquisition costs	—	16,731	—	16,731
Operating expenses (1)	—	5,300	—	5,300
Exchange losses	—	85	—	85
Net investment income	—	90,387	—	90,387
Interest expense (2)	—	234	—	234
<b>Net income from life and annuity operations</b>	<b>\$ —</b>	<b>\$ 21,599</b>	<b>\$ —</b>	<b>\$ 21,599</b>
<b>Financial Operations:</b>				
Net premiums earned			\$104,718	\$ 104,718
Fee income and other			7,073	7,073
Net losses and loss expenses			21,031	21,031
Acquisition costs			14,445	14,445
Operating expenses (1)			31,171	31,171
Exchange (gains)			(2,777)	(2,777)
<b>Underwriting profit</b>			<b>\$ 47,921</b>	<b>\$ 47,921</b>
Net investment income — financial guarantee			\$ 17,005	\$ 17,005
Net investment income — structured products			78,975	78,975
Interest expense — structured products			38,147	38,147
Operating expenses — structured products (1)			27,092	27,092
Net income from financial and investment affiliates			3,134	3,134
Minority interest			7,087	7,087
Net results from structured derivatives (2)			19,667	19,667
<b>Contribution from financial operations</b>			<b>\$ 94,376</b>	<b>\$ 94,376</b>

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)****Six months ended June 30, 2004 (continued):****(U.S. dollars in thousands, except ratios)**

(Unaudited)

	<b>Financial</b>			<b>Total</b>
	<b>Insurance</b>	<b>Reinsurance</b>	<b>Products and Services</b>	
Net investment income — general operations				\$293,126
Net realized and unrealized gains on investments and derivative instruments (4)				143,074
Net income from operating affiliates				95,956
Interest expense (3)				70,989
Amortization of intangible assets				6,514
Corporate operating expenses				80,395
Minority interest				(143)
Income tax				68,151
<b>Net Income</b>				<b>\$835,933</b>
<b>General Operations:</b>				
Loss and loss expense ratio (5)	63.0%	56.6%		60.3%
Underwriting expense ratio (5)	26.9%	28.6%		27.6%
Combined ratio (5)	89.9%	85.2%		87.9%

(1) Operating expenses exclude corporate operating expenses, shown separately.

(2) Includes net realized and unrealized gains on credit derivatives of \$24.6 million, and losses on weather and energy derivatives of \$4.6 million.

(3) Interest expense excludes interest expense related to life and annuity operations, shown separately.

(4) This includes net realized gains on investments of \$124.1 million, net realized and unrealized gains on investment derivatives of \$19.0 million, but does not include unrealized appreciation or depreciation on investments, which are included in "accumulated other comprehensive income (loss)".

(5) Ratios are based on net premiums earned from general operations. The underwriting expense ratio excludes exchange gains and losses.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)**

The following tables summarize the Company's net premiums earned by line of business:

**Three months ended June 30, 2005:****(U.S. dollars in thousands)**

(Unaudited)

	<b>Financial</b>		
	<b>Insurance</b>	<b>Reinsurance</b>	<b>Products and Services</b>
<b>General Operations:</b>			
Professional liability	\$ 348,743	\$ 90,755	\$ —
Casualty	275,811	226,405	—
Property catastrophe	23,300	70,273	—
Other property	149,308	149,588	—

Marine, energy, aviation and satellite	184,747	43,997	—
Accident and health	(228)	8,306	—
Other (1)	72,679	83,877	—
<b>Total general operations</b>	<b>\$1,054,360</b>	<b>\$ 673,201</b>	<b>\$ —</b>
<b>Life and annuity operations</b>	<b>—</b>	<b>1,933,215</b>	<b>—</b>
<b>Financial operations</b>	<b>—</b>	<b>—</b>	<b>51,992</b>
<b>Total</b>	<b>\$1,054,360</b>	<b>\$2,606,416</b>	<b>\$51,992</b>

(1) Other, includes surety, bonding, warranty and other lines.

**Three months ended June 30, 2004:**

**(U.S. dollars in thousands)**

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
<b>General Operations:</b>			
Professional liability	\$ 373,685	\$ 99,223	\$ —
Casualty	253,689	221,235	—
Property catastrophe	15,401	79,571	—
Other property	155,690	193,214	—
Marine, energy, aviation and satellite	238,178	44,680	—
Accident and health	6,674	9,751	—
Other (1)	60,268	74,956	—
<b>Total general operations</b>	<b>\$1,103,585</b>	<b>\$ 722,630</b>	<b>\$ —</b>
<b>Life and annuity operations</b>	<b>—</b>	<b>986,930</b>	<b>—</b>
<b>Financial operations</b>	<b>—</b>	<b>—</b>	<b>56,970</b>
<b>Total</b>	<b>\$1,103,585</b>	<b>\$1,709,560</b>	<b>\$56,970</b>

(1) Other, includes surety, bonding, warranty and other lines.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**4. Segment Information (continued)**

**Six months ended June 30, 2005:**

**(U.S. dollars in thousands)**

(Unaudited)

	Insurance	Reinsurance	Financial Products and Services
<b>General Operations:</b>			
Professional liability	\$ 714,011	\$ 181,348	\$ —
Casualty	561,466	452,388	—
Property catastrophe	43,180	136,236	—
Other property	310,916	332,698	—
Marine, energy, aviation and satellite	391,612	85,272	—
Accident and health	(170)	17,359	—
Other (1)	115,863	151,651	—
<b>Total general operations</b>	<b>\$2,136,878</b>	<b>\$1,356,952</b>	<b>\$ —</b>
<b>Life and Annuity Operations</b>	<b>—</b>	<b>2,014,686</b>	<b>—</b>

<b>Financial Operations</b>	—	—	103,687
<b>Total</b>	\$2,136,878	\$3,371,638	\$103,687

(1) Other, includes surety, bonding, warranty and other lines.

**Six months ended June 30, 2004:**  
(U.S. dollars in thousands)  
(Unaudited)

	<b>Insurance</b>	<b>Reinsurance</b>	<b>Financial Products and Services</b>
<b>General Operations:</b>			
Professional liability	\$ 647,272	\$ 185,086	\$ —
Casualty	477,620	421,025	—
Property catastrophe	26,974	142,859	—
Other property	277,936	387,415	—
Marine, energy, aviation and satellite	459,028	98,995	—
Accident and health	8,087	20,144	—
Other (1)	85,189	181,831	—
<b>Total general operations</b>	<b>\$1,982,106</b>	<b>\$1,437,355</b>	<b>\$ —</b>
<b>Life and annuity operations</b>	<b>—</b>	<b>1,078,738</b>	<b>—</b>
<b>Financial operations</b>	<b>—</b>	<b>—</b>	<b>104,718</b>
<b>Total</b>	<b>\$1,982,106</b>	<b>\$2,516,093</b>	<b>\$104,718</b>

(1) Other, includes surety, bonding, warranty and other lines.

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**5. Unpaid Losses and Loss Expenses**

During the quarter ended June 30, 2005, the Company increased net losses and loss expenses by an additional \$190.6 million due to higher than expected losses in its North American reinsurance operations primarily from claims arising from workers' compensation, umbrella liability, errors & omissions and directors' & officers' lines written, largely, in years prior to 2001. This increase resulted from the Company's scheduled semi-annual reserve review.

**6. Future Policy Benefit Reserves**

As a result of paid losses exceeding expectation on certain novated blocks of U.S.-based term life reinsurance business, the Company undertook an in depth review of the reported losses and recorded a premium deficiency charge to earnings of \$63.3 million. This charge comprised a write-off of deferred acquisition costs of \$25.9 million and an increase in claims and policy benefits of \$37.4 million. These contracts were novated to the Company from an affiliated company.

**7. Notes Payable and Debt and Financing Arrangements**

The Company replaced its 364-day credit facility that expired on June 22, 2005, with a new 5-year, \$2.35 billion credit facility that expires on June 22, 2010. The facility provides letter of credit capacity of up to \$2.25 billion and revolving credit of up to \$1.0 billion. The revolving credit sub-limit of \$1.0 billion is shared with the June 2004 3-year credit facility in that the Company can have no more than \$1.0 billion in aggregate in revolving credit outstanding under the two facilities. In addition, the 2005 5-year facility contains a \$100 million revolving-credit-only sub-limit which means that no more than \$2.25 billion of the total facility of \$2.35 billion is available in the form of letters of credit.

**8. Exposures under Guaranties**

The Company provides financial guaranty insurance and reinsurance to support public and private borrowing arrangements. Financial guaranty insurance guarantees the timely payment of principal and interest on insured obligations to third party holders of such securities in the event of default by an issuer. The Company's potential liability in the event of non-payment by the issuer of an insured or reinsured obligation represents the aggregate outstanding principal insured or reinsured under its policies and contracts and related interest payable at the date of default. In synthetic transactions, the Company guarantees payment obligations of counterparties under credit default swaps. The Company's potential liability under credit default swaps represents the notional amount of such swaps.

At June 30, 2005 the Company's net outstanding par exposure under its in force financial guaranty insurance and reinsurance policies and contracts aggregated \$70.4 billion and net reserves for losses and loss adjustment expenses relating to such exposures was \$158.5 million at such date. In addition, at June 30, 2005 the Company's notional exposure under credit default swaps aggregated \$11.0 billion and the net liability for these credit default swaps reflected in the Company's consolidated balance sheet at June 30, 2005 was \$26.6 million.

## 9. Derivative Instruments

The Company enters into investment, structured financial and weather and energy derivative instruments for both risk management and trading purposes. The Company also enters into credit derivatives in connection with its Financial Products and Services business. The Company is exposed to potential loss from various market risks and manages its market risks based on guidelines established by senior management. All these derivative instruments are carried at fair value. Resulting realized and unrealized gains and losses on credit derivatives are accounted for as discussed in Note 2(a). Resulting realized and unrealized gains and losses on all other derivatives are recognized in net realized and unrealized gains and losses on derivatives during the period in which they occur.

### XL CAPITAL LTD NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

#### 9. Derivative Instruments (continued)

The following table summarizes the net realized and unrealized gains on derivative instruments included in net income for the three and six months ended June 30, 2005 and 2004:

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2005	2004	2005	2004
Credit derivatives	\$ (4,011)	\$15,023	\$ 6,238	\$24,553
Weather and energy risk management derivatives	4,112	48	10,166	(4,616)
Other non-investment derivatives	17,386	415	17,161	(270)
Net results from derivatives financial operations	\$ 17,487	\$15,486	\$ 33,565	\$19,667
Investment derivatives	(65,428)	15,388	(36,328)	18,974
Net realized and unrealized gains (losses) on derivatives	\$(47,941)	\$30,874	\$ (2,763)	\$38,641

The Company records premiums received from sales of investment grade credit derivatives in gross written premiums and establishes loss reserves for this derivative business. These loss reserves represent the Company's best estimate of the probable losses expected under these contracts. Net realized and unrealized gains and losses on credit derivative instruments are computed as the difference between fair value and the net of unpaid losses and loss expenses and unpaid losses and loss expenses recoverable. Changes in unrealized gains and losses on credit derivative instruments are reflected in the consolidated statements of income. Cumulative unrealized gains and losses are reflected as assets and liabilities, respectively, in the Company's consolidated balance sheet. Net realized and unrealized gains and losses resulting from changes in the fair value of derivatives occur because of changes in interest rates, credit spreads, recovery rates, the credit ratings of the referenced entities and other market factors.

The following table summarizes insurance activities related to credit default swap derivative instruments excluding gains and losses on credit default swaps within the investment portfolio.

(U.S. dollars in thousands)	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2005	2004	2005	2004
<i>Statement of Income:</i>				
Net earned premiums	\$ 6,269	\$11,818	\$14,446	\$20,175
Net losses and loss expenses	\$(10,154)	\$ 552	\$(8,028)	\$ 5,079
Net realized and unrealized gains (losses) on credit derivatives	\$ (4,011)	\$15,023	\$ 6,238	\$24,553

(U.S. dollars in thousands)	(Unaudited)	
	As at June 30, 2005	As at December 31, 2004
<i>Balance Sheet:</i>		
Unpaid losses and loss expenses recoverable	\$ 201	\$ 419

Other assets	\$22,228	\$16,475
Unpaid losses and loss expenses	\$17,238	\$26,090
Other liabilities	\$31,752	\$28,982

**XL CAPITAL LTD**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)**

**10. XL Capital Finance (Europe) plc**

XL Capital Finance (Europe) plc (“XLFE”) is a wholly owned finance subsidiary of the XL Capital Ltd. In January 2002, XLFE issued \$600.0 million par value 6.5% Guaranteed Senior Notes due January 2012. These Notes are fully and unconditionally guaranteed by the XL Capital Ltd. XL Capital Ltd’s ability to obtain funds from its subsidiaries is subject to certain contractual restrictions, applicable laws and statutory requirements of the various countries in which the Company operates including Bermuda, the U.S. and the U.K., among others. Required statutory capital and surplus for the principal operating subsidiaries of the Company was \$3.6 billion as of December 31, 2004.

**11. Computation of Earnings Per Ordinary Share and Ordinary Share Equivalent**

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2005	2004	2005	2004
<b>Basic earnings per ordinary share:</b>				
Net income	\$145,975	\$373,684	\$599,000	\$835,933
Less: preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
Net income available to ordinary shareholders	\$135,895	\$363,604	\$578,840	\$815,773
Weighted average ordinary shares outstanding	138,948	137,655	138,488	137,568
Basic earnings per ordinary share	\$0.98	\$2.64	\$4.18	\$5.93
<b>Diluted earnings per ordinary share:</b>				
Net income	\$145,975	\$373,684	\$599,000	\$835,933
Less: preference share dividends	(10,080)	(10,080)	(20,160)	(20,160)
Net income available to ordinary shareholders	\$135,895	\$363,604	\$578,840	\$815,773
Weighted average ordinary shares outstanding — basic	138,948	137,655	138,488	137,568
Average stock options outstanding (1)	1,456	1,086	1,353	1,080
Weighted average ordinary shares outstanding — diluted	140,404	138,741	139,841	138,648
Diluted earnings per ordinary share	\$ 0.97	\$ 2.62	\$ 4.14	\$ 5.88
<b>Dividends per ordinary share</b>	<b>\$ 0.50</b>	<b>\$ 0.49</b>	<b>\$ 1.00</b>	<b>\$ 0.98</b>

(1) Net of shares repurchased under the treasury stock method.

**12. Commitments and Contingencies**

Included in unpaid losses and loss expenses recoverable at June 30, 2005 is an unsecured reinsurance recoverable from Winterthur Swiss Insurance Company (the “Seller”) of \$1.45 billion, related to certain contractual arrangements with the sale and purchase agreement, as amended (“SPA”), relating to the Company’s acquisition of Winterthur International in July 2001. The Seller is currently rated “A-” by S&P. The Seller provides the Company with post-closing protection determined as of June 30, 2004 with respect to, among other things, adverse development of incurred losses and premium balances relating to the acquired Winterthur International business (“Winterthur Business”). This protection is based upon net loss experience and development over a three-year, post-closing seasoning period based on actual loss development experience, collectible reinsurance and certain other factors set forth in the SPA. The SPA includes an independent actuarial process for determining the net amount due to the Company from the Seller. In this process, each of the Company and the Seller submits their respective net reserves and seasoned premium amounts. The independent actuary develops its own value of the seasoned net reserves and seasoned premium amounts and the actual final seasoned amount would be in each case, the submission that is closest to the number developed by the independent actuary.

**12. Commitments and Contingencies (continued)**

As the Company and the Seller were unable to come to an agreement, the Company submitted to the Seller notice to trigger the independent actuarial process as contemplated by the SPA. On February 3, 2005, both the Company and the Seller made submissions for the independent actuarial process. The independent actuary has commenced the evaluation process. Based on submissions and meetings to date, the Company continues to expect that the independent actuary will make his determinations prior to year-end. The Company's submissions would result in a net payable to the Company of approximately \$1.45 billion in aggregate and the Seller's submissions would result in a net payable to the Company of \$541.0 million in aggregate. At the completion of the independent actuarial process, the Company will be entitled to a lump sum payment.

In addition, the Seller provides protection to the Company with respect to third party reinsurance receivables and recoverables related to the Winterthur Business which were approximately \$1.6 billion, in the aggregate, as of June 30, 2005. There are two levels of protection from the Seller for these balances:

1. At the time of the Winterthur International acquisition, the Seller provided to the Company a liquidity facility. At the time of the payment of the net reserve seasoned amount as described above, the Company has the right to repay up to the balances outstanding on this facility by assignment to the Seller of an equal amount of receivables relating to reinsurance recoverables selected by the Company. The payable balance related to this facility is included within other liabilities on the Company's balance sheet at June 30, 2005 and amounted to approximately \$270 million at that date.
2. Under two retrocession agreements the Company has reinsurance protection on the remaining portion of reinsurance recoverables with respect to incurred losses seasoned as of June 30, 2004 to the extent that the Company does not receive payment of such amounts from applicable reinsurers with one agreement providing a limit of \$1.3 billion for the insurance written in the period to June 30, 2001 and the other agreement providing a limit of \$1.3 billion for the insurance written prior to December 31, 2000.

Certain reinsurers responsible for some portions of the reinsurance of the Winterthur business have raised issues as to whether amounts claimed are due and the resolution of those discussions is also currently ongoing.

The Company may record a loss in future periods if any or some of the following occur:

- (i) The submission of the Seller is closer to the valuation developed by the independent actuary, in which case the Company may record a loss of approximately \$900 million.
- (ii) There is deterioration of the net reserves and premium balances, relating to the Winterthur Business, from what was reported in the Company's December 31, 2004 financial statements;
- (iii) The Company is unable to make full recovery of the reinsurance recoverables related to the Winterthur Business, either from third parties or from the Seller under the additional protections; and/or
- (iv) Any amount due from the Seller proves to be uncollectible from the Seller for any reason.

---

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**General**

The following is a discussion of the Company's financial condition and liquidity and results of operations. Certain aspects of the Company's business have loss experience characterized as low frequency and high severity. This may result in volatility in both the Company's and an individual segment's results of operations and financial condition.

This "Management's Discussion and Analysis of Financial Condition and Results of Operations" contains forward-looking statements that involve inherent risks and uncertainties. Statements that are not historical facts, including statements about the Company's beliefs and expectations, are forward-looking statements. These statements are based upon current plans, estimates and projections. Actual results may differ materially from those included in such forward-looking statements, and therefore undue reliance should not be placed on them. See "Cautionary Note Regarding Forward-Looking Statements" below for a list of factors that could cause actual results to differ materially from those contained in any forward-looking statement.

This discussion and analysis should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations", and the audited Consolidated Financial Statements and notes thereto, presented under Item 7 and Item 8, respectively, of the Company's Form 10-K for the year ended December 31, 2004.

**Executive Overview**

See "Executive Overview" in Item 7 of the Company's Form 10-K for the year ended December 31, 2004.

**Results of Operations**

The following table presents an analysis of the Company's net income available to ordinary shareholders and other financial measures (described below) for the three months ended June 30, 2005 and 2004:

(U.S. dollars and shares in thousands, except per share amounts)	Three Months Ended	
	June 30,	
	2005	2004
Net income available to ordinary shareholders	\$135,895	\$363,604
Earnings per ordinary share — basic	\$ 0.98	\$ 2.64
Earnings per ordinary share — diluted	\$ 0.97	\$ 2.62
Weighted average number of ordinary shares and ordinary share equivalents — basic	138,948	137,655
Weighted average number of ordinary shares and ordinary share equivalents — diluted	140,404	138,741

27

The following table presents an analysis of the Company's net income available to ordinary shareholders and other financial measures (described below) for the six months ended June 30, 2005 and 2004.

(U.S. dollars and shares in thousands, except per share amounts)	(Unaudited)	
	Six Months Ended	
	June 30,	
	2005	2004
Net income available to ordinary shareholders	\$578,840	\$815,773
Earnings per ordinary share — basic	\$ 4.18	\$ 5.93
Earnings per ordinary share — diluted	\$ 4.14	\$ 5.88
Weighted average number of ordinary shares and ordinary share equivalents — basic	138,488	137,568
Weighted average number of ordinary shares and ordinary share equivalents — diluted	139,841	138,648

The Company's net income and other financial measures as shown below for the three and six months ended June 30, 2005 have been affected, among other things, by the following significant items:

- 1) Net adverse prior year loss development;
- 2) Continuing competitive underwriting environment;
- 3) Growing asset base and positive contribution from collateralized debt obligation;
- 4) Life reinsurance loss recognition.

#### 1. Net adverse prior year loss development.

The second quarter results have been adversely impacted by an increase in net reserves in the Company's North American reinsurance operations of \$190.6 million. The after tax charge was \$186.3 million or \$1.33 per ordinary share. This increase resulted from the Company's semi-annual reserve review. Net adverse prior period loss development occurs when there is an increase to loss reserves recorded at the beginning of the year, resulting from actual or reported loss development for prior years exceeding expected loss development. The net adverse prior period loss development in the six months ended June 30, 2005 related principally to losses on business written prior to 2001 in the Company's U.S. casualty reinsurance business. See the discussion of the Reinsurance segments results below.

#### 2. Continuing competitive underwriting environment.

Competition in the insurance and reinsurance markets has continued to increase in the first six months of 2005 in many lines of business. The insurance market is becoming increasingly competitive from a product and geographic perspective in terms of pricing. Marine, offshore energy lines, aviation and satellite prices have held up relatively well due, in part, to the impact of the hurricanes of last year and general pricing discipline. However, large account property rates continue to decline. The Company has seen some stabilizing in professional liability rates, however there is increasing competition in employment practice insurance. The Company continues to see opportunities in D&O in both the U.S. and Europe in specific targeted classes and continues to execute on recently established growth opportunities, such as operations in U.S. primary Casualty and the Design and Select Professional operations. The reinsurance market worldwide remains broadly well priced but increasingly competitive, particularly in the property and aviation lines of business. As of July 1, 2005, the Company has seen rate reductions along with increased net retentions by cedants. Casualty reinsurance pricing is generally flat, to slightly down. Property and Marine treaties that were impacted by the 2004 hurricanes have seen pricing improvements, typically up to 25%. Reinsurance policies that have good loss experience continue to see reductions in the order of 10 - 15%.

28

#### 3. Growing asset base and positive contribution from collateralized debt obligations.

Net investment income was \$367.4 million and \$675.6 million for the three months and six months ended June 30, 2005, respectively, compared to \$240.4 million and \$479.5 million, respectively, for the same periods in 2004 due to a higher investment base and higher investment yields primarily due to increases in short-term U.S. interest rates. The investment portfolio increased due to positive operating cash flows and growth in structured and spread balances through these periods. In addition, during the quarter the Company received a distribution associated with the unwind of a collateralized debt obligation, which resulted in a current benefit to net investment income of \$28.6 million.

Net income (loss) from investment affiliates was (\$10.8) million and \$59.7 million for the three months and six months, respectively, compared to \$8.0 million and \$71.5 million, respectively, for the same periods in 2004. These results reflect decreased returns from the Company's alternative fund investments during the second quarter of 2005.

#### 4. Life reinsurance loss recognition.

During the second quarter, results were adversely impacted by a \$63.3 million after tax charge related to the Company's life and annuity reinsurance operations. The Company has completed a detailed actuarial experience study of this business. In accordance with U.S. GAAP treatment for life business, a loss recognition test process was carried out to determine if expected future premiums will be sufficient to pay for expected future losses. This process has led to the Company's decision to unlock the current policy benefit reserve ratio and record a loss recognition charge of \$63.3 million. With a recognition that the business is loss making based on existing assumptions, the total charge was first applied to write-off the deferred acquisition costs and Value of Business Acquired assets of \$25.9 million, with the remaining \$37.4 million recorded as a net increase in policy benefit reserves.

#### Financial Measures

The following are some of the financial measures management considers important in evaluating the Company's operating performance:

(U.S. dollars in thousands, except ratios and per share amounts)

	(Unaudited)	
	Three Months Ended	
	June 30,	
	2005	2004
Underwriting profit — general operations	\$ 45,368	\$222,518
Combined ratio — general operations	97.9%	87.1%
Investment income — general operations	\$209,727	\$146,180

	(Unaudited)	
	Six Months Ended	
	June 30,	
	2005	2004
Underwriting profit — general operations	\$220,808	\$413,708
Combined ratio — general operations	93.7%	87.9%
Investment income — general operations	\$381,657	\$293,126
Annualized return on average ordinary shareholders' equity	15.4%	25.1%

	(Unaudited)	
	June 30,	December 31,
	2005	2004
Book value per ordinary share	\$ 55.95	\$ 51.98

#### Underwriting profit — general operations

One way the Company evaluates the performance of its property and casualty insurance and reinsurance general operations is the underwriting profit or loss. The Company does not measure performance based on the amount of gross premiums written. Underwriting profit or loss is calculated from premiums earned and fee income, less net

losses incurred and expenses related to the underwriting activities. Underwriting profits in the three and six months ended June 30, 2005 are primarily reflective of the combined ratio discussed below.

#### Combined ratio — general operations

The combined ratio for general operations is used by the Company, and many other property and casualty insurance and reinsurance companies, as another measure of underwriting profitability. The combined ratio is calculated from the net losses incurred and underwriting expenses as a ratio of the net premiums earned for the Company's general insurance and reinsurance operations. A combined ratio of less than 100% indicates an underwriting profit and greater than 100% reflects an underwriting loss. Increases in the Company's combined ratio for the three and six months ended June 30, 2005, compared to the same periods in the previous year, were primarily a result of a higher loss and loss expense ratio partially offset by a decreasing underwriting expense ratio. The increase in the loss and loss expense ratio was primarily due to the increase in net reserves in the Company's North American reinsurance operations noted above.

#### Net investment income — general operations

Net investment income from the Company's general operations is an important measure that affects the Company's overall profitability. The largest liability of the Company relates to its unpaid loss reserves, and the Company's investment portfolio provides liquidity for claims settlements of these reserves as they become due. A significant part of the portfolio is in fixed income securities. Net investment income is affected by overall market interest rates and also the size of the portfolio. The average investment portfolio outstanding during the three and six months ended June 30, 2005 has increased as compared to the same periods in 2004 due to positive cash flow and structured and spread transactions. Total investments as at June 30, 2005 were \$33.8 billion as compared to \$25.7 billion as at June 30, 2004. Short-term interest rates have risen in 2005, which has also contributed to the increase in investment income. In addition, during the quarter the Company received a distribution associated with the unwind of a collateralized debt obligation, which resulted in a current benefit to net investment income of \$28.6 million.

#### *Book value per ordinary share*

Management also views the Company's book value per ordinary share as an additional measure of the Company's performance. Book value per ordinary share is calculated by dividing ordinary shareholders' equity by the number of outstanding ordinary shares at any period end. Book value per ordinary share is affected primarily by the Company's net income and also by any changes in the net unrealized gains and losses on its investment portfolio. Book value per ordinary share has increased by \$3.97 in the first half of 2005. The Company's continued growth and profitability has created \$599.0 million in net income for the first half of the year. The net unrealized gains associated with the Company's investment portfolio, which decreased in the first quarter of 2005, has increased in the second quarter resulting in a net \$50.0 million increase for the first six months of 2005. These changes were driven by U.S. interest rate increases during the first quarter, followed by decreases in the second quarter and an overall flattening of the yield curve.

#### *Annualized return on average ordinary shareholders' equity*

Annualized return on average ordinary shareholders' equity ("ROE") is a widely used measure of a company's profitability. It is calculated by dividing the net income for any period by the average of the opening and closing ordinary shareholders' equity. The Company establishes target ROEs for its total operations, segments and lines of business. If the Company's ROE return targets are not met with respect to any line of business over time, the Company seeks to re-evaluate these lines. In addition, the Company's compensation of its senior officers is significantly dependant on the achievement of the Company's performance goals to enhance shareholder value, including ROE. The decline in this financial measure in the first half of 2004 as compared to the same period in 2004 was due to the key operating factors noted above.

#### **Other Key Focuses of Management**

See the discussion of the Other Key Focuses of Management in Item 7 of the Company's Form 10-K for the year ended December 31, 2004. That discussion is updated with the disclosures set forth below.

---

#### *Winterthur International Net Reserve Seasoning*

Management continues to focus on the settlement and collection of certain post-closing balances under the sale and purchase agreement, as amended ("SPA"), related to the 2001 acquisition of the Winterthur International operations from Winterthur Swiss Insurance Company. The independent actuary has commenced the evaluation process related to the post-closing seasoning process relating to the Company's acquisition of Winterthur International. Based on submissions and meetings to date, the Company continues to expect that the independent actuary will make his determinations prior to year-end. For further information regarding the settlement and collection under the SPA, see "Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable" below.

#### **Critical Accounting Policies and Estimates**

During the quarterly period ended June 30, 2005, management increased the levels of reserves in XL Reinsurance America Inc. ("XLRA"), a subsidiary of the Company, to reflect unexpected loss development. Effective as of January 1, 2004, XLRA entered into an adverse development reinsurance treaty with another reinsurance subsidiary of the Company. The treaty related to the 1985 through (and including) 2000 underwriting years covering any adverse development on reserves calculated as of December 31, 2003 between January 1, 2004 and December 31, 2005. The treaty has a limit of \$500 million and limits loss development at XLRA relating to these underwriting years. During the current quarter, a significant portion of the adverse development recorded in XLRA was ceded to this treaty, reducing the net losses to XLRA. As part of management's continuing evaluation of its deferred tax asset, the treaty is critical in evaluating the future income position of the U.S. group of companies. Management continues to believe that there is sufficient positive evidence of future profitability in the U.S. such that a valuation allowance as a charge against the deferred tax asset is not required at this time.

See the discussion of the Company's Critical Accounting Policies and Estimates in Item 7 of the Company's Form 10-K for the year ended December 31, 2004.

#### **Variable Interest Entities and Other Off-Balance Sheet Arrangements**

See the discussion of the Company's variable interest entities and other off-balance sheet arrangements in Item 7 of the Company's Form 10-K for the year ended December 31, 2004.

#### **Segment Results for the three months ended June 30, 2005 compared to the three months ended June 30, 2004**

The Company operates through three business segments: Insurance, Reinsurance and Financial Products and Services. These business segments were determined in accordance with FAS No. 131, "Disclosures about Segments of an Enterprise and Related Information".

Following changes in certain executive management responsibilities, the Company changed the reporting segments under which certain business units are reported in order to reflect these changes in responsibilities.

The following areas have been changed for all periods presented:

- Results of business structured by XL Financial Solutions Ltd ("XLFS") are now included entirely within the Financial Products and Services segment whereas previously this unit was reported in all three segments, depending on the nature of individual contracts.
- Certain blocks of U.S.-based term life mortality reinsurance business previously included in the Financial Products and Services segment are now included

in the Reinsurance segment as management of these contracts was transferred to the life reinsurance business units in order to centralize the Company's management of traditional mortality-based reinsurance business.

- Political risk insurance business units now report to executive management of the Financial Products and Services segment and, as such, future earnings from this business will no longer be reported in the Insurance segment but included with financial operations.
- All operations of business units within the Financial Products and Services segment, including municipal reinvestment contracts and funding agreements, are now reported under financial operations in order to consolidate businesses with similar operating characteristics and risks.
- All net investment income and net income from affiliates generated by assets and interest expense incurred on liabilities of the business units within the Financial Products and Services segment is reported under financial operations. This income and expense is included in financial operations as it relates to interest on portfolios of separately identified and managed assets and deposit liabilities. The Company believes this change will better reflect the nature of spread focused business.

In addition, the Company has changed its presentation of certain credit derivatives and now records premiums received from sales of these derivatives in gross written premiums and establishes unearned premium reserves and loss reserves for its investment grade credit derivative business. Previously all components of the Company's consolidated statements of income impact related to credit default swaps had been reported on one line, "net realized and unrealized gains (losses) on credit and derivative instruments." Prior periods have been re-presented for consistency in presentation.

### Insurance

General insurance business written includes risk management and specialty lines. Risk management products are comprised of global property and casualty insurance programs for large multinational companies, including umbrella liability, integrated risk and primary master property and liability coverages. Specialty lines products include directors' and officers' liability, environmental liability, professional liability, aviation and satellite, employment practices liability, surety, marine, equine and certain other insurance coverages including program business. The Company has announced its intention to discontinue writing surety business in 2005.

A large part of the Company's casualty insurance business written has loss experience that is low frequency and high severity. As a result, large losses, though infrequent, can have a significant impact on the Company's results of operations, financial condition and liquidity. The Company attempts to mitigate this risk by using strict underwriting guidelines and various reinsurance arrangements.

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)

(Unaudited)  
Three Months Ended  
June 30,

	2005	2004	% Change
Gross premiums written	\$1,414,389	\$1,509,938	(6.3)%
Net premiums written	1,112,212	1,193,476	(6.8)%
Net premiums earned	1,054,360	1,103,585	(4.5)%
Fee income and other	(2,916)	5,457	NM
Net losses and loss expenses	676,374	706,869	(4.3)%
Acquisition costs	119,032	154,867	(23.1)%
Operating expenses	140,261	130,254	7.7%
Exchange (gains) losses	(34,104)	10,419	NM
Underwriting profit	\$ 149,881	\$ 106,633	40.6%

\* NM — Not Meaningful

Gross and net premiums written decreased by 6.3% and 6.8%, respectively, in the three months ended June 30, 2005 compared with the three months ended June 30, 2004. These decreases are primarily due to continued competitive pressures and price decreases across most lines but were partially offset by favorable foreign exchange movements. The most significant pricing pressures continue to be seen in property and professional lines of business where prices have decreased between 10-15% since the prior year. While the U.S. dollar strengthened against the Euro and U.K. sterling in the quarter, the overall weakening of the U.S. dollar against those currencies since the second quarter of 2004 accounted for approximately \$21.0 million of gross premiums written increase in the three months ended June 30, 2005. The decrease in net premiums written compared to the same period in 2004 was in line with that of gross premiums due to the strategic decision to increase retentions in certain lines of business, most notably professional lines, being offset by ceded premium commutations in the second quarter of 2004.

Net premiums earned decreased by 4.5% in the three months ended June 30, 2005 compared with the three months ended June 30, 2004. The decrease was due to the factors affecting net premiums written noted above. Additionally, the second quarter of 2004 included certain one-time ceded reinsurance commutations, which increased net premium earned by \$18.0 million in the second quarter of 2004 and were not repeated in 2005.

Exchange gains in the three months ended June 30, 2005 were primarily due to the impact of the weakening of the U.K. sterling and the Euro against the U.S. dollar during the quarter.

The following table presents the ratios for this segment:

	(Unaudited)	
	Three Months Ended June 30,	
	2005	2004
Loss and loss expense ratio	64.2%	64.1%
Underwriting expense ratio	24.5%	25.8%
Combined ratio	88.7%	89.9%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss and loss expense reserves held at the beginning of the year. Although the loss ratio for the three months ended June 30, 2005 remained consistent compared with the three months ended June 30, 2004, the loss ratios recorded on current quarter business earned is slightly higher than prior year because of recent price reductions. The three months ended June 30, 2004 included approximately \$29.0 million in net prior period reserve strengthening.

The decrease in the underwriting expense ratio in the three months ended June 30, 2005 compared to the same period in 2004 was due to a decrease in the acquisition expense ratio of 2.7 points (11.2% as compared to 13.9%) while the operating expense ratio increased slightly. The reduction in the acquisition expense ratio was due primarily to a change in the commission structure with certain brokers compared to the same quarter in the prior year, partially offset by the effects on net earned premiums of the prior year ceded reinsurance commutations described above.

### Reinsurance

#### Reinsurance — General Operations

General reinsurance business written includes casualty, property, marine, aviation and other specialty reinsurance on a global basis. The Company's reinsurance property business generally has loss experience characterized as low frequency and high severity, which can have a negative impact on the Company's results of operations, financial condition and liquidity. The Company endeavors to manage its exposures to catastrophic events by limiting the amount of its exposure in each geographic zone worldwide and requiring that its property catastrophe contracts provide for aggregate limits and varying attachment points.

The following table summarizes the underwriting results for the general operations of this segment:

(U.S. dollars in thousands)

	(Unaudited)		
	Three Months Ended June 30,		
	2005	2004	% Change
Gross premiums written	\$ 506,250	\$ 634,484	(20.2)%
Net premiums written	347,492	539,299	(35.6)%
Net premiums earned	673,201	722,630	(6.8)%
Fee income and other	(463)	68	NM
Net losses and loss expenses	568,154	377,800	50.4%
Acquisition costs	149,049	172,985	(13.8)%
Operating expenses	38,153	48,396	(21.2)%
Exchange losses	21,895	7,632	NM
Underwriting (loss) profit	\$(104,513)	\$ 115,885	NM

\* NM — Not Meaningful

Gross and net premiums written decreased by 20.2% and 35.6%, respectively, in the second quarter of 2005 as compared to the second quarter in 2004. The decline in gross written premiums was due primarily to the U.S. casualty and surety business and to a lesser extent U.S. property, and Lloyds whole account treaties written in Bermuda. These decreases largely reflect timing differences, augmented by some reduction in the volume of new and renewal business, combined with reduced to flat rates across most lines and regions, as well as negative premium adjustments on existing treaties compared to the same period in 2004. In addition, non-renewal of business in the Company's U.S. surety book following withdrawal from this market contributed \$25.0 million to the decrease in gross written premium. Favorable foreign exchange movements also contributed approximately \$40.5 million to gross written premiums. Net premiums written reflected the above changes in gross premiums written combined with timing changes on certain segment reinsurance programs.

Net premiums earned in the second quarter of 2005 decreased 6.8% as compared to the second quarter of 2004. This decrease is a reflection of the reduction of net premiums written over the last 24 months.

The following table presents the ratios for this segment:

	(Unaudited)	
	Three Months Ended	
	June 30,	
	2005	2004
Loss and loss expense ratio	84.4%	52.3%
Underwriting expense ratio	27.8%	30.6%
Combined ratio	112.2%	82.9%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss reserves held at the beginning of the year. The increase in the loss and loss expense ratio in the three months ended June 30, 2005, compared to the same three months ended in 2004, primarily reflected higher than expected adverse prior year development relating to U.S. casualty business. This increase resulted from the Company's scheduled semi-annual reserve review.

34

The prior year reserve increase is attributable to the following sources:

(U.S. dollars in thousands)	Adverse Prior Year	
	Development	% of Total
Workers' compensation	\$ 64,719	34%
Pre-1997 underwriting years excluding workers' compensation	15,603	8%
1997 – 2001 underwriting years excluding workers' compensation	76,011	40%
Post – 2001 underwriting years excluding workers' compensation	34,306	18%
Net Reserve Increase	\$190,639	100%

Approximately 90% of the Workers' Compensation reserve increase was related to an XLRA working layer program written across multiple underwriting years with a single cedent. This program was not renewed at the end of 2001. Other than this program, XLRA has not written significant working layer Workers' Compensation business.

The reserve increase relating to the pre-1997 underwriting years, excluding Workers' Compensation, was primarily driven by a small number of increases in reported claims in the Other Liability and Errors & Omissions lines of business in those underwriting years.

The reserve increase relating to the 1997- 2001 underwriting years, excluding Workers' Compensation, was principally driven by recently reported claims in Umbrella Liability, Errors & Omissions and Directors & Officers lines of business in those underwriting years. The professional lines claims activity arises largely from a limited number of cedents. This reserve increase was partially offset by favorable development in the 1997- 2001 underwriting years in the Medical Malpractice business line.

The reserve increase related to the post - 2001 underwriting years, was primarily due to certain large individual claims affecting a number of lines including; Surety, Umbrella Liability and Errors & Omissions.

Other than the prior period reserve development discussed above for XLRA, the reinsurance Segment results reflect favorable development on prior period reserves of \$33 million on a net basis. The favorable development in the non-XLRA reinsurance operating units is attributable to revised loss estimates for the 2004 Tsunami and continuing favorable run-off of the 2002 through 2004 Property reserves. This favorable development was partially offset by adverse development on the 2004 hurricanes during the second quarter of \$2 million net.

The decrease in the underwriting expense ratio in the three months ended June 30, 2005, as compared with the three months ended June 30, 2004, was due to decreases in the both acquisition expense ratio and operating expense ratio to 22.1% and 5.7%, respectively, as compared to 23.9% and 6.8%, respectively, in the second quarter of 2004. The decrease in the acquisition expense ratio was due to decreased profit commissions that resulted from unfavorable loss development compared to prior periods. The operating expense ratio decrease was primarily due to the prior year comparison which included several one-time costs.

Exchange losses in the three months ended June 30, 2005 were mainly attributable to an overall strengthening, during the quarter, in the value of the U.S. dollar against U.K. Sterling and the Euro in those operations with U.S. dollar as their functional currency and net U.K. sterling and Euro assets.

#### **Reinsurance — Life and Annuity Operations**

Life business written by the reinsurance operations is primarily European life reinsurance. This includes term assurances, group life, critical illness cover, immediate annuities and disability income business. Due to the nature of these contracts, premium volume may vary significantly from period to period. In addition, certain closed block U.S. life and annuity reinsurance contracts previously included in the Financial Products and Services segment are now included in the Reinsurance segment as management of these contracts was transferred to the traditional life reinsurance business units in order to centralize management of mortality-based life and annuity reinsurance business.

35

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)

(Unaudited)  
Three Months Ended  
June 30,

	2005	2004	% Change
Gross premiums written	\$1,942,748	\$ 986,519	96.9%
Net premiums written	1,933,008	986,119	96.0%
Net premiums earned	1,933,215	986,930	95.9%
Fee income and other	114	116	(1.7)%
Claims and policy benefits	2,020,664	1,010,131	100.0%
Acquisition costs	35,058	10,561	231.9%
Operating expenses	5,068	2,950	71.8%
Exchange losses	403	125	222.4%
Net investment income	71,963	45,486	58.2%
Interest expense	—	(42)	(100.0)%
Net (loss) income from life and annuity operations	\$ (55,901)	\$ 8,807	NM

\* NM — Not Meaningful

Gross and net premiums written as well as net premiums earned and claims and policy benefits increased significantly in the second quarter of 2005 as compared to the second quarter of 2004. These increases were primarily a result of a large immediate annuity portfolio contract written in the current quarter, representing \$1.8 billion in net premiums written and earned. In addition, the Company wrote several new regular installment premium term assurance contracts since June 30, 2004, which generated further written premiums in the current quarter. The increase in ceded premium relates to the addition of several retrocessions of certain European mortality risks.

