

Rating Report

**Imagine Insurance Company
Limited**

Ratings

Financial Strength Rating A-

Rating Outlook

Stable

Affiliate Ratings

**Imagine International
Reinsurance Limited**

Financial Strength Rating A-

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■ **Summary**

On Oct. 5, 2006 Fitch Ratings affirmed the 'A-' insurer financial strength (IFS) ratings of Imagine Insurance Company Limited (Imagine) and Imagine International Reinsurance Limited (Imagine International). The Rating Outlook is Stable.

The affirmations reflect Imagine's lower than average underwriting risk, conservative investment strategy, historically strong capital formation rate (Imagine has grown its total capital to more than \$600 million from \$200 million since inception in 2000 through retained earnings and capital contributions) and the continued majority ownership of Imagine by Brookfield Asset Management (Brookfield, formerly known as Brascan Corporation). Fitch considers Imagine to be a strategic subsidiary of Brookfield. Although Fitch considers Imagine's underwriting risk to be below-average, the company's underwriting risk has been increasing as it has implemented its expansion from transactions with contractually-capped loss profiles (also known as finite-risk reinsurance) into traditional property, casualty and life reinsurance. As a writer of traditional reinsurance, Imagine competes globally against many larger, better-capitalized competitors.

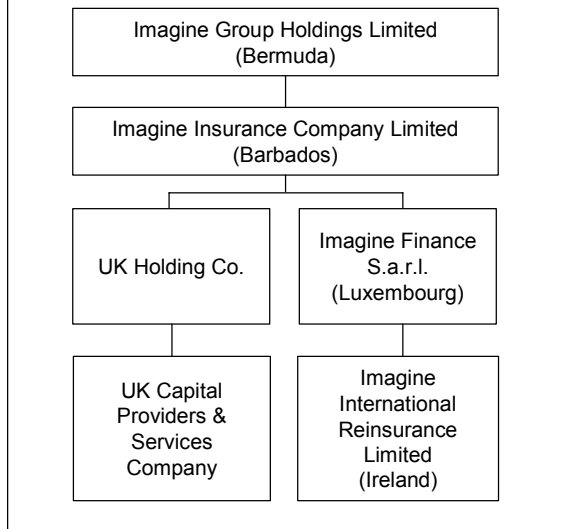
■ **Expectations**

The Stable Rating Outlook reflects Fitch's expectations that Imagine will revert to its historical level of profitability (return on average equity in the low double digits) following last year's modest return (0.2%), which resulted due to natural catastrophe and one-time charges. Fitch believes Imagine will continue to demonstrate less earnings volatility than its Bermuda reinsurer peers and will continue to employ a conservative investment strategy for the assets supporting its insurance liabilities, closely matching maturities and currencies. Fitch also expects continued majority ownership by Brookfield, which currently owns 77.5% of Imagine Group's common stock.

Imagine discounts the reserves on nine contracts for the time value of money representing 7.4% of current reserves carried. Fitch expects some adverse loss reserve development as a result of the unwinding of the loss reserve discount, but this should be offset by investment income arising from Imagine's matched investment strategy.

**Imagine Group Holdings Limited
Simplified Organization Chart**

(As of Oct. 1, 2006)



■ **Company Description**

Imagine Insurance Company Limited

Imagine is a Barbados-based global, diversified, specialty insurance company that was formed and became licensed to conduct business in late 2000. Imagine is wholly owned by and the principal subsidiary of Imagine Group Holdings Limited (Imagine Group), a Bermuda-based reinsurance holding company formed in conjunction with Imagine.

Imagine International is incorporated in Ireland as a wholly-owned subsidiary of Imagine. Its principal office is located in Dublin. Fitch considers Imagine International, which commenced operations in May 2001 to help service the European clients of Imagine, to be a strategic subsidiary of Imagine based on business synergies, common management, common branding and shared resources. Imagine provides explicit support to Imagine International through a net-worth maintenance agreement.

As of Dec. 31, 2005, Imagine reported total consolidated assets of \$2.3 billion and consolidated equity of \$574 million on an International Financial Reporting Standards (IFRS) basis. Imagine International reported total consolidated assets of \$411.5 million and consolidated equity of \$19.5 million on a statutory accounting basis.

