



FORM 10-K

WHITE MOUNTAINS INSURANCE GROUP LTD - WTM

Filed: March 30, 1998 (period: December 31, 1997)

Annual report which provides a comprehensive overview of the company for the past year

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 1997

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 1-8993

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
(Exact name of Registrant as specified in its charter)

Delaware 94-2708455
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

80 South Main Street, Hanover, New Hampshire 03755-2053
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (603) 643-1567

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$1.00 per share	New York Stock Exchange

Securities registered pursuant to section 12(g) of the Act:
None

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 if disclosure of delinquent filers pursuant to Item
405 of Regulation S-K is not contained herein, and will not be contained, to the
best of the Registrant's knowledge, in definitive proxy or information
statements incorporated by reference in Part III of this Form 10-K or any
amendment to this Form 10-K.

The aggregate market value of voting shares (based on the closing price of
those shares listed on the New York Stock Exchange and the consideration
received for those shares not listed on a national or regional exchange) held by
non-affiliates of the Registrant as of March 20, 1998, was \$799,580,145.

As of March 20, 1998, 5,857,730 shares of Common Stock, par value of \$1.00
per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Notice of 1998 Annual Meeting of Shareholders and
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Fund American

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PART I

Item 1. Business

GENERAL

Fund American Enterprises Holdings, Inc., (the "Company"), is a Delaware corporation which was organized in 1980. Within this report, the consolidated organization is referred to as "Fund American." Fund American's principal businesses are conducted through White Mountains Holdings, Inc. and its operating subsidiaries ("White Mountains"). White Mountains' consolidated and unconsolidated insurance operations are conducted through its subsidiaries and affiliates in the businesses of property and casualty insurance, reinsurance and financial guaranty insurance. White Mountains' mortgage banking operations are conducted through Source One Mortgage Services Corporation and its subsidiaries ("Source One"). Fund American also owns a passive investment portfolio consisting primarily of common equity securities. The Company's principal office is located at 80 South Main Street, Hanover, New Hampshire, 03755-2053, and its telephone number is (603) 643-1567.

INSURANCE OPERATIONS

Consolidated Insurance Operations

Since 1995 White Mountains has been acquiring and developing various insurance operating interests. In December 1995, White Mountains acquired Valley Group, Inc. ("VGI") of Albany, Oregon and Charter Group, Inc. ("CGI") of Richardson, Texas for \$41.7 million in cash less \$3.0 million of purchase price adjustments. In September 1995, White Mountains formed White Mountains Insurance Company ("WMIC") which is a New Hampshire-based mid-size commercial property and casualty company. Since 1995 White Mountains has been active in developing, capitalizing and reorganizing its insurance operations.

Valley. VGI, through its wholly-owned subsidiaries including Valley Insurance Company ("VIC"), Valley Property & Casualty Insurance Company ("Valley P&C"), Valley National Insurance Company ("Valley National") and certain related non-insurance affiliates, collectively ("Valley"), write personal and commercial lines as further described below:

VIC: A Northwest-based property and casualty company which writes personal and commercial lines. In 1997 and 1996, VIC had \$77.7 million and \$75.1 million of net written premiums, respectively, primarily in Oregon, California and Washington. At December 31, 1997, VIC had \$146.6 million of total admitted assets and \$61.2 million of policyholders' surplus. VIC was established in 1982 and began writing insurance policies in 1985. VIC is rated "A" or "excellent" by A.M. Best.

Valley P&C: On December 5, 1996, Valley's parent company formed Valley P&C to specifically write property and casualty insurance within Oregon. Valley P&C wrote its first policies in February 1997 and had \$5.2 million in net written premiums during 1997. At December 31, 1997, Valley P&C had \$7.7 million of total admitted assets and \$3.7 million of policyholders' surplus.

Valley National: On January 19, 1996, Valley purchased an inactive insurance company for \$13.2 million, net of cash balances acquired. The newly acquired insurance company, which was renamed Valley National, is licensed to

write property and casualty insurance in 48 states. Assets acquired pursuant to the purchase of Valley National included an investment portfolio, consisting principally of fixed maturity investments, totalling \$6.7 million. Valley National wrote its first policies in December 1996 and had \$2.7 million in gross written premiums (\$.3 million of net written premiums) during 1997. Valley National is expected to further expand its operations

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to certain other states in which it is currently licensed. At December 31, 1997, Valley National had \$11.5 million of total admitted assets and \$11.1 million of policyholders' surplus. Valley National is a wholly-owned subsidiary of VIC and shares its A.M. Best's "A" rating through a combination of a reinsurance arrangement with VIC and its ownership structure.

Valley markets insurance products principally through independent agents. Valley's primary business focus is to establish strong long-term relationships with its agents and insured customers by focusing on providing quality insurance products to families and family-owned businesses. This approach has resulted in an established track record of growth:

Statutory Basis, in Millions	Year Ended December 31,				
	1997	1996	1995	1994	1993
Gross written premiums	\$ 89.2	\$ 81.9	\$ 73.1	\$64.8	\$ 52.5
Total assets at year-end	154.3	138.2	126.8	80.4	65.8
Policyholders' surplus at year-end	64.9	57.8	58.5	23.5	22.9

In 1997 and 1996 Valley wrote \$89.2 million and \$81.9 million, respectively, of gross premiums within the following states, through approximately 285 independent agents:

Dollars in millions	Year Ended December 31, 1997		
	Gross Written Premiums	Policies In Force*	Agents*
Oregon	\$43.1	30,789	98
California	26.2	12,333	80
Washington	17.2	6,960	69
Arizona, Idaho, Utah and other	2.7	2,180	38
Totals	\$89.2	52,262	285

Dollars in millions	Year Ended December 31, 1996		
	Gross Written Premiums	Policies In Force*	Agents*
Oregon	\$40.9	31,118	99
California	27.5	12,910	74
Washington	13.2	4,554	63
Arizona, Idaho, Utah and other	.3	222	9
Totals	\$81.9	48,804	245

* Determined at year end.

Valley began to write business in the states of Arizona, Idaho and Utah during the fourth quarter of 1996. Valley intends to increase its premium writings in those states in the future.

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Valley's focus on delivering insurance products to families and family-owned businesses has resulted in a book of business which is balanced between personal lines and commercial lines. Gross written premiums for Valley's primary lines of business are shown below:

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Millions	Year Ended December 31,				
	1997	1996	1995	1994	1993
Personal lines:					
Automobile	\$ 29.3	\$25.9	\$23.9	\$22.5	\$ 20.5
Homeowners	13.4	12.0	10.4	8.3	6.3
Other	1.5	1.3	1.1	.8	.8
Total personal lines	44.2	39.2	35.4	31.6	27.6
Commercial lines:					
Multiple peril	42.2	39.1	34.3	30.2	21.3
Other	2.8	3.6	3.4	3.0	3.6
Total commercial lines	45.0	42.7	37.7	33.2	24.9
Total gross written premiums	\$ 89.2	\$81.9	\$73.1	\$64.8	\$ 52.5

The long-term relationships cultivated by Valley with its agents and insured customers, along with superior customer service and convenient premium billing and payment systems, have produced a relatively high level of persistency in Valley's "package" book of business. In 1997 and 1996, package business represented approximately 79.1% and 80.0% of Valley's premium writings, respectively, for both personal and commercial lines:

Renewal retention ratios	Year Ended December 31,				
	1997	1996	1995	1994	1993
Personal automobile/homeowners packages	91.4%	89.4%	88.2%	87.8%	89.0%
Commercial multiple peril packages	78.9%	75.5%	76.5%	84.5%	86.0%

Renewal persistency can be a significant indicator of an insurance company's long-term prospects for successful underwriting. An insurance company typically incurs more marketing and underwriting costs to write new business (e.g., policies written for new customers) than it does to write "seasoned" business (e.g., policy renewals). Additionally, losses and loss adjustment expenses are typically higher and less predictable for new business than for seasoned business.

WMIC. WMIC is currently licensed to write insurance in Maine, New Hampshire, Vermont, Massachusetts and New York and is expected to expand its operations to other states as additional regulatory approvals are obtained. WMIC markets its products principally through independent agents and had gross written premiums during 1997 and 1996 of \$5.2 million and \$2.4 million (\$4.7 million and \$2.0 million of net written premiums), respectively. At December 31, 1997, WMIC had \$31.4 million of total admitted assets and \$29.1 million of policyholders' surplus. WMIC is a wholly-owned subsidiary of VIC and shares its A.M. Best's "A" rating through a combination of a reinsurance arrangement with VIC and its ownership structure.

Charter. CGI, through its wholly-owned subsidiary Charter Indemnity Company, its controlled affiliate Charter County Mutual Insurance Company and certain related non-insurance subsidiaries (collectively "Charter"), markets and underwrites nonstandard automobile insurance to individuals in the State of Texas. For the years ended December 31, 1997 and 1996, Charter's net written premiums totalled \$62.9 million and \$69.9 million, respectively and its

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earned premiums totalled \$62.4 million and \$37.7 million, respectively. Written premiums (and related expenses and losses) for Charter's policies written prior to January 1, 1996, were entirely ceded to Charter's former parent and are now fully retained, therefore, Charter's 1997 and 1996 earned premiums are not

directly comparable.

Charter writes all its business through independent agents located in Texas. At December 31, 1997, Charter had approximately 750 agents located throughout the State. Charter expects to write policies in Oklahoma during 1998 and is expected to expand its operations to other states.

The nonstandard automobile insurance market consists of drivers who are unable to obtain coverage from standard carriers due to their prior driving records, other underwriting criteria or market conditions. Management believes that opportunities in the nonstandard automobile insurance market in Texas are influenced by many factors including the market conditions for standard automobile insurance, the residual market plan of the State, and the extent to which State motor vehicle laws are enforced. The nonstandard automobile insurance market has grown in recent years as the result of tightening of underwriting standards by underwriters of standard and preferred automobile insurance, and increased enforcement of motor vehicle laws including driving while intoxicated and uninsured motorist laws.

Charter offers both liability and physical damage coverage in the Texas nonstandard automobile insurance market, generally with policies having terms of 6 months or 12 months. Most of Charter's policyholders choose basic limits of liability coverage, which in Texas are \$20,000 per person and \$40,000 per accident for bodily injury, and \$15,000 for property damage. For the year ended December 31, 1997, Charter's net written premiums totalled \$43.0 million for liability coverages and \$19.9 million for property damage coverages.

Management pursues a strategy of establishing Charter as a low-cost provider of nonstandard automobile insurance while maintaining a commitment to provide "service beyond expectation" to both agents and the insured. Management believes that Charter has become a low cost provider of nonstandard automobile insurance. Increased automation of certain marketing, underwriting, claims and administrative functions has provided Charter with the ability to process more business without a corresponding increase in costs, while maintaining a high level of service to its agents and insured customers.

Management believes that most classes of nonstandard automobile insurance can be underwritten profitably if they are priced adequately. Charter seeks to classify risks into narrowly defined segments through the utilization of available underwriting criteria and internal performance statistical data. Charter maintains a proprietary database which contains statistical records with respect to its agents and the insured. Management believes this database enhances Charter's ability to analyze loss experience, and to underwrite and price its products based on a number of variables. Charter utilizes many factors and analyses to determine its rates including: type, age and location of the vehicle; number of vehicles per policyholder; number and type of traffic violations or accidents; limits of liability; deductibles; and age, sex and marital status of the insured. Charter's combined ratio for the years ended December 31, 1997 and 1996 was 94.2% and 99.3%, respectively.

Investments in Unconsolidated Insurance Affiliates

White Mountains' investments in unconsolidated insurance affiliates represent strategic operating investments in other insurers in which White Mountains has a significant voting and economic interest but does not own greater than 50.0% of the entity. Since 1994, Fund American has been active in accumulating its investments in unconsolidated affiliates which are further described below:

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Financial Security Assurance Holdings Ltd. ("FSA"). FSA conducts its operations principally through Financial Security Assurance Inc., a wholly-owned monoline financial guarantee insurance subsidiary with Triple-A claims-paying ratings from Moody's, Standard & Poor's and Fitch. FSA is principally engaged in guaranteeing municipal bonds as well as residential mortgage and other asset-backed securities. For 1997, 1996 and 1995 the present value of FSA's gross written premiums totalled \$250.3 million, \$226.3 million and \$139.1 million, respectively, and its net income was \$100.5 million, \$80.8 million and \$55.0 million, respectively. As of December 31, 1997 and 1996, FSA's total assets were \$1.9 billion and \$1.5 billion, respectively and its shareholders' equity was \$882.4 million and \$801.3 million, respectively.

In May 1994 the Company purchased 2,000,000 shares of the common stock of FSA ("FSA Common Stock") from U S WEST Capital Corp., a wholly-owned subsidiary of U S WEST, Inc. The purchase was part of an initial public offering of 8,082,385 shares of FSA Common Stock at the initial offering price of \$20.00 per share.

In September 1994 the Company acquired various fixed price options and shares of convertible preferred stock ("FSA Options and Preferred Stock") which, in total, give Fund American the right to acquire up to 4,560,607 additional shares of FSA Common Stock for aggregate consideration of \$125.7 million.

In 1995 and 1996, respectively, the Company purchased an additional 460,200 shares of FSA Common Stock on the open market for \$8.8 million and an additional 1,000,000 shares of FSA Common Stock in a private transaction for \$26.5 million.

All shares of and rights to FSA Common Stock owned or acquired by the Company as described above (other than those acquired on the open market) are subject to certain restrictions on transfer, voting provisions and other limitations and requirements set forth in a Shareholders' Agreement, a Registration Rights Agreement and a Voting Trust Agreement. As of December 31, 1997, 1996 and 1995 Fund American's economic interest in FSA was approximately 26.2%, 25.1% and 21.0%, respectively, and Fund American's voting interest in FSA was approximately 24.0%, 23.0% and 19.0%, respectively. During 1997 Fund American transferred all of its interests in FSA to Source One.

Mr. John J. ("Jack") Byrne (Chairman of the Company) is Vice Chairman of FSA and Mr. K. Thomas Kemp (President and CEO of the Company and Chairman and CEO of White Mountains) and Mr. James H. Ozanne, (President of Fund American Enterprises, Inc. ("FAE"), a wholly-owned subsidiary of the Company) are directors of FSA. In addition to being FSA directors, Mr. Kemp is Chairman of FSA's Human Resources Committee and Mr. Ozanne is Chairman of FSA's Underwriting Committee.

Fund American's investment in FSA Common Stock is accounted for using the equity method. FSA Common Stock is publicly traded on the New York Stock Exchange ("NYSE"). The market value of the FSA Common Stock as of December 31, 1997 and 1996, as quoted on the NYSE, exceeded Fund American's carrying value of the FSA Common Stock on the equity method. Fund American's investments in FSA Options and Preferred Stock are accounted for under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115 whereby the investments are reported at fair value as of the balance sheet date, with related unrealized investment gains and losses, after tax, reported as a net amount in a separate component of shareholders' equity and reported on the income statement as a component of comprehensive net income.

Main Street America Holdings, Inc. ("MSA"). MSA, a subsidiary of National Grange Mutual Insurance Company of Keene, New Hampshire ("NGM"), participates in 40% of NGM's business through a reinsurance pooling agreement. NGM writes personal and commercial property and casualty insurance in the Eastern United States. MSA's net written premiums totalled \$156.6 million, \$147.2 million and \$130.9 million in 1997, 1996 and 1995, respectively, and its net income was \$11.9 million, \$9.7 million and \$12.4 million, respectively. MSA's year-

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end total assets as of December 31, 1997 and 1996 were \$337.2 million and \$316.2 million, respectively, and its shareholders' equity was \$120.6 million and \$101.4 million, respectively.

In December 1994 the Company acquired 90,606 shares of the common stock of MSA ("MSA Common Stock") for \$25.0 million in cash. In 1995 the Company paid NGM an additional \$1.2 million in purchase price adjustments for the MSA Common Stock. In December 1995 the Company transferred all of its interest in MSA to White Mountains. White Mountains' investment in MSA at December 31, 1997, 1996 and 1995 represented approximately 33.1% of the outstanding common stock of MSA at those times.

Fund American's investment in MSA Common Stock is accounted for using the equity method. White Mountains' President, Mr. Terry L. Baxter, and Mr. Kemp are directors of MSA.

Folksamerica Holding Company, Inc. ("Folksamerica"). Folksamerica owns a multi-line broker-market reinsurance company which in 1997 and 1996 had net written premiums of \$232.4 million and \$171.9 million, respectively. At December 31, 1997 and 1996, Folksamerica had total assets \$1.2 billion and \$1.0 billion, respectively, and shareholders' equity of \$255.0 million and \$167.6 million, respectively.

In June 1996 White Mountains purchased, for \$79.9 million including related expenses, a 50.0% economic interest in Folksamerica. On November 20, 1997, White Mountains made an additional investment in Folksamerica of \$20.8 million which served to maintain its 50.0% economic interest. White Mountains' investment in Folksamerica includes (i) 6,920,000 shares of ten-year 6.5% voting preferred stock having a liquidation preference of \$79.4 million ("Folksamerica Preferred Stock"), (ii) ten-year warrants ("Folksamerica Warrants") to purchase up to 6,920,000 shares of the common stock of Folksamerica ("Folksamerica Common Stock") for \$11.47 per share, subject to certain adjustments and (iii) 1,563,907 shares of Folksamerica Common Stock. Folksamerica reported a book value per share at December 31, 1997 and 1996, of \$15.03 and \$12.11, respectively.

White Mountains' investment in Folksamerica Common Stock is accounted for using the equity method. White Mountains' investment in Folksamerica Preferred Stock and Folksamerica Warrants are accounted for under the provisions of SFAS No. 115 whereby the investments are reported at fair value as of the balance sheet date, with related unrealized investment gains and losses, after tax, reported as a net amount in a separate component of shareholders' equity and reported on the income statement as a component of comprehensive net income. Dividends earned on the Folksamerica Preferred Stock are recorded as earnings from unconsolidated insurance affiliates on the income statement. Messrs. Baxter and Kemp are directors of Folksamerica.

ML (Bermuda) Limited ("Murray Lawrence"). Murray Lawrence is a Bermuda-based managing agency group in the Lloyd's insurance market. On December 8, 1997 White Mountains purchased, for \$23.6 million, approximately 15.8% of the common stock of Murray Lawrence ("Murray Lawrence Common Stock"). Mr. Kemp is a director of Murray Lawrence.

MORTGAGE BANKING OPERATIONS

General

Source One was incorporated in 1972 and is the successor to Citizens Mortgage Corporation which was organized in 1946. Source One's principal office is located in Farmington Hills, Michigan. Source One is a wholly-owned subsidiary of Fund American whereby the Company currently owns 3% of the outstanding common stock of Source One and White Mountains owns the remaining 97% of the outstanding common stock of Source One.

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As a mortgage banker, Source One engages primarily in the business of producing and selling conforming and subprime residential mortgage loans and servicing and subservicing residential mortgage loans for third parties. Its sources of revenue are net mortgage servicing revenue, net interest revenue, net gain on sales of mortgages, net gain on sales of servicing and other revenue. Through subsidiaries, Source One also markets credit-related insurance products (such as life, disability, health, accidental death and property and casualty insurance).

As of December 31, 1997 and 1996, Source One owned a mortgage loan servicing portfolio totalling \$11.6 billion and \$26.4 billion, respectively, and subserviced a portfolio of mortgage loans for others totalling \$14.9 billion and \$2.8 billion, respectively. Source One services and subservices mortgage loans on behalf of numerous institutional investors and other security holders. During 1997 and 1996, Source One originated \$4.4 billion and \$3.8 billion in mortgage loans, respectively.

Industry Overview

Mortgage banking is the business of serving as a financial intermediary in the: (i) origination and purchase of mortgage loans; (ii) holding of such loans while aggregating sufficient loans to form appropriate mortgage-backed security pools; (iii) subsequent sale of such loans through pools or directly to investors; and (iv) ongoing management or servicing of such loans during the repayment period. Mortgage bankers generate revenue in each of the four stages of the mortgage banking process.

The origination process involves providing competitive mortgage loan rates, soliciting loan applications, reviewing title and credit matters, and funding loans at closing. Mortgage loans are often purchased from the originators thereof, who may receive a premium for releasing the right to service such purchased mortgage loans. The purchase price and any premium paid for servicing rights are greatly influenced by existing market conditions.

When interest rates on long-term mortgage loans exceed average interest rates incurred on total borrowings by Source One, as is generally the case, the holding of mortgage loans generates net interest income. In periods when borrowing rates exceed long-term mortgage lending rates, the holding of mortgage loans can generate net interest expense.

Marketing or selling mortgage loans requires matching the needs of the production market (consisting of homebuyers and homeowners seeking new mortgages) with the needs of the secondary market for mortgage loans (consisting of securities broker-dealers, depository institutions, insurance companies, pension funds and other investors). Conventional mortgage loans (e.g., those not guaranteed or insured by agencies of the Federal government) which are secured by one- to four-family residential properties, and which comply with applicable requirements, are packaged for direct sale or conversion to a mortgage-backed security, generally in pools of \$1.0 million or more. Such mortgage-backed securities are guaranteed by the Federal Home Loan Mortgage Corporation ("FHLMC") or the Federal National Mortgage Association ("FNMA"). Mortgage-backed securities are sold by mortgage banking companies primarily to securities broker-dealers. Federal Housing Administration ("FHA") insured mortgage loans and Veterans Administration ("VA") partially guaranteed mortgage loans are packaged in the form of modified pass-through mortgage-backed securities guaranteed by the Government National Mortgage Association ("GNMA") for sale primarily to securities broker-dealers. In addition, private entities may pool mortgage loans in the form of collateralized mortgage obligations or pass-through certificates, which may or may not qualify as real estate mortgage investment conduits ("REMICs") under the Internal Revenue Code of 1986, as amended (the "IRC"), and offer the resulting mortgage-backed securities to the public through

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securities broker-dealers. There is also a limited private market for mortgage

loans which have not been pooled or securitized.

Servicing involves: (i) collecting principal, interest and funds to be escrowed for tax and insurance payments from mortgage loan borrowers; (ii) remitting principal and interest to mortgage loan investors; (iii) paying property taxes and insurance premiums on mortgaged property; (iv) in some cases, advancing uncollected payments to mortgage loan investors; (v) administering delinquent loans; (vi) supervising foreclosures in the event of unremedied defaults; and (vii) performing all related accounting and reporting activities. Servicing generates cash income in the form of fees, which represent a percentage of the declining outstanding principal amount of the loans serviced and are collected from each mortgage loan payment received plus any late charges.

Mortgage Loan Production

Source One produces residential mortgage loans through a system of retail branch offices, a specialized marketing program, mortgage brokers, and a correspondent network of banks, thrift institutions and other mortgage lenders. The existence of multiple mortgage production sources gives Source One the flexibility to shift its production between those sources as market conditions warrant and allows Source One to emphasize the production mode which is most economically advantageous at the time.

Loans produced, whether through origination or purchase, include conventional residential mortgage loans as well as mortgage loans which are either insured by the FHA or partially guaranteed by the VA. In evaluating loans purchased through its correspondent network and loans originated through its broker network, Source One applies the same quality standards as those required for loans originated by Source One itself. Source One's quality control department reviews a random sample of the loans purchased to determine compliance with Source One's standards.

Source One primarily produces fixed rate mortgage loans. Generally speaking, fixed rate mortgages tend to capture a large share of origination volumes in a declining interest rate environment. Additionally, fixed rate mortgage loans are inherently less susceptible to prepayment risk than adjustable rate mortgages. During periods of increasing interest rates, the likely adverse effects of lower fixed rate mortgage loan originations are mitigated by a reduction in the prepayment risk on the fixed rate mortgage loans Source One services. During 1997 and 1996, fixed rate mortgage loan production accounted for approximately 88% and 90%, respectively, of Source One's total mortgage loan production.

The following table sets forth selected information regarding Source One's mortgage loan production:

Millions	Year Ended December 31,				
	1997	1996	1995	1994	1993
Loan production by type of loan:					
FHA insured and VA guaranteed	\$2,985	\$2,035	\$1,565	\$2,065	\$ 3,453
Conventional	1,418	1,796	1,287	2,521	7,999
Total	\$4,403	\$3,831	\$2,852	\$4,586	\$11,452
Loan production by origination source:					
Correspondent network acquisitions	\$2,552	\$1,640	\$1,157	\$1,081	\$ 2,643
Retail branch office originations	1,339	1,590	1,347	2,005	4,922
Mortgage broker originations	390	369	196	696	1,708
Specialized marketing program originations	122	232	152	804	2,179
Total	\$4,403	\$3,831	\$2,852	\$4,586	\$11,452

During 1997 Source One broadened its product line by offering higher profit margin products such as FHA home improvement ("203(k)") loans, manufactured housing loans, subprime loans and 125% loan to value second mortgage ("125% LTV") loans. The 203(k) loans and manufactured housing loans produced by Source One are sold to third parties with servicing retained whereby the subprime loans and 125% LTV loans produced by Source One are sold to third parties on a servicing released basis. Source One is currently planning to establish the capability to service and subservice subprime loans and to subservice 125% LTV loans. These new products did not account for a significant portion of Source One's total mortgage loan production during 1997 and are expected to account for less than 10% of Source One's 1998 mortgage loan production.

Correspondent Network. Source One conducts a program through which it agrees to purchase mortgage loans from a network of banks, thrift institutions and other mortgage lenders. The funding price for such loans is set by Source

One on a daily basis. In addition, Source One pays a premium for the release of servicing rights which is negotiated on a case-by-case basis. As of December 31, 1997, there were approximately 236 participants in Source One's correspondent network, with no single participant or group of affiliated participants accounting for more than 12% of Source One's total mortgage loan originations.

Retail Branch Offices. As of December 31, 1997, Source One had 129 retail branch offices in 26 states with its highest concentration of branch offices located in California, Washington and New York. Each office has sales representatives who originate mortgage loans through contacts with real estate brokers, builders, developers and others, as well as through direct contact with homebuyers.

Mortgage loans originated by Source One are subject to a defined underwriting process in order to assess each prospective borrower's ability to repay the loan requested and the adequacy of each property as collateral. In addition, Source One is subject to the underwriting guidelines of FHA, VA, FHLMC and FNMA, as well as specific contractual requirements of institutional investors who have agreed to acquire mortgage loans originated by Source One. Most branch office originations are referred to regional operating centers for preparation of loan

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documentation, evaluation of compliance with Source One's underwriting conditions and closing of the loans.

Mortgage Brokers. Source One conducts a program through which it closes loans originated by a network of mortgage brokers. The funding price for such loans is set by Source One on a daily basis. The originating mortgage broker receives compensation equivalent to the difference between Source One's pricing schedule and the closing price. As of December 31, 1997, there were approximately 425 active participants in Source One's mortgage broker network, with no single broker or group of affiliated brokers accounting for more than 1% of Source One's total mortgage loan originations.

Specialized Marketing Program. Source One also generates mortgage loan originations through affinity programs and by responding to refinancing requests from the population of loans currently serviced by Source One.

Sales of Loans

Source One sells mortgage loans either through mortgage-backed securities issued pursuant to programs of GNMA, FNMA and FHLMC, or to institutional investors. Most mortgage loans are aggregated in pools of \$1.0 million or more, which are purchased by institutional investors after having been guaranteed by GNMA, FNMA or FHLMC. During 1997 approximately 65.5%, 23.3% and 6.7% of the principal amount of Source One's loans were sold in pools through GNMA, FNMA and FHLMC, respectively. During 1996 approximately 42.8%, 35.3% and 11.6% of the principal amount of Source One's loans were sold in pools through GNMA, FNMA and FHLMC, respectively. During 1995 approximately 46.3%, 34.3% and 9.3% of the principal amount of Source One's loans were sold in pools through GNMA, FNMA and FHLMC, respectively. Substantially all GNMA securities are sold without recourse to Source One for loss of principal in the event of a subsequent default by the mortgage borrower due to the underlying FHA and VA insurance. Prior to December 1992, substantially all conventional securities were sold with recourse to Source One, to the extent of insufficient proceeds from private mortgage insurance, foreclosure and other recoveries. Since December 1992 all conventional loans have been sold without recourse to Source One.

Servicing agreements relating to mortgage-backed securities issued pursuant to the programs of GNMA, FNMA or FHLMC require Source One to advance funds to make the required payments to investors in the event of a delinquency by the borrower. Source One expects that it would recover most funds advanced upon cure of default by the borrower or at foreclosure. However, in connection with VA partially guaranteed loans and certain conventional loans (which may be partially insured by private mortgage insurers), funds advanced may not cover losses due to potential declines in collateral value. In addition, most of Source One's servicing agreements for mortgage-backed securities typically require the payment to investors of a full month's interest on each loan although the loan may be paid off (by optional prepayment or foreclosure) other than on a month-end basis. In this instance, Source One is obligated to pay the investor interest at the pass-thru rate from the date of the loan payoff through the end of that calendar month without reimbursement.

Historically, Source One's sales of loans have generated net gains. However, if secondary market interest rates decline after Source One obtains a mandatory forward commitment for a loan, the loan may not close and Source One may incur a loss from the cost of covering its obligations under such commitment. If secondary market interest rates increase after Source One commits to an interest rate for a loan, and Source One has not obtained a forward commitment, Source One may incur a loss when the loan is subsequently sold. To minimize this risk, Source One obtains mandatory forward commitments of up to 120 days to sell

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mortgage-backed securities with respect to all loans which have been funded and a substantial portion of loans in process (the "Pipeline") which it believes will close.

Source One's risk management function closely monitors the Pipeline to determine appropriate forward commitment coverage on a daily basis. In addition, the risk management area seeks to reduce counterparty risk by committing to sell mortgage loans only to approved dealers, with no dealer having in excess of 20% of current commitments. Source One currently transacts business with 17 approved dealers.

Loan Servicing

Source One generally retains the rights to service the mortgage loans it produces with the exception of subprime and 125% LTV loans which are sold to third parties on a servicing released basis. In addition, Source One may acquire the rights to service or subservice a mortgage loan portfolio without originating or acquiring the underlying mortgage loans. Source One customarily purchases servicing rights from banks, thrift institutions and other mortgage lenders. The fees paid to acquire such servicing rights are negotiated on a case-by-case basis. During 1996, Source One purchased the rights to service \$2.8 billion of mortgage loans from third parties. There were no significant purchases of mortgage servicing rights by Source One during 1997.

Source One also sells servicing rights when management deems it economically advantageous. During 1997 Source One sold the rights to service a \$17.0 billion portfolio of nonrecourse mortgage loans and continues to subservice a portion of these loans pursuant to a subservicing agreement. During 1996 Source One sold the rights to service \$3.3 billion of mortgage loans and did not retain the right to subservice the loans.

The following table summarizes the changes in Source One's mortgage loan servicing portfolio, excluding loans sold but not transferred:

Billions	1997	Year Ended December 31, 1996	1995	1994	1993
Servicing portfolio owned at beginning of year	\$ 26.4	\$ 27.8	\$ 35.3	\$ 38.4	\$ 37.3
Mortgage loan production	4.4	3.8	2.9	4.6	11.4
Servicing acquisitions and other	--	2.8	4.7	3.7	6.4
Total servicing in	4.4	6.6	7.6	8.3	17.8
Regular payoffs	1.2	3.0	2.3	4.7	13.5
Sales of servicing	17.0	3.3	11.0	3.9	-
Principal amortization, foreclosures and other	1.0	1.7	1.8	2.8	3.2
Total servicing out	19.2	8.0	15.1	11.4	16.7
Servicing portfolio owned	11.6	26.4	27.8	35.3	38.4
Subservicing portfolio	14.9	2.8	4.0	4.3	-
Balance at end of year	\$ 26.5	\$ 29.2	\$ 31.8	\$ 39.6	\$ 38.4

Related Activities

In conjunction with its mortgage origination and servicing activities, Source One markets certain credit-related insurance products (such as life, disability, health, accidental death, and property and casualty insurance). Source One acts as an agent and receives fees based on premium value but does not assume any insurance risk. Total fees recognized under these programs for 1997 and 1996 were \$4.2 and \$4.6 million, respectively.

INVESTMENT PORTFOLIO MANAGEMENT

The passive investment portfolios of the Company and White Mountains are primarily managed by a small group of employees located in Hanover, New Hampshire. FAE's passive investment portfolio is primarily managed by a small group of employees located in White River Junction, Vermont.

During 1997 and 1996, Fund American engaged First Manhattan Co. to provide discretionary investment management services with respect to the disposition of a portfolio of passive investment securities. The invested assets managed by First Manhattan Co. included certain equity securities held by the Company, FAE, White Mountains, Valley, Charter and WMIC. First Manhattan Co. is a registered investment advisor.

During 1997 and 1996 Fund American also engaged affiliates of FSA and MSA to provide discretionary investment management services with respect to the fixed income investment portfolios of Valley, Charter and WMIC.