Claims and policy benefits also increased significantly as a result of the annuity payout liabilities assumed under the contract noted above. Changes in claims and policy benefits also include the movement in policy benefit reserves related to other contracts where investment assets were acquired with the assumption of the policy benefit reserves at the inception of the contract. In addition, \$37.4 million in claims and policy benefits were recorded related to certain novated blocks of U.S.-based term-life mortality reinsurance business as a result of the actuarially modeled impact of actual paid losses being greater than expected.

Acquisition costs increased in the second quarter of 2005, as compared to the second quarter of 2004, due to the write-off of certain deferred costs related to the U.S. mortality business of \$25.9 million, as current profit projections do not support the recovery of these deferred costs. Operating expenses decreased in the second quarter of 2005 compared to the same period in 2004, reflecting reduced corporate allocations, partially offset by the start-up costs of new life operations in the U.S.

Net investment income is included in the calculation of net income from life and annuity operations, as it relates to income earned on portfolios of separately identified and managed life investment assets and other allocated assets. Several new large annuity contracts have been written since June 30, 2004, which have significantly increased the invested assets relating to these operations.

### Financial Products and Services

Financial Products and Services provides (i) financial guaranty insurance and reinsurance, (ii) a wide range of structured financial and alternative risk transfer products, (iii) municipal investment and funding agreements, (iv) political risk insurance, and (v) weather and energy risk management products. Many of the products offered by Financial Products and Services are unique and tailored to the specific needs of the insured or user.

Financial guaranty insurance and reinsurance generally guarantees payments of interest and principal on an issuer's obligations when due. Obligations guaranteed or enhanced by the Company range in duration and premiums are received either on an installment basis or upfront. Guaranties written in credit default swap form provide coverage for losses upon the occurrence of specified credit events set forth in the swap documentation.

Structured financial and alternative risk transfer products cover complex financial risks, including property, casualty and mortality insurance and reinsurance, and business enterprise risk management products

Municipal investment contracts and funding agreements provide users guaranteed rates of interest on amounts deposited with the Company. The Company has investment risk related to its ability to generate sufficient investment income to enable the total invested assets to cover the payment of its estimated ultimate liability on such agreements.

Political risk insurance generally covers risks arising from expropriation, currency inconvertibility, contract frustration, non-payment and war on land or political violence (including terrorism) in developing regions of the world. Political risk insurance is typically provided to financial institutions, equity investors, exporters, importers, export credit agencies and multilateral agencies in connection with investments and contracts in emerging market countries.

The Company's weather and energy risk management products are customized solutions designed to assist corporate customers, primarily energy companies and utilities, to manage their financial exposure to variations in underlying weather conditions and related energy markets.

The following table summarizes the contribution for this segment:

(U.S. dollars in thousands)

(Unaudited)  
Three Months Ended  
June 30,

	2005	2004	% Change
Gross premiums written	\$102,450	\$99,545	2.9%
Net premiums written	100,386	96,670	3.8
Net premiums earned	51,992	56,970	(8.7)%
Fee income and other	217	2,511	(91.4)%
Net losses and loss expenses	17,179	12,171	41.1%
Acquisition costs	7,849	8,995	(12.7)%
Operating expenses	17,338	15,637	10.9%
Exchange (gains) losses	1,113	(2,263)	NM
Underwriting profit	\$ 8,730	\$24,941	(65.0)%
Net investment income — financial guarantee	\$ 14,986	\$ 8,872	68.9%
Net investment income — structured products	70,725	39,888	77.3%
Interest expense — structured products	54,134	21,876	147.5%
Operating expenses — structured products	13,439	11,686	15.0%
Net income (losses) from financial and investment affiliates	(7,437)	2,599	NM
Minority interest	2,300	2,427	(5.2)%
Net results from derivatives	17,487	15,486	12.9%
Net contribution from financial operations	\$ 34,618	\$55,797	(38.0)%

\* NM — Not Meaningful

Gross and net premiums written primarily relate to the financial guaranty line of business and reflect premiums received and accrued for in the period and do not include the present value of future cash receipts expected from financial guaranty installment premium policies and contracts written in the period. In addition to the financial guaranty premiums, segment premiums also include premiums received from political risk and other structured property and casualty business lines. Increases in gross and net premiums written of 2.9% and 3.8%, respectively, in the second quarter of 2005, as compared to the comparable period in 2004 were primarily due to two significant upfront financial guaranty insurance policies written during the current quarter. Excluding such policies, net premiums written declined in the quarter. The quarter over quarter decline was primarily attributable to tight credit spreads and intense competition in the financial guaranty line of business, as well as increased retentions by primaries. The Company expects this competition to remain intense for at least the short term.

Net premiums earned decreased in the second quarter of 2005, as compared to the same period in 2004. This decrease related primarily to slightly higher premiums ceded to reinsurers in the financial guaranty business. In addition, several contracts in the segment's financial solutions business matured.

The following table provides a line of business breakdown of the Financial Products and Services segment's net premiums earned:

(U.S. dollars in thousands)

(Unaudited)  
Three Months Ended  
June 30,

	2005	2004	% Change
Financial Guaranty	\$40,850	\$43,576	(6.3)%
Political Risk	6,352	8,587	(26.0)%
Other (1)	4,790	4,807	4.8%

(1) Includes structured financial and alternative risk transfer products and weather and energy risk management products

Net losses and loss expenses include current year net losses incurred and adverse or favorable development of prior year net loss and loss expense reserves. Net losses and loss expenses for the three months ended June 30, 2005 increased by 41.1% compared to the three months ended June 30, 2004. This increase was primarily a result of case reserve provisions relating to an insured project financing and an insured residential mortgage backed securitization that were partially offset by the release of certain other case reserves to reflect current best estimates of ultimate losses, as well as that relating to risks on a synthetic execution that expired during the quarter without a claim.

For the three months ended June 30, 2005, acquisition costs as a percentage of net premiums earned were consistent with that of the comparable period in the prior year.

Operating expenses increased in the second quarter of 2005, as compared to the second quarter of 2004, due to increases in corporate allocations and certain segment management costs.

Net investment income related to financial guaranty business increased by 68.9% in the three months ended June 30, 2005, due to the larger investment portfolio created by increased premium receipts and a \$125.0 million capital infusion during the fourth quarter of 2004. In addition, \$1.9 million in investment income relates to the Company's investment in Financial Security Assurance International Ltd ("FSAI"), which is now reported as investment income in accordance with EITF Issue No. 02-14 ("EITF 02-14"), *Whether an Investor Should Apply the Equity Method of Accounting to Investments Other than Common Stock* as opposed to net income from financial affiliates as in the three months ended June 30, 2004.

Net investment income related to structured products increased by 77.3% as a result of significant increases in the combined average funding agreement and guaranteed investment contract balances from \$3.7 billion to \$4.6 billion at June 30, 2004 and 2005, respectively.

Interest expenses on structured products relate to the accretion charges on deposit liabilities related to funding agreements, guaranteed investment contracts and certain structured insurance and reinsurance contracts. The increase in interest expense during the three months ended June 30, 2005 compared to the same period in 2004 related primarily to the increase in the combined average funding agreement and guaranteed investment contract balances for the three months ended June 30, 2005, as compared to the comparable prior year period.

Net results from derivatives represent changes in the market value of the Company's insured credit derivative portfolio, weather and energy derivative instruments and certain structured derivatives. The net results from derivatives for the three months ended June 30, 2005 primarily related to a gain on the early termination of a structured derivative product tied to appreciation in a housing price index. Credit derivatives had a small negative mark-to-market movement in the quarter compared to a positive movement for same period of 2004.

Net income from financial and investment affiliates includes earnings on the Company's investment in Primus Guaranty, Ltd ("Primus") and certain of the Company's investment affiliates. The decrease in the second quarter of 2005 as compared to the second quarter of 2004 was due primarily to decreased earnings from Primus combined with the reporting of income from FSAI to net investment income as described above. Primus specializes in providing credit risk protection through credit derivatives. Primus had a negative mark-to-market adjustment in the quarter.

Minority interest has remained consistent with the prior year.

### Investment Activities

The following table illustrates the change in net investment income from general operations, net income from investment affiliates, net realized gains on investments and net realized and unrealized (losses) gains on investment derivative instruments for the three months ended June 30, 2005 and 2004.

(U.S. dollars in thousands)

	(Unaudited) Three Months Ended June 30,		
	2005	2004	% Change
Net investment income — general operations	\$209,727	146,180	43.5%
Net (loss) income from investment affiliates — general operations	(7,936)	6,758	NM
Net realized gains on investments	90,055	8,763	927.6%
Net realized and unrealized (losses) gains on investment derivative instruments — general operations	(65,428)	15,388	NM

\* NM — Not Meaningful

Net investment income related to general operations increased in the second quarter of 2005 as compared to the second quarter of 2004 due primarily to a higher investment base, as well as increases in the yield of the portfolio. The growth in the investment base reflected the Company's cash flow from operations. The market yield to maturity on the fixed income portfolio was 4.3% at June 30, 2005, as compared to 3.9% at June 30, 2004. In addition, the Company received a distribution associated with the unwind of a collateral debt obligation which resulted in a one time benefit to net investment income of \$28.6 million.

Net loss from investment affiliates in the second quarter of 2005 compared to net income for the second quarter of 2004 was due primarily to weaker performance in alternative fund affiliates.

The Company manages its investment grade fixed income securities using an asset/liability management framework. Due to the unique nature of the underlying liabilities, customized benchmarks are used to measure investment performance and comparison to standard market indices is not meaningful. Investment performance is not monitored for certain assets primarily consisting of operating cash and special regulatory deposits. The following is a summary of the investment portfolio returns for the general account asset/liability portfolios, structured and spread product portfolios and risk asset portfolios:

	(Unaudited) Three Months Ended June 30, 2005 (1)	(Unaudited) Three Months Ended June 30, 2004 (1)
	<b>General Account Asset/Liability portfolios</b>	
USD fixed income portfolio	2.3%	(2.0)%
Non USD fixed income portfolio	(0.1)%	(1.5)%
<b>Structured and Spread Products portfolios</b>		

USD fixed income portfolio	2.4%	(2.1)%
Non USD fixed income portfolio	5.5%	(1.3)%
<b>Risk Asset portfolios</b>		
Alternative portfolio (2)	(0.7)%	0.4%
Equity portfolio	1.3%	(0.3)%
High-Yield fixed income portfolio	3.0%	(1.0)%

- Portfolio returns are calculated by dividing the sum of net investment income, realized gains (losses) and unrealized gains (losses) by the daily weighted average market value of each portfolio. Non U.S. dollar fixed income performance is measured in either the underlying currency or in U.S. dollars
- Performance on the alternative portfolio reflects the three months to May 31, 2005 and May 31, 2004, respectively.

### **Net Realized Gains and Losses and Other than Temporary Declines in the Value of Investments**

Net realized gains on investments in the second quarter of 2005 included net realized gains of \$101.3 million from sales of investments and net realized losses of approximately \$11.2 million related to the write-down of certain of the Company's fixed income and equity investments where the Company determined that there was an other than temporary decline in the value of these investments.

Net realized gains on investments in the second quarter of 2004 included net realized gains of \$12.5 million from sales of investments and net realized losses of approximately \$3.7 million related to the write-down of certain of the Company's fixed income and equity investments where the Company determined that there was an other than temporary decline in the value of those investments.

The Company's process for identifying declines that are other than temporary in the fair value of investments involves consideration of several factors. These factors include: (i) the time period during which there has been a significant decline in value; (ii) an analysis of the liquidity, business prospects and overall financial condition of the issuer; (iii) the significance of the decline; (iv) an analysis of the collateral structure and other credit support, as applicable, of the securities in question; and (v) the Company's intent and ability to hold the investment for a sufficient period of time for the value to recover. Where the Company's analysis of the above factors results in the Company's conclusion that declines in fair values are other than temporary, the cost of the security is written down to fair value and the previously unrealized loss is therefore recorded as realized.

Net realized and unrealized losses on investment derivatives for the three months ended June 30, 2005 resulted from the Company's investment strategy to economically hedge certain interest, credit and foreign exchange risks within the investment portfolio.

### **Net Unrealized Gains and Losses on Investments**

At June 30, 2005, the Company had net unrealized gains on fixed income and short term securities of \$760.0 million and net unrealized gains on equities of \$151.8 million. Of these amounts, gross unrealized losses on fixed income and short term securities and equities were \$122.5 million and \$11.8 million, respectively. The information presented below for the gross unrealized losses on the Company's investments at June 30, 2005 shows the potential effect upon future earnings and financial position should management later conclude that some of the current declines in the fair value of these investments are other than temporary.

At June 30, 2005, approximately 6,000 fixed income securities out of a total of approximately 16,800 securities were in an unrealized loss position. The largest single unrealized loss in the fixed income portfolio was \$2.7 million. Approximately 400 equity securities out of a total of approximately 1,800 securities were in an unrealized loss position at June 30, 2005 with the largest individual loss being \$0.4 million.

The following is an analysis of how long each of those securities with an unrealized loss at June 30, 2005 had been in a continual unrealized loss position:

<b>(U.S. dollars in thousands)</b>		<b>(Unaudited) Amount of unrealized loss at June 30, 2005</b>	<b>(Unaudited) Fair Value of Securities in unrealized loss position at June 30, 2005</b>
<b>Type of Securities</b>	<b>Length of time in a continual unrealized loss position</b>		
Fixed Income and Short-Term	Less than six months	\$ 59,055	\$ 5,689,457
	At least 6 months but less than 12 months	28,743	2,741,460
	At least 12 months but less than 2 years	30,611	1,566,948
	2 years and over	4,069	148,300
	<b>Total</b>	<b>\$ 122,478</b>	<b>\$ 10,146,165</b>
Equities	Less than six months	\$ 8,254	\$ 107,303
	At least 6 months but less than 12 months	3,502	55,792
	<b>Total</b>	<b>\$ 11,756</b>	<b>\$ 163,095</b>

At June 30, 2005, the following was the maturity profile of the fixed income securities that were in a gross unrealized loss position:

(U.S. dollars in thousands)

	(Unaudited)	(Unaudited)
Maturity profile in years of fixed income securities in a continual unrealized loss position	Amount of unrealized loss at June 30, 2005	Fair value of securities in unrealized loss positions at June 30, 2005
Less than 1 year remaining	\$ 6,067	\$ 1,205,775
At least 1 years but less than 5 years remaining	37,479	2,785,853
At least 5 years but less than 10 years remaining	12,710	1,020,751
At least 10 years but less than 20 years remaining	2,872	139,371
At least 20 years or more remaining	4,903	195,613
Mortgage and asset backed securities	58,447	4,798,802
Total	\$122,478	\$10,146,165

41

The Company operates a risk asset portfolio that includes high yield (below investment grade) fixed income securities. These represented approximately 3.6% of the total fixed income portfolio market value at June 30, 2005. Fair values of these securities have a higher volatility than investment grade securities. Of the total gross unrealized losses in the Company's fixed income portfolio as at June 30, 2005, \$21.9 million related to securities that were below investment grade or not rated. The following is an analysis of how long each of these below investment grade and unrated securities had been in a continual unrealized loss position at the date indicated:

(U.S. dollars in thousands)

	(Unaudited)	(Unaudited)
Length of time in a continual unrealized loss position	Amount of unrealized loss at June 30, 2005	Fair value of securities in unrealized loss position June 30, 2005
Less than six months	\$20,198	\$1,920,590
At least 6 months but less than 12 months	1,171	19,514
At least 12 months but less than 2 years	329	7,513
2 years and over	177	2,579
Total	\$21,875	\$1,950,196

#### Other Revenues and Expenses

The following table sets forth other revenues and expenses for the three months ended June 30, 2005 and 2004:

(U.S. dollars in thousands)

	(Unaudited)		
	Three Months Ended June 30,		
	2005	2004	% Change
Net income from operating affiliates – general operations	\$ 18,393	\$ 20,934	(12.1)%
Amortization of intangible assets	3,043	3,257	(6.6)%
Corporate operating expenses	34,691	38,793	(10.6)%
Interest expense	43,632	37,286	17.0%
Income tax expense	41,776	32,266	29.5%

Net income from operating affiliates was lower for the three months ended June 30, 2005 as compared to the same period in 2004 due to lower income from the Company's Investment Manager affiliates.

Corporate operating expenses in the three months ended June 30, 2005 decreased compared to the three months ended June 30, 2004 due to the ongoing conscious efforts towards cost reduction across the Company and the higher costs in 2004 related to the first year of compliance with the Sarbanes-Oxley Act.

The increase in interest expense primarily reflected the increase in outstanding debt since June 30, 2004. For more information on the Company's financial structure, see "Liquidity and Capital Resources".

The increase in the Company's income taxes arose principally from the increase in the profitability of the Company's U.S. operations. The overall corporate effective tax rate has increased as a significant proportion of the reinsurance reserve increases are captured in non-U.S. subsidiaries where tax relief is not available.

42

## Insurance

The following table summarizes the underwriting results for this segment:

(U.S. dollars in thousands)

(Unaudited)  
Six Months Ended  
June 30,

	2005	2004	% Change
Gross premiums written	\$3,092,164	\$3,223,658	(4.1)%
Net premiums written	2,392,362	2,483,435	(3.7)%
Net premiums earned	2,136,878	1,982,106	7.8%
Fee income and other	1,011	7,616	(86.7)%
Net losses and loss expenses	1,401,889	1,249,658	12.2%
Acquisition costs	257,775	273,206	(5.6)%
Operating expenses	266,129	258,236	3.1%
Exchange (gains) losses	(19,789)	12,057	NM
Underwriting profit	\$ 231,885	\$ 196,565	18.0%

\* NM — Not Meaningful

Gross and net premiums written decreased by 4.1% and 3.7%, respectively, in the six months ended June 30, 2005 compared with the six months ended June 30, 2004. These decreases are primarily due to continued competitive pricing across most lines, most notably property and professional. Decreases were partially offset by continued growth in the new Select and Design Professional and U.S. Primary Casualty units, and the weakening of the U.S. dollar against the U.K. sterling and the Euro as compared to the first half of 2004. Net premiums written have declined in line with gross premiums written as increased retentions were significantly offset by ceded reinsurance commutations related to professional lines in the prior year.

Net premiums earned increased by 7.8% in the six months ended June 30, 2005 compared with the six months ended June 30, 2004. Growth in net premium earned is primarily as a result of the earn out of net premiums written in 2004, including the new business initiatives mentioned above and increased retentions

Exchange gains in the six months ended June 30, 2005 were primarily due to the weakening of the U.K. sterling and the Euro against the U.S. dollar during the second quarter on several large internal contracts.

The following table presents the ratios for this segment:

(Unaudited)  
Six Months Ended  
June 30,

	2005	2004
Loss and loss expense ratio	65.6%	63.0%
Underwriting expense ratio	24.5%	26.9%
Combined ratio	90.1%	89.9%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss and loss expense reserves held at the beginning of the year. The loss and loss expense ratio for the six months ended June 30, 2005 increased compared with the six months ended June 30, 2004, primarily reflecting the impact of softening market conditions.

The underwriting expense ratio in the six months ended June 30, 2005 decreased compared to the same period in 2004 as a result of a decrease in the operating expense ratio of 0.7 points (12.4% as compared to 13.1%) combined with

a decrease in the acquisition expense ratio of 1.7 points (12.1% as compared to 13.8%). The decrease in the operating expense ratio was due primarily to the higher earned premiums combined with relatively flat operating costs. The reduction in the acquisition expense ratio was due primarily to a change in the commission structure with certain brokers.

## Reinsurance

### Reinsurance — General Operations

The following table summarizes the underwriting results for the general operations of this segment:

(U.S. dollars in thousands)

(Unaudited)  
Six Months Ended

June 30,

	2005	2004	% Change
Gross premiums written	\$2,200,452	\$2,339,946	(6.0)%
Net premiums written	1,915,362	2,053,084	(6.7)%
Net premiums earned	1,356,952	1,437,355	(5.6)%
Fee income and other	(446)	139	NM
Net losses and loss expenses	978,504	813,409	20.3%
Acquisition costs	291,239	320,296	(9.1)%
Operating expenses	79,559	90,822	(12.4)%
Exchange losses	18,281	(4,176)	NM
Underwriting (loss) profit	\$ (11,077)	\$ 217,143	(105.1)%

\* NM — Not Meaningful

Gross and net premiums written decreased 6.0% and 6.7%, respectively, in the first half of 2005 as compared to the first half of 2004. The decline in gross written premiums was seen primarily in the U.S. casualty business as a result of increased retentions by ceding companies and contract renewal timing changes. Favorable foreign exchange movements partially offset the decrease in gross written premiums. Net written premiums reflect the above gross changes.

Net premiums earned in the first half of 2005 decreased 5.6% as compared to the first half of 2004, due primarily to the earn out of the impact of rate pressures seen in gross written premium over the last 12 months.

The following table presents the ratios for this segment:

	(Unaudited) Six Months Ended June 30,	
	2005	2004
Loss and loss expense ratio	72.1%	56.6%
Underwriting expense ratio	27.3%	28.6%
Combined ratio	99.4%	85.2%

The loss and loss expense ratio includes net losses incurred for both the current year and any adverse or favorable prior year development of loss reserves held at the beginning of the year. The increase in the loss and loss expense ratio in the six months ended June 30, 2005 compared to the same period in 2004 primarily reflected higher than expected development in the second quarter relating to U.S. casualty business of \$190.6 million noted above.

The decrease in the underwriting expense ratio in the first half of 2005 as compared with the first half of 2004 was due to a decrease in both the acquisition expense ratio and operating expense ratio to 21.4% and 5.9%, respectively, as compared to 22.3% and 6.3%, respectively, in the first half of 2004. The decrease was mainly due to

44

decreased profit commissions which resulted from the 2004 hurricane activity. The operating expense ratio decrease reflects general operating expenses together with lower allocated corporate costs.

Exchange losses in the six months ended June 30, 2005 were mainly attributable to an overall strengthening in the value of the U.S. dollar against the U.K. Sterling and the Euro in those operations with U.S. dollars as their functional currency and net U.K. Sterling and Euro assets.

#### Reinsurance — Life and Annuity Operations

The following summarizes net income from life and annuity operations:

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30,		
	2005	2004	% Change
Gross premiums written	\$2,033,757	\$1,078,183	88.6%
Net premiums written	2,014,264	1,077,057	87.0%
Net premiums earned	2,014,686	1,078,738	86.8%
Fee income and other	179	231	(22.5)%

Claims and policy benefits	2,146,291	1,125,407	90.7%
Acquisition costs	41,409	16,731	147.5%
Operating expenses	9,251	5,300	74.5%
Exchange losses	673	85	NM
Net investment income	131,866	90,387	45.9%
Interest expense	—	234	(100.0)%
Net loss from life and annuity operations	\$ (50,893)	\$ 21,599	NM%

\* NM — Not Meaningful

Gross and net premiums written as well as net premiums earned and claims and policy benefits increased significantly in the first half of 2005 as compared to the first half of 2004 primarily as a result of several large immediate annuity portfolio contracts bound since June 30, 2004. In addition, the Company wrote several new regular premium term assurance contracts in the same period, which generate written premiums in the current year.

Claims and policy benefits also increased significantly as a result of the annuity payout liabilities accepted under the contracts noted above. Changes in claims and policy benefits also included the movement in policy benefit reserves related to other contracts where investment assets were acquired with the assumption of the policy benefit reserves at the inception of the contract. In addition, \$37.4 million in losses were recorded related to certain novated blocks of U.S.-based term life mortality reinsurance business as a result of the actuarially modeled impact of actual paid losses being greater than expected.

Acquisition costs increased in the first half of 2005 as compared to the first half of 2004 reflecting the write-off of certain deferred costs related to the U.S. mortality business noted above, as current profit projections do not support the recovery of the deferred costs product commissions booked in the prior year. Operating expenses increased in the first half of 2005 compared to the same period in 2004 due to build out of existing operations and start-up costs of new life operations in the U.S. partially and offset by reduced corporate allocations.

Net investment income increased in the first half of 2005 compared to the first half of 2004 reflecting the increase in life business invested assets primarily arising from new large annuity contracts written since June 30, 2004.

### Financial Products and Services

The following table summarizes the contribution for this segment:

(U.S. dollars in thousands)

(Unaudited)  
Six Months Ended  
June 30,

	2005	2004	% Change
Gross premiums written	\$163,397	\$170,511	(4.2)%
Net premiums written	153,015	163,326	(6.3)%
Net premiums earned	103,687	104,718	(1.0)%
Fee income and other	13,368	7,073	89.0%
Net losses and loss expenses	24,375	21,031	15.9%
Acquisition costs	14,959	14,445	3.6%
Operating expenses	34,894	31,171	11.9%
Exchange (gains) losses	1,064	(2,777)	NM
Underwriting profit	\$ 41,763	\$ 47,921	(12.9)%
Net investment income — financial guarantee	\$ 29,504	\$ 17,005	73.5%
Net investment income — structured products	132,579	78,975	67.9%
Interest expense — structured products	96,544	38,147	153.1%
Operating expenses — structured products	23,197	27,092	(14.4)%
Net (loss) income from financial and investment affiliates	(809)	3,134	NM
Minority interest	4,575	7,087	(35.4)%
Net results from derivatives	33,565	19,667	70.7%
Net contribution from financial operations	\$112,286	\$ 94,376	19.0%

\* NM — Not Meaningful

Gross and net premiums written primarily relate to the financial guaranty line of business and reflect premiums received and accrued for in the period and do not include the present value of future cash receipts expected from financial guaranty installment premium policies and contracts written in the period. In addition to financial guaranty premiums, segment premiums also include premiums received from political risk and other structured property and casualty business lines. Decreases in gross and net premiums written of 4.2% and 6.3%, respectively, for the six month period ended June 30, 2005, as compared to the comparable

period in 2004 were primarily due to decreased upfront and installment premiums on financial guaranty business. The period over period decline was primarily attributable to tight credit spreads and intense competition, as well as increased retentions by primaries, which adversely affected assumed premiums. The Company expects competition to remain intense for at least the short term.

Net premiums earned were essentially flat during the six months ended 2005 as compared to the same period in 2004.

The following table provides a line of business breakdown of the Financial Products and Services segment's net premiums earned:

(U.S. dollars in thousands)

(Unaudited)  
Six Months Ended  
June 30,

	2005	2004	% Change
Financial Guaranty	\$80,457	\$82,436	(2.4)%
Political Risk	13,403	15,339	(12.6)%
Other (1)	9,827	6,943	41.5%

(1) Includes structured financial and alternative risk transfer products and weather and energy risk management products.

Net losses and loss expenses include current year net losses incurred and adverse or favorable development of prior year net loss and loss expense reserves. Net losses and loss expenses for the six months ended June 30, 2005 increased by 15.9%, as compared to the comparable period in 2004. This increase was primarily a result of case reserve provisions relating to an insured project financing and an insured residential mortgage backed securitization that were partially offset by the release of certain other case reserves to reflect current best estimates of ultimate losses, as well as that relating to risks on a synthetic execution that expired during the period without a claim.

For the six months ended June 30, 2005, acquisition costs as a percentage of net premiums earned were consistent with that of the comparable period in the prior year.

Total operating expenses decreased marginally in the six months ended June 30, 2005 as compared to the same period in 2004 due to lower costs associated with weather and energy operations partially offset by increases in certain other compensation and consulting costs.

Net investment income related to financial guaranty business increased by 73.5% in the six months ended June 30, 2005 due to the larger investment portfolio created by increased premium receipts and a \$125.0 million capital infusion in the fourth quarter of 2004. In addition, \$4.3 million in investment income relates to the Company's investment in Financial Security Assurance International Ltd ("FSAI"), which is now reported as investment income in accordance with EITF 02-14 as opposed to net income from financial affiliates as in 2004.

Net investment income related to structured products increased by 67.9% as a result of significant increases in the combined average funding agreement and guaranteed investment contract balances from \$2.3 billion to \$4.6 billion.

Interest expenses on structured products are comprised of the accretion charges on deposit liabilities related to funding agreements, guaranteed investment contracts and certain structured insurance and reinsurance contracts. The increase in interest expenses in the six months ended June 30, 2005 compared to the same period in 2004 related primarily to the increase in the number of funding agreements in place during the six months ended June 30, 2005 combined with the commutation of certain structured reinsurance contracts in 2004.

Net results from derivatives represent changes in the market value of the Company's insured credit derivative portfolio, weather and energy derivative instruments and certain index derivatives. The net results from derivatives in the six months ended June 30, 2005 related primarily to the fair value adjustment for credit derivatives. These gains were mainly unrealized and related to the improvement of credit quality for certain credit pools. These gains were combined with the settlement of a housing price index derivative contract written on the financial solutions platform. This gain was primarily due to the extraordinary performance of the housing market over the last few years.

Net income (loss) from financial and investment affiliates includes, earnings on the Company's investment in Primus Guaranty, Ltd ("Primus") and certain of the Company's investment affiliates. The decrease in the six months ended June 30, 2005 as compared to the same period in 2004 was due primarily to a flat year-to-date performance in Primus.

The decrease in minority interest in 2005 and 2004 was due to a decrease in the profitability of XL Financial Assurance Ltd., of which 15% is held by a minority shareholder.

### Investment Activities

The following table illustrates the change in net investment income from general operations, net income from investment affiliates, net realized gains on investments and net realized and unrealized (losses) gains on investment derivative instruments for the six months ended June 30, 2005 and 2004.

(U.S. dollars in thousands)

(Unaudited)  
Six Months Ended  
June 30,

	2005	2004	% Change
Net investment income — general operations	\$381,657	\$293,126	30.2%
Net income from investment affiliates — general operations	59,978	67,123	(10.6)%
Net realized gains on investments	150,726	124,100	21.5%
Net realized and unrealized (losses) gains on investment derivative instruments — general operations	(36,328)	18,974	NM

\* NM — Not Meaningful

Net investment income related to general operations increased in the first half of 2005 as compared to the first half of 2004 due primarily to a higher investment base as well as increases in the yield of the portfolio. The growth in the investment base reflected the Company's cash flow from operations and growth in structured and spread balances. The market yield to maturity on the general account portion of the fixed income portfolio was 4.1% at June 30, 2005 as compared to 3.9% at June 30, 2004. In addition, the Company received a distribution associated with the unwind of a collateral debt obligation which resulted in a one time benefit to net investment income of \$28.6 million.

Net income from investment affiliates decreased in the first half of 2005 compared to the first half of 2004 due to poor performance in alternative fund affiliates in the second quarter partially offset by strong performance in private equity fund affiliates.

The Company manages its investment grade fixed income securities using an asset/liability management framework. Due to the unique nature of the underlying liabilities, customized benchmarks are used to measure investment performance and comparison to standard market indices is not meaningful. Investment performance is not monitored for certain assets primarily consisting of operating cash and special regulatory deposits. The following is a summary of the investment portfolio returns for the general account asset/liability portfolios, structured and spread product portfolios and risk asset portfolios:

	(Unaudited) Six Months Ended June 30, 2005 (1)	(Unaudited) Six Months Ended June 30, 2004 (1)
<b>General Account Asset/Liability portfolios</b>		
USD fixed income portfolio	1.9%	0.1%
Non USD fixed income portfolio	(0.3)%	0.8%
<b>Structured and Spread Products portfolios</b>		
USD fixed income portfolio	3.1%	0.5%
Non USD fixed income portfolio	6.3%	0.4%
<b>Risk Asset portfolios</b>		
Alternative portfolio (2)	2.2%	4.4%
Equity portfolio	0.8%	4.6%
High-Yield fixed income portfolio	1.6%	0.7%

(1) Portfolio returns are calculated by dividing the sum of net investment income, realized gains (losses) and unrealized gains (losses) by the daily weighted average market value of each portfolio. Non U.S. dollar fixed income performance is measured in either the underlying currency or in U.S. dollars.

(2) Performance on the alternative portfolio reflects the six months to May 31, 2005 and May 31, 2004, respectively.

#### **Net Realized Gains and Losses and Other Than Temporary Declines in the Value of Investments**

Net realized gains on investments in the first six months of 2005 included net realized gains of \$184.5 million from sales of investments and net realized losses of approximately \$33.8 million related to the write-down of certain

of the Company's fixed income and equity investments where the Company determined that there was an other than temporary decline in the value of these investments.

Net realized gains on investments in the first six months of 2004 included net realized gains of \$128.2 million from sales of investments and net realized losses of approximately \$4.1 million related to the write-down of certain of the Company's fixed income and equity investments where the Company determined that there was an other than temporary decline in the value of those investments.

#### ***Other Revenues and Expenses***

The following table sets forth other revenues and expenses for the six months ended June 30, 2005 and 2004:

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30,		
	2005	2004	% Change

Net income from operating affiliates	\$33,615	\$28,831	16.6%
Amortization of intangible assets	5,836	6,514	(10.4)%
Corporate operating expenses	83,076	80,395	3.3%
Interest expense	89,508	70,989	26.1%
Income tax expense	94,650	68,151	38.9%

Net income from operating affiliates for the six months ended June 30, 2005 increased by 16.6% compared to the same period in 2004. This increase related primarily to the performance of Investment Manager affiliates.

Corporate operating expenses in the six months ended June 30, 2005 increased compared to the six months ended June 30, 2004 due to certain compensation costs partially offset by the ongoing conscious efforts towards cost reduction across the Company and the higher costs related to the first year of compliance with the Sarbanes-Oxley Act in 2004.

The increase in interest expense primarily reflected the increase in outstanding debt since June 30, 2004. For more information on the Company's financial structure, see "Liquidity and Capital Resources".

The increase in the Company's income taxes arose principally from an improvement in the profitability of the Company's U.S. and European operations after. The overall corporate effective tax rate has increased as a significant proportion of these losses are captured in non-U.S. subsidiaries.

### Investments

The primary objectives of the investment strategy are to support the liabilities arising from the operations of the Company, generate stable investment income and to build book value for the Company over the longer term. The strategy strives to maximize investment returns while taking into account market and credit risk. The Company's overall investment portfolio is structured to take into account a number of variables including local regulatory requirements, business needs, collateral management and risk tolerance.

At June 30, 2005 and December 31, 2004, total investments and cash and cash equivalents were \$36.1 billion and \$32.1 billion, respectively. The following table summarizes the composition of the Company's invested assets:

(U.S. dollars in thousands)	(Unaudited)		(Unaudited)	
	Market Value at June 30, 2005	Percent of Total	Market Value at December 31, 2004	Percent of Total
Cash and cash equivalents	\$ 2,467,775	6.8%	\$ 2,304,303	7.2%
Net payable for investments purchased	(150,842)	(0.4)%	(273,535)	(0.9)%
Fixed maturities	28,524,432	79.1%	25,100,194	78.2%
Short-term investments	2,005,731	5.6%	1,760,714	5.5%
Equity securities	918,740	2.5%	962,920	3.0%
Investments in affiliates	2,044,085	5.7%	1,936,852	6.0%
Other investments	262,292	0.7%	305,160	1.0%
<b>Total investments and cash and cash equivalents</b>	<b>\$36,072,213</b>	<b>100%</b>	<b>\$32,096,608</b>	<b>100%</b>

The Company reviews, on a regular basis, its corporate debt concentration, credit quality and compliance with established guidelines. At June 30, 2005 and December 31, 2004, the average credit quality of the Company's total fixed income portfolio was "AA". Approximately 56% of the fixed income portfolio was rated "AAA" by one or more of the principal ratings agencies. Approximately 3.6% was below investment grade or not rated.

### Unpaid Losses and Loss Expenses

The Company establishes reserves to provide for estimated claims, the general expenses of administering the claims adjustment process and for losses incurred but not reported. These reserves are calculated using actuarial and other reserving techniques to project the estimated ultimate net liability for losses and loss expenses. The Company's reserving practices and the establishment of any particular reserve reflects management's judgment concerning sound financial practice and do not represent any admission of liability with respect to any claims made against the Company.

Unpaid losses and loss expenses relates primarily to the casualty insurance and reinsurance business written by the Company. The balance was \$19.8 billion at both June 30, 2005, and December 31, 2004.

The table below represents a reconciliation of the Company's unpaid losses and loss expenses for the six months ended June 30, 2005 (unaudited):

(U.S. dollars in thousands)	Gross unpaid Losses and loss expenses	Unpaid losses and loss expenses recoverable	Net unpaid losses and loss expenses
Balance as at December 31, 2004	\$19,837,669	\$6,947,771	\$12,889,898
Losses and loss expenses incurred	2,913,701	508,933	2,404,768
Losses and loss expenses paid /recovered	(2,368,760)	(780,769)	(1,587,991)

Foreign exchange and other	(607,200)	(230,529)	(376,671)
Balance as at June 30, 2005	\$19,775,410	\$6,445,406	\$13,330,004

While the Company reviews the adequacy of established reserves for unpaid losses and loss expenses regularly, no assurance can be given that actual claims made and payments related thereto will not be in excess of the amounts reserved. In the future, if such reserves develop adversely, such deficiency would have a negative impact on future results of operations. See "Unpaid Losses and Loss Expenses" in Item 1, "Critical Accounting Policies and Estimates" in Item 7 and Item 8, Note 9 to the Consolidated Financial Statements, each in the Company's Form 10-K for the year ended December 31, 2004, for further discussion.

50

### *Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable*

As a significant portion of the Company's net premium written incept in the first six months ended of the year, certain assets and liabilities have increased at June 30, 2005 compared to December 31, 2004. This includes deferred acquisition costs, unearned premiums, premiums receivable and prepaid reinsurance premiums.

In the normal course of business, the Company seeks to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk assumed in various areas of exposure with other insurers or reinsurers. While reinsurance agreements are designed to limit the Company's losses from large exposures and permit recovery of a portion of direct unpaid losses, reinsurance does not relieve the Company of its ultimate liability to its insureds. Accordingly, the loss and loss expense reserves on the balance sheet represent the Company's total unpaid gross losses. Unpaid losses and loss expenses recoverable relates to estimated reinsurance recoveries on the unpaid loss and loss expense reserves.

Unpaid losses and loss expenses recoverables were \$6.5 billion at June 30, 2005 and \$7.0 billion at December 31, 2004. The table below presents the Company's net reinsurance recoverable at June 30, 2005 and December 31, 2004.

(U.S. dollars in thousands)	(Unaudited)	
	June 30 2005	December 31 2004
Reinsurance balances receivable	\$ 965,215	\$1,097,709
Bad debt reserve on reinsurance balances receivable	(7,311)	(1,970)
Reinsurance recoverable on future policy benefits	18,613	23,585
Unpaid losses and loss expenses recoverable	6,736,969	7,226,480
Bad debt reserve on unpaid losses and loss expenses	(291,563)	(278,709)
Net paid and unpaid losses and loss expenses recoverable and reinsurance balances receivable	\$7,421,923	\$8,067,095

Included in unpaid losses and loss expenses recoverable at June 30, 2005 is an unsecured reinsurance recoverable from Winterthur Swiss Insurance Company (the "Seller") of \$1.45 billion, related to certain contractual arrangements with the sale and purchase agreement, as amended ("SPA"), relating to the Company's acquisition of Winterthur International in July 2001. The Seller is currently rated "A-" by S&P. The Seller provides the Company with post-closing protection determined as of June 30, 2004 with respect to, among other things, adverse development of incurred losses and premium balances relating to the acquired Winterthur International business ("Winterthur Business"). This protection is based upon net loss experience and development over a three-year, post-closing seasoning period based on actual loss development experience, collectible reinsurance and certain other factors set forth in the SPA. The SPA includes an independent actuarial process for determining the net amount due to the Company from the Seller. In this process, each of the Company and the Seller submits their respective net reserves and seasoned premium amounts. The independent actuary develops its own value of the seasoned net reserves and seasoned premium amounts and the actual final seasoned amount would be in each case, the submission that is closest to the number developed by the independent actuary.

As the Company and the Seller were unable to come to an agreement, the Company submitted to the Seller notice to trigger the independent actuarial process as contemplated by the SPA. On February 3, 2005, both the Company and the Seller made submissions for the independent actuarial process. The independent actuary has commenced the evaluation process. Based on submissions and meetings to date, the Company continues to expect that the independent actuary will make his determinations prior to year-end. The Company's submissions would result in a net payable to the Company of approximately \$1.45 billion in aggregate and the Seller's submissions would result in a net payable to the Company of \$541.0 million in aggregate. At the completion of the independent actuarial process, the Company will be entitled to a lump sum payment.

In addition, the Seller provides protection to the Company with respect to third party reinsurance receivables and recoverables related to the Winterthur Business which were approximately \$1.6 billion, in the aggregate, as of June 30, 2005. There are two levels of protection from the Seller for these balances:

51

- At the time of the Winterthur International acquisition, the Seller provided to the Company a liquidity facility. At the time of the payment of the net reserve seasoned amount as described above, the Company has the right to repay up to the balances outstanding on this facility by assignment to the Seller of an equal amount of receivables relating to reinsurance recoverables selected by the Company. The payable balance related to this facility is included within other liabilities on the Company's balance sheet at June 30, 2005 and amounted to approximately \$270 million at that date.
- Under two retrocession agreements the Company has reinsurance protection on the remaining portion of reinsurance recoverables with respect to incurred losses seasoned as of June 30, 2004 to the extent that the Company does not receive payment of such amounts from applicable reinsurers with one

agreement providing a limit of \$1.3 billion for the insurance written in the period to June 30, 2001 and the other agreement providing a limit of \$1.3 billion for the insurance written prior to December 31, 2000.

Certain reinsurers responsible for some portions of the reinsurance of the Winterthur business have raised issues as to whether amounts claimed are due and the resolution of those discussions is also currently ongoing.

The Company may record a loss in future periods if any or some of the following occur:

- (i) The submission of the Seller is closer to the valuation developed by the independent actuary, in which case the Company may record a loss of approximately \$900 million.
- (ii) There is deterioration of the net reserves and premium balances, relating to the Winterthur Business, from what was reported in the Company's December 31, 2004 financial statements;
- (iii) The Company is unable to make full recovery of the reinsurance recoverables related to the Winterthur Business, either from third parties or from the Seller under the additional protections; and/or
- (iv) Any amount due from the Seller proves to be uncollectible from the Seller for any reason.