**Consolidated Condensed Financial
Highlights — Brookfield Asset
Management**

(US\$ Mil., US GAAP Basis)

	2005	2004
Net Income	1,743	636
Total Assets	25,920	20,986
Preferred Equity	847	912
Common Equity	4,619	3,328
Common and Preferred Equity	5,466	4,240

Source: Brookfield Asset Management.

Brookfield Asset Management, Inc.

Brookfield (TSE, NYSE: BAM) is an asset manager focused on property, power and infrastructure assets, with over US\$50 billion of assets under management. Brookfield owns a portfolio of approximately 65 office properties and over 130 power generating facilities. Brookfield has assets located in North America, Europe and Brazil. In addition, Brookfield develops master planned communities and provides clients with an array of financial and advisory services. Brookfield once owned London Life Insurance Company, who in turn owned London Reinsurance Group. Brookfield reported \$25.9 billion in assets and \$4.6 billion in common equity as of Dec. 31, 2005.

Brookfield has made no contractual commitments to guarantee Imagine's reserves or to supply more capital if needed. Brookfield also has indicated no plans to take dividends out of Imagine. Therefore, the insurer financial strength rating is assigned to Imagine primarily on a stand-alone basis.

Imagine Group Holdings Limited

Imagine Group is incorporated in Bermuda. Brookfield was the Imagine Group's sole investor until 2004 when two new institutional investors purchased an additional \$100 million of common share equity. This investment diluted Brookfield's shareholding to approximately 80%. At Dec. 31, 2005, Imagine Group reported total consolidated assets of \$2.3 billion and equity of \$527 million (International Financial Reporting Standards [IFRS] basis).

Products

Imagine is a global provider of specialty insurance and reinsurance. Imagine provides reinsurance and insurance products and advisory services through its subsidiaries or offices in Barbados, Ireland, the United Kingdom, Denmark, the United States, Germany, Japan and Australia, and through its

managing agency and syndicates at Lloyd's of London (Lloyd's).

Imagine offers specialty reinsurance and insurance coverage in three product segments: (i) property, including marine and aviation, (ii) casualty and (iii) life and health, including accident and annuities. Within these product segments, Imagine underwrites reinsurance and insurance contracts on both a traditional and nontraditional basis. Under a traditional approach, risks are assumed by Imagine using customary and standard market terms and conditions. Under a nontraditional approach, Imagine structures customized transactions to address the specific risks of its reinsured, incorporating risk mitigation features that may reduce the risk being assumed by Imagine in consideration of a lower premium or a sharing of profits between Imagine and the reinsured.

Imagine writes property catastrophe, financial institutions, liability, accident and health, and other specialty casualty business on a traditional basis at Lloyd's. Workers' compensation, professional liability, general liability, medical malpractice, non-standard auto, life and other specialty casualty lines are written on a nontraditional basis by Imagine and Imagine International.

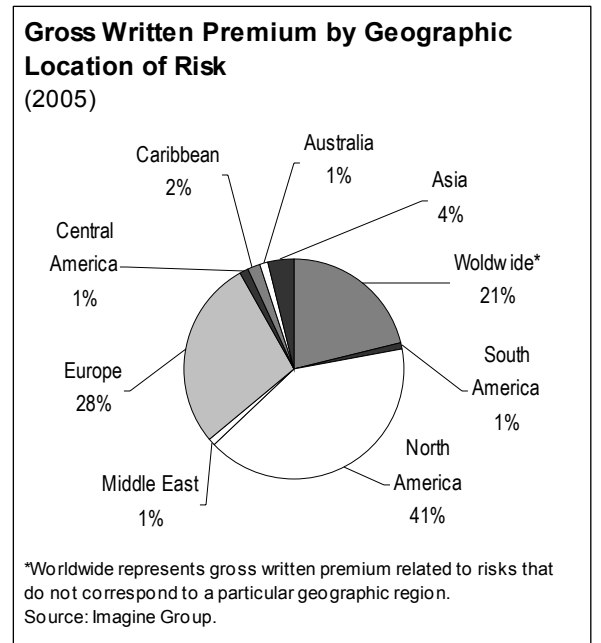
Imagine has been in business for approximately six years. As a still relatively young company, Imagine's strategy and product offerings continue to evolve. Originally, Imagine focused exclusively on nontraditional insurance products written by Imagine. However, the nontraditional insurance market is changing by moving towards greater underwriting risk. In addition to a nontraditional market that is becoming more like the traditional market, Imagine also increased its underwriting risk by expanding into traditional insurance and reinsurance with its December 2004 purchase of Danish Re (Bermuda) Limited and its subsidiaries (Danish Re). In 2005 Imagine purchased Abacus Syndicates Limited and provides capacity to its two managed syndicates.

