

Endurance Specialty Holdings Ltd. And Subsidiaries Ratings Affirmed: Outlook Remains Stable

Rationale

On July 29, 2008, Standard & Poor's Ratings Services affirmed its 'BBB+' counterparty credit rating on Bermudian holding company Endurance Specialty Holdings Ltd. (NYSE:ENH). At the same time, Standard & Poor's affirmed its 'A' counterparty credit and financial strength ratings on the holding company's core operating subsidiaries: Endurance Specialty Insurance Ltd., Endurance Reinsurance Corp. of America, Endurance American Specialty Insurance Co., and Endurance Worldwide Insurance Ltd. (collectively referred to as Endurance). The outlook on all these companies remains stable.

The affirmation reflects the companies' strong competitive position, very strong capitalization, strong operating performance, and excellent enterprise risk management (ERM). (We recently revised our opinion of the group's ERM to excellent from strong.) Partially offsetting these strengths are the expansion in certain lines in a soft insurance cycle and material exposure to property catastrophe risk.

Endurance has a strong competitive position as a specialty re/insurer based on its global market presence, scale, and diversified insurance and reinsurance platforms. The company has a global and credible presence through its three main underwriting hubs in Bermuda, New York, and London. Since its creation in 2001, the company has been successful in developing its franchise organically and through several favorable acquisitions. Its competitive position has further improved in 2007 and in the first half of 2008 based on the company's build-out of its admitted and—to a lesser extent—nonadmitted platforms in the U.S. In addition, Endurance has created a competitive advantage within the areas of

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agricultural insurance, property catastrophe reinsurance, and hospital professional liability (health care).

Endurance's large shareholders' equity base of \$2.51 billion at year-end 2007 (\$2.54 billion as of March 31, 2008) allows the company to compete effectively in a crowded marketplace and gain market acceptance. Its capitalization is very strong, including a net aggregate exposure property catastrophe charge to incorporate the company's probable maximum loss (PML) based on the 1-in-250-year return period. Property catastrophe exposure remains the principal risk, constituting about 33% of total risk capital, as measured by Standard & Poor's risk-adjusted capital model. The company's stated objective is to limit its loss in a 1-in-100-year event to 25% of equity capital or less; this figure was about 19% as of Jan 1, 2008.

Endurance's operating performance is strong and stable, as demonstrated by its five-year (2003-2007) average combined ratio of 91.1% and a return on revenue (ROR) of 19.0%, including above-normal catastrophe losses in 2005. The quality of earnings is strong, with modest volatility, as measured by a five-year combined ratio and ROR standard deviation of 18%. Since inception through first-quarter 2008, Endurance has been able to generate an underwriting profit for all of its lines of business except for its marine (offshore energy) book of business, which the company exited after 2005. We expect that Endurance's underwriting results will remain strong in the first half of 2008, with minimal catastrophe losses.

We consider Endurance's ERM to be excellent. Supporting this view are an excellent risk culture and risk governance process, several examples of strong or excellent controls for the company's most significant risks such as catastrophic and noncatastrophic insurance risks and asset risks, and an excellent process to integrate risk management with strategic management. We consider it highly unlikely that Endurance will experience losses outside its tolerances. The company has a robust process to identify and evaluate risk/reward trade-offs and consistently uses that process to optimize risk-adjusted returns.

Partially offsetting these strengths are the company's expansion in certain lines of business in a challenging environment. Endurance significantly grew its California workers' compensation book of business to \$262 million of gross premiums written (GPW) in 2007 relative to \$94 million in 2006. As a mitigating factor, Endurance has experience with this business as it previously reinsured it (\$90 million of workers' compensation reinsurance premiums in 2005) prior to converting onto Endurance paper in 2006. Furthermore, Endurance's workers' compensation is an opportunistic play with a well-defined exit strategy. We expect that this line of business will run one to two years before conditions in California might cause Endurance to discontinue the program. In the second half of 2008, this book of business will likely be largely a renewal business, reducing in size quarter-over-quarter in line with rate reductions and normal levels of attrition.

With the acquisition of ARMtech Insurance Services Inc. and its affiliates in late 2007, Endurance has further strengthened the competitive position of its specialty unit. As a result, agricultural insurance will become a significant source of premiums in 2008. ARMtech's combination of strong distribution, extensive agribusiness experience and client relationships, and an efficient operating model built on a sophisticated technology platform render this business a long-term franchise for Endurance. On the other hand, agricultural insurance can be volatile because of the increase in frequency and severity of weather vagaries and the recent run-up in commodity prices, but this downside risk is somewhat mitigated in the U.S. by the federal insurance program. Endurance also

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purchased additional third-party stop-loss protection that will limit its agriculture insurance worst-case loss ratio to approximately 105% in 2008.

Endurance's aggregate probable maximum loss for 1-in-250-year event as percentage of its available economic capital is relatively high vis-à-vis its peers. However, the company's very strong capital base and excellent ERM mitigate this risk. Risk modeling is an inherent part of the company's operating procedure. The company's internal model, which incorporates several sound practices, is the primary tool to measure and monitor its catastrophe risks. These approaches are on par with industry leaders in this area. Endurance's risk platform provides real-time or near-real-time perspectives on concentrations, aggregations, and risk interactions and real-time marginal return on capital tracked at the contract level. Zonal aggregates are closely tracked against defined limits. It produces a detailed risk dashboard that highlights aggregate and individual risk categories.

Outlook

The stable outlook is based on Standard & Poor's expectation that Endurance will generate strong operating results in 2008 despite the challenging environment. Given its diversified business mix in re/insurance, conservative reserving, strong risk selection, and excellent ERM, Endurance should produce strong earnings and not be a negative outlier in an above-average catastrophe season, and its potential losses shouldn't be disproportional to a loss event. We expect that Endurance will generate a combined ratio of about 90%, and the addition of ARMtech would not exacerbate earnings' volatility because of Endurance's comprehensive reinsurance protection.

Endurance should maintain its strong competitive position in the re/insurance market, opportunistically expanding and contracting its various lines of business based on its excellent risk-management capabilities. In 2008, GPW will likely grow significantly (about 25%) because of the ARMtech acquisition. Excluding the agricultural business, Endurance's top-line growth would have been flat to slightly down in 2008. Depending on the capital market's performance, we expect that ROE will be in the vicinity of 15%.

A positive outlook is unlikely over the next 12 months because of the negative pricing trend in the re/insurance market. Alternatively, we could revise the outlook to negative if Endurance's operating results are more volatile than those of its peers or if its underwriting losses are material, especially in its workers' compensation book of business.

Ratings List

Ratings Affirmed

Endurance Specialty Holdings Ltd.
Counterparty Credit Rating
Local Currency BBB+/Stable/—
Endurance American Specialty Insurance Co.
Endurance Worldwide Insurance Ltd.
Endurance Specialty Insurance Ltd.
Endurance Reinsurance Corp. of America
Counterparty Credit Rating
Local Currency A/Stable/—
Financial Strength Rating

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Local Currency A/Stable/—

Endurance Specialty Holdings Ltd.

Senior Unsecured (2 issues) BBB+

Preferred Stock (1 issue) BBB-

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