Fund American's philosophy is to invest all assets to maximize their after tax total return over a three- to five-year time frame. Under this approach, each dollar of after tax investment income, realized capital gains and unrealized appreciation is valued equally. Management believes that it should focus its equity investment efforts on a small number of quality companies selling at reasonable prices in the marketplace. While such an approach results in a highly concentrated portfolio, management believes it will provide superior returns over a three- to five-year horizon. However, management does not believe that owning a large portfolio of passive investment securities in a taxable corporation format will maximize shareholder returns over the long-term. Therefore, Fund American's long-term goal is to reinvest its passive investment securities into operating businesses in which management has knowledge and experience.

CERTAIN BUSINESS CONDITIONS

Inflation and changes in market interest rates can have significant effects on White Mountains' insurance operations. Inflation increases the costs of settling insurance claims over time. Increases in market interest rates, which often occur during periods of high inflation, reduce the market value of the insurance operations' fixed-income investments. Conversely, reductions in market interest rates increase the market value of White Mountains' fixed-income investments.

Changes in the economy or prevailing interest rates can also have significant effects, including material adverse effects, on the mortgage banking industry including Source One. Inflation and changes in interest rates can have differing effects on various aspects of Source One's business, particularly with respect to marketing gains and losses from the sale of mortgage loans, mortgage loan production, the value of Source One's servicing portfolio and net

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interest revenue. Historically, Source One's loan originations and loan production income have increased in response to falling interest rates and have decreased during periods of rising interest rates. Periods of low inflation and falling interest rates tend to reduce loan servicing income and the value of Source One's mortgage loan servicing portfolio because prepayments of mortgages increase and the average life of mortgage servicing rights is shortened. Conversely, periods of increasing inflation and rising interest rates tend to increase loan servicing income and the value of Source One's mortgage servicing rights because prepayments of mortgages decline and the average life of loan servicing rights is lengthened. In an attempt to mitigate Source One's exposure to changes in market interest rates, Source One utilizes various derivative financial instruments. See "Management's Discussion and Analysis".

COMPETITION

The principal competitive factors that affect White Mountains' insurance subsidiaries are: (i) pricing; (ii) underwriting; (iii) quality of claims and policyholder services; (iv) appointing and retaining high quality independent agents; (v) operating efficiencies; and (vi) product differentiation and availability. No single company or group of affiliated companies dominates the insurance industry. The highly competitive environment in the property and casualty insurance market during the past several years has intensified due to increased capacity resulting from growing capital supporting the industry and robust investment returns achieved in recent years. Each of White Mountains' insurance operating affiliates strives to be a low cost operator within its sector of the insurance industry while maintaining superior levels of customer service. Each of White Mountains' insurance affiliates also maintains a disciplined approach to pricing and underwriting of insurance risks. Application of this disciplined approach in a highly competitive environment results in a lower volume of insurance premiums than would result from a less disciplined approach, but should produce better overall financial returns from the business over long periods of time.

Perception of financial strength, as reflected in the ratings assigned to an insurance company, especially by A.M. Best, is also a factor in White Mountains' insurance subsidiaries' competitive position. Each of White Mountains' insurance operating affiliates has consistently maintained adequate capitalization and claims payment ratings to effectively conduct its business and management believes that such strength will continue to be maintained in the future.

In the United States, property and casualty insurance can be obtained through national and regional companies that use an agency distribution system, direct writers (who may have an employed agency force) or brokers, or through self-insurance including the use by corporations of subsidiary captive insurers. All of White Mountains' consolidated insurance companies market their products principally through independent agents.

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Source One competes nationally and locally for loan production with other mortgage banks, state and national banks, thrift institutions and insurance companies. National banks and thrift institutions have substantially more flexibility in their loan origination programs than Source One, which generally originates loans meeting the standards of the secondary market. Mortgage lenders compete primarily with respect to price and service. Competition may also occur on mortgage terms and closing costs. Source One competes, in part, by using its commissioned sales force to maintain close relationships with real estate brokers, builders and developers and members of its correspondent and broker network. It is the opinion of the management of Source One that no single mortgage lender dominates the industry.

REGULATION

Valley, Charter and WMIC are subject to regulation and supervision of their operations in each of the jurisdictions where they conduct business. Regulations vary between jurisdictions but, generally, they provide regulatory authorities with broad supervisory, regulatory and administrative powers over such matters as licenses, standards of solvency, premium rates, policy forms, investments, security deposits, methods of accounting, form and content of financial statements, reserves for unpaid losses and loss adjustment expenses, reinsurance, minimum capital and surplus requirements, dividends and other distributions to shareholders, periodic examinations and annual and other report filings. Over the last several years most states have, and continue to implement, laws which establish standards for current, as well as continued, state accreditation. In addition, the National Association of Insurance Commissioners ("NAIC") has adopted risk-based capital ("RBC") standards for property and casualty companies. The RBC ratios for Valley, Charter and WMIC, as of December 31, 1997, were above the levels which would require regulatory action.

Source One is subject to the rules and regulations of, and examinations by, investors and insurers including FNMA, FHLMC, GNMA, FHA and VA with respect to the origination and selling and servicing of mortgage loans. Lenders are required to submit audited financial statements annually and to maintain specified net worth levels which vary depending on the amount of loans serviced and annual production. Mortgage loan origination activities are also subject to fair housing laws, the Equal Credit Opportunity Act, the Federal Truth-in-Lending Act, the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, licensing laws, usury laws, the Home Mortgage Disclosure Act, and regulations promulgated thereunder which, among other things, prohibit discrimination in residential lending and require disclosure of certain information to borrowers. There are various other state laws and regulations affecting Source One's mortgage banking and insurance operations. Source One's internal audit and quality control departments monitor compliance with all these laws and regulations.

Fund American is not aware of any current recommendations by regulatory authorities that would be expected to have a material effect on its results of operations or liquidity or any other matters that would require disclosure herein.

EMPLOYEES

As of December 31, 1997, the Company employed 11 persons and White Mountains employed 2,038 persons (including 281 persons at Valley, 165 persons at Charter, 1,572 persons at Source One and 3 persons at FAE). None of Fund American's employees are covered by a collective bargaining agreement. Management believes that Fund American's employee relations are good.

FORWARD-LOOKING STATEMENTS

From time to time, the Company may publish forward-looking statements relating to such matters as anticipated financial performance, business prospects, new products and similar matters. This information is often subject to various risks and uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that numerous factors could cause actual results and experience to differ materially from anticipated results or other expectations expressed in its forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company's business include those discussed elsewhere herein (such as competition and regulation).

Item 2. Properties

Fund American leases 8,600 square feet of space at 80 South Main Street, Hanover, New Hampshire, under a lease expiring in 2006. This space is used as the principal office for the Company, White Mountains and WMIC. Valley owns a 40,000 square foot office building in Albany, Oregon and leases 6,200 square feet in Sacramento, California under a lease expiring in 1998. Charter leases 56,000 square feet of office space in Richardson, Texas under a lease expiring in 2007. Source One owns its principal office in Farmington Hills, Michigan,

which houses the majority of its employees. Fund American leases several other office facilities and operating equipment under cancelable and noncancelable agreements. Most of such leases contain renewal clauses.

Item 3. Legal Proceedings

Various claims have been made against Fund American in the normal course of its business. In management's opinion, the outcome of such claims will not, in the aggregate, have a material effect on Fund American's financial position or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of Fund American's shareholders during the fourth quarter of 1997.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

As of March 20, 1998, there were 506 registered holders of shares of the Company's Common Stock, par value \$1.00 per share ("Shares").

From 1992 to 1994 the Company did not pay regular cash dividends to holders of Shares. In the fourth quarter of 1995 the Company's Board of Directors (the "Board") reinstated and paid a \$.20 regular quarterly dividend per Share. During 1997 and 1996, the Company declared and paid quarterly cash dividends of \$.20 per Share and expects to pay regular quarterly cash dividends of \$.40 per Share during 1998. The Board currently intends to reconsider from time to time the declaration of regular periodic dividends on Shares with due consideration given to the financial characteristics of Fund American's remaining invested assets and operations and the amount and regularity of its cash flows at the time. The Company's Common Stock (symbol FFC) is listed on the NYSE. The quarterly trading range for Shares during 1997 and 1996 is presented below:

	1997		1996	
	High	Low	High	Low
Quarter ended:				
December 31	\$ 124	\$ 105 1/4	\$ 95 3/4	\$ 86 3/4
September 30	108	99 1/2	93 1/2	80 1/4
June 30	110 1/2	98	82 1/4	76
March 31	109 3/4	94	79 7/8	72 1/8

Item 6. Selected Financial Data

Selected consolidated income statement data and ending balance sheet data for each of the five years ended December 31, 1997, follows:

Millions, except per share amounts	Year Ended December 31,				
	1997	1996	1995	1994	1993
Income Statement Data:					
Revenues	\$ 314	\$ 332	\$ 222	\$ 229	\$ 251
Expenses	336	347	226	226	234
Pretax operating earnings (loss)	(22)	(15)	(4)	3	17
Net investment gains	97	39	39	39	124
Pretax earnings	75	24	35	42	141
Income tax provision	29	19	17	21	71
After tax earnings	46	5	18	21	70
Loss on early extinguishment of debt, after tax	(6)	--	--	--	--
Gain from sale of discontinued operations, after tax	--	--	66 (a)	--	--
Cumulative effect of accounting change - purchased mortgage servicing, after tax	--	--	--	(44) (b)	--
Net income (loss)	40	5	84	(23)	70
Change in net unrealized investment gains, after tax	56	55	18	(55)	46
Comprehensive net income (loss)	\$ 96	\$ 60	\$ 102	\$ (78)	\$ 116
Basic earnings per share:					
After tax earnings	\$ 6.89	\$.66	\$ 1.88	\$ 1.27	\$ 6.07
Net income (loss)	5.98	.66	10.30	(3.72)	6.07
Comprehensive net income (loss)	14.55	8.01	12.64	(9.89)	10.84

Diluted earnings per share:					
After tax earnings	6.22	.60	1.71	1.20	5.68
Net income (loss)	5.40	.60	9.36	(3.51)	5.68
Comprehensive net income (loss)	13.17	7.33	11.48	(9.34)	10.15
Cash dividends paid per share of common stock	.80	.80	.20	--	--

Ending Balance Sheet Data:

Total assets	\$ 2,033	\$ 1,981	\$ 1,872	\$ 1,807	\$ 3,305
Short-term debt	571	408	445	254	1,537
Long-term debt	304	424	407	547	601
Minority interest - preferred stock of subsidiary	44	44	44	100	--
Shareholders' equity	674 (c)	687 (c)	700 (c)	661 (c)	905 (c)
Book value per common and equivalent share (d)	102.19	90.81	83.28	68.95	77.27

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- (a) Reflects the settlement of certain tax liabilities relating to the sale of Fireman's Fund Insurance Company ("Fireman's Fund") for less than the previously accrued amount.
- (b) Reflects the prior years' cumulative effect of a change in Source One's methodology used to measure impairment of its purchased mortgage servicing rights asset.
- (c) Reflects redemptions of the Company's Voting Preferred Stock Series D, par value \$1.00 per share (the "Series D Preferred Stock") and/or repurchases of Shares. See Note 13 of the Notes to Consolidated Financial Statements.
- (d) Book value per common share as adjusted for the after tax dilutive effects of outstanding options and warrants to acquire Shares.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

RESULTS OF OPERATIONS: Years Ended December 31, 1997, 1996 and 1995

Consolidated Results

Fund American reported comprehensive net income (which includes the net change in after tax unrealized investment gains) of \$95.6 million for the year ended December 31, 1997, which compares to comprehensive net income of \$59.5 million and \$102.3 million for 1996 and 1995, respectively. Net income for 1997 was \$39.3 million versus \$4.9 million and \$84.1 million for 1996 and 1995, respectively. The 1997 income statement includes pretax net realized investment gains of \$96.7 million versus \$38.5 million of pretax gains recorded in 1996 and \$38.8 million recorded in 1995. The 1996 income statement includes a \$32.6 million pretax, \$29.4 million after tax, write-off of all Source One's existing goodwill and certain other intangible assets. The 1995 income statement includes four non-recurring items: (i) the adoption of SFAS No. 122 as of January 1, 1995, by Source One; (ii) a \$46.2 million pretax charge to compensation expense related to outstanding employee stock warrants; (iii) a \$66.0 million favorable tax development relating to the sale of Fireman's Fund; and (iv) the receipt of a \$9.7 million pretax breakup fee, plus related expenses, from Home Holdings, Inc. These four items served to increase 1995 net income by a total of \$41.8 million.

After tax earnings for 1997 were \$45.3 million versus \$4.9 million and \$18.5 million for 1996 and 1995, respectively.

Book value per common and common equivalent share was \$102.19 at December 31, 1997, which compares to \$90.81 at December 31, 1996. Strong operating results at White Mountains' growing consolidated and unconsolidated insurance operations and favorable investment portfolio results produced most of the increase in book value per share from 1996 to 1997.

Insurance Operations

White Mountains is acquiring and developing various insurance operating interests. Fund American acquired its investment in MSA in 1994 and assigned the investment to White Mountains in 1995, White Mountains acquired Valley and Charter and created WMIC in 1995, White Mountains acquired its investments in Folksamerica Preferred Stock and Folksamerica Common Stock in June 1996 and November 1997, respectively, and White Mountains acquired its investment in Murray Lawrence in December 1997. White Mountains also owns approximately 97% of Source One which owns Fund American's investments in FSA which were acquired during 1994, 1995 and 1996.

Valley, Charter and WMIC represent Fund American's consolidated insurance subsidiaries. Valley, Charter and WMIC's results for the years ended December 31, 1997 and 1996, included \$145.3 million and \$109.7 million of property and casualty insurance premiums earned, respectively, and \$97.1 million and \$85.9 million of losses and loss adjustment expenses, respectively. Valley, Charter and WMIC's results for the one-month period ended December 31, 1995, included \$5.8 million of property and casualty insurance premiums earned and \$8.2 million of losses and loss adjustment expenses.

A summary of 1997 and 1996 underwriting results for Valley, Charter and WMIC follows:

Dollars in millions	Year Ended December 31, 1997		
	Valley	Charter	WMIC
Net written premiums	\$ 83.2	\$ 62.9	\$ 4.7
Earned premiums	79.6	62.4	3.3
Losses and loss adjustment expenses	51.8	41.8	3.5
Underwriting expenses	28.3	17.1	2.0

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Underwriting (loss) profit	\$ (.5)	\$ 3.5	\$ (2.2)
Statutory ratios:			
Loss and loss adjustment expense	65.0%	66.9%	107.8%
Underwriting expense	34.8	27.3	53.1
Combined	99.8%	94.2%	160.9%

Dollars in millions	Year Ended December 31, 1996		
	Valley	Charter	WMIC
Net written premiums	\$ 75.1	\$ 69.9	\$ 2.0
Earned premiums	70.7	37.7	1.3
Losses and loss adjustment expenses	54.3	30.3	1.2
Underwriting expenses	24.9	8.0	.9
Underwriting loss	\$ (8.5)	\$ (.6)	\$ (.8)
Statutory ratios:			
Loss and loss adjustment expense	76.8%	80.4%	95.8%
Underwriting expense	34.9	18.9	50.4
Combined	111.7%	99.3%	146.2%

Valley and Charter's 1997 underwriting results produced satisfactory combined ratios and an overall underwriting profit. However, premium growth at both Valley and Charter suffered during 1997 as a result of increased competition in the marketplace which illustrates Fund American's underwriting discipline in a highly competitive market. WMIC's 1997 results were adversely impacted by several large workers' compensation claims although underwriting results on this small and growing book of business are not yet considered to be meaningful.

Valley's 1996 underwriting results were adversely impacted by severe fourth quarter storm-related losses and by \$3.5 million in reserve strengthening for losses and loss adjustment expenses incurred in prior years. Charter's earned premiums trailed net written premiums during 1996 because Charter began for the first time in 1996 to retain virtually all its written premiums. Charter's policies written prior to 1996 were fully ceded to a former affiliate of Charter.

Losses and loss adjustment expenses are charged against income as incurred. Unpaid losses and loss adjustment expenses are based on estimates by claims adjusters, legal counsel and actuarial staff of the ultimate costs of settling claims, including the effects of inflation and other societal and economic factors. Unpaid loss and loss adjustment expense reserves represent management's best estimate of ultimate losses and loss adjustment expenses net of estimated salvage and subrogation recoveries. Such estimates are regularly reviewed and updated and any adjustments resulting therefrom are reflected in current operations. The process of estimating loss and loss adjustment expenses involves a considerable degree of judgement by management and the ultimate amount of expense to be incurred could be considerably greater than or less than the amounts currently reflected in the financial statements.

In the normal course of business, Valley, Charter and WMIC seek to limit losses that may arise from catastrophes or other events that may cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. Valley, Charter and WMIC remain contingently liable for risks reinsured with third parties to the extent that the reinsurer is unable to honor its obligations under reinsurance contracts at the time of loss.

While there may be greater individual risks of loss associated with nonstandard automobile insurance than with standard automobile insurance (e.g., higher loss frequency), the insurance premiums charged in consideration of these additional risk characteristics are generally higher.

than those of standard automobile coverage and in many cases, if the coverage is properly underwritten, the risk to rate characteristics of writing nonstandard automobile insurance are at least equal to or more favorable than that of standard automobile coverage. Additionally, nonstandard automobile individual liability limits are generally lower than those of standard automobile coverages which results in the amount of individual losses being less volatile (e.g., lower loss severity). In general, loss costs for nonstandard automobile insurance are, in fact, more predictable than those for several other lines of property and casualty insurance (e.g., medical malpractice or umbrella liability coverages).

FSA, MSA, Folksamerica and Murray Lawrence represent Fund American's investments in unconsolidated insurance affiliates. Fund American's investment in FSA increased \$80.1 million during 1997 which consisted of \$11.4 million of pretax earnings from FSA Common Stock, \$68.0 million of pretax unrealized investment gains from FSA Options and Preferred Stock, \$2.1 million of pretax unrealized investment gains from FSA's investment portfolio, less \$1.4 million of dividends received from FSA Common Stock. Fund American's investment in FSA increased \$23.1 million during 1996 (excluding Fund American's purchase of 1,000,000 additional shares of FSA Common Stock for \$26.5 million during 1996) which consisted of \$7.8 million of pretax earnings from FSA Common Stock, \$17.3 million of pretax unrealized investment gains from FSA Options and Preferred Stock, less \$1.0 million of pretax unrealized investment losses from FSA's investment portfolio, less \$1.0 million of dividends received from FSA Common Stock.

White Mountains' investment in MSA increased \$6.2 million during 1997 which consisted of \$3.8 million of pretax earnings from MSA Common Stock and \$2.4 million of pretax unrealized investment gains from MSA's investment portfolio. White Mountains' investment in MSA increased \$1.0 million during 1996 which consisted of \$1.5 million of pretax earnings from MSA Common Stock offset by \$.5 million of pretax unrealized investment losses from MSA's investment portfolio.

White Mountains' investment in Folksamerica increased \$25.1 million during 1997 (excluding White Mountains' purchase of Folksamerica Common Stock for \$20.8 million during 1997) which consisted of \$.9 million of pretax earnings from Folksamerica Common Stock, \$22.4 million of pretax unrealized investment gains from Folksamerica Preferred Stock, \$1.8 million of pretax unrealized investment gains from Folksamerica's investment portfolio. White Mountains' investment in Folksamerica increased \$.2 million from June 1996 to December 31, 1996 as a result of pretax unrealized investment gains from Folksamerica Warrants and Folksamerica Preferred Stock.

White Mountains investment in Murray Lawrence, which was acquired on December 8, 1997, remained at its cost of \$23.6 million during 1997.

Management expects that White Mountains' consolidated and unconsolidated insurance operations will have a significantly larger impact on Fund American's reported financial results in future years. See "Liquidity and Capital Resources."

Mortgage Origination and Servicing Operations

For the year ended December 31, 1997 Source One had a net loss applicable to common stock of \$17.2 million versus a loss of \$8.0 million for 1996. Source One's 1997 results include the following charges: (i) a \$6.0 million after tax extraordinary loss on early extinguishment of debt, (ii) restructuring and compensation charges of \$3.1 million pretax, \$2.0 million after tax, associated with Source One's plan to reduce its operating costs and improve its financial performance, (iii) an \$8.0 million pretax, \$5.2 million after tax, loss on sales of mortgage

servicing rights and assumption of subservicing and (iv) a \$17.7 million pretax, \$11.5 million after tax, charge to Source One's valuation allowance for impairment of their capitalized mortgage loan servicing portfolio. Source One's 1996 results include a \$29.1 million pretax (\$25.9 million after tax) write-off of goodwill and certain other intangible assets which was partially offset by a \$10.1 million pretax, \$6.6 million after tax, gain on sales of mortgage servicing rights. Source One had net income applicable to common shareholders of \$18.6 million for the year ended December 31, 1995 which includes a \$40.0 million pretax, \$26.0 million after tax, gain on mortgage servicing rights which was partially offset by \$28.0 million pretax, \$18.2 million after tax, of capitalized mortgage servicing portfolio impairment.

Gross mortgage servicing revenue was \$95.0 million for the year ended December 31, 1997 which compares to \$139.6 million in 1996 and \$141.9 million in 1995. The decrease in gross mortgage servicing revenue from 1995 to 1997 is primarily the result of sales of servicing rights with respect to \$17.0 billion and \$3.3 billion of mortgage loans during 1997 and 1996, respectively.

Source One's net mortgage servicing revenue decreased to \$42.1 million for the year ended December 31, 1997, from \$77.6 in 1996 and \$61.3 million in 1995. Net mortgage servicing revenue for 1997 has been reduced by \$17.7 million of pretax impairment resulting from decreases in market interest rates during the year versus pretax impairment of \$.9 million for 1996 and \$28.0 million in 1995. Net mortgage servicing revenue for the year ended December 31, 1997 was enhanced by \$11.3 million of pretax net gains on financial instruments versus gains of \$9.9 million for 1996 and \$.8 million for 1995.

Source One utilizes derivative contracts, consisting of interest rate floor contracts and principal-only swaps, in an attempt to offset the effect on earnings of higher amortization and impairment of the capitalized servicing asset caused by changes in market interest rates. These financial instruments are carried at fair value on the balance sheet with unrealized and realized gains reported as net gains on financial instruments on the income statement. The interest rate contracts, which were first entered into during 1995, derive their value from differences between the floor strike rate specified in the contract and prevailing market interest rates and are not subject to total losses in excess of their original cost. As of December 31, 1997, 1996 and 1995, Source One's open interest rate contracts had a fair value of \$8.2 million, \$4.8 million and \$3.5 million and had an applicable original cost of \$4.7 million, \$5.4 million and \$2.6 million, respectively. As of December 31, 1997, the open interest rate contracts had a total notional principal amount of \$.7 billion and had remaining terms ranging from 3 to 5 years. The principal-only swap transactions, which were first entered into during 1996, derive their value from changes in the value of referenced principal-only securities. As of December 31, 1997 and 1996, Source One's principal-only swap transactions had a fair value of \$12.5 million and \$3.2 million, respectively. Source One's exposure to losses on the principal-only swap transactions is related to changes in the market value of the underlying principal-only securities over the life of the contract. As of December 31, 1997, the open principal-only swap transactions had an original notional principal amount of \$98.1 million and had remaining terms of 3 to 4 years.

Net gains on sales of mortgages were \$21.5 million for the year ended December 31, 1997, versus \$38.3 million in 1996 and \$24.0 million in 1995. The 1997 amount includes a \$3.0 million pretax charge, recorded during 1997, related to mortgage loans held for investment which have been identified for sale and marked down from amortized cost to current market value. The balance of the 1997 decline is due primarily to a change in Source One's loan production mix which included a proportionately higher volume of correspondent production which generates lower originated mortgage servicing rights income, as compared to 1996. The increased gains from 1995 to 1996 reflect increased production and related mortgage sales volumes during the period.

During 1997 Source One sold the rights to service \$17.0 billion of nonrecourse mortgage loans for adjusted proceeds of \$266.9 million, resulting in a pretax loss of \$4.3 million. As part of the servicing sale, Source One retained the right to subservice these loans until 1998. Source One recorded an additional pretax loss of \$3.7 million during 1997 in connection with the extension of its subservicing responsibilities for these loans for one additional year at less favorable terms than the original agreement provided. During 1996 Source One sold the rights to service \$3.3 billion of mortgage loans for net proceeds of \$55.9 million, resulting in a pretax gain of \$10.1 million. During 1995 Source One sold the rights to service \$11.0 billion of mortgage loans for net proceeds of \$199.1 million, resulting in a pretax gain of \$40.0 million.

Total mortgage loan production for the years ended December 31, 1997, 1996 and 1995, was \$4.4 billion, \$3.8 billion and \$2.9 billion, respectively. The increase in production from 1995 to 1997 is reflective of overall lower market interest rates and a corresponding increase in refinancing activities during the period. Production related to refinancing activities made up 40%, 33% and 23% of total production during 1997, 1996 and 1995, respectively. Regular mortgage loan payoffs due principally to refinancings on Source One's owned servicing portfolio

for the years ended December 31, 1997, 1996 and 1995, were \$1.2 billion, \$3.0 billion and \$2.3 billion, respectively.

Source One's 1997 results include \$9.5 million of pretax earnings associated with Fund American's investment in FSA which was contributed to Source One during 1997 to provide additional credit support to Source One's mortgage banking operations.

The total return from Fund American's investment activities is shown below:

Millions	Year Ended December 31,		
	1997	1996	1995
Net investment income:			
Mortgage banking operations	\$ 45.8	\$ 40.8	\$ 37.7
Insurance operations and passive investment portfolio	19.3	16.5	17.7
Total net investment income	65.1	57.3	55.4
Net realized investment gains	96.7	38.5	38.8
Change in net unrealized investment gains, before tax (a)	(10.1)	68.0	20.0
Total net investment return, before tax	\$151.7	\$163.8	\$ 114.2

(a) Excludes net unrealized investment gains and losses recorded from Fund American's investments in unconsolidated insurance affiliates.

Fund American's net investment income is comprised primarily of interest income earned on mortgage loans originated by Source One (gross of related interest expense on short-term borrowings used to finance such loans), interest income associated with the fixed maturity investments of its consolidated insurance operations, dividend income from its equity investments and interest income from short-term investments. The increase in net investment income from mortgage banking operations from 1995 to 1997 is mainly attributable to increased interest income from mortgage loans held for sale related to higher mortgage loan production experienced during those periods. The increase in net investment income from insurance and other operations during from 1996 to 1997 is a result of increases in investment income from White Mountains' growing portfolio of fixed maturity investments. The decrease in net investment income from insurance operations and the passive investment portfolio from 1995 to 1996 was primarily the result of lower dividend income due to net sales from Fund American's passive investment portfolio during 1995 and 1996.

Net realized investment gains during 1997 included \$37.2 million of pretax gains from the sale of 1,980,982 shares of the common stock of Travelers Property Casualty Corp. ("Travelers P&C") for net proceeds of \$69.2 million, \$24.3 million of pretax gains from the sale of 5,000,000 units of beneficial interest of San Juan Basin Royalty Trust ("San Juan") for net proceeds of \$45.7 million, \$10.3 million of pretax gains from the sale of 388,140 shares of the common stock of Mid Ocean Limited ("Mid Ocean") for net proceeds of \$22.6 million and \$15.5 million of pretax gains from the sale of 834,895 shares of the common stock of Veritas DGC Inc. for net proceeds of \$20.9 million. Net realized investment gains during 1996, before tax, included \$27.2 million of pretax gains from the sale of 2,928,100 shares of the common stock of The Louisiana Land & Exploration Company common stock for net proceeds of \$125.1 million, \$1.4 million of pretax gains from the sale of 2,042,572 shares of the common stock of Zurich Reinsurance Centre Holdings, Inc. ("ZRC") for net proceeds of \$61.8 million and \$9.3 million of pretax gains from the sale of 600,000 of the shares of common stock of Mid Ocean for net proceeds of \$28.2 million. Net realized investment gains during 1995 included \$23.9 million of pretax gains from the sale of 2,401,000 shares of the common stock of American Express Company for net proceeds of \$76.7 million.

A review of certain significant holdings in Fund American's portfolio of common equity securities and other investments at December 31, 1997 follows. Share or unit and dollar amounts refer to the aggregate number of common shares or units of beneficial interest owned

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and the aggregate fair value at December 31, 1997, of Fund American's holdings of each security discussed.

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White River Corporation (718,818 shares; "White River Shares"; \$57.1 million). White River Corporation ("White River") was formerly a wholly-owned subsidiary of Fund American. On December 22, 1993, the Company distributed approximately 74% of the outstanding White River Shares to its shareholders. White River through its consolidated subsidiaries, provides automated vehicle valuation and collision repair estimating services and software for use by the insurance and automobile repair industries, and services which improve the handling and settling of automobile damage claims. White River also owns a passive investment portfolio. Fund American owns a total of 1,014,750 White River Shares, including 295,932 White River Shares carried in other assets which are being held for delivery upon the exercise of existing employee stock options. As of December 31, 1997, Fund American's total ownership position represented approximately 20.8% of the total White River Shares. Fund American does not account for its investment in White River Shares on the equity method

as it does not currently possess the ability to exercise significant influence over White River.

San Juan (5,994,876 units; \$55.5 million). San Juan units receive a 75% net overriding royalty interest from certain of Southland Royalty Company's leasehold and royalty interests in the San Juan Basin of Northwestern New Mexico. Fund American believes that changes in crude oil and natural gas prices and in the level of development and production expenditures by the operator of San Juan may affect the distributions to unitholders of San Juan and, therefore, the market prices of the units of San Juan. In addition, Fund American believes that the tax and accounting issues involved in owning units in San Juan may make such units unappealing to many investors. Fund American's investment in San Juan as of December 31, 1997, represented approximately 12.9% of the total San Juan units outstanding. San Juan units are nonvoting. Fund American does not account for its investment in San Juan units on the equity method as it does not possess the ability to exercise significant influence over the Trustee of San Juan.

Travelers P&C (1,161,924 shares; \$49.2 million). Travelers P&C is one of the largest property and casualty insurers in the United States and is an independent agency writer of personal and commercial lines. Fund American's investment in Travelers P&C as of December 31, 1997, represented approximately 1.7% of the total shares publicly traded. Mr. Jack Byrne is a director of Travelers P&C.

Expenses

Compensation expense as reported totalled \$101.8 million, \$91.3 million and \$111.6 million for each of the years ended December 31, 1997, 1996 and 1995, respectively. Compensation expense for 1995 includes a \$46.2 million pretax charge related to an extension of the expiration date of outstanding employee stock warrants. Additionally, Source One nets mortgage loan origination fees (which can fluctuate significantly during periods of strong mortgage loan production), less certain direct costs, against compensation and benefits expense. Excluding the effects of the 1995 warrant extension and mortgage loan origination fees, adjusted compensation and benefits expense was \$121.4 million, \$111.1 million and \$82.9 million for each of the years ended December 31, 1997, 1996 and 1995, respectively. The increase in adjusted compensation and benefits expense from 1995 to 1996 is primarily the result of the inclusion of a full year of Valley and Charter's personnel costs in the 1996 consolidated financial statements. The increase in adjusted compensation and benefits expense from 1996 to 1997 is primarily the result of an increase in stock-based compensation accruals associated with certain of the Company's long-term compensation plans and its qualified and nonqualified retirement plans. During 1997 the market value of the Company's common stock rose 26% from \$95.75 to \$121.00 per share.

General expenses of \$87.6 million for 1997 compare to 1996 and 1995 amounts of \$87.4 million and \$60.3 million, respectively. The increase in general expenses from 1995 to 1996 is

primarily the result of the inclusion of a full year of Valley and Charter's operations in the 1996 consolidated financial statements. General expenses for 1997 include \$3.1 million of pretax restructuring and compensation charges at Source One.

Source One's provision for mortgage loan losses, included in general expenses, was \$8.6 million in 1997 which compares to \$10.3 million for 1996 and \$7.0 million for 1995. The increase in the provision for loan losses from 1995 to 1996 is due primarily to (i) higher average loss volumes relating to certain California residential mortgage loans, (ii) charge-offs relating to certain commercial real estate owned properties and (iii) an increase in delinquencies as the result of servicing portfolio acquisitions made by Source One during the fourth quarters of 1996 and 1995. The delinquency rates of these portfolios (which were acquired on favorable terms considered to be reflective of the higher delinquency rates inherent on the portfolios) were generally higher than those of Source One's existing portfolio resulting in a higher provision for loan losses; however, Source One's proactive management of such delinquencies is expected to reduce future delinquency rates on the acquired portfolios to a level more commensurate with the balance of Source One's servicing portfolio. The decrease in provision for loan losses from 1996 to 1997 primarily reflects a significant reduction in the size of Source One's owned mortgage servicing portfolio during 1997.

