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Research Update:

R.V.I. Guaranty Co. Ltd. And Affiliates Ratings Lowered To 'BBB' From 'A-'; Outlook Negative

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Table Of Contents

Rationale

Outlook

Ratings List

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Rationale

On April 1, 2009, Standard & Poor's Ratings Services lowered its counterparty credit and financial strength ratings on Bermuda-based R.V.I. Guaranty Co. Ltd. and its U.S.-based subsidiaries--R.V.I. America Insurance Co. and R.V.I. National Insurance Co.--to 'BBB' from 'A-'. At the same time, Standard & Poor's removed the ratings on all of these companies (collectively referred to as RVI) from CreditWatch, where they were placed on Aug. 12, 2008, with negative implications. The outlook on RVI is negative.

The downgrade is based on our opinion that the weak macroeconomic environment has hurt the value of RVI's franchise. The rapidly deteriorating economic conditions, rising gas prices in the second quarter and third quarter of 2008 (which have since declined), low new vehicle sales, a decline in used car prices at auction as reflected in third-party index values, and the higher unemployment rate were the main drivers of the adverse loss development in RVI's passenger vehicle residual value portfolio in 2008. As a result, RVI settled all present and future value asset risk coverage with its top three clients in the fourth quarter of 2008. However, the loss exposure and potential development on RVI's existing passenger vehicle book of business could be higher, accentuated by a deepening recessionary trend, and not commensurate with the former rating.

With the financial guaranty market in turmoil, RVI revised its business strategy. It abandoned its 2008 business plan of reinsuring super-senior corporate debt portfolios, and it has written no new business since December 2007. RVI has reinsured 11 financial guaranty transactions--all written in 2006 and 2007. The assumed portfolio consists of nine super-senior corporate debt portfolios and two insured utilities. The dramatically outsized exposures relative to RVI's balance sheet and capital base create the possibility that a small deviation in portfolio performance could have a material impact on RVI.

The company reduced its risk exposure as it substantially reduced its real estate portfolio. In its passenger vehicle and commercial equipment lines, RVI no longer provides primary asset risk coverage and will only underwrite lower-risk Financial Accounting Standards Board (FASB) level of coverage, thereby exposing the franchise to any potential change in FAS 13. The significant majority of RVI's premium volume is subject to the lease accounting standards currently in place. The potential change in accounting standards could significantly affect RVI's premium volume and earnings, which remains a significant risk. If this were to occur, the company could head into run-off, and we would expect another downgrade. However, at this point in 2009, the FASB has made no significant progress regarding FAS 13, so it seems that there will be no resolution to this issue for at least three years.

Partially offsetting these weaknesses is RVI's conservative investment strategy, which is focused on the preservation of principal and optimization

of after-tax yield. At year-end 2008, \$211.1 million in invested assets were of high quality (average credit rating 'AA') and primarily invested in fixed-income securities and cash (bonds, 78%; cash and cash equivalent, 20%; and preferred stocks, 2%). RVI also has good liquidity because its invested assets are readily exchangeable into cash with a 2.2-year tax-adjusted effective duration. Furthermore, about \$66 million of its holdings will mature in one year or less.

RVI has good capital adequacy, which we expect that the company will maintain to compensate for its volatile earnings and concentrated risk profile. Based on Standard & Poor's risk-adjusted capital model, RVI's capitalization is redundant at the current rating, including credits for net unearned premium reserves (\$148.0 million), the present value of financial guarantee installment premiums (\$12.5 million), and soft capital (a \$50.7 million capital commitment and a \$12.4 promissory note).

Outlook

The negative outlook reflects RVI's narrow business focus, as the worsening market conditions have significantly affected the franchise. On an ongoing basis, RVI will provide only FASB coverage for both passenger vehicle and commercial equipment, which will reduce passenger vehicle premiums by about 50% in 2009, which is significant.

With the increase in unemployment and the depreciating asset values of passenger vehicles, we expect that RVI will report modest earnings in 2009 under the company's economic-financial reporting basis. The only projected losses in 2009 will likely be within the passenger vehicle segment, where a change in asset values differing from RVI's current loss model projections could affect profitability. Earnings volatility will persist because the company will be less diversified as it concentrates on passenger vehicle and commercial equipment lines of business. In addition, with the amount of exposure remaining within the financial guarantee business, deterioration in the economic conditions could have a significant adverse effect on the company's operating performance. As a mitigating factor, RVI will concentrate exclusively on writing FASB level of coverage, where the amount of asset risk it assumes is less compared with indemnity coverage.

A revision of the outlook to stable could occur if RVI removes the financial guarantee risk from its books and stabilizes its passenger vehicle residual value business over the next 12 to 18 months. However, if the company cannot sustain its already constrained competitive position and suffers further losses, which would diminish its capital position, we could lower the ratings again.

Ratings List

Downgraded; CreditWatch/Outlook Action

To

From

R.V.I. Guaranty Co. Ltd.

R.V.I. National Insurance Company

R.V.I. America Insurance Co.

Counterparty Credit Rating

Research Update: R.V.I. Guaranty Co. Ltd. And Affiliates Ratings Lowered To 'BBB' From 'A-'; Outlook Negative

Local Currency	BBB/Negative/--	A-/Watch Neg/--
Financial Strength Rating		
Local Currency	BBB/Negative/--	A-/Watch Neg/--

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