In 2004 and 2005, nontraditional insurance came under great scrutiny as the result of perceived abuses by some market participants. Although Imagine was not accused of any wrongdoing and is not known to be the target of any investigations, it has been affected by changing customer demand for nontraditional products. Some customers, fearful of the negative attention that nontraditional insurance

has received, have withdrawn from the market. In other cases, customers are still present but proposed transactions must undergo a far more extensive vetting and review process (by management and their actuaries, accountants, regulators, etc.). As a result, nontraditional insurance transactions often take much longer to close. Additionally, the nontraditional transactions that do close are often larger since the cost of the review process cannot be justified for small transactions.

Imagine responded by expanding its underwriting capabilities to better assess the increasing underwriting risk in nontraditional insurance and to diversify out of pure nontraditional reinsurance into traditional insurance and reinsurance.

Fitch sees the merit in Imagine's diversification strategy. Nontraditional reinsurance is a market of limited size, and reliance on a single product line exposed the company to significant regulatory risk. That notwithstanding, there is also risk in diversification. The implementation of any new strategy carries execution risk. Additionally, the level of underwriting risk in traditional insurance is significantly higher than in nontraditional insurance, resulting in greater volatility in operating results. This greater potential volatility causes a corresponding increase in the amount of capital needed to support the business.



**Consolidated Income Statement* —
Imagine Insurance Company Limited**
(\$000)

	2005	2004
Revenues		
Net Written Premium	516,425	506,252
Net Earned Premium	488,662	567,071
Investment Income	56,588	35,684
Net Realized Gains	259	4,325
Negative Goodwill	0	30,941
Net Foreign Exchange Gains	3,199	2,306
Other Income	26,609	18,152
Total Revenues	575,317	658,479
Expenses		
Claims and Claims		
Adjustment Expenses Incurred	453,447	463,349
Policy Acquisition Costs	66,457	105,528
Operating Expenses	64,975	41,976
Impairment Loss on Disposal Group	5,000	0
Total Expenses	589,879	610,853
Income Before Finance Costs	(14,562)	47,626
Finance Costs	3,157	196
Income Before Income Taxes	(17,719)	47,430
Income Tax Recovery (Expense)	18,564	2,342
Net Income	845	49,772
Ratios (%)		
Loss and LAE Ratio	92.8	81.7
Expense Ratio	26.9	26.0
Combined Ratio	119.7	107.7
Investment and Other Income Ratio	17.0	9.5
Operating Ratio	102.7	98.2

*International accounting standards. Source: Imagine Group, Fitch Ratings.

Target Market

Imagine's business is produced mainly by professional advisors and intermediaries. For its nontraditional business, Imagine also markets directly to the CEOs and CFOs of potential clients when a prior relationship already exists.

Imagine's contracts cover risks located throughout the world. As a practical matter, however, most of these risks are located in either North America or Europe since those two locations comprise most of the world's insured risks. See the chart on the prior page for a breakdown of 2005 gross written premium by geographic location of risk.