### **Liquidity and Capital Resources**

As a holding company, the Company's assets consist primarily of its investments in subsidiaries, and the Company's future cash flows depend on the availability of dividends or other statutorily permissible payments from its subsidiaries. The ability to pay such dividends is limited by the applicable laws and regulations of the various countries the Company operates in including, among others, Bermuda, the United States, Ireland, Switzerland and the United Kingdom, and those of the Society of Lloyd's and certain contractual provisions. No assurance can be given that the Company or its subsidiaries will be permitted to pay dividends in the future.

The Company and its subsidiaries provide no guarantees or other commitments (express or implied) of financial support to the Company's subsidiaries or affiliates, except for express written financial support provided by XL Insurance (Bermuda) Ltd in connection with the Company's financial guaranty subsidiaries and where other express written guaranty or other financial support arrangements are in place.

### **Liquidity**

Liquidity is a measure of the Company's ability to generate sufficient cash flows to meet the short and long term cash requirements of the Company's business operations.

The Company's operating subsidiaries provide liquidity in that premiums are generally received months or even years before losses are paid under the policies related to such premiums. Historically, cash receipts from operations, consisting of insurance premiums and investment income, have provided more than sufficient funds to pay losses, operating expenses and dividends to the Company.

New cash from operations was approximately \$2.6 billion in the first six months of 2005 compared with \$2.0 billion in the same period in 2004. Net new cash in 2005 was due to the growth of the immediate annuity business in the quarter.

### **Capital Resources**

At June 30, 2005, the Company had total shareholders' equity of \$8.4 billion. In addition to ordinary and preferred share capital, the Company depends on external sources of financing such as debt, credit facilities and contingent capital to support its underwriting activities.

The Company does not intend, subject to the terms and conditions of the Series A or Series B preference ordinary shares as set forth in the relevant prospectus supplement, to redeem either the Series A or Series B preference ordinary shares unless replaced with capital having at least the equivalent credit.

As at June 30, 2005, the Company had revolving credit facilities and loan facilities from a variety of sources, including commercial banks, totaling \$3.8 billion of which \$2.7 billion in debt was outstanding. In addition, the Company had letters of credit facilities amounting to \$5.6 billion of which \$2.8 billion was utilized to provide of letters of credit in issue at June 30, 2005, 6.8% of which were collateralized by the Company's investment portfolio. Such letters of credit principally support the Company's U.S. non-admitted business and the Company's capital requirements at Lloyd's.

In the event that the amount developed by the independent actuary in the net reserve seasoning process is closer to the amount submitted by the Seller (as more fully described under Unpaid Losses and Loss Expenses Recoverable and Reinsurance Balances Receivable above) the Company may need to raise additional capital.

### **Debt**

The following table presents the Company's indebtedness under outstanding debt securities and lenders' commitments as at June 30, 2005:

Notes Payable And Debt (U.S. dollars in thousands)	Commitment	In Use	Year Of Expiry	Payments Due By Period			
				Less Than 1 Year	1 To 3 Years	3 To 5 Years	After 5 Years
364-day revolver	\$ 60,000	\$ —	2005	\$ —	\$ —	\$ —	\$ —
5 year and 3 year revolvers (1)	1,000,000	—	2007 2010				

7.15% Senior Notes								
due 2005	100,000	100,000	2005		100,000			
2.53% Senior Notes								
due 2009 (3)	825,000	825,000	2009				825,000	
6.58% Guaranteed Senior								
Notes due 2011	255,000	255,000	2011					255,000
6.50% Guaranteed Senior								
Notes due 2012 (2)	597,914	597,914	2012					600,000
5.25% Senior Notes								
due 2014 (2)	594,003	594,003	2014					600,000
6.375% Senior Notes								
due 2024 (2)	350,000	350,000	2024					350,000
Total debt	\$3,781,916	\$2,721,916			\$100,000	\$ —	\$825,000	\$1,805,000

(1) The syndicated revolving credit and letter of credit facilities created in June 2004 and 2005 consist of a \$2.35 billion 5 year facility that expires in June 2010 and a \$2.0 billion 3-year facility that expires in June 2007. The combined revolving credit sub-limit of these facilities is \$1.0 billion. The 5 year facility includes a revolving-credit-only sub-limit of \$100 million.

(2) “Commitment” and “In Use” data represent June 30, 2005, accreted values. “After 5 years” data represent ultimate redemption values.

(3) The 2.53% Senior Notes due 2009 are a component of the Equity Security Units issued in March 2004. In addition to the Senior Notes coupon of 2.53%, contract adjustment payments of 3.97% per annum are paid on forward purchase contracts for ordinary shares for a total distribution per annum on the Units of 6.50%. The forward purchase contracts will be settled on May 15, 2007 and the Senior Notes will mature on May 15, 2009.

The total pre-tax interest expense on the borrowing described above was \$72.1 million and \$52.5 million for the six months ended June 30, 2005 and June 30, 2004, respectively.

#### *Credit facilities, contingent capital and other sources of collateral.*

The Company replaced its 364-day credit facility that expired on June 22, 2005, with a new 5-year \$2.35 billion credit facility that expires on June 22, 2010. The facility provides letter of credit capacity of up to \$2.25 billion and revolving credit of up to \$1.0 billion. The revolving credit sublimit of \$1.0 billion is shared with the June 2004 3-year credit facility such that the Company can have no more than \$1.0 billion in aggregate in revolving credit outstanding under the two facilities. In addition, the 2005 5-year facility contains a \$100 million revolving-credit-only sublimit which means that no more than \$2.25 billion of the total facility of \$2.35 billion is available in the form of letters of credit.

On August 3, 2005, the Company entered into a \$100,000,000 5-year bilateral revolving credit facility. See Part II, Item 5.

The following table presents the Company’s letter of credit facilities available, in use, and expiration dates as at June 30, 2005:

Other Commercial Commitments (U.S. dollars in thousands)	Commitment	In Use	Year Of Expiry	Amount of Commitment Expiration Per Period			
				Less Than 1 Year	1 To 3 Years	3 To 5 Years	After 5 Years
6 Letter of Credit facilities	\$507,820	\$ 391,802	2005	\$507,820	\$ —	\$ —	\$ —
1 Letter of Credit facility	806,265	696,286	2006	—	806,265	—	—
1 Letter of Credit facility	2,000,000	1,703,563	2007	—	2,000,000	—	—
1 Letter of Credit facility	2,250,000	46,744	2010	—	—	2,250,000	—
9 Letter of Credit facilities	\$5,564,085	\$2,838,395		\$507,820	\$2,806,265	\$2,250,000	\$ —

Of the total letter of credit commitment above, \$900 million is also included in the revolvers under notes payable and debt.

The Company has several letter of credit facilities provided on a syndicated and bilateral basis from commercial banks. These facilities are principally utilized to support non-admitted insurance and reinsurance operations in the United States and capital requirements at Lloyd’s. Several of the facilities are scheduled for renewal during the remainder of 2005. In addition to letters of credit, the Company has established insurance trusts in the U.S. that provide cedants with statutory relief under state insurance regulations in the U.S. It is anticipated that the commercial facilities will be renewed on expiry but such renewals are subject to the

availability of credit from banks utilized by the Company. In the event that such credit support is insufficient, the Company could be required to provide alternative security to cedants. This could take the form of additional insurance trusts supported by the Company's investment portfolio or funds withheld using the Company's cash resources. The value of letters of credit required is driven by, among other things, loss development of existing reserves, the payment pattern of such reserves, the expansion of business written by the Company and loss experience of such business.

In addition to funded debt transactions, the Company and a majority-owned subsidiary XL Financial Assurance Ltd. ("XLFA") have entered into contingent capital transactions as further described below. No up-front proceeds were received by the Company or XLFA under these transactions, however, in the event that the associated irrevocable put option agreements are exercised, proceeds previously raised from investors from the issuance of pass-through trust securities would be received in return for the issuance of preferred shares by the Company or XLFA, as applicable.

On December 10, 2004, XLFA entered into a put option agreement and an asset trust expense reimbursement agreement with Twin Reefs Asset Trust (the "Asset Trust"). The put option agreement provides XLFA with the irrevocable right to require the Asset Trust at any time and from time to time to purchase XLFA's non-cumulative perpetual

Series B Preferred Shares with an aggregate liquidation preference of up to \$200 million. There is no limit to the number of times that XLFA may exercise the put option, redeem the Series B Preferred Shares from the Asset Trust and exercise the put option again. XLFA is obligated to reimburse the Asset Trust for certain fees and ordinary expenses. To the extent that any Series B Preferred Shares are put to the Asset Trust and remain outstanding, a corresponding portion of such fees and ordinary expenses will be payable by XLFA pursuant to the asset trust expense reimbursement agreement. The put option agreement is perpetual but would terminate on delivery of notice by XLFA on or after December 9, 2009, or under certain defined circumstances, such as the failure of XLFA to pay the put option premium when due or bankruptcy. The premium payable by XLFA is the sum of certain trustee and investment managers expenses, the distribution of income paid to holders of the pass-through trust securities, less the investment yield on the eligible assets purchased using the proceeds originally raised from the issuance of the pass-through securities.

In July 2003, the Company entered into a contingent capital transaction with an aggregate value of \$500.0 million. This transaction provides the Company with an insurance trust that provides the Company with statutory relief under state insurance regulations in the U.S. Under the terms of this facility, the Company has acquired an irrevocable put option to issue preference ordinary shares into a trust in return for proceeds raised from investors. This put option may be exercised by the Company at any time. In addition, the Company may be required to issue preference ordinary shares to the trust under certain circumstances, including, but not limited to, the non-payment of the put option premium and a ratings downgrade of the Company. In connection with this transaction, the fair value of the put premiums and other related costs, in total of \$111.9 million was transferred from "Additional paid in capital" to a deferred liability which was established (included with "Other liabilities") in the consolidated balance sheet at December 31, 2003.

### Ratings

The Company's ability to underwrite business is dependent upon the quality of its claims paying and financial strength ratings as evaluated by independent rating agencies. As a result, in the event that the Company is downgraded, its ability to write business would be adversely affected in financial guaranty and long-tailed insurance and reinsurance lines of business. In the normal course of business, the Company evaluates its capital needs to support the volume of business written in order to maintain its claims paying and financial strength ratings. The Company regularly provides financial information to rating agencies to both maintain and enhance existing ratings.

The following are the current financial strength and claims paying ratings from internationally recognized rating agencies in relation to the Company's principal insurance and reinsurance subsidiaries and pools:

Rating agency	Rating
Standard & Poor's	AA- (Outlook Stable)
Fitch	AA (Ratings Watch Negative)
A.M. Best	A+ (Outlook Negative)
Moody's Investor Services	Aa2 (Outlook Negative except members of the XL America Pool, XL Re Ltd and XL Life Insurance and Annuity Company, which are rated Aa3.)

On July 12, 2005, XL Re Europe's rating from Standard & Poor's was raised to AA- (with a Stable Outlook) from A+ (with a Positive Outlook). The reason cited for the change by the agency was that Standard & Poor's had revised its view on the company from a strategically important subsidiary of XL Capital Ltd to a core operating subsidiary.

The following are the financial strength ratings from internationally recognized rating agencies in relation to the Company's principal financial guaranty insurance and reinsurance subsidiaries:

Rating agency	Rating
Standard & Poor's	AAA
Fitch	AAA
Moody's Investor Services	Aaa

In addition, XL Capital Ltd currently has the following long term debt ratings: "a-" (Outlook Negative Implications) from A.M. Best, "A" (Negative) from Standard and Poor's, "A2" (Outlook Negative) from Moody's and "A" (Ratings Watch Negative) from Fitch.

## Other

For information regarding cross-default and certain other provisions in the Company's debt and convertible securities documents, see Item 7 of the Company's Form 10-K for the year ended December 31, 2004.

The Company has had several share repurchase programs in the past as part of its capital management strategy. On January 9, 2000, the Board of Directors authorized a program for the repurchase of shares up to \$500.0 million. Under this plan, the Company has purchased 6.6 million shares at an aggregate cost of \$364.6 million or an average cost of \$55.24 per share. The Company has \$135.4 million remaining in its share repurchase authorization. During the six months ended June 30, 2005, no shares were repurchased in the open market. The Company has repurchased shares from employees and directors in relation to withholding tax on restricted stock. See Part II, Item 2 "Unregistered Sales of Equity Securities and Use of Proceeds", below.

### CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 ("PSLRA") provides a "safe harbor" for forward-looking statements. Any prospectus, prospectus supplement, the Company's Annual Report to ordinary shareholders, any proxy statement, any Form 10-K, other Form 10-Q or Form 8-K of the Company or any other written or oral statements made by or on behalf of the Company may include forward looking statements which reflect the Company's current views with respect to future events and financial performance. Such statements include forward-looking statements both with respect to the Company in general, and to the insurance, reinsurance and financial products and services sectors in particular (both as to underwriting and investment matters). Statements which include the words "expect", "intend", "plan", "believe", "project", "anticipate", "will", and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the PSLRA or otherwise.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in such statements. The Company believes that these factors include, but are not limited to, the following: (i) the adequacy of rates and in terms and conditions may not be as sustainable as the Company is currently projecting; (ii) the timely and full recoverability of reinsurance placed by the Company with third parties, or other amounts due to the Company, including, without limitation, amounts due to the Company from the Winterthur Swiss Insurance Company (a) in connection with the independent actuarial process or (b) under other contractual arrangements; (iii) the projected amount of ceded reinsurance recoverables and the ratings and creditworthiness of reinsurers may change; (iv) the timing of claims payments being faster or the receipt of reinsurance recoverables being slower than anticipated by the Company; (v) ineffectiveness or obsolescence of the Company's business strategy due to changes in current or future market conditions; (vi) increased competition on the basis of pricing, capacity, coverage terms or other factors; (vii) greater frequency or severity of claims and loss activity, including as a result of natural or man-made catastrophic events, than the Company's underwriting, reserving or investment practices anticipate based on historical experience or industry data; (viii) developments in the world's financial and capital markets that adversely affect the performance of the Company's investments and the Company's access to such markets; (ix) the potential impact on the Company from government-mandated insurance coverage for acts of terrorism; (x) the potential impact of variable interest entities or other off-balance sheet arrangements on the Company; (xi) developments in bankruptcy proceedings or other developments related to bankruptcies of companies insofar as they affect property and casualty insurance and reinsurance coverages or claims that the Company may have as a counterparty; (xii) availability of borrowings and letters of credit under the Company's credit facilities; (xiii) changes in regulation or tax laws applicable to the Company or its subsidiaries, brokers or customers; (xiv) acceptance of the Company's products and services, including new products and services; (xv) changes in the availability, cost or quality of reinsurance; (xvi) changes in the distribution or placement of risks due to increased consolidation of insurance and reinsurance brokers; (xvii) loss of key personnel; (xviii) the effects of mergers, acquisitions and divestitures; (xix) changes in rating agency policies or practices; (xx) changes in accounting policies or practices or the application thereof; (xxi) legislative or regulatory developments; (xxii) changes

in general economic conditions, including inflation, foreign currency exchange rates and other factors; (xxiii) the effects of business disruption or economic contraction due to war, terrorism or other hostilities; and (xxiv) the other factors set forth in the Company's other documents on file with the SEC. The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included herein or elsewhere. The Company undertakes no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future developments or otherwise.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Except as described below, there have been no material changes in the Company's market risk exposures, or how those exposures are managed, since December 31, 2004. The following discussion should be read in conjunction with "Quantitative and Qualitative Disclosures About Market Risk" presented under Item 7A of the Company's Form 10-K for the year ended December 31, 2004.

The Company enters into derivatives and other financial instruments primarily for risk management purposes. The Company's derivative transactions can expose the Company to credit default swap risk, weather and energy risk, investment market risk and foreign currency exchange rate risk. The Company attempts to manage these risks based on guidelines established by senior management. Derivative instruments are carried at fair value with resulting changes in fair value recognized in income in the period in which they occur.

Value-at-risk ("VaR") is one of the tools used by management to estimate potential losses in fair values using historical rates, market movements and credit spreads to estimate the volatility and correlation of these factors to calculate the potential loss that could occur over a defined period of time given a certain probability.

This risk management discussion and the estimated amounts generated from the sensitivity and VaR analyses presented in this document are forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these estimated results due to, among other things, actual developments in the global financial markets. The results of analysis used by the Company to assess and mitigate risk should not be considered projections of future events or losses. See generally "Cautionary Note Regarding Forward-Looking Statements" in Item 2.

#### Credit Default Swaps

The Company has written certain financial guaranty transactions in derivative or swap form. The Company does not actively trade these transactions and generally issues and holds these contracts to maturity. Changes in fair value can result from changes in market credit spreads, supply and demand for similar type instruments, changes in future loss and/or recovery estimates, interest rates and credit rating upgrades or downgrades. The Company therefore is at risk for

changes in fair value due to changes in any of the above factors. In addition, the Company enters into credit default swap transactions as part of its overall investment strategy.

### Weather and Energy Market Risk

The Company offers weather and energy risk management products in insurance or derivative form to end-users, while managing the risks in the over-the-counter and exchange traded derivatives markets in a weather and energy derivatives trading portfolio.

Fair values for the Company's natural gas derivative contracts are determined through the use of quoted market prices. As quoted market prices are not widely available in the weather derivative market, management uses available market data and internal pricing models based upon consistent statistical methodologies to estimate fair values. Estimating fair value of instruments that do not have quoted market prices requires management judgment in determining amounts that could reasonably be expected to be received from, or paid to, a third party in settlement of the contracts. The amounts could be materially different from the amounts that might be realized in an actual sale transaction. Fair values are subject to change in the near-term and reflect management's best estimate based on various fac-

tors including, but not limited to, realized and forecasted weather conditions, changes in commodity prices, changes in interest rates and other market factors.

The following table summarizes the movement in the fair value of weather and energy contracts outstanding during the six months ended June 30, 2005.

<b>(U.S. dollars in thousands)</b>	<b>(Unaudited) Six Months Ended June 30, 2005</b>
Fair value of contracts outstanding, beginning of the period	\$ 7,219
Net option premiums realized (1)	10,544
Reclassification of settled contracts to realized (2)	(2,482)
Other changes in fair value (3)	(10,132)
Fair value of contracts outstanding, end of period	\$ 5,149

(1) The Company received \$10 million of premiums and realized \$20.5 million of premiums on expired transactions for a net increase in the balance sheet derivative asset of \$10.5 million.

(2) The Company paid \$2.5 million to settle derivative positions during the period resulting in a reclassification of this amount from unrealized to realized and an increase in the derivative asset on the balance sheet.

(3) This represents the effects of changes in commodity prices, the time value of options, and other valuation adjustments.

The change in the fair value of contracts outstanding at June 30, 2005 as compared to the beginning of the period, is primarily due to favorable weather development in the European weather portfolio and the impact on seasonal contracts that are at the end of their risk periods.

The following table summarizes the maturity of contracts outstanding as of June 30, 2005:

<b>(U.S. dollars in thousands) (Unaudited)</b>	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>Greater Than 5 Years</b>	<b>Total Fair Value</b>
Prices actively quoted	\$ —	\$ —	\$ —	\$ —	\$ —
Prices based on models and other valuation methods	(6,241)	11,743	(354)	—	5,149
Total fair value of contracts outstanding	\$(6,241)	\$11,743	\$(354)	\$—	\$5,149

The Company manages its weather and energy portfolio through the employment of a variety of strategies. These include geographical and directional diversification of risk exposures and direct hedging within the capital and reinsurance markets. Risk management is undertaken on a product portfolio-wide basis, to maintain a portfolio that the Company believes is well diversified and which remains within the aggregate risk tolerance established by the Company's senior management.

The Company's aggregate average, low and high seasonal VaR amounts for its weather risk management portfolio, calculated at a 99% confidence level, during the period ended June 30, 2005 were \$100.8 million, \$86.0 million and \$115.1 million, respectively. The corresponding levels for the weather risk management portfolio during the period ended June 30, 2004 were \$163.2 million, \$126.5 million and \$214.0 million, respectively. The Company calculates its aggregate VaR by summing the VaR amounts for each of its seasonal portfolios. The Company's aggregation methodology yields a conservative aggregate portfolio VaR, given that current weather events and patterns have an immaterial effect on expectations for future seasons and the Company could therefore greatly reduce or eliminate

its VaR on future seasons by selling its positions prior to the beginning of a season. At present, the Company's VaR calculation does not exceed \$40.0 million in any one season.

For electricity generation outage insurance products, VaR is calculated using an annual holding period. Management has established an annual VaR limit of \$25.0 million for this book of business. The Company's average, low and high annual VaR amounts, calculated at a 99% confidence level, during the period ended June 30, 2005 were \$21.0 million, \$15.3 million, and \$28.8 million, respectively. The corresponding amounts during the period ended June 30, 2004 were \$4.2 million, \$2.6 million, and \$7.6 million, respectively.

### **Investment Market Risk**

The Company's investment portfolio consists of exposures to fixed income securities, equities, alternative investments, derivatives, business and other investments and cash. These securities and investments are denominated in both U.S. dollars and foreign currencies.

Through the structure of the Company's investment portfolio, the Company's earnings and book value are directly affected by changes in the valuations of the securities and investments held in the investment portfolio. These valuation changes reflect changes in interest rates (e.g. changes in the level, slope and curvature of the yield curves, volatility of interest rates, mortgage prepayment speeds and credit spreads), credit quality, equity prices (e.g. changes in prices and volatilities of individual securities, equity baskets and equity indices) and foreign currency exchange rates (e.g. changes in spot prices, forward prices and volatilities of currency rates). Market risk therefore arises due to the uncertainty surrounding the future valuations of these different assets, the factors that impact their values and the impact that this could have on the Company's earnings and book value.

The Company seeks to manage the risks of the investment portfolio through a combination of asset class, country, industry and security level diversification and investment manager allocations. These allocation decisions are made relative to the liability profile of the Company and the Company's surplus. Further, individual security and issuer exposures are generally controlled and monitored at the investment portfolio level, via specific investment constraints outlined in investment guidelines and agreed with the Company's external investment professionals. Additional constraints are generally agreed with the external investment professionals which may address exposures to eligible securities, prohibited investments/transactions, credit quality and general concentration limits.

The Company's direct use of investment derivatives includes futures, forwards, swaps and option contracts that derive their value from underlying assets, indices, reference rates or a combination of these factors. When investment guidelines allow for the use of derivatives, these can generally only be used for the purposes of managing interest rate risk, foreign exchange risk, credit risk and replicating permitted investments, provided the use of such instruments is incorporated in the overall portfolio duration, spread, convexity and other relevant portfolio metrics. The direct use of derivatives to economically leverage the portfolio outside of the stated guidelines is generally not permitted. Derivatives may also be used to add value to the investment portfolio where market inefficiencies are perceived to exist, to utilize cash holdings to purchase equity indexed derivatives and to adjust the duration of a portfolio of fixed income securities to match the duration of related deposit liabilities.

### **Investment Value-At-Risk**

The VaR of the Company's total investment portfolio at June 30, 2005, based on a 95% confidence level with a one month holding period, was approximately \$511.2 million as compared to \$487.3 million as at December 31, 2004. The VaR of all investment related derivatives as at June 30, 2005 was approximately \$15.8 million as compared to \$15.1 million as at December 31, 2004. The Company's investment portfolio VaR as at June 30, 2005 is not necessarily indicative of future VaR levels.

To complement the VaR analysis which is based on normal market environments, the Company considers the potential impact on the investment portfolio of several different historical stress periods to analyze the effect of unusual market conditions. The Company establishes certain historical stress test scenarios which are applied to the actual investment portfolio. As these stress tests and estimated gains and losses are based on historical events, they will not necessarily reflect future stress events or gains and losses from such events. The results of the stress test scenarios are reviewed on a regular basis to ensure they reflect current shareholders' equity, market conditions and the Company's total risk tolerance. Given the investment portfolio allocations as at June 30, 2005, the Company would

expect to lose approximately 5.8% of the portfolio if the most damaging event stress tested was repeated, all other things held equal, as compared to 5.7% at December 31, 2004. Given the investment portfolio allocations as at June 30, 2005, the Company would expect to gain approximately 19.7% on the portfolio if the most favorable event stress tested was repeated, all other things held equal, as compared to 18.4% at December 31, 2004. The Company assumes that no action is taken during the stress period to either liquidate or rebalance the portfolio and believes that this fairly reflects the potential decreased liquidity that is often associated with stressed market environments.

### **Fixed Income Portfolio**

The Company's fixed income portfolio is exposed to credit and interest rate risk. The fixed income portfolio includes fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased.

As at June 30, 2005, the value of the Company's fixed income portfolio, including cash and cash equivalents and net payable for investments purchased, was approximately \$32.8 billion as compared to approximately \$28.9 billion as at December 31, 2004. As at June 30, 2005, the fixed income portfolio consisted of approximately 90.2% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) as compared to approximately 89.1% as at December 31, 2004.

The table below shows the Company's fixed income portfolio by credit rating in percentage terms of the Company's total fixed income portfolio (including fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased) as at June 30, 2005.

**Total**

AAA	55.6%
AA	12.6%
A	17.3%
BBB	10.9%
BB & BELOW	3.1%
NR	0.5%
<hr/>	
Total	100.0%

At June 30, 2005, the average credit quality of the Company's total fixed income portfolio was "AA".

As at June 30, 2005, the top 10 corporate holdings, which exclude government guaranteed and government sponsored represented approximately 4.1% of all corporate holdings. The top 10 corporate holdings listed below represent the direct exposure to the corporations listed below, including their subsidiaries, and excludes any securitized, credit enhanced and collateralized asset or mortgage backed securities, and excludes any reduction to this exposure through credit default swaps, if applicable.

<b>Top 10 Corporate Holdings</b>	<b>Percentage of Total Fixed Income Portfolio (1)</b>
General Electric Company	0.5%
Citigroup Inc	0.5%
Lloyds TSB Group plc	0.4%
HBOS plc	0.4%
Royal Bank of Scotland Group plc	0.4%
Bank of America Corp	0.4%
Morgan Stanley	0.4%
Banco Santander Central Hispano SA	0.4%
Wal-Mart Stores Inc.	0.4%
Goldman Sachs Group Inc	0.3%

(1) Including fixed maturities, short-term investments, cash and cash equivalents and net payable for investments purchased.

The Company's fixed income portfolio is exposed to interest rate risk. Interest rate risk is the price sensitivity of a fixed income security to changes in interest rates. The hypothetical case of an immediate 100 basis point adverse parallel shift in global bond curves as at June 30, 2005 would decrease the fair value of the Company's fixed income portfolio by approximately 4.7% or \$1.5 billion as compared to approximately 4.4% or \$1.3 billion as at December 31, 2004. Based on historical observations, it is unlikely that all global yield curves would shift in the same direction, by the same amount and at the same time.

### Equity Portfolio

As at June 30, 2005, the Company's equity portfolio, which for financial reporting purposes includes certain fixed income mutual fund investments that do not have the risk characteristics of equity investments, was \$918.7 million as compared to \$962.9 million as at December 31, 2004. As at June 30, 2005, the Company's allocation to equity securities was approximately 2.5% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) as compared to approximately 3.0% as at December 31, 2004.

As at June 30, 2005, approximately 55% of the equity portfolio was invested in U.S. companies as compared to approximately 60% as at December 31, 2004. As at June 30, 2005, the top ten equity holdings represented approximately 7.7% of the Company's total equity portfolio as compared to approximately 8.0% as at December 31, 2004.

The Company's equity portfolio is exposed to price risk. Equity price risk is the potential loss arising from decreases in the market value of equities. An immediate hypothetical 10% change in the value of each equity position would affect the fair value of the portfolio by approximately \$91.9 million as at June 30, 2005 as compared to \$96.3 million as at December 31, 2004.

### Alternative Investment Portfolio

The Company's alternative investment portfolio (included in investments in affiliates or other investments) had approximately 80 separate fund investments at June 30, 2005 with a total portfolio of \$1.7 billion representing approximately 4.7% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased) as compared to December 31, 2004 where the Company had approximately 100 separate fund investments with a total portfolio of \$1.7 billion representing approximately 5.2% of the total investment portfolio.

As at June 30, 2005, the alternative investment style allocation was 49% in directional/tactical strategies, 26% in event-driven strategies, 22% in arbitrage strategies, and 3% in multi-strategy strategies. As at December 31, 2004, the alternative investment style allocation was 42% in directional/tactical strategies, 25% in event-driven strategies, 25% in arbitrage strategies, and 8% in multi-strategy strategies.

### Private Investment Portfolio

As at June 30, 2005, the Company's exposure to private investments was approximately \$213 million compared to \$206 million as at December 31, 2004. As at June 30, 2005, the Company's exposure to private investments comprised approximately 0.6% of the total investment portfolio (including cash and cash equivalents, accrued investment income and net payable for investments purchased), as compared to 0.6% as at December 31, 2004.

### **Bond and Stock Index Futures Exposure**

As at June 30, 2005, bond and stock index futures outstanding had a net short position of \$102.4 million as compared to a net long position of \$1.3 billion as at December 31, 2004. A 10% appreciation or depreciation of the underlying exposure to these derivative instruments would have resulted in realized gains or realized losses of \$10.2 million as at June 30, 2005 and \$129.5 million as at December 31, 2004, respectively. The Company may reduce its exposure to these futures through offsetting transactions, including options and forwards.

---

### **Foreign Currency Exchange Risk**

The Company has exposure to foreign currency exchange rate fluctuations through its operations, unpaid losses and loss expenses and in its investment portfolio. The Company's net foreign currency denominated payable on foreign exchange contracts as at June 30, 2005 was \$106.0 million as compared to \$3.8 million as at December 31, 2004, with a net unrealized gain of \$0.1 million as compared to a net unrealized loss of \$11.8 million as at December 31, 2004.

Foreign exchange contracts within the investment portfolio are utilized to manage individual portfolio foreign exchange exposures, subject to investment manager guidelines established by management. These contracts are not designated as specific hedges for financial reporting purposes and, therefore, realized and unrealized gains and losses on these contracts are recorded in income in the period in which they occur. These contracts generally have maturities of three months or less.

The Company also attempts to manage the foreign exchange volatility arising on certain transactions denominated in foreign currencies. These include, but are not limited to, premium receivable, reinsurance contracts, claims payable and investments in subsidiaries.

### **Credit Risk**

The Company is exposed to credit risk in the event of non-performance by the other parties to the forward contracts, however the Company does not anticipate non-performance. The difference between the notional principal amounts and the associated market value is the Company's maximum credit exposure.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that all material information relating to the Company required to be filed in this report has been made known to them in a timely fashion.

### **Changes in Internal Control Over Financial Reporting**

There have been no changes in internal control over financial reporting identified in connection with the Company's evaluation required pursuant to Rules 13a-15 and 15d-15 promulgated under the Securities Exchange Act of 1934, as amended, that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

---

## **PART II — OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

On June 21, 2004, a consolidated and amended class action complaint (the "Amended Complaint") was served on the Company and certain of its present and former directors and officers as defendants in a putative class action (Malin et al. v. XL Capital Ltd et al.) filed in United States District Court, District of Connecticut (the "Malin Action"). The Malin Action purports to be on behalf of purchasers of the Company's common stock between November 1, 2001 and October 16, 2003, and alleges claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder ("Securities Laws"). The Amended Complaint alleges that the defendants violated the Securities Laws by, among other things, failing to disclose in various public and shareholder and investor reports and other communications the alleged inadequacy of the Company's loss reserves for its NAC Re subsidiary (now known as XL Reinsurance America, Inc.) and that, as a consequence, the Company's earnings and assets were materially overstated. Defendants filed a motion to dismiss the Amended Complaint which motion is pending before the Court. Defendants have recently filed a separate motion to dismiss the claims of each of the plaintiffs who have appeared in the litigation for lack of their ability to prove loss causation and the resulting absence of the court's subject matter jurisdiction under a recent decision of the United States Supreme Court. There has been no discovery in the Malin Action. The Company and the defendant present and former officers and directors intend to vigorously defend the claims asserted against them.

On June 17, 2004, William Kronenberg, III, Frank A. Piliero and David M. Rosenberg (together, the "Claimants") commenced an arbitration against the Company before the American Arbitration Association ("AAA") in New York, New York. The Claimants and the Company were parties to a stock purchase agreement dated June 1, 1999, pursuant to which the Company acquired the outstanding capital stock of ECS, Inc (the "Stock Purchase Agreement"). In their AAA arbitration demand, the Claimants assert claims of fraud and deceitful conduct, negligent misrepresentation, and breach of contract and a covenant of good faith and fair dealing, all relating to the allegation that the Company failed to make certain contingent payments allegedly due to the Claimants under the Stock Purchase Agreement. Claimants seek \$85 million (the maximum amount payable under the contingent payment provision at issue), plus punitive damages, interest, costs and attorneys' fees. On July 30, 2004, the Company filed an Answering Statement and Motion to Stay or Dismiss the AAA arbitration. On April

13, 2004, the Company commenced a separate arbitration procedure, as provided in the Stock Purchase Agreement, but the Claimants have refused to participate in this procedure. On July 15, 2004, the Company filed a petition in the United States District Court for the Southern District of New York, seeking an order of the Court compelling the Claimants to arbitrate the dispute pursuant to those procedures and staying or dismissing the AAA arbitration. On September 19, 2004, the District Court denied the Company's petition. On October 22, 2004, the Company filed an appeal of the District Court's decision to the United States Court of Appeals for the Second Circuit. The appeal has been fully briefed and argued, but has not yet been decided. Hearings in the AAA arbitration commenced on July 25, 2005 and are currently underway. The Company is vigorously defending the Claimants' claims.

The Company is also subject to litigation and arbitration in the normal course of its business. These lawsuits and arbitrations principally involve claims on policies of insurance and contracts of reinsurance and are typical for the Company and for the property and casualty insurance and reinsurance industry in general. Such legal proceedings are considered in connection with the Company's loss and loss expense reserves. Reserves in varying amounts may or may not be established in respect of particular claims proceedings based on many factors, including the legal merits thereof. In addition to claims litigation, the Company and its subsidiaries are subject to lawsuits in the normal course of business that do not arise from or directly relate to claims on policies of insurance or contracts of reinsurance.

As previously disclosed, in May and June of 2005, the Company received a subpoena from the SEC and a grand jury subpoena from the U.S. Attorney's Office for the Southern District of New York, respectively, in each case for documents and information relating to certain finite risk and loss mitigation insurance products. The Company is fully cooperating and responding to these requests.

The Company believes that the ultimate outcome of all outstanding litigation and arbitration will not have a material adverse effect on its consolidated financial condition, future operating results and/or liquidity, although an adverse resolution of a number of these items could have a material adverse effect on the Company's results of operations in a particular fiscal quarter or year.

Although not a litigation or arbitration, the Company has entered into a binding independent actuarial valuation process related to certain contractual agreements in the sale and purchase agreement, as amended ("SPA"), relating to the Company's acquisition of Winterthur International in July 2001. This process is further described in Item 1, Note 12 to the Unaudited Consolidated Financial Statements and Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations." The parties are in the process of making oral and written submissions to the independent actuary, and the current schedule contemplates that the independent actuary will make his determinations prior to year-end.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**(c) Purchases of Equity Securities by the Issuer and Affiliate Purchasers**

The following table provides information about purchases by the Company during the three months ended June 30, 2005 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

**ISSUER PURCHASES OF EQUITY SECURITIES**

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs		Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (3)
			Publicly Announced Plans or Programs	Part of Publicly Announced Plans or Programs	
April 1-30, 2005	6,136	\$72.53	—	—	\$135.4 million
May 1-31, 2005	906	73.32	—	—	\$135.4 million
June 1-30, 2005	174	75.69	—	—	\$135.4 million
<b>Total</b>	<b>7,216</b>	<b>\$72.70</b>	<b>—</b>	<b>—</b>	<b>\$135.4 million</b>

(1) All of the shares included in each period were purchased in connection with the vesting of restricted shares granted under the Company's restricted stock plan. All of these purchases were made in connection with satisfying tax withholding obligations of those employees. These shares were not purchased as part of the Company's publicly announced share repurchase program.

(2) The price paid per share is the closing price of the shares on the vesting date.

(3) On January 9, 2000, the Board of Directors previously authorized a \$500.0 million share repurchase program. The Company did not repurchase any equity securities under the share repurchase program during the three or six months ended June 30, 2005. As of June 30, 2005, the Company could repurchase up to approximately \$135.4 million of its equity securities under the share repurchase program.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

At the Annual General Meeting of holders (the "Shareholders") of Class A Ordinary Shares held on April 29, 2005 at the Executive Offices of the Company, XL House, One Bermudiana Road, Hamilton HM 11, Bermuda, the Shareholders approved the following:

1. The election of four Class I Directors to hold office until 2008:

	Votes in Favor	Votes Withheld
M. P. Esposito, Jr.	121,004,202	1,695,660
R. R. Glauber	108,704,400	13,995,462
C.Rance	120,836,553	1,863,309
E. E. Thrower	121,331,270	1,368,592

64

In addition, the terms of the following Directors continued after the Annual General Meeting: D.R. Comey, B.M. O'Hara, J.T. Thornton, J.W. Weiser, J. Loudon, R.S. Parker, A.Z. Senter and E.M. McQuade. Messrs. Glauber and Loudon have resigned from the Board of Directors as of May 19, 2005 and June 8, 2005, respectively.

2. The appointment of PricewaterhouseCoopers LLP, New York, New York, to act as the independent auditors of the Company for the year ending December 31, 2005:

Votes In Favor	Votes Against	Abstentions
121,750,119	269,679	686,682

3. The amendment and restatement of the Company's 1991 Performance Incentive Program:

Votes In Favor	Votes Against	Abstentions	Broker Non-Votes
80,543,819	33,109,313	743,346	8,303,384

## ITEM 5. OTHER INFORMATION

On August 3, 2005, the Company, together with its wholly-owned subsidiaries X.L. America, Inc., a Delaware corporation ("XLA"), XL Insurance (Bermuda) Ltd, a Bermuda exempted company ("XLI"), and XL Re Ltd, a Bermuda exempted company ("XLRe" and, together with the Company, XLA and XLI, the "Obligors"), entered into a \$100,000,000 5-year revolving credit agreement (the "Agreement") with Bear Stearns Corporate Lending Inc., as Administrative Agent, and the Lenders party thereto.

The Agreement provides for up to \$100,000,000 of revolving credit loans. Interest and fees payable under the Agreement shall be determined pursuant to the terms set forth therein. The commitments under the Agreement will expire on, and amounts borrowed under the Agreement may be borrowed, repaid and reborrowed from time to time until, the earlier of (i) August 3, 2010 and (ii) the date of termination in whole of the commitments upon an optional termination or reduction of the commitments by the Obligors or upon an event of default. Each of the Company, XLA, XLI and XLRe guarantees the obligations of the other Obligors under the Agreement. The Agreement contains financial covenants that require the Company to maintain a minimum consolidated net worth and a maximum ratio of total consolidated debt to the sum of total consolidated debt plus consolidated net worth. In addition, the Agreement contains other customary affirmative and negative covenants for credit facilities of this type as well as certain customary events of default. The foregoing description of the Agreement is qualified in its entirety by reference to the Agreement, which is attached hereto as Exhibit 10.3 and incorporated herein by reference.

Bear Stearns Corporate Lending Inc. and its affiliates have, from time to time, performed various investment or commercial banking and financial advisory services for the Obligors in the ordinary course of business.

## ITEM 6. EXHIBITS

10.1 Amendment No.1, dated as of June 22, 2005, to the Three-Year Credit Agreement, dated as of June 23, 2004, between XL Capital Ltd, X.L. America, Inc., XL Insurance (Bermuda) Ltd and XL Re Ltd, as Account Parties and Guarantors, the lenders party thereto, and JPMorgan Chase Bank N.A., as Administrative Agent, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 27, 2005.

10.2 Credit Agreement, dated as of June 22, 2005, between XL Capital Ltd, X.L. America, Inc., XL Insurance (Bermuda) Ltd and XL Re Ltd, as Account Parties and Guarantors, the lenders party thereto and JPMorgan Chase Bank N.A., as Administrative Agent, incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on June 27, 2005.

10.3 Credit Agreement, dated as of August 3, 2005, between XL Capital Ltd, X.L. America, Inc., XL Insurance (Bermuda) Ltd and XL Re Ltd, as Borrowers and Guarantors, the Lenders party thereto and Bear Stearns Corporate Lending Inc. as Administrative Agent.

65

31 Rule 13a-14(a)/15d-14(a) Certifications.

32 Section 1350 Certification.

99.1 XL Capital Assurance Inc. condensed consolidated financial statements (unaudited) for the three and six month periods ended June 30, 2005 and 2004.

99.2 XL Financial Assurance Ltd. condensed financial statements (unaudited) for the three and six month periods ended June 30, 2005 and 2004.