Source One closely monitors the rate of delinquencies and foreclosures incidental to its servicing portfolio. The following table summarizes delinquency and foreclosure experience with respect to the residential mortgage loans serviced and subserviced by Source One:

December 31,					

1997	1996	1995	1994	1993	

Percent of total residential loans serviced

and subserviced:

Past due:					
31-59 days	4.77%	4.74%	3.99%	3.15%	3.41%
60-89 days	.96	.95	.70	.54	.58
90 days or more	.62	.55	.59	.38	.45

Total delinquencies	6.35%	6.24%	5.28%	4.07%	4.44%

Foreclosures	1.18%	.93%	.80%	.77%	.92%
=====					

Source One has established an allowance for mortgage loan losses which totalled \$12.8 million and \$15.4 million as of December 31, 1997 and 1996, respectively. In addition, Source One has established an \$8.2 million and \$7.3 million pretax reserve for estimated losses on its principal recourse portfolio as of December 31, 1997 and 1996, respectively. Source One believes that its total allowances are adequate to provide for estimated uninsured losses on the mortgage servicing portfolio.

Interest expense of \$49.7 million in 1997 compares to \$50.0 million for 1996 and \$45.8 million for 1995. The fluctuations in interest expense primarily reflect increases and decreases in average indebtedness outstanding during each year at Source One which is mainly driven by mortgage loan production.

Insurance losses and loss adjustment expenses for the years ended 1997 and 1996 totalled \$97.1 million and \$85.9 million, respectively. Loss and loss adjustment expenses of \$8.2 million for 1995 reflect only one-month of activity due to the timing of White Mountains' acquisition of Valley and Charter. Insurance losses and loss adjustment expenses reported for the years ended December 31, 1996 and 1995, included \$3.5 million and \$3.0 million of reserve strengthening for losses and loss adjustment expenses incurred in prior periods, respectively. During 1997, losses and loss adjustment expenses relating to prior years developed favorably by \$2.5 million.

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During 1996 Fund American re-assessed the recoverability of goodwill and certain other intangible assets related to Source One and determined that it should write-off all such assets related to Source One. This resulted in a \$32.6 million pretax write-off of goodwill and other intangible assets. Factors considered in the determination to write-off all Source One's goodwill and other assets were (i) increased competition and industry consolidation during 1996 which had adversely impacted the value of both the mortgage loan production and servicing operations of Source One and (ii) the attainment of a definitive agreement in the fourth quarter of 1996 to sell the majority of Source One's mortgage servicing portfolio at essentially book value.

Fund American's consolidated affiliates are currently expected to be year 2000 compliant by the third quarter of 1998. Fund American has been identifying, modifying and testing its internal systems and controls that will be impacted by the year 2000 issue. Fund American estimates that its total pretax cost of becoming internally year 2000 compliant, excluding its unconsolidated insurance affiliates, is approximately \$2.5 million of which approximately \$1.3 million has been expensed as of December 31, 1997. These figures do not include the cost of normal software replacements and upgrades.

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Fund American has also been closely monitoring the year 2000 issues of its third party constituents (e.g. customers, suppliers, reinsurers, creditors, borrowers...) and of its unconsolidated insurance affiliates. Based on preliminary determinations, it is not expected that Fund American will be materially adversely affected by its third party constituents. This determination has been made as a result of an extensive interview process which requests that constituents demonstrate an ability to become year 2000 compliant on a timely basis. For those constituents who are deemed to be unlikely to remedy their own year 2000 issues in a timely manner, Fund American is in the process of either replacing that constituent or establishing similar relationships with new parties. All of Fund American's unconsolidated insurance affiliates are expected to be internally year 2000 compliant by the fourth quarter of 1998 and each affiliate is in the process of determining its third party exposures in a similar manner to that of Fund American. The total cost of the year 2000 issue for Fund American's unconsolidated insurance affiliates has not yet been specifically determined, however, Fund American's portion of such costs are not expected to be material.

Income Taxes

The income tax provision related to pretax earnings for 1997, 1996 and 1995 represents an effective tax rate of 39.4%, 79.3% and 47.3%, respectively. The primary reason for the increase in Fund American's effective tax rate from 1995 to 1996 was the 1996 write-off of goodwill and certain other intangible assets related to Source One. The total pretax write-off of these assets was \$32.6 million and the related tax benefit was \$3.2 million, as no deferred tax liability was established related to Source One's goodwill. This had the effect

of increasing Fund American's 1996 effective income tax rate from 45.4% to 79.3%.

Fund American has recorded a net deferred Federal income tax liability of \$27.5 million as of December 31, 1997. The deferred tax liability includes a \$79.3 million liability related to net unrealized gains on investment securities partially offset by \$51.8 million in net assets related to various operating items.

On January 2, 1991, the Company sold Fireman's Fund to Allianz of America, Inc. The \$1.3 billion gain from the sale as reported in 1991 included a \$75.0 million tax benefit related to the Company's estimated tax loss from the sale. Since 1991 the Company has carried an estimated reserve related to tax matters affecting the amount of the deductible tax loss from the sale and other tax matters. The conclusion in 1995 of Internal Revenue Service ("IRS") audits of Fund American's Federal income tax returns for all years through December 31, 1985, resolved certain of the tax matters affecting the amount of the Company's deductible tax loss from the sale of Fireman's Fund and the Company, therefore, re-estimated its tax reserve. As a result of the reserve re-estimation, the Company included in its 1995 income statement an additional \$66.0 million income tax benefit from the sale. The amount of tax benefit from the sale of Fireman's Fund ultimately realized by the Company may be significantly more or less than the Company's current estimate due to possible changes in or new interpretations of tax rules, possible amendments to Fund American's 1991 or prior years' Federal income tax returns, the results of further IRS audits and other matters affecting the amount of the deductible tax loss from the sale.

LIQUIDITY AND CAPITAL RESOURCES

Since the sale of Fireman's Fund, Fund American has been gradually liquidating its portfolio of passive investment securities. Management's primary strategic goal is to either (i) reinvest Fund American's passive investments, together with other resources available to Fund American, into operating businesses in which management has knowledge and experience (if appropriate opportunities can be found) or (ii) return excess capital to shareholders through additional repurchases of Shares. Management believes that this strategy will, over time, further

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enhance shareholder value. As is further described below, the formation, capitalization and ongoing development of White Mountains embodies this strategy.

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Parent Company

The primary sources of cash inflows for the Company are investment income, sales of investment securities and dividends received from its operating subsidiaries.

In November 1996 the Company entered into a \$35.0 million revolving credit agreement with a syndicate of banks which served to replace an expiring arrangement in the amount of \$75.0 million. Under the agreement, through November 25, 1998, the Company and certain of its subsidiaries may borrow up to \$35.0 million at short-term market interest rates. The credit agreement contains certain customary covenants including a minimum tangible net worth requirement, a minimum financial asset coverage requirement and a maximum leverage ratio requirement. At December 31, 1997 and 1996, the Company was in compliance with all covenants under the facility and had no borrowings outstanding under the agreement.

During 1993 the Company issued \$150.0 million in principal amount of medium-term notes for net cash proceeds of \$148.0 million after related costs. During 1995 and 1994 the Company repurchased \$8.8 million and \$24.9 million, respectively, in principal amount of the notes due in February 2003. At December 31, 1997, the \$116.3 million of remaining outstanding notes had an average maturity of 5.4 years and a yield to maturity of 7.82%.

In July 1995 the Company redeemed the remaining 20,833 shares of the Series D Preferred Stock outstanding for \$75.0 million. The redemption price for the shares of Series D Preferred Stock redeemed was equal to the stock's liquidation preference. The annual dividend rate on the Series D Preferred Stock during 1995 was 8.75%.

During 1997, 1996 and 1995 the Company repurchased 924,739 Shares, 779,077 Shares and 877,868 Shares, respectively, for \$103.5 million, \$66.3 million and \$65.5 million, respectively. All Shares repurchased from 1995 to 1997 have been retired. The repurchases of Shares represent a return of excess capital to the Company's shareholders.

In the fourth quarter of 1995 the Board reinstated and paid a \$.20 regular quarterly dividend per Share. During 1997 and 1996 the Company declared and paid quarterly cash dividends of \$.20 per Share and expects to pay regular quarterly

cash dividends of \$.40 per Share during 1998.

In connection with Source One's February 28, 1997 sale of approximately \$17.0 billion of mortgage servicing rights to a third party, the Company has made certain collection, payment and performance guarantees to the buyer for a period of no more than ten years. The aggregate amount of the Company's guaranty is initially limited to \$20.0 million and is expected to amortize down to \$15.0 million.

As approved by shareholders at the 1995 Annual Meeting, the Company entered into a five year employment contract (the "Agreement") with Mr. Jack Byrne. The Agreement provided Mr. Byrne with the right to receive from the Company a guarantee of a loan obtained from a third party, in an amount up to \$15.0 million. In accordance with the Agreement, in October 1995 the Company guaranteed a \$15.0 million loan from a third party to Mr. Byrne. The new loan is recourse to Mr. Byrne's net worth and has a term ending December 31, 1999, a market interest rate and otherwise standard commercial terms. The Company was not required to provide collateral protection for its guarantee of the loan and, accordingly, the loan guarantee is not recorded on the balance sheet.

Pursuant to the terms of a 1993 credit agreement among the Company and White River, the Company provided White River with a \$50.0 million term note (the "Term Note") and a \$40.0 million revolving credit facility (the "Revolver"). The credit agreement granted White River the right to use certain of its investment securities to repay these borrowings.

On June 29, 1995, White River repaid \$35.1 million in principal amount of the Revolver with (i) 930,000 shares of the common stock of Mid Ocean and (ii) options to acquire an additional 388,140 shares of the common stock of Mid Ocean through November 2002. On July 3, 1995, White River repaid the remaining \$4.9 million principal balance of the Revolver and \$5.0 million in principal amount of the Term Note in exchange for certain common equity securities. On

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August 31, 1995, White River repaid the remaining \$45.0 million principal balance of the Term Note with 1,525,424 shares of common stock of ZRC.

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White Mountains, Valley and Charter

In November 1996 White Mountains and Valley entered into a five year credit facility under which they may borrow up to \$50.0 million and \$15.0 million, respectively, at market interest rates. The \$15.0 million of borrowings under the facility available to Valley are guaranteed by White Mountains. The facility contains certain customary covenants including a minimum tangible net worth requirement, a minimum financial asset coverage requirement, a maximum leverage ratio requirement, a minimum fixed charge coverage ratio requirement and a minimum policyholders' surplus requirement. The facility also limits White Mountains' ability to pay dividends to its shareholders. As of December 31, 1997 and 1996, White Mountains and Valley were in compliance with all covenants under the facility. During 1997 and 1996 Valley had \$15.0 million of borrowings outstanding under the facility with a weighted average interest rate of 6.09% and 5.83%, respectively. White Mountains had no borrowings outstanding at December 31, 1997 and 1996 under the facility.

In November 1995 Charter issued two notes totalling \$20.2 million. Certain of the notes were due in 1996 and other notes could be extended to be payable in three equal installments in 1997, 1998 and 1999. During 1996 Charter elected to extend the maturity of \$3.2 million of notes payable. The notes are collateralized by certain assets of Charter.

During 1997 the Company reorganized its structure in order to strengthen Source One and make it a part of Fund American's permanent operating group under White Mountains. Pursuant to this reorganization plan, White Mountains was merged into FAE and the combined entity was immediately renamed White Mountains. In addition, Source One received \$139 million of capital infusions, consisting primarily of Fund American's investments in FSA, in order to improve Source One's debt ratings and reduce its borrowing costs. As a result of the reorganization plan, the Company currently owns 3% of the outstanding common stock of Source One and White Mountains owns the remaining 97% of the outstanding common stock of Source One.

On November 20, 1997, White Mountains purchased 1,563,907 shares of Folksamerica Common Stock for \$20.8 million and on December 8, 1997 White Mountains purchased 38,651,270 shares of Murray Lawrence Common Stock for \$23.6 million. The purchase prices paid for the Folksamerica Common Stock and the Murray Lawrence Common Stock was paid with proceeds from sales of passive investment securities.

On November 1, 1996, Fund American signed a definitive agreement (the "MSA Agreement") to increase its ownership of MSA from 33% to 50%. MSA currently shares in 40% of NGM's business through a quota share reinsurance agreement which will be increased to 60% pursuant to the MSA Agreement. Also pursuant to

the MSA Agreement, NGM will contribute certain of its insurance, reinsurance and financial services subsidiaries to MSA. The aggregate purchase price to be paid by Fund American pursuant to the MSA Agreement is approximately \$70.1 million, subject to certain purchase price adjustments. Fund American expects to assign the additional investment in MSA to White Mountains. White Mountains expects that the purchase price for the additional MSA investment will be paid with proceeds from borrowings under White Mountains' \$50.0 million revolving credit facility, and sales of passive investment securities. The closing is dependent upon the receipt of state regulatory approvals and is expected to occur in the first quarter of 1998.

Under the insurance laws of the various states under which Valley, Charter and WMIC are incorporated or licensed to write business, an insurer is restricted with respect to the amount of dividends it may pay without prior approval by state regulatory authorities. Accordingly, there is no assurance that dividends may be paid by Valley, Charter and WMIC in the future.

Source One

On February 28, 1997, Source One sold the rights to service \$17.0 billion of nonrecourse mortgage loans to a third party for adjusted proceeds of \$266.9 million. Source One will

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continue to service these loans pursuant to a subservicing agreement until 1999. The proceeds were used by Source One to reduce and retire debt.

In 1996 Source One sold the rights to service \$3.3 billion of mortgage loans to third parties for net cash proceeds of \$55.9 million. The proceeds were used by Source One for general corporate purposes.

In 1995 Source One sold the rights to service \$11.0 billion of mortgage loans to third parties for net cash proceeds of \$199.1 million. The proceeds were used by Source One to retire debt and to repurchase shares of its common stock.

In July 1997 Source One amended and restated its secured revolving credit agreement to reflect a reduction in its borrowing requirements resulting from the 1997 servicing sale. The provisions of the amended agreement decreased Source One's revolving credit facility from \$750.0 million to \$600.0 million and reduced Source One's borrowing costs by lowering the facility fee. At December 31, 1997, Source One was in compliance with all covenants under the facility. As of December 31, 1997, Source One had \$559.0 million of borrowing outstanding under this facility. As of December 31, 1996, Source One had no outstanding borrowings under the previous facility.

In May 1997 Source One entered into a new unsecured revolving credit agreement under which it can borrow up to \$15.0 million through June 1, 1998. As of December 31, 1997, there was \$10.5 million outstanding under the revolving credit agreement. As of December 31, 1996, Source One had no outstanding borrowings under a previous facility which allowed for borrowings of up to \$10.0 million.

Source One has a \$650.0 million domestic commercial paper program. During 1997 Source One's commercial paper rating was downgraded by Moody's to "Not Prime" and by Standard & Poor's to "A-3". As a result of the 1997 ratings downgrades, Source One has not issued fresh commercial paper and has supplanted its commercial paper borrowings with its \$600.0 million committed facility. As of December 31, 1996, there was \$347.2 million of commercial paper outstanding. The weighted average number of days to maturity of commercial paper outstanding at December 31, 1996 was 23 days.

In 1997 Source One amended a short-term borrowing agreement which it had entered into in 1996. The amended agreement increased Source One's facility from \$25.0 million to \$50.0 million. As a result of the 1997 ratings downgrade, Source One is not able to borrow under this agreement. As of December 31, 1996, there was \$15.0 million outstanding under the original agreement.

In August 1995 Source One entered into a \$60.0 million unsecured revolving credit facility which expired in July 1997. As of December 31, 1996 there was \$45.0 million outstanding under this arrangement.

In 1991 Source One issued \$160.0 million of 8.875% medium-term notes due in 2001 of which \$138.4 million remained outstanding at December 31, 1996. During 1997 Source One repurchased and retired in principal amount \$119.7 million of these notes leaving \$18.7 million outstanding at December 31, 1997.

In 1992 Source One issued \$100.0 million of 9% debentures due in 2012 pursuant to a \$250.0 million shelf registration statement. The debentures may not be redeemed by Source One prior to maturity. The proceeds from issuance were used for general corporate purposes.

In December 1995, Source One exchanged and retired 2,239,061 shares of preferred stock (the "Source One Preferred Stock") for \$56.0 million in principal amount of 9.375% subordinated debentures. The subordinated debentures are due in 2025 but are redeemable at the option of Source One, in whole or

part, at any time on or after May 1, 1999. Source One pays quarterly cash dividends on the Source One Preferred Stock at an annual rate of 8.42%. Dividends on the Source One Preferred Stock totalled \$3.7 million, \$3.7 million and \$8.4 million during 1997, 1996 and 1995, respectively.

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In 1989 Source One issued \$40.0 million of medium-term notes due in 1996 and having a total weighted average interest rate of 9.65%. During 1996 Source One repurchased and retired the remaining \$29.7 million in principal amount outstanding of these notes.

In 1986 Source One issued \$125.0 million of 8.25% debentures due November 1, 1996. During 1996 Source One repurchased and retired the remaining \$74.6 in principal amount outstanding of these debentures.

Source One is currently considering further steps to restructure its debt including the issuance of approximately \$50.0 million of additional medium-term notes pursuant to an existing shelf registration and entering into interest rate swaps which would enable Source One to achieve a floating rate of interest on certain of its fixed interest obligations.

Source One must comply with certain financial covenants provided in its secured and unsecured revolving credit facilities, including restrictions relating to tangible net worth and leverage. In addition, the secured facility contains certain covenants which limit Source One's ability to pay dividends or make distributions of its capital in excess of preferred stock dividends and subordinated debt interest requirements each year. Source One is currently in compliance with all such covenants.

Source One's investments, mortgage loans held for sale and mortgage loan servicing portfolio provide a liquidity reserve since these assets may be sold to meet cash needs.

Item 8. Financial Statements and Supplementary Data

The financial statements and supplementary data have been filed as a part of this Annual Report on Form 10-K as indicated in the Index to Financial Statements and Financial Statement Schedule appearing on page 46 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

On January 24, 1997, the Company's Board of Directors, upon recommendation of the Audit Committee, appointed KPMG Peat Marwick LLP as its independent auditors for the fiscal year ending December 31, 1997, to replace Ernst & Young LLP ("Ernst & Young") as independent auditors for the Company and Coopers & Lybrand L.L.P. ("Coopers & Lybrand") as independent auditors for Valley, effective upon the date of their reports on such consolidated financial statements for the year ended December 31, 1996, contained herein.

In connection with the audits of the two years ended December 31, 1996, there were no disagreements with Ernst & Young on any matter of accounting principles or practices, financial statement disclosure, or auditing scope and procedures which, if not resolved to their satisfaction, would have caused them to make reference in connection with their opinion to the subject matter of the disagreement.

The Company acquired Valley on December 1, 1995. Coopers & Lybrand served as the independent auditors of Valley through 1996. The report of Coopers & Lybrand on the consolidated financial statements of Valley for the year ended December 31, 1996, has been relied upon in the Ernst & Young report contained herein. There have been no disagreements with Coopers & Lybrand on any matter of accounting principles or practices, financial statement disclosure, or auditing scope and procedures with respect to Valley.

The Company requested Ernst & Young and Coopers & Lybrand to furnish a letter addressed to the Commission stating whether it agrees with the above statements. Copies of those letters, dated March 27, 1997, are contained herein as Exhibits 16(a) and 16(b).

PART III

Item 10. Directors and Executive Officers

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a. Directors (as of March 20, 1998)

Reported under the caption "Election of Directors" on pages 3 through 5 of the Company's 1998 Proxy Statement, herein incorporated by reference.

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b. Executive Officers (as of March 20, 1998)

Name	Position	Age	Executive officer since
Raymond Barrette	Executive Vice President and Chief Financial Officer	47	1997
Terry L. Baxter	President of White Mountains	52	1994
Reid T. Campbell	Vice President and Director of Finance	30	1996
Morgan W. Davis	Executive Vice President of White Mountains	47	1994
K. Thomas Kemp	President and CEO	57	1991
Michael S. Paquette	Senior Vice President and Controller	34	1993
David G. Staples	Vice President and Director of Taxation	37	1997

All executive officers are elected by the Company's Board of Directors for a term of one year or until their successors have been elected and have duly qualified.

Mr. Barrette joined Fund American in November 1997 as the Company's Executive Vice President and Chief Financial Officer. Mr. Barrette is also Executive Vice President and Chief Financial Officer of White Mountains. He was formerly a consultant with Tillinghast-Towers Perrin from 1994 to 1996 and was President of the Personal Insurance Division of Fireman's Fund from 1991 to 1993. Mr. Barrette is a director of FAE, Source One, White Mountains, MSA and WMIC.

Mr. Baxter was elected President of White Mountains in February 1997. Mr. Baxter previously served as Chairman of Source One from May 1996 to February 1997 and as President and Secretary of FAE from 1994 to 1997. Prior to joining Fund American in 1994, Mr. Baxter was Managing Director of the National Transportation Safety Board from 1990. Prior to that, he was the Assistant Director of OMB in the Reagan Administration. Mr. Baxter is a director of FAE, MSA, Source One, Folksamerica, White Mountains, Valley, Charter, WMIC and Sextant Underwriting Plc.

Mr. Campbell was elected Vice President and Director of Finance in February 1998 and previously served as Assistant Controller from 1996 to 1998 and Director of Accounting from 1995 to 1996. Mr. Campbell has been with Fund American since 1994. Mr. Campbell is also Vice President and Director of Finance of White Mountains and is a director of WMIC and Merastar Insurance Company and is an advisory director of Southern Heritage Insurance Company. Prior to joining Fund American, Mr. Campbell was with KPMG Peat Marwick from 1990 to 1994.

Mr. Davis has served as White Mountains' Executive Vice President since 1997 and served as Senior Vice President since 1994. Mr. Davis is also President and Chief Executive Officer of WMIC and Chairman and President of VGI. Prior to joining Fund American in 1994, Mr. Davis was an independent consultant. Mr. Davis is a director of White Mountains, WMIC, Valley, MSA, Charter and CCC Information Services Group Inc. and is a trustee of Azusa Pacific University.

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Mr. Kemp was appointed President and Chief Executive Officer in October 1997. Mr. Kemp previously served as Executive Vice President since 1993 and as Vice President, Treasurer and Secretary from 1991 to 1993. Mr. Kemp also serves as a director of the Company, Chairman and Chief Executive Officer of White Mountains and Chairman of WMIC. He is also a director of Folksamerica, FSA, FAE, MSA and Murray Lawrence.

Mr. Paquette was elected Vice President and Chief Accounting Officer in 1993, was appointed Vice President and Controller in February 1995 and became a Senior Vice President in November 1997. Mr. Paquette is also Senior Vice President and Controller of White Mountains and WMIC. Mr. Paquette has been a member of the Fund American organization since 1989. Mr. Paquette is a director of White Mountains and WMIC.

Mr. Staples was elected Vice President and Director of Taxation in February 1997 and has been with Fund American since 1996. Prior to joining Fund American, Mr. Staples served as Vice President and Director of Taxation for Crum & Forster Holdings, Inc. from 1993 to 1996, and was with KPMG Peat Marwick from 1983 to 1993.

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Item 11. Executive Compensation

Reported under the captions "Compensation of Executive Officers" on pages 10 through 14, "Reports of the Compensation Committees on Executive

Compensation" on pages 15 through 18, "Shareholder Return Graph" on page 19, and "Compensation Plans" on page 20 of the Company's 1998 Proxy Statement, herein incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Reported under the caption "Voting Securities and Principal Holders Thereof" on pages 8 through 9 of the Company's 1998 Proxy Statement, herein incorporated by reference.

Item 13. Certain Relationships and Related Transactions

Reported under the captions "Certain Relationships and Related Transactions" on page 14 and "Compensation Committee Interlocks and Insider Participation in Compensation Decisions" on page 21 of the Company's 1998 Proxy Statement, herein incorporated by reference.

PART IV

Item 14. Exhibits, Financial Statement Schedule, and Reports on Form 8-K

a. Documents Filed as Part of the Report

The financial statements and financial statement schedule and report of independent auditors have been filed as part of this Annual Report on Form 10-K as indicated in the Index to Financial Statements and Financial Statement Schedule appearing on page 46 of this report. A listing of exhibits filed as part of the report appear on pages 41 and 43 of this report.

b. Reports on Form 8-K

On October 15, 1997, the Company filed a Current Report on Form 8-K announcing the resignation of its Senior Vice President and Chief Financial Officer, Allan L. Waters, which was effective on October 8, 1997. Mr. Waters, who held the position of Chief Financial Officer since 1993, left the Company for personal reasons.

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c. Exhibits

Exhibit number	Name
3 (i)	-- Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3(a) of the Company's 1993 Annual Report on Form 10-K)
(ii)	-- Amended and Restated By-Laws of the Company (incorporated by reference to Exhibit 3(b) of the Company's 1993 Annual Report on Form 10-K)
4	-- Indenture dated January 1, 1993, with The First National Bank of Chicago, as trustee, pursuant to the Company's offering of \$150 million of medium-term notes (incorporated by reference to Exhibit (4) of the Company's Report on Form 8-K dated January 15, 1993)
9	-- Voting Trust Agreement dated September 2, 1994 between the Company, U S WEST Capital Corporation and First Chicago Trust Company of New York (filed pursuant to Exhibit 10(f) herein)
10(a)	-- Credit Agreement dated November 26, 1996 among the Company, Fund American Enterprises, Inc., the Lenders (as named therein) and The First National Bank of Chicago (incorporated by reference to Exhibit 10(e) of the Company's 1996 Annual Report on Form 10-K)
(b)	-- Credit Agreement dated November 26, 1996 among White Mountains Holdings, Inc., the Lenders (as named therein) and The First National Bank of Chicago (incorporated by reference to Exhibit 10(f) of the Company's 1996 Annual Report on Form 10-K)
(c)	-- Credit Agreement dated November 26, 1996 among VGI, the Lenders (as named therein) and The First National Bank of Chicago (incorporated by reference to Exhibit 10(g) of the Company's 1996 Annual Report on Form 10-K)
(d)	-- Amended and Restated Credit Agreement dated July 31, 1997 among the Company, Fund American Enterprises, Inc., the Lenders (as named therein) and The First National Bank of Chicago (*)
(e)	-- Amended and Restated Credit Agreement dated July 30, 1997 among White Mountains Holdings, Inc., the Lenders (as named therein) and The First National Bank of Chicago (*)

- (f) -- Amended and Restated Credit Agreement dated July 30, 1997 among VGI, the Lenders (as named therein) and The First National Bank of Chicago (*)
 - (g) -- First Amendment dated November 20, 1997 to the Amended and Restated Credit Agreement dated July 30, 1997 among White Mountains Holdings, Inc., the Lenders (as named therein) and The First National Bank of Chicago (*)
 - (h) -- First Amendment dated November 20, 1997 to the Amended and Restated Credit Agreement dated July 30, 1997 among VGI, the Lenders (as named therein) and The First National Bank of Chicago (*)
 - (i) -- Securities Purchase Agreement dated April 10, 1994 between the Company, U S WEST, Inc., U S WEST Capital Corporation and Financial Security Assurance Holdings Ltd. (incorporated by reference to Exhibit 10(a) of the Company's Report on Form 8-K dated April 10, 1994)
 - (j) -- Stock Purchase Agreement dated August 8, 1995 between the Company, Skandia U.S. Holding Corporation, and Skandia America Corporation (incorporated by reference to Exhibit 10(e) of the Company's 1995 Annual Report on Form 10-K)
 - (k) -- Securities Purchase Agreement dated March 6, 1996 between the Company and Folksamerica Holding Company, Inc. (incorporated by reference to Exhibit 10(a) of the Company's Report on Form 8-K dated June 19, 1996)
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- (l) -- Subscription Agreement dated November 6, 1997 between Folksamerica Holding Company, Inc., the Company, White Mountains, Folksam Mutual General Insurance Company, Folksam International Insurance Co. Ltd, Weiner Staedtische Allgemeine Versicherung AG, P&V Assurances S.C. and Samvirke Skadeforsikring AS (*)
 - (m) -- Guaranty, dated February 28, 1997, by the Company to and for the benefit of Chemical Mortgage Company (incorporated by reference to Exhibit 10(y) of the Company's 1996 Annual Report on Form 10-K)
 - (n) -- Employment Agreement dated February 15, 1995, between the Company and John J. Byrne incorporated by reference to Appendix II of the Company's Notice of 1995 Annual Meeting of Shareholders and Proxy Statement) (**)
 - (o) -- Common Stock Warrant Agreement with respect to shares of the Company's Common stock between the Company and John J. Byrne (incorporated by reference to Exhibit 10(v) of the Company's Registration Statement on Form S-1 (No. 33-0199)) (**)
 - (p) -- The Company's Retirement Plan for Non-Employee Directors (incorporated by reference to Exhibit 10(aa) of the Company's 1992 Annual Report on Form 10-K) (**)
 - (q) -- The Company's Voluntary Deferred Compensation Plan, as amended on November 15, 1996 (incorporated by reference to Exhibit 10(o) of the Company's 1996 Annual Report on Form 10-K) (**)
 - (r) -- The Company's Deferred Benefit Plan, as amended on November 15, 1996 (incorporated by reference to Exhibit 10(p) of the Company's 1996 Annual Report on Form 10-K) (**)
 - (s) -- The Company's Long-Term Incentive Plan, as amended February 15, 1995 (incorporated by reference to Appendix I of the Company's Notice of 1995 Annual Meeting of Shareholders and Proxy Statement) (**)
 - (t) -- Valley Group Employees' 401(k) Savings Plan (incorporated by reference to Exhibit 4(c) of the Company's Registration Statement on Form S-8 (No. 333-30233)) (**)
- 11 -- Statement Re Computation of Per Share Earnings (***)
 - 16(a) -- Letter of Ernst & Young LLP dated March 27, 1997 (incorporated by reference to Exhibit 16(a) of the Company's 1996 Annual Report on Form 10-K)
 - (b) -- Letter of Coopers & Lybrand L.L.P. dated March 27, 1997 (incorporated by reference to Exhibit 16(b) of the Company's 1996 Annual Report on Form 10-K)
- 21 -- Subsidiaries of the Registrant (*)
 - 23(a) -- Consent of KPMG Peat Marwick LLP dated March 27, 1998 (*)
 - (b) -- Consent of Ernst & Young LLP dated March 27, 1998 (*)
 - (c) -- Consent of Coopers & Lybrand L.L.P. dated March 27, 1998 relating

to Valley and FSA (*)

- 24 -- Powers of Attorney (*)
- 27.1 -- 1997 Financial Data Schedule (*)
- 27.2 -- 1995 and 1996 restated Financial Data Schedules (*)
- 99(a) -- Report of Coopers & Lybrand L.L.P. dated February 14, 1997 relating to VGI (incorporated by reference to Exhibit 99(a) of the Company's 1996 Annual Report on Form 10-K)
- (b) -- The Consolidated Financial Statements of FSA and the related Report of Independent Accountants as of December 31, 1997 and 1996 and for each of the three years in the period ended December 31, 1997 (*)

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(*) Included herein.

(**) Management contracts or compensation plans/arrangements required to be filed as an exhibit pursuant to Item 14(a)3 of Form 10-K.

(***) Not included herein as the information is contained elsewhere within report. See Note 1 of the Notes to Consolidated Financial Statements.

d. Financial Statement Schedule

The financial statement schedule and report of independent auditors have been filed as part of this Annual Report on Form 10-K as indicated in the Index to Financial Statements and Financial Statement Schedule appearing on page 46 of this report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.