■ **Financial Review**

Profitability

Imagine has been consistently profitable since its inception in late 2000. However, Imagine's expansion into traditional insurance and reinsurance

**Consolidated Balance Sheet* —
Imagine Insurance Company Limited**
\$000

	2005	2004
Assets		
Cash	380,624	422,457
Short-Term Investments	231,621	239,917
Fixed Maturities	957,429	736,992
Derivative Financial Instruments	28	2,946
Structured Insurance Assets	76,211	88,739
Equities	24,567	5,312
Total Cash and Investments	1,670,480	1,496,363
Accrued Investment Income	11,463	7,729
Funds Held by Ceding Companies	15,220	17,415
Premiums and Other		
Reinsurance Receivable	177,692	110,993
Deferred Policy Acquisition Costs	36,502	23,330
Prepaid Reinsurance Premiums	19,267	19,001
Investment Contract Assets	40,430	43,000
Reinsurance Losses Recoverable	203,283	123,256
Assets Classified as Held for Sale	65,877	0
Goodwill	4,411	5,804
Tax Assets and Recoveries	18,872	3,281
Other Assets	49,403	26,644
Total Assets	2,312,900	1,876,816
Liabilities		
Claims and Claims		
Adjustment Expenses	1,171,676	871,365
Unearned Premiums	164,635	105,967
Reinsurance Balances Payable	105,885	55,155
Tax Liabilities	12,425	16,783
Investment Contract Liabilities	142,590	172,043
Loans Payable	27,219	42,446
Derivative Financial Instruments	1,496	2,046
Liabilities Classified as Held for Sale	55,816	0
Accounts Payable and Other Liabilities	57,108	85,965
Total Liabilities	1,738,850	1,351,770
Shareholders' Equity		
Share Capital	532,355	482,355
Unrealized Investment Gains (Losses)	1,713	(115)
Cumulative Translation Adjustment	(2,380)	1,288
Retained Earnings	41,341	40,673
Total Shareholders' Equity	573,029	524,201
Minority Interest	1,021	845
Minority Interest and Shareholders' Equity	574,050	525,046
Total Liabilities and Shareholders' Equity	2,312,900	1,876,816
Ratios:		
NWP/Equity	0.9	1.0
Loss Reserves to Equity	2.0	1.7

*International accounting standards. NWP – Net written premium
Source: Imagine Group, Fitch Ratings.

has introduced property catastrophe risk, and the resultant volatility, into its earnings. In 2005, Imagine's exposure to property catastrophe risks was limited to 11% and 9% on a gross and net written premium basis, respectively. Imagine reported net income, as measured under IFRS, of \$0.8 million in 2005, a significant drop from the \$49.8 million reported in 2004. Imagine's return on average equity

was approximately 0.2% in 2005. Imagine stumbled somewhat by entering into a transaction whereby it posted funds at Lloyd's (FAL) for a syndicate for which it did not control the underwriting process. This syndicate reported heavy catastrophe losses in 2005 that contributed significantly to Imagine's 2005 decline in income. Positively, Imagine was able to report positive income in a year when many of its peers reported losses and in a year that contained the single costliest insurance loss ever (Hurricane Katrina). Effective Jan. 1, 2006, Imagine no longer posts FAL when it does not control the syndicate's underwriting.

Imagine's earnings have historically included a number of non-recurring items of both income and expense that complicate an assessment of the ongoing profitability of the company. Danish Re was purchased at a discount to book value, which resulted in a \$31 million gain (negative goodwill) in 2004. In addition to the previously mentioned catastrophe losses, 2005 also included a \$5 million loss on the impairment of an asset held for disposal. Prior years also include other negative goodwill transactions, a number of unusual income items including income in the form of the right to collect insurance broker commissions from a portfolio of long-term care policies and investment income where Imagine purchased the right to collect insurance claims against certain insurance companies operating under Schemes of Arrangement.

Investment income rose to \$56.6 million in 2005 from \$35.6 million in 2004. The full-year's inclusion of investment income from Danish Re contributed to the increase.

Imagine prepares its financial statements in accordance with IFRS. Imagine discounts loss reserves under certain situations. Imagine has discounted the reserves on nine contracts at Dec. 31, 2005, using various interest rates between 2.4%–5.7%. Discounting reduced reported reserves by \$153.8 million at Dec. 31, 2005 with a corresponding increase in equity and the deferred tax liability.