---

**SIGNATURES**

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**XL CAPITAL LTD**

(Registrant)

Date: August 4, 2005

/s/ **BRIAN M. O'HARA**\_\_\_\_\_  
Brian M. O'Hara*President and Chief Executive Officer*

Date: August 4, 2005

/s/ **JERRY DE ST. PAER**\_\_\_\_\_  
Jerry de St. Paer*Executive Vice President and Chief Financial Officer*

## CREDIT AGREEMENT

dated as of

August 3, 2005

between

XL CAPITAL LTD,  
X.L. AMERICA, INC., XL INSURANCE (BERMUDA) LTD and XL RE LTD,  
as Borrowers and Guarantors,

and

BEAR STEARNS CORPORATE LENDING INC.,  
as Lender

\_\_\_\_\_  
\$100,000,000  
\_\_\_\_\_

## TABLE OF CONTENTS

	<u>Page</u>
ARTICLE I	1
DEFINITIONS	1
SECTION 1.01. <u>Defined Terms</u>	1
SECTION 1.02. <u>Terms Generally</u>	13
SECTION 1.03. <u>Accounting Terms; GAAP and SAP</u>	14
ARTICLE II	14
THE CREDITS	14
SECTION 2.01. <u>Loans and Borrowings</u>	14
SECTION 2.02. <u>Requests for Borrowings</u>	15
SECTION 2.03. <u>Funding of Borrowings</u>	16
SECTION 2.04. <u>Interest Elections</u>	17
SECTION 2.05. <u>Termination and Reduction of the Commitments</u>	18
SECTION 2.06. <u>Repayment of Loans; Evidence of Debt</u>	18
SECTION 2.07. <u>Prepayment of Loans</u>	19
SECTION 2.08. <u>Fees</u>	20
SECTION 2.09. <u>Interest</u>	20
SECTION 2.10. <u>Alternate Rate of Interest</u>	21
SECTION 2.11. <u>Increased Costs</u>	21
SECTION 2.12. <u>Break Funding Payments</u>	22
SECTION 2.13. <u>Taxes</u>	23
SECTION 2.14. <u>Payments Generally; Pro Rata Treatment; Sharing of Set-offs</u>	24
SECTION 2.15. <u>Mitigation Obligations; Replacement of Lenders</u>	26
ARTICLE III	27
GUARANTEE	27
SECTION 3.01. <u>The Guarantee</u>	27
SECTION 3.02. <u>Obligations Unconditional</u>	27
SECTION 3.03. <u>Reinstatement</u>	28
SECTION 3.04. <u>Subrogation</u>	28
SECTION 3.05. <u>Remedies</u>	28
SECTION 3.06. <u>Continuing Guarantee</u>	28
SECTION 3.07. <u>Rights of Contribution</u>	28
SECTION 3.08. <u>General Limitation on Guarantee Obligations</u>	29
ARTICLE IV	30
REPRESENTATIONS AND WARRANTIES	30
SECTION 4.01. <u>Organization; Powers</u>	30

SECTION 4.02.	<u>Authorization; Enforceability</u>	30
SECTION 4.03.	<u>Governmental Approvals; No Conflicts</u>	30
SECTION 4.04.	<u>Financial Condition; No Material Adverse Change</u>	30

---

SECTION 4.05.	<u>Properties</u>	31
SECTION 4.06.	<u>Litigation and Environmental Matters</u>	31
SECTION 4.07.	<u>Compliance with Laws and Agreements</u>	31
SECTION 4.08.	<u>Investment and Holding Company Status</u>	31
SECTION 4.09.	<u>Taxes</u>	32
SECTION 4.10.	<u>ERISA</u>	32
SECTION 4.11.	<u>Disclosure</u>	32
SECTION 4.12.	<u>Use of Credit</u>	32
SECTION 4.13.	<u>Subsidiaries</u>	33
SECTION 4.14.	<u>Withholding Taxes</u>	33
SECTION 4.15.	<u>Stamp Taxes</u>	33
SECTION 4.16.	<u>Legal Form</u>	33

ARTICLE V		33
CONDITIONS		33

SECTION 5.01.	<u>Effective Date</u>	33
SECTION 5.02.	<u>Each Credit Event</u>	34

ARTICLE VI		35
AFFIRMATIVE COVENANTS		35

SECTION 6.01.	<u>Financial Statements and Other Information</u>	35
SECTION 6.02.	<u>Notices of Material Events</u>	37
SECTION 6.03.	<u>Preservation of Existence and Franchises</u>	37
SECTION 6.04.	<u>Insurance</u>	37
SECTION 6.05.	<u>Maintenance of Properties</u>	37
SECTION 6.06.	<u>Payment of Taxes and Other Potential Charges and Priority Claims;</u> <u>Payment of Other Current Liabilities</u>	38
SECTION 6.07.	<u>Financial Accounting Practices</u>	38
SECTION 6.08.	<u>Compliance with Applicable Laws</u>	38
SECTION 6.09.	<u>Use of Loan Proceeds</u>	39
SECTION 6.10.	<u>Continuation of and Change in Businesses</u>	39
SECTION 6.11.	<u>Visitation</u>	39
SECTION 6.12.	<u>Most Favored Lender Status</u>	39

ARTICLE VII		40
NEGATIVE COVENANTS		40

SECTION 7.01.	<u>Mergers</u>	40
SECTION 7.02.	<u>Dispositions</u>	40
SECTION 7.03.	<u>Liens</u>	41
SECTION 7.04.	<u>Transactions with Affiliates</u>	42
SECTION 7.05.	<u>Ratio of Total Funded Debt to Total Capitalization</u>	43
SECTION 7.06.	<u>Consolidated Net Worth</u>	43
SECTION 7.07.	<u>Indebtedness</u>	43
SECTION 7.08.	<u>Financial Strength Ratings</u>	43
SECTION 7.09.	<u>Private Act</u>	43
SECTION 7.10.	<u>Ratable Borrowings</u>	43

---

ARTICLE VIII		44
EVENTS OF DEFAULT		44

ARTICLE IX		46
THE ADMINISTRATIVE AGENT		46

ARTICLE X		48
MISCELLANEOUS		48

SECTION 10.01.	<u>Notices</u>	48
SECTION 10.02.	<u>Waivers; Amendments</u>	49
SECTION 10.03.	<u>Expenses; Indemnity; Damage Waiver</u>	50
SECTION 10.04.	<u>Successors and Assigns</u>	51
SECTION 10.05.	<u>Survival</u>	54

SECTION 10.06.	<u>Counterparts; Integration; Effectiveness</u>	54
SECTION 10.07.	<u>Severability</u>	55
SECTION 10.08.	<u>Right of Setoff</u>	55
SECTION 10.09.	<u>Governing Law; Jurisdiction; Etc</u>	55
SECTION 10.10.	<u>WAIVER OF JURY TRIAL</u>	56
SECTION 10.11.	<u>Headings</u>	56
SECTION 10.12.	<u>Treatment of Certain Information; Confidentiality</u>	56
SECTION 10.13.	<u>Judgment Currency</u>	57
SECTION 10.14.	<u>USA PATRIOT Act</u>	58

SCHEDULE I	- Commitments
SCHEDULE II	- Indebtedness and Liens
SCHEDULE III	- Litigation
SCHEDULE IV	- Environmental Matters
SCHEDULE V	- Subsidiaries
EXHIBIT A	- Form of Assignment and Assumption
EXHIBIT B-1	- Form of Opinion of Counsel to XL Capital
EXHIBIT B-2	- Form of Opinion of Counsel to XL America
EXHIBIT B-3	- Form of Opinion of Special U.S. Counsel to the Obligors
EXHIBIT B-4	- Form of Opinion of Special Bermuda Counsel to XL Insurance and XL Re
EXHIBIT B-5	- Form of Opinion of Special Cayman Islands Counsel to XL Capital

CREDIT AGREEMENT dated as of August 3, 2005, between XL CAPITAL LTD, a Cayman Islands exempted limited liability company ("XL Capital"), X.L. AMERICA, INC., a Delaware corporation ("XL America"), XL INSURANCE (BERMUDA) LTD, a Bermuda limited liability company ("XL Insurance") and XL RE LTD, a Bermuda limited liability company ("XL Re" and, together with XL Capital, XL America and XL Insurance, each a "Borrower" and each a "Guarantor" and collectively, the "Borrowers" and the "Guarantors"; the Borrowers and the Guarantors being collectively referred to as the "Obligors"), the LENDERS party hereto, and BEAR STEARNS CORPORATE LENDING INC., as Administrative Agent.

The Borrowers have requested that the Lenders make loans to them in an aggregate principal amount not exceeding \$100,000,000 at any one time outstanding, and the Lenders are prepared to make such loans upon the terms and conditions hereof. Accordingly, the parties hereto agree as follows:

## ARTICLE I

### DEFINITIONS

SECTION 1.01. Defined Terms. As used in this Agreement, the following terms have the meanings specified below:

"ABR", when used in reference to any Loan or Borrowing, refers to whether such Loan, or the Loans constituting such Borrowing, are bearing interest at a rate determined by reference to the Alternate Base Rate.

"Adjusted LIBO Rate" means, for the Interest Period for any Eurodollar Borrowing, an interest rate per annum (rounded upwards, if necessary, to the next 1/16 of 1%) equal to (a) the LIBO Rate for such Interest Period multiplied by (b) the Statutory Reserve Rate for such Interest Period.

"Administrative Agent" means Bear Stearns Corporate Lending Inc., in its capacity as administrative agent for the Lenders hereunder.

"Administrative Questionnaire" means an Administrative Questionnaire in a form supplied by the Administrative Agent.

"Affiliate" means, with respect to a specified Person, another Person that directly, or indirectly, Controls or is Controlled by or is under common Control with the Person specified.

"Aggregate Credit Exposure" means the aggregate amount of the Credit Exposures of each of the Lenders.

"Alternate Base Rate" means, for any day, a rate per annum equal to the greater of (a) the Prime Rate in effect on such day, and (b) the Federal Funds Effective Rate for such day plus 1/2 of 1%. Any change in the Alternate Base Rate due to a change

in the Prime Rate or the Federal Funds Effective Rate shall be effective from and including the effective date of such change in the Prime Rate or the Federal Funds Effective Rate, as the case may be.

### Credit Agreement

- 2 -

“Applicable Additional Margin” means a rate per annum equal to 0.10% for any period during which the aggregate outstanding principal amount of the Loans shall be greater than 50% of the Commitments then in effect.

“Applicable Margin” means, with respect to any Eurodollar Loan, the rate per annum specified under the caption “Applicable Margin” in the table contained in the definition of “Applicable Rate” in this Section or otherwise determined in accordance with such definition.

“Applicable Percentage” means, with respect to any Lender, the percentage of the Commitments of all the Lenders represented by such Lender’s Commitment. If the Commitments have terminated or expired, the Applicable Percentages shall be determined based upon the Commitments most recently in effect, giving effect to any assignments.

“Applicable Rate” means, for any day, with respect to interest margins applicable to Eurodollar Loans or the facility fees payable hereunder, as the case may be, the applicable rate per annum set forth below under the caption “Applicable Margin” or “Applicable Facility Fee Rate”, respectively, based upon the S&P Rating and/or Moody’s Rating, on such date:

S&P/ Moody’s Ratings	Applicable Margin	Applicable Facility Fee Rate
≥ A+/A1	0.19%	0.06%
A/A2	0.23%	0.07%
A-/A3	0.27%	0.08%
≤ BBB+/Baa1 or unrated	0.40%	0.10%

For purposes of the foregoing, (i) if either Moody’s or S&P shall not have in effect a Moody’s Rating or a S&P Rating, as the case may be (other than by reason of the circumstances referred to in the last sentence of this definition), then the Applicable Rate shall be based upon the remaining rating, (ii) if the Moody’s Rating and the S&P Rating shall fall within different ratings, the Applicable Rate shall be based on the higher of the two ratings unless one of the two ratings is two or more Categories higher than the other, in which case the Applicable Rate shall be determined by reference to the ratings level next above that of the lower of the two ratings, and (iii) if the Moody’s Rating and the S&P Rating established or deemed to have been established by Moody’s and S&P, respectively, shall be changed (other than as a result of a change in the rating system of Moody’s or S&P), such change shall be effective as of the date on which it is first announced by the applicable rating agency. Each change in the Applicable Rate shall apply during the period commencing on the effective date of such change and ending on the date immediately preceding the effective date of the next such change. If the rating system of

### Credit Agreement

- 3 -

Moody’s or S&P shall change, or if either such rating agency shall cease to be in the business of providing insurance ratings, XL Capital and the Lenders shall negotiate in good faith to amend this definition to reflect such changed rating system or the unavailability of ratings from such rating agency and, pending the effectiveness of any such amendment, the Applicable Rate shall be determined by reference to the rating most recently in effect prior to such change or cessation.

“Approved Fund” means any Person (other than a natural person) that is engaged in making, purchasing, holding or investing in bank loans and similar extensions of credit in the ordinary course of its business and that is administered or managed by (a) a Lender or any Other Lender, (b) an Affiliate of a Lender or any Other Lender or (c) an entity or an Affiliate of an entity that administers or manages a Lender or any Other Lender.

“Assignment and Assumption” means an assignment and assumption entered into by a Lender and an assignee (with the consent of any party whose consent is required by Section 10.04), and accepted by the Administrative Agent, in the form of Exhibit A or any other form approved by the Administrative Agent.

“Availability Period” means the period from and including the Effective Date to but excluding the Commitment Termination Date.

“Board” means the Board of Governors of the Federal Reserve System of the United States of America.

“Borrower Jurisdiction” means (a) Bermuda, (b) the Cayman Islands and (c) any other country (i) where any Borrower is licensed or qualified to do business or (ii) from or through which payments hereunder are made by any Borrower.

“Borrowers” means each of XL Capital, XL America, XL Insurance and XL Re.

“Borrowing” means, with respect to any Borrower, (a) all ABR Loans of such Borrower made, converted or continued on the same date or (b) all Eurodollar Loans of such Borrower that have the same Interest Period.

“Borrowing Request” means a request by a Borrower for a Borrowing in accordance with Section 2.02.

“Business Day” means any day (a) that is not a Saturday, Sunday or other day on which commercial banks in New York City, London, the Cayman Islands or Bermuda are authorized or required by law to remain closed and (b) if such day relates to a borrowing of, a payment or prepayment of principal of or interest on, a continuation or conversion of or into, or the Interest Period for, a Eurodollar Loan, or to a notice by a Borrower with respect to any such borrowing, payment, prepayment, continuation, conversion, or Interest Period, that is also a day on which dealings in Dollar deposits are carried out in the London interbank market.

“Capital Lease Obligations” of any Person means the obligations of such Person to pay rent or other amounts under any lease of (or other arrangement conveying the right to use) real or personal property, or a combination thereof, which obligations are required to be classified and accounted for as capital leases on a balance sheet of such Person under GAAP, and

### Credit Agreement

---

- 4 -

the amount of such obligations shall be the capitalized amount thereof determined in accordance with GAAP.

“Change in Control” means the occurrence of any of the following events or conditions: (a) any Person, including any syndicate or group deemed to be a Person under Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, acquires beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition transaction or series of transactions, of shares of capital stock of XL Capital entitling such Person to exercise 40% or more of the total voting power of all shares of capital stock of XL Capital that is entitled to vote generally in elections of directors, other than an acquisition by XL Capital, any of its Subsidiaries or any employee benefit plans of XL Capital; or (b) XL Capital merges or consolidates with or into any other Person (other than a Subsidiary), another Person (other than a Subsidiary) merges into XL Capital or XL Capital conveys, sells, transfers or leases all or substantially all of its assets to another Person (other than a Subsidiary), other than any transaction: (i) that does not result in a reclassification, conversion, exchange or cancellation of the outstanding shares of capital stock of XL Capital (other than the cancellation of any outstanding shares of capital stock of XL Capital held by the Person with whom it merges or consolidates) or (ii) which is effected solely to change the jurisdiction of incorporation of XL Capital and results in a reclassification, conversion or exchange of outstanding shares of capital stock of XL Capital solely into shares of capital stock of the surviving entity; or (c) a majority of the members of XL Capital’s board of directors are persons who are then serving on the board of directors without having been elected by the board of directors or having been nominated for election by its shareholders.

“Change in Law” means (a) the adoption of any law, rule or regulation after the date of this Agreement, (b) any change in any law, rule or regulation or in the interpretation or application thereof by any Governmental Authority after the date of this Agreement or (c) compliance by any Lender (or, for purposes of Section 2.11(b), by any lending office of such Lender or by such Lender’s holding company, if any) with any request, guideline or directive (whether or not having the force of law) of any Governmental Authority made or issued after the date of this Agreement.

“Code” means the Internal Revenue Code of 1986, as amended from time to time.

“Commitment” means, with respect to any Lender, the commitment of such Lender to make Loans under Section 2.01, in each case expressed as an amount representing the maximum aggregate amount of such Lender’s Credit Exposure hereunder, as such commitment may be (i) reduced from time to time pursuant to Section 2.05 and (ii) reduced or increased from time to time pursuant to assignments by or to such Lender pursuant to Section 10.04. The initial amount of each Lender’s Commitment is set forth on Schedule I or in the Assignment and Assumption pursuant to which such Lender shall have assumed its Commitment, as applicable. The initial aggregate amount of the Lenders’ Commitments is \$100,000,000.

“Commitment Termination Date” means August 3, 2010.

“Consolidated Net Worth” means, at any time, the consolidated stockholders’ equity of XL Capital and its Subsidiaries, provided that the calculation of such consolidated stockholders’ equity shall exclude (a) the effect thereon of any adjustments required under

### Credit Agreement

---

- 5 -

Statement of Financial Accounting Standards No. 115 (“Accounting for Certain Investments in Debt and Equity Securities”) and (b) any Exempt Indebtedness (and the assets relating thereto) in the event such Exempt Indebtedness is consolidated on the consolidated balance sheet of XL Capital and its consolidated Subsidiaries in accordance with GAAP.

“Control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of a Person, whether through the ability to exercise voting power, by contract or otherwise. “Controlling” and “Controlled” have meanings correlative thereto.

“Credit Exposure” means, with respect to any Lender at any time, the aggregate outstanding principal amount of such Lender’s Loans at such time.

“Default” means any event or condition which constitutes an Event of Default or which upon notice, lapse of time or both would, unless cured or waived, become an Event of Default.

“Dollars” or “\$” refers to lawful money of the United States of America.

“Effective Date” means the date on which the conditions specified in Section 5.01 are satisfied (or waived in accordance with Section 10.02) .

“Eligible Transferee” means (a) any Lender, (b) any Other Lender, (b) an Affiliate of a Lender or any Other Lender, (c) an Approved Fund or (d) if an Event of Default under clause (a), (b), (g) or (h) of Article VIII has occurred and is continuing, any other Person.

“Environmental Laws” means any Law, whether now existing or subsequently enacted or amended, relating to (a) pollution or protection of the environment, including natural resources, (b) exposure of Persons, including but not limited to employees, to Hazardous Materials, (c) protection of the public health or welfare from the effects of products, by-products, wastes, emissions, discharges or releases of Hazardous Materials or (d) regulation of the manufacture, use or introduction into commerce of Hazardous Materials, including their manufacture, formulation, packaging, labeling, distribution, transportation, handling, storage or disposal.

“Environmental Liability” means any liability, contingent or otherwise (including any liability for damages, costs of environmental remediation, fines, penalties or indemnities), of a Borrower or any Subsidiary resulting from or based upon (a) violation of any Environmental Law, (b) the generation, use, handling, transportation, storage, treatment or disposal of any Hazardous Materials, (c) exposure to any Hazardous Materials, (d) the release or threatened release of any Hazardous Materials into the environment or (e) any contract or agreement pursuant to which liability is assumed or imposed with respect to any of the foregoing.

“Equity Rights” means, with respect to any Person, any subscriptions, options, warrants, commitments, preemptive rights or agreements of any kind (including any shareholders’ or voting trust agreements) for the issuance, sale, registration or voting of, or securities convertible into, any additional shares of capital stock of any class, or partnership or other ownership interests of any type in, such Person.

#### Credit Agreement

---

- 6 -

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended from time to time.

“ERISA Affiliate” means any trade or business (whether or not incorporated) that, together with any Borrower, is treated as a single employer under Section 414(b) or (c) of the Code, or, solely for purposes of Section 302 of ERISA and Section 412 of the Code, is treated as a single employer under Section 414 of the Code.

“ERISA Event” means (a) any “reportable event”, as defined in Section 4043 of ERISA or the regulations issued thereunder with respect to a Plan (other than an event for which the 30-day notice period is waived); (b) the existence with respect to any Plan of an “accumulated funding deficiency” (as defined in Section 412 of the Code or Section 302 of ERISA), whether or not waived; (c) the filing pursuant to Section 412(d) of the Code or Section 303(d) of ERISA of an application for a waiver of the minimum funding standard with respect to any Plan; (d) the incurrence by any Borrower or any of such Borrower’s ERISA Affiliates of any liability under Title IV of ERISA with respect to the termination of any Plan; (e) the receipt by any Borrower or any ERISA Affiliate from the PBGC or a plan administrator of any notice relating to an intention to terminate any Plan or Plans or to appoint a trustee to administer any Plan; (f) the incurrence by any Borrower or any of its ERISA Affiliates of any liability with respect to the withdrawal or partial withdrawal from any Plan or Multiemployer Plan; or (g) the receipt by any Borrower or any ERISA Affiliate of any notice, or the receipt by any Multiemployer Plan from any Borrower or any ERISA Affiliate of any notice, concerning the imposition of Withdrawal Liability or a determination that a Multiemployer Plan is, or is expected to be, insolvent or in reorganization, within the meaning of Title IV of ERISA.

“Eurodollar”, when used in reference to any Loan or Borrowing, refers to whether such Loan, or the Loans constituting such Borrowing, are bearing interest at a rate determined by reference to the Adjusted LIBO Rate.

“Event of Default” has the meaning assigned to such term in Article VIII.

“Excess Funding Guarantor” has the meaning assigned to such term in Section 3.07.

“Excess Payment” has the meaning assigned to such term in Section 3.07.

“Excluded Taxes” means, with respect to the Administrative Agent, any Lender or any other recipient of any payment to be made by or on account of any obligation of any Borrower hereunder, (a) Taxes imposed on (or measured by) its net income, net profits or overall gross receipts (including, without limitation, branch profits or similar taxes) by the United States of America, or by any jurisdiction under the laws of which such recipient is organized or resident, in which such recipient has an office or with which such recipient has any other connection (other than a connection that is deemed to arise solely by reason of both (I) the transactions contemplated by this Agreement and (II) a Borrower being organized in, maintaining an office in, conducting business in, or having a connection with, such jurisdiction), (b) any Taxes not described in clause (a) above (other than Other Taxes) that are imposed as a result of a connection the Administrative Agent or any Lender, as the case may be, has with the relevant jurisdiction (other than a connection that is deemed to arise solely by reason of both (I)

---

#### Credit Agreement

---

- 7 -

the transactions contemplated by this Agreement and (II) a Borrower being organized or resident in, maintaining an office in, conducting business in, or having a connection with, such jurisdiction) and (c) any Tax imposed pursuant to a law in effect at the time such Lender first becomes a party to this Agreement except to the extent that such Lender’s assignor, if any, was entitled at the time of the assignment to receive additional amounts from the Borrowers with respect to such Tax under Sections 2.13(a) or 2.13(c) and (d) any Tax that is attributable to such Lender’s failure or inability (other than as a result of a Change in Law formally announced after such Lender becomes a party to this Agreement) to comply with Section 2.13(e) .

“Exempt Indebtedness” means any Indebtedness of any Person (other than XL Capital or any of its Affiliates) that is consolidated on the balance sheet of XL Capital and its consolidated Subsidiaries in accordance with GAAP (whether or not required to be so consolidated); provided that (a) at the time of the incurrence of such Indebtedness by such Person, the cash flows from the assets of such Person shall reasonably be expected by such Person to liquidate such Indebtedness and all other liabilities (contingent or otherwise) of such Person and (b) no portion of such Indebtedness of such Person shall be Guaranteed (other than guarantees of the type referred to in clause (a) or (b) of the definition of Indebtedness) by, or shall be secured by a Lien on any assets owned by, XL Capital or any of its Subsidiaries and neither such Person nor any of the holders of such Indebtedness shall have any direct or indirect recourse to XL Capital or any of its Subsidiaries (other than in respect of liabilities and guarantees of the type referred to in clause (a) or (b) of the definition of Indebtedness).

“Federal Funds Effective Rate” means, for any day, the weighted average (rounded upwards, if necessary, to the next 1/100 of 1%) of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers, as published on the next succeeding Business Day by the Federal Reserve Bank of New York, or, if such rate is not so published for any day that is a Business Day, the average (rounded upwards, if necessary, to the next 1/100 of 1%) of the quotations for such day for such transactions received by the Administrative Agent (or any Affiliate of the Person serving as Administrative Agent or any other Person reasonably selected by the Administrative Agent for this purpose) from three Federal funds brokers of recognized standing selected by it.

“Financial Officer” means, with respect to any Obligor, a principal financial officer of such Obligor.

“GAAP” means generally accepted accounting principles in the United States of America.

“GIC” means a guaranteed investment contract or funding agreement or other similar agreement issued by a Borrower or any of its Subsidiaries that guarantees to a counterparty a rate of return on the invested capital over the life of such contract or agreement.

“Governmental Authority” means the government of the United States of America, or of any other nation (including the European Union), or any political subdivision thereof, whether state or local, and any agency, authority, instrumentality, regulatory body, court, central bank or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative powers or functions of or pertaining to government.

---

#### Credit Agreement

---

- 8 -

“Granting Lender” has the meaning assigned to such term in Section 10.04.

“Guarantee” means, with respect to any Person, without duplication, any obligations of such Person (other than endorsements in the ordinary course of business of negotiable instruments for deposit or collection) guaranteeing or intended to guarantee any Indebtedness of any other Person in any manner, whether direct or indirect, and including any obligation, whether or not contingent, (i) to purchase any such Indebtedness or any property constituting security therefor for the purpose of assuring the holder of such Indebtedness, (ii) to advance or provide funds or other support for the payment or purchase of any such Indebtedness or to maintain working capital, solvency or other balance sheet condition of such other Person (including keepwell agreements,

maintenance agreements, comfort letters or similar agreements or arrangements) for the benefit of any holder of Indebtedness of such other Person, (iii) to lease or purchase property, securities or services primarily for the purpose of assuring the holder of such Indebtedness, or (iv) to otherwise assure or hold harmless the holder of such Indebtedness against loss in respect thereof. The amount of any Guarantee hereunder shall (subject to any limitations set forth therein) be deemed to be an amount equal to the outstanding principal amount of the Indebtedness in respect of which such Guarantee is made. The terms “Guarantee” and “Guaranteed” used as a verb shall have a correlative meaning.

“Guaranteed Obligations” has the meaning assigned to such term in Section 3.01.

“Guarantors” means each of XL Capital, XL America, XL Insurance and XL Re.

“Hazardous Materials” means all explosive or radioactive substances or wastes and all hazardous or toxic substances, wastes or other pollutants, including petroleum or petroleum distillates, asbestos or asbestos containing materials, polychlorinated biphenyls, radon gas, infectious or medical wastes and all other substances or wastes of any nature regulated pursuant to any Environmental Law.

“Hedging Agreement” means any interest rate protection agreement, foreign currency exchange agreement, commodity price protection agreement or other interest or currency exchange rate or commodity price hedging arrangement.

“Indebtedness” means, for any Person, without duplication: (i) all indebtedness or liability for or on account of money borrowed by, or for or on account of deposits with or advances to (but not including accrued pension costs, deferred income taxes or accounts payable of) such Person; (ii) all obligations (including contingent liabilities) of such Person evidenced by bonds, debentures, notes, banker’s acceptances or similar instruments; (iii) all indebtedness or liability for or on account of property or services purchased or acquired by such Person; (iv) any amount secured by a Lien on property owned by such Person (whether or not assumed) and Capital Lease Obligations of such Person (without regard to any limitation of the rights and remedies of the holder of such Lien or the lessor under such capital lease to repossession or sale of such property); (v) the maximum available amount of all standby letters of credit issued for the account of such Person and, without duplication, all drafts drawn thereunder (to the extent unreimbursed); and (vi) all Guarantees of such Person; provided that the following shall be excluded from Indebtedness of XL Capital and any of its Subsidiaries for purposes of this Agreement: (a) all payment liabilities of any such Person under insurance and reinsurance policies from time to time issued by such Person, including guarantees of any such payment

#### Credit Agreement

---

- 9 -

liabilities; (b) all other liabilities (or guarantees thereof) arising in the ordinary course of any such Person’s business as an insurance or reinsurance company (including GICs and Stable Value Instruments and any Specified Transaction Agreement relating thereto), or as a corporate member of The Council of Lloyd’s, or as a provider of financial or investment services or contracts (including GICs and Stable Value Instruments and any Specified Transaction Agreement relating thereto); and (c) any Exempt Indebtedness.

“Indemnified Taxes” means Taxes imposed on the Administrative Agent or any Lender on or with respect to any payment hereunder, other than Excluded Taxes and Other Taxes.

“Insurance Subsidiary” means any Subsidiary which is subject to the regulation of, and is required to file statutory financial statements with, any governmental body, agency or official in any State or territory of the United States or the District of Columbia which regulates insurance companies or the doing of an insurance business therein.

“Interest Election Request” means a request by a Borrower to convert or continue a Borrowing in accordance with Section 2.04.

“Interest Payment Date” means (a) with respect to any ABR Loan, each Quarterly Date and (b) with respect to any Eurodollar Loan, the last day of each Interest Period therefor and, in the case of any Interest Period of more than three months’ duration, each day prior to the last day of such Interest Period that occurs at three-month intervals after the first day of such Interest Period.

“Interest Period” means, for any Eurodollar Loan or Borrowing, the period commencing on the date of such Loan or Borrowing and ending on the numerically corresponding day in the calendar month that is one, two, three or six months thereafter, as specified in the applicable Borrowing Request or Interest Election Request; provided that (i) if any Interest Period would end on a day other than a Business Day, such Interest Period shall be extended to the next succeeding Business Day unless such next succeeding Business Day would fall in the next calendar month, in which case such Interest Period shall end on the next preceding Business Day, and (ii) any Interest Period that commences on the last Business Day of a calendar month (or on a day for which there is no numerically corresponding day in the last calendar month of such Interest Period) shall end on the last Business Day of the last calendar month of such Interest Period. For purposes hereof, the date of a Loan initially shall be the date on which such Loan is made and thereafter shall be the effective date of the most recent conversion or continuation of such Loan, and the date of a Borrowing comprising Loans that have been converted or continued shall be the effective date of the most recent conversion or continuation of such Loans.

“ISDA” has the meaning assigned to such term in Section 7.03(f) .

“JPMCB” means JPMorgan Chase Bank, N.A.

“Law” means any law (including common law), constitution, statute, treaty, regulation, rule, ordinance, order, injunction, writ, decree or award of any Governmental Authority.

### Credit Agreement

---

- 10 -

“Lenders” means the Persons listed on Schedule I and any other Person that shall have become a party hereto pursuant to an Assignment and Assumption, other than any such Person that ceases to be a party hereto pursuant to an Assignment and Assumption. As of the Closing Date, the only Lender hereunder is Bear Stearns Corporate Lending Inc.

“LIBO Rate” means, for the Interest Period for any Eurodollar Borrowing, the rate appearing on Page 3750 of the Telerate Service (or on any successor or substitute page of such Service, or any successor to or substitute for such Service, providing rate quotations comparable to those currently provided on such page of such Service, as determined by the Administrative Agent from time to time for purposes of providing quotations of interest rates applicable to Dollar deposits in the London interbank market) at approximately 11:00 a.m., London time, two Business Days prior to the commencement of such Interest Period, as the rate for the offering of Dollar deposits with a maturity comparable to such Interest Period. In the event that such rate is not available at such time for any reason, then the LIBO Rate for such Interest Period shall be the rate at which Dollar deposits of \$5,000,000 and for a maturity comparable to such Interest Period are offered by the principal London office of the Administrative Agent (or any Affiliate of the Person serving as the Administrative Agent or any other Person reasonably selected by the Administrative Agent for this purpose) in immediately available funds in the London interbank market at approximately 11:00 a.m., London time, two Business Days prior to the commencement of such Interest Period.

“Lien” means, with respect to any asset, any mortgage, deed of trust, pledge, lien, security interest, charge or other encumbrance or security arrangement of any nature whatsoever, including but not limited to any conditional sale or title retention arrangement, and any assignment, deposit arrangement or lease intended as, or having the effect of, security.

“Loans” means the loans made by the Lenders to the Borrower pursuant to Section 2.01.

“Margin Stock” means “margin stock” within the meaning of Regulations T, U and X of the Board.

“Material Adverse Effect” means a material adverse effect on: (a) the assets, business, financial condition or operations of a Borrower and its Subsidiaries taken as a whole; or (b) the ability of a Borrower to perform any of its payment or other material obligations under this Agreement.

“Moody’s” means Moody’s Investors Service, Inc., or any successor thereto.

“Moody’s Rating” means, at any time, the rating of XL Capital’s long-term senior unsecured debt (provided that such debt is not supported by any other Person).

“Multiemployer Plan” means a multiemployer plan as defined in Section 4001(a)(3) of ERISA.

“Non-U.S. Benefit Plan” means any plan, fund (including any superannuation fund) or other similar program established or maintained outside the United States by any Borrower or any of their Subsidiaries, with respect to which such Borrower or such Subsidiary

### Credit Agreement

---

- 11 -

has an obligation to contribute, for the benefit of employees of such Borrower or such Subsidiary, which plan, fund or other similar program provides, or results in, the type of benefits described in Section 3(1) or 3(2) of ERISA, and which plan is not subject to ERISA or the Code.

“Obligors” means each of the Borrowers and each of the Guarantors.

“Other Credit Agreements” shall mean (a) the Three-Year Credit Agreement dated as of June 23, 2004 among the Borrowers, the lenders party thereto and JPMCB (formerly JPMorgan Chase Bank), as Administrative Agent and (b) the Credit Agreement dated as of June 22, 2005 among the Borrowers, the lenders party thereto and JPMCB, as Administrative Agent, in each case as amended and in effect from time to time, including any renewals, extensions, restatements or replacements thereof.

“Other Lender” shall mean any Person party as a lender to any Other Credit Agreement.

“Other Taxes” means any and all present or future stamp or documentary taxes or any other similar excise or property Taxes, arising from any payment made hereunder or from the execution, delivery or enforcement of this Agreement, but excluding property or similar Taxes other than any such Taxes imposed in such circumstances solely as a result of the Borrower being

organized or resident in, maintaining an office in, conducting business in or maintaining property located in the taxing jurisdiction in question.

“Participant” has the meaning assigned to such term in Section 10.04.

“PBGC” means the Pension Benefit Guaranty Corporation referred to and defined in ERISA and any successor entity performing similar functions.

“Person” means any natural person, corporation, limited liability company, trust, joint venture, association, company, partnership, Governmental Authority or other entity.

“Plan” means any employee pension benefit plan (other than a Multiemployer Plan) subject to the provisions of Title IV of ERISA or Section 412 of the Code or Section 302 of ERISA, and in respect of which any Borrower or any ERISA Affiliate is (or, if such plan were terminated, would under Section 4069 of ERISA be deemed to be) an “employer” as defined in Section 3(5) of ERISA.

“Prime Rate” means the rate of interest per annum publicly announced from time to time by JPMCB as its prime rate in effect at its principal office in New York City; each change in the Prime Rate shall be effective from and including the date such change is publicly announced as being effective.

“Private Act” means separate legislation enacted in Bermuda with the intention that such legislation apply specifically to a Borrower, in whole or in part.

“Pro Rata Share” has the meaning assigned to such term in Section 3.07.

“Quarterly Date” means the last Business Day of March, June, September and December in each year, the first of which shall be the first such day after the date hereof.

#### Credit Agreement

---

- 12 -

“Register” has the meaning assigned to such term in Section 10.04.

“Related Parties” means, with respect to any specified Person, such Person’s Affiliates and the respective directors, officers, employees, agents and advisors of such Person and such Person’s Affiliates.

“Required Lenders” means, at any time, Lenders having Commitments representing more than 50% of the aggregate amount of the Commitments at such time; provided that, if the Commitments have expired or been terminated, “Required Lenders” means Lenders having more than 50% of the Aggregate Credit Exposure at such time.

“S&P” means Standard & Poor’s Ratings, or any successor thereto.

“S&P Rating” means, at any time, the rating of XL Capital’s long-term senior unsecured debt (provided that such debt is not supported by any other Person).

“SAP” means, as to each Borrower and each Subsidiary that offers insurance products, the statutory accounting practices prescribed or permitted by the relevant Governmental Authority for such Borrower’s or such Subsidiary’s domicile for the preparation of its financial statements and other reports by insurance corporations of the same type as such Borrower or such Subsidiary in effect on the date such statements or reports are to be prepared, except if otherwise notified by XL Capital as provided in Section 1.03.

“SEC” means the Securities and Exchange Commission or any successor entity.

“Significant Subsidiary” means, at any time, each Subsidiary of XL Capital that, as of such time, meets the definition of a “significant subsidiary” under Regulation S-X of the SEC.

“Specified Transaction Agreement” means any agreement, contract or documentation with respect to the following types of transactions: rate swap transaction, swap option, basis swap, asset swap, forward rate transaction, commodity swap, commodity option, equity or equity index swap, equity or equity index option, bond option, interest rate option, foreign exchange transaction, cap transaction, floor transaction, collar transaction, current swap transaction, cross-currency rate swap transaction, currency option, credit protection transaction, credit swap, credit default swap, credit default option, total return swap, credit spread transaction, repurchase transaction, reverse repurchase transaction, buy/sell-back transaction, securities lending or borrowing transaction, weather index transaction or forward purchase or sale of a security, commodity or other financial instrument or interest, and transactions on any commodity futures or other exchanges, markets and their associated clearing houses (including any option with respect to any of these transactions).

“SPV” has the meaning assigned to such term in Section 10.04.

“Stable Value Instrument” means any insurance, derivative or similar financial contract or instrument designed to mitigate the volatility of returns during a given period on a specified portfolio of securities held by one party (the “customer”) through the commitment of the other party (the “SVI provider”) to provide the customer with a credited rate of return on the portfolio, typically determined through an interest-crediting mechanism (and in exchange for which the SVI provider typically receives a fee).

## Credit Agreement

---

- 13 -

“Statutory Reserve Rate” means, for any day (or for the Interest Period for any Eurodollar Borrowing), a fraction (expressed as a decimal), the numerator of which is the number one and the denominator of which is the number one minus the aggregate of the maximum reserve percentages (including any marginal, special, emergency or supplemental reserves) expressed as a decimal established by the Board to which the Administrative Agent is subject on such day (or, with respect to an Interest Period, the denominator of which is the number one minus the arithmetic mean of such aggregates for the days in such Interest Period) with respect to the Adjusted LIBO Rate, for eurocurrency funding (currently referred to as “Eurocurrency liabilities” in Regulation D of the Board). Such reserve percentages shall include those imposed pursuant to such Regulation D. Eurodollar Loans shall be deemed to constitute eurocurrency funding and to be subject to such reserve requirements without benefit of or credit for proration, exemptions or offsets that may be available from time to time to any Lender under such Regulation D or any comparable regulation. The Statutory Reserve Rate shall be adjusted automatically on and as of the effective date of any change in any reserve percentage.

“Subsidiary” means, with respect to any Person (the “parent”), at any date, any corporation (or similar entity) of which a majority of the shares of outstanding capital stock normally entitled to vote for the election of directors (regardless of any contingency which does or may suspend or dilute the voting rights of such capital stock) is at such time owned directly or indirectly by the parent or one or more subsidiaries of the parent. Unless otherwise specified, “Subsidiary” means a Subsidiary of a Borrower.

“Taxes” means any and all present or future taxes, levies, imposts, duties, deductions, charges or withholdings imposed by any Governmental Authority.

“Total Funded Debt” means, at any time, all Indebtedness of XL Capital and its Subsidiaries and any other Person which would at such time be classified in whole or in part as a liability on the consolidated balance sheet of XL Capital and its consolidated Subsidiaries in accordance with GAAP (it being understood for avoidance of doubt that any liability or obligation excluded from the definition of Indebtedness shall not constitute Indebtedness for purposes of this definition).

“Transactions” means the execution, delivery and performance by the Obligor of this Agreement, the borrowing of Loans and the use of the proceeds thereof.

“Type”, when used in reference to any Loan or Borrowing, refers to whether the rate of interest on such Loan, or on the Loans constituting such Borrowing, is determined by reference to the Adjusted LIBO Rate or the Alternate Base Rate.

“Withdrawal Liability” means liability to a Multiemployer Plan as a result of a complete or partial withdrawal from such Multiemployer Plan, as such terms are defined in Part I of Subtitle E of Title IV of ERISA.

SECTION 1.02. Terms Generally. The definitions of terms herein shall apply equally to the singular and plural forms of the terms defined. Whenever the context may require, any pronoun shall include the corresponding masculine, feminine and neuter forms. The words “include”, “includes” and “including” shall be deemed to be followed by the phrase “without limitation”. The word “will” shall be construed to have the same meaning and effect as the word

## Credit Agreement

---

- 14 -

“shall”. Unless the context requires otherwise (a) any definition of or reference to any agreement, instrument or other document herein shall be construed as referring to such agreement, instrument or other document as from time to time amended, supplemented or otherwise modified (subject to any restrictions on such amendments, supplements or modifications set forth herein), (b) any reference herein to any Person shall be construed to include such Person’s successors and assigns, (c) the words “herein”, “hereof” and “hereunder”, and words of similar import, shall be construed to refer to this Agreement in its entirety and not to any particular provision hereof, (d) all references herein to Articles, Sections, Exhibits and Schedules shall be construed to refer to Articles and Sections of, and Exhibits and Schedules to, this Agreement and (e) the words “asset” and “property” shall be construed to have the same meaning and effect and to refer to any and all tangible and intangible assets and properties, including cash, securities, accounts and contract rights.

SECTION 1.03. Accounting Terms; GAAP and SAP. Except as otherwise expressly provided herein, all terms of an accounting or financial nature shall be construed in accordance with GAAP or SAP, as the context requires, each as in effect from time to time; provided that, if XL Capital notifies the Administrative Agent that the Borrowers request an amendment to any provision hereof to eliminate the effect of any change occurring after the date hereof in GAAP or SAP, as the case may be, or in the application thereof on the operation of such provision (or if the Administrative Agent notifies the Borrowers that the Required Lenders request an amendment to any provision hereof for such purpose), regardless of whether any such notice is given before or

after such change in GAAP or SAP, as the case may be, or in the application thereof, then such provision shall be interpreted on the basis of GAAP or SAP, as the case may be, as in effect and applied immediately before such change shall have become effective until such notice shall have been withdrawn or such provision amended in accordance herewith.

## ARTICLE II

### THE CREDITS

#### SECTION 2.01. Loans and Borrowings.

(a) Commitments. Subject to the terms and conditions set forth herein, each Lender agrees to make Loans to a Borrower from time to time during the Availability Period in an aggregate principal amount that will not result in (i) such Lender's Credit Exposure exceeding such Lender's Commitment or (ii) the Aggregate Credit Exposure exceeding the total Commitments. Loans may be made, or be outstanding, to more than one of the Borrowers at any time. Within the foregoing limits and subject to the terms and conditions set forth herein, the Borrowers may borrow, prepay and reborrow Loans.