Date: March 27, 1998

By: /s/ MICHAEL S. PAQUETTE
Senior Vice President and Controller

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature -----	Title -----	Date ----
RAYMOND BARRETTE* ----- Raymond Barrette	Executive Vice President and Chief Financial Officer	March 27, 1998
JOHN J. BYRNE* ----- John J. Byrne	Chairman	March 27, 1998
PATRICK M. BYRNE* ----- Patrick M. Byrne	Director	March 27, 1998
HOWARD L. CLARK* ----- Howard L. Clark	Director	March 27, 1998
HOWARD L. CLARK, JR.* ----- Howard L. Clark, Jr.	Director	March 27, 1998
ROBERT P. COCHRAN* ----- Robert P. Cochran	Director	March 27, 1998
GEORGE J. GILLESPIE, III* ----- George J. Gillespie, III	Director	March 27, 1998
/s/ K. THOMAS KEMP -----	President, Chief Executive Officer and Director	March 27, 1998

K. Thomas Kemp

GORDON S. MACKLIN*

Director

March 27, 1998

Gordon S. Macklin

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FRANK A. OLSON*

Director

March 27, 1998

Frank A. Olson

MICHAEL S. PAQUETTE*

Senior Vice President and Controller

March 27, 1998

Michael S. Paquette

ARTHUR ZANKEL*

Director

March 27, 1998

Arthur Zankel

*By: /s/ K. THOMAS KEMP

K. Thomas Kemp, Attorney-in-Fact

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FUND AMERICAN ENTERPRISES HOLDINGS, INC.
Index to Financial Statements and Financial Statement Schedule

	Form 10-K page(s)
Financial statements:	
Consolidated balance sheets as of December 31, 1997 and 1996.....	F-1
Consolidated income statements for each of the years ended December 31, 1997, 1996 and 1995.....	F-3
Consolidated statements of shareholders' equity for each of the years ended December 31, 1997, 1996 and 1995.....	F-5
Consolidated statements of cash flows for each of the years ended December 31, 1997, 1996 and 1995.....	F-6
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Other financial information:	
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Selected quarterly financial data (unaudited).....	F-47
Financial statement schedule:	
I. Condensed financial information of the Registrant.....	FS-1

All other schedules are omitted as they are not applicable or the information required is included in the financial statements or notes thereto.

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CONSOLIDATED BALANCE SHEETS

Dollars in millions	December 31,	
	1997	1996
Assets		
Common equity securities, at fair value (cost \$64.7 and \$101.1)	\$ 104.2	\$ 160.8
Fixed maturity investments, at fair value (cost \$165.4 and \$154.5)	168.3	155.4
Other investments (cost \$103.1 and \$119.7)	167.9	176.5
Short-term investments, at amortized cost (which approximated fair value)	62.8	67.5
Total investments	503.2	560.2
Cash	7.0	4.8
Mortgage loans held for sale	519.3	314.9
Capitalized mortgage servicing, net of accumulated amortization	181.0	410.9
Pool loan purchases	149.8	131.5

Mortgage claims receivable and real estate acquired, less allowance for mortgage loan losses of \$12.8 and \$15.4	41.2	57.1
Receivable from sale of mortgage servicing	27.3	--
Insurance premiums receivable	56.1	52.2
Reinsurance recoverable on paid and unpaid losses	9.6	40.0
Investments in unconsolidated insurance affiliates	382.7	226.9
Other assets	155.7	182.1
Total assets	\$ 2,032.9	\$ 1,980.6
Liabilities		
Short-term debt	\$ 571.4	\$ 407.9
Long-term debt	304.3	424.2
Unearned insurance premiums	78.0	72.6
Loss and loss adjustment expense reserves	71.9	65.4
Accounts payable and other liabilities	289.7	279.5
Total liabilities	1,315.3	1,249.6
Minority interest - preferred stock of subsidiary	44.0	44.0
Shareholders' equity		
Common stock - authorized 125,000,000 shares, issued 31,015,463 and 31,940,202 shares	31.0	31.9
Paid-in surplus	355.9	366.5
Retained earnings	1,008.9	1,067.1
Common stock in treasury, at cost: 25,034,939 shares	(871.0)	(871.0)
Net unrealized investment gains, after tax	148.8	92.5
Total shareholders' equity	673.6	687.0
Total liabilities, minority interest and shareholders' equity	\$ 2,032.9	\$ 1,980.6

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See Notes to Consolidated Financial Statements.

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CONSOLIDATED INCOME STATEMENTS

Millions, except per share amounts	Year Ended December 31,		
	1997	1996	1995
Revenues:			
Gross mortgage servicing revenue	\$ 95.0	\$139.6	\$ 141.9
Amortization and impairment of capitalized mortgage servicing	(64.2)	(71.9)	(81.4)
Net gain on financial instruments	11.3	9.9	.8
Net mortgage servicing revenue	42.1	77.6	61.3
Net gain on sales of mortgages	21.5	38.3	24.0
Gain (loss) on sales of mortgage servicing rights and assumption of subservicing	(8.0)	10.1	40.0
Other mortgage operations revenue	19.1	18.1	15.6
Earned property and casualty insurance premiums	145.3	109.7	5.8
Earnings from unconsolidated insurance affiliates	21.3	12.0	9.4
Other insurance operations revenue	7.8	9.4	10.8
Net investment income	65.1	57.3	55.4
Total revenues	314.2	332.5	222.3
Expenses:			
Compensation and benefits	101.8	91.3	111.6
General expenses	87.6	87.4	60.3
Interest expense	49.7	50.0	45.8
Insurance losses and loss adjustment expenses	97.1	85.9	8.2
Write-off of goodwill and other intangible assets	--	32.6	--
Total expenses	336.2	347.2	225.9
Pretax operating loss	(22.0)	(14.7)	(3.6)
Net realized investment gains	96.7	38.5	38.8
Pretax earnings	74.7	23.8	35.2
Income tax provision	29.4	18.9	16.7
After tax earnings	45.3	4.9	18.5
Tax benefit from sale of discontinued operations	--	--	66.0
Loss on early extinguishment of debt, after tax	(6.0)	--	(.4)
Net income	39.3	4.9	84.1
Change in net unrealized investment gains, after tax	56.3	54.6	18.2

Source: WHITE MOUNTAINS INSU, 10-K, March 30, 1998

Comprehensive net income	95.6	59.5	102.3
Dividends on preferred stock	--	--	(3.8)
<hr/>			
Comprehensive net income applicable to common stock	\$ 95.6	\$ 59.5	\$ 98.5
<hr/>			
Basic earnings per share:			
After tax earnings	\$ 6.89	\$.66	\$ 1.88
Tax benefit from sale of discontinued operations	--	--	8.47
Loss on early extinguishment of debt, after tax	(.91)	--	(.05)
<hr/>			
Net income	\$ 5.98	\$.66	\$ 10.30
<hr/>			
Comprehensive net income	\$ 14.55	\$ 8.01	\$ 12.64
<hr/>			

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Diluted earnings per share:			
After tax earnings	\$ 6.22	\$.60	\$ 1.71
Tax benefit from sale of discontinued operations	--	--	7.70
Loss on early extinguishment of debt, after tax	(.82)	--	(.05)
<hr/>			
Net income	\$ 5.40	\$.60	\$ 9.36
<hr/>			
Comprehensive net income	\$ 13.17	\$ 7.33	\$ 11.48
<hr/>			

See Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Millions	Total	Preferred stock	Common stock and paid-in surplus	Retained earnings	Common stock in treasury	Net unrealized investment gains	Loan for common stock issued
Balances at January 1, 1995	\$661.1	\$75.0	\$371.7	\$1,098.2	\$(878.5)	\$ 19.7	\$(25.0)
Net income	84.1	--	--	84.1	--	--	--
Dividends to shareholders	(4.8)	--	--	(4.8)	--	--	--
Redemption of preferred stock	(75.0)	(75.0)	--	--	--	--	--
Purchases of common stock retired	(65.4)	--	(9.7)	(55.7)	--	--	--
Stock options and warrants exercised	10.3	--	--	2.8	7.5	--	--
Extension of outstanding stock warrants	46.2	--	46.2	--	--	--	--
Change in net unrealized investment gains and losses, after tax	18.2	--	--	--	--	18.2	--
Repayment of loan for common stock issued	25.0	--	--	--	--	--	25.0
Balances at December 31, 1995	699.7	--	408.2	1,124.6	(871.0)	37.9	--
Net income	4.9	--	--	4.9	--	--	--
Dividends to shareholders	(5.9)	--	--	(5.9)	--	--	--
Purchases of common stock retired	(66.3)	--	(9.8)	(56.5)	--	--	--
Change in net unrealized investment gains and losses, after tax	54.6	--	--	--	--	54.6	--
Balances at December 31, 1996	687.0	--	398.4	1,067.1	(871.0)	92.5	--
Net income	39.3	--	--	39.3	--	--	--
Dividends to shareholders	(5.3)	--	--	(5.3)	--	--	--
Purchases of common stock retired	(103.7)	--	(11.5)	(92.2)	--	--	--
Change in net unrealized investment gains and losses, after tax	56.3	--	--	--	--	56.3	--
Balances at December 31, 1997	\$673.6	\$ --	\$386.9	\$1,008.9	\$(871.0)	\$148.8	\$ --

See Notes to Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Millions	Year Ended December 31,		
	1997	1996	1995
Net income	\$ 39.3	\$ 4.9	\$ 84.1
Charges (credits) to reconcile net income (loss) to cash flows from operations:			
Undistributed earnings from unconsolidated insurance affiliates	(14.7)	(8.2)	(8.6)
Net realized investment gains	(96.7)	(38.5)	(38.8)
Net unrealized gain on financial instruments	(13.3)	(1.8)	(.8)
Mortgage loan production	(4,403.3)	(3,831.6)	(2,852.0)
Mortgage loan sales and amortization	4,198.9	3,897.7	2,681.5
Loss (gain) on sales of mortgage servicing rights	8.0	(10.1)	(40.0)
Increase in unearned insurance premiums	5.4	37.6	2.7
Increase in insurance premiums receivable	(3.9)	(6.9)	(1.3)
(Decrease) increase in deferred insurance policy acquisition costs	(1.1)	(6.5)	.2
Net increase in insurance loss reserves	6.5	21.2	12.3
Depreciation and amortization of servicing assets, goodwill and other	67.1	85.4	86.4
Net change in current and deferred income taxes receivable and payable	4.5	11.8	14.9
Change in other assets	55.9	(29.3)	(4.9)
Change in accounts payable and other liabilities	11.1	33.7	35.9
Tax benefit from sale of discontinued operations	--	--	(66.0)
Compensation expense resulting from warrant extension	--	--	46.2
Write-off of goodwill and other intangible assets	--	32.6	--
Other, net	23.5	6.1	(5.8)
Net cash (used for) provided from operating activities	(112.8)	198.1	(54.0)
Cash flows from investing activities:			
Net decrease in short-term investments	4.7	36.1	15.6
Sales of common stocks and other investments	207.9	231.6	208.3
Sales of fixed maturity investments	92.5	131.7	62.1
Purchases of common stocks and other investments	(54.8)	(85.0)	(63.7)
Purchases of fixed maturity investments	(102.6)	(180.8)	(48.8)
Acquisitions of consolidated insurance affiliates	--	(13.2)	(42.2)
Investments in unconsolidated insurance affiliates	(44.4)	(107.6)	(33.0)
Collections on other mortgage origination and servicing assets	274.2	175.3	210.9
Additions to capitalized mortgage servicing rights	(139.5)	(88.6)	(120.8)
Proceeds from sales of mortgage servicing rights	242.6	11.7	181.1
Additions to other mortgage origination and servicing assets	(285.1)	(205.7)	(172.7)
Net (purchases) sales of fixed assets	(2.9)	(7.3)	.4
Net cash provided from (used for) investing activities	192.6	(101.8)	197.2
Cash flows from financing activities:			
Net issuances (repayments) of short-term debt	162.4	(36.2)	96.5
Issuances of long-term debt	--	15.0	--
Repayments of long-term debt	(131.0)	--	(93.7)
Purchases of common stock retired	(103.7)	(66.3)	(65.5)
Cash dividends paid to shareholders	(5.3)	(5.9)	(6.4)
Redemptions of preferred stock	--	--	(75.0)
Other	--	(.8)	2.1
Net cash used for financing activities	(77.6)	(94.2)	(142.0)
Net increase in cash during year	2.2	2.1	1.2
Cash balance at beginning of year	4.8	2.7	1.5
Cash balance at end of year	\$ 7.0	\$ 4.8	\$ 2.7

See Notes to Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries and have been prepared in accordance with Generally Accepted Accounting Principles ("GAAP"). All significant intercompany transactions have been eliminated in consolidation. The financial statements include all adjustments considered necessary by management to fairly present the financial position, results of operations and cash flows of Fund American. 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 as of 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. Certain amounts in the prior year financial statements have been restated to conform with the current year presentation.

The Company adopted the provisions of SFAS No. 130, "Reporting Comprehensive Income" as of December 31, 1997. SFAS No. 130 establishes standards for the reporting and display of comprehensive income and its components (such as changes in net unrealized investment gains and losses) in a financial statement that is displayed with the same prominence as other financial statements. In accordance with the adoption of SFAS No. 130, the Company now reports comprehensive net income on its income statement. All prior period income statements have been restated to reflect application of this statement. Additionally, the Company has provided supplemental comprehensive earnings per share computations.

Investment securities

Fund American's portfolio of common equity securities, fixed maturity investments and other investments are mainly classified as available for sale and are reported at fair value as of the balance sheet date. Net unrealized investment gains and losses, after tax, associated with such investments are reported as a net amount in a separate component of shareholders' equity. Changes in net unrealized investment gains and losses, after tax, are reported on the income statement as a component of comprehensive net income.

Premiums and discounts on fixed maturity investments are accreted to income over the anticipated life of the investment.

Other investments include: non-redeemable preferred and common equity securities having no established public market value and carried at internally appraised fair value; securities which, due to restrictions regarding resale, are carried at a discount to the quoted market value for similar unrestricted securities; investment partnership interests accounted for using the equity method or otherwise; mortgage loans held for investment; REMICs; interest rate floor contracts; and principal-only swap agreements. Mortgage loans held for investment are stated at the lower of cost or fair value, determined on an individual loan basis. REMICs are classified as held to maturity and are carried at amortized cost using a method which approximates the effective yield method of amortization. Interest rate floor contracts and principal-only swap agreements are classified as trading securities and are carried at fair value with realized and unrealized gains and losses reported in net gain on financial instruments.

Realized gains and losses resulting from sales of investment securities or from other than temporary impairments of value are accounted for using the specific identification method.

Short-term investments consist primarily of money market instruments and mortgage-backed securities with remaining maturities of up to one year. Money market instruments are carried at amortized cost which approximated fair value as of December 31, 1997 and 1996. Short-term mortgage-

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backed securities are classified as trading securities and are stated at fair value with unrealized gains and losses, if any, reported in income.

Fund American's consolidated insurance operations are required to maintain deposits with insurance regulators of certain states in order to maintain their insurance licenses. The total fair value of such deposits totalled \$11.3 million and \$10.7 million as of December 31, 1997 and 1996, respectively.

Insurance operations

Premiums are taken into income as earned on a daily pro rata basis over the terms of the policies. Unearned premiums represent the portion of premiums applicable to future insurance coverage provided by policies in force. As of December 31, 1997, White Mountains' insurance subsidiaries insured commercial and personal property and casualty risks in Arizona, California, Idaho, New Hampshire, Massachusetts, Oregon, Texas, Utah, Vermont and Washington.

Policy acquisition costs include commissions, premium taxes and other costs that vary with and are primarily related to the acquisition of new and renewal insurance policies. Policy acquisition costs are deferred and amortized over the terms of the applicable policies. Deferred acquisition costs are reviewed to determine if they are recoverable from future income, and if not, are charged to expense.

Losses and loss adjustment expenses are charged against income as incurred. Unpaid losses and loss adjustment expenses are based on estimates by claims adjusters, legal counsel and actuarial staff of the ultimate costs of settling claims, including the effects of inflation and other societal and economic factors. Unpaid loss and loss adjustment expense reserves represent management's best estimate of ultimate losses and loss adjustment expenses net of estimated salvage and subrogation recoveries. Such estimates are regularly reviewed and updated and any adjustments resulting therefrom are reflected in current operations. The process of estimating loss and loss adjustment expenses involves a considerable degree of judgement by management and the ultimate amount of expense to be incurred could be considerably greater than or less than the amounts currently reflected in the financial statements.

In the normal course of business, White Mountains' insurance subsidiaries

seek to limit losses that may arise from catastrophes or other events that may cause unfavorable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurance enterprises or reinsurers. White Mountains' insurance subsidiaries remain contingently liable for risks reinsured with third parties to the extent that the reinsurer is unable to honor its obligations under reinsurance contracts at the time of loss.

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance premiums, commissions, expense reimbursements and reserves related to reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums ceded to other companies have been reported as a reduction of premiums written. Amounts applicable to reinsurance ceded for unearned premium reserves, and loss and loss adjustment expense reserves, (e.g., prepaid reinsurance premiums and reinsurance recoverable on unpaid losses, respectively) are not material and have been included as a component of other assets. Expense allowances received in connection with reinsurance ceded have been accounted for as a reduction of the related policy acquisition costs and are deferred and amortized accordingly.

Mortgage origination and servicing

Fund American acquired Source One in 1986. The purchase price paid for Source One in 1986 was in excess of the estimated fair value of the net assets acquired on that date and was

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allocated to goodwill. Prior to December 1996 Source One's goodwill was being amortized over 20 years. During 1996 Fund American re-assessed the recoverability of goodwill and certain other intangible assets related to Source One and determined that it should write-off all such assets related to Source One. This resulted in a \$32.6 million pretax write-off of goodwill and other intangible assets. Factors considered in the determination to write-off all Source One's goodwill and other assets were (i) increased competition and industry consolidation during 1996 which had adversely impacted the value of both the mortgage loan production and servicing operations of Source One and (ii) the attainment of a definitive agreement in the fourth quarter of 1996 to sell the majority of Source One's mortgage servicing portfolio at essentially book value.

Mortgage loans held for sale are stated at the lower of aggregate cost or fair value, including the fair value of commitments to originate and sell mortgage loans. Conventional mortgage loans are placed on a non-accrual basis when delinquent 90 days or more as to interest or principal. Interest on delinquent FHA insured loans is accrued at the insured rate beginning on the sixty-first day of delinquency. Interest on delinquent VA guaranteed loans is accrued at the loan rate during the period of delinquency.

Gains and losses from sales of mortgage loans are recognized when the proceeds are received. Loan origination fees, net of certain direct costs, are deferred and recognized as income when the related mortgage loans are sold. Discounts from the origination of mortgage loans held for sale are deferred and recognized as adjustments to gains or losses on sales.

Capitalized mortgage servicing includes certain costs incurred in the origination and acquisition of mortgage servicing rights which are deferred and amortized over the expected life of the loan. The total cost of acquiring mortgage loans, either through origination activities or purchase transactions, is allocated between the mortgage servicing rights and the loans based on their relative fair values. The fair values of mortgage servicing rights are estimated by calculating the present value of the expected future net cash flows associated with such rights, incorporating assumptions that market participants would use in their estimates of future servicing income and expense. A current market rate is used to discount estimated future cash flows. Impairment of capitalized mortgage servicing rights is measured on a disaggregated basis by stratifying the mortgage servicing rights based on one or more predominant risk characteristics of the underlying loans. Impairment is recognized through a valuation allowance for each individual stratum. The valuation allowance for Source One's principal recourse portfolio includes a reserve for estimated losses on the corresponding loans.

Pool loan purchases, which are carried at cost, represent FHA insured, VA guaranteed and conventional loans which were either delinquent or in the process of foreclosure at the time they were purchased from GNMA, FNMA or FHLMC mortgage-backed security pools which Source One services. Interest is accrued on these purchased loans at a rate based on expected recoveries.

Mortgage claims receivable represent claims filed primarily with FHA and VA. These receivables are carried at cost less an estimated allowance for amounts that are not fully recoverable from the claims filed with the underlying mortgage insuring agencies.

Real estate acquired is stated at the lower of fair value less estimated selling costs or the recorded balance satisfied at the date of acquisition, as determined on an individual property basis. Costs related to maintaining the

properties are charged to expense as incurred.

Mortgage servicing revenue represents fees earned for servicing real estate mortgage loans owned by investors and late charge income. The servicing fees are calculated based on the outstanding principal balances of the loans serviced and are recognized together with late charge income when received.

Earnings per share

The Company adopted the provisions of SFAS No. 128, "Earnings Per Share" in December 1997. SFAS No. 128 simplified the computation of earnings per share and is intended to make

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the U.S. standard more compatible with existing international standards. The adoption of SFAS No. 128 did not materially change the method by which the Company computes its earnings per share but replaces the Company's historic presentation of "primary earnings per share" and "fully diluted earnings per share" with a presentation of "basic earnings per share" and "diluted earnings per share".

Basic earnings per share amounts are based on the weighted average number of Shares outstanding. In the basic earnings per share calculation, net income is reduced by preferred stock dividends to arrive at earnings applicable to common stock.

Diluted earnings per share amounts are based on the weighted average number of Shares and potential dilutive Shares outstanding. Potential dilutive Shares include stock options, warrants and preferred stock redeemable for Shares. In the diluted earnings per share calculation, net income is reduced by preferred stock dividends when the assumed redemption of preferred stock is anti-dilutive.

The following table outlines the Company's computation of earnings per share for the years ended December 31, 1997, 1996 and 1995:

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	Year Ended December 31,		
	1997	1996	1995

Basic earnings per share numerators (in millions):			
After tax earnings	\$45.3	\$ 4.9	\$18.5
Dividends on preferred stock	--	--	(3.8)
After tax earnings applicable to common stock	45.3	4.9	14.7
Tax benefit from sale of discontinued operations	--	--	66.0
Loss on early extinguishment of debt, after tax	(6.0)	--	(.4)
Net income available applicable to common stock	\$39.3	\$ 4.9	\$80.3
Comprehensive net income applicable to common stock	\$95.6	\$59.5	\$98.5

Diluted earnings per share numerators (in million):			
After tax earnings applicable to common stock	\$45.3	\$ 4.9	\$14.7
After tax dilution to earnings from unconsolidated insurance affiliates	(.2)	--	--
Diluted after tax earnings available applicable to common stock	45.1	4.9	14.7
Tax benefit from sale of discontinued operations	--	--	66.0
Loss on early extinguishment of debt, after tax	(6.0)	--	(.4)
Diluted net income available applicable to common stock	\$39.1	\$ 4.9	\$80.3
Diluted comprehensive net income applicable to common stock	\$95.4	\$59.5	\$98.5

Earnings per share denominators (in thousands):			
Basic earnings per share numerator (average common shares outstanding)	6,570	7,429	7,794
Dilutive stock options and warrants to acquire common stock (a)	674	681	788
Diluted earnings per share denominator	7,244	8,110	8,582

Basic earnings per share (in dollars):			
After tax earnings	\$6.89	\$.66	\$1.88

Tax benefit from sale of discontinued operations	--	--	8.47
Loss on early extinguishment of debt, after tax	(.91)	--	(.05)
Net income applicable to common stock	\$5.98	\$.66	\$10.30
Comprehensive net income	\$14.55	\$8.01	\$12.64

Diluted earnings per share (in dollars):			
After tax earnings	\$6.22	\$.60	\$1.71
Tax benefit from sale of discontinued operations	--	--	7.70
Loss on early extinguishment of debt, after tax	(.82)	--	(.05)
Net income applicable to common stock and assumed conversions	\$5.40	\$.60	\$9.36
Comprehensive net income	\$13.17	\$7.33	\$11.48
=====			

(a) See Note 11 for detailed information concerning the Company's outstanding dilutive stock options and warrants to acquire common stock.

Future application of accounting standards

In December 1996 the Financial Accounting Standards Board (the "FASB") issued SFAS No. 127, "Deferral of the Effective Date of Certain Provisions of SFAS No. 125" which has further deferred the adoption of certain other provisions of SFAS No. 125 to periods beginning

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after December 31, 1997. Fund American does not expect that the adoption of SFAS No. 127 will have a material effect on its financial position or results of operations.

In December 1997 the American Institute of Certified Public Accountants (the "AICPA") issued Statement of Position ("SOP") 97-3 "Accounting by Insurance and Other Enterprises for Insurance-Related Assessments", which provides guidance for determining when an insurance or other enterprise should recognize a liability for guaranty-fund and other insurance related assessments and guidance for measuring the liability. The statement becomes effective in 1999 and allows for early application. Fund American does not expect the adoption of this statement to have a material effect on its financial position or results of operation.

In March 1998 the AICPA issued SOP 98-1 "Accounting for Internal Use Software", which provides guidance for determining when internal use software costs (whether acquired or internally developed) are expensed as incurred or capitalized. The statement becomes effective in 1999 and allows for early application. Fund American does not expect the adoption of this statement to have a material effect on its financial position or results of operation.

NOTE 2. Insurance Operations

Consolidated insurance operations recently acquired and formed

On December 1, 1995, White Mountains acquired Valley and Charter for \$41.7 million in cash less \$3.0 million of purchase price adjustments. The purchase price for Valley and Charter was paid with proceeds from sales of short-term investments. Valley's wholly-owned subsidiary, VIC, is a Northwest-based property and casualty company which writes personal and commercial lines through independent agents. In 1997 and 1996, VIC had \$77.7 million and \$75.1 million of net written premiums, respectively, primarily in Oregon, Washington and California. Charter wrote \$62.9 million and \$69.9 million of non-standard automobile insurance premiums in Texas during 1997 and 1996, respectively. The purchase price paid for Valley and Charter was \$.9 million less than the aggregate book value and estimated fair value of the net assets of the companies on the date of acquisition. The resulting negative goodwill is being amortized to income on a straight-line basis over five years.

WMIC is currently licensed to write insurance in Maine, New Hampshire, Vermont, Massachusetts and New York and is expected to expand its operations to other states as additional regulatory approvals are obtained. WMIC had gross written premiums during 1997 and 1996 of \$5.2 million and \$2.4 million (\$4.7 million and \$2.0 million of net written premiums), respectively. At December 31, 1997, WMIC had \$31.4 million of total admitted assets and \$29.1 million of policyholders' surplus. WMIC is a wholly-owned subsidiary of VIC.

On January 19, 1996, VIC purchased Valley National for \$13.2 million, net of cash balances acquired. Valley National is licensed to write property and casualty insurance in 48 states. Assets acquired pursuant to the Valley National acquisition included an investment portfolio, consisting principally of fixed maturity investments, totalling \$6.7 million. Valley National wrote its first policies in December 1996 and had \$2.7 million in gross written premiums (\$.3 million of net written premiums) during 1997. Valley National is expected to further expand its operations to certain other states in which it is currently

licensed. The purchase price paid for Valley National exceeded the fair value of the tangible assets received. The excess purchase price of \$6.4 million is being amortized over a five year period. Valley National is a wholly-owned subsidiary of VIC.

On December 5, 1996, Valley's parent company formed Valley P&C to specifically write property and casualty insurance within Oregon. Valley P&C wrote its first policies in February

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1997 and had \$5.2 million in net written premiums during 1997. At December 31, 1997, Valley P&C had \$7.7 million of total admitted assets and \$3.7 million of policyholders' surplus.

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Loss and loss adjustment expense reserve activity

The following table summarizes Valley, Charter and WMIC's loss and loss adjustment expense reserve activity for the years ended December 31, 1997 and 1996:

Millions	Year Ended December 31,		
	1997	1996	1995
Beginning balance	\$ 65.4	\$ 44.1	\$ --
Reserves acquired through the purchase of Valley and Charter	--	--	39.9
Losses and loss adjustment expenses incurred relating to:			
Current year losses	99.6	82.4	5.2
Prior year losses	(2.5)	3.5	3.0
Loss and loss adjustment expenses paid relating to:			
Current year losses	(58.7)	(47.8)	(4.0)
Prior year losses	(30.0)	(18.5)	--
Changes in reinsurance and other	(1.9)	1.7	--
Ending balance	\$ 71.9	\$ 65.4	\$ 44.1

Additional insurance operations information

Total policyholders' surplus of Valley, Charter and WMIC, as reported to various regulatory authorities, as of December 31, 1997 and 1996, was \$93.8 million and \$81.4 million, respectively. Statutory net income for the year ended December 31, 1997 for Valley, Charter and WMIC totalled \$11.0 million. For the year ended December 31, 1996 and the one-month period ended December 31, 1995, Valley, Charter and WMIC had a statutory net loss of \$6.4 million and \$2.3 million, respectively. The principal differences between Valley, Charter and WMIC's statutory amounts and the amounts reported in accordance with GAAP are not material and include deferred taxes, surplus debentures and deferred acquisition costs. Valley, Charter and WMIC's statutory policyholders' surplus at December 31, 1997 and 1996, was in excess of the minimum requirements of relevant state insurance regulations.

Under the insurance laws of the various states under which Valley, Charter and WMIC are incorporated or licensed to write business, an insurer is restricted with respect to the amount of dividends it may pay without prior approval by state regulatory authorities. Accordingly, there is no assurance that dividends may be paid by Valley, Charter and WMIC in the future. At December 31, 1997 and 1996, \$87.9 million and \$75.6 million, respectively, of Valley, Charter and WMIC's statutory surplus was unavailable for the payment of dividends to its shareholders without prior approval of regulatory authorities.

NOTE 3. Tax Benefit From Sale of Subsidiary

On January 2, 1991, the Company sold Fireman's Fund to Allianz of America, Inc. The \$1.3 billion gain from the sale as reported in 1991 included a \$75.0 million tax benefit related to the Company's estimated tax loss from the sale. Since 1991 the Company has carried an estimated reserve related to tax matters affecting the amount of the deductible tax loss from the sale and other tax matters.

The conclusion in 1995 of IRS audits of Fund American's Federal income tax returns for all years through December 31, 1985, resolved certain of the tax matters affecting the amount of

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the Company's deductible tax loss from the sale of Fireman's Fund and the Company, therefore, re-estimated its tax reserve. As a result of the reserve re-estimation, the Company included in its 1995 income statement an additional \$66.0 million income tax benefit from the sale.

The amount of tax benefit from the sale of Fireman's Fund ultimately realized by the Company may be significantly more or less than the Company's current estimate due to possible changes in or new interpretations of tax rules, possible amendments to Fund American's 1991 or prior years' Federal income tax returns, the results of further IRS audits and other matters affecting the amount of the deductible tax loss from the sale.

NOTE 4. Investment Securities

Fund American's net investment income is comprised primarily of interest income earned on mortgage loans originated by Source One (gross of related interest expense on short-term borrowings used to finance such loans), interest income associated with the fixed maturity investments of its consolidated insurance operations, dividend income from its equity investments and interest income from short-term investments. Net investment income consisted of the following:

Millions	Year Ended December 31,		
	1997	1996	1995
Investment income:			
Mortgage loans held for sale	\$43.1	\$39.3	\$35.9
Fixed maturity investments	11.3	10.4	9.0
Common equity securities	7.3	4.3	2.5
Short-term investments	3.9	6.6	6.6
Other	--	(2.3)	1.7
Total investment income	65.6	58.3	55.7
Less investment expenses and other charges	(.5)	(1.0)	(.3)
Net investment income, before tax	\$65.1	\$57.3	\$55.4

Total net investment gains, before tax, associated with Fund American's investment portfolio consisted of the following:

Millions	Year Ended December 31,		
	1997	1996	1995
Gross realized investment gains	\$ 98.6	\$ 43.3	\$46.3
Gross realized investment losses	(1.9)	(4.8)	(7.5)
Net realized investment gains	96.7	38.5	38.8
Net unrealized investment (losses) gains (a)	(10.1)	68.0	20.0
Total net investment gains, before tax	\$ 86.6	\$106.5	\$58.8

(a) Excludes net unrealized investment gains and losses recorded from Fund American's investments in unconsolidated insurance affiliates.

The components of Fund American's ending net unrealized investment gains and losses on its investment portfolio and its investments in unconsolidated insurance affiliates were as follows:

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Millions	December 31,	
	1997	1996
Investment securities:		
Gross unrealized investment gains	\$112.1	\$121.0
Gross unrealized investment losses	(2.0)	(.8)
Net unrealized gains from investment securities	110.1	120.2
Net unrealized gains from investments in unconsolidated insurance affiliates	118.8	22.1
Total net unrealized investment gains, before tax	\$228.9	\$142.3

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The cost or amortized cost, gross unrealized investment gains and losses, and carrying values of Fund American's fixed maturity investments as of December

31, 1997 and 1996, were as follows:

Millions	December 31, 1997			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
U S WEST, Inc. redeemable preferred stock	\$ 49.4	\$ --	\$ --	\$ 49.4
Municipal obligations	33.3	.6	--	33.9
Debt securities issued by industrial corporations	32.4	1.0	(.7)	32.7
U. S. Government and agency obligations	32.3	.9	--	33.2
GNMA Mortgage-backed securities	15.4	1.0	--	16.4
Aggregate of holdings less than \$10 million	2.6	.1	--	2.7
Total fixed maturity investments	\$165.4	\$3.6	\$ (.7)	\$168.3

Millions	December 31, 1996			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
U. S. Government and agency obligations	\$ 63.6	\$.8	\$ (.1)	\$ 64.3
U S WEST, Inc. redeemable preferred stock	49.1	--	--	49.1
Debt securities issued by industrial corporations	31.3	.3	(.1)	31.5
GNMA Mortgage-backed securities	9.1	--	--	9.1
Aggregate of holdings less than \$10 million	1.4	--	--	1.4
Total fixed maturity investments	\$154.5	\$1.1	\$ (.2)	\$155.4

The cost or amortized cost and carrying value of Fund American's fixed maturity investments at December 31, 1997 and 1996, are presented below by contractual maturity. Actual maturities could differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

Millions	December 31,			
	1997		1996	
	Cost or amortized cost	Carrying value	Cost or amortized cost	Carrying value
Due in one year or less	\$ --	\$ --	\$ 7.1	\$ 7.1
Due after one year through five years	6.8	7.0	6.6	6.6
Due after five years through ten years	93.1	93.7	98.2	98.5
Due after ten years	50.1	51.2	33.5	34.1
GNMA Mortgage-backed securities	15.4	16.4	9.1	9.1
Total	\$165.4	\$168.3	\$154.5	\$155.4

Sales of investments, excluding short-term investments, totalled \$300.4 million, \$363.3 million and \$270.4 million for the years ended December 31, 1997, 1996 and 1995, respectively. Non-cash exchanges of investment securities totalling \$2.3 million and \$90.4 million during 1996

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and 1995, respectively, are not reflected in the Consolidated Statements of Cash Flows. There were no non-cash exchanges of investment securities during 1997.