Investments/Liquidity

Overall, Imagine employs a relatively conservative investment portfolio in which higher risk investments are offset by Treasury securities. The amount of investment risk varies depending upon whether the investments support insurance liabilities or capital. The most conservative investments support insurance liabilities and the most volatile investments support capital.

Imagine actively manages its investment portfolio under investment guidelines approved by its board of directors for reinsurance assets, capital and retained earnings. Over time, Imagine has diversified the portfolio to include a balance of U.S. government securities, corporate securities, other investment-grade assets and some non-investment-grade assets. This pattern of increased diversification can be seen in the comparison of the invested asset mix as of Dec. 31, 2005 and 2004, in the table below.

Invested Asset Mix — Imagine Insurance Company Limited

(\$000)

	Dec. 31, 2005		Dec. 31, 2004	
	Fair Value	Percent (%)	Fair Value	Percent (%)
Cash and Cash Equivalents	380,624	22.8	422,457	28.2
Short-Term Investments	231,621	13.9	239,917	16.0
Fixed Maturities				
U.S. Government Securities	356,908	21.4	394,315	26.4
Non-U.S. Government Securities	99,511	6.0	28,606	1.9
U.S. Corporate Securities	210,450	12.6	172,004	11.5
Non-U.S. Corporate Securities	107,853	6.5	0	0.0
Mortgage-Backed Securities	116,066	7.0	72,719	4.9
Asset-Backed Securities	43,706	2.6	47,390	3.2
Collateralized Debt Obligations	17,029	1.0	21,958	1.5
Other	5,906	0.4	0	0.0
Total Fixed Maturities	957,429	57.3	736,992	49.3
Derivative Financial Instruments	28	0.0	2,946	0.2
Structured Insurance Assets	76,211	4.6	88,739	5.9
Equities	24,567	1.5	5,312	0.4
Total Cash and Investments	1,670,480	100.0	1,496,363	100.0

Source: Imagine Group.

The credit quality of its portfolio remains very high with approximately 70% of the fixed income portfolio at Dec. 31, 2005, rated 'AAA' or invested in U.S. Treasury securities versus the same amount at year-end 2004. The allocation to below-investment-grade bonds and unrated assets has moderated in recent years, increasing to 5.5% at Dec. 31, 2005, compared to 5.2% at year-end 2004. Nonetheless, this allocation has fallen notably from 10.4% of the portfolio at Dec. 31, 2003.

The declining allocation to below-investment-grade bonds has been offset by an increasing allocation to equities. The allocation to equities increased by \$19 million in 2005 to 1.5% of the invested asset portfolio. Equities represented only 0.4% of invested assets at year-end 2004 and there were no equity investments in 2003.

Investment Guidelines

Imagine broadly divides its investment portfolio into two categories: assets representing equity and assets held to settle insurance liabilities. Separate investment guidelines have been established for each category and any departure from the guidelines must be approved by the board of directors. The general investment guidelines establish percentage limitations for each category's investments in the following asset classes:

- Cash and Short-Term Investments
- Investment-Grade Securities
- Non-Investment-Grade Securities
- Alternative Investments
- Equity Investments
- Derivatives

Assets supporting core equity permit a broad range of investments in the above asset classes while insuring liquidity for claim payments. A portion of the investment guidelines for equity is allocated for investment in high-yield bond funds, real estate funds and other assets that may be below investment grade or not rated.

Assets supporting reinsurance liabilities are structured to cash flow and currency match liabilities for minimal interest rate and currency risk. Investments are limited to investment-grade bonds with a minimum rating of 'BBB-' and a target portfolio average of 'AA' or better.

Reinsurance

Nontraditional reinsurers are generally not big users of retrocessional coverage and Imagine does not use much retrocessional reinsurance in its nontraditional reinsurance program. However, the diversification into traditional insurance, and the accompanying increase in property catastrophe exposure, has necessitated an increased purchase of reinsurance.