(b) Obligations of Lenders. Except as provided herein, each Loan shall be made as part of a Borrowing consisting of Loans of the same Type made by the Lenders ratably in accordance with their respective Commitments. The failure of any Lender to make any Loan required to be made by it shall not relieve any other Lender of its obligations hereunder; provided that the Commitments of the Lenders to make Loans hereunder are several and no Lender shall be responsible for any other Lender's failure to make Loans as required.

#### Credit Agreement

---

- 15 -

(c) Type of Loans. Subject to Section 2.02, each Borrowing shall be constituted entirely of ABR Loans or of Eurodollar Loans as any Borrower may request in accordance herewith. Each Lender at its option may make any Eurodollar Loan by causing any domestic or foreign branch or Affiliate of such Lender to make such Loan; provided that any exercise of such option shall not affect the obligation of the Borrowers to repay such Loan in accordance with the terms of this Agreement.

(d) Minimum Amounts; Limitation on Number of Borrowings. Each Eurodollar Borrowing shall be in an aggregate amount of \$10,000,000 or a larger multiple of \$1,000,000. Each ABR Borrowing shall be in an aggregate amount equal to \$10,000,000 or a larger multiple of \$1,000,000. Borrowings of more than one Type may be outstanding at the same time; provided that there shall not at any time be more than a total of ten Eurodollar Borrowings outstanding.

(e) Limitations on Interest Periods. Notwithstanding any other provision of this Agreement, no Borrower shall be entitled to request (or to elect to convert to or continue as a Eurodollar Borrowing) any Borrowing if the Interest Period requested therefor would end after the Commitment Termination Date.

#### SECTION 2.02. Requests for Borrowings.

(a) Notice by the Borrowers. To request a Borrowing, XL Capital shall notify the Administrative Agent of such request by telephone (i) in the case of a Eurodollar Borrowing, not later than 11:00 a.m., New York City time, three Business Days before the date of the proposed Borrowing or (ii) in the case of an ABR Borrowing, not later than 11:00 a.m., New York City time, one Business Day before the date of the proposed Borrowing. Each such telephonic Borrowing Request shall be irrevocable and shall be confirmed promptly by hand delivery or telecopy to the Administrative Agent of a written Borrowing Request in a form approved by the Administrative Agent and signed by XL Capital.

(b) Content of Borrowing Requests. Each telephonic and written Borrowing Request shall specify the following information in compliance with Section 2.07:

(i) the relevant Borrower;

(ii) the aggregate amount of the requested Borrowing;

(iii) the date of such Borrowing, which shall be a Business Day;

(iv) whether such Borrowing is to be an ABR Borrowing or a Eurodollar Borrowing;

(v) in the case of a Eurodollar Borrowing, the Interest Period therefor, which shall be a period contemplated by the definition of the term "Interest Period" and permitted under Section 2.01(e); and

(vi) the location and number of such Borrower's account to which funds are to be disbursed.

#### Credit Agreement

---

- 16 -

(c) Notice by the Administrative Agent to the Lenders. Promptly following receipt of a Borrowing Request in accordance with this Section, the Administrative Agent shall advise each relevant Lender of the details thereof and of the amount of such Lender's Loan to be made as part of the requested Borrowing.

(d) Failure to Elect. If no election as to the Type of a Borrowing is specified, then the requested Borrowing shall be an ABR Borrowing. If no Interest Period is specified with respect to any requested Eurodollar Borrowing, then the requested Borrowing shall be made instead as an ABR Borrowing.

#### SECTION 2.03. Funding of Borrowings.

(a) Funding by Lenders. Each Lender shall make each Loan to be made by it hereunder on the proposed date thereof by wire transfer of immediately available funds by 12:00 noon, New York City time, to the account of the Administrative Agent most recently designated by it for such purpose by notice to the Lenders. The Administrative Agent will make such Loans available to the relevant Borrower by promptly remitting the amounts so received, in like funds, to the account of such Borrower designated by such Borrower in the applicable Borrowing Request.

(b) Presumption by the Administrative Agent. Unless the Administrative Agent shall have received notice from a Lender prior to the proposed date of any Borrowing (or in the case of any ABR Borrowing, on or prior to the proposed date of such Borrowing) that such Lender will not make available to the Administrative Agent such Lender's share of such Borrowing, the Administrative Agent may assume that such Lender has made such share available on such date in accordance with paragraph (a) of this Section and may, in reliance upon such assumption, make available to the relevant Borrower a corresponding amount. In such event, if a Lender has not in fact made its share of the applicable Borrowing available to the Administrative Agent, then the applicable Lender and the relevant Borrower severally agree to pay to the Administrative Agent forthwith on demand such corresponding amount with interest thereon, for each day from and including the date such amount is made available to such Borrower to but excluding the date of payment to the Administrative Agent, at (i) in the case of such Lender, the Federal Funds Effective Rate or (ii) in the case of such Borrower, the interest rate applicable to ABR Loans. If such Lender pays such amount to the Administrative Agent, then such amount shall constitute such Lender's Loan included in such Borrowing.

### Credit Agreement

---

- 17 -

#### SECTION 2.04. Interest Elections.

(a) Elections by the Borrowers. The Loans constituting each Borrowing initially shall be of the Type specified in the applicable Borrowing Request and, in the case of a Eurodollar Borrowing, shall have the Interest Period specified in such Borrowing Request. Thereafter, the relevant Borrower may elect to convert such Borrowing to a Borrowing of a different Type or to continue such Borrowing as a Borrowing of the same Type and, in the case of a Eurodollar Borrowing, may elect the Interest Period therefor, all as provided in this Section. The relevant Borrower may elect different options with respect to different portions of the affected Borrowing, in which case each such portion shall be allocated ratably among the Lenders holding the Loans constituting such Borrowing, and the Loans constituting each such portion shall be considered a separate Borrowing.

(b) Notice of Elections. To make an election pursuant to this Section, XL Capital shall notify the Administrative Agent of such election by telephone by the time that a Borrowing Request would be required under Section 2.02 if XL Capital were requesting a Borrowing of the Type resulting from such election to be made on the effective date of such election. Each such telephonic Interest Election Request shall be irrevocable and shall be confirmed promptly by hand delivery or telecopy to the Administrative Agent of a written Interest Election Request in a form approved by the Administrative Agent and signed by XL Capital.

(c) Content of Interest Election Requests. Each telephonic and written Interest Election Request shall specify the following information in compliance with Section 2.01:

(i) the Borrowing to which such Interest Election Request applies and, if different options are being elected with respect to different portions thereof, the portions thereof to be allocated to each resulting Borrowing (in which case the information to be specified pursuant to clauses (iii) and (iv) of this paragraph shall be specified for each resulting Borrowing);

(ii) the effective date of the election made pursuant to such Interest Election Request, which shall be a Business Day;

(iii) whether the resulting Borrowing is to be an ABR Borrowing or a Eurodollar Borrowing; and

(iv) if the resulting Borrowing is a Eurodollar Borrowing, the Interest Period therefor after giving effect to such election, which shall be a period contemplated by the definition of the term "Interest Period" and permitted under Section 2.01(e).

(d) Notice by the Administrative Agent to the Lenders. Promptly following receipt of an Interest Election Request, the Administrative Agent shall advise each Lender of the details thereof and of such Lender's portion of each resulting Borrowing.

(e) Failure to Elect; Events of Default. If XL Capital fails to deliver a timely and complete Interest Election Request with respect to a Eurodollar Borrowing prior to the end of the Interest Period therefor, then, unless such Borrowing is repaid as provided

herein, at the end of such Interest Period such Borrowing shall be converted to an ABR Borrowing. Notwithstanding any contrary provision hereof, if an Event of Default has occurred and is continuing and the

## Credit Agreement

---

- 18 -

Administrative Agent, at the request of the Required Lenders, so notifies XL Capital, then, so long as an Event of Default is continuing (i) no outstanding Borrowing may be converted to or continued as a Eurodollar Borrowing and (ii) unless repaid, each Eurodollar Borrowing shall be converted to an ABR Borrowing at the end of the Interest Period therefor.

### SECTION 2.05. Termination and Reduction of the Commitments.

(a) Scheduled Termination. Unless previously terminated, the Commitments shall terminate at the close of business on the Commitment Termination Date.

(b) Voluntary Termination or Reduction. The Borrowers may at any time terminate, or from time to time reduce, the Commitments; provided that (i) each reduction of the Commitments shall be in an amount that is \$25,000,000 or a larger multiple of \$5,000,000 and (ii) the Borrowers shall not terminate or reduce the Commitments if the Aggregate Credit Exposure would exceed the Commitments. XL Capital shall notify the Administrative Agent of any election to terminate or reduce the Commitments under this paragraph (b) at least three Business Days prior to the effective date of such termination or reduction, specifying such election and the effective date thereof. Promptly following receipt of any such notice, the Administrative Agent shall advise the Lenders of the contents thereof. Each notice delivered by XL Capital pursuant to this paragraph (b) shall be irrevocable; provided that a notice of termination of the Commitments delivered by XL Capital may state that such notice is conditioned upon the effectiveness of other credit facilities, in which case such notice may be revoked by XL Capital (by notice to the Administrative Agent on or prior to the specified effective date) if such condition is not satisfied. Subject to the proviso in the immediately preceding sentence, any termination or reduction of the Commitments shall be permanent. Each reduction of the Commitments shall be made ratably among the Lenders in accordance with their respective Commitments.

### SECTION 2.06. Repayment of Loans; Evidence of Debt.

(a) Repayment. Each Borrower hereby unconditionally promises to pay to the Administrative Agent for account of the relevant Lenders the outstanding principal amount of the Loans made to such Borrower on the Commitment Termination Date.

(b) Manner of Payment. Prior to any repayment or prepayment of any Borrowings hereunder, XL Capital shall select the Borrowing or Borrowings to be paid and shall notify the Administrative Agent by telephone (confirmed by telecopy) of such selection not later than 11:00 a.m., New York City time, three Business Days before the scheduled date of such repayment; provided that each repayment of Borrowings shall be applied to repay any outstanding ABR Borrowings before any other Borrowings. If XL Capital fails to make a timely selection of the Borrowing or Borrowings to be repaid or prepaid, such payment shall be applied, first, to pay any outstanding ABR Borrowings and, second, to other Borrowings in the order of the remaining duration of their respective Interest Periods (the Borrowing with the shortest remaining Interest Period to be repaid first). Each payment of a Borrowing shall be applied ratably to the Loans included in such Borrowing.

(c) Maintenance of Records by Lenders. Each Lender shall maintain in accordance with its usual practice records evidencing the indebtedness of each Borrower to such

## Credit Agreement

---

- 19 -

Lender resulting from each Loan made by such Lender to such Borrower, including the amounts of principal and interest payable and paid to such Lender from time to time hereunder.

(d) Maintenance of Records by the Administrative Agent. The Administrative Agent shall maintain records in which it shall record (i) the amount of each Loan made to each Borrower hereunder, the Type thereof and each Interest Period therefor, (ii) the amount of any principal or interest due and payable or to become due and payable from such Borrower to each Lender hereunder and (iii) the amount of any sum received by the Administrative Agent hereunder for account of the Lenders and each Lender's share thereof.

(e) Effect of Entries. The entries made in the records maintained pursuant to paragraph (c) or (d) of this Section shall be prima facie evidence of the existence and amounts of the obligations recorded therein; provided that the failure of any Lender or the Administrative Agent to maintain such records or any error therein shall not in any manner affect the obligation of the Borrowers to repay the Loans in accordance with the terms of this Agreement.

(f) Promissory Notes. Any Lender may request that Loans made by it to any Borrower be evidenced by a promissory note of such Borrower. In such event, each Borrower shall prepare, execute and deliver to such Lender a promissory note payable to such Lender (or, if requested by such Lender, to such Lender and its registered assigns) and in a form approved by the Administrative Agent. Thereafter, the Loans evidenced by such promissory note and interest thereon shall at all times (including

after assignment pursuant to Section 10.04) be represented by one or more promissory notes in such form payable to the payee named therein (or, if such promissory note is a registered note, to such payee and its registered assigns).

#### SECTION 2.07. Prepayment of Loans.

(a) Right to Prepay Borrowings. The Borrowers shall have the right at any time and from time to time to prepay any Borrowing in whole or in part, subject to the requirements of this Section.

(b) Notices, Etc. XL Capital shall notify the Administrative Agent by telephone (confirmed by telecopy) of any prepayment hereunder (i) in the case of prepayment of a Eurodollar Borrowing, not later than 11:00 a.m., New York City time, three Business Days before the date of prepayment or (ii) in the case of prepayment of an ABR Borrowing, not later than 11:00 a.m., New York City time, one Business Day before the date of prepayment. Each such notice shall be irrevocable and shall specify the prepayment date and the principal amount of each Borrowing or portion thereof to be prepaid; provided that, if a notice of prepayment is given in connection with a conditional notice of termination of the Commitments as contemplated by Section 2.05, then such notice of prepayment may be revoked if such notice of termination is revoked in accordance with Section 2.05. Promptly following receipt of any such notice relating to a Borrowing, the Administrative Agent shall advise the relevant Lenders of the contents thereof. Each partial prepayment of any Borrowing shall be in an amount that would be permitted in the case of a Borrowing of the same Type as provided in Section 2.01. Each prepayment of a Borrowing shall be applied ratably to the Loans included in the prepaid Borrowing. Prepayments shall be accompanied by accrued interest to the extent required by Section 2.09 and shall be made in the manner specified in Section 2.06(b) .

### Credit Agreement

---

- 20 -

#### SECTION 2.08. Fees.

(a) Facility Fee. XL Capital agrees to pay to the Administrative Agent for account of each Lender a facility fee which shall accrue at a rate per annum equal to the Applicable Rate (i) prior to the termination of such Lender's Commitment, on the daily amount of such Commitment (whether used or unused) during the period from and including the Effective Date to but excluding the earlier of the date on which such Commitment terminates and the Commitment Termination Date and (ii) if such Lender continues to have any Credit Exposure after its Commitment terminates, on the daily amount of such Lender's Credit Exposure from and including the date on which such Lender's Commitment terminates to but excluding the date on which such Lender ceases to have any Credit Exposure. Accrued facility fees shall be payable on each Quarterly Date and on the earlier of the date the Commitments terminate and the Commitment Termination Date; provided that any facility fees accruing after such earlier date shall be payable on demand.

(b) Payment and Computation of Fees. All fees payable hereunder shall be paid on the dates due, in immediately available funds, to the Administrative Agent for distribution, to the Lenders entitled thereto. Fees paid shall not be refundable under any circumstances. All fees payable under this Section shall be computed on the basis of a year of 360 days and shall be payable for the actual number of days elapsed (including the first day but excluding the last day).

#### SECTION 2.09. Interest.

(a) ABR Loans. The Loans constituting each ABR Borrowing shall bear interest at a rate per annum equal to the Alternate Base Rate plus the Applicable Additional Margin, if any.

(b) Eurodollar Loans. The Loans constituting each Eurodollar Borrowing shall bear interest at a rate per annum equal to the Adjusted LIBO Rate for the Interest Period for such Borrowing plus the Applicable Margin plus the Applicable Additional Margin, if any.

(c) Default Interest. Notwithstanding the foregoing, if any principal of or interest on any Loan or any fee or other amount payable by the Borrowers hereunder is not paid when due, whether at stated maturity, upon acceleration or otherwise, such overdue amount shall bear interest, after as well as before judgment, at a rate per annum equal to (i) in the case of overdue principal of any Loan, 2% plus the rate otherwise applicable to such Loan as provided above or (ii) in the case of any other amount, 2% plus the rate applicable to ABR Loans as provided in paragraph (a) of this Section.

(d) Payment of Interest. Accrued interest on each Loan shall be payable by the applicable Borrower in arrears on each Interest Payment Date for such Loan and upon the date the Commitments terminate; provided that (x) interest accrued pursuant to paragraph (c) of this Section shall be payable on demand, (y) in the event of any repayment or prepayment of any Loan (other than a prepayment of an ABR Loan prior to the Commitment Termination Date), accrued interest on the principal amount repaid or prepaid shall be payable on the date of such repayment or prepayment and (z) in the event of any conversion of any Eurodollar Borrowing prior to the end of the Interest Period therefor, accrued interest on such Borrowing shall be payable on the effective date of such conversion.

### Credit Agreement

---

- 21 -

(e) Computation. All interest hereunder shall be computed on the basis of a year of 360 days, except that interest computed by reference to the Alternate Base Rate at times when the Alternate Base Rate is based on the Prime Rate shall be computed on the basis of a year of 365 days (or 366 days in a leap year), and in each case shall be payable for the actual number of days elapsed (including the first day but excluding the last day). The applicable Alternate Base Rate or Adjusted LIBO Rate shall be determined by the Administrative Agent, and such determination shall be conclusive absent manifest error.

SECTION 2.10. Alternate Rate of Interest. If prior to the commencement of the Interest Period for any Eurodollar Borrowing:

(a) the Administrative Agent determines in good faith (which determination shall be conclusive absent manifest error) that adequate and reasonable means do not exist for ascertaining the Adjusted LIBO Rate for such Interest Period; or

(b) the Administrative Agent is advised by the Required Lenders (acting in good faith) that the Adjusted LIBO Rate for such Interest Period will not adequately and fairly reflect the cost to such Lenders of making or maintaining their respective Loans included in such Borrowing for such Interest Period;

then the Administrative Agent shall give notice thereof to XL Capital and the Lenders by telephone or telecopy as promptly as practicable thereafter and, until the Administrative Agent notifies XL Capital and the Lenders that the circumstances giving rise to such notice no longer exist, (i) any Interest Election Request that requests the conversion of any Borrowing to, or the continuation of any Borrowing as, a Eurodollar Borrowing shall be ineffective and such Borrowing (unless prepaid) shall be continued as, or converted to, an ABR Borrowing and (ii) if any Borrowing Request requests a Eurodollar Borrowing, such Borrowing shall be made as an ABR Borrowing.

SECTION 2.11. Increased Costs.

(a) Increased Costs Generally. If any Change in Law shall:

(i) impose, modify or deem applicable any reserve, special deposit or similar requirement against assets of, deposits with or for account of, or credit extended by, any Lender (except any such reserve requirement reflected in the Adjusted LIBO Rate); or

(ii) impose on any Lender or the London interbank market any other condition affecting this Agreement or any Eurodollar Loan made by such Lender;

and the result of any of the foregoing shall be to increase the cost to such Lender of making or maintaining any Eurodollar Loan (or of maintaining its obligation to make any such Loan) or to reduce the amount of any sum received or receivable by such Lender hereunder (whether of principal, interest or otherwise), then the Borrowers jointly and severally agree that they will pay to such Lender such additional amount or amounts as will compensate such Lender for such additional costs incurred or reduction suffered.

(b) Capital Requirements. If any Lender determines that any Change in Law regarding capital requirements has or would have the effect of reducing the rate of return on such

#### Credit Agreement

---

- 22 -

Lender's capital or on the capital of such Lender's holding company, if any, as a consequence of this Agreement or the Loans made by such Lender to a level below that which such Lender or such Lender's holding company could have achieved but for such Change in Law (taking into consideration such Lender's policies and the policies of such Lender's holding company with respect to capital adequacy), then from time to time the Borrowers will pay to such Lender such additional amount or amounts as will compensate such Lender or such Lender's holding company for any such reduction suffered.

(c) Certificates from Lenders. A certificate of a Lender setting forth such Lender's good faith determination of the amount or amounts necessary to compensate such Lender or its holding company, as the case may be, as specified in paragraph (a) or (b) of this Section shall be delivered to XL Capital and shall be conclusive absent manifest error. The Borrowers shall pay such Lender the amount shown as due on any such certificate within 10 days after receipt thereof by XL Capital.

(d) Delay in Requests. Failure or delay on the part of any Lender to demand compensation pursuant to this Section shall not constitute a waiver of such Lender's right to demand such compensation; provided that the Borrowers shall not be required to compensate a Lender pursuant to this Section for any increased costs or reductions incurred more than 90 days prior to the date that such Lender notifies XL Capital of the Change in Law giving rise to such increased costs or reductions and of such Lender's intention to claim compensation therefor; provided further that, if the Change in Law giving rise to such increased costs or reductions is retroactive, then the 90 day period referred to above shall be extended to include the period of retroactive effect thereof.

(e) Application to Taxes. Notwithstanding anything in this Section to the contrary, this Section shall not apply to Taxes, which shall be governed solely by Section 2.13.

SECTION 2.12. Break Funding Payments. In the event of (a) the payment of any principal of any Eurodollar Loan other than on the last day of an Interest Period therefor (including as a result of an Event of Default), (b) the conversion of any Eurodollar Loan other than on the last day of an Interest Period therefor, (c) the failure to borrow, convert, continue or prepay any Loan on the date specified in any notice delivered pursuant hereto (regardless of whether such notice is permitted to be revocable under Section 2.07(b) and is revoked in accordance herewith), or (d) the assignment as a result of a request by XL Capital pursuant to Section 2.15(b) of any Eurodollar Loan other than on the last day of an Interest Period therefor, then, in any such event, the Borrowers shall compensate each Lender for the loss attributable to such event. The loss to any Lender attributable to any such event shall be deemed to be an amount determined by such Lender to be equal to the excess, if any, of (i) the amount of interest that such Lender would pay for a deposit equal to the principal amount of such Loan for the period from the date of such payment, conversion, failure or assignment to the last day of the then current Interest Period for such Loan (or, in the case of a failure to borrow, convert or continue, the duration of the Interest Period that would have resulted from such borrowing, conversion or continuation) if the interest rate payable on such deposit were equal to the Adjusted LIBO Rate for such Interest Period, over (ii) the amount of interest that such Lender would earn on such principal amount for such period if such Lender were to invest such principal amount for such period at the interest rate that would be bid by such Lender (or an affiliate of such Lender) for Dollar deposits from other banks in the eurodollar market at the commencement

---

Credit Agreement

---

- 23 -

of such period. A certificate of any Lender setting forth such Lender's good faith determination of any amount or amounts that such Lender is entitled to receive pursuant to this Section shall be delivered to XL Capital and shall be conclusive absent manifest error. The Borrowers shall pay such Lender the amount shown as due on any such certificate within 10 days after receipt thereof by XL Capital.

SECTION 2.13. Taxes.

(a) Payments Free of Taxes. Any and all payments by or on account of any obligation of the Borrowers hereunder shall be made free and clear of and without deduction for any Indemnified Taxes; provided that if any Borrower shall be required to deduct any Indemnified Taxes from such payments, then (i) the sum payable shall be increased as necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section) the Administrative Agent or Lender (as the case may be) receives an amount equal to the sum it would have received had no such deductions been made, (ii) such Borrower shall make such deductions and (iii) such Borrower shall pay the full amount deducted to the relevant Governmental Authority in accordance with applicable law.

(b) Payment of Other Taxes by the Borrowers. In addition, each Borrower shall pay any Other Taxes to the relevant Governmental Authority in accordance with applicable law.

(c) Indemnification by the Borrowers. The Borrowers shall indemnify the Administrative Agent and each Lender, within 10 days after written demand to XL Capital therefor, for the full amount of any Indemnified Taxes and Other Taxes (including Indemnified Taxes imposed or asserted on or attributable to amounts payable under this Section) paid by the Administrative Agent or such Lender, as the case may be, and any penalties, interest and reasonable expenses arising therefrom or with respect thereto, whether or not such Indemnified Taxes or Other Taxes, as the case may be, were correctly or legally imposed or asserted by the relevant Governmental Authority. A certificate setting forth the Administrative Agent's or such Lender's, as the case may be, good faith determination of the amount of such payment or liability delivered to XL Capital by a Lender, or by the Administrative Agent on its own behalf or on behalf of a Lender, shall be conclusive as between such Lender or the Administrative Agent, as the case may be, and the Borrowers absent manifest error.

(d) Evidence of Payments. As soon as practicable after any payment of Indemnified Taxes or Other Taxes by any Borrower to a Governmental Authority, XL Capital on behalf of such Borrower shall deliver to the Administrative Agent the original or a certified copy of a receipt issued by such Governmental Authority evidencing such payment, a copy of the return reporting such payment or other evidence of such payment reasonably satisfactory to the Administrative Agent.

(e) Exemptions. Each Lender and the Administrative Agent shall, at the written request of XL Capital, provide to any Borrower such form, certification or similar documentation, if any (each duly completed, accurate and signed) as is currently required by any Borrower Jurisdiction or any other jurisdiction, or comply with such other requirements, if any, as is currently applicable in such Borrower Jurisdiction or any other jurisdiction, in order to obtain an exemption from, or reduced rate of, deduction, payment or withholding of Indemnified Taxes or Other Taxes to which such Lender or the Administrative Agent is entitled pursuant to

---

Credit Agreement

---

- 24 -

an applicable tax treaty or the law of such Borrower Jurisdiction or any other jurisdiction; provided that XL Capital shall have furnished to such Lender or the Administrative Agent in a reasonably timely manner copies of such documentation and notice of such requirements together with applicable instructions. Upon the reasonable request of XL Capital in writing, each Lender and the Administrative Agent will provide to XL Capital such form, certification or similar documentation (each duly completed, accurate

and signed) as may in the future be required by any Borrower Jurisdiction or any other jurisdiction, or comply with such other requirements, if any, as may be applicable in such Borrower Jurisdiction or any other jurisdiction in order to obtain an exemption from, or reduced rate of, deduction, payment or withholding of Indemnified Taxes or Other Taxes to which such Lender or the Administrative Agent is entitled pursuant to an applicable tax treaty or the law of the relevant jurisdiction. In addition, each Lender agrees from time to time when a lapse in time or change in circumstances renders the previous documentation obsolete or inaccurate in any material respect, it will deliver to the Borrowers such properly completed and executed documentation as will permit such payments to continue to be made without withholding or at a reduced rate, or notify the Borrowers that it is unable to do so.

(f) If the Administrative Agent or a Lender determines, in its reasonable discretion, that it has received a refund from the relevant Governmental Authority (in cash or as an offset against another tax liability owing to such Governmental Authority) of any Taxes or Other Taxes as to which it has been indemnified by a Borrower or with respect to which a Borrower has paid additional amounts pursuant to this Section, it shall pay over such refund to such Borrower (but only to the extent of indemnity payments made, or additional amounts paid, by such Borrower under this Section with respect to the Taxes or Other Taxes giving rise to such refund), net of all out-of-pocket expenses of the Administrative Agent or such Lender and without interest (other than any interest paid by the relevant Governmental Authority with respect to such refund); provided that such Borrower, upon the request of the Administrative Agent or such Lender, agrees to repay the amount paid over to such Borrower (plus any penalties, interest or other charges imposed by the relevant Governmental Authority) to the Administrative Agent or such Lender in the event the Administrative Agent or such Lender is required to repay such refund to such Governmental Authority. This Section shall not be construed to require the Administrative Agent or any Lender to make available its tax returns (or any other information relating to its taxes not expressly required to be made available hereunder which it reasonably deems confidential) to any Borrower or any other Person.

#### SECTION 2.14. Payments Generally; Pro Rata Treatment; Sharing of Set-offs.

(a) Payments by the Borrowers. The Borrowers shall make each payment required to be made by them hereunder (whether of principal, interest or fees, under Section 2.11, 2.12 or 2.13, or otherwise) prior to 12:00 noon, New York City time, on the date when due, in immediately available funds, without set-off or counterclaim. Any amounts received after such time on any date may, in the discretion of the Administrative Agent, be deemed to have been received on the next succeeding Business Day for purposes of calculating interest thereon. All such payments shall be made to the Administrative Agent at its offices at 383 Madison Avenue, New York, New York 10179, except payments pursuant to Sections 2.11, 2.12, 2.13 and 10.03, which shall be made directly to the Persons entitled thereto. The Administrative Agent shall distribute any such payments received by it for account of any other Person to the appropriate recipient promptly following receipt thereof. If any payment

#### Credit Agreement

---

- 25 -

hereunder shall be due on a day that is not a Business Day, the date for payment shall be extended to the next succeeding Business Day and, in the case of any payment accruing interest, interest thereon shall be payable for the period of such extension. All payments hereunder shall be made in Dollars.

(b) Application of Insufficient Payments. If at any time insufficient funds are received by and available to the Administrative Agent to pay fully all amounts of principal, interest and fees then due hereunder, such funds shall be applied (i) first, to pay interest and fees then due hereunder, ratably among the parties entitled thereto in accordance with the amounts of interest and fees then due to such parties, and (ii) second, to pay principal then due hereunder, ratably among the parties entitled thereto in accordance with the amounts of principal then due to such parties.

(c) Pro Rata Treatment. Except to the extent otherwise provided herein: (i) each Borrowing shall be made from the Lenders, each payment of fees under Section 2.08 shall be made for account of the relevant Lenders, and each termination or reduction of the amount of the Commitments under Section 2.05 shall be applied to the respective Commitments, in each case pro rata according to the amounts of their respective Commitments (or, in the case of any such payment after the termination of the Commitments, pro rata according to the Aggregate Credit Exposure); (ii) each Borrowing shall be allocated pro rata among the Lenders according to the amounts of their respective Commitments (in the case of the making of Loans) or their respective Loans that are to be included in such Borrowing (in the case of conversions and continuations of Loans); (iii) each payment or prepayment of principal of Loans by any Borrower shall be made for account of the Lenders pro rata according to the respective unpaid principal amounts of the Loans of such Borrower; and (iv) each payment of interest on Loans by a Borrower shall be made for account of the Lenders pro rata according to the amounts of interest on such Loans then due and payable thereunder.

(d) Sharing of Payments by Lenders. If any Lender shall, by exercising any right of set-off or counterclaim or otherwise, obtain payment in respect of any principal of or interest on any of its Loans resulting in such Lender receiving payment of a greater proportion of the aggregate amount of its Loans and accrued interest thereon then due than the proportion received by any other relevant Lender, then the Lender receiving such greater proportion shall purchase (for cash at face value) participations in the Loans of such other Lenders to the extent necessary so that the benefit of all such payments shall be shared by the Lenders ratably in accordance with the aggregate amount of principal of and accrued interest on their respective Loans; provided that (i) if any such participations are purchased and all or any portion of the payment giving rise thereto is recovered, such participations shall be rescinded and the purchase price restored to the extent of such recovery, without interest, and (ii) the provisions of this paragraph shall not be construed to apply to any payment made by any Borrower pursuant to and in accordance with the express terms of this

Agreement or any payment obtained by a Lender as consideration for the assignment of or sale of a participation in any of its Loans to any assignee or participant, other than to any Borrower or any Subsidiary or Affiliate thereof (as to which the provisions of this paragraph shall apply). Each Borrower consents to the foregoing and agrees, to the extent it may effectively do so under applicable law, that any Lender acquiring a participation pursuant to the foregoing arrangements may exercise against such Borrower rights of set-off and counterclaim with respect to such participation as fully as if such Lender were a direct creditor of such Borrower in the amount of such participation.

### Credit Agreement

---

- 26 -

(e) Presumptions of Payment. Unless the Administrative Agent shall have received notice from a Borrower prior to the date on which any payment is due to the Administrative Agent for account of the relevant Lenders hereunder that such Borrower will not make such payment, the Administrative Agent may assume that such Borrower has made such payment on such date in accordance herewith and may, in reliance upon such assumption, distribute to the relevant Lenders the amount due. In such event, if the relevant Borrower has not in fact made such payment, then each of the Lenders severally agrees to repay to the Administrative Agent forthwith on demand the amount so distributed to such Lender with interest thereon, for each day from and including the date such amount is distributed to it to but excluding the date of payment to the Administrative Agent, at the Federal Funds Effective Rate.

(f) Certain Deductions by the Administrative Agent. If any Lender shall fail to make any payment required to be made by it pursuant to Section 2.14(e), then the Administrative Agent may, in its discretion (notwithstanding any contrary provision hereof), apply any amounts thereafter received by the Administrative Agent for account of such Lender to satisfy such Lender's obligations under such Sections until all such unsatisfied obligations are fully paid.

#### SECTION 2.15. Mitigation Obligations; Replacement of Lenders.

(a) Designation of a Different Lending Office. If any Lender requests compensation under Section 2.11, or if any Borrower is required to pay any additional amount or indemnification payment to any Lender or any Governmental Authority for account of any Lender pursuant to Section 2.13, then such Lender shall use reasonable efforts to designate a different lending office for funding or booking its Loans hereunder or to assign its rights and obligations hereunder to another of its offices, branches or Affiliates, if, in the reasonable judgment of such Lender, such designation or assignment (i) would eliminate or reduce amounts payable pursuant to Section 2.11 or 2.13, as the case may be, in the future and (ii) would not subject such Lender to any unreimbursed cost or expense and would not otherwise be disadvantageous to such Lender. Each Borrower hereby agrees to pay all reasonable costs and expenses incurred by any Lender in connection with any such designation or assignment.

(b) Replacement of Lenders. If any Lender requests compensation under Section 2.11, or if any Borrower is required to pay any additional amount to any Lender or any Governmental Authority for account of any Lender pursuant to Section 2.13, or if any Lender defaults in its obligation to fund Loans, then XL Capital may, at its sole expense and effort, upon notice to such Lender and the Administrative Agent, require such Lender to assign and delegate, without recourse (in accordance with and subject to the restrictions contained in Section 10.04), all its interests, rights and obligations under this Agreement to an assignee selected by XL Capital that shall assume such obligations (which assignee may be another Lender, if a Lender accepts such assignment); provided that (i) XL Capital shall have received the prior written consent of the Administrative Agent, which consent shall not unreasonably be withheld, (ii) such Lender shall have received payment of an amount equal to the outstanding principal of its Loans, accrued interest thereon, accrued fees and all other amounts payable to it hereunder, from the assignee (to the extent of such outstanding principal and accrued interest and fees) or the relevant Borrower (in the case of all other amounts) and (iii) in the case of any such assignment resulting from a claim for compensation under Section 2.11 or payments required to be made pursuant to Section 2.13, such assignment will result in a reduction in such compensation or payments. A Lender shall not be required to make any such assignment and delegation if, prior thereto, as a

### Credit Agreement

---

- 27 -

result of a waiver by such Lender or otherwise, the circumstances entitling the relevant Borrower to require such assignment and delegation cease to apply.

## ARTICLE III

### GUARANTEE

SECTION 3.01. The Guarantee. Each Guarantor hereby jointly and severally guarantees to each Lender and the Administrative Agent and their respective successors and assigns the prompt payment in full when due (whether at stated maturity, by acceleration or otherwise) of the principal of and interest on the Loans made by the Lenders to each of the Borrowers (other than such Guarantor in its capacity as a Borrower hereunder) and all other amounts from time to time owing to the Lenders or the Administrative Agent by such Borrowers under this Agreement, in each case strictly in accordance with the terms thereof (such obligations being herein collectively called the "Guaranteed Obligations"). Each Guarantor hereby further jointly and severally agrees that if any Borrower (other than such Guarantor in its capacity as a Borrower hereunder) shall fail to pay in full when due

(whether at stated maturity, by acceleration or otherwise) any of the Guaranteed Obligations, such Guarantor will promptly pay the same, without any demand or notice whatsoever, and that in the case of any extension of time of payment or renewal of any of the Guaranteed Obligations, the same will be promptly paid in full when due (whether at extended maturity, by acceleration or otherwise) in accordance with the terms of such extension or renewal.

SECTION 3.02. Obligations Unconditional. The obligations of the Guarantors under Section 3.01 are absolute and unconditional, joint and several, irrespective of the value, genuineness, validity, regularity or enforceability of the obligations of the Borrowers under this Agreement or any other agreement or instrument referred to herein or therein, or any substitution, release or exchange of any other guarantee of or security for any of the Guaranteed Obligations, and, to the fullest extent permitted by applicable law, irrespective of any other circumstance whatsoever that might otherwise constitute a legal or equitable discharge or defense of a surety or guarantor, it being the intent of this Article that the obligations of the Guarantors hereunder shall be absolute and unconditional, joint and several, under any and all circumstances. Without limiting the generality of the foregoing, it is agreed that the occurrence of any one or more of the following shall not alter or impair the liability of the Guarantors hereunder, which shall remain absolute and unconditional as described above:

(i) at any time or from time to time, without notice to the Guarantors, the time for any performance of or compliance with any of the Guaranteed Obligations shall be extended, or such performance or compliance shall be waived;

(ii) any of the acts mentioned in any of the provisions of this Agreement or any other agreement or instrument referred to herein shall be done or omitted; or

(iii) the maturity of any of the Guaranteed Obligations shall be accelerated, or any of the Guaranteed Obligations shall be modified, supplemented or amended in any respect, or any right under this Agreement or any other agreement or instrument referred

#### Credit Agreement

---

- 28 -

to herein shall be waived or any other guarantee of any of the Guaranteed Obligations or any security therefor shall be released or exchanged in whole or in part or otherwise dealt with.

The Guarantors hereby expressly waive diligence, presentment, demand of payment, protest and all notices whatsoever, and any requirement that the Administrative Agent or any Lender exhaust any right, power or remedy or proceed against any Borrower under this Agreement or any other agreement or instrument referred to herein, or against any other Person under any other guarantee of, or security for, any of the Guaranteed Obligations.

SECTION 3.03. Reinstatement. The obligations of the Guarantors under this Article shall be automatically reinstated if and to the extent that for any reason any payment by or on behalf of any Borrower in respect of the Guaranteed Obligations is rescinded or must be otherwise restored by any holder of any of the Guaranteed Obligations, whether as a result of any proceedings in bankruptcy or reorganization or otherwise, and the Guarantors jointly and severally agree that they will indemnify the Administrative Agent and each Lender on demand for all reasonable costs and expenses (including reasonable fees of counsel) incurred by the Administrative Agent or such Lender in connection with such rescission or restoration, including any such costs and expenses incurred in defending against any claim alleging that such payment constituted a preference, fraudulent transfer or similar payment under any bankruptcy, insolvency or similar law.

SECTION 3.04. Subrogation. The Guarantors hereby jointly and severally agree that until the payment and satisfaction in full of all Guaranteed Obligations and the expiration and termination of the Commitments they shall not exercise any right or remedy arising by reason of any performance by them of their guarantee in Section 3.01, whether by subrogation or otherwise, against any Borrower or any other guarantor of any of the Guaranteed Obligations or any security for any of the Guaranteed Obligations.

SECTION 3.05. Remedies. The Guarantors jointly and severally agree that, as between the Guarantors and the Lenders, the obligations of the Borrowers under this Agreement may be declared to be forthwith due and payable as provided in Article VIII (and shall be deemed to have become automatically due and payable in the circumstances provided in Article VIII) for purposes of Section 3.01 notwithstanding any stay, injunction or other prohibition preventing such declaration (or such obligations from becoming automatically due and payable) as against any Borrower and that, in the event of such declaration (or such obligations being deemed to have become automatically due and payable), such obligations (whether or not due and payable by any Borrower) shall forthwith become due and payable by the Guarantors for purposes of Section 3.01.

SECTION 3.06. Continuing Guarantee. The guarantee in this Article is a continuing guarantee, and shall apply to all Guaranteed Obligations whenever arising.

SECTION 3.07. Rights of Contribution. The Guarantors (other than XL Capital) hereby agree, as between themselves, that if any such Guarantor shall become an Excess Funding Guarantor (as defined below) by reason of the payment by such Guarantor of any Guaranteed Obligations, each other Guarantor (other than XL Capital) shall, on demand of such Excess

Credit Agreement

---

Funding Guarantor (but subject to the next sentence), pay to such Excess Funding Guarantor an amount equal to such Guarantor's Pro Rata Share (as defined below and determined, for this purpose, without reference to the properties, debts and liabilities of such Excess Funding Guarantor) of the Excess Payment (as defined below) in respect of such Guaranteed Obligations. The payment obligation of a Guarantor to any Excess Funding Guarantor under this Section shall be subordinate and subject in right of payment to the prior payment in full of the obligations of such Guarantor under the other provisions of this Article III and such Excess Funding Guarantor shall not exercise any right or remedy with respect to such excess until payment and satisfaction in full of all of such obligations.

For purposes of this Section, (i) "Excess Funding Guarantor" means, in respect of any Guaranteed Obligations, a Guarantor that has paid an amount in excess of its Pro Rata Share of such Guaranteed Obligations, (ii) "Excess Payment" means, in respect of any Guaranteed Obligations, the amount paid by an Excess Funding Guarantor in excess of its Pro Rata Share of such Guaranteed Obligations and (iii) "Pro Rata Share" means, for any Guarantor, the ratio (expressed as a percentage) of (x) the amount by which the aggregate present fair saleable value of all properties of such Guarantor (excluding any shares of stock of any other Guarantor) exceeds the amount of all the debts and liabilities of such Guarantor (including contingent, subordinated, unmatured and unliquidated liabilities, but excluding the obligations of such Guarantor hereunder and any obligations of any other Guarantor that have been Guaranteed by such Guarantor) to (y) the amount by which the aggregate fair saleable value of all properties of all of the Guarantors (other than XL Capital) exceeds the amount of all the debts and liabilities (including contingent, subordinated, unmatured and unliquidated liabilities, but excluding the obligations of the Guarantors under this Article III) of all of the Guarantors (other than XL Capital), determined (A) with respect to any Guarantor that is a party hereto on the date hereof, as of the date hereof, and (B) with respect to any other Guarantor, as of the date such Guarantor becomes a Guarantor hereunder.

SECTION 3.08. General Limitation on Guarantee Obligations. In any action or proceeding involving any corporate law, or any bankruptcy, insolvency, reorganization or other law affecting the rights of creditors generally, if the obligations of any Guarantor under Section 3.01 would otherwise, taking into account the provisions of Section 3.07, be held or determined to be void, invalid or unenforceable, or subordinated to the claims of any other creditors, on account of the amount of its liability under Section 3.01, then, notwithstanding any other provision hereof to the contrary, the amount of such liability shall, without any further action by such Guarantor, any Lender, the Administrative Agent or any other Person, be automatically limited and reduced to the highest amount that is valid and enforceable and not subordinated to the claims of other creditors as determined in such action or proceeding.