Fund American adopted the provisions of SFAS No. 130 during 1997 and now reports the change in net unrealized investment gains, after tax, on its income statement to arrive at comprehensive net income. All prior period income statements have been restated to reflect application of this statement. The components of the change in net unrealized investment gains, after tax, are as follows:

Millions	Year Ended December 31,		
	1997	1996	1995
Net realized investment gains	\$ 96.7	\$38.5	\$38.8
Income tax expense applicable to net realized investment gains	(33.8)	(13.5)	(13.6)
Net realized investment gains, after tax	62.9	25.0	25.2
Net unrealized investment gains arising during the year, after tax (a)	119.2	79.6	43.4
Net unrealized gains reclassified to realized gains for investments sold	(62.9)	(25.0)	(25.2)
Change in net unrealized investment gains, after tax	\$ 56.3	\$54.6	\$18.2

(a) Net of income tax expense of \$64.2 million, \$42.9 million and \$23.4 million for the years ended December 31, 1997, 1996 and 1995, respectively.

NOTE 5. Capitalized Mortgage Servicing

Source One estimates the fair values of its mortgage servicing rights by calculating the present value of the expected future net cash flows associated with such rights. In making those estimates, Source One incorporates assumptions that market participants would use in their estimates of future servicing income and expense.

To measure impairment of capitalized mortgage servicing rights, Source One stratifies its owned mortgage loan servicing portfolio based on the portfolio's predominant risk characteristics which have been determined to be prepayment, default and operational risks. Accordingly, Source One has stratified its owned mortgage loan servicing portfolio by interest rate, loan type (investor), original term to maturity and principal recourse. In estimating the fair value of its owned mortgage loan servicing portfolio, Source One uses market consensus prepayment rates and discounts future net cash flows using representative market interest rates which were 10.5% for conventional loans, 12.0% for insured loans, and for 1997 and 1996, 21.0% for recourse loans. The fair value of each stratum is computed and compared to its recorded book value to determine if an impairment valuation allowance, or recovery of a previously established valuation allowance, is required. In 1996, as a result of the contracted sale of \$17.0 billion of nonrecourse mortgage servicing rights, Source One valued the portfolio to be sold as one stratum using the contract price.

After the 1997 servicing sale, Source One's recourse portfolio became a more significant component of its total remaining owned servicing portfolio. Included in Source One's calculation for measuring impairment of its capitalized servicing asset is an \$8.2 million and \$7.3 million pretax reserve for estimated recourse losses on the corresponding loans in determining the fair value of its principal recourse portfolio as of December 31, 1997 and 1996, respectively.

The discount rate and prepayment assumptions are significant factors used in estimating the fair value of Source One's mortgage servicing rights. Accordingly, the value of mortgage servicing rights can be significantly impacted by changes in interest rates.

Source One adopted certain provisions of SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" in the 1997 first quarter. SFAS

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No. 125 served to eliminate the distinction between "normal" servicing rights and excess servicing receivables. Source One estimated the fair value of its portfolio during 1997 in accordance with SFAS No. 125 which did not materially effect Source One's 1997 results.

Prior to the adoption of SFAS No. 125, Source One estimated the fair value of its capitalized excess servicing asset by discounting the anticipated future cash flows over the estimated life of the related loans. Source One uses "interest only strip" interest rates to determine the appropriate discount rates and prepayment speed assumption rates that are based on interest rates, loan types (investor) and original term to maturity. The discount rate used to capitalize excess servicing for the year ended December 31, 1996, ranged from 12.0% to 12.6% and was 12.0% for the year ended December 31, 1995. For the years ended December 31, 1996 and 1995, the weighted average discount rates inherent in the carrying amount of the capitalized excess servicing asset were 10.4% and 10.0%, respectively.

The following table summarizes the fair value of mortgage servicing rights and certain characteristics of Source One's servicing portfolio related to such mortgage servicing rights by loan type as of December 31, 1997:

	Fair value of mortgage servicing rights (millions)	Principal balance serviced (a) (millions)	Weighted average interest rate	Weighted average maturity (months)	Weighted average service fee
Loan Type:					
Insured	\$ 102.2	\$ 5,314	8.85%	291	.46%
Conventional	44.9	2,515	8.13	273	.39
Recourse	28.7	2,413	8.60	205	.49
Adjustable	12.4	418	7.09	326	.53
Total servicing portfolio	\$188.2	\$10,660	8.56%	269	.46%

(a) Excludes \$773 million of principal balance of mortgage servicing rights not capitalized prior to the adoption of an accounting standard implemented by Source One as of January 1, 1995.

The following table summarizes changes in Source One's capitalized servicing asset:

Millions	Mortgage servicing	Valuation allowance	Subservicing	Deferred gain on sale of servicing	Total capitalized servicing
Balances at January 1, 1995	\$ 547.7	\$ --	\$ --	\$ (17.2)	\$ 530.5
Additions	102.8	--	--	--	102.8
Scheduled amortization	(52.8)	--	--	--	(52.8)
Impairment/unscheduled amortization	(.5)	(28.0)	--	--	(28.5)
Amortization of deferred gain	--	--	--	4.2	4.2
Sales	(159.1)	--	--	--	(159.1)
Balances at December 31, 1995	438.1	(28.0)	--	(13.0)	397.1
Additions	125.5	--	--	--	125.5

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Scheduled amortization	(69.9)	--	--	--	(69.9)
Impairment/unscheduled amortization	(1.1)	(.9)	--	--	(2.0)
Amortization of deferred gain	--	--	--	6.1	6.1
Sales	(45.9)	--	--	--	(45.9)
Balances at December 31, 1996	446.7	(28.9)	--	(6.9)	410.9
Additions	90.4	(1.2)	--	--	89.2
Scheduled amortization	(37.5)	--	(8.9)	--	(46.4)
Impairment/unscheduled amortization	--	(17.3)	(.5)	--	(17.8)
Amortization of deferred gain	--	--	--	6.9	6.9
Sales	(273.7)	2.3	9.6	--	(261.8)
Balances at December 31, 1997	\$ 225.9	\$ (45.1)	\$.2	\$ --	\$ 181.0

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During 1997 Source One sold the rights to service \$17.0 billion of nonrecourse mortgage loans for adjusted proceeds of \$266.9 million, resulting in a pretax loss of \$4.3 million. As part of the servicing sale, Source One retained the right to subservice these loans until 1998. Source One recorded an additional pretax loss of \$3.7 million during 1997 in connection with the extension of its subservicing responsibilities for these loans for one additional year at less favorable terms than the original agreement provided. The subservicing asset associated with Source One's subservicing responsibilities is being amortized on a straight-line basis over the subservicing period and is tested for impairment. During 1996 Source One sold the rights to service \$3.3 billion of mortgage loans for net proceeds of \$55.9 million, resulting in a pretax gain of \$10.1 million. During 1995 Source One sold the rights to service \$11.0 billion of mortgage loans for net proceeds of \$199.1 million, resulting in a pretax gain of \$40.0 million.

During 1994 Source One sold the rights to service \$3.9 billion of mortgage loans to a third party and retained the rights to subservice those loans pursuant to a subservicing agreement. In connection with the servicing sale, a pretax gain of \$19.9 million was deferred in 1994 and was to be recognized as income over the five-year life of the subservicing agreement. In 1996, the third party sold the rights to service approximately \$1.0 billion of these loans subserviced by Source One which resulted in Source One recognizing \$2.4 million

of the deferred gain on an accelerated basis. In 1997, the third party sold the remainder of the loans subserviced by Source One which resulted in Source One recognizing the remaining balance of the deferred gain during 1997.

NOTE 6. Mortgage Servicing

Source One services loans throughout the United States. Source One's portfolio of mortgage loans serviced (including loans subserviced, interim servicing contracts and portfolios under contract to acquire but excluding loans sold but not transferred) totalled \$26.5 billion and \$29.2 billion as of December 31, 1997 and 1996, respectively. The following table summarizes the mortgage loan servicing portfolio as of December 31, 1997:

Loan type	Principal balance serviced (millions)	Weighted average			
		Loan balance (thousands)	Interest rate	Net servicing fee rate	Remaining contractual life (months)
Residential					
Conventional	\$ 5,521	\$ 68	8.37%	.424%	240
FHA	3,916	57	8.80	.427	297
VA	2,124	62	8.42	.403	298
Commercial	66	889	7.45	.176	163
Owned servicing portfolio	\$11,627	\$ 63	8.52%	.420%	269
Subservicing portfolio	14,919				
Total mortgage servicing portfolio	\$26,546	\$ 61	8.45%	n/m	249

n/m - not meaningful

The servicing fee rates in the preceding table are shown after deducting applicable guarantee fees. Guarantee fees, when applicable, range from 6 basis points for governmental loans to approximately 30 basis points for certain conventional loans. Certain loans sold to private investors have no guarantee fees.

The following tables summarize Source One's owned mortgage loan servicing portfolio by interest rate range and by location of property:

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Interest rate range	December 31, 1997			December 31, 1996		
	Number of loans	Aggregate principal balance (millions)	Weighted average interest rate	Number of loans	Aggregate principal balance (millions)	Weighted average interest rate
5.99% and lower	843	\$ 66	5.41%	1,239	\$ 87	5.50%
6.00% - 6.49%	1,823	159	6.13	5,449	288	6.22
6.50% - 6.99%	4,166	319	6.66	15,369	1,111	6.68
7.00% - 7.49%	12,968	729	7.17	42,363	2,395	7.11
7.50% - 7.99%	29,240	2,455	7.63	58,622	4,104	7.60
8.00% - 8.49%	27,989	2,280	8.13	60,852	4,337	8.10
8.50% - 8.99%	32,178	1,867	8.59	77,061	4,047	8.58
9.00% - 9.49%	13,452	722	9.07	37,714	2,052	9.06
9.50% - 9.99%	29,142	1,420	9.55	69,548	3,618	9.57
10% and above	32,488	1,610	10.49	83,585	4,371	10.49
Total	184,289	\$11,627	8.52%	451,802	\$26,410	8.59%

State	December 31, 1997			December 31, 1996		
	Number of loans	Aggregate principal balance (millions)	Percentage of servicing portfolio	Number of loans	Aggregate principal balance (millions)	Percentage of servicing portfolio
California	20,459	\$ 1,889	16.3%	60,547	\$ 4,955	18.7%
New York	22,118	1,162	10.0	42,195	2,441	9.2
Texas	15,655	736	6.3	29,851	1,513	5.7
Washington	7,889	690	5.9	23,048	1,692	6.4
Florida	12,894	663	5.7	28,361	1,408	5.3
Michigan	10,773	520	4.5	25,553	1,019	3.9
New Jersey	7,088	503	4.3	13,689	895	3.4

Illinois	6,335	420	3.6	16,704	1,036	3.9
Maryland	5,020	362	3.1	8,966	534	2.0
Ohio	6,658	357	3.1	15,772	656	2.5
Other	69,400	4,325	37.2	187,116	10,261	39.0
Total	184,289	\$11,627	100.0%	451,802	\$26,410	100.0%

Escrow funds of approximately \$196.8 million, \$207.8 million and \$236.0 million as of December 31, 1997, 1996 and 1995, respectively, relating to mortgages serviced and subserviced, were held in non-interest bearing accounts at non-affiliated banks and are not included in the consolidated financial statements.

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NOTE 7. Mortgage Loans Held For Sale and Pool Loan Purchases

The following tables summarize Source One's mortgage loans held for sale and pool loan purchases:

Millions	December 31,	
	1997	1996
Adjustable rate mortgage loans, weighted average interest rates of 6.36% and 6.60%	\$ 51.6	\$ 35.1
Fixed rate 5 year through 25 year mortgage loans, weighted average interest rates of 7.68% and 7.73%	60.4	51.2
Fixed rate 30 year mortgage loans, weighted average interest rates of 7.76% and 8.19%	405.0	228.0
Total principal amount	517.0	314.3
Net premiums	2.3	.6
Total mortgage loans held for sale	\$519.3	\$314.9

Dollars in Millions	December 31,			
	Principal balance		Number of loans	
	1997	1996	1997	1996
Loan type: FHA	\$103.1	\$ 89.9	1,781	1,621
VA	43.3	35.3	669	592
Conventional	3.4	6.3	45	75
Total pool loan purchases	\$149.8	\$131.5	2,495	2,288

NOTE 8. Debt

Short-term debt

Short-term debt outstanding consisted of the following:

Millions	December 31,	
	1997	1996
Charter: Notes payable and lease obligations	\$ 2.0	\$ 1.7
Source One:		
Credit agreement borrowings	569.5	45.0
Commercial paper and short-term borrowings	--	362.2
Less net discounts	(.1)	(1.0)
Total Source One	569.4	406.2
Total short-term debt	\$ 571.4	\$ 407.9

The weighted average interest rates of short-term debt outstanding during the year ended December 31, 1997 and 1996 were as follows:

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	Year Ended December 31,	
	1997	1996
White Mountains: Credit facility	6.04%	--
Parent Company: Revolving credit facility	--	5.82%

Charter: Notes payable	6.50%	6.50%
Source One:		
Credit agreements borrowings	6.34%	6.19%
Commercial paper and short-term borrowings	5.81%	5.69%

In November 1995 Charter issued two notes totalling \$20.2 million. Certain of the notes were due in 1996 and other notes could be extended to be payable in three equal installments in 1997, 1998 and 1999. During 1996 Charter elected to extend the maturity of \$3.2 million of notes payable. The notes are collateralized by certain assets of Charter.

In July 1997 Source One amended and restated its secured revolving credit agreement to reflect a reduction in its borrowing requirements resulting from the 1997 servicing sale. The provisions of the amended agreement decreased Source One's revolving credit facility from \$750.0 million to \$600.0 million and reduced Source One's borrowing costs by lowering the facility fee. At December 31, 1997, Source One was in compliance with all covenants under the facility. As of December 31, 1997, Source One had \$559.0 million of borrowing outstanding under this facility. As of December 31, 1996, Source One had no outstanding borrowings under the previous facility.

In May 1997 Source One entered into a new unsecured revolving credit agreement under which it can borrow up to \$15.0 million through June 1, 1998. As of December 31, 1997, there was \$10.5 million outstanding under the revolving credit agreement. As of December 31, 1996, Source One had no outstanding borrowings under a previous facility which allowed for borrowings of up to \$10.0 million.

In August 1995 Source One entered into a \$60.0 million unsecured revolving credit facility which expired in July 1997. As of December 31, 1996 there was \$45.0 million outstanding under this arrangement.

Source One has a \$650.0 million domestic commercial paper program. In November 1997 Source One's commercial paper rating was downgraded by Moody's to "Not Prime" and by Standard & Poor's to "A-3". As a result of the 1997 ratings downgrades, Source One has not issued fresh commercial paper and has supplanted its commercial paper borrowings with its \$600.0 million credit agreement facility. As of December 31, 1996, there was \$347.2 million of commercial paper outstanding. The weighted average number of days to maturity of commercial paper outstanding at December 31, 1996 was 23 days.

In 1997 Source One amended a short-term borrowing agreement which it had entered into in 1996. The amended agreement increased Source One's facility from \$25.0 million to \$50.0 million. As a result of the 1997 ratings downgrade, Source One is not able to borrow under this agreement. As of December 31, 1996, there was \$15.0 million outstanding under the original agreement.

In 1986 Source One issued \$125.0 million of 8.25% debentures due November 1, 1996. During 1996 Source One repurchased and retired the remaining \$74.6 in principal amount outstanding of these debentures.

In 1989 Source One issued \$40.0 million of medium-term notes due in 1996 and having a total weighted average interest rate of 9.65%. During 1996 Source One repurchased and retired the remaining \$29.7 million in principal amount outstanding of these notes.

Source One must comply with certain financial covenants provided in its secured and unsecured revolving credit facilities, including restrictions relating to tangible net worth and leverage. In addition, the secured facility contains certain covenants which limit Source One's

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ability to pay dividends or make distributions of its capital in excess of preferred stock dividends and subordinated debt interest requirements each year. Source One is currently in compliance with all such covenants.

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In November 1996 the Company entered into a \$35.0 million revolving credit agreement with a syndicate of banks which served to replace an expiring arrangement in the amount of \$75.0 million. Under the agreement, through November 25, 1998, the Company and certain of its subsidiaries may borrow up to \$35.0 million at short-term market interest rates. The credit agreement contains certain customary covenants including a minimum tangible net worth requirement, a minimum financial asset coverage requirement and a maximum leverage ratio requirement. At December 31, 1997 and 1996, the Company was in compliance with all covenants under the facility and had no borrowings outstanding under the agreement.

Long-term debt

Long-term debt outstanding consisted of the following:

Millions	December 31,	
	1997	1996
Parent Company:		
Medium-term notes	\$116.3	\$116.2
Less net discounts	(.7)	(.8)
Total Parent Company	115.6	115.4
Source One:		
Medium-term notes, 8.875% due in 2001	18.7	138.4
Debentures, 9.0% due in 2012	100.0	100.0
Subordinate debentures, 9.375% due in 2025	56.0	56.0
Less net discounts	(2.1)	(2.8)
Total Source One	172.6	291.6
Valley: Medium-term notes	15.0	15.0
Charter: Notes payable in 1998 and 1999	1.1	2.2
Total long-term debt	\$304.3	\$424.2

In 1993 the Company issued \$150.0 million in principal amount of medium-term notes for net cash proceeds of \$148.0 million after related costs. During 1995 and 1994 the Company repurchased \$8.8 million and \$24.9 million, respectively, in principal amount of the notes due in February 2003. At December 31, 1997, the \$116.3 million of remaining outstanding notes had an average maturity of 5.4 years and a yield to maturity of 7.82%.

In 1991 Source One issued \$160.0 million of 8.875% medium-term notes due in 2001 of which \$138.4 million remained outstanding at December 31, 1996. During 1997 Source One repurchased and retired in principal amount \$119.7 million of these notes which resulted in a \$6.0 million after tax extraordinary loss on early extinguishment of debt.

In 1992 Source One issued \$100.0 million of 9% debentures due in 2012 pursuant to a \$250.0 million shelf registration statement. The debentures may not be redeemed by Source One prior to maturity. The proceeds from issuance were used for general corporate purposes.

In December 1995, Source One exchanged and retired 2,239,061 shares of Source One Preferred Stock for \$56.0 million in principal amount of 9.375% subordinated debentures. The subordinated debentures are due in 2025. The subordinated debentures are redeemable at the option of Source One, in whole or part, at any time on or after May 1, 1999. The non-cash portion of the exchange of subordinated debentures for Source One Preferred Stock is not reflected in the Consolidated Statements of Cash Flows.

In 1989 Source One issued \$40.0 million of medium-term notes due in 1996 and having a total weighted average interest rate of 9.65%. During 1996 Source One repurchased and retired the remaining \$29.7 million in principal amount outstanding of these notes.

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Source One is currently considering further steps to restructure its debt including the issuance of approximately \$50.0 million of additional medium-term notes pursuant to an existing shelf registration and entering into interest rate swaps which would enable Source One to achieve a floating rate of interest on certain of its fixed interest obligations.

In connection with Source One's February 28, 1997 sale of approximately \$17.0 billion of mortgage servicing rights to a third party, the Company has made certain collection, payment and performance guarantees to the buyer for a period of no more than ten years. The aggregate amount of the Company's guaranty is initially limited to \$20.0 million and is expected to amortize down to \$15.0 million.

Total interest paid by Fund American for both short-term and long-term debt was \$51.9 million, \$51.5 million and \$47.9 million in 1997, 1996 and 1995, respectively.

Fund American's long-term debt maturities, including current portion of long-term debt, for 1998, 1999, 2000, 2001, 2002 and beyond are \$1.1 million, \$1.1 million, \$4.0 million, \$18.7 million, \$15.0 million and \$268.3 million, respectively.

NOTE 9. Income Taxes

The Company and its qualifying subsidiaries file a consolidated Federal income tax return. The Federal income tax provision is computed on the consolidated taxable income of the Company and those subsidiaries.

The total income tax provision (benefit) consisted of the following:

Millions	Year Ended December 31,		
	1997	1996	1995
Tax on pretax earnings:			
Federal	\$ 26.7	\$ 18.1	\$ 16.6
State and local	2.7	.8	.1
Income tax provision on pretax earnings	29.4	18.9	16.7
Tax benefit from sale of discontinued operations	--	--	(66.0)
Tax benefit from loss on early extinguishment of debt	3.2	--	(.2)
Total income tax provision (benefit)	\$ 32.6	\$ 18.9	\$ (49.5)
Net income tax payments	\$ 24.9	\$ 7.0	\$ 2.6
Tax provision recorded directly to shareholders' equity related to:			
Exercises of employee stock options and warrants	\$ --	\$ --	\$.2
Changes in net unrealized investment gains and losses	\$ 30.3	\$ 29.4	\$ 9.8

The components of the income tax provision (benefit) on pretax earnings follow:

Millions	Year Ended December 31,		
	1997	1996	1995
Current provision	\$ 33.5	\$ 22.5	\$ 26.4
Deferred benefit	(4.1)	(3.6)	(9.7)
Total income tax provision on pretax earnings	\$ 29.4	\$ 18.9	\$ 16.7

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Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax return purposes. Significant components of Fund American's net deferred Federal income tax asset and liability follow:

Millions	December 31,	
	1997	1996
Deferred tax assets related to:		
Employee compensation and benefit accruals	\$ 39.1	\$ 32.8
Capitalized mortgage servicing	26.2	18.4
Unearned insurance premiums	5.3	4.9
Allowance for mortgage loan losses	4.8	4.8
Discounting of loss reserves	2.9	2.7
Other items	10.1	10.1
Total deferred tax assets	88.4	73.7
Deferred tax liabilities related to:		
Net unrealized investment gains	79.3	49.0
Earnings from insurance affiliates	11.8	6.7
Purchase accounting adjustments	5.5	6.2
Deferred acquisition costs	5.0	4.6
Unrealized gains on financial instruments	4.6	.9
Other items	9.7	7.6
Total deferred tax liabilities	115.9	75.0
Net deferred Federal income tax liability	\$ (27.5)	\$ (1.3)

A reconciliation of taxes calculated using the 35% Federal statutory rate to the income tax provision on pretax earnings follows:

Millions	Year Ended December 31,		
	1997	1996	1995

Tax provision at Federal statutory rate	\$ 26.1	\$ 8.3	\$ 12.3
Differences in taxes resulting from:			
Dividends received deduction	(3.1)	(2.3)	(1.9)
Nonconventional fuel source tax credits	(2.4)	--	--
Tax reserve adjustments	5.1	4.2	2.3
State income taxes	1.8	.5	--
Minority interest dividends	1.3	1.3	2.7
Write-off of goodwill and other intangible assets	--	8.1	--

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Other, net	.6	(1.2)	1.3

Total income tax provision on pretax earnings	\$ 29.4	\$ 18.9	\$ 16.7
	=====		

The Company believes that it is more likely than not that results of future operations will generate sufficient taxable income to realize the deferred tax asset balances carried as of December 31, 1997 and 1996.

NOTE 10. Retirement and Post-Retirement Plans

In 1993 the Company and certain of its subsidiaries established an unfunded, nonqualified defined contribution plans for a select group of management employees for the purpose of providing retirement and postretirement benefits (the "Deferred Benefit Plans"). The amount of annual contributions to the Deferred Benefit Plans are determined using actuarial assumptions; however, participants in the Deferred Benefit Plans may choose between various investment options for their plan balances. At December 31, 1997 and 1996, Fund American's liability to participants pursuant to the Deferred Benefit Plans was \$3.9 million and \$2.9 million, respectively.

In 1993 the Company and certain of its subsidiaries also established an unfunded, nonqualified plans for a select group of management employees for the purpose of deferring current compensation for retirement savings (the "Deferred Compensation Plans"). Pursuant to the Deferred Compensation Plans, participants may voluntarily defer all or a portion of qualifying remuneration payable by Fund American. Participants in the Deferred Compensation Plans may choose between various investment options for their plan balances. At December 31, 1997 and 1996, Fund American's liability to participants pursuant to the Deferred Compensation Plans was \$37.6 million and \$21.8 million, respectively.

Through December 1, 1995, substantially all the employees of Valley and Charter were covered under a defined benefit pension plan sponsored by the former parent of Valley and Charter. Coverage for employees under that plan was terminated as of December 31, 1995. Valley established a new defined contribution plan for the benefit of substantially all Valley and Charter employees as of January 1, 1996. The new plan provides Valley and Charter employees with full credit for prior service. The pension cost and funding status of the new plan are not material to Fund American's financial statements.

Source One established a defined benefit pension plan as of July 1, 1986, for the benefit of its employees. Benefits under the Source One plan are based on years of service and each employee's highest average eligible compensation over five consecutive years in his or her last ten years of employment. Funding of retirement costs complies with the minimum funding requirements specified by the Employee Retirement Income Security Act. Cash contributions made by Source One to the plan for the years ended December 31, 1997, 1996 and 1995, totalled \$.6 million, \$1.3 million and \$1.7 million, respectively.

Source One also has a supplemental pension plan which is a nonqualified, unfunded benefit plan designed to provide supplementary retirement benefits for employees whose pensionable compensation exceeds statutory limits.

Total accrued postretirement benefit costs included in accounts payable and other liabilities for Source One employees was \$3.7 million and \$3.5 million at December 31, 1997 and 1996, respectively.

NOTE 11. Employee Stock Plans

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At the Company's 1995 Annual Meeting shareholders approved certain amendments to the Fund American Long-Term Incentive Plan (the "Incentive Plan"). The Incentive Plan provides for granting to executive officers and other key employees of the Company (and certain of its subsidiaries) various types of stock-based incentive awards including stock options and performance shares. At December 31, 1997, 377,000 Shares remained available for grants under the

Incentive Plan.

Performance shares are conditional grants of a specified maximum number of Shares or an equivalent amount of cash. The grants are generally payable, subject to the attainment of a specified return on equity at the end of three to five year periods or as otherwise determined by the Compensation Committee of the Board. The Compensation Committee consists solely of non-management directors.

Pursuant to the Incentive Plan 50,000, 73,000 and 56,429 performance shares were granted in 1997, 1996 and 1995, respectively, of which 400, 3,000 and 1,800 of the performance shares granted, respectively, remain unallocated to participants as of December 31, 1997 and are not deemed to be outstanding. During 1997, 1996 and 1995, 22,944, 0, and 0 performance shares were canceled, respectively, and 86,156, 10,650 and 0 performance shares were paid in cash, respectively. At December 31, 1997, 174,229 performance shares were outstanding. The financial goal for full payment of the performance shares is the achievement of a 13% to 15% annual return on equity as measured over the applicable performance periods.

Stock options are rights to purchase a specified number of Shares at or above the fair market value of Shares at the time an option is granted. Stock options generally vest over a four year period and expire no later than ten years after the date on which they are granted. As of December 31, 1997, 1996 and 1995 there were 2,000, 3,000 and 7,000 stock options outstanding, respectively, which had exercise prices ranging from \$24.82 to \$32.60 per Share. All Fund American stock options outstanding during the three year period ended December 31, 1997, were fully vested and exercisable. No new stock options have been issued to Fund American employees since 1991.

In 1985 the Company's Chairman purchased warrants (the "Warrants") from American Express Company ("American Express") entitling him to buy 1,700,000 Shares for \$25.75 per Share. Warrants to purchase 420,000 Shares, 130,000 Shares and 150,000 Shares were exercised by the Chairman during 1992, 1994 and 1995, respectively, leaving Warrants to purchase 1,000,000 Shares outstanding at December 31, 1995. Pursuant to a proposal approved by shareholders at the Company's 1995 Annual Meeting, the expiration date with respect to the Warrants was extended from January 2, 1996, to January 2, 2002. In accordance with APB No. 25, the extension of the Warrants resulted in a \$46.2 million pretax charge to compensation expense which was recorded in the second quarter of 1995. No Warrants were exercised by the Chairman during 1997 and 1996. Pursuant to certain anti-dilution adjustments related to the distribution of White River Shares to the Company's shareholders, the exercise price for the Warrants to purchase Fund American Shares was reduced to \$21.66 per Share.

All employees (other than employees of Source One and FAE) are eligible to participate in an employee savings plan qualified under Section 401(k) of the IRC (the "Valley 401(k) Plan"). Contributions to the Valley 401(k) Plan can be invested in various investment options including Shares. There is an employer match provision to the Valley 401(k) Plan which is equal to 50% of the first 6% of employee compensation contributed to the plan, subject to IRC limits. Employees of the Company and White Mountains became eligible to participate in the Valley 401(k) Plan beginning January 1, 1997. Fund American added Shares to the investment options offered under the Valley 401(k) Plan as of July 1, 1997. As of December 31, 1997 participants of the Valley 401(k) Plan owned a total of 1,825 Shares.

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Source One also has a qualified employee stock plan. Contributions to this plan are determined at the discretion of Source One's Board of Directors. In October 1996 Source One amended this plan to add an employee savings plan feature qualified under Section 401(k) of the IRC (the "Source One 401(k) Plan"). Contributions to the plan can be invested in various investments including Shares. In 1997, Source One added a matching contribution feature to the Source One 401(k) Plan which is equal to a certain percentage of employee contributions, up to a maximum of 5%, dependent upon Source One's return on equity. As of December 31, 1997 participants of the Source One 401(k) Plan owned a total of 44,502 Shares.

Source One has various long-term incentive plans which provide for the granting, to key senior management employees of Source One, stock-based and cash incentive awards. Awards made pursuant to the plans are payable upon the achievement of specified financial goals over multi-year periods.

SFAS No. 123, "Accounting for Stock Based Compensation," was issued in October 1995. That standard requires significantly more disclosure regarding all employee stock options and encourages companies to recognize compensation expense for stock-based awards based on the fair value of such awards on the date of grant. Alternatively, companies may continue following existing accounting standards provided that disclosures are made regarding the net income and earnings per share impact as if the value recognition and measurement criteria of SFAS No. 123 had been adopted. Fund American has not adopted the recognition and measurement criteria of SFAS No. 123 and alternatively has chosen to disclose the pro forma effects of SFAS No. 123 as it relates to outstanding Warrants and performance shares granted in 1997, 1996 and 1995, as follows:

Millions, except per share amounts	Year Ended December 31,		
	1997	1996	1995
Net income:			
As reported	\$ 39.3	\$ 4.9	\$ 84.1
Pro forma	39.4	-	108.6
Basic net income per share:			
As reported	\$ 5.98	\$.66	\$ 10.30
Pro forma	5.99	-	13.44
Diluted net income per share:			
As reported	\$ 5.40	\$.60	\$ 9.36
Pro forma	5.41	-	12.21

SFAS No. 123 provides for the expense of Warrants, stock options and performance shares over the life of the award. In determining the pro forma effects of SFAS No. 123, the Company recognizes the pro forma expense of the Warrants over time and assumes that the \$46.2 million pretax charge associated with the extension of the Warrants recognized in 1995 did not occur. The pro forma net income figures disclosed above may not be representative of the effects on reported net income to be reported in future years.

NOTE 12. Minority Interest - Preferred Stock of Subsidiary

In 1994 Source One issued 4,000,000 shares of 8.42% Source One Preferred Stock, having a liquidation preference of \$25.00 per share, for net cash proceeds of \$96.8 million. On December 8, 1995, Source One exchanged and retired 2,239,061 shares of Source One Preferred Stock for \$56.0 million in principal amount of subordinated debentures. The Source

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One Preferred Stock is not redeemable prior to May 1, 1999. In consolidation, dividends on the Source One Preferred Stock are included as a component of Fund American's interest expense.

NOTE 13. Shareholders' Equity

Series D preferred stock

On July 31, 1995, the Company redeemed all 20,833 remaining shares of the Series D Preferred Stock for \$75.0 million of cash, an amount equal to the stock's liquidation preference.