Imagine's 2006 reinsurance program applies principally to its traditional (Lloyd's) business. The company has purchased reinsurance protection for property catastrophe, accident and health, employers/public liability financial institutions and professional indemnity. All of the reinsurers on the Imagine's 2006 reinsurance program are rated 'A-' or better. Imagine's single greatest natural catastrophe exposure is to US/Caribbean Windstorm. As of July 1, 2006, the company's 250-year probable maximum loss to this exposure was \$99.5 million gross and \$45.9 million net of reinsurance. This equates to 19% and 9%, respectively, of year-end 2005 equity.

Imagine's reinsurance recoverable balance relates entirely to its traditional business. Credit exposure related to reinsurance recoverables has increased from minimal at year-end 2003 to 35% of equity at year-end 2005. A large part of the increase was the acquisition of Danish Re at year-end 2004. Reinsurance recoverables also increased in 2005 due to ceded losses from Hurricanes Katrina, Rita and Wilma. The table below contains a breakout of the Imagine's 10 largest reinsurance recoverable exposures.

**Ten Largest Reinsurance Recoverables
— Imagine Group Holdings Limited**

(\$ Mil., As of Dec. 31, 2005)

Reinsurer	Gross Reinsurance Recoverable, Net of Collateral	Fitch Rating
National Indemnity Company	28.6	'AAA'
Munich Re	15.0	'AA--'
GE Frankona Reinsurance Limited	10.8	NR
Syndicate 780	10.6	'A'
Hannover Ruck AG	9.3	'A+'
Lexington Insurance Company	9.1	'AA+'
Brit Insurance Limited	8.9	'A+'
Glacier Re AG	6.3	NR
PXRE Group Ltd	5.8	'BB+'
Royal Sun Alliance Insurance plc	3.9	'BBB+'
Total	108.3	

NR – Not rated. Sources: Imagine Group, Fitch Ratings.

Reserves

Previously, Imagine's status as a relatively recent start-up meant that the company did not have the reserve adequacy uncertainties related to prior accident years of a more mature insurance organization. This changed with the acquisition of Danish Re, with which Imagine has now acquired traditional insurance prior accident-year reserves. Positively, there is substantial structural protection built into the transaction that mitigates this risk. Part of the Danish Re purchase price was paid by Imagine in the form of a note. The terms of the note allow Imagine to offset a significant amount of any adverse development of acquired reserves against note principal. To date, there has been some adverse development, but well within the range of protection provided by the note.

Additionally, Imagine now writes traditional casualty insurance and reinsurance. Although casualty insurance losses are generally more predictable than property insurance, which includes natural catastrophe risk, there is a much greater time period (the "claim tail") between the time when casualty losses are incurred and when those losses are adjusted and paid. Long-tailed liabilities expose the company to greater risk of reserve misestimation.

As noted previously, Imagine discounts reserves relating to nine contracts at rates typically reflecting a matched asset/liability investment strategy. The implication of this accounting policy is that the underwriting gain is higher than would have been reported if reserves were not discounted, because discounted reserves are lower than nominal dollar

reserves. This has the effect of reducing subsequent years' earnings as the interest implied by the discounting must be expensed each year (and will show up as reserve development) so that the discounted reserves converge on their nominal dollar amount by the date they are to be paid.

Capitalization

Previously, when Imagine focused exclusively on nontraditional reinsurance, Fitch viewed Imagine's capitalization level as a positive for the rating. However, Fitch views traditional reinsurance as much more capital intensive than nontraditional because Imagine now has much greater exposure to catastrophes, adverse loss reserve development and uncollectible reinsurance, which increase its capital needs. Additionally, when compared to its Bermuda-based reinsurance peers, Imagine is on the small size as most of its competitors have \$1 billion or more of capital. Nonetheless, Fitch considers Imagine's capital level to be adequate for the current rating.

Imagine's rate of capital formation, through retained earnings and capital contributions, has been strong. Imagine was initially capitalized with \$200 million in 2000. Subsequently, Imagine has increased its capital to \$625 million including: \$135 million of additional common equity contributed by Brookfield in 2002 and 2003, approximately \$90 million of retained earnings, \$100 million of common equity contributed by new investors and \$60 million of subordinated debt sold to Brookfield. Fitch is aware of no on- or off-balance sheet items, which represent either capital shortfalls or sources of hidden capital.

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