#### Credit Agreement

---

### ARTICLE IV

#### REPRESENTATIONS AND WARRANTIES

Each Borrower represents and warrants to the Lenders that:

SECTION 4.01. Organization; Powers. Such Borrower and each of its Significant Subsidiaries is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization, has all requisite power and authority to carry on its business as now conducted and, except where the failure to do so, individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect, is qualified to do business in, and is in good standing in, every jurisdiction where such qualification is required.

SECTION 4.02. Authorization; Enforceability. The Transactions are within such Borrowers' corporate powers and have been duly authorized by all necessary corporate and, if required, by all necessary shareholder action. This Agreement has been duly executed and delivered by such Borrower and constitutes a legal, valid and binding obligation of such Borrower, enforceable against such Borrower in accordance with its terms, except as such enforceability may be limited by (a) bankruptcy, insolvency, reorganization, moratorium, examination or similar laws of general applicability affecting the enforcement of creditors' rights and (b) the application of general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law).

SECTION 4.03. Governmental Approvals; No Conflicts. The Transactions (a) do not require any consent or approval of (including any exchange control approval), registration or filing with, or any other action by, any Governmental Authority, except such as have been obtained or made and are in full force and effect, (b) will not violate any applicable law or regulation or the charter, by-laws or other organizational documents of such Borrower or any of its Significant Subsidiaries or any order of any Governmental Authority, (c) will not violate or result in a default under any material indenture, agreement or other instrument binding upon such Borrower or any of its Significant Subsidiaries or assets, or give rise to a right thereunder to require any payment to be made by any such Person, and (d) will not result in the creation or imposition of any Lien on any asset of such Borrower or any of its Significant Subsidiaries.

SECTION 4.04. Financial Condition; No Material Adverse Change.

(a) Financial Condition. Such Borrower has heretofore furnished to the Lenders the consolidated balance sheet and statements of income, stockholders' equity and cash flows of such Borrower and its consolidated Subsidiaries (A) as of and for the fiscal year ended December 31, 2004, reported on by PricewaterhouseCoopers LLP, independent public accountants (as provided in XL Capital's Report on Form 10-K filed with the SEC for the fiscal year ended December 31, 2004), and (B) as of and for the fiscal quarter ended March 31, 2005, as provided in XL Capital's Report on Form 10-Q filed with the SEC for the fiscal quarter ended March 31, 2005. Such financial statements present fairly, in all material respects, the financial position and results of operations and cash flows of such Borrower and its respective consolidated Subsidiaries as of such dates and for such periods in accordance with GAAP or (in the case of XL Insurance or XL Re) SAP, subject to year-end audit adjustments and the absence

#### Credit Agreement

---

- 31 -

of footnotes in the case of the statements referred to in clause (B) of the first sentence of this paragraph.

(b) No Material Adverse Change. Since December 31, 2004, there has been no material adverse change in the assets, business, financial condition or operations of such Borrower and its Subsidiaries, taken as a whole.

#### SECTION 4.05. Properties.

(a) Property Generally. Such Borrower and each of its Significant Subsidiaries has good title to, or valid leasehold interests in, all its real and personal property material to its business, subject only to Liens permitted by Section 7.03 and except for minor defects in title that do not interfere with its ability to conduct its business as currently conducted or to utilize such properties for their intended purposes.

(b) Intellectual Property. Such Borrower and each of its Significant Subsidiaries owns, or is licensed to use, all trademarks, tradenames, copyrights, patents and other intellectual property material to its business, and the use thereof by such Borrower and its Subsidiaries does not infringe upon the rights of any other Person, except for any such infringements that, individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect.

#### SECTION 4.06. Litigation and Environmental Matters.

(a) Actions, Suits and Proceedings. Except as disclosed in Schedule III or as routinely encountered in claims activity, there are no actions, suits or proceedings by or before any arbitrator or Governmental Authority now pending against or, to the knowledge of such Borrower, threatened against or affecting such Borrower or any of its Subsidiaries (i) as to which there is a reasonable possibility of an adverse determination and that could reasonably be expected, individually or in the aggregate, to result in a Material Adverse Effect or (ii) that involve this Agreement or the Transactions.

(b) Environmental Matters. Except as disclosed in Schedule IV and except with respect to any other matters that, individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect, neither such Borrower nor any of its Subsidiaries (i) has failed to comply with any Environmental Law or to obtain, maintain or comply with any permit, license or other approval required for its business under any Environmental Law, (ii) has incurred any Environmental Liability, (iii) has received notice of any claim with respect to any Environmental Liability or (iv) knows of any basis for any Environmental Liability.

SECTION 4.07. Compliance with Laws and Agreements. Such Borrower and each of its Subsidiaries is in compliance with all laws, regulations and orders of any Governmental Authority applicable to it or its property and all indentures, agreements and other instruments binding upon it or its property, except where the failure to do so, individually or in the aggregate, could not reasonably be expected to result in a Material Adverse Effect. No Default has occurred and is continuing.

SECTION 4.08. Investment and Holding Company Status. Such Borrower is not (a) an "investment company" as defined in, or subject to regulation under, the Investment

#### Credit Agreement

---

- 32 -

Company Act of 1940 or (b) a "holding company" as defined in, or subject to regulation under, the Public Utility Holding Company Act of 1935.

SECTION 4.09. Taxes. Such Borrower and each of its Subsidiaries has timely filed or caused to be filed all Tax returns and reports required to have been filed and has paid or caused to be paid all Taxes required to have been paid by it, except (a) Taxes that are being contested in good faith by appropriate proceedings and for which such Person has set aside on its books adequate reserves or (b) to the extent that the failure to file any such Tax return or pay any such Taxes could not reasonably be expected to result in a Material Adverse Effect.

SECTION 4.10. ERISA. No ERISA Event has occurred or is reasonably expected to occur that, when taken together with all other such ERISA Events for which liability is reasonably expected to occur, could reasonably be expected to result in a

Material Adverse Effect. The present value of all accumulated benefit obligations under each Plan (based on the assumptions used for purposes of Statement of Financial Accounting Standards No. 87) did not, as of the date of the most recent financial statements reflecting such amounts, exceed the fair market value of the assets of such Plan by an amount that could reasonably be expected to result in a Material Adverse Effect.

Except as could not reasonably be expected to result in a Material Adverse Effect, (i) all contributions required to be made by any Borrower or any of their Subsidiaries with respect to a Non-U.S. Benefit Plan have been timely made, (ii) each Non-U.S. Benefit Plan has been maintained in compliance with its terms and with the requirements of any and all applicable laws and has been maintained, where required, in good standing with the applicable Governmental Authority and (iii) neither any Borrower nor any of their Subsidiaries has incurred any obligation in connection with the termination or withdrawal from any Non-U.S. Benefit Plan.

SECTION 4.11. Disclosure. The reports, financial statements, certificates or other information furnished by such Borrower to the Lenders in connection with the negotiation of this Agreement or delivered hereunder (taken as a whole) do not contain any material misstatement of fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; provided that, with respect to projected financial information, such Borrower represents only that such information was prepared in good faith based upon assumptions believed to be reasonable at the time.

SECTION 4.12. Use of Credit. Neither such Borrower nor any of its Subsidiaries is engaged principally, or as one of its important activities, in the business of extending credit for the purpose, whether immediate, incidental or ultimate, of buying or carrying Margin Stock. No part of the proceeds of any Loan hereunder will be used to buy or carry any Margin Stock (except for repurchases of the capital stock of XL Capital and purchases of Margin Stock in accordance with XL Capital's Statement of Investment Policy Objectives and Guidelines as in effect on the date hereof or as it may be changed from time to time by a resolution duly adopted by the board of directors of XL Capital (or any committee thereof)). The purchase of any Margin Stock with the proceeds of any Loan will not be in violation of Regulation U or X of the Board and, after applying the proceeds of such Loan, not more than 25% of the value of the assets of XL Capital and its Subsidiaries taken as a whole consists or will consist of Margin Stock.

#### Credit Agreement

---

- 33 -

SECTION 4.13. Subsidiaries. Set forth in Schedule V is a complete and correct list of all of the Subsidiaries of XL Capital as of March 31, 2005, together with, for each such Subsidiary, (i) the jurisdiction of organization of such Subsidiary, (ii) each Person holding ownership interests in such Subsidiary and (iii) the percentage of ownership of such Subsidiary represented by such ownership interests. Except as disclosed in Schedule V, (x) each of XL Capital and its Subsidiaries owns, free and clear of Liens, and has the unencumbered right to vote, all outstanding ownership interests in each Person shown to be held by it in Schedule V, (y) all of the issued and outstanding capital stock of each such Person organized as a corporation is validly issued, fully paid and nonassessable and (z) except as disclosed in filings of XL Capital with the SEC prior to the date hereof, there are no outstanding Equity Rights with respect to any Borrower.

SECTION 4.14. Withholding Taxes. Based upon information with respect to each Lender provided by each Lender to the Administrative Agent, as of the date hereof, the payment of the principal of and interest on the Loans, the fees under Section 2.08 and all other amounts payable hereunder will not be subject, by withholding or deduction, to any Indemnified Taxes imposed by Bermuda or the Cayman Islands.

SECTION 4.15. Stamp Taxes. To ensure the legality, validity, enforceability or admissibility in evidence of this Agreement or any promissory notes evidencing Loans made (or to be made), it is not necessary, as of the date hereof, that this Agreement or such promissory notes or any other document be filed or recorded with any Governmental Authority in Bermuda or the Cayman Islands, or that any stamp or similar tax be paid on or in respect of this Agreement in any such jurisdiction, or such promissory notes or any other document other than such filings and recordations that have already been made and such stamp or similar taxes that have been paid.

SECTION 4.16. Legal Form. Each of this Agreement and any promissory notes evidencing Loans made (or to be made) is in proper legal form under the laws of any Borrower Jurisdiction for the admissibility thereof in the courts of such Borrower Jurisdiction.

#### ARTICLE V

#### CONDITIONS

SECTION 5.01. Effective Date. The obligations of the Lenders to make Loans hereunder are subject to the receipt by the Administrative Agent of each of the following documents, each of which shall be satisfactory to the Administrative Agent (and to the extent specified below, to each Lender) in form and substance (or such condition shall have been waived in accordance with Section 10.02):

(a) Executed Counterparts. From each party hereto either (i) a counterpart of this Agreement signed on behalf of such party or (ii) written evidence satisfactory to the Administrative Agent (which may include telecopy transmission of a signed signature page to this Agreement) that such party has signed a counterpart of this Agreement.

### Credit Agreement

---

- 34 -

(b) Opinions of Counsel to the Obligors. Opinions, each dated the Effective Date, of (i) Charles F. Barr, Esq., counsel to XL Capital, substantially in the form of Exhibit B-1, (ii) Richard G. McCarty, Esq., counsel to XL America, substantially in the form of Exhibit B-2, (iii) Cahill Gordon & Reindel LLP, special U.S. counsel for the Obligors, substantially in the form of Exhibit B-3, (iv) Conyers, Dill & Pearman, special Bermuda counsel to XL Insurance and XL Re, substantially in the form of Exhibit B-4 and (v) Appleby Spurling Hunter, special Cayman Islands counsel to XL Capital, substantially in the form of Exhibit B-5.

(c) Corporate Documents. Such documents and certificates as the Administrative Agent or its counsel may reasonably request relating to the organization, existence and good standing, if applicable, of the Obligors, the authorization of the Transactions and any other legal matters relating to the Obligors, this Agreement or the Transactions, all in form and substance reasonably satisfactory to the Administrative Agent and its counsel.

(d) Officer's Certificate. A certificate, dated the Effective Date and signed by the President, a Vice President or a Financial Officer of XL Capital, confirming compliance with the conditions set forth in the lettered clauses of the first sentence of Section 5.02.

(e) Other Documents. Such other documents as the Administrative Agent or any Lender or its counsel may reasonably request.

The obligation of any Lender to make its initial extension of credit hereunder is also subject to the payment by XL Capital of such fees as XL Capital shall have agreed to pay to any Lender or the Administrative Agent in connection herewith, including the reasonable fees and expenses of one counsel to the initial Lender hereunder, in connection with the negotiation, preparation, execution and delivery of this Agreement and the extensions of credit hereunder (to the extent that reasonably detailed statements for such fees and expenses have been delivered to XL Capital).

The Administrative Agent shall notify the Borrowers and the Lenders of the Effective Date, and such notice shall be conclusive and binding.

SECTION 5.02. Each Credit Event. The obligation of each Lender to make any Loan is additionally subject to the satisfaction of the following conditions:

(a) the representations and warranties of the Obligors set forth in this Agreement (other than, at any time after the Effective Date, in Section 4.04(b)) shall be true and correct on and as of the date of such Loan (or, if any such representation or warranty is expressly stated to have been made as of a specific date, as of such specific date); and

(b) at the time of and immediately after giving effect to the making of such Loan, no Default shall have occurred and be continuing.

Each Borrowing shall be deemed to constitute a representation and warranty by the Obligors on the date thereof as to the matters specified in clauses (a) and (b) of the immediately preceding sentence.

### Credit Agreement

---

- 35 -

## ARTICLE VI

### AFFIRMATIVE COVENANTS

Until the Commitments have expired or been terminated, the principal of and interest on each Loan and all fees payable hereunder shall have been paid in full, the Borrowers covenant and agree with the Lenders that:

SECTION 6.01. Financial Statements and Other Information. Each Borrower will furnish to the Administrative Agent and each Lender:

(a) within 135 days after the end of each fiscal year of each Borrower except for XL America (but in the case of XL Capital, within 100 days after the end of each fiscal year of XL Capital), the audited consolidated balance sheet and related statements of operations, stockholders' equity and cash flows of such Borrower and its consolidated Subsidiaries as of the end of and for such year, setting forth in each case in comparative form the figures for the previous fiscal year (if such figures were already produced for such corresponding period or periods) (it being understood that delivery to the Lenders of XL

Capital's Report on Form 10-K filed with the SEC shall satisfy the financial statement delivery requirements of this paragraph (a) to deliver the annual financial statements of XL Capital so long as the financial information required to be contained in such Report is substantially the same as the financial information required under this paragraph (a)), all reported on by independent public accountants of recognized national standing (without a "going concern" or like qualification or exception and without any qualification or exception as to the scope of such audit) to the effect that such consolidated financial statements present fairly in all material respects the financial condition and results of operations of such Borrower and its consolidated Subsidiaries on a consolidated basis in accordance with GAAP or (in the case of XL Insurance and XL Re) SAP, as the case may be, consistently applied;

(b) by June 15 of each year, (i) an unaudited consolidated balance sheet and related statements of operations, stockholders' equity and cash flows of XL America and its consolidated Subsidiaries as of the end of and for the immediately preceding fiscal year, setting forth in each case in comparative form the figures for the previous fiscal year (if such figures were already produced for such corresponding period or periods), all certified by a Financial Officer of XL America as presenting fairly in all material respects the financial condition and results of operations of XL America and its consolidated Subsidiaries on a consolidated basis in accordance with GAAP consistently applied, subject to normal year-end audit adjustments and the absence of footnotes, and (ii) audited statutory financial statements for each Insurance Subsidiary of XL America reported on by independent public accountants of recognized national standing (without a "going concern" or like qualification or exception and without any qualification or exception as to the scope of such audit) to the effect that such audited consolidated financial statements present fairly in all material respects the financial condition and results of operations of such Insurance Subsidiaries in accordance with SAP, consistently applied;

### Credit Agreement

---

- 36 -

(c) within 60 days after the end of each of the first three fiscal quarters of each fiscal year of such Borrower, the consolidated balance sheet and related statements of operations, stockholders' equity and cash flows of such Borrower and its consolidated Subsidiaries as of the end of and for such fiscal quarter and the then elapsed portion of the fiscal year, setting forth in each case in comparative form the figures for (or, in the case of the balance sheet, as of the end of) the corresponding period or periods of the previous fiscal year (if such figures were already produced for such corresponding period or periods), all certified by a Financial Officer of such Borrower as presenting fairly in all material respects the financial condition and results of operations of such Borrower and its consolidated Subsidiaries on a consolidated basis in accordance with GAAP or (in the case of XL Insurance and XL Re) SAP, as the case may be, consistently applied, subject to normal year-end audit adjustments and the absence of footnotes (it being understood that delivery to the Lenders of XL Capital's Report on Form 10-Q filed with the SEC shall satisfy the financial statement delivery requirements of this paragraph (c) to deliver the quarterly financial statements of XL Capital so long as the financial information required to be contained in such Report is substantially the same as the financial information required under this paragraph (c));

(d) concurrently with any delivery of financial statements under clause (a), (b) or (c) of this Section, a certificate signed on behalf of each Borrower by a Financial Officer (i) certifying as to whether a Default has occurred and, if a Default has occurred, specifying the details thereof and any action taken or proposed to be taken with respect thereto, (ii) setting forth reasonably detailed calculations demonstrating compliance with Sections 7.03, 7.05, 7.06 and 7.07 and (iii) stating whether any change in GAAP or (in the case of XL Insurance, XL Re and any Insurance Subsidiary of XL America) SAP or in the application thereof has occurred since the date of the audited financial statements referred to in Section 4.04 and, if any such change has occurred, specifying any material effect of such change on the financial statements accompanying such certificate;

(e) concurrently with any delivery of financial statements under clauses (a) and (b)(ii) of this Section, a certificate of the accounting firm that reported on such financial statements stating whether they obtained knowledge during the course of their examination of such financial statements of any Default (which certificate may be limited to the extent required by accounting rules or guidelines);

(f) promptly after the same become publicly available, copies of all periodic and other reports, proxy statements and other materials filed by such Borrower or any of its respective Subsidiaries with the SEC, or any Governmental Authority succeeding to any or all of the functions of said Commission, or with any U.S. or other securities exchange, or distributed by such Borrower to its shareholders generally, as the case may be;

(g) concurrently with any delivery of financial statements under clause (a), (b) or (c) of this Section, a certificate of a Financial Officer of XL Capital, setting forth on a consolidated basis for XL Capital and its consolidated Subsidiaries as of the end of the fiscal year or quarter to which such certificate relates (i) the aggregate book value of assets which are subject to Liens permitted under Section 7.03(h) and the aggregate book value of liabilities which are subject to Liens permitted under Section 7.03(h)(it being understood that the reports required by paragraphs (a), (b) and (c) of this Section shall

### Credit Agreement

---

- 37 -

satisfy the requirement of this clause (i) of this paragraph (g) if such reports set forth separately, in accordance with GAAP, line items corresponding to such aggregate book values) and (ii) a calculation showing the portion of each of such aggregate amounts which portion is attributable to transactions among wholly-owned Subsidiaries of XL Capital;

(h) within 90 days after the end of each of the first three fiscal quarters of each fiscal year and within 135 days after the end of each fiscal year of XL Capital (commencing with the fiscal year ending December 31, 2005), a statement of a Financial Officer of XL Capital listing, as of the end of the immediately preceding fiscal quarter of XL Capital, the amount of cash and the securities of the Borrowers and their Subsidiaries that have been posted as collateral under Section 7.03(f); and

(i) promptly following any request therefor, such other information regarding the operations, business affairs and financial condition of XL Capital or any of its Subsidiaries, or compliance with the terms of this Agreement, as the Administrative Agent or any Lender may reasonably request.

SECTION 6.02. Notices of Material Events. Each Borrower will furnish to the Administrative Agent and each Lender prompt written notice of the following:

(a) the occurrence of any Default; and

(b) any event or condition constituting, or which could reasonably be expected to have a Material Adverse Effect.

Each notice delivered under this Section shall be accompanied by a statement of a Financial Officer or other executive officer of the relevant Borrower setting forth the details of the event or development requiring such notice and any action taken or proposed to be taken by such Borrower with respect thereto.

SECTION 6.03. Preservation of Existence and Franchises. Each Borrower will, and will cause each of its Significant Subsidiaries to, maintain its corporate existence and its material rights and franchises in full force and effect in its jurisdiction of incorporation; provided that the foregoing shall not prohibit any merger or consolidation permitted under Section 7.01. Each Borrower will, and will cause each of its Subsidiaries to, qualify and remain qualified as a foreign corporation in each jurisdiction in which failure to receive or retain such qualification would have a Material Adverse Effect.

SECTION 6.04. Insurance. Each Borrower will, and will cause each of its Significant Subsidiaries to, maintain with financially sound and reputable insurers, insurance with respect to its properties in such amounts as is customary in the case of corporations engaged in the same or similar businesses having similar properties similarly situated.

SECTION 6.05. Maintenance of Properties. Each Borrower will, and will cause each of its Subsidiaries to, maintain or cause to be maintained in good repair, working order and condition the properties now or hereafter owned, leased or otherwise possessed by and used or useful in its business and will make or cause to be made all needful and proper repairs, renewals,

#### Credit Agreement

---

- 38 -

replacements and improvements thereto so that the business carried on in connection therewith may be properly conducted at all times except if the failure to do so would not have a Material Adverse Effect, provided, however, that the foregoing shall not impose on such Borrower or any Subsidiary of such Borrower any obligation in respect of any property leased by such Borrower or such Subsidiary in addition to such Borrower's obligations under the applicable document creating such Borrower's or such Subsidiary's lease or tenancy.

SECTION 6.06. Payment of Taxes and Other Potential Charges and Priority Claims; Payment of Other Current Liabilities. Each Borrower will, and will cause each of its Subsidiaries to, pay or discharge:

(a) on or prior to the date on which penalties attach thereto, all taxes, assessments and other governmental charges or levies imposed upon it or any of its properties or income;

(b) on or prior to the date when due, all lawful claims of materialmen, mechanics, carriers, warehousemen, landlords and other like Persons which, if unpaid, might result in the creation of a Lien upon any such property; and

(c) on or prior to the date when due, all other lawful claims which, if unpaid, might result in the creation of a Lien upon any such property (other than Liens not forbidden by Section 7.03) or which, if unpaid, might give rise to a claim entitled to priority over general creditors of such Borrower or such Subsidiary in any proceeding under the Bermuda Companies Law or Bermuda Insurance Law, or any insolvency proceeding, liquidation, receivership, rehabilitation, dissolution or winding-up involving such Borrower or such Subsidiary;

provided that unless and until foreclosure, distraint, levy, sale or similar proceedings shall have been commenced, such Borrower or such Subsidiary need not pay or discharge any such tax, assessment, charge, levy or claim (i) so long as the validity thereof is contested in good faith and by appropriate proceedings diligently conducted and so long as such reserves or other appropriate provisions as may be required by GAAP or SAP, as the case may be, shall have been made therefor or (ii) so long as such failure to pay or discharge would not have a Material Adverse Effect.

SECTION 6.07. Financial Accounting Practices. Such Borrower will, and will cause each of its consolidated Subsidiaries to, make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect its transactions and dispositions of its assets and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements required under Section 6.01 in conformity with GAAP and SAP, as applicable, and to maintain accountability for assets.

SECTION 6.08. Compliance with Applicable Laws. Each Borrower will, and will cause each of its Subsidiaries to, comply with all applicable Laws (including but not limited to the Bermuda Companies Law and Bermuda Insurance Laws) in all respects; provided that such Borrower or any Subsidiary of such Borrower will not be deemed to be in violation of this Section as a result of any failure to comply with any such Law which would not (i) result in

---

Credit Agreement

- 39 -

finances, penalties, injunctive relief or other civil or criminal liabilities which, in the aggregate, would have a Material Adverse Effect or (ii) otherwise impair the ability of such Borrower to perform its obligations under this Agreement.

SECTION 6.09. Use of Loan Proceeds. No part of the proceeds of any Loan will be used, whether directly or indirectly, for any purpose that entails a violation of any of the Regulations of the Board, including Regulations U and X. Each Borrower will use the proceeds of all Loans made to it for the general corporate purposes of, such Borrower and its Affiliates.

SECTION 6.10. Continuation of and Change in Businesses. Each Borrower and its Significant Subsidiaries will continue to engage in substantially the same business or businesses it engaged in (or proposes to engage in) on the date of this Agreement and businesses related or incidental thereto.

SECTION 6.11. Visitation. Each Borrower will permit such Persons as any Lender may reasonably designate to visit and inspect any of the properties of such Borrower, to discuss its affairs with its financial management, and provide such other information relating to the business and financial condition of such Borrower at such times as such Lender may reasonably request. Each Borrower hereby authorizes its financial management to discuss with any Lender the affairs of such Borrower.

SECTION 6.12. "Most Favored Lender" Status. If at any time after the Effective Date XL Capital shall enter into any new syndicated credit facility (including any increase, renewal, extension, amendment, restatement or replacement of either of the Other Credit Agreements) that contains any provision (each a "Subject Provision") which is more beneficial to the lenders under such new syndicated credit facility, or is more restrictive on XL Capital or any of its Subsidiaries, than the provisions of this Agreement, then XL Capital shall provide prompt written notice thereof to the Administrative Agent (and furnish the Administrative Agent a copy of the definitive documentation for such new syndicated credit facility). Thereupon, unless waived in writing by the Required Lenders within 10 Business Days of the Administrative Agent's receipt of such notice, such Subject Provision shall be deemed incorporated by reference into this Agreement, *mutatis mutandis*, as if set forth fully herein effective as of the date when such Subject Provision became effective under such new syndicated credit facility. If at any time the terms of any Subject Provision incorporated into this Agreement pursuant to this Section shall be amended or otherwise modified in a manner that is beneficial to XL Capital, then, upon notice thereof by XL Capital to the Administrative Agent, such Subject Provision shall be deemed so amended or otherwise modified in this Agreement, provided that, to the extent that XL Capital shall directly or indirectly pay or cause to be paid any amendment or similar fee to lenders (but not including any agency or upfront fees in connection with any such new syndicated credit facility) as consideration for or as an inducement to the entering into of any amendment or modification of any Subject Provision, XL Capital shall pay such fee, on the same terms, ratably to each Lender. Upon the request of the Required Lenders, the Obligors shall enter into such amendments to this Agreement as the Required Lenders may reasonably request, evidencing the incorporation of such Subject Provision into this Agreement.

---

Credit Agreement

- 40 -

ARTICLE VII

NEGATIVE COVENANTS

Until the Commitments have expired or terminated, the principal of and interest on each Loan and all fees payable hereunder have been paid in full, each of the Borrowers covenants and agrees with the Lenders that:

SECTION 7.01. Mergers. No Borrower will merge with or into or consolidate with any other Person, except that if no Default shall occur and be continuing or shall exist at the time of such merger or consolidation or immediately thereafter and after giving effect thereto (a) any Borrower may merge or consolidate with any other corporation, including a Subsidiary, if such Borrower shall be the surviving corporation, (b) XL Capital may merge with or into or consolidate with any other Person in a transaction that does not result in a reclassification, conversion, exchange or cancellation of the outstanding shares of capital stock of XL Capital (other than the cancellation of any outstanding shares of capital stock of XL Capital held by the Person with whom it merges or consolidates) and (c) any Borrower may enter into a merger or consolidation which is effected solely to change the

jurisdiction of incorporation of such Borrower and results in a reclassification, conversion or exchange of outstanding shares of capital stock of such Borrower solely into shares of capital stock of the surviving entity.

SECTION 7.02. Dispositions. No Borrower will, nor will it permit any of its Significant Subsidiaries to, sell, convey, assign, lease, abandon or otherwise transfer or dispose of, voluntarily or involuntarily (any of the foregoing being referred to in this Section as a “Disposition” and any series of related Dispositions constituting but a single Disposition), any of its properties or assets, tangible or intangible (including but not limited to sale, assignment, discount or other disposition of accounts, contract rights, chattel paper or general intangibles with or without recourse), except:

(a) Dispositions in the ordinary course of business involving current assets or other invested assets classified on such Borrower’s or its respective Subsidiaries’ balance sheet as available for sale or as a trading account;

(b) sales, conveyances, assignments or other transfers or dispositions in immediate exchange for cash or tangible assets, provided that any such sales, conveyances or transfers shall not individually, or in the aggregate for the Borrowers and their respective Subsidiaries, exceed \$500,000,000 in any calendar year;

(c) Dispositions of equipment or other property which is obsolete or no longer used or useful in the conduct of the business of such Borrower or its Subsidiaries; or

(d) Dispositions from a Borrower or a wholly-owned Subsidiary to any other Borrower or wholly-owned Subsidiary.

#### Credit Agreement

---

- 41 -

SECTION 7.03. Liens. No Borrower will, nor will it permit any of its Subsidiaries to, create, incur, assume or permit to exist any Lien on any property or assets, tangible or intangible, now owned or hereafter acquired by it, except:

(a) Liens existing on the date hereof (and extension, renewal and replacement Liens upon the same property, provided that the amount secured by each Lien constituting such an extension, renewal or replacement Lien shall not exceed the amount secured by the Lien theretofore existing) and listed on Part B of Schedule II;

(b) Liens arising from taxes, assessments, charges, levies or claims described in Section 6.06 that are not yet due or that remain payable without penalty or to the extent permitted to remain unpaid under the provision of Section 6.06;

(c) Liens on property securing all or part of the purchase price thereof to such Borrower and Liens (whether or not assumed) existing on property at the time of purchase thereof by such Borrower (and extension, renewal and replacement Liens upon the same property); provided (i) each such Lien is confined solely to the property so purchased, improvements thereto and proceeds thereof, and (ii) the aggregate amount of the obligations secured by all such Liens on any particular property at any time purchased by such Borrower, as applicable, shall not exceed 100% of the lesser of the fair market value of such property at such time or the actual purchase price of such property;

(d) zoning restrictions, easements, minor restrictions on the use of real property, minor irregularities in title thereto and other minor Liens that do not in the aggregate materially detract from the value of a property or asset to, or materially impair its use in the business of, such Borrower or any such Subsidiary;

(e) Liens securing Indebtedness permitted by Section 7.07(b) covering assets whose market value is not materially greater than the amount of the Indebtedness secured thereby plus a commercially reasonable margin;

(f) Liens on cash and securities of a Borrower or any of its Subsidiaries incurred as part of the management of its investment portfolio including, but not limited to, pursuant to any International Swaps and Derivatives Association, Inc. (“ISDA”) documentation or any Specified Transaction Agreement in accordance with XL Capital’s Statement of Investment Policy Objectives and Guidelines as in effect on the date hereof or as it may be changed from time to time by a resolution duly adopted by the board of directors of XL Capital (or any committee thereof);

(g) Liens on cash and securities not to exceed \$500,000,000 in the aggregate securing obligations of a Borrower or any of its Subsidiaries arising under any ISDA documentation or any other Specified Transaction Agreement (it being understood that in no event shall this clause (g) preclude any Person (other than any Subsidiary of XL Capital) in which XL Capital or any of its Subsidiaries shall invest (each an “investee”) from granting Liens on such Person’s assets to secure hedging obligations of such Person, so long as such obligations are non-recourse to XL Capital or any of its Subsidiaries (other than any investees)), provided that, for purposes of determining the aggregate amount of cash and/or securities subject to such Liens under this clause (g), the aggregate

#### Credit Agreement

---

- 42 -

amount of cash and/or securities on which any Borrower or any Subsidiary shall have granted a Lien in favor of a counterparty at any time shall be netted against the aggregate amount of cash and/or securities on which such counterparty shall have granted a Lien in favor of such Borrower or such Subsidiary, as the case may be, at such time, so long as the relevant agreement between such Borrower or such Subsidiary, as the case may be, provides for the netting of their respective obligations thereunder;

(h) Liens on (i) assets received, and on actual or imputed investment income on such assets received incurred as part of its business including activities utilizing ISDA documentation or any Specified Transaction Agreement relating and identified to specific insurance payment liabilities or to liabilities arising in the ordinary course of any Borrowers' or any of their Subsidiary's business as an insurance or reinsurance company (including GICs and Stable Value Instruments) or corporate member of The Council of Lloyd's or as a provider of financial or investment services or contracts, or the proceeds thereof (including GICs and Stable Value Instruments), in each case held in a segregated trust, trust or other account and securing such liabilities, (ii) assets securing Exempt Indebtedness of any Person (other than XL Capital or any of its Affiliates) in the event such Exempt Indebtedness is consolidated on the consolidated balance sheet of XL Capital and its consolidated Subsidiaries in accordance with GAAP or (iii) any other assets subject to any trust or other account arising out of or as a result of contractual, regulatory or any other requirements; provided that in no case shall any such Lien secure Indebtedness and any Lien which secures Indebtedness shall not be permitted under this clause (h);

(i) statutory and common law Liens of materialmen, mechanics, carriers, warehousemen and landlords and other similar Liens arising in the ordinary course of business; and

(j) Liens existing on property of a Person immediately prior to its being consolidated with or merged into any Borrower or any of their Subsidiaries or its becoming a Subsidiary, and Liens existing on any property acquired by any Borrower or any of their Subsidiaries at the time such property is so acquired (whether or not the Indebtedness secured thereby shall have been assumed) (and extension, renewal and replacement Liens upon the same property, provided that the amount secured by each Lien constituting such an extension, renewal or replacement Lien shall not exceed the amount secured by the Lien theretofore existing), provided that (i) no such Lien shall have been created or assumed in contemplation of such consolidation or merger or such Person's becoming a Subsidiary or such acquisition of property and (ii) each such Lien shall extend solely to the item or items of property so acquired and, if required by terms of the instrument originally creating such Lien, other property which is an improvement to or is acquired for specific use in connection with such acquired property.

SECTION 7.04. Transactions with Affiliates. No Borrower will, nor will it permit any of its Significant Subsidiaries to, enter into or carry out any transaction with (including purchase or lease property or services to, loan or advance to or enter into, suffer to remain in existence or amend any contract, agreement or arrangement with) any Affiliate of such Borrower, or directly or indirectly agree to do any of the foregoing, except (i) transactions

#### Credit Agreement

---

- 43 -

involving guarantees or co-obligors with respect to any Indebtedness described in Part A of Schedule II, (ii) transactions among the Borrowers and their wholly-owned Subsidiaries and (iii) transactions with Affiliates in good faith in the ordinary course of such Borrower's business consistent with past practice and on terms no less favorable to such Borrower or any Subsidiary than those that could have been obtained in a comparable transaction on an arm's length basis from an unrelated Person.

SECTION 7.05. Ratio of Total Funded Debt to Total Capitalization. XL Capital will not permit its ratio of (a) Total Funded Debt to (b) the sum of Total Funded Debt plus Consolidated Net Worth to be greater than 0.35:1.00 at any time.

SECTION 7.06. Consolidated Net Worth. XL Capital will not permit its Consolidated Net Worth to be less than the sum of (a) \$5,000,000,000 plus (b) 25% of consolidated net income (if positive) of XL Capital and its Subsidiaries for each fiscal quarter ending on or after June 30, 2005.

SECTION 7.07. Indebtedness. No Borrower will, nor will it permit any of its Subsidiaries to, at any time create, incur, assume or permit to exist any Indebtedness, or agree, become or remain liable (contingent or otherwise) to do any of the foregoing, except:

(a) Indebtedness created hereunder;

(b) secured Indebtedness (including secured reimbursement obligations with respect to letters of credit) of any Borrower or any Subsidiary in an aggregate principal amount (for all Borrowers and their respective Subsidiaries) not exceeding at any time outstanding 15% of Consolidated Net Worth;

(c) other unsecured Indebtedness, so long as upon the incurrence thereof no Default would occur or exist;

(d) Indebtedness consisting of accounts or claims payable and accrued and deferred compensation (including options) incurred in the ordinary course of business by any Borrower or any Subsidiary;

(e) Indebtedness incurred in transactions described in Section 7.03(f) and (g); and

(f) Indebtedness existing on the date hereof and described in Part A of Schedule II and extensions, renewals and replacements of any such Indebtedness that do not increase the outstanding principal amount thereof.

SECTION 7.08. Financial Strength Ratings. None of XL Capital, XL Insurance and XL Re will permit at any time its financial strength ratings to be less than "A-" from A.M. Best & Co. (or its successor).

SECTION 7.09. Private Act. No Borrower will become subject to a Private Act other than the X.L. Insurance Company, Ltd. Act, 1989.

SECTION 7.10. Ratable Borrowings. No Borrower shall permit Loans to be outstanding hereunder in an aggregate principal amount greater than the Maximum Percentage of

#### Credit Agreement

---

- 44 -

the Aggregate Revolving Credit Exposure for a period of more than 10 Business Days; provided that, if an Event of Default shall have occurred and be continuing, no Borrower shall permit Loans to be outstanding hereunder in an aggregate principal amount greater than the Maximum Percentage of the Aggregate Revolving Credit Exposure at any time. For this purpose, (i) "Aggregate Revolving Credit Commitments" means, at any time, the sum of, without duplication, (a) the Commitments then in effect and (b) the maximum amount of commitments to make loans (whether used or unused) by the lenders under the Other Credit Agreements then in effect; (ii) "Aggregate Revolving Credit Exposure" means, at any time, the sum of (a) the Aggregate Credit Exposure and (b) the aggregate outstanding principal amount of the loans under the Other Credit Agreements at such time; and (iii) "Maximum Percentage" means the percentage of the Aggregate Revolving Credit Commitments represented by the Commitments.

### ARTICLE VIII

#### EVENTS OF DEFAULT

If any of the following events ("Events of Default") shall occur:

(a) any Borrower shall fail to pay any principal of any Loan when and as the same shall become due and payable, whether at the due date thereof or at a date fixed for prepayment thereof or otherwise;

(b) any Borrower shall fail to pay any interest on any Loan or any fee payable under this Agreement or any other amount (other than an amount referred to in clause (a) of this Article) payable under this Agreement, when and as the same shall become due and payable, and such failure shall continue unremedied for a period of 5 or more days;

(c) any representation or warranty made or deemed made by any Borrower in or in connection with this Agreement or any amendment or modification hereof, or in any certificate or financial statement furnished pursuant to the provisions hereof, shall prove to have been false or misleading in any material respect as of the time made (or deemed made) or furnished;

(d) any Borrower shall fail to observe or perform any covenant, condition or agreement contained in Article VII;

(e) any Obligor shall fail to observe or perform any covenant, condition or agreement contained in this Agreement (other than those specified in clause (a), (b) or (d) of this Article or the reporting requirement pursuant to Section 6.01(h)) and such failure shall continue unremedied for a period of 20 or more days after notice thereof from the Administrative Agent (given at the request of any Lender) to such Obligor;

(f) any Borrower or any of its Subsidiaries shall default (i) in any payment of principal of or interest on any other obligation for borrowed money in principal amount of \$50,000,000 or more, or any payment of any principal amount of \$50,000,000 or more under Hedging Agreements, in each case beyond any period of grace provided with respect thereto, or (ii) in the performance of any other agreement, term or condition

#### Credit Agreement

---

- 45 -

contained in any such agreement (other than Hedging Agreements) under which any such obligation in principal amount of \$50,000,000 or more is created, if the effect of such default is to cause or permit the holder or holders of such obligation (or trustee on behalf of such holder or holders) to cause such obligation to become due prior to its stated maturity or to terminate its commitment under such agreement, provided that this clause (f) shall not apply to secured Indebtedness that becomes due as a result of the voluntary sale or transfer of the property or assets securing such Indebtedness;

(g) a decree or order by a court having jurisdiction in the premises shall have been entered adjudging any Borrower a bankrupt or insolvent, or approving as properly filed a petition seeking reorganization of such Borrower under the Bermuda Companies Law or the Cayman Islands Companies Law or any other similar applicable Law, and such decree or order shall have continued undischarged or unstayed for a period of 60 days; or a decree or order of a court having jurisdiction in the

premises for the appointment of an examiner, receiver or liquidator or trustee or assignee in bankruptcy or insolvency of such Borrower or a substantial part of its property, or for the winding up or liquidation of its affairs, shall have been entered, and such decree or order shall have continued undischarged and unstayed for a period of 60 days;

(h) any Borrower shall institute proceedings to be adjudicated a voluntary bankrupt, or shall consent to the filing of a bankruptcy proceeding against it, or shall file a petition or answer or consent seeking reorganization under the Bermuda Companies Law or the Cayman Islands Companies Law or any other similar applicable Law, or shall consent to the filing of any such petition, or shall consent to the appointment of an examiner, receiver or liquidator or trustee or assignee in bankruptcy or insolvency of it or a substantial part of its property, or shall make an assignment for the benefit of creditors, or shall admit in writing its inability to pay its debts generally as they become due, or corporate or other action shall be taken by such Borrower in furtherance of any of the aforesaid purposes;

(i) one or more judgments for the payment of money in an aggregate amount in excess of \$100,000,000 shall be rendered against any Borrower or any of its Subsidiaries or any combination thereof and the same shall not have been vacated, discharged, stayed (whether by appeal or otherwise) or bonded pending appeal within 45 days from the entry thereof;

(j) an ERISA Event (or similar event with respect to any Non-U.S. Benefit Plan) shall have occurred that, in the opinion of the Required Lenders, when taken together with all other ERISA Events and such similar events that have occurred, could reasonably be expected to result in liability of the Borrowers and their Subsidiaries in an aggregate amount exceeding \$100,000,000;

(k) a Change in Control shall occur;

(l) XL Capital shall cease to own, beneficially and of record, directly or indirectly all of the outstanding voting shares of capital stock of XL Insurance, XL Re or XL America; or

#### Credit Agreement

---

- 46 -

(m) the guarantee contained in Article III shall terminate or cease, in whole or material part, to be a legally valid and binding obligation of each Guarantor or any Guarantor or any Person acting for or on behalf of any of such parties shall contest such validity or binding nature of such guarantee itself or the Transactions, or any other Person shall assert any of the foregoing;

then, and in every such event (other than an event with respect to any Borrower described in clause (g) or (h) of this Article), and at any time thereafter during the continuance of such event, the Administrative Agent may, and at the request of the Required Lenders shall, by notice to the Borrowers, take either or both of the following actions, at the same or different times: (i) terminate the Commitments, and thereupon the Commitments shall terminate immediately, and (ii) declare the Loans then outstanding to be due and payable in whole (or in part, in which case any principal not so declared to be due and payable may thereafter be declared to be due and payable), and thereupon the principal of the Loans so declared to be due and payable, together with accrued interest thereon and all fees and other obligations of the Borrowers accrued hereunder, shall become due and payable immediately, without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Borrowers; and in case of any event with respect to any Borrower described in clause (g) or (h) of this Article, the Commitments shall automatically terminate and the principal of the Loans then outstanding, together with accrued interest thereon and all fees and other obligations of the Borrowers accrued hereunder, shall automatically become due and payable, without presentment, demand, protest or other notice of any kind, all of which are hereby waived by the Borrowers.