Common share repurchases

During 1997, 1996 and 1995 the Company repurchased 924,739 Shares, 779,077 Shares and 877,868 Shares, respectively, for \$103.7 million, \$66.3 million and \$65.4 million, respectively. All such Shares repurchased from 1995 to 1997 have been retired. At December 31, 1997, the Company had outstanding authorization to purchase an additional 193,417 Shares.

Loan for common stock issued

On December 30, 1992, pursuant to a request from the Board, the Company's Chairman agreed to an early exercise of stock options and Warrants to purchase 1,000,000 Shares. The Board's request reflected concerns regarding proposed tax legislation which could have limited or eliminated the Company's tax benefits from certain employee stock options and Warrants exercised in 1993 and thereafter. To encourage exercise of the stock options and Warrants, the Company provided a \$30.0 million 4% secured loan to the Chairman. The loan was fully repaid on its maturity date, October 23, 1995.

Common stock dividends

In the fourth quarter of 1995 the Board of Directors reinstated and paid a \$.20 regular quarterly dividend per Share. During 1996 and 1997 the Company declared and paid regular quarterly cash dividends of \$.20 per Share.

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NOTE 14. Industry Segments

Revenues, pretax earnings (loss) and ending identifiable assets for Fund American's industry segments are shown below:

Millions	Year Ended December 31,		
	1997	1996	1995

Revenues:			
Mortgage banking operations	\$ 118.2	\$ 184.9	\$ 178.6
Insurance operations	188.0	140.1	32.6
Other	8.0	7.5	11.1
Total	\$ 314.2	\$ 332.5	\$ 222.3
Pretax earnings (loss):			
Mortgage banking operations	\$ (26.6)	\$ (2.1)	\$ 35.3
Insurance operations	32.6	.2	18.9
Other	68.7	25.7	(19.0)
Total	\$ 74.7	\$ 23.8	\$ 35.2
Ending assets:			
Mortgage banking operations	\$1,084.9	\$1,131.1	\$1,138.5
Insurance operations	748.3	586.2	373.7
Other	199.7	263.3	359.7
Total	\$2,032.9	\$1,980.6	\$1,871.9

NOTE 15. Investments in Unconsolidated Affiliates

Investment in FSA

Fund American owned 3,460,200, 3,460,200 and 2,460,200 shares of FSA Common Stock at December 31, 1997, 1996 and 1995. This represented approximately 12.1%, 11.5% and 7.8%, respectively, of the total shares of FSA Common Stock outstanding at those times. Fund American had voting rights to an additional 3,893,940 shares of FSA Common Stock at December 31, 1997, 1996 and 1995, raising Fund American's voting control of FSA to approximately 24.0%, 23.0% and 19.0%, respectively. At December 31, 1997, 1996 and 1995, Fund American also owned FSA Options and Preferred Stock which, in total, give Fund American the right to acquire up to 4,560,607 additional shares of FSA Common Stock for aggregate consideration of \$125.7 million. As of December 31, 1997, 1996 and 1995, Fund American's economic interest in FSA was 26.2%, 25.1% and 21.0%, respectively.

Fund American's investment in FSA Common Stock is accounted for using the equity method. FSA Common Stock is publicly traded on the NYSE. The market value of the FSA Common Stock as of December 31, 1997 and 1996, as quoted on the NYSE, exceeded Fund American's carrying value of the FSA Common Stock on the equity method. Fund American's investments in FSA Options and Preferred Stock are accounted for under the provisions of SFAS No. 115 whereby the investments are reported at fair value as of the balance sheet date, with related unrealized investment gains and losses, after tax, reported as a net amount in a separate component of shareholders' equity and reported on the income statement as a component of comprehensive net income.

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The following table summarizes financial information for FSA:

Millions	1997	1996	1995
FSA balance sheet data:			
Total investments	\$1,431.6	\$1,154.4	\$1,110.7
Total assets	1,900.6	1,537.7	1,490.3
Deferred premium revenue	595.2	511.2	463.9
Loss and loss adjustment expense reserve	75.4	72.1	111.8
Preferred shareholder's equity	.7	.7	.7
Common shareholders' equity	881.7	800.6	777.2
FSA income statement data:			
Gross premiums written	\$ 236.4	\$ 177.0	\$ 110.7
Net premiums written	172.9	121.0	77.6
Net premiums earned	109.5	90.4	69.3
Net investment income	72.1	65.1	49.0
Net income	100.5	80.8	55.0
Amounts recorded by Fund American:			
Investment in FSA Common Stock	\$ 104.3	\$ 92.3	\$ 60.0
Investment in FSA Options and Preferred Stock	87.8	19.8	2.5
Total Investment in FSA	\$ 192.1	\$ 112.1	\$ 62.5
Equity in earnings from FSA Common Stock (a)	\$ 11.4	\$ 7.8	\$ 5.4
Equity in net unrealized investment gains (losses) from FSA's investment portfolio, before tax (b)	2.1	(1.0)	4.5
Unrealized investment gains on FSA Options and Preferred Stock, before tax (b)	68.0	17.3	.3

(a) Recorded net of related amortization of goodwill.

- (b) Recorded directly to shareholders' equity (after tax) with related changes in net unrealized investment gains and losses (after tax) reported on the income statement as a component of comprehensive net income.

At December 31, 1997 and 1996, Fund American's consolidated retained earnings included \$24.1 million and \$13.8 million, respectively, of undistributed earnings of FSA.

Investment in MSA

At December 31, 1997, 1996 and 1995, Fund American owned 90,606 shares of MSA Common Stock. This represented approximately and 33.1% of the total shares of MSA Common Stock outstanding at those times. Fund American's investment in MSA is accounted for using the equity method.

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The following tables summarize financial information for MSA:

Millions	1997	1996	1995

MSA balance sheet data:			
Total investments	\$280.1	\$249.4	\$240.8
Total assets	337.2	316.2	309.6
Unearned premium reserve	71.8	64.0	58.4
Loss and loss adjustment expense reserves	123.7	120.1	116.2
Shareholders' equity	120.6	101.4	92.0
MSA income statement data:			
Net premiums written	\$156.6	\$147.2	\$130.9
Net premiums earned	148.7	141.6	127.7
Net investment income	15.4	14.9	15.0
Net income	11.9	9.7	12.4

Amounts recorded by Fund American:			
Investment in MSA Common Stock	\$ 40.9	\$ 34.7	\$ 33.7
Equity in earnings from MSA Common Stock (a)	3.8	1.5	4.0
Equity in net unrealized investment gains (losses) from MSA's investment portfolio, before tax (b)	2.4	(.5)	3.2
=====			

- (a) Recorded net of related amortization of goodwill.

- (b) Recorded directly to shareholders' equity (after tax) with related changes in net unrealized investment gains and losses (after tax) reported on the income statement as a component of comprehensive net income.

At December 31, 1997 and 1996, Fund American's consolidated retained earnings included \$10.9 million and \$6.5 million, respectively, of undistributed earnings of MSA.

Investment in Folksamerica

White Mountains owned 6,920,000 shares of Folksamerica Preferred Stock at December 31, 1997 and 1996. White Mountains owned 1,563,907 shares of Folksamerica Common Stock at December 31, 1997. White Mountains ownership percentage of Folksamerica at December 31, 1997 and 1996 represented 50.0% of the total Folksamerica voting shares outstanding at that time. At December 31, 1997 and 1996, White Mountains also owned ten year Folksamerica Warrants to purchase up to 6,920,000 shares of Folksamerica Common Stock for aggregate consideration of \$79.4 million. Fund American acquired its investment in Folksamerica Preferred Stock and Folksamerica Warrants on June 19, 1996. White Mountains acquired its investment in Folksamerica Common Stock on November 20, 1997.

White Mountains' investment in Folksamerica Common Stock is accounted for using the equity method. Fund American's investment in Folksamerica Preferred Stock and Folksamerica Warrants are accounted for under the provisions of SFAS No. 115 whereby the investments are reported at fair value as of the balance sheet date, with related unrealized investment gains and losses, after tax, reported as a net amount in a separate component of shareholders' equity and reported on the income statement as a component of comprehensive net income. Dividends earned on the Folksamerica Preferred Stock are recorded as earnings from unconsolidated insurance affiliates on the income statement.

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The following table summarizes financial information for Folksamerica:

Millions	1997	1996

Folksamerica balance sheet data:		
Total investments	\$ 926.2	\$711.4

Total assets	1,213.6	994.8
Unearned premium reserve	96.5	61.5
Loss and loss adjustment expense reserve	739.1	628.9
Preferred shareholder's equity	79.4	79.4
Common shareholders' equity	175.6	88.2
Folksamerica income statement data:		
Gross premiums written	\$ 251.0	\$187.2
Net premiums written	232.4	171.9
Net premiums earned	238.0	181.4
Net investment income	46.7	32.4
Net income	35.9	17.1

Amounts recorded by Fund American:		
Investment in Folksamerica Common Stock	\$ 23.5	\$ --
Investment in Folksamerica Preferred Stock	78.0	77.9
Investment in Folksamerica Warrants	24.6	2.2
	-----	-----
Total Investment in Folksamerica	\$ 126.1	\$ 80.1
	-----	-----
Equity in earnings from Folksamerica Common Stock (a)	\$.9	\$ --
Dividends from Folksamerica Preferred Stock (a)	5.2	2.7
Equity in net unrealized investment gains from Folksamerica's investment portfolio, before tax (b)	1.8	--
Unrealized investment gains on Folksamerica Warrants and Preferred Stock, before tax (b)	22.4	.2
	=====	=====

- (a) Recorded net of related amortization of goodwill and accretion of discount.
- (b) Recorded directly to shareholders' equity (after tax) with related changes in net unrealized investment gains and losses (after tax) reported on the income statement as a component of comprehensive net income.

At December 31, 1997 and 1996, Fund American's consolidated retained earnings included \$1.0 million and \$0 million of undistributed earnings of Folksamerica.

Investment in Murray Lawrence

At December 31, 1997 White Mountains owned 38,651,270 shares of Murray Lawrence Common Stock which it had acquired on December 8, 1997 for \$23.6 million. This represented approximately 15.8% of the total shares of Murray Lawrence Common Stock outstanding at that time. White Mountains' carrying value of the Murray Lawrence investment was equal to its cost of \$23.6 million at December 31, 1997.

NOTE 16. Financial Instruments With Off-Balance-Sheet Risk

Source One utilizes derivative financial instruments in the management of interest rate risk. Source One's use of derivative financial instruments is primarily limited to (i) commitments to extend credit, (ii) mandatory forward commitments and (iii) interest rate floor contracts and principal-only swap agreements. Although SFAS No. 115 requires that these financial instruments be classified as held for trading purposes, Fund American does not consider these investments to be speculative holdings.

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Source One is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its exposure to fluctuations in interest rates. These financial instruments primarily include commitments to extend credit and mandatory forward commitments. Those instruments involve, to varying degrees, elements of credit and market interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of risk Source One has related to the instruments.

Source One's exposure to credit loss in the event of nonperformance by the other party for commitments to extend credit is represented by the contractual notional amount of those commitments. Source One's locked mortgage loan commitments expected to close totalled \$284.5 million and \$175.7 million at December 31, 1997 and 1996, respectively. Fixed rate commitments result in Source One having market interest rate risk as well as credit risk. Variable rate commitments result primarily in credit risk. The amount of collateral required upon extension of credit is based on management's credit evaluation of the mortgagor and consists of the mortgagor's residential property.

Source One obtains mandatory forward commitments of up to 120 days to sell mortgage-backed securities to hedge the market interest rate risk associated with a substantial portion of the Pipeline that is expected to close and all mortgage loans receivable. At December 31, 1997 and 1996, Source One had \$776.8 million and \$454.6 million, respectively, of mandatory forward commitments outstanding. If secondary market interest rates decline after Source One commits to an interest rate for a loan, the loan may not close and Source One may incur

a loss from the cost of covering its obligations under a related mandatory forward commitment. If secondary market interest rates increase after Source One commits to an interest rate for a loan and Source One has not obtained a forward commitment, Source One may incur a loss when the loan is subsequently sold.

Source One's risk management function closely monitors the Pipeline to determine appropriate forward commitment coverage on a daily basis in order to manage the risk inherent in these off-balance-sheet financial instruments. In addition, the risk management area seeks to reduce counterparty risk by committing to sell mortgage loans only to approved dealers with no dealer having in excess of 20% of current commitments.

Source One sells loans through mortgage-backed securities issued pursuant to programs of GNMA, FNMA and FHLMC, or through institutional investors. Most loans are aggregated in pools of \$1.0 million or more which are purchased by institutional investors after having been guaranteed by GNMA, FNMA or FHLMC. Substantially all GNMA securities are sold by Source One without recourse for loss of principal in the event of a subsequent default by the mortgagor due to the FHA and VA insurance underlying such securities. Prior to December 1992, substantially all conventional securities were sold with recourse to Source One, to the extent of insufficient proceeds from private mortgage insurance, foreclosure and other recoveries. Since December 1992 all conventional loans have been sold without recourse to Source One.

Servicing agreements relating to mortgage-backed securities issued pursuant to programs of GNMA, FNMA or FHLMC require Source One to advance funds to make the required payments to investors in the event of a delinquency by the borrower. Source One expects that it would recover most funds advanced upon cure of default by the borrower or foreclosure. However, funds advanced in connection with VA partially guaranteed loans and certain conventional loans (which are at most partially insured by private mortgage insurers) may not be fully recovered due to potential declines in collateral value. Source One is subject to limited amounts of risk with respect to these loans since the insurer has the option to reimburse the servicer for the lower of fair value of the property or the mortgage loan outstanding, in addition to the VA guarantee on the loan. In addition, most of Source One's servicing agreements for mortgage-backed securities typically require the payment to investors of a full month's interest

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on each loan although the loan may be paid off (by optional prepayment or foreclosure) other than on a month-end basis. In this instance, Source One is obligated to pay the investor interest at the pass-thru rate from the date of loan payoff through the end of the calendar month without reimbursement.

At December 31, 1997 and 1996, Source One serviced approximately \$5.4 billion and \$13.5 billion of GNMA loans (without substantial recourse), respectively, and \$2.5 billion and \$2.9 billion of conventional loans (with recourse), respectively.

To cover loan losses that may result from these servicing arrangements and other losses, Source One has provided an allowance for loan losses of \$12.8 million and \$15.4 million at December 31, 1997 and 1996, respectively. In addition, the valuation allowance for Source One's capitalized servicing asset related to its principal recourse portfolio includes an \$8.2 million and \$7.3 million reserve for estimated losses at December 31, 1997 and 1996, respectively. Source One's management believes the allowance for loan losses is adequate to cover unreimbursed foreclosure advances and principal losses, including losses on loans with recourse.

In order to offset changes in the value of Source One's capitalized servicing asset and to mitigate the effect on earnings of higher amortization and impairment of such rights which results from increased prepayment activity, Source One invests in various financial instruments. As interest rates decline, prepayment activity increases, thereby reducing the value of the capitalized servicing asset, while the value of the financial instrument increases. Conversely, as interest rates increase, the value of the capitalized servicing asset increases while the value of the financial instrument decreases. The financial instruments utilized by Source One include interest rate floor contracts and principal-only swap transactions.

The interest rate floor contracts derive their value from differences between the floor rate specified in the contract and market interest rates. The floor strike rates range from 4.00% to 6.14%. To the extent that market interest rates increase, the value of the floors declines. However, Source One is not exposed to losses in excess of its initial investment in the floors. The interest rate floor contracts are carried at fair value with unrealized gains and losses recorded in net gain on financial instruments on the consolidated income statements. As of December 31, 1997 and 1996, the carrying value of Source One's open interest rate floor contracts totalled \$8.2 million and \$4.8 million, respectively, with a total notional principal amount of \$.7 billion and \$1.0 billion, respectively. The floors have terms ranging from 3 to 5 years.

The value of the principal-only swaps is determined by changes in the value of referenced principal-only strips. As of December 31, 1997 and 1996, the carrying value of Source One's principal-only swap transactions totalled \$12.5 million and \$3.2 million, respectively, with an original notional principal

amount of \$98.1 million and \$50.0 million, respectively. The principal-only swaps have remaining terms of 3 to 4 years.

White Mountains' insurance subsidiaries extend credit to their policyholders in the normal course of business, perform credit evaluations and maintain allowances for potential credit losses. Concentration of credit risk with respect to receivables is limited due to the large number of policyholders and their dispersion across a multi-state area.

NOTE 17. Fair Value of Financial Instruments

The estimated fair values of Fund American's financial instruments have been determined by using appropriate market information and valuation methodologies. Considerable judgement is required to develop the estimates of fair value. Therefore, the estimates provided herein are not necessarily indicative of the amounts that could be realized in a current market exchange.

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Carrying value equals or approximates fair value for common equity securities, fixed maturity investments, derivative instruments, short-term investments, cash, other financial assets and other financial liabilities. For each other class of financial instrument for which it is practicable to estimate fair value, the following methods and assumptions were used to estimate such value:

Other Investments. For 1997, mortgage loans held for investment were carried at fair value. For 1996, the fair value of mortgage loans held for investment were estimated using quoted market prices for securities backed by similar loans. Fair values of REMICs are estimated using discounted cash flow analyses reflecting interest only strip and LIBOR interest rates, and "Prepayment Speed Assumption" rates, taking into consideration the characteristics of the related collateral. For interest rate floor contracts and principal-only swap transactions, fair value is estimated based on quoted market prices for those or similar investments and equals carrying value. For all other securities classified as other investments, fair values have been determined using quoted market values or internal appraisal techniques.

Capitalized Excess Mortgage Servicing. Prior to 1997, the fair value of Source One's excess mortgage servicing asset was estimated by computing the anticipated revenue to be received over the life of the related loans based on market consensus prepayment rates, discounted using quoted interest only strip interest rates.

Mortgage Loans Held for Sale. Fair values are estimated using quoted market prices for securities backed by similar loans.

Pool Loan Purchases. Fair values are estimated based on discounted cash flow analyses using Source One's short-term incremental borrowing rate, quoted market prices for securities backed by similar loans or actual prices at which the loans were subsequently sold.

Mortgage Claims Receivable. Fair values are estimated by discounting anticipated future cash flows using Source One's short-term incremental borrowing rate.

Debt. Fair value is estimated by discounting future cash flows using incremental borrowing rates for similar types of borrowing arrangements or quoted market prices.

Off-Balance-Sheet Financial Instruments. Fair value for commitments to sell mortgage loans is based on current settlement values for those commitments, net of the face amounts of the commitments. Fair value for commitments to extend credit is based on current quoted market prices for securities backed by similar loans, net of the principal amounts of the commitments.

The carrying amounts and estimated fair values of Fund American's financial instruments were as follows:

Millions	December 31, 1997		December 31, 1996	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets:				
Common equity securities	\$104.2	\$104.2	\$160.8	\$160.8
Fixed maturity investments	168.3	168.3	155.4	155.4
Other investments (excluding derivative instruments)	151.1	160.6	168.5	168.4
Derivative instruments:				
Interest rate floor contracts	8.2	8.2	4.8	4.8
Principal-only swaps	12.5	12.5	3.2	3.2
Short-term investments	62.8	62.8	67.5	67.5
Cash	7.0	7.0	4.8	4.8
Capitalized excess mortgage servicing (a)	-	-	38.7	39.6
Mortgage loans held for sale	519.3	529.3	314.9	315.9

Pool loan purchases	149.8	150.2	131.5	135.8
Mortgage claims receivable, net (b)	35.6	34.9	38.4	37.7
Other financial assets	43.4	43.4	35.9	35.9

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Financial liabilities:				
Short-term debt	571.4	571.4	407.9	407.9
Long-term debt	304.3	326.5	424.2	460.2
Other financial liabilities	22.3	22.3	18.3	18.3
Off-balance-sheet financial instruments:				
Mandatory forward commitments	-	1.6	-	(.2)
Commitments to extend credit expected to close	-	6.5	-	1.9

(a) Not applicable for 1997 due to the adoption of SFAS No. 125. See Note 5.

(b) Excludes \$5.6 million and \$13.1 million of real estate owned in 1997 and 1996, respectively.

Other financial assets includes investment income receivable, accounts receivable from securities sales, notes receivable and White River Shares held for delivery upon exercise of existing employee stock options.

Other financial liabilities includes accrued interest payable, accounts payable on securities purchases, dividends payable to shareholders and liability for existing employee stock options to purchase White River Shares.

Fund American's investments in FSA Options and Preferred Stock, Folksamerica Preferred Stock and Folksamerica Warrants are not presented in the table above. These financial instruments are accounted for under the provisions of SFAS No. 115 and are carried on the balance sheet at fair value. See Note 15.

The estimated fair value amounts for Fund American's financial instruments have been determined using available market information and valuation methodologies. Such estimates provided herein are not necessarily indicative of the amounts that would be potentially realized in a current market exchange.

NOTE 18. Related Party Transactions

For corporate travel purposes Fund American jointly owns two short-range aircraft with Haverford Utah, LLC ("Haverford"). Messrs. Jack Byrne, Patrick M. Byrne, a director of the Company and White Mountains, and Kemp are principals of Haverford. Both aircraft were acquired from unaffiliated third parties during 1996. In exchange for Haverford's 20% ownership interest in the aircraft, Haverford contributed capital equal to 20% of the total initial cost of the aircraft and Haverford bears the full costs of its usage and maintenance of the aircraft pursuant to a Joint Ownership Agreement dated September 16, 1996.

Prior to the Joint Ownership Agreement, Fund American was a party to a "dry lease" agreement dated January 2, 1995, for the use of aircraft owned by Haverford Transportation Inc. ("HTI") for corporate travel purposes. Messrs. Jack Byrne and Kemp are the sole shareholders of HTI. During 1996 and 1995 Fund American paid HTI a total of \$279,739 and \$183,563, respectively, pursuant to the dry lease arrangement. The terms of the agreement provided for the use of HTI's aircraft (excluding pilot and fuel) for a fixed hourly charge of \$200 for a single engine piston aircraft and \$800 to \$1,000 for a twin engine turbine aircraft. Based on the Company's experience in operating comparable aircraft, the hourly operating charges incurred pursuant to the HTI dry lease are considered to be representative of the actual hourly costs of operating HTI's aircraft.

Through December 22, 1993, White River was a wholly-owned subsidiary of the Company. The Company currently owns 1,014,750 White River Shares, or approximately 20.8% of the outstanding White River Shares of which 295,932 shares, or 6.0% of the outstanding White River Shares, have been reserved by Fund American for delivery upon exercise of existing employee stock options. White River had outstanding the \$50.0 million Term Note and the \$40.0 million Revolver payable to the Company which were repaid on various dates during 1995. Mr. Gordon S. Macklin, a director of the Company, is Chairman, President and Chief

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Executive Officer of White River. Mr. Patrick M. Byrne is also a director of White River.

Mr. Howard Clark, Jr., a director of the Company, is Vice Chairman of Lehman Brothers Inc. Lehman Brothers Inc. has, from time to time, provided various services to Fund American including investment banking services,

brokerage services, underwriting of debt and equity securities and financial consulting services.

Mr. Robert P. Cochran, a director of the Company, is Chairman and Chief Executive Officer of FSA. FSA has been retained by Fund American to manage portions of its fixed maturity portfolio.

Mr. George J. Gillespie, III, a director of the Company, is a Partner in the firm Cravath, Swaine & Moore, which has been retained by Fund American from time to time to perform legal services.

Mr. Arthur Zankel, a director of the Company, is Co-Managing Partner of First Manhattan Co. First Manhattan Co. has provided brokerage, discretionary investment management and non-discretionary investment advisory services to Fund American from time to time.

Fund American believes that all the above transactions were on terms that were reasonable and competitive. Additional transactions of this nature may be expected to take place in the ordinary course of business in the future.

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REPORT ON MANAGEMENT'S RESPONSIBILITIES

The financial information included in this annual report, including the audited consolidated financial statements, has been prepared by the management of Fund American. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and, where necessary, include amounts based on informed estimates and judgments. In those instances where there is no single specified accounting principle or standard, management makes a choice from reasonable, accepted alternatives which are believed to be most appropriate under the circumstances. Financial information presented elsewhere in this annual report is consistent with that shown in the financial statements.

Fund American maintains internal financial and accounting controls designed to provide reasonable and cost effective assurance that assets are safeguarded from loss or unauthorized use, that transactions are recorded in accordance with management's policies and that financial records are reliable for preparing financial statements. The internal controls structure is documented by written policies and procedures which are communicated to all appropriate personnel and is updated as necessary. Fund American's business ethics policies require adherence to the highest ethical standards in the conduct of its business. Compliance with these controls, policies and procedures is continuously maintained and monitored by management.

KPMG Peat Marwick LLP have audited the consolidated financial statements of Fund American as of December 31, 1997 and for the year then ended, and issued their unqualified report thereon dated January 29, 1998, which appears on page F-43. Ernst & Young LLP served as Fund American's independent auditors as of December 31, 1996 and 1995, and for the years then ended, and issued their unqualified report thereon dated March 21, 1997, which appears on page F-45. Coopers & Lybrand L.L.P. served as independent auditors of Valley as of December 31, 1996 and for the year then ended. Their unqualified report thereon, dated February 14, 1997, has been included as an exhibit to this annual report.

In connection with their audits, the independent auditors provide an objective, independent review and evaluation of the structure of internal controls to the extent they consider necessary. Management reviews all recommendations of the independent auditors concerning the structure of internal controls and responds to such recommendations with corrective actions, as appropriate.

The Audit Committee of the Board, which is comprised solely of non-management directors, has general responsibility for the oversight and surveillance of the accounting, reporting and financial control practices of Fund American. The Audit Committee, which reports to the full Board, annually reviews the effectiveness of the independent auditors, Fund American's internal auditors and management with respect to the financial reporting process and the adequacy of internal controls. Both the internal auditors and the independent auditors have, at all times, free access to the Audit Committee, without members of management present, to discuss the results of their audits, the adequacy of internal controls and any other matter that they believe should be brought to the attention of the Audit Committee.

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K. Thomas Kemp
Director, President
and Chief Executive Officer

Raymond Barrette
Executive Vice President
and Chief Financial Officer

Michael S. Paquette
Senior Vice President
and Controller

INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
Fund American Enterprises Holdings, Inc.

We have audited the accompanying consolidated balance sheet of Fund American Enterprises Holdings, Inc. and Subsidiaries (the "Company") as of December 31, 1997 and the related consolidated income statement, and consolidated statements of shareholders' equity and cash flows for the year then ended (collectively the "consolidated financial statements"). In connection with our audit of the consolidated financial statements, we also have audited the 1997 financial information in Schedule I Condensed Financial Information of the Registrant (the "financial statement schedule"). These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audit. We did not audit the consolidated financial statements of Financial Security Assurance Holdings Ltd. ("FSA") (a 12.1 percent owned equity investee company). The Company's equity investment in FSA at December 31, 1997 was \$104.3 million and its equity in earnings of FSA was \$11.4 million for the year ended 1997. The consolidated financial statements of FSA were audited by other auditors, Coopers and Lybrand L.L.P., whose report has been furnished to us, and, our opinion, insofar as it relates to the amounts included for FSA is based solely on the report of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Fund American Enterprises Holdings, Inc. and Subsidiaries as of December 31, 1997, and the results of their operations and their cash flows for the year then ended in conformity with generally accepted accounting principles. Also in our opinion, the 1997 information in the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

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KPMG Peat Marwick LLP

Hartford, Connecticut
January 29, 1998

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Shareholders
Fund American Enterprises Holdings, Inc.

We have audited the accompanying consolidated balance sheets of Fund American Enterprises Holdings, Inc., as of December 31, 1996, and the related consolidated income statements and statements of shareholders' equity and cash flows for each of the two years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our audits also included the financial statement schedule listed at Item 14(d). Our responsibility is to express an opinion on these financial statements and schedule based on our audits. We did not audit the consolidated financial statements of Valley Group, Inc., a wholly-owned subsidiary, representing substantially all of the Company's consolidated insurance operations, which statements reflect total assets of \$288.0 million as of December 31, 1996 and total revenues of \$126.9 million for the year then ended, and the consolidated financial statements of Financial Security Assurance Holdings Ltd. ("FSA"), an equity method investee. The Company's equity method investment in FSA represents \$92.3 million of assets at December 31, 1996 and its equity in FSA's earnings represents \$7.8 million of total revenues for the year then ended. Those statements were audited by other auditors, Coopers and Lybrand L.L.P., whose reports have been furnished to us, and our opinion, insofar as it relates to data included for Valley Group, Inc. and FSA, with respect to the amounts in the preceding sentence,

is based solely on the reports of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Fund American Enterprises Holdings, Inc. at December 31, 1996, and the consolidated results of its operations and its cash flows for each of the two years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statements schedule when considered in relation to the basic financial statements taken as a whole present fairly in all material respects the information set forth therein.

As discussed in the Notes to Consolidated Financial Statements, in 1995 the Company changed its method of accounting for originated mortgage servicing rights.

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Ernst & Young LLP
New York, New York
March 21, 1997

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SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

Selected quarterly financial data for 1997 and 1996 is shown in the following table. The quarterly financial data includes, in the opinion of management, all recurring adjustments necessary for a fair presentation of the results of operations for the interim periods.

Millions, except per share amounts	1997 Three Months Ended (a)				1996 Three Months Ended (b)			
	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Revenues	\$ 82.8	\$ 79.4	\$ 70.3	\$81.7	\$ 72.8	\$89.9	\$ 82.6	\$ 87.2
Expenses	92.8	78.7	82.7	82.0	120.1	81.2	76.9	69.0
Pretax operating earnings (loss)	(10.0)	.7	(12.4)	(.3)	(47.3)	8.7	5.7	18.2
Net realized investment gains (losses)	49.1	21.8	16.2	9.6	10.4	(1.6)	1.4	28.3
Pretax earnings (loss)	39.1	22.5	3.8	9.3	(36.9)	7.1	7.1	46.5
Income tax provision (benefit)	14.7	7.1	3.2	4.4	(5.8)	3.4	3.6	17.7
After tax earnings (loss)	24.4	15.4	.6	4.9	(31.1)	3.7	3.5	28.8
Loss on early extinguishment of debt, after tax	--	--	(6.0)	--	--	--	--	--
Net income (loss)	24.4	15.4	(5.4)	4.9	(31.1)	3.7	3.5	28.8
Change in net unrealized gains, after tax	(18.1)	36.3	44.5	(6.4)	36.5	18.5	16.5	(16.9)
Comprehensive net income (loss)	\$ 6.3	\$ 51.7	\$ 39.1	\$ (1.5)	\$ 5.4	\$ 22.2	\$ 20.0	\$ 11.9
Basic earnings per share:								
After tax earnings (loss)	\$ 3.89	\$ 2.41	\$.09	\$.71	\$ (4.37)	\$.50	\$.45	\$ 3.75
Net income (loss)	3.89	2.41	(.80)	.71	(4.37)	.50	.45	3.75
Comprehensive net income (loss)	1.01	8.09	5.82	(.22)	.76	3.05	2.61	1.55
Diluted earnings per share:								
After tax earnings (loss)	3.50	2.18	.08	.65	(4.37)	.46	.42	3.45
Net income (loss)	3.50	2.18	(.73)	.65	(4.37)	.46	.42	3.45
Comprehensive net income (loss)	.90	7.31	5.29	(.20)	.76	2.79	2.40	1.42

- (a) The quarterly amounts for the three month period ended June 30, 1997 include a \$9.2 million pretax loss on early extinguishment of Source One's debt which served to decrease second quarter 1997 net income by \$6.0 million. The quarterly amounts for the three month period ended December 31, 1997 include \$49.1 million of pretax realized investment gains which served to increase fourth quarter 1997 net income by \$31.9 million.
- (b) The quarterly amounts for the three month period ended March 31, 1996

include a \$20.0 million pretax recovery of the valuation allowance for the impairment of Source One's capitalized mortgage servicing rights which served to

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increase first quarter 1996 net income by \$13.0 million. The quarterly amounts for the three month period ended December 31, 1996 include a \$32.6 million pretax write-off of all Source One's existing goodwill and certain other intangible assets and \$28.4 million of pretax impairment of Source One's capitalized mortgage servicing asset. These two items served to decrease fourth quarter 1996 net income by \$48.5 million.