### ARTICLE IX

#### THE ADMINISTRATIVE AGENT

Each of the Lenders hereby irrevocably appoints the Administrative Agent as its agent and authorizes the Administrative Agent to take such actions on its behalf and to exercise such powers as are delegated to the Administrative Agent by the terms hereof, together with such actions and powers as are reasonably incidental thereto.

The Person serving as the Administrative Agent hereunder shall have the same rights and powers in its capacity as a Lender as any other Lender and may exercise the same as though it were not the Administrative Agent, and such Person and its Affiliates may accept deposits from, lend money to and generally engage in any kind of business with any Borrower or any Subsidiary or other Affiliate thereof as if it were not the Administrative Agent hereunder.

The Administrative Agent shall not have any duties or obligations except those expressly set forth herein. Without limiting the generality of the foregoing, (a) the Administrative Agent shall not be subject to any fiduciary or other implied duties, regardless of whether a Default has occurred and is continuing, (b) the Administrative Agent shall not have any duty to take any discretionary action or exercise any discretionary powers, except discretionary rights and powers expressly contemplated hereby that the Administrative Agent is required to exercise in writing by the Required Lenders, and (c) except as expressly set forth herein, the Administrative Agent shall not have any duty to disclose, and shall not be liable for

the failure to disclose, any information relating to any Borrower or any of their Subsidiaries that is communicated to or obtained by the bank serving as Administrative Agent or any of its Affiliates in any capacity. The Administrative Agent shall not be liable for any action taken or not taken by it with the consent or at the request of the Required Lenders or in the absence of its own gross negligence or willful misconduct. The Administrative Agent shall be deemed not to have knowledge of any Default unless and until written notice thereof is given to the Administrative Agent by a Borrower or a Lender, and the Administrative Agent shall not be responsible for or have any duty to ascertain or inquire into (i) any statement, warranty or representation made in or in connection with this Agreement, (ii) the contents of any certificate, report or other document delivered hereunder or in connection herewith, (iii) the performance or observance of any of the covenants, agreements or other terms or conditions set forth herein, (iv) the validity, enforceability, effectiveness or genuineness of this Agreement or any other agreement, instrument or document, or (v) the satisfaction of any condition set forth in Article V or elsewhere herein, other than to confirm receipt of items expressly required to be delivered to the Administrative Agent.

The Administrative Agent shall be entitled to rely upon, and shall not incur any liability for relying upon, any notice, request, certificate, consent, statement, instrument, document or other writing believed by it to be genuine and to have been signed or sent by the proper Person. The Administrative Agent also may rely upon any statement made to it orally or by telephone and believed by it to be made by the proper Person, and shall not incur any liability for relying thereon. The Administrative Agent may consult with legal counsel (who may be counsel for any Borrower), independent accountants and other experts selected by it, and shall not be liable for any action taken or not taken by it in accordance with the advice of any such counsel, accountants or experts.

The Administrative Agent may perform any and all its duties and exercise its rights and powers by or through any one or more sub-agents appointed by the Administrative Agent. The Administrative Agent and any such sub-agent may perform any and all its duties and exercise its rights and powers through their respective Related Parties. The exculpatory provisions of the preceding paragraphs shall apply to any such sub-agent and to the Related Parties of the Administrative Agent and any such sub-agent, and shall apply to their respective activities in connection with the syndication of the credit facilities provided for herein as well as activities as Administrative Agent.

The Administrative Agent may resign at any time by notifying the Lenders and the Borrowers. Upon any such resignation, the Required Lenders shall have the right, in consultation with XL Capital, to appoint a successor. If no successor shall have been so appointed by the Required Lenders and shall have accepted such appointment within 30 days after the retiring Administrative Agent gives notice of its resignation, then the retiring Administrative Agent's resignation shall nonetheless become effective and (1) the retiring Administrative Agent shall be discharged from its duties and obligations hereunder and (2) the Required Lenders shall perform the duties of the Administrative Agent (and all payments and communications provided to be made by, to or through the Administrative Agent shall instead be made by or to each Lender directly) until such time as the Required Lenders appoint a successor agent as provided for above in this paragraph. Upon the acceptance of its appointment as Administrative Agent hereunder by a successor, such successor shall succeed to and become vested with all the rights, powers, privileges and duties of the retiring (or retired) Administrative

#### Credit Agreement

---

Agent and the retiring Administrative Agent shall be discharged from its duties and obligations hereunder (if not already discharged therefrom as provided above in this paragraph). The fees payable by XL Capital to a successor Administrative Agent shall be the same as those payable to its predecessor unless otherwise agreed between XL Capital and such successor. After the Administrative Agent's resignation hereunder, the provisions of this Article and Section 10.03 shall continue in effect for its benefit in respect of any actions taken or omitted to be taken by it while it was acting as Administrative Agent.

Each Lender acknowledges that it has, independently and without reliance upon the Administrative Agent or any other Lender and based on such documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement. Each Lender also acknowledges that it will, independently and without reliance upon the Administrative Agent or any other Lender and based on such documents and information as it shall from time to time deem appropriate, continue to make its own decisions in taking or not taking action under or based upon this Agreement, any related agreement or any document furnished hereunder or thereunder.

#### ARTICLE X

#### MISCELLANEOUS

SECTION 10.01. Notices. Except in the case of notices and other communications expressly permitted to be given by telephone, all notices and other communications provided for herein shall be in writing and shall be delivered by hand or overnight courier service, mailed by certified or registered mail or sent by telecopy, as follows:

(a) if to any Borrower, to XL Capital at XL House, One Bermudiana Road, Hamilton HM 11 Bermuda, Attention of Roderick Gray (Telecopy No. (441) 296-6399); *with a copy* to Kirstin Romann Gould, Esq. at the same address and telecopy number (441) 295-2840);

(b) if to the Administrative Agent, to Bear Stearns Corporate Lending Inc., 383 Madison Avenue, New York, New York 10179, Attention of Randall Trombley (Telecopy No. (212) 272-8871; Telephone No. (212) 272-9184); and

(c) if to a Lender, to it at its address (or telecopy number) set forth in its Administrative Questionnaire.

Any party hereto may change its address or telecopy number for notices and other communications hereunder by notice to the other parties hereto (or, in the case of any such change by a Lender, by notice to the Borrowers and the Administrative Agent). All notices and other communications given to any party hereto in accordance with the provisions of this Agreement shall be deemed to have been given on the date of receipt.

Notices and other communications to the Lenders hereunder may be delivered or furnished by electronic communications pursuant to procedures approved by the Administrative Agent; provided that the foregoing shall not apply to notices pursuant to Article II unless

#### Credit Agreement

---

- 49 -

otherwise agreed by the Administrative Agent and the applicable Lender. The Administrative Agent or any Borrower may, in its discretion, agree to accept notices and other communications to it hereunder by electronic communications pursuant to procedures approved by it; provided that approval of such procedures may be limited to particular notices or communications. Without limiting the foregoing, the Borrowers may furnish to the Administrative Agent and the Lenders the financial statements required to be furnished by it pursuant to Section 6.01(a), 6.01(b) or 6.01(c) by electronic communications pursuant to procedures approved by the Administrative Agent.

#### SECTION 10.02. Waivers; Amendments.

(a) No Deemed Waivers; Remedies Cumulative. No failure or delay by the Administrative Agent or any Lender in exercising any right or power hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any such right or power, or any abandonment or discontinuance of steps to enforce such a right or power, preclude any other or further exercise thereof or the exercise of any other right or power. The rights and remedies of the Administrative Agent and the Lenders hereunder are cumulative and are not exclusive of any rights or remedies that they would otherwise have. No waiver of any provision of this Agreement or consent to any departure by the Borrowers therefrom shall in any event be effective unless the same shall be permitted by paragraph (b) of this Section, and then such waiver or consent shall be effective only in the specific instance and for the purpose for which given. Without limiting the generality of the foregoing, the making of a Loan shall not be construed as a waiver of any Default, regardless of whether the Administrative Agent or any Lender may have had notice or knowledge of such Default at the time.

(b) Amendments. Neither this Agreement nor any provision hereof may be waived, amended or modified except pursuant to an agreement or agreements in writing entered into by the Obligors and the Required Lenders or by the Obligors and the Administrative Agent with the consent of the Required Lenders; provided that no such agreement shall:

(i) increase the Commitment of any Lender without the written consent of such Lender,

(ii) reduce the principal amount of any Loan or reduce the rate of interest thereon, or reduce any fees or other amounts payable hereunder, without the written consent of each Lender directly affected thereby,

(iii) postpone the scheduled date of payment of the principal amount of any Loan, or any interest thereon, or any fees payable hereunder, or reduce the amount of, waive or excuse any such payment, or postpone the scheduled date of expiration of any Commitment, without the written consent of each Lender directly affected thereby,

(iv) change Section 2.20(c) or 2.20(d) without the consent of each Lender directly affected thereby,

(v) release any of the Guarantors from any of their guarantee obligations under Article III without the written consent of each Lender, and

#### Credit Agreement

---

- 50 -

(vi) change any of the provisions of this Section or the percentage in the definition of the term "Required Lenders" or any other provision hereof specifying the number or percentage of Lenders required to waive, amend or modify any rights hereunder or make any determination or grant any consent hereunder, without the written consent of each Lender;

and provided further that no such agreement shall amend, modify or otherwise affect the rights or duties of the Administrative Agent hereunder without the prior written consent of the Administrative Agent.

#### SECTION 10.03. Expenses; Indemnity; Damage Waiver.

(a) Costs and Expenses. The Borrowers jointly and severally agree to pay (i) all reasonable out-of-pocket expenses incurred by the Administrative Agent and its Affiliates, including the reasonable fees, charges and disbursements of counsel for the Administrative Agent, in connection with the syndication of the credit facilities provided for herein, the preparation and administration of this Agreement or any amendments, modifications or waivers of the provisions hereof (whether or not the transactions contemplated hereby or thereby shall be consummated), and (ii) all out-of-pocket expenses incurred by the Administrative Agent or any Lender, including the fees, charges and disbursements of one legal counsel for the Administrative Agent and one legal counsel for the Lenders, in connection with the enforcement or protection of its rights in connection with this Agreement, including its rights under this Section, or in connection with the Loans made hereunder, including in connection with any workout, restructuring or negotiations in respect thereof.

(b) Indemnification by the Borrowers. The Borrowers shall jointly and severally indemnify the Administrative Agent and each Lender, and each Related Party of any of the foregoing Persons (each such Person being called an “Indemnitee”) against, and to hold each Indemnitee harmless from, any and all losses, claims, damages, liabilities and related expenses, including the fees, charges and disbursements of any counsel for any Indemnitee (but not including Excluded Taxes), incurred by or asserted against any Indemnitee arising out of, in connection with, or as a result of (i) the execution or delivery of this Agreement or any agreement or instrument contemplated hereby, the performance by the parties hereto of their respective obligations hereunder or the consummation of the Transactions or any other transactions contemplated hereby, (ii) any Loan or the use of the proceeds thereof, (iii) any actual or alleged presence or release of Hazardous Materials on or from any property owned or operated by any Borrower or any of its Subsidiaries, or any Environmental Liability related in any way to any Borrower or any of its Subsidiaries, or (iv) any actual or prospective claim, litigation, investigation or proceeding relating to any of the foregoing, whether based on contract, tort or any other theory and regardless of whether any Indemnitee is a party thereto; provided that such indemnity shall not, as to any Indemnitee, be available to the extent that such losses, claims, damages, liabilities or related expenses result from or arise out of the gross negligence or willful misconduct of such Indemnitee.

(c) Reimbursement by Lenders. To the extent that the Borrowers fail to pay any amount required to be paid by them to the Administrative Agent under paragraph (a) or (b) of this Section, each Lender severally agrees to pay to the Administrative Agent such Lender’s Applicable Percentage (determined as of the time that the applicable unreimbursed expense or

#### Credit Agreement

---

- 51 -

indemnity payment is sought) of such unpaid amount; provided that the unreimbursed expense or indemnified loss, claim, damage, liability or related expense, as the case may be, was incurred by or asserted against the Administrative Agent in its capacity as such.

(d) Waiver of Consequential Damages, Etc. To the extent permitted by applicable law, no Borrower shall assert, and each Borrower hereby waives, any claim against any Indemnitee, on any theory of liability, for special, indirect, consequential or punitive damages (as opposed to direct or actual damages) arising out of, in connection with, or as a result of, this Agreement or any agreement or instrument contemplated hereby, the Transactions, any Loan or the use of the proceeds thereof.

(e) Payments. All amounts due under this Section shall be payable promptly after written demand therefor.

#### SECTION 10.04. Successors and Assigns.

(a) Assignments Generally. The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns permitted hereby, except that (i) no Borrower may assign or otherwise transfer any of its rights or obligations hereunder without the prior written consent of each Lender (and any attempted assignment or transfer by a Borrower without such consent shall be null and void) and (ii) no Lender may assign or otherwise transfer its rights or obligations hereunder except in accordance with this Section. Nothing in this Agreement, expressed or implied, shall be construed to confer upon any Person (other than the parties hereto, their respective successors and assigns permitted hereby, Participants (to the extent provided in paragraph (c) of this Section) and, to the extent expressly contemplated hereby, the Related Parties of each of the Administrative Agent and the Lenders) any legal or equitable right, remedy or claim under or by reason of this Agreement.

(b) Assignments by Lenders. (i) Subject to the conditions set forth in paragraph (b)(ii) of this Section, any Lender may assign all or a portion of its rights and obligations under this Agreement (including all or a portion of its Commitment and the Loans) to (A) any Eligible Transferee or (B) with the prior written consent of the Borrowers and the Administrative Agent (such consent, in each case, not to be unreasonably withheld) any other Person.

(ii) Assignments shall be subject to the following additional conditions:

(A) except in the case of an assignment to any Eligible Transferee or an assignment of the entire remaining amount of the assigning Lender’s Commitment, the amount of the Commitment of the assigning Lender subject to each such assignment (determined as of the date the Assignment and Assumption with respect to such assignment is delivered to the Administrative Agent) shall not be less than \$5,000,000 unless each of the Borrowers and the Administrative Agent otherwise consent, provided that no such consent of the Borrowers shall be required if an Event of Default under clause (a), (b), (g) or (h) of Article VIII has occurred and is continuing;

(B) each partial assignment shall be made as an assignment of a proportionate part of all the assigning Lender's rights and obligations under this Agreement;

#### Credit Agreement

---

- 52 -

(C) the parties to each assignment shall execute and deliver to the Administrative Agent an Assignment and Assumption, together with a processing and recordation fee of \$3,500; and

(D) the assignee, if it shall not be a Lender, shall deliver an Administrative Questionnaire to the Administrative Agent (with a copy to XL Capital).

(iii) Subject to acceptance and recording thereof pursuant to paragraph (b)(v) of this Section, from and after the effective date specified in each Assignment and Assumption, the assignee thereunder shall be a party hereto and, to the extent of the interest assigned by such Assignment and Assumption, have the rights and obligations of a Lender under this Agreement, and the assigning Lender thereunder shall, to the extent of the interest assigned by such Assignment and Assumption, be released from its obligations under this Agreement (and, in the case of an Assignment and Assumption covering all of the assigning Lender's rights and obligations under this Agreement, such Lender shall cease to be a party hereto but shall continue to be entitled to the benefits of Sections 2.11, 2.12, 2.13 and 10.03). Any assignment or transfer by a Lender of rights or obligations under this Agreement that does not comply with this Section 10.04 shall be treated for purposes of this Agreement as a sale by such Lender of a participation in such rights and obligations in accordance with paragraph (c) of this Section.

(iv) Notwithstanding anything to the contrary contained herein, any Lender (a "Granting Lender") may grant to a special purpose vehicle (an "SPV") of such Granting Lender, identified as such in writing from time to time by the Granting Lender to the Administrative Agent and the Borrowers, the option to provide to the Borrowers all or any part of any Loan that such Granting Lender would otherwise be obligated to make to the Borrowers pursuant to Section 2.01, provided that (i) nothing herein shall constitute a commitment by any SPV to make any Loan, (ii) if an SPV elects not to exercise such option or otherwise fails to provide all or any part of such Loan, the Granting Lender shall be obligated to make such Loan pursuant to the terms hereof and (iii) the Borrowers may bring any proceeding against either or both the Granting Lender or the SPV in order to enforce any rights of the Borrowers hereunder. The making of a Loan by an SPV hereunder shall utilize the Commitment of the Granting Lender to the same extent, and as if, such Loan were made by the Granting Lender. Each party hereto hereby agrees that no SPV shall be liable for any payment under this Agreement for which a Lender would otherwise be liable, for so long as, and to the extent, the related Granting Lender makes such payment. In furtherance of the foregoing, each party hereto hereby agrees (which agreement shall survive the termination of this Agreement) that, prior to the date that is one year and one day after the payment in full of all outstanding commercial paper or other senior indebtedness of any SPV, it will not institute against, or join any other person in instituting against, such SPV any bankruptcy, reorganization, arrangement, insolvency or liquidation proceedings or similar proceedings under the laws of the United States or any State thereof arising out of any claim against such SPV under this Agreement. In addition, notwithstanding anything to the contrary contained in this Section, any SPV may with notice to, but without the prior written consent of, the Borrowers or the Administrative Agent and without paying any processing fee therefor, assign all or a portion of its interests in any Loan to its Granting Lender or to any financial institutions (consented to by the Borrowers and the Administrative Agent) providing liquidity and/or credit support (if any) with respect to commercial paper issued by such

#### Credit Agreement

---

- 53 -

SPV to fund such Loans and such SPV may disclose, on a confidential basis, confidential information with respect to any Borrower and its Subsidiaries to any rating agency, commercial paper dealer or provider of a surety, guarantee or credit liquidity enhancement to such SPV. Notwithstanding anything to the contrary in this Agreement, no SPV shall be entitled to any greater rights under Section 2.11 or Section 2.13 than its Granting Lender would have been entitled to absent the use of such SPV. This paragraph may not be amended without the consent of any SPV at the time holding Loans under this Agreement.

(v) The Administrative Agent, acting for this purpose as an agent of the Borrowers, shall maintain at one of its offices in New York City a copy of each Assignment and Assumption delivered to it and a register for the recordation of the names and addresses of the Lenders, the Commitment of, and principal amount of the Loans owing to, each Lender pursuant to the terms hereof from time to time (the "Register"). The entries in the Register shall be conclusive, and the Borrowers, the Administrative Agent and the Lenders shall treat each Person whose name is recorded in the Register pursuant to the terms hereof as a Lender hereunder for all purposes of this Agreement, notwithstanding notice to the contrary. The Register shall be available for inspection by any Borrower and any Lender, at any reasonable time and from time to time upon reasonable prior notice.

(vi) Upon its receipt of a duly completed Assignment and Assumption executed by an assigning Lender and an assignee, the assignee's completed Administrative Questionnaire (unless the assignee shall already be a Lender hereunder), the processing and recordation fee referred to in paragraph (b)(ii)(C) of this Section and any written consent to such assignment required by paragraph (b)(i) of this Section, the Administrative Agent shall accept such Assignment and Assumption and record the information contained therein in the Register. No assignment shall be effective for purposes of this Agreement unless it has been recorded in the Register as provided in this paragraph.

(c) Participations. (i) Any Lender may sell participations to one or more banks or other entities (a “Participant”) in all or a portion of such Lender’s rights and obligations under this Agreement (including all or a portion of its Commitment, the Loans owing to it); provided that (A) any such participation sold to a Participant which is not an Eligible Transferee or a Federal Reserve Bank shall be made only with the consent (which in each case shall not be unreasonably withheld) of XL Capital and the Administrative Agent, (B) such Lender’s obligations under this Agreement shall remain unchanged, (C) such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations and (D) the Borrowers, the Administrative Agent and the other Lenders shall continue to deal solely and directly with such Lender in connection with such Lender’s rights and obligations under this Agreement. Any agreement or instrument pursuant to which a Lender sells such a participation shall provide that such Lender shall retain the sole right to enforce this Agreement and to approve any amendment, modification or waiver of any provision of this Agreement; provided that such agreement or instrument may provide that such Lender will not, without the consent of the Participant, agree to any amendment, modification or waiver described in the first proviso to Section 10.02(b) that affects such Participant. Subject to paragraph (c)(ii) of this Section, the Borrowers agree that each Participant shall be entitled to the benefits of Sections 2.11, 2.12 and 2.13 (subject to the requirements of such Sections) to the same extent as if it were a Lender and had acquired its interest by assignment pursuant to paragraph (b) of this Section. To the extent

#### Credit Agreement

---

- 54 -

permitted by law, each Participant also shall be entitled to the benefits of Section 10.08 as though it were a Lender, provided that such Participant agrees to be subject to Section 2.14(d) as though it were a Lender.

(ii) A Participant shall not be entitled to receive any greater payment under Section 2.11, 2.12 or 2.13 than the applicable Lender would have been entitled to receive with respect to the participation sold to such Participant or the Lender interest assigned, unless (A) the sale of the participation to such Participant is made with the Borrowers’ prior written consent and (B) in the case of Section 2.11 or 2.13, the entitlement to greater payment results solely from a Change in Law formally announced after such Participant became a Participant.

(d) Certain Pledges. Any Lender may at any time pledge or assign a security interest in all or any portion of its rights under this Agreement to secure obligations of such Lender, including any such pledge or assignment to secure obligations to a Federal Reserve Bank, and this Section shall not apply to any such pledge or assignment of a security interest; provided that no such pledge or assignment of a security interest shall release a Lender from any of its obligations hereunder or substitute any such pledgee or assignee for such Lender as a party hereto.

(e) No Assignments to Borrowers or Affiliates. Anything in this Section to the contrary notwithstanding, no Lender may assign or participate any interest in any Loan held by it hereunder to any Borrower or any of its Affiliates or Subsidiaries without the prior consent of each Lender.

SECTION 10.05. Survival. All covenants, agreements, representations and warranties made by the Borrowers herein and in the certificates or other instruments delivered in connection with or pursuant to this Agreement shall be considered to have been relied upon by the other parties hereto and shall survive the execution and delivery of this Agreement and the making of any Loans, regardless of any investigation made by any such other party or on its behalf and notwithstanding that the Administrative Agent or any Lender may have had notice or knowledge of any Default or incorrect representation or warranty at the time any credit is extended hereunder, and shall continue in full force and effect as long as the principal of, or any accrued interest on, any Loan or any fee or any other amount payable under this Agreement is outstanding and unpaid is outstanding and so long as the Commitments have not expired or terminated. The provisions of Sections 2.11, 2.12, 2.13 and 10.03 and Article IX shall survive and remain in full force and effect regardless of the consummation of the transactions contemplated hereby, the repayment of the Loans and the expiration or termination of the Commitments or the termination of this Agreement or any provision hereof.

SECTION 10.06. Counterparts; Integration; Effectiveness. This Agreement may be executed in counterparts (and by different parties hereto on different counterparts), each of which shall constitute an original, but all of which when taken together shall constitute a single contract. This Agreement constitutes the entire contract between and among the parties relating to the subject matter hereof and supersede any and all previous agreements and understandings, oral or written, relating to the subject matter hereof. Except as provided in Section 5.01, this Agreement shall become effective when it shall have been executed by the Administrative Agent and when the Administrative Agent shall have received counterparts hereof which, when taken together, bear the signatures of each of the other parties hereto, and thereafter shall be binding

#### Credit Agreement

---

- 55 -

upon and inure to the benefit of the parties hereto and their respective successors and assigns. Delivery of an executed counterpart of a signature page to this Agreement by telecopy shall be effective as delivery of a manually executed counterpart of this Agreement.

SECTION 10.07. Severability. Any provision of this Agreement held to be invalid, illegal or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such invalidity, illegality or unenforceability without

affecting the validity, legality and enforceability of the remaining provisions hereof; and the invalidity of a particular provision in a particular jurisdiction shall not invalidate such provision in any other jurisdiction.

SECTION 10.08. Right of Setoff. If an Event of Default shall have occurred and be continuing, each Lender is hereby authorized at any time and from time to time, to the fullest extent permitted by law, to set off and apply any and all deposits (general or special, time or demand, provisional or final) at any time held and other indebtedness at any time owing by such Lender to or for the credit or the account of any Borrower against any of and all the obligations of such Borrower now or hereafter existing under this Agreement held by such Lender, irrespective of whether or not such Lender shall have made any demand under this Agreement and although such obligations may be unmatured. The rights of each Lender under this Section are in addition to other rights and remedies (including other rights of setoff) which such Lender may have.

SECTION 10.09. Governing Law; Jurisdiction; Etc.

(a) Governing Law. This Agreement shall be construed in accordance with and governed by the law of the State of New York.

(b) Submission to Jurisdiction. Each Obligor hereby irrevocably and unconditionally submits, for itself and its property, to the nonexclusive jurisdiction of the Supreme Court of the State of New York sitting in New York County and of the United States District Court of the Southern District of New York, and any appellate court from any thereof, in any action or proceeding arising out of or relating to this Agreement, or for recognition or enforcement of any judgment, and each of the parties hereto hereby irrevocably and unconditionally agrees that all claims in respect of any such action or proceeding may be heard and determined in such New York State or, to the extent permitted by law, in such Federal court. Each of the parties hereto agrees that a final judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law. Nothing in this Agreement shall affect any right that the Administrative Agent or any Lender may otherwise have to bring any action or proceeding relating to this Agreement against any Obligor or its properties in the courts of any jurisdiction.

(c) Waiver of Venue. Each Obligor hereby irrevocably and unconditionally waives, to the fullest extent it may legally and effectively do so, any objection which it may now or hereafter have to the laying of venue of any suit, action or proceeding arising out of or relating to this Agreement in any court referred to in paragraph (b) of this Section. Each of the parties hereto hereby irrevocably waives, to the fullest extent permitted by law, the defense of an inconvenient forum to the maintenance of such action or proceeding in any such court.

#### Credit Agreement

---

- 56 -

(d) Service of Process. By the execution and delivery of this Agreement, XL Capital Ltd, XL Insurance (Bermuda) Ltd and XL Re Ltd acknowledge that they have by a separate written instrument, designated and appointed CT Corporation System, 111 Eighth Avenue, 13<sup>th</sup> floor, New York, New York 10011 (or any successor entity thereto), as its authorized agent upon which process may be served in any suit or proceeding arising out of or relating to this Agreement that may be instituted in any federal or state court in the State of New York. Each party to this Agreement irrevocably consents to service of process in the manner provided for notices in Section 10.01. Nothing in this Agreement will affect the right of any party to this Agreement to serve process in any other manner permitted by law.

(e) Waiver of Immunities. To the extent that any Borrower has or hereafter may acquire any immunity from jurisdiction of any court or from any legal process (whether through service of notice, attachment prior to judgment, attachment in aid of execution or execution, on the ground of sovereignty or otherwise) with respect to itself or its property, it hereby irrevocably waives, to the fullest extent permitted by applicable law, such immunity in respect of its obligations under this Agreement.

SECTION 10.10. WAIVER OF JURY TRIAL. EACH PARTY HERETO HEREBY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN ANY LEGAL PROCEEDING DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY (WHETHER BASED ON CONTRACT, TORT OR ANY OTHER THEORY). EACH PARTY HERETO (A) CERTIFIES THAT NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER AND (B) ACKNOWLEDGES THAT IT AND THE OTHER PARTIES HERETO HAVE BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION.

SECTION 10.11. Headings. Article and Section headings and the Table of Contents used herein are for convenience of reference only, are not part of this Agreement and shall not affect the construction of, or be taken into consideration in interpreting, this Agreement.

SECTION 10.12. Treatment of Certain Information; Confidentiality.

(a) Treatment of Certain Information. Each of the Borrowers acknowledge that from time to time financial advisory, investment banking and other services may be offered or provided to any Borrower or one or more of their Subsidiaries (in

connection with this Agreement or otherwise) by any Lender or by one or more subsidiaries or affiliates of such Lender and each of the Borrowers hereby authorizes each Lender to share any information delivered to such Lender by such Borrower and its Subsidiaries pursuant to this Agreement, or in connection with the decision of such Lender to enter into this Agreement, to any such subsidiary or affiliate, it being understood that (i) any such information shall be used only for the purpose of advising the Borrowers or preparing presentation materials for the benefit of the Borrowers and (ii) any such subsidiary or affiliate receiving such information shall be bound by the provisions of paragraph (b) of this Section as if it were a Lender hereunder. Such authorization shall

#### Credit Agreement

---

- 57 -

survive the repayment of the Loans, the expiration or termination of the Commitments or the termination of this Agreement or any provision hereof.

(b) Confidentiality. Each of the Administrative Agent, the Lenders and each SPV agrees to maintain the confidentiality of the Information (as defined below), except that Information may be disclosed (i) to its and its Affiliates' directors, officers, employees and agents, including accountants, legal counsel and other advisors (it being understood that the Persons to whom such disclosure is made will be informed of the confidential nature of such Information and instructed to keep such Information confidential), (ii) to the extent requested by any regulatory authority (including self-regulating organizations) having jurisdiction over the Administrative Agent or any Lender (or any Affiliate thereof), (iii) to the extent required by applicable laws or regulations or by any subpoena or similar legal process, (iv) to any other party to this Agreement, (v) in connection with the exercise of any remedies hereunder or any suit, action or proceeding relating to this Agreement or the enforcement of rights hereunder, (vi) subject to an agreement in writing containing provisions substantially the same as those of this paragraph and for the benefit of the Borrowers, to (a) any assignee of or Participant in, or any prospective assignee of or Participant in, any of its rights or obligations under this Agreement or (b) any actual or prospective counterparty (or its advisors) to any swap or derivative transaction relating to any Borrower and its obligations, (vii) with the consent of the Borrowers or (viii) to the extent such Information (A) becomes publicly available other than as a result of a breach of this paragraph or (B) becomes available to the Administrative Agent or any Lender on a nonconfidential basis from a source other than a Borrower. For the purposes of this paragraph, "Information" means all information received from a Borrower relating to a Borrower or its business, other than any such information that is available to the Administrative Agent or any Lender on a nonconfidential basis prior to disclosure by such Borrower; provided that, in the case of information received from a Borrower after the date hereof, such information is clearly identified at the time of delivery as confidential. Any Person required to maintain the confidentiality of Information as provided in this Section shall be considered to have complied with its obligation to do so if such Person has exercised the same degree of care to maintain the confidentiality of such Information as such Person would accord to its own confidential information. Notwithstanding the foregoing, each of the Administrative Agent and the Lenders agree that they will not trade the securities of any of the Borrowers based upon non-public Information that is received by them.

SECTION 10.13. Judgment Currency. This is an international loan transaction in which the obligations of each Borrower under this Agreement to make payment hereunder shall be satisfied only in Dollars and only if such payment shall be made in New York City, and the obligations of each Borrower under this Agreement to make payment to (or for account of) a Lender in Dollars shall not be discharged or satisfied by any tender or recovery pursuant to any judgment expressed in or converted into any other currency or in another place except to the extent that such tender or recovery results in the effective receipt by such Lender in New York City of the full amount of Dollars payable to such Lender under this Agreement. If for the purpose of obtaining judgment in any court it is necessary to convert a sum due hereunder in Dollars into another currency (in this Section called the "judgment currency"), the rate of exchange that shall be applied shall be that at which in accordance with normal banking procedures the Administrative Agent could purchase such Dollars at the principal office of the Administrative Agent in New York City with the judgment currency on the Business Day next preceding the day on which such judgment is rendered. The obligation of each Borrower in

#### Credit Agreement

---

- 58 -

respect of any such sum due from it to the Administrative Agent or any Lender hereunder (in this Section called an "Entitled Person") shall, notwithstanding the rate of exchange actually applied in rendering such judgment, be discharged only to the extent that on the Business Day following receipt by such Entitled Person of any sum adjudged to be due hereunder in the judgment currency such Entitled Person may in accordance with normal banking procedures purchase and transfer Dollars to New York City with the amount of the judgment currency so adjudged to be due; and each Borrower hereby, as a separate obligation and notwithstanding any such judgment, agrees to indemnify such Entitled Person against, and to pay such Entitled Person on demand, in Dollars, the amount (if any) by which the sum originally due to such Entitled Person in Dollars hereunder exceeds the amount of the Dollars so purchased and transferred.

SECTION 10.14. USA PATRIOT Act. Each Lender hereby notifies the Borrowers that pursuant to the requirements of the USA Patriot Act (Title III of Pub. L. 107-56 (signed into law October 26, 2001)), such Lender is required to obtain, verify and record information that identifies the Borrowers, which information includes the name and address of the Borrowers and other information that will allow such Lender to identify each Borrower in accordance with said Act.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

XL CAPITAL LTD,  
as a Borrower and a Guarantor

By /s/ SIMON RICH  
Name: SIMON RICH  
Title: SVP & Controller

U.S. Federal Tax Identification No.: 98-0191089

X.L. AMERICA, INC.,  
as a Borrower and a Guarantor

By /s/ CAROL A. McFATE  
Name: CAROL A. McFATE  
Title: Managing Director, Treasury Department

U.S. Federal Tax Identification No.: 06-1516268

XL INSURANCE (BERMUDA) LTD,  
as a Borrower and a Guarantor

By /s/ CHRISTOPHER A. COELHO  
Name: CHRISTOPHER A. COELHO  
Title: Senior Vice President &  
Chief Financial Officer

U.S. Federal Tax Identification No.: 98-0354869

XL RE LTD,  
as a Borrower and a Guarantor

By /s/ MARK BERRY  
Name: MARK BERRY  
Title: Senior Vice President

U.S. Federal Tax Identification No.: 98-0351953

LENDERS

BEAR STEARNS CORPORATE LENDING INC.,  
individually and as Administrative Agent

By: /s/ KEITH C. BARNISH  
Name: KEITH C. BARNISH  
Title: Executive Vice President

Credit Agreement

---

**Certification of Chief Executive Officer**

**XL Capital Ltd**

**Pursuant to Section 302 of The Sarbanes-Oxley Act of 2002**

(Chapter 98, Title 15 U.S.C. Ss. 7241)

I, Brian M. O'Hara, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of XL Capital Ltd;
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
-

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 4, 2005

*/s/ BRIAN M. O'HARA*

---

BRIAN M. O'HARA  
President and Chief Executive Officer

---

**Certification of Chief Financial Officer**

**XL Capital Ltd**

**Pursuant to Section 302 of The Sarbanes-Oxley Act Of 2002**

(Chapter 98, Title 15 U.S.C. Ss. 7241)

I, Jerry de St. Paer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of XL Capital Ltd;
  2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
  3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
  4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
    - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
-

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 4, 2005

*/s/ JERRY DE ST. PAER*

---

JERRY DE ST. PAER  
Executive Vice President and  
Chief Financial Officer

---

**Certification Accompanying Form 10-Q Report  
of  
XL Capital Ltd  
Pursuant To Section 906 of The Sarbanes-Oxley Act of 2002  
(Chapter 63, Title 18 U.S.C. Ss.Ss. 1350(A) And (B))**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. ss.ss. 1350(a) and (b)), each of the undersigned hereby certifies that the Quarterly Report on Form 10-Q for the period ended June 30, 2005 of XL Capital Ltd (the "Company") fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 and that the information contained in such Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 4 , 2005

*/s/ BRIAN M. O'HARA*

---

Brian M. O'Hara  
President and Chief Executive Officer  
XL Capital Ltd

Dated: August 4 , 2005

*/s/ JERRY DE ST. PAER*

---

Jerry de St. Paer  
Executive Vice President and Chief Financial  
Officer  
XL Capital Ltd

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to XL Capital Ltd and will be retained by XL Capital Ltd and furnished to the Securities and Exchange Commission or its staff upon request.

---

**XL CAPITAL ASSURANCE INC.  
AND SUBSIDIARY**  
**CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**  
**FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

**XL Capital Assurance Inc. and Subsidiary**  
**Condensed Consolidated Balance Sheets**  
**(UNAUDITED)**  
**(U.S. Dollars in thousands, except share and per share amounts)**

	<b>As At June 30, 2005</b>	<b>As At December 31, 2004</b>
<b>Assets</b>		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: 2005 - \$277,733; 2004 - \$270,523)	\$ 281,648	\$ 272,950
Short-term investments, at fair value (amortized cost: 2005 - \$4,278; 2004 - \$3,657)	4,277	3,657
<b>Total investments</b>	<b>285,925</b>	<b>276,607</b>
Cash and cash equivalents	59,013	58,038
Accrued investment income	2,534	2,564
Prepaid reinsurance premium	408,115	362,725
Premiums receivable	4,218	6,938
Reinsurance balances recoverable on unpaid losses	115,552	91,111
Intangible assets - acquired licenses	11,529	11,529
Deferred Federal income tax assets	16,803	17,260
Other assets	23,750	20,676
<b>Total assets</b>	<b>\$ 927,439</b>	<b>\$ 847,448</b>
<b>Liabilities and Shareholder's Equity</b>		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 123,955	\$ 95,324
Deferred premium revenue	456,980	406,296
Deferred ceding commissions, net	36,116	37,270
Reinsurance premiums payable	32,628	25,849
Accounts payable, accrued expenses and other liabilities	29,948	25,182
Current Federal income tax payable	2,917	2,917
Intercompany payable to affiliates	10,165	20,644
<b>Total liabilities</b>	<b>\$ 692,709</b>	<b>\$ 613,482</b>
Shareholder's Equity:		

Common stock (par value \$7,500 per share; 8,000 shares authorized; 2,000 shares issued and outstanding)	\$ 15,000	\$ 15,000
Additional paid-in capital	239,173	239,173
Accumulated other comprehensive income (Net of deferred Federal income tax effect of: 2005 - \$1,370; 2004 - \$850)	2,543	1,578
Accumulated deficit	(21,986)	(21,785)
	<hr/>	<hr/>
<b>Total shareholder's equity</b>	<b>234,730</b>	<b>233,966</b>
	<hr/>	<hr/>
<b>Total liabilities and shareholder's equity</b>	<b>\$ 927,439</b>	<b>\$ 847,448</b>
	<hr/>	<hr/>

See accompanying notes to condensed consolidated financial statements.

## XL Capital Assurance Inc. and Subsidiary

### Condensed Consolidated Statements of Operations and Comprehensive Income (UNAUDITED) (U.S. Dollars in thousands)

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Revenues</b>				
Gross premiums written	\$ 77,964	\$ 65,390	\$ 115,378	\$ 107,329
Ceded premiums written	(69,795)	(58,904)	(103,503)	(90,596)
	<hr/>	<hr/>	<hr/>	<hr/>
Net premiums written	8,169	6,486	11,875	16,733
Change in deferred premium revenue	(4,802)	(3,345)	(5,295)	(9,836)
	<hr/>	<hr/>	<hr/>	<hr/>
Net premiums earned (Net of ceded earned premium for the six months of \$58,113 in 2005 and \$42,472 in 2004)	3,367	3,141	6,580	6,897
Net investment income	3,167	2,554	6,201	5,049
Net realized gains (losses) on investments	65	(1,162)	9	(689)
Net realized and unrealized gains (losses) on credit derivatives	(336)	197	(128)	515
Fee income and other	21	-	76	-
	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues	6,284	4,730	12,738	11,772
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Expenses</b>				
Net losses and loss adjustment expenses (net of ceded losses and loss adjustment expenses for the six months of \$25,709 in 2005 and \$8,713 in 2004)	4,120	758	4,482	1,415
Net operating expenses	4,960	5,655	8,520	11,894
	<hr/>	<hr/>	<hr/>	<hr/>
Total expenses	9,080	6,413	13,002	13,309
	<hr/>	<hr/>	<hr/>	<hr/>
Loss before Federal income tax benefit	(2,796)	(1,683)	(264)	(1,537)
	<hr/>	<hr/>	<hr/>	<hr/>
Federal income tax benefit	(1,038)	(557)	(63)	(507)
	<hr/>	<hr/>	<hr/>	<hr/>
<b>Net loss</b>	<b>(1,758)</b>	<b>(1,126)</b>	<b>(201)</b>	<b>(1,030)</b>
	<hr/>	<hr/>	<hr/>	<hr/>

<b>Comprehensive Income (Loss)</b>				
Other comprehensive income (loss)	3,556	(5,627)	965	(2,996)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>Comprehensive income (loss)</b>	\$ 1,798	\$ (6,753)	\$ 764	\$ (4,026)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to condensed consolidated financial statements.

**XL Capital Assurance Inc. and Subsidiary**  
**Condensed Consolidated Statements of Changes in Shareholder's Equity**  
**(UNAUDITED)**  
**(U.S. Dollars in thousands, except share amounts)**

	<b>Six months ended June 30, 2005</b>	<b>Year Ended December 31, 2004</b>
	<u>          </u>	<u>          </u>
<b>Common Shares</b>		
Number of shares, beginning of year	2,000	2,000
	<u>          </u>	<u>          </u>
Number of shares, end of period	2,000	2,000
	<u>          </u>	<u>          </u>
<b>Common Stock</b>		
Balance - beginning of year	\$ 15,000	\$ 15,000
	<u>          </u>	<u>          </u>
Balance- end of period	15,000	15,000
	<u>          </u>	<u>          </u>
<b>Additional Paid-In Capital</b>		
Balance - beginning of year	239,173	239,173
	<u>          </u>	<u>          </u>
Balance- end of period	239,173	239,173
	<u>          </u>	<u>          </u>
<b>Accumulated Other Comprehensive Income</b>		
Balance - beginning of year	1,578	1,327
Net change in unrealized appreciation of investments, net of deferred Federal tax expense of \$519 in 2005 and \$134 in 2004	965	251
	<u>          </u>	<u>          </u>
Balance- end of period	2,543	1,578
	<u>          </u>	<u>          </u>
<b>Accumulated deficit</b>		
Balance - beginning of year	(21,785)	(18,272)
Net loss	(201)	(3,513)
	<u>          </u>	<u>          </u>
Balance- end of period	(21,986)	(21,785)
	<u>          </u>	<u>          </u>
<b>Total shareholder's equity</b>	\$ 234,730	\$ 233,966
	<u>          </u>	<u>          </u>

See accompanying notes to condensed consolidated financial statements.