SCHEDULE I

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
(Parent Company Only)

CONDENSED BALANCE SHEETS

Millions	December 31,	
	1997	1996
Assets:		
Fixed maturity investments	\$ --	\$ 46.0
Common equity securities and other investments	49.2	100.1
Short-term investments, at amortized cost	2.3	.3
Other assets	40.4	18.1
Investments in unconsolidated insurance affiliates	--	27.7
Investments in consolidated affiliates	857.8	725.2
Total assets	\$949.7	\$ 917.4
Liabilities:		
Long-term debt with third parties	\$115.6	\$ 115.4
Intercompany borrowings	30.0	--
Accounts payable and other liabilities	130.5	115.0
Total liabilities	276.1	230.4
Shareholders' equity	673.6	687.0
Total liabilities and shareholders' equity	\$949.7	\$ 917.4

CONDENSED INCOME STATEMENTS

Millions	Year Ended December 31,		
	1997	1996	1995
Revenues	\$ 8.5	\$ 11.7	\$ 28.7
Expenses			
	21.2	15.5	68.9
Pretax operating loss	(12.7)	(3.8)	(40.2)
Net realized investment gains (losses)	44.2	(3.1)	12.6
Pretax earnings (loss)	31.5	(6.9)	(27.6)
Income tax provision (benefit)	16.3	.5	(8.7)
Parent company only operating income (loss)	15.2	(7.4)	(18.9)
Earnings from consolidated affiliates	24.1	12.3	37.4
Tax benefit from sale of discontinued operations	--	--	66.0
Loss on early extinguishment of debt, after tax	--	--	(.4)
Consolidated net income	\$ 39.3	\$ 4.9	\$ 84.1
Consolidated change in net unrealized investment gains, after tax	56.3	54.6	18.2
Consolidated comprehensive net income	\$ 95.6	\$ 59.5	\$ 102.3

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SCHEDULE I
(continued)

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
(Parent Company Only)

CONDENSED STATEMENTS OF CASH FLOWS

Millions	Year Ended December 31,		
	1997	1996	1995
Net income	\$ 39.3	\$ 4.9	\$ 84.1
Charges (credits) to reconcile net income to net cash from operations:			
Net realized investment (gains) losses	(44.2)	3.1	(12.6)
Earnings from consolidated subsidiaries	(24.1)	(12.3)	(37.4)
Undistributed earnings from unconsolidated insurance affiliates	(.4)	(1.1)	(9.0)
Changes in current income taxes receivable and payable	5.1	28.4	2.9
Deferred income tax (benefit) provision	(3.7)	.1	(13.5)
Dividends and return of capital distributions received from subsidiaries	--	65.0	233.3
Tax benefit from sale of discontinued operations	--	--	(66.0)
Compensation expense resulting from warrant extension	--	--	46.2
Other, net	2.4	(15.9)	(3.7)
Net cash (used for) provided from operations	(25.6)	72.2	224.3
Cash flows from investing activities:			
Net (increase) decrease in short-term investments	(2.0)	28.2	34.3
Sales of investment securities	119.4	134.4	45.1
Purchases of investment securities	--	(108.9)	(41.3)
Investments in consolidated affiliates	(12.7)	(25.2)	(77.2)
Investments in unconsolidated affiliates	--	(27.7)	(33.8)
Purchases of fixed assets	--	(.8)	--
Net cash provided from (used for) investing activities	104.7	--	(72.9)
Cash flows from financing activities:			
Purchases of common stock retired	(103.8)	(66.3)	(65.5)
Proceeds from issuances of common stock from treasury	--	--	3.3
Intercompany borrowings from subsidiaries	30.0	--	--
Repayments of long-term debt	--	--	(7.9)
Redemption of preferred stock	--	--	(75.0)
Dividends paid to shareholders	(5.3)	(5.9)	(6.4)
Net cash used for financing activities	(79.1)	(72.2)	(151.5)
Net decrease in cash during year	--	--	(.1)
Cash balance at beginning of year	--	--	.1
Cash balance at end of year	\$ --	\$ --	\$ --

\$35,000,000

CREDIT AGREEMENT

AMONG

FUND AMERICAN ENTERPRISES HOLDINGS, INC.,

as Borrower,

FUND AMERICAN ENTERPRISES, INC.,

as Subsidiary Borrower,

THE LENDERS NAMED HEREIN

and

THE FIRST NATIONAL BANK OF CHICAGO,

as Agent

DATED AS OF

July 31, 1997

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CREDIT AGREEMENT

This Credit Agreement, dated as of July 31, 1997, is among FUND AMERICAN ENTERPRISES HOLDINGS, INC., a Delaware corporation, FUND AMERICAN ENTERPRISES, INC. (formerly known as Fund American Enterprises II, Inc.), a Delaware corporation, the Lenders and THE FIRST NATIONAL BANK OF CHICAGO, individually and as Agent.

R E C I T A L S:

A. The Borrowers have requested the Lenders to make financial accommodations to them in the aggregate principal amount of \$35,000,000, the proceeds of which the Borrowers will use for the working capital and general corporate needs of the Borrowers and their Subsidiaries; and

B. The Lenders are willing to extend such financial accommodations on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Borrowers, the Lenders and the Agent hereby agree as follows:

ARTICLE I

DEFINITIONS

As used in this Agreement:

"ABR Advance" means an Advance which bears interest at the Alternate Base Rate.

"Advance" means a borrowing pursuant to Section 2.1 consisting of the aggregate amount of the several Loans made on the same Borrowing Date by the

Lenders to the Relevant Borrower of the same Type and, in the case of Eurodollar Advances, for the same Interest Period.

"Affiliate" of any Person means any other Person directly or indirectly controlling, controlled by or under common control with such Person. A Person shall be deemed to control another Person if the controlling Person owns 20% or more of any class of voting securities (or other ownership interests) of the controlled Person or possesses, directly or indirectly, the power to direct or cause the direction of the management or policies of the controlled Person, whether through ownership of stock, by contract or otherwise.

"Agent" means First Chicago in its capacity as agent for the Lenders pursuant to Article X, and not in its individual capacity as a Lender, and any successor Agent appointed pursuant to Article X.

"Aggregate Commitment" means the aggregate of the Commitments of all the Lenders hereunder. The initial Aggregate Commitment is \$35,000,000.

"Agreement" means this Credit Agreement, as it may be amended, modified or restated and in effect from time to time.

"Agreement Accounting Principles" means generally accepted accounting principles as in effect from time to time; provided, however, that if any changes in accounting principles from those in effect on the date of this Agreement are adopted which result in a material change in the method of calculation of any of the financial covenants, standards or terms in this Agreement, the parties agree to enter into negotiations to determine whether such provisions require amendment and, if so, the terms of such amendment so as to equitably reflect such changes. Until a resolution thereof is reached, all calculations made for the purposes of determining compliance with the terms of this Agreement shall be made by application of generally accepted accounting principles in effect on the date of this Agreement applied, to the extent applicable, on a basis consistent with that used in the preparation of the financial statements furnished to the Lenders pursuant to Section 5.5 hereof.

"Alternate Base Rate" means, for any day, a rate of interest per annum equal to the higher of (a) the Corporate Base Rate for such day, and (b) the sum of the Federal Funds Effective Rate for such day plus 1/2% per annum, in each case changing when and as the Corporate Base Rate and the Federal Funds Effective Rate, as the case may be, changes.

"Applicable Credit Rating" shall mean the highest rating level assigned by S&P or Moody's, as the case may be, to any long-term senior debt of the Borrower which ranks on parity, as to payment and security, with the Loans and the obligations of the Borrower under Article XIV.

"Applicable Eurodollar Margin" means the applicable percentage set forth below based upon the Level then in effect:

Level	Margin
Level I	.175%
Level II	.190%
Level III	.230%
Level IV	.270%
Level V	.300%
Level VI	.375%
Level VII	.550%

"Applicable Facility Fee Margin" means the applicable percentage set forth below based upon the Level then in effect:

Level	Margin
Level I	.050%
Level II	.060%
Level III	.070%
Level IV	.080%
Level V	.100%
Level VI	.125%
Level VII	.200%

"Article" means an article of this Agreement unless another document is specifically referenced.

"Authorized Officer" means, with respect to the Borrower or the Subsidiary

Borrower, any of the chief executive officer, president, chief financial officer, treasurer or controller thereof, acting singly.

"Bankruptcy Code" means Title 11, United States Code, sections 1 et seq., as the same may be amended from time to time, and any successor thereto or replacement therefor which may be hereafter enacted.

"Benefit Plan" means any deferred benefit plan for the benefit of present, future or former employees, whether or not such benefit plan is a Plan.

"Borrower" means Fund American Enterprises Holdings, Inc., a Delaware corporation, and its successors and assigns.

"Borrowers" means, collectively, the Borrower and the Subsidiary Borrower.

"Borrowing Date" means a date on which an Advance is made hereunder.

"Borrowing Notice" is defined in Section 2.7.

"Business Day" means (a) with respect to any borrowing, payment or rate selection of Eurodollar Advances, a day (other than a Saturday or Sunday) on which banks generally are open

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in Chicago for the conduct of substantially all of their commercial lending activities and on which dealings in United States dollars are carried on in the London interbank market, and (b) for all other purposes, a day (other than a Saturday or Sunday) on which banks generally are open in Chicago for the conduct of substantially all of their commercial lending activities.

"Capitalized Lease" of a Person means any lease of Property by such Person as lessee which would be capitalized on a balance sheet of such Person prepared in accordance with Agreement Accounting Principles.

"Capitalized Lease Obligations" of a Person means the amount of the obligations of such Person under Capitalized Leases which would be shown as a liability on a balance sheet of such Person prepared in accordance with Agreement Accounting Principles.

"Change" is defined in Section 3.2.

"Change in Control" means (a) the acquisition by any "person" or "group" (as such terms are used in Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934, as amended) (other than John J. Byrne or any Plan or any Benefit Plan of the Borrower or any of its Subsidiaries), including without limitation any acquisition effected by means of any transaction contemplated by Section 6.12, of beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended) of 25% or more of the outstanding shares of voting stock of the Borrower or of the Subsidiary Borrower, or (b) during any period of 12 consecutive calendar months, commencing on the date of the Agreement, the ceasing of those individuals (the "Continuing Directors") who (i) were directors of the Borrower or of the Subsidiary Borrower, as the case may be, on the first day of each such period or (ii) subsequently became directors of the Borrower or of the Subsidiary Borrower, as the case may be, and whose initial election or initial nomination for election subsequent to that date was approved by a majority of the Continuing Directors then on the board of directors of the Borrower or of the Subsidiary Borrower, as the case may be, to constitute a majority of the board of directors of the Borrower or of the Subsidiary Borrower, as the case may be, or (c) during any period of 12 consecutive calendar months, commencing on the date of this Agreement, the ceasing of individuals who hold an office possessing the title Senior Vice President or such title that ranks senior to a Senior Vice President (collectively, "Senior Management") of the Borrower or of the Subsidiary Borrower, as the case may be, on the first day of each such period to constitute a majority of the Senior Management of the Borrower or of the Subsidiary Borrower, as the case may be; provided, however, that (x) the provisions of this definition shall not apply to the Subsidiary Borrower in connection with a transaction permitted by Section 6.12(d)(ii) and (y) clauses (b) and (c) of this definition shall not apply to the Subsidiary Borrower during the time the Subsidiary Borrower is a Wholly-Owned Subsidiary of the Borrower

"Code" means the Internal Revenue Code of 1986, as amended, reformed or otherwise

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modified from time to time.

"Commitment" means, for each Lender, the obligation of such Lender to make Loans not exceeding the amount set forth opposite its signature below and as set forth in any Notice of Assignment relating to any assignment which has become effective pursuant to Section 12.3.2, as such amount may be modified from time to time pursuant to the terms hereof.

"Consolidated" or "consolidated", when used in connection with any calculation, means a calculation to be determined on a consolidated basis for a Person and its Subsidiaries in accordance with Agreement Accounting Principles.

"Consolidated Person" means, for the taxable year of reference, each Person which is a member of the affiliated group of the Borrower if Consolidated returns are or shall be filed for such affiliated group for federal income tax purposes or any combined or unitary group of which the Borrower is a member for state income tax purposes.

"Contingent Obligation" of a Person means any agreement, undertaking or arrangement by which such Person assumes, guarantees, endorses, contingently agrees to purchase or provide funds for the payment of, or otherwise becomes or is contingently liable upon, the obligation or liability of any other Person, or agrees to maintain the net worth or working capital or other financial condition of any other Person, or otherwise assures any creditor of such other Person against loss, including, without limitation, any comfort letter, operating agreement or take-or-pay contract or application for a Letter of Credit, excluding however (a) insurance policies and insurance contracts issued in the ordinary course of business and (b) any financial guarantees issued by Financial Security Assurance Holdings Ltd.

"Controlled Group" means all members of a controlled group of corporations and all trades or businesses (whether or not incorporated) under common control which, together with the Borrower or any of its Subsidiaries, are treated as a single employer under Section 414 of the Code.

"Conversion/Continuation Notice" is defined in Section 2.8.

"Corporate Base Rate" means a rate per annum equal to the corporate base rate of interest publicly announced by First Chicago from time to time, changing when and as said corporate base rate changes. The Corporate Base Rate is a reference rate and does not necessarily represent the lowest or best rate of interest actually charged to any customer. First Chicago may make commercial loans or other loans at rates of interest at, above or below the Corporate Base Rate.

"Default" means an event described in Article VII.

"Environmental Laws" is defined in Section 5.18.

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

"Eurodollar Advance" means an Advance which bears interest at the Eurodollar Rate.

"Eurodollar Base Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the rate determined by the Agent to be the rate at which deposits in U.S. dollars are offered by First Chicago to first-class banks in the London interbank market at approximately 11 a.m. (London time) two Business Days prior to the first day of such Interest Period, in the approximate amount of First Chicago's relevant Eurodollar Advance and having a maturity approximately equal to such Interest Period.

"Eurodollar Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the sum of (a) the quotient of (i) the Eurodollar Base Rate applicable to such Interest Period, divided by (ii) one minus the Reserve Requirement (expressed as a decimal) applicable to such Interest Period, plus (b) the Applicable Eurodollar Margin. The Eurodollar Rate shall be rounded to the next higher multiple of 1/100 of 1% if the rate is not such a multiple.

"Facility Fee" is defined in Section 2.4(a).

"Federal Funds Effective Rate" means, for any day, an interest rate per annum equal to the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published for such day (or, if such day is not a Business Day, for the immediately preceding Business Day) by the Federal Reserve Bank of New York, or, if such rate is not so published for any day which is a Business Day, the average of the quotations at approximately 10 a.m. (Chicago time) on such day on such transactions received by the Agent from three Federal

funds brokers of recognized standing selected by the Agent in its sole discretion.

"Finance Assets" means each of the following: (a) investments in securities issued or fully guaranteed by the United States of America or any agency or instrumentality thereof (provided that the full faith and credit of the United States of America is pledged in support thereof), (b) investments in equity securities traded on the New York Stock Exchange, the American Stock Exchange or NASDAQ and securities convertible in to such equity securities, (c) investments in Investment Grade Obligations, (d) investments in money market funds substantially all the assets of which are comprised of securities of the types described in clauses (a) through (c) above and (e) so long as put rights with respect thereto are available to the Borrowers, investments in US West Preferred Stock; provided, that Finance Assets shall not include any securities pledged to secure any obligation (contingent or otherwise).

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"Finance Assets Ratio" means, at any time, the ratio of (a) Finance Assets of the Borrower and the Subsidiary Borrower at such time to (b) the sum of (i) Funded Indebtedness of the Borrower and the Subsidiary Borrower at such time minus (ii) cash and Money Market Investments of the Borrower and the Subsidiary Borrower at such time. For purposes of this definition, Finance Assets shall be valued, without duplication, at fair market value to the extent there exists a readily ascertainable fair market value for such Finance Asset or, in the event there exists no such readily ascertainable fair market value for such Finance Asset, at book value, as calculated in accordance with Agreement Accounting Principles.

"Financial Statements" is defined in Section 5.5.

"First Chicago" means The First National Bank of Chicago in its individual capacity, and its successors.

"Fiscal Quarter" means one of the four three-month accounting periods comprising a Fiscal Year.

"Fiscal Year" means the twelve-month accounting period ending December 31 of each year.

"Funded Indebtedness" means Indebtedness of the type described in clauses (a), (d), (e) and (h) of the definition "Indebtedness".

"Governmental Authority" means any government (foreign or domestic) or any state or other political subdivision thereof or any governmental body, agency, authority, department or commission (including without limitation any taxing authority or political subdivision) or any instrumentality or officer thereof (including without limitation any court or tribunal) exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government and any corporation, partnership or other entity directly or indirectly owned or controlled by or subject to the control of any of the foregoing.

"Hazardous Materials" is defined in Section 5.18.

"Indebtedness" of a Person means such Person's (a) obligations for borrowed money, (b) obligations representing the deferred purchase price of Property or services (other than accounts payable arising in the ordinary course of such Person's business payable on terms customary in the trade), (c) obligations, whether or not assumed, secured by Liens or payable out of the proceeds or production from Property now or hereafter owned or acquired by such Person, (d) obligations which are evidenced by notes, acceptances, or similar instruments, (e) Capitalized Lease Obligations, (f) Rate Hedging Obligations, (g) Contingent Obligations, (h) obligations for which such Person is obligated pursuant to or in respect of a Letter of Credit and (i) repurchase obligations or liabilities of such Person with respect to accounts or notes receivable sold by such Person; provided that

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financial guarantees entered into in the ordinary course of business by Financial Security Assurance Holdings Ltd. or its subsidiaries shall not be included within "Indebtedness" for purposes of Section 6.19.2 (if Financial Security Assurance Holdings Ltd. shall become a Subsidiary).

"Insurance Subsidiaries" means Subsidiaries which are engaged in the insurance business as an issuer or underwriter of insurance policies and/or insurance contracts.

"Interest Period" means, with respect to a Eurodollar Advance, a period of one, two, three or six months commencing on a Business Day selected by the Borrower pursuant to this Agreement. Such Interest Period shall end on (but exclude) the day which corresponds numerically to such date one, two, three or six months thereafter; provided, however, that if there is no such numerically corresponding day in such next, second, third or sixth succeeding month, such Interest Period shall end on the last Business Day of such next, second, third or sixth succeeding month. If an Interest Period would otherwise end on a day which is not a Business Day, such Interest Period shall end on the next succeeding Business Day; provided, however, that if said next succeeding Business Day falls in a new calendar month, such Interest Period shall end on the immediately preceding Business Day.

"Investment Grade Obligations" means, as of any date, investments having a National Association of Insurance Commissioners investment rating of 1 or 2, or a S&P rating within the range of ratings from AAA to BBB-, or a Moody's rating within the range of ratings from Aaa to Baa3.

"Lenders" means the lending institutions listed on the signature pages of this Agreement and their respective successors and assigns.

"Lending Installation" means, with respect to a Lender or the Agent, any office, branch, subsidiary or affiliate of such Lender or the Agent.

"Letter of Credit" of a Person means a letter of credit or similar instrument which is issued upon the application of such Person or upon which such Person is an account party or for which such Person is in any way liable.

"Level" means, and includes, Level I, Level II, Level III, Level IV, Level V, Level VI or Level VII, whichever is in effect at the relevant time.

"Level I" shall exist at any time the Applicable Credit Rating of S&P is equal to or greater than A+ or the Applicable Credit Rating of Moody's is equal to or greater than A1.

"Level II" shall exist at any time (a) the Applicable Credit Rating of S&P is equal to or greater than A or the Applicable Credit Rating of Moody's is equal to or greater than A2 and (b)

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Level I does not exist.

"Level III" shall exist at any time (a) the Applicable Credit Rating of S&P is equal to or greater than A- or the Applicable Credit Rating of Moody's is equal to or greater than A3 and (b) Levels I and II do not exist.

"Level IV" shall exist at any time (a) the Applicable Credit Rating of S&P is equal to or greater than BBB+ or the Applicable Credit Rating of Moody's is equal to or greater than Baa1 and (b) Levels I, II and III do not exist.

"Level V" shall exist at any time (a) the Applicable Credit Rating of S&P is equal to or greater than BBB or the Applicable Credit Rating of Moody's is equal to or greater than Baa2 and (b) Levels I, II, III and IV do not exist.

"Level VI" shall exist at any time the Applicable Credit Rating of S&P is BBB- and the Applicable Credit Rating of Moody's is Baa3.

"Level VII" shall exist at any time the Applicable Credit Rating of S&P is less than BBB- or the Applicable Credit Rating of Moody's is less than Baa3 or at any time neither S&P nor Moody's assigns an Applicable Credit Rating.

"Leverage Ratio" means, at any time, the ratio of (a) the combined Funded Indebtedness of the Borrower and the Subsidiary Borrower at such time to (b) the sum of the combined Funded Indebtedness of the Borrower and the Subsidiary Borrower at such time plus the Borrower's Net Worth at such time, in all cases determined in accordance with Agreement Accounting Principles.

"Lien" means any security interest, lien (statutory or other), mortgage, pledge, hypothecation, assignment, deposit arrangement, encumbrance or preference, priority or other security agreement or preferential arrangement of any kind or nature whatsoever (including, without limitation, the interest of a vendor or lessor under any conditional sale, Capitalized Lease or other title retention agreement), save in respect of liabilities and obligations arising out of the underwriting of insurance policies and contracts of insurance.

"Loan" means, with respect to a Lender, such Lender's portion of any Advance and "Loans" means, with respect to the Lenders, the aggregate of all Advances.

"Loan Documents" means this Agreement, the Notes and the other documents and agreements contemplated hereby and executed by either of the Borrowers in

favor of the Agent or any Lender.

"Margin Stock" has the meaning assigned to that term under Regulation U.

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"Material Adverse Effect" means a material adverse effect on (a) the business, Property, condition (financial or other), performance, results of operations, or prospects of the Borrower and its Subsidiaries taken as a whole or of the Subsidiary Borrower and its Subsidiaries taken as a whole, (b) the ability of either of the Borrowers or any Subsidiary to perform its obligations under the Loan Documents, or (c) the validity or enforceability of any of the Loan Documents or the rights or remedies of the Agent or the Lenders thereunder.

"Maturity Date" means January 29, 1999.

"Money Market Investments" means (a) direct obligations of the United States of America, or of any agency thereof, or obligations guaranteed as to principal and interest by the United States of America, or of any agency thereof, in either case maturing not more than one year from the date of acquisition thereof; (b) certificates of deposit issued by any bank or trust company organized under the laws of the United States of America or any state thereof and having capital, surplus and undivided profits of at least \$500,000,000, maturing not more than 90 days from the date of acquisition thereof; (c) commercial paper rated A-1 or better or P-1 or better by S&P or Moody's, respectively, maturing not more than 90 days from the date of acquisition thereof; and (d) shares in an open-end management investment company with U.S. dollar denominated investments in fixed income obligations, including repurchase agreements, fixed time deposits and other obligations, with a dollar weighted average maturity of not more than one year, and for the calculation of this dollar weighted average maturity, certain instruments which have a variable rate of interest readjusted no less frequently than annually are deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate.

"Moody's" means Moody's Investors Services, Inc., and any successor thereto.

"Multiemployer Plan" means a Plan maintained pursuant to a collective bargaining agreement or any other arrangement to which the Borrower or any member of the Controlled Group is a party to which more than one employer is obligated to make contributions.

"Net Worth" means, with respect to any Person, at any date the consolidated shareholders' equity of such Person and its Consolidated Subsidiaries determined in accordance with Agreement Accounting Principles (but excluding the effect of Statement of Financial Accounting Standards No. 115).

"Non-Excluded Taxes" is defined in Section 2.17(a).

"Note" means a promissory note in substantially the form of Exhibit A hereto, with appropriate insertions, duly executed and delivered to the Agent by each of the Borrowers and payable to the order of a Lender in the amount of its Commitment, including any amendment, modification, renewal or replacement of such promissory note.

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"Notice of Assignment" is defined in Section 12.3.2.

"Obligations" means all unpaid principal of and accrued and unpaid interest on the Notes, all accrued and unpaid fees and all expenses, reimbursements, indemnities and other obligations of the Borrowers to the Lenders or to any Lender, the Agent or any indemnified party hereunder arising under any of the Loan Documents.

"Participants" is defined in Section 12.2.1.

"Payment Date" means the last day of each March, June, September and December.

"PBGC" means the Pension Benefit Guaranty Corporation or any successor thereto.

"Person" means any natural person, corporation, firm, joint venture, partnership, association, enterprise, trust or other entity or organization, or any government or political subdivision or any agency, department or

instrumentality thereof.

"Plan" means an employee pension benefit plan, as defined in Section 3(2) of ERISA, as to which the Borrower or any member of the Controlled Group may have any liability.

"Proceeding" is defined in Section 5.18.

"Property" of a Person means any and all property, whether real, personal, tangible, intangible, or mixed, of such Person, or other assets owned, leased or operated by such Person.

"pro-rata" means, when used with respect to a Lender, and any described aggregate or total amount, an amount equal to such Lender's pro-rata share or portion based on its percentage of the Aggregate Commitment or if the Aggregate Commitment has been terminated, its percentage of the aggregate principal amount of outstanding Advances.

"Purchasers" is defined in Section 12.3.1.

"Rate Hedging Obligations" of a Person means any and all obligations of such Person, whether absolute or contingent and howsoever and whensoever created, arising, evidenced or acquired (including all renewals, extensions and modifications thereof and substitutions therefor), under (a) any and all agreements, devices or arrangements designed to protect at least one of the parties thereto from the fluctuations of interest rates, exchange rates or forward rates applicable to such party's assets, liabilities or exchange transactions, including, but not limited to, dollar-denominated or cross-currency interest rate exchange agreements, forward currency exchange agreements, interest rate cap or collar protection agreements, forward rate currency or interest rate options, puts and warrants, and (b) any and all cancellations, buy backs, reversals, terminations or

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assignments of any of the foregoing.

"Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of Governors relating to reserve requirements applicable to depository institutions.

"Regulation G" means Regulation G of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by Persons other than banks, brokers and dealers for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation T" means Regulation T of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of such Board of Governors relating to the extension of credit by securities brokers and dealers for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation U" means Regulation U of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by banks for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation X" means Regulation X of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by the specified lenders for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Release" is defined in the Comprehensive Environmental Response, Compensation and Liability Act, as amended, 42 U.S.C. 39601 et seq.

"Relevant Borrower" means, with respect to any outstanding or requested Loan or Advance, whichever of the Borrowers is the existing or proposed primary obligor in respect of such Loan or Advance.

"Reportable Event" means a reportable event as defined in Section 4043 of ERISA and the regulations issued under such section, with respect to a Plan, excluding, however, such events as to which the PBGC has by regulation waived the requirement of Section 4043(a) of ERISA that it be notified within 30 days of the occurrence of such event; provided, that a failure to meet the minimum funding standard of Section 412 of the Code and of Section 302 of ERISA shall be a Reportable Event regardless of the issuance of any such waiver of the notice requirement in accordance with

either Section 4043(a) of ERISA or Section 412(d) of the Code.

"Required Lenders" means Lenders in the aggregate having at least 66-2/3% of the Aggregate Commitment or, if the Aggregate Commitment has been terminated, Lenders in the aggregate holding at least 66-2/3% of the aggregate unpaid principal amount of the outstanding Loans.

"Reserve Requirement" means, with respect to an Interest Period, the maximum aggregate reserve requirement (including all basic, supplemental, marginal and other reserves) which is imposed under Regulation D on Eurocurrency liabilities.

"Revolver Termination Date" means July 30, 1998.

"Risk-Based Capital Guidelines" is defined in Section 3.2.

"S&P" means Standard & Poor's Ratings Group, and any successor thereto.

"Section" means a numbered section of this Agreement, unless another document is specifically referenced.

"Significant Subsidiary" shall mean and include, at any time, the Subsidiary Borrower and each other Subsidiary of the Borrower to the extent that the Net Worth of such Subsidiary is equal to or greater than \$5,000,000.

"Single Employer Plan" means a Plan subject to Title IV of ERISA maintained by the Borrower or any member of the Controlled Group for employees of the Borrower or any member of the Controlled Group, other than a Multiemployer Plan.

"Solvent" means, when used with respect to a Person, that (a) the fair saleable value of the assets of such Person is in excess of the total amount of the present value of its liabilities (including for purposes of this definition all liabilities (including loss reserves as determined by such Person), whether or not reflected on a balance sheet prepared in accordance with Agreement Accounting Principles and whether direct or indirect, fixed or contingent, secured or unsecured, disputed or undisputed), (b) such Person is able to pay its debts or obligations in the ordinary course as they mature and (c) such Person does not have unreasonably small capital to carry out its business as conducted and as proposed to be conducted. "Solvency" shall have a correlative meaning.

"SOMSC" means Source One Mortgage Services Corporation, a Delaware corporation.

"SOMSC Credit Agreement" means the credit agreement or credit agreements from time to time in effect among SOMSC, the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented, restated, replaced or otherwise

modified from time to time (and, subsequent to the termination thereof, as in effect on the date of such termination).

"Stock Transfers" means, collectively, (a) any repurchase by the Borrower of its capital stock and (b) any extraordinary dividend or distribution declared and paid or made by the Borrower to the holders of its capital stock, including, without limitation, any distribution by the Borrower of the shares of capital stock of any of its Subsidiaries.

"Subsidiary" of a Person means (a) any corporation more than 50% of the outstanding securities having ordinary voting power of which shall at the time be owned or controlled, directly or indirectly, by such Person or by one or more of its Subsidiaries or by such Person and one or more of its Subsidiaries, or (b) any partnership, association, joint venture, limited liability company or similar business organization more than 50% of the ownership interests having ordinary voting power of which shall at the time be so owned or controlled. Unless otherwise expressly provided, all references herein to a "Subsidiary" shall mean a Subsidiary of the Borrower.

"Subsidiary Borrower" means Fund American Enterprises, Inc., a Delaware corporation.

"Subsidiary Guarantor" means the Subsidiary Borrower in its capacity as a

guarantor pursuant to Article XV.

"Termination Event" means, with respect to a Plan which is subject to Title IV of ERISA, (a) a Reportable Event, (b) the withdrawal of the Borrower or any other member of the Controlled Group from such Plan during a plan year in which the Borrower or any other member of the Controlled Group was a "substantial employer" as defined in Section 4001(a)(2) of ERISA or was deemed such under Section 4068(f) of ERISA, (c) the termination of such Plan, the filing of a notice of intent to terminate such Plan or the treatment of an amendment of such Plan as a termination under Section 4041 of ERISA, (d) the institution by the PBGC of proceedings to terminate such Plan or (e) any event or condition which might constitute grounds under Section 4042 of ERISA for the termination of, or appointment of a trustee to administer, such Plan.

"Transferee" is defined in Section 12.4.

"Type" means, with respect to any Advance, its nature as an ABR Advance or Eurodollar Advance.

"Unfunded Liability" means the amount (if any) by which the present value of all vested and unvested accrued benefits under a Single Employer Plan exceeds the fair market value of assets allocable to such benefits, all determined as of the then most recent valuation date for such Plans using PBGC actuarial assumptions for single employer plan terminations.

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"Unmatured Default" means an event which but for the lapse of time or the giving of notice, or both, would constitute a Default.

"Unrestricted Subsidiary" means SOMSC and any Subsidiary thereof.

"US West Preferred Stock" means the US West Series B cumulative redeemable preferred stock \$1.00 par value per share purchased by the Borrower pursuant to and subject to the terms of the Securities Purchase Agreement dated April 10, 1994 among the Borrower, US West, Inc., US West Capital Corporation and Financial Security Assurance Holdings Ltd. (as such agreement may be amended from time to time).

"Valley Credit Agreement" means the Amended and Restated Credit Agreement, dated as of July 30, 1997, among Valley Group, Inc., the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented or otherwise modified from time to time (and, subsequent to the termination thereof, as in effect on the date of such termination).

"White Mountains" means White Mountains Holdings, Inc., a Delaware corporation formerly known as Fund American Enterprises, Inc. and the survivor of a merger with White Mountains Holdings, Inc., a New Hampshire corporation.

"White Mountains Credit Agreement" means the Amended and Restated Credit Agreement, dated as of July 30, 1997, among White Mountains, the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented or otherwise modified from time to time (and, subsequent to the termination thereof, as in effect on the date of such termination).

"Wholly-Owned Subsidiary" of a Person means (a) any Subsidiary all of the outstanding voting securities of which (other than directors' qualifying or similar shares) shall at the time be owned or controlled, directly or indirectly, by such Person or one or more Wholly-Owned Subsidiaries of such Person, or by such Person and one or more Wholly-Owned Subsidiaries of such Person, or (b) any partnership, association, joint venture, limited liability company or similar business organization 100% of the ownership interests having ordinary voting power of which (other than directors' qualifying shares) shall at the time be so owned or controlled.

The foregoing definitions (other than the definitions of "Borrower" and "Borrowers") shall be equally applicable to both the singular and plural forms of the defined terms.