**XL Capital Assurance Inc. and Subsidiary**  
**Condensed Consolidated Statements of Cash Flows**  
**(UNAUDITED)**  
**(U.S. Dollars in thousands)**

**Six months ended  
June 30,  
2005                      2004**

<b>Cash flows from operating activities:</b>				
Net Loss	\$	(201)	\$	(1,030)
Adjustments to reconcile net loss to net cash used in operating activities				
Net realized (gains) losses on sale of investments		(9)		689
Net realized and unrealized (gains) losses on credit derivatives excluding cash received and paid		128		(515)
Amortization of premium on bonds		578		686
Increase (decrease) in unpaid losses and loss adjustment expenses, net		4,190		(158)
Increase in deferred premium revenue, net		5,295		9,836
(Decrease) increase in deferred ceding commissions, net		(1,154)		284
Increase (decrease) in reinsurance premiums payable		6,779		(10,913)
Decrease (increase) in premiums receivable		2,720		(3,671)
Decrease in accrued investment income		30		60
(Increase) in deferred Federal income tax assets		(63)		(507)
Increase (decrease) in accounts payable and accrued expenses		4,638		(5,507)
(Decrease) increase in intercompany payable to affiliates		(10,479)		4,715
Other		(3,089)		2,367
Total adjustments		9,564		(2,634)
Net cash provide by (used in) operating activities		9,363		(3,664)
<b>Cash flows from investing activities:</b>				
Proceeds from sale of fixed maturities and short-term investments		54,113		132,506
Proceeds from maturity of fixed maturities and short-term investments		6,159		385
Purchase of fixed maturities and short-term investments		(68,660)		(153,914)
Net cash used in investing activities		(8,388)		(21,023)
Increase (decrease) in cash and cash equivalents		975		(24,687)
Cash and cash equivalents- beginning of year		58,038		76,854
Cash and cash equivalents- end of period	\$	59,013	\$	52,167
Taxes paid	\$	-	\$	-

See accompanying notes to condensed consolidated financial statements.

## **XL Capital Assurance Inc. and Subsidiary**

### **Notes to Condensed Consolidated Financial Statements**

#### **(UNAUDITED)**

## **1. Organization and Ownership**

XL Capital Assurance Inc. (the "Company") is a wholly owned subsidiary of XL Reinsurance America, Inc. ("XL RE AM"). XL RE AM and the Company are indirect wholly owned subsidiaries of XL Capital Ltd ("XL Capital"), a public company whose shares are listed on the New York Stock Exchange.

The Company is an insurance company domiciled in the State of New York and licensed to conduct financial guaranty insurance business throughout the United States, as well as in Puerto Rico, the District of Columbia, and the U.S. Virgin Islands. The Company has triple-A financial strength ratings from Standard & Poor's, Moody's Investors Service, and Fitch Ratings. The Company is primarily engaged in the business of providing credit enhancement on fixed and variable rate income securities through the issuance of financial guaranty insurance policies, and credit protection on specific referenced credits or on pools of specific referenced credits through the issuance of credit default swaps.

Financial guaranty insurance provides an unconditional and irrevocable guaranty that protects the holder of a financial obligation against non-payment of principal and interest when due. Financial guaranty insurance may be issued to the holders of the insured obligations at the time of issuance of those obligations, or may be issued in the secondary market to holders of public bonds and structured securities. Credit default swaps are derivative contracts which offer credit protection relating to a particular security or issuer. Under the terms of a credit default swap, the seller of credit protection makes a specified payment to the buyer of credit protection upon the occurrence of one or more specified credit events with respect to a reference obligation or entity. Credit derivatives typically provide protection to a buyer rather than credit enhancement of an issue as in traditional financial guaranty insurance.

On April 24, 2002, the Company formed XL Capital Assurance (U.K.) Limited, ("XLCA-UK"), an insurance company organized under the laws of England. XLCA-UK is a wholly owned subsidiary of the Company.

In addition to its New York headquarters and London subsidiary (which has a Madrid branch), the Company maintains branch offices domestically in California and abroad in Singapore.

## 2. Basis of Presentation and Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its subsidiary and are unaudited. In the opinion of management, all adjustments, which include only normal recurring adjustments, necessary for a fair statement of the financial position, results of operations and cash flows at June 30, 2005 and for all periods presented, have been made and all significant intercompany accounts and transactions have been eliminated.

The accompanying condensed consolidated financial statements have been prepared in accordance with instructions to Form 10-Q and, accordingly, do not include all of the information and disclosures required by accounting principals generally accepted in the United States of America. These statements should be read in conjunction with the Company's December 31, 2004 consolidated financial statements and notes thereto. The accompanying condensed consolidated balance sheet as of December 31, 2004 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the periods ended June 30, 2005 and 2004 are not necessarily indicative of the operating results for the full year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of

---

## XL Capital Assurance Inc. and Subsidiary Notes to Condensed Consolidated Financial Statements (UNAUDITED)

---

contingent assets and liabilities, as well as the reported amounts of revenue and expenses. Actual results may differ from those estimates. Certain comparative figures have been reclassified to conform with the current year's presentation.

## 3. Credit Default Swaps

Credit default swaps are recorded at fair value which is determined using a model developed by the Company and is dependent upon a number of factors including changes in interest rates, credit spreads, changes in credit quality, expected recovery rates and other market factors. The change resulting from movements in these factors is unrealized as the credit default swaps are not traded to realize this value and is included in "net realized and unrealized gains on credit derivatives". Other elements of the change in fair value are based upon pricing established at the inception of the contract, as well as actual and expected loss payments by the Company.

Effective January 1, 2005, the Company changed the presentation of the results from credit default swaps in its statement of operations to reclassify changes in the fair value of such instruments attributable to earnings from premiums received by the Company from the issuance of such contracts and losses from actual and expected payments to counterparties under such contracts from the line item caption entitled "net realized and unrealized gains (losses) on credit derivatives" to the "premium" and "losses and loss adjustment expense" captions in the statement, respectively. In addition, certain reclassifications were made to the Company's balance sheet to correspond with the aforementioned changes in its statement of operations. This change in presentation is applicable only to credit default swaps issued by the Company that it has the intent and ability to hold to maturity and is consistent with practices in the financial guaranty insurance industry for reporting the results of such instruments. Results of the prior period presented have been reclassified to conform the current period presented.

The credit default swap portfolio consists of structured pools of corporate obligations that were awarded investment grade ratings at the respective deals' inception. At June 30, 2005, approximately 90% of the portfolio was rated AAA with the remaining 10% allocated to other investment grade ratings. The weighted average term of the contracts in force was approximately 3.83 years, and the credit default swaps represented approximately 9% of the Company's credit enhancement par exposure at June 30, 2005.

---

## XL Capital Assurance Inc. and Subsidiary Notes to Condensed Consolidated Financial Statements (UNAUDITED)

---

Amounts related to credit default swaps appear in the following financial statement line items as of and for the periods noted:

(U.S. Dollars in thousands)

**(Unaudited)**  
**Three Months Ended**  
**June 30,**

2005

2004

**Income Statement**

Gross written premiums	\$	3,474	\$	8,169
Net premiums earned		310		779
Net realized and unrealized gains (losses) on credit derivatives		(336)		197
Net losses and loss expenses		27		62

**(Unaudited)**  
**Six Months Ended**  
**June 30,**

	<b>2005</b>	<b>2004</b>
<b>Income Statement</b>		
Gross written premiums	\$ 8,357	\$ 13,161
Net premiums earned	761	1,172
Net realized and unrealized gains (losses) on credit derivatives	(128)	515
Net losses and loss expenses	81	155
	<b>As of</b> <b>June 30,</b> <b>2005</b>	<b>As of</b> <b>December 31,</b> <b>2004</b>
<b>Assets</b>		
Reinsurance balances recoverable on unpaid losses	\$ 8,750	\$ 8,215
Reinsurance recoverable on unrealized losses on derivatives	23,501	20,514
Total assets	\$ 32,251	\$ 28,729
<b>Liabilities</b>		
Unpaid losses and loss adjustment expenses	\$ 9,502	\$ 8,886
Unrealized losses on derivatives	22,367	19,252
Total liabilities	\$ 31,869	\$ 28,138

#### 4. Recent Developments

In March 2005, the FASB issued FASB Staff Position ("FSP") FIN 46(R)-5, Implicit Variable Interests Under FASB Interpretation No. 46(R) which requires an enterprise to consider whether it holds an implicit variable interest in a Variable Interest Entity ("VIE") and what affect this may have on the calculation of expected losses and residual returns of the VIE and the determination of which party, if any, is considered the primary beneficiary of the VIE. The Company adopted the FSP effective April 1, 2005. The adoption of this FSP had no material impact on the Company's financial condition or results of operations.

At the request of the Securities and Exchange Commission, the Financial Accounting Standards Board has added a project to their agenda to review the accounting for financial guaranty insurance. The Company recognizes that there is diversity in practice among financial guarantee insurers and reinsurers

### **XL Capital Assurance Inc. and Subsidiary**

#### **Notes to Condensed Consolidated Financial Statements**

**(UNAUDITED)**

with respect to their accounting policies. Current accounting literature, specifically Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 60 "Accounting and Reporting by Insurance Enterprises" ("SFAS 60") and FASB Statement of Financial Accounting Standards No. 97 "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments" ("SFAS 97"), does not specifically address the unique characteristics of loss reserves for financial guarantee insurance contracts. Consequently, the accounting principles applied by the industry, as well as the Company, have evolved over time and incorporate the concepts of both short-duration and long-duration contract accounting under the provisions of SFAS 60 and SFAS 97, as well as other accounting literature, such as FASB No. 5 "Accounting for Contingencies" and Emerging Issues Task Force ("EITF") Issue No. 85-20 "Recognition of Fees for Guaranteeing a Loan". The Company will continue its loss reserving methodology as described in the 2004 year-end financial statements until further guidance is provided by the FASB.

#### 5. Variable Interest Entities

The Company participates in transactions which utilize variable interest entities ("VIE's") in the ordinary course of the Company's business. The Company provides financial guaranty insurance of structured transactions backed by pools of assets of specified types, municipal obligations supported by the issuers' ability to charge fees for specified services or projects, and corporate risk obligations including essential infrastructure projects and obligations backed by receivables from future sales of commodities and other specified services. The obligations related to these transactions are often securitized through off-balance sheet VIE's. In synthetic transactions, the Company guarantees payment obligations of counterparties, including VIE's, through credit default swaps referencing asset portfolios. The Company only provides financial guaranty insurance of these VIE's for fixed premiums at market rates but does not hold any equity positions or subordinated debt in these off-balance sheet arrangements. These financial guaranty insurance contracts represent variable interests held by the Company in VIE's.

In underwriting financial guaranty insurance, the Company believes the risk of any loss to be remote based upon the Company's requirement that guaranteed obligations be investment-grade prior to the provision of credit enhancement. Typically, in the case of asset-backed securities and other structured obligations, such investment grade ratings are based upon subordination, cash reserves and other structural protections. Consequently, the Company has determined that it is not the primary beneficiary of any VIE's in which it holds a variable interest. Accordingly, these VIE's are not consolidated.

## 6. Tax Sharing Agreement

The Company's U.S. Federal income tax return is consolidated with XLA and its subsidiaries. XLA maintains a tax sharing agreement with its subsidiaries, whereby the consolidated U.S. Federal income tax liability is allocated among affiliates in the ratio that each affiliate's separate return liability bears to the sum of the separate return liabilities of all affiliates that are members of the consolidated group. In addition, a complementary method is used which results in reimbursement by profitable affiliates to loss affiliates for tax benefits generated by loss affiliates. As of June 30, 2005 and December 31, 2004, the Company had deferred Federal income tax assets of \$16,803,000 and \$17,260,000, respectively. Management has concluded that the net deferred federal income tax assets are more likely than not to be realized, therefore, no valuation allowance has been provided.

## 7. Treaties and Agreements with Affiliates

### General Services Agreements

The Company entered into a General Services Agreement effective January 28, 2002 (the "XLFAS General Services Agreement") with an affiliated company, XL Financial Administrative Services Inc.

---

## XL Capital Assurance Inc. and Subsidiary Notes to Condensed Consolidated Financial Statements (UNAUDITED)

---

("XLFAS"). For the three months ended June 30, 2005 and 2004, operating expenses were allocated to the Company under this agreement in the amount of \$19,805,652 and \$16,031,901, respectively. For the six months ended June 30, 2005 and 2004, such expenses were \$29,206,287 and \$28,529,280, respectively.

In addition to the XLFAS General Services Agreement the Company has entered into two service agreements with certain of its U.S. affiliates, including its ultimate U.S. holding company, X.L. America, Inc. ("XLA"). These services agreements include the Amended and Restated General Services Agreement, dated January 1, 2003 (the "Global Services Agreement") among X.L. Global Services, Inc. ("XLGS"), XLA on behalf of: the Company, XLFAS and various other affiliates and the Second Amended and Restated General Services Agreement, dated January 1, 2003 (the "XL America General Services Agreement"), among XLA, XLFAS, the Company and various other affiliates. Expenses allocated to the Company under the Global Services Agreement and the XL America General Services Agreement for the three months ended June 30, 2005 and 2004 were \$4,694,225 and \$2,830,248, respectively. For the six months ended June 30, 2005 and 2004, such expenses were \$8,321,892 and \$5,624,628, respectively.

Effective January 1, 2005 the Company entered into an arrangement with an affiliate for investment management services. For the three and six months ended June 30, 2005, the Company incurred expenses of \$39,138 and \$78,121, respectively, under the agreement.

### Employee Benefit Plans

XLA maintains a qualified defined contribution pension plan for the benefit of all eligible employees and a non-qualified deferred compensation plan for the benefit of certain employees of XLFAS and some other subsidiaries (collectively, the "Plans"). XLFAS's discretionary contributions to both Plans are based on a fixed percentage of employee contributions and compensation as defined by the Plans. The Company's share of allocated pension expense was \$703,650 and \$417,174 for the three months ended June 30, 2005 and 2004, respectively, and \$1,272,660 and \$1,033,932 for the six months ended June 30, 2005 and 2004, respectively.

### Facultative Quota Share Reinsurance Treaties

On October 6, 1999, the Company entered into an arm's-length Facultative Quota Share Reinsurance Treaty ("Treaty") with XL Financial Assurance Ltd. ("XLFA"), a Bermuda financial guaranty reinsurer, which is 86.8% owned by XL Capital through its wholly owned subsidiary, XL Insurance (Bermuda) Ltd. The remaining 13.2% of XLFA is owned by Financial Security Assurance Holdings Ltd., an unrelated company. Under the terms of this agreement, XLFA agrees to reinsure up to 90% of the Company's acceptable risks. The Company is allowed up to a 30% ceding commission (or such other percentage on an arm's-length basis) on ceded premiums written under the terms of this agreement.

The Company entered into a Facultative Master Certificate (the "XL Re Treaty") with XL RE AM, effective as of December 1, 2002. Under the terms of the XL Re Treaty, XL RE AM agrees to automatically reinsure risks insured by the Company under financial guaranty insurance policies up to the amount necessary for the Company to comply with single risk limitations set forth in Section 6904(d) of the New York Insurance Laws. The reinsurance provided by XL RE AM may be on an excess of loss or quota share basis. The Company is allowed up to 30% ceding commission (or such other percentage on an arm's-length basis) on ceded premiums written under the terms of this agreement.

---

## XL Capital Assurance Inc. and Subsidiary Notes to Condensed Consolidated Financial Statements (UNAUDITED)

---

Amounts ceded to affiliate reinsurers are as follows:

(U.S. Dollars in thousands)

	Three Months ended June 30, 2005	Three Months ended June 30, 2004
--	--	--

Ceded premiums written	\$ 68,989	\$ 57,921
Ceded premiums earned	28,089	28,701
Ceding commission revenue	13,553	8,871
Ceded losses and loss adjustment expenses	21,827	5,552
	<b>Six Months ended June 30, 2005</b>	<b>Six Months ended June 30, 2004</b>
Ceded premiums written	\$ 101,203	\$ 88,375
Ceded premiums earned	56,004	52,055
Ceding commission revenue	22,369	16,175
Ceded losses and loss adjustment expenses	25,433	8,111

### Related Party Guarantees

In 2002, the Company began providing financial guaranty insurance policies insuring timely payment of investment agreements issued by XL Asset Funding Company I LLC ("XLAF"), an affiliate of the Company. As of June 30, 2005 and December 31, 2004, the net aggregate amount of investment agreements insured was \$317,500,600 and \$255,730,165, respectively. These insurance policies are collateralized by investment securities, accrued interest, cash and cash equivalents, which as of June 30, 2005 and December 31, 2004 had an aggregate fair value of \$325,302,310 and \$262,421,920, respectively. In the current quarter, the Company began providing coverage of certain derivative contracts entered into by XLAF. As of June 30, 2005, the total notional value insured was \$25,000,000. Under these agreements, the Company recorded net premiums written and earned of \$763,308 and \$424,694 during the three months ended June 30, 2005 and 2004, respectively, and \$1,371,552 and \$830,227 during the six months ended June 30, 2005 and 2004, respectively.

### 8. Liability for Losses and Loss Adjustment Expenses

The Company's liability for losses and loss adjustment expenses consists of case basis reserves and unallocated reserves. Activity in the liability for losses and loss adjustment expenses is summarized as follows:

### XL Capital Assurance Inc. and Subsidiary Notes to Condensed Consolidated Financial Statements (UNAUDITED)

	As of and for the Six Months ended June 30, 2005		As of and for the Twelve Months ended December 31, 2004	
<i>(U.S. dollars in thousands)</i>	Case Reserves	Unallocated Reserves	Case Reserves	Unallocated Reserves
<b>Balance, beginning of period</b>	\$ 45,550	\$ 49,774	\$ -	\$ 30,976
Incurring losses and loss adjustment expense	22,016	7,432	47,755	18,798
Paid loss and loss adjustment expense	(817)		(2,205)	--
<b>Balance, end of period</b>	66,749	57,206	45,550	49,774
Reinsurance recoverable	(62,705)	(52,847)	(45,124)	(45,987)
<b>Net balance, end of period</b>	\$ 4,044	\$ 4,359	\$ 426	\$ 3,787

#### Case Basis Reserves for Losses and Loss Adjustment Expenses

During the year ended December 31, 2004, the Company recorded a provision for losses of approximately \$42.1 million, representing the present value loss expected to be incurred in the future with respect to an insured project financing. Because this loss represented a full limit loss to the subordinated tranche of the insured transaction, the remaining unearned premium pertaining to such tranche, which aggregated approximately \$23.3 million, was fully earned resulting in a net loss, before reinsurance, of approximately \$18.8 million. The portion of the insured exposure to which this loss relates was fully reinsured on a first-loss basis by an affiliate of the Company and, accordingly, there was no net impact on the Company's results of operations from this loss provision. Pursuant to the assumptions upon which the estimate was based, under its existing reinsurance arrangements, approximately 17.5% of any additional loss provision in excess of the aforementioned amount provided will be retained by the Company. During the three-month period ended June 30, 2005, the company recorded an additional provision for loss relating to this transaction of \$16.0 million, on a net present value basis, to reflect certain adverse developments, after reinsurance to the aforementioned affiliate, the net impact on the Company's results of operations from this loss provision was \$2.8 million. The total remaining par insured by the Company in connection with this transaction aggregated approximately \$250 million (\$43.9 million net of reinsurance to affiliates) at December 31, 2004, and amortizes over many years into the future. The estimate of loss was necessarily based on assumptions and estimates extending over many years into the future. There is currently no payment default with respect to this transaction. Management continues to monitor the exposure and will revise its loss estimate as

necessary. The financing vehicle through which the project financing was issued is considered a variable interest entity under FASB Interpretation 46/46R, *Consolidation of Variable Interest Entities*, however, the Company is not the primary beneficiary. If this transaction is restructured or if the Company exercises its contractual rights in the event of a default, the primary beneficiary in the transaction will have to be reconsidered. If such events occur, the Company will likely be required to consolidate the financing vehicle.

During the three-month period ended June 30, 2005, the company recorded a provision for loss of \$5.2 million representing the present value loss expected to be incurred in the future with respect to an insured residential mortgage securitization. The insured exposure to which this loss relates was 82.6% reinsured by an affiliate of the Company on a pro rata basis and, accordingly, the net impact on the Company's results of operations from this loss provision was \$0.9 million. The total remaining par insured by the Company in connection with this transaction aggregated approximately \$366.6 million (\$55.4 million net

---

## **XL Capital Assurance Inc. and Subsidiary**

### **Notes to Condensed Consolidated Financial Statements**

#### **(UNAUDITED)**

---

of reinsurance to affiliates) at June 30, 2005, and amortizes over many years into the future. The estimate of loss was necessarily based on assumptions and estimates extending over many years into the future. There is currently no payment default with respect to this transaction. Management continues to monitor the exposure and will revise its loss estimate as necessary, as information becomes available.

Other than the two matters described above, case basis reserves at June 30, 2005 consisted of reserves for loss adjustment expenses which relate to remediation efforts associated with certain insured transactions, including the aforementioned project financing.

#### *Unallocated Reserves*

The Company maintains an unallocated loss reserve for expected levels of losses associated with currently insured issues, which is estimated by management based upon an actuarial reserving analysis. The actuarial methodology applied by the Company is in accordance with Actuarial Standards of Practice No. 36, *Determination of Reasonable Provision*. This methodology was adopted by the Company in 2002. The methodology applied is based on the selection of an initial expected loss ratio, as well as an expected loss emergence pattern. The Company's selection of an initial expected loss ratio and loss emergence pattern considered the characteristics of the Company's own book of business as well its actual loss experience and that of the industry. On an annual basis, the Company compares its selected initial expected loss ratio to its actual loss experience, as well as to industry loss experience, and will adjust it as considered necessary, to ensure such initial expected loss ratio continues to be appropriate for the risks in its in-force business. In addition, the expected loss emergence pattern will be adjusted or realigned on an annual basis, as considered necessary, to better correlate with the underlying changes in the Company's in force business. The Company's unallocated reserve is available to be applied to new case basis reserves that may be established for claims on current outstanding insured principal and interest in the future.

---

**XL FINANCIAL ASSURANCE LTD.**

(Incorporated in Bermuda)

**CONDENSED FINANCIAL STATEMENTS**

(UNAUDITED)

**FOR THE THREE AND SIX MONTH PERIODS ENDED****JUNE 30, 2005 AND 2004****XL FINANCIAL ASSURANCE LTD.****CONDENSED BALANCE SHEETS****AS AT JUNE 30, 2005 AND DECEMBER 31, 2004**

(UNAUDITED)

(U.S. dollars in thousands, except per share amounts)

	2005	2004
<b>Assets:</b>		
Investments :		
Fixed maturities, at fair value (amortized cost: 2005 - \$827,030; 2004 - \$794,190)	\$ 827,091	\$ 792,723
Short-term investments, at fair value (amortized cost: 2005 - \$143,622; 2004 - \$88,227)	143,322	87,875
Total investments available for sale	970,413	880,598
Cash and cash equivalents	12,306	13,210
Accrued investment income	6,837	6,764
Deferred acquisition costs	88,110	83,868
Prepaid reinsurance premiums	57,278	52,486
Reinsurance balances receivable	33,679	40,859
Unpaid losses and loss expenses recoverable	67,608	55,441
Amounts due from parent and affiliates	37,108	32,708
Net receivable for investments sold	108	-
Derivative assets	18,897	17,396
Other assets	116	138
<b>Total assets</b>	<b>\$ 1,292,460</b>	<b>\$ 1,183,468</b>
<b>Liabilities, Redeemable Preferred Shares and Shareholders' Equity</b>		
<b>Liabilities:</b>		
Unpaid losses and loss expenses	\$ 131,550	\$ 109,151
Deferred premium revenue	486,362	437,654
Reinsurance balances payable	5,557	4,022
Net payable for investments purchased	-	7
Accounts payable and accrued liabilities	1,506	2,738
Amounts due to parent and affiliates	12,510	11,482
Derivative liabilities	3,940	1,669
Dividend payable on preferred shares	5,388	1,950
<b>Total liabilities</b>	<b>\$ 646,813</b>	<b>\$ 568,673</b>
<b>Redeemable Preferred Shares:</b>		
Series A Redeemable preferred shares (par value of \$120 per share; 10,000 shares authorized; 363 issued and outstanding as at June 30, 2005 and December 31, 2004, respectively)	\$ 44	\$ 44
Additional paid-in capital	38,956	38,956
<b>Total redeemable preferred shares</b>	<b>\$ 39,000</b>	<b>\$ 39,000</b>

**Shareholders' Equity:**

Common shares (par value of \$120 per share; 10,000 shares authorized; 2,449 issued and outstanding as at June 30, 2005 and December 31, 2004, respectively)	\$ 294	\$ 294
Additional paid-in capital	345,606	345,606
Accumulated other comprehensive loss	(239)	(1,819)
Retained earnings	260,986	231,714
<b>Total shareholders' equity</b>	<b>\$ 606,647</b>	<b>\$ 575,795</b>
<b>Total liabilities, redeemable preferred shares and shareholders' equity</b>	<b>\$ 1,292,460</b>	<b>\$ 1,183,468</b>

The accompanying notes are an integral part of these condensed financial statements.

**XL FINANCIAL ASSURANCE LTD.****CONDENSED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME FOR  
THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

(UNAUDITED)

(U.S. dollars in thousands, except per share amounts)

	Three Months ended June 30,		Six Months ended June 30,	
	2005	2004	2005	2004
<b>REVENUES :</b>				
Net premiums earned	\$ 29,687	\$ 27,547	\$ 58,147	\$ 52,144
Net investment income	9,096	5,737	17,370	10,877
Net realized gains (losses) on investments	(24)	(3,361)	(1,381)	1,519
Fee and other income	180	--	675	--
Net realized and unrealized gains (losses) on derivative instruments	(4,074)	1,845	(1,839)	8,641
<b>Total revenues</b>	<b>\$ 34,865</b>	<b>\$ 31,768</b>	<b>\$ 72,972</b>	<b>\$ 73,181</b>
<b>EXPENSES :</b>				
Losses and loss expenses	\$ 10,782	\$ 5,373	\$ 11,348	\$ 7,411
Acquisition costs	14,117	8,081	22,664	14,335
Operating expenses	1,883	2,131	3,651	4,185
<b>Total expenses</b>	<b>\$ 26,782</b>	<b>\$ 15,585</b>	<b>\$ 37,663</b>	<b>\$ 25,931</b>
<b>NET INCOME</b>	<b>\$ 8,083</b>	<b>\$ 16,183</b>	<b>\$ 35,309</b>	<b>\$ 47,250</b>
<b>COMPREHENSIVE INCOME</b>				
Net income	\$ 8,083	\$ 16,183	\$ 35,309	\$ 47,250
Unrealized gains (losses)	14,142	(21,913)	199	(12,913)
Less: reclassification for gains (losses) realized in income	(24)	(3,361)	(1,381)	1,519
<b>Other comprehensive gain (loss)</b>	<b>\$ 14,166</b>	<b>\$ (18,552)</b>	<b>\$ 1,580</b>	<b>\$ (14,432)</b>

The accompanying notes are an integral part of these condensed financial statements.

**XL FINANCIAL ASSURANCE LTD.**  
**CONDENSED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2005 AND FOR THE YEAR ENDED**  
**DECEMBER 31, 2004**  
 (UNAUDITED)  
 (U.S. dollars in thousands, except per share amounts)

	2005	2004
<b>Common Shares – Number issued</b>		
Number of shares, beginning of year and period	2,449	2,057
Issuance of common shares	- -	392
Number of shares, end of year and period	2,449	2,449
<b>Common Shares – Issued at par</b>		
Balance - beginning of year and period	\$ 294	\$ 247
Issuance of common shares	- -	47
Balance – end of year and period	\$ 294	\$ 294
<b>Additional Paid-in Capital</b>		
Balance - beginning of year and period	\$ 345,606	\$ 220,653
Issuance of common shares	- -	124,953
Balance – end of year and period	\$ 345,606	\$ 345,606
<b>Accumulated Other Comprehensive Loss</b>		
Balance - beginning of year and period	\$ (1,819)	\$ 1,174
Other comprehensive loss	1,580	(2,993)
Balance - end of year and period	\$ (239)	\$ (1,819)
<b>Retained Earnings</b>		
Balance - beginning of year and period	\$ 231,714	\$ 169,565
Net income	35,309	76,252
Dividends on Series A preferred shares	(6,037)	(14,103)
Balance - end of year and period	\$ 260,986	\$ 231,714
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>\$ 606,647</b>	<b>\$ 575,795</b>

The accompanying notes are an integral part of these condensed financial statements.

**XL FINANCIAL ASSURANCE LTD.**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**  
(UNAUDITED)  
(U.S. dollars in thousands, except per share amounts)

	2005	2004
<b>Cash flows provided by operating activities:</b>		
Net income for the period	\$ 35,309	\$ 47,250
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized losses (gains) on investments	1,381	(1,519)
Amortization of premium on fixed maturities	1,758	2,828
Net realized gains on investment derivatives	-	(19)
Net realized and unrealized (gains) losses on credit derivatives excluding cash received and paid	772	(7,411)
Net realized and unrealized gains on put option	(2)	-
Accrued investment income	(73)	2,083
Unpaid losses and loss expenses	22,399	6,315
Deferred premium revenue	48,708	53,458
Unpaid losses and loss expenses recoverable	(12,167)	(1,533)
Deferred acquisition costs	(4,242)	(13,686)
Amounts due from parent and affiliates	(4,400)	(7,992)
Accounts payable and accrued liabilities	(1,232)	(705)
Amounts due to parent and affiliates	1,028	2,280
Prepaid reinsurance premiums	(4,792)	330
Reinsurance balances receivable	7,180	8,405
Reinsurance balances payable	1,535	(561)
Other assets	22	(10)
Total adjustments	57,875	42,263
Net cash provided by operating activities	93,184	89,513
<b>Cash flows used in investing activities:</b>		
Proceeds from sale of fixed maturities and short-term investments	363,363	1,872,772
Proceeds from redemption of fixed maturities and short-term investments	35,030	368,350
Purchase of fixed maturities and short-term investments	(489,881)	(2,332,815)
Net cash used in investing activities	(91,488)	(91,693)
<b>Cash flows used in financing activities:</b>		
Dividends paid on Series A preferred shares	(2,600)	-
<b>Decrease in Cash and Cash Equivalents</b>	(904)	(2,180)
<b>Cash and Cash Equivalents – Beginning of period</b>	13,210	26,346
<b>Cash and Cash Equivalents – End of period</b>	\$ 12,306	\$ 24,166

The accompanying notes are an integral part of these condensed financial statements.

## 1. Organization and Business

XL Financial Assurance Ltd. (the "Company") was incorporated with limited liability under the Bermuda Companies Act 1981 on October 14, 1998 and is registered as a Class 3 insurer under The Insurance Act 1978, amendments thereto and related regulations ("The Act"). At June 30, 2005, the Company was approximately 87% owned by XL Insurance (Bermuda) Ltd (a wholly-owned subsidiary of XL Capital Ltd); 5% by Financial Security Assurance Inc. (a wholly-owned subsidiary of Financial Security Assurance Holdings Ltd.) and 8% by Financial Security Assurance International Ltd. (owned 20% by XL Insurance (Bermuda) Ltd and 80% by Financial Security Assurance Inc.). At June 30, 2004, the Company was approximately 85% owned by XL Insurance (Bermuda) Ltd; 6% by Financial Security Assurance Inc. and 9% by Financial Security Assurance International Ltd. The Company is an integral part of a joint venture agreement between XL Capital Ltd and Financial Security Assurance Holdings Ltd.

The Company is primarily engaged in the business of providing reinsurance of financial guaranties on asset-backed and municipal obligations underwritten by XL Insurance (Bermuda) Ltd, Financial Security Assurance Inc. and XL Capital Assurance Inc. (a wholly-owned subsidiary of XL Capital Ltd) and other monoline and multiline insurance companies. This may be in the form of traditional financial guaranty insurance or via a credit derivatives execution. The Company's underwriting policy is to provide reinsurance of asset-backed and municipal obligations that would be of a lower investment-grade quality without the benefit of the Company's reinsurance. The asset-backed obligations reinsured by the Company are generally issued in structured transactions and are backed by pools of assets such as residential mortgage loans, consumer or trade receivables, securities or other assets having ascertainable cash flows or market value. The municipal obligations reinsured by the Company consist primarily of general obligation bonds that are supported by the issuers' taxing power and of special revenue bonds and other special obligations of states and local governments that are supported by the issuers' ability to impose and collect fees and charges for public services or specific projects. The Company's reinsurance guarantees payments when due of scheduled payments on an insured obligation. In the case of a payment default on an insured obligation, the Company is generally required to pay the principal, interest or other such amounts due in accordance with the obligations' original payment schedule or, at its option, to pay such amounts on an accelerated basis. The Company conducts surveillance on its exposures to try and ensure early identification of any loss events. In addition, in the normal course of business, the Company seeks to reduce the loss that may arise from such events by reinsuring certain levels of risks in various areas of exposure with other insurance enterprises or reinsurers.

On October 6, 1999, the Company entered into a Facultative Quota Share Reinsurance Treaty ("Treaty") with XL Capital Assurance Inc. ("XLCA"). The Treaty was amended and restated on June 22, 2001 and May 1, 2004. Under the terms of this Treaty, the Company agrees to reinsure up to 90% of XLCA's compliant risks. The Company is subject to ceding commissions of up to 30% on business assumed under the terms of this Treaty.

On October 3, 2001, the Company entered into an excess of loss reinsurance agreement with XL Insurance (Bermuda) Ltd, which indemnifies the Company up to an aggregate limit of liability of \$500 million in excess of defined obligor losses.

Effective December 1, 2004 the Company established a trust account in accordance with Regulation 114 of the New York Insurance Department for the benefit of XLCA to secure the obligations of the Company to XLCA under the Treaty. This trust account is required for XLCA to take financial credit for statutory reporting purposes for the reinsurance cessions by XLCA to the Company under the Treaty, since the Company is not a licensed insurer or reinsurer in any state of the United States of America. At June 30, 2005, investments at an amortized cost of \$970,652 were on deposit in the trust account.

---

## **XL FINANCIAL ASSURANCE LTD.**

### **NOTES TO CONDENSED FINANCIAL STATEMENTS FOR SIX MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

(UNAUDITED)

(U.S. dollars in thousands, except per share amounts)

---

## 2. Significant Accounting Policies

### Basis of Preparation

The accompanying condensed financial statements have been prepared by the Company and are unaudited. In the opinion of management, all adjustments, which include only normal recurring adjustments necessary to present fairly the financial position, results of operations and cash flows at June 30, 2005 and for all periods presented, have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. These statements should be read in conjunction with the Company's December 31, 2004 financial statements and notes thereto. The December 31, 2004 condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the periods ended June 30, 2005 and 2004 are not necessarily indicative of the operating results for the full year.

The preparation of condensed financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Any such adjustments are reflected in income in the period in which the adjustments are made. The financial statement estimates subject to most uncertainty are estimates for loss reserves and calculation of the fair value of credit default swap derivative instruments.

### Recent Accounting Pronouncements

In March 2005, the FASB issued FASB Staff Position ("FSP") FIN 46(R)-5, Implicit Variable Interests Under FASB Interpretation No. 46(R) which requires an enterprise to consider whether it holds an implicit variable interest in a Variable Interest Entity ("VIE") and what affect this may have on the calculation of expected losses and residual returns of the VIE and the determination of which party, if any, is considered the primary beneficiary of the VIE. This statement was in effect March 3, 2005 and for the the current quarterly reporting period did not have a material impact on the Company's financial condition or results of operations.

The Company has become aware of the SEC's recent review of the loss reserving practices of certain financial guarantee companies. The Company recognizes that there is diversity in practice among financial guarantee insurers and reinsurers with respect to their accounting policies for loss reserves. Current accounting literature, specifically FASB Statement of Financial Accounting Standards No. 60 "Accounting and Reporting by Insurance Enterprises" ("FAS 60") and FASB Statement of Financial Accounting Standards No. 97 "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments" ("FAS 97"), do not specifically address the unique characteristics of financial guarantee insurance contracts. Consequently, the accounting principles applied by the industry, as well as the Company, have evolved over time and incorporate the concepts of both short-duration and long-duration contracts accounting under the provisions of FAS 60 and FAS 97. It is our understanding that the SEC has requested that the FASB review this matter and provide guidance for the accounting of financial guarantee insurance contracts. The Company will continue its loss reserving methodology as noted above until further guidance is provided by the SEC or FASB.

## **XL FINANCIAL ASSURANCE LTD.**

### **NOTES TO CONDENSED FINANCIAL STATEMENTS FOR SIX MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

(UNAUDITED)

(U.S. dollars in thousands, except per share amounts)

#### **3. Derivative Instruments**

Credit derivatives issued by the Company meet the definition of a derivative under FAS 133. The Company has recorded these products at fair value, modeled on prevailing market conditions and certain other factors relating to the structure of the transaction. The Company considers credit derivatives to be financial guaranty contracts, in substance, as the Company intends to hold them to maturity. The Company determines fair value using a model which calculates the difference between the actual remaining present value of installment premiums and an estimated remaining present value of installment premiums under current market conditions. In essence, the model estimates the cost of an offsetting position to the original credit derivatives from other comparable counterparties under the current market environment. The model is dependent upon a number of factors including changes in credit spreads, changes in credit quality, foreign exchange and other market factors.

The Company's credit derivatives portfolio generally requires the Company to meet payment obligations for referenced credits within the portfolio in the event of specific credit events after erosion or exhaustion of various first loss protection levels. These credit events are contract specific, but generally cover bankruptcy, failure to pay and repudiation. The notional exposure of the credit derivatives portfolio as of June 30, 2005 was \$6.7 billion. Approximately 95% and 4% of the portfolio is rated AAA and BBB, respectively, with the remainder being split amongst AA and A. The weighted average term of the contracts in force was 5.16 years.

For the six months ended June 30, 2005, the Company amended the presentation of credit derivative transactions in the statements of income to include certain components of the transactions in "gross premiums written", "net premiums earned", "net losses and loss expenses incurred" and "fee and other income", and certain components of the change in fair value in "unpaid loss and loss expenses." Previously, components of the transactions and the change in fair value were reflected in one line item under "Net realized and unrealized gains and losses on derivative instruments", and the fair value had been reflected in "Derivative assets" and "Derivative liabilities." There was no effect on net income as a result of this change and prior period results have been reclassified to reflect this presentation. This change in presentation is applicable only to credit default swaps assumed by the Company that are investment grade and that the Company intends and has the ability to hold to maturity and is consistent with practices in the financial guaranty insurance industry for reporting the results of such instruments. Results of the prior period presented have been reclassified to conform to the current period presentation.

In terms of the 2005 and 2004 condensed financial statements, the effect of the reclassification is outlined as follows:

	(Unaudited)		(Unaudited)	
	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
<b>Income Statement</b>				
Net earned premiums	\$ 7,642	\$ 7,570	\$ 11,535	\$ 12,487
Net losses and loss expenses	1,911	463	2,885	1,210
Acquisition costs	2,229	37	2,244	98
Net realized and unrealized gains (losses) on derivative instruments	(3,626)	635	(772)	7,411
			(Unaudited)	
			As at	
			June 30, 2005	December 31, 2004
<b>Assets</b>				
Derivative assets			18,897	\$ 17,396

## **XL FINANCIAL ASSURANCE LTD.**

### **NOTES TO CONDENSED FINANCIAL STATEMENTS FOR SIX MONTH PERIODS ENDED JUNE 30, 2005 AND 2004**

(UNAUDITED)  
(U.S. dollars in thousands, except per share amounts)

	(Unaudited)	
	As at	
	June 30, 2005	December 31, 2004
<b>Liabilities</b>		
Net losses and loss expenses	12,903	10,018
Derivative liabilities	3,940	1,669

The Company is also party to a put option agreement and an asset trust expense reimbursement agreement with Twin Reefs Asset Trust (the "Asset Trust"). The put option agreement provides The Company with the irrevocable right to require the Asset Trust at any time and from time to time to purchase the Company's non-cumulative perpetual Series B Preferred Shares with an aggregate liquidation preference of up to \$200 million. The Company is obligated to reimburse the Asset Trust for certain fees and ordinary expenses. To the extent that any Series B Preferred Shares are put to the Asset Trust and remain outstanding, a corresponding portion of such fees and ordinary expenses will be payable by the Company pursuant to the asset trust expense reimbursement agreement. The put option agreement is perpetual but would terminate on delivery of notice by the Company on or after December 10, 2009, or under certain defined circumstances, such as the failure of the Company to pay the put option premium when due or bankruptcy. The put option is recorded at fair value with changes in fair value recognized in "Net realized and unrealized gains and losses on derivative instruments". At June 30, 2005, the fair value adjustment was a \$2 increase to income. In addition, put option premiums of \$1,069 were recognized during the six month period ended June 30, 2005.

#### 4. Reinsurance

The effect of reinsurance on premiums written and earned for the three month periods ended June 30, 2005 and 2004 is shown below:

	Assumed	Ceded	Net
Three months ended June 30, 2005			
Premium written	\$ 75,958	\$ (7,366)	\$ 68,592
Premium earned	36,416	(6,729)	29,687
Losses and loss adjustment expenses	20,928	(10,146)	10,782
Three months ended June 30, 2004			
Premium written	\$ 74,563	\$ (7,318)	\$ 67,245
Premium earned	35,409	(7,862)	27,547
Losses and loss adjustment expenses	6,353	(980)	5,373
Six months ended June 30, 2005			
Premium written	\$ 119,011	\$ (16,948)	\$ 102,063
Premium earned	70,303	(12,156)	58,147
Losses and loss adjustment expenses	23,882	(12,534)	11,348
Six months ended June 30, 2004			
Premium written	\$ 120,467	\$ (14,535)	\$ 105,932
Premium earned	67,009	(14,865)	52,144
Losses and loss adjustment expenses	8,944	(1,533)	7,411