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ARTICLE II

THE CREDITS

2.1. Advances. (a) From and including the date hereof to but excluding the Revolver Termination Date, each Lender severally (and not jointly) agrees, on the terms and conditions set forth in this Agreement, to make Advances to the Borrowers from time to time in amounts not to exceed in the aggregate at any one

time outstanding the amount of its pro-rata share of the Aggregate Commitment existing at such time. Subject to the terms of this Agreement, the Borrowers may borrow, repay and reborrow Advances at any time prior to the Revolver Termination Date. The Commitments to lend hereunder shall expire on the Revolver Termination Date. Principal payments made after the Revolver Termination Date may not be reborrowed.

(b) The Borrowers hereby agree that if at any time, prior to the Revolver Termination Date, as a result of reductions in the Aggregate Commitment pursuant to Section 2.4 or otherwise, the aggregate balance of the Loans exceeds the Aggregate Commitment, they shall repay, or cause to be repaid, immediately outstanding Loans in such amount as may be necessary to eliminate such excess.

(c) The Borrowers' obligation to pay the principal of, and interest on, the Loans shall be evidenced by the Notes. Although the Notes shall be dated the date of this Agreement, interest in respect thereof shall be payable only for the periods during which the Loans evidenced thereby are outstanding and, although the stated amount of each Note shall be equal to the applicable Lender's Commitment, each Note shall be enforceable, with respect to the Relevant Borrower's obligation to pay the principal amount thereof, only to the extent of the unpaid principal amount of the Loans at the time evidenced thereby.

(d) All Advances and all Loans shall mature, and the principal amount thereof and the unpaid accrued interest thereon shall be due and payable in full, on the Maturity Date.

2.2. Ratable Loans. Each Advance hereunder shall consist of Loans made from the several Lenders ratably in proportion to the ratio that their respective Commitments bear to the Aggregate Commitment.

2.3. Types of Advances. The Advances may be ABR Advances or Eurodollar Advances, or a combination thereof, selected by the Borrower in accordance with Sections 2.7 and 2.8.

2.4. Facility Fee; Reductions in Aggregate Commitment. (a) The Borrower agrees to pay to the Agent for the account of each Lender a facility fee ("Facility Fee") in an amount equal to the Applicable Facility Fee Margin per annum times the daily average Commitment (or, on and after

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the Revolver Termination Date, times the aggregate outstanding principal amount of the Loans) of such Lender from the date hereof to and including the Maturity Date, payable on each Payment Date hereafter and on the Maturity Date. All accrued Facility Fees shall be payable on the effective date of any termination of the obligations of the Lenders to make Loans hereunder.

(b) The Borrower may permanently reduce the Aggregate Commitment in whole, or in part ratably among the Lenders in a minimum aggregate amount of \$2,000,000, upon at least three (3) Business Days' written notice to the Agent, which notice shall specify the amount of any such reduction; provided, however, that the amount of the Aggregate Commitment may not be reduced below the aggregate principal amount of the outstanding Advances.

2.5. Minimum Amount of Each Advance. Each Advance shall be in the minimum amount of \$2,000,000 (and in integral multiples of \$500,000 if in excess thereof), provided, however, that (a) any ABR Advance may be in the amount of the unused Aggregate Commitment and (b) in no event shall more than six (6) Eurodollar Advances be permitted to be outstanding at any time.

2.6. Optional Principal Payments. The Borrowers may from time to time pay, without penalty or premium, all outstanding ABR Advances, or, in a minimum aggregate amount of \$2,000,000, any portion of the outstanding ABR Advances, upon two Business Days' prior notice to the Agent. Subject to Section 3.4 and upon like notice, a Eurodollar Advance may be paid prior to the last day of the applicable Interest Period in a minimum amount of \$2,000,000 or an integral multiple of \$500,000 in excess thereof.

2.7. Method of Selecting Types and Interest Periods for New Advances. The Borrower shall select the Type of Advance and, in the case of each Eurodollar Advance, the Interest Period applicable to each Advance from time to time; provided, however, that in the event Loans are incurred on the date of this Agreement, all Loans incurred on such date shall be ABR Advances. The Borrower shall give the Agent irrevocable notice (a "Borrowing Notice") not later than 10:00 a.m. (Chicago time) on the Borrowing Date of each ABR Advance and at least three (3) Business Days before the Borrowing Date for each Eurodollar Advance, specifying:

- (a) the Borrowing Date of such Advance, which shall be a Business Day;
- (b) the Relevant Borrower which is to receive such Advance;
- (c) the aggregate amount of such Advance;

- (d) the Type of Advance selected;
- (e) in the case of each Eurodollar Advance, the Interest Period applicable thereto,

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which shall end on or prior to the Maturity Date; and

- (f) any changes to money transfer instructions previously delivered to the Agent.

Not later than noon (Chicago time) on each Borrowing Date, each Lender shall make available its Loan or Loans, in funds immediately available in Chicago, to the Agent at its address specified pursuant to Article XIII. The Agent will make the funds so received from the Lenders available to the Borrower at the Agent's aforesaid address or at such account at such other institution in the United States of America as the Borrower may indicate in the Borrowing Notice.

2.8. Conversion and Continuation of Outstanding Advances. ABR Advances shall continue as ABR Advances unless and until such ABR Advances are converted into Eurodollar Advances. Each Eurodollar Advance shall continue as a Eurodollar Advance until the end of the then applicable Interest Period therefor, at which time such Eurodollar Advance shall be automatically converted into an ABR Advance unless the Borrower shall have given the Agent a Conversion/Continuation Notice requesting that, at the end of such Interest Period, such Eurodollar Advance continue as a Eurodollar Advance for the same or another Interest Period. Subject to the terms of Section 2.5, the Borrower may elect from time to time to convert all or any part of an Advance of any Type into any other Type or Types of Advances; provided, however, that any conversion of any Eurodollar Advance shall be made on, and only on, the last day of the Interest Period applicable thereto. The Borrower shall give the Agent irrevocable notice (a "Conversion/Continuation Notice") of each conversion of an ABR Advance or continuation of a Eurodollar Advance not later than 10:00 a.m. (Chicago time) on the conversion date, in the case of a conversion into an ABR Advance, or at least three (3) Business Days, in the case of a conversion into or continuation of a Eurodollar Advance, prior to the date of the requested conversion or continuation, specifying:

- (a) the requested date of such conversion or continuation, which shall be a Business Day;
- (b) the Relevant Borrower with respect to such Advance;
- (c) the aggregate amount and Type of the Advance which is to be converted or continued; and
- (d) the amount and Type(s) of Advance(s) into which such Advance is to be converted or continued and, in the case of a conversion into or continuation of a Eurodollar Advance, the duration of the Interest Period applicable thereto, which shall end on or prior to the Maturity Date.

2.9. Changes in Interest Rate, etc. Each ABR Advance shall bear interest at the

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Alternate Base Rate from and including the date of such Advance or the date on which such Advance was converted into an ABR Advance to (but not including) the date on which such ABR Advance is paid or converted to a Eurodollar Advance. Changes in the rate of interest on that portion of any Advance maintained as an ABR Advance will take effect simultaneously with each change in the Alternate Base Rate. Each Eurodollar Advance shall bear interest from and including the first day of the Interest Period applicable thereto to, but not including, the last day of such Interest Period at the Eurodollar Rate determined as applicable to such Eurodollar Advance plus the Applicable Eurodollar Margin. Changes in the Applicable Eurodollar Margin will take effect simultaneously with each change in a Level. No Interest Period may end after the Revolver Termination Date.

2.10. Rates Applicable After Default. Notwithstanding anything to the contrary contained in Section 2.7 or 2.8, no Advance may be made as, converted into or continued as a Eurodollar Advance (except with the consent of the Agent and the Required Lenders) when any Default or Unmatured Default has occurred and is continuing. During the continuance of a Default the Required Lenders may, at their option, by notice to the Borrower (which notice may be revoked at the option of the Required Lenders notwithstanding any provision of Section 8.2 requiring unanimous consent of the Lenders to changes in interest rates), declare that each Eurodollar Advance and ABR Advance shall bear interest (for the remainder of the applicable Interest Period in the case of Eurodollar

Advances) at a rate per annum equal to the rate otherwise applicable plus two percent (2%) per annum; provided, however, that such increased rate shall automatically and without action of any kind by the Lenders become and remain applicable until revoked by the Required Lenders in the event of a Default described in Section 7.6 or 7.7.

2.11. Method of Payment. All payments of the Obligations hereunder shall be made, without setoff, deduction or counterclaim, in immediately available funds to the Agent at the Agent's address specified pursuant to Article XIII, or at any other Lending Installation of the Agent specified in writing by the Agent to the Borrower (at least two Business Days in advance), by noon (Chicago time) on the date when due and shall be applied ratably by the Agent among the Lenders. Each payment delivered to the Agent for the account of any Lender shall be delivered promptly by the Agent to such Lender in the same type of funds that the Agent received at its address specified pursuant to Article XIII or at any Lending Installation specified in a notice received by the Agent from such Lender. The Agent is hereby authorized to charge the account of the Borrower maintained with the Agent for each payment of principal, interest and fees as it becomes due hereunder.

2.12. Notes. Each Lender is hereby authorized to record the principal amount of each of its Loans and each repayment on the schedule attached to its Note; provided, however, that neither the failure to so record nor any error in such recordation shall affect the Relevant Borrower's obligations under such Note.

2.13. Interest Payment Dates; Interest and Fee Basis. Interest accrued on each ABR Advance shall be payable on each Payment Date, commencing with the first such date to occur after the date hereof, on any date on which an ABR Advance is prepaid, whether due to acceleration or

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otherwise, and at maturity. Interest accrued on that portion of the outstanding principal amount of any ABR Advance converted into a Eurodollar Advance on a day other than a Payment Date shall be payable on the date of conversion. Interest accrued on each Eurodollar Advance shall be payable on the last day of its applicable Interest Period, on any date on which the Eurodollar Advance is prepaid, whether by acceleration or otherwise, and at maturity. Interest accrued on each Eurodollar Advance having an Interest Period longer than three months shall also be payable on the last day of each three-month interval during such Interest Period. Interest and commitment fees shall be calculated for actual days elapsed on the basis of a 360-day year. Interest shall be payable for the day an Advance is made but not for the day of any payment on the amount paid if payment is received prior to noon (Chicago time) at the place of payment. If any payment of principal or interest on an Advance shall become due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and, in the case of a principal payment, such extension of time shall be included in computing interest in connection with such payment.

2.14. Notification of Advances, Interest Rates, Prepayments and Commitment Reductions. Promptly after receipt thereof, the Agent will notify each Lender of the contents of each Aggregate Commitment reduction notice, Borrowing Notice, Conversion/Continuation Notice, and repayment notice received by it hereunder. The Agent will notify each Lender of the interest rate applicable to each Eurodollar Advance promptly upon determination of such interest rate and will give each Lender prompt notice of each change in the Alternate Base Rate.

2.15. Lending Installations. Each Lender may book its Loans at any Lending Installation selected by such Lender and may change its Lending Installation from time to time. All terms of this Agreement shall apply to any such Lending Installation and the Notes shall be deemed held by each Lender for the benefit of such Lending Installation. Each Lender may, by written or telex notice to the Agent and the Borrower, designate a Lending Installation through which Loans will be made by it and for whose account Loan payments are to be made.

2.16. Non-Receipt of Funds by the Agent. Unless the Borrowers or a Lender, as the case may be, notifies the Agent prior to the date on which it is scheduled to make payment to the Agent of (a) in the case of a Lender, the proceeds of a Loan, or (b) in the case of the Borrowers, a payment of principal, interest or fees to the Agent for the account of the Lenders, that it does not intend to make such payment, the Agent may assume that such payment has been made. The Agent may, but shall not be obligated to, make the amount of such payment available to the intended recipient in reliance upon such assumption. If the Borrowers have not in fact made such payment to the Agent, the Lenders shall, on demand by the Agent, repay to the Agent the amount so made available together with interest thereon in respect of each day during the period commencing on the date such amount was so made available by the Agent until the date the Agent recovers such amount at a rate per annum equal to the Federal Funds Effective Rate for such day. If any Lender has not in fact made such payment to the Agent, such Lender or the Borrowers shall, on demand by the Agent, repay to the Agent the amount so

during the period commencing on the date such amount was so made available by the Agent until the date the Agent recovers such amount at a rate per annum equal to (a) in the case of payment by a Lender, the Federal Funds Effective Rate for such day, or (b) in the case of payment by the Borrowers, the interest rate applicable to the relevant Loan.

2.17. Taxes. (a) Any payments made by the Borrowers under this Agreement shall be made free and clear of, and without deduction or withholding for or on account of, any present or future income, stamp or other taxes, levies, imposts, duties, charges, fees, deductions or withholdings, now or hereafter imposed, levied, collected, withheld or assessed by any Governmental Authority, excluding net income taxes and franchise taxes or any other tax based upon any income imposed on the Agent or any Lender by the jurisdiction in which the Agent or such Lender is incorporated or has its principal place of business or maintains its Lending Installation. If any such non-excluded taxes, levies, imposts, duties, charges, fees, deductions or withholdings ("Non-Excluded Taxes") are required to be withheld from any amounts payable to the Agent or any Lender hereunder, the amounts so payable to the Agent or such Lender shall be increased to the extent necessary to yield to the Agent or such Lender (after payment of all Non-Excluded Taxes) interest or any such other amounts payable hereunder at the rates or in the amounts specified in or pursuant to this Agreement; provided, however, that the Borrowers shall not be required to increase any such amounts payable to any Lender that is not organized under the laws of the U.S. or a state thereof if such Lender fails to comply with the requirements of paragraph (b) of this Section 2.17. Whenever any Non-Excluded Taxes are payable by the Borrowers, as promptly as practicable thereafter the Borrowers shall send to the Agent for its own account or for the account of such Lender, as the case may be, a certified copy of an original official receipt received by the Borrower showing payment thereof. If the Borrowers fails to pay any Non-Excluded Taxes when due to the appropriate taxing authority or fails to remit to the Agent the required receipts or other required documentary evidence, the Borrowers shall indemnify the Agent and the Lenders for any incremental taxes, interest or penalties that may become payable by any Agent or any Lender as a result of any such failure. The agreements in this Section 2.17 shall survive the termination of this Agreement and the payment of all other amounts payable hereunder.

(b) At least five Business Days prior to the first date on which interest or fees are payable hereunder for the account of any Lender, each Lender that is not incorporated under the laws of the United States of America, or a state thereof, agrees that it will deliver to each of the Borrowers and the Agent two duly completed and properly executed copies of United States Internal Revenue Service Form 1001 or 4224 (or a successor form), certifying in either case that such Lender is entitled to receive payments under this Agreement and the Notes without deduction or withholding of any United States federal income taxes. Each Lender which so delivers a Form 1001 or 4224 (or a successor form) further undertakes to deliver to each of the Borrower and the Agent two additional duly completed and properly executed copies of such form (or a successor form) on or before the date that such form expires (currently, three successive calendar years for Form 1001 and each tax year for Form 4224) or becomes obsolete or after the occurrence of any event requiring a change in

the most recent forms so delivered by it, and such amendments thereto or extensions or renewals thereof as may be reasonably requested by the Borrowers or the Agent, in each case certifying that such Lender is entitled to receive payments under this Agreement and the Notes without deduction or withholding of any United States federal income taxes, unless an event (including, without limitation, any change in treaty, law or regulation) has occurred prior to the date on which any such delivery would otherwise be required which renders all such forms inapplicable or which would prevent such Lender from duly completing and delivering any such form with respect to it and such Lender advises the Borrowers and the Agent that it is not capable of receiving payments without any deduction or withholding of United States federal income tax.

2.18. Agent's Fees. The Borrowers shall pay to the Agent those fees, in addition to the Facility Fees referenced in Section 2.4(a), in the amounts and at the times separately agreed to between the Agent and the Borrowers.

ARTICLE III

CHANGE IN CIRCUMSTANCES

3.1. Yield Protection. If, after the date hereof, the adoption of or any change in any law or any governmental or quasi-governmental rule, regulation, policy, guideline or directive (whether or not having the force of law), or any new interpretation thereof, or the compliance of any Lender with such adoption, change or interpretation.

(a) subjects any Lender or any applicable Lending Installation to any tax, duty, charge or withholding on or from payments due from either of the Borrowers (excluding taxation of the overall net income of any Lender or applicable Lending Installation imposed by the jurisdiction in which such Lender or Lending Installation is incorporated or has its principal place of business), or changes the basis of taxation of principal, interest or any other payments to any Lender or Lending Installation in respect of its Loans or other amounts due it hereunder, or

(b) imposes or increases or deems applicable any reserve, assessment, insurance charge, special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by, any Lender or any applicable Lending Installation (other than reserves and assessments taken into account in determining the interest rate applicable to Eurodollar Advances), or

(c) imposes any other condition the result of which is to increase the cost to any Lender or any applicable Lending Installation of making, funding or maintaining Loans or reduces any amount receivable by any Lender or any applicable Lending Installation in connection with any Loans, or requires any Lender or any applicable Lending Installation to make any payment calculated by reference to the amount of Loans held, or interest received by it, by an amount deemed material by such Lender,

then, within 15 days of demand by such Lender, the Borrower shall pay such Lender that portion of such increased expense incurred or resulting in an amount received which such Lender determines is attributable to making, funding and maintaining its Loans and its Commitment.

3.2. Changes in Capital Adequacy Regulations. If a Lender determines the amount of capital required or expected to be maintained by such Lender, any Lending Installation of such Lender or any corporation controlling such Lender is increased as a result of a Change, then, within 15 days of demand by such Lender, the Borrower shall pay such Lender the amount necessary to compensate for any shortfall in the rate of return on the portion of such increased capital which such

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Lender determines is attributable to this Agreement, its Loans or its obligation to make Loans hereunder (after taking into account such Lender's policies as to capital adequacy). "Change" means (a) any change after the date of this Agreement in the Risk-Based Capital Guidelines, or (b) any adoption of or change in any other law, governmental or quasi-governmental rule, regulation, policy, guideline, interpretation, or directive (whether or not having the force of law) after the date of this Agreement which affects the amount of capital required or expected to be maintained by any Lender or any Lending Installation or any corporation controlling any Lender. "Risk-Based Capital Guidelines" means (a) the risk-based capital guidelines in effect in the United States on the date of this Agreement and (b) the corresponding capital regulations promulgated by regulatory authorities outside the United States implementing the July 1988 report of the Basle Committee on Banking Regulation and Supervisory Practices entitled "International Convergence of Capital Measurements and Capital Standards" and any amendments to such regulations adopted prior to the date of this Agreement.

3.3. Availability of Types of Advances. If any Lender determines that maintenance of its Eurodollar Loans at a suitable Lending Installation would violate any applicable law, rule, regulation, or directive, whether or not having the force of law, or if the Required Lenders determine that (a) deposits of a type and maturity appropriate to match fund Eurodollar Advances are not available, or (b) the interest rate applicable to a Eurodollar Advance does not accurately or fairly reflect the cost of making or maintaining such Advance, then the Agent shall suspend the availability of Eurodollar Advances until such circumstance no longer exists and require any Eurodollar Advances to be repaid.

3.4. Funding Indemnification. If any payment of a Eurodollar Advance occurs on a date which is not the last day of the applicable Interest Period, whether because of acceleration, prepayment or otherwise, or a Eurodollar

Advance is not made on the date specified by the Relevant Borrower for any reason other than default by the Lenders, the Borrower will indemnify the Agent and each Lender for any loss or cost incurred by it resulting therefrom, including, without limitation, any loss or cost in liquidating or employing deposits acquired to fund or maintain the Eurodollar Advance.

3.5. Lender Statements; Survival of Indemnity. To the extent reasonably possible, each Lender shall designate an alternate Lending Installation with respect to its Eurodollar Advances to reduce any liability of the Borrower to such Lender under Sections 2.17, 3.1 and 3.2 or to avoid the unavailability of a Type of Advance under Section 3.3, so long as such designation is not disadvantageous to such Lender. Each Lender shall deliver a written statement of such Lender to the Borrower (with a copy to the Agent) as to the amount due, if any, under Section 3.1, 3.2 or 3.4. Such written statement shall set forth in reasonable detail the calculations upon which such Lender determined such amount and shall be final, conclusive and binding on the Borrower in the absence of manifest error. Determination of amounts payable under such Sections in connection with a Eurodollar Advance shall be calculated as though each Lender funded its Eurodollar Advances

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through the purchase of a deposit of the type and maturity corresponding to the deposit used as a reference in determining the Eurodollar Rate applicable to such Loan, whether in fact that is the case or not. Unless otherwise provided herein, the amount specified in the written statement of any Lender shall be payable on demand after receipt by the Borrower of the written statement. The obligations of the Borrower under Sections 3.1, 3.2 and 3.4 shall survive payment of the Obligations and termination of this Agreement.

ARTICLE IV

CONDITIONS PRECEDENT

4.1. Initial Loans. The Lenders shall not be required to make the initial Advance hereunder unless the Borrower has furnished the following to the Agent with sufficient copies for the Lenders and the other conditions set forth below have been satisfied:

(a) Charter Documents; Good Standing Certificates. Copies of the certificate of incorporation of the Borrower and the Subsidiary Borrower, together with all amendments thereto, both certified by the appropriate governmental officer in their respective jurisdictions of incorporation, together with a good standing certificate issued by the Secretary of State of their respective jurisdictions of incorporation and such other jurisdictions as shall be reasonably requested by the Agent.

(b) By-Laws and Resolutions. Copies, certified by the Secretary or Assistant Secretary of the Borrower and the Subsidiary Borrower, of their respective by-laws and of their respective Board of Directors' resolutions authorizing the execution, delivery and performance of the Loan Documents to which the Borrower and the Subsidiary Borrower are a party.

(c) Secretary's Certificate. An incumbency certificate, executed by the Secretary or Assistant Secretary of each of the Borrower and the Subsidiary Borrower, which shall identify by name and title and bear the signature of the officers of the Borrower and the Subsidiary Borrower authorized to sign the Loan Documents and to make borrowings hereunder, upon which certificate the Agent and the Lenders shall be entitled to rely until informed of any change in writing by the Borrower and the Subsidiary Borrower.

(d) Officer's Certificate. A certificate signed by an Authorized Officer of the Borrower and the Subsidiary Borrower, in form and substance satisfactory to the Agent, to the effect that on the date hereof (both before and after giving effect to the consummation of the other transactions contemplated hereby and the making of any Loans hereunder on

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such date): (i) no Default or Unmatured Default has occurred and is continuing; (ii) no injunction or temporary restraining order which would prohibit the making of the Loans or other litigation which could reasonably be expected to have a Material Adverse Effect is pending or, to the best of such Person's knowledge, threatened; (iii) all orders, consents, approvals, licenses, authorizations, or validations of, or filings, recordings or registrations with,

or exemptions by, any Governmental Authority required in connection with the execution, delivery and performance of this Agreement have been or, prior to the time required, will have been, obtained, given, filed or taken and are or will be in full force and effect (or the Borrowers have obtained effective judicial relief with respect to the application thereof) and all applicable waiting periods have expired; (iv) each of the representations and warranties set forth in Article V of this Agreement is true and correct on and as of the date hereof; and (v) since December 31, 1996, no event or change has occurred that has caused or evidences a Material Adverse Effect.

(ei Legal Opinion. (i) A written opinion of Brobeck, Phleger & Harrison LLP, counsel to the Borrowers, addressed to the Agent and the Lenders in form and substance acceptable to the Agent and its counsel.

(fi Notes. Notes payable to the order of each of the Lenders duly executed by each of the Borrowers.

(gi Loan Documents. Executed originals of this Agreement and each of the Loan Documents, which shall be in full force and effect, together with all schedules, exhibits, certificates, instruments, opinions, documents and financial statements required to be delivered pursuant hereto and thereto.

(hi Letters of Direction. Written money transfer instructions with respect to the initial Advances and to future Advances in form and substance acceptable to the Agent and its counsel addressed to the Agent and signed by an Authorized Officer, together with such other related money transfer authorizations as the Agent may have reasonably requested.

(ii Solvency Certificate. A written solvency certificate from the chief financial officer of the Borrower and the Subsidiary Borrower in form and content satisfactory to the Agent with respect to the value, Solvency and other factual information of, or relating to, as the case may be, the Borrower, on a consolidated basis, and of the Subsidiary Borrower, on a consolidated basis.

(ji Bank Payoff Letter. A bank payoff letter, or other evidence of satisfaction, in form and substance acceptable to the Agent from The First National Bank of Chicago, as agent, to the effect that the total amount due under the Credit Agreement, dated as of November 26, 1996, among the Borrower, Fund American Enterprises, Inc., The First

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National Bank of Chicago, individually and as agent, and Fleet National Bank howsoever due and owing (whether as principal or interest) shall be satisfied (and such agreements terminated) upon payment of an amount certain and such amount shall have been paid.

(ki Other. Such other documents as the Agent, any Lender or their counsel may have reasonably requested.

4.2. Each Future Advance. The Lenders shall not be required to make any Advance unless on the applicable Borrowing Date:

(ai There exists no Default or Unmatured Default and none would result from such Advance;

(bi The representations and warranties contained in Article V are true and correct as of such Borrowing Date (except to the extent such representations and warranties are expressly made as of a specified date, in which event such representations and warranties shall be true and correct as of such specified date);

(ci A Borrowing Notice shall have been properly submitted; and

(di All legal matters incident to the making of such Advance shall be satisfactory to the Lenders and their counsel.

Each Borrowing Notice with respect to each such Advance shall constitute a representation and warranty by the Borrowers that the conditions contained in Section 4.2 (a), (b) and (c) have been satisfied. Any Lender may require a duly completed compliance certificate in substantially the form of Exhibit B hereto as a condition to making an Advance.

ARTICLE V

REPRESENTATIONS AND WARRANTIES

The Borrowers represent and warrant to the Lenders that:

5.1. Corporate Existence and Standing. Each of the Borrower and each Subsidiary is a corporation duly incorporated, validly existing and in good standing under the laws of its respective jurisdiction of incorporation and is

duly qualified and in good standing as a foreign corporation and is duly authorized to conduct its business in each jurisdiction in which its business is conducted or proposed to be conducted, except where the failure to be so qualified could not

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reasonably be expected to have a Material Adverse Effect. As of the date of this Agreement, the Subsidiary Borrower is a Wholly-Owned Subsidiary of White Mountains.

5.2. Authorization and Validity. Each of the Borrowers has all requisite power and authority (corporate and otherwise) and legal right to execute and deliver each of the Loan Documents to which it is a party and to perform its obligations thereunder. The execution and delivery by each of the Borrower of the Loan Documents to which it is a party and the performance of their respective obligations thereunder have been duly authorized by proper corporate proceedings and the Loan Documents constitute legal, valid and binding obligations of the Borrowers, as applicable, enforceable against the Borrowers, as applicable, in accordance with their terms, except as enforceability may be limited by bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally.

5.3. Compliance with Laws and Contracts. The Borrower and its Subsidiaries have complied in all material respects with all applicable statutes, rules, regulations, orders and restrictions of any domestic or foreign government or any instrumentality or agency thereof, having jurisdiction over the conduct of their respective businesses or the ownership of their respective properties, except where the failure to so comply could not reasonably be expected to have a Material Adverse Effect. Neither the execution and delivery by the Borrowers of the Loan Documents to which it is a party, the application of the proceeds of the Loans or the consummation of the transactions contemplated in the Loan Documents, nor compliance with the provisions of the Loan Documents will, or at the relevant time did, (a) violate any law, rule, regulation (including Regulations G, T, U and X), order, writ, judgment, injunction, decree or award binding on the Borrower or any Subsidiary or the Borrower's or any Subsidiary's charter, articles or certificate of incorporation or by-laws, (b) violate the provisions of or require the approval or consent of any party to any indenture, instrument or agreement to which the Borrower or any Subsidiary is a party or is subject, or by which it, or its property, is bound, or conflict with or constitute a default thereunder, or result in the creation or imposition of any Lien (other than Liens permitted by, the Loan Documents) in, of or on the property of the Borrower or any Subsidiary pursuant to the terms of any such indenture, instrument or agreement, or (c) require any consent of the stockholders of any Person, except for approvals or consents which will be obtained on or before the initial Advance and are disclosed on Schedule 5.3, except for any violation of, or failure to obtain an approval or consent required under, any such indenture, instrument or agreement that could not reasonably be expected to have a Material Adverse Effect.

5.4. Governmental Consents. No order, consent, approval, qualification, license, authorization, or validation of, or filing, recording or registration with, or exemption by, or other action in respect of, any court, governmental or public body or authority, or any subdivision thereof, any securities exchange or other Person is or at the relevant time was required to authorize, or is or at the relevant time was required in connection with the execution, delivery, consummation or performance of, or the legality, validity, binding effect or enforceability of, any of the Loan

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Documents. Neither the Borrower nor any Subsidiary is in default under or in violation of any foreign, federal, state or local law, rule, regulation, order, writ, judgment, injunction, decree or award binding upon or applicable to the Borrower or such Subsidiary, in each case the consequences of which default or violation could reasonably be expected to have a Material Adverse Effect.

5.5. Financial Statements. The Borrower has heretofore furnished to each of the Lenders (a) the December 31, 1996 audited consolidated financial statements of the Borrower and its Subsidiaries, and (b) the unaudited consolidated financial statements of the Borrower and its Subsidiaries through March 31, 1997 (collectively, the "Financial Statements"). Each of the Financial Statements was prepared in accordance with Agreement Accounting Principles and fairly presents the consolidated financial condition and operations of the Borrower and its Subsidiaries at such dates and the consolidated results of their operations for the respective periods then ended (except, in the case of such unaudited statements, for normal year-end audit adjustments).

5.6. Material Adverse Change. No material adverse change in the business, Property, condition (financial or otherwise), performance, prospects or results of operations of the Borrower and its Subsidiaries or of the Subsidiary Borrower and its Subsidiaries has occurred since December 31, 1996.

5.7. Taxes. The Borrower and its Subsidiaries have filed or caused to be filed on a timely basis and in correct form all United States federal and applicable foreign, state and local tax returns and all other tax returns which are required to be filed and have paid all taxes due pursuant to said returns or pursuant to any assessment received by the Borrower or any Subsidiary, except such taxes, if any, as are being contested in good faith and as to which adequate reserves have been provided in accordance with Agreement Accounting Principles and as to which no Lien exists. As of the date hereof, the United States income tax returns of the Borrower on a consolidated basis have been audited by the Internal Revenue Service through its fiscal period ending December 31, 1985, and all tax years beginning on or after January 1, 1986 are currently being audited or are subject to audit. No tax liens have been filed and no claims are being asserted with respect to any such taxes which could reasonably be expected to have a Material Adverse Effect. The charges, accruals and reserves on the books of the Borrower and its Subsidiaries in respect of any taxes or other governmental charges are in accordance with Agreement Accounting Principles.

5.8. Litigation and Contingent Obligations. There is no litigation, arbitration, proceeding, inquiry or governmental investigation pending or, to the knowledge of any of their officers, threatened against or affecting the Borrower or any Subsidiary or any of their respective properties which could reasonably be expected to have a Material Adverse Effect or to prevent, enjoin or unduly delay the making of the Loans under this Agreement. Neither the Borrower nor any Subsidiary has any material contingent obligations incurred outside of the ordinary course of its business except as set forth on Schedule 5.8 or disclosed in the Financial Statements or in financial statements required to be delivered under Sections 6.1(a) and (b) and as permitted under this

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Agreement.

5.9. Capitalization. Schedule 5.9 hereto contains (a) an accurate description of the Borrower's capitalization as of March 31, 1997 and (b) an accurate list of all of the existing Subsidiaries as of the date of this Agreement, setting forth their respective jurisdictions of incorporation and the percentage of their capital stock owned by the Borrower or other Subsidiaries. All of the issued and outstanding shares of capital stock of the Borrower and of each Subsidiary have been duly authorized and validly issued, are fully paid and non-assessable, and are free and clear of all Liens.

5.10. ERISA. Except as disclosed on Schedule 5.10, neither the Borrower nor any other member of the Controlled Group maintains any Single Employer Plans, and no Single Employer Plan has any Unfunded Liability. Neither the Borrower nor any other member of the Controlled Group maintains, or is obligated to contribute to, any Multiemployer Plan or has incurred, or is reasonably expected to incur, any withdrawal liability to any Multiemployer Plan. Each Plan complies in all material respects with all applicable requirements of law and regulations other than any such failure to comply which could not reasonably be expected to have a Material Adverse Effect. Neither the Borrower nor any member of the Controlled Group has, with respect to any Plan, failed to make any contribution or pay any amount required under Section 412 of the Code or Section 302 of ERISA or the terms of such Plan. There are no pending or, to the knowledge of the Borrower, threatened claims, actions, investigations or lawsuits against any Plan, any fiduciary thereof, or the Borrower or any member of the Controlled Group with respect to a Plan. Neither the Borrower nor any member of the Controlled Group has engaged in any prohibited transaction (as defined in Section 4975 of the Code or Section 406 of ERISA) in connection with any Plan which would subject such Person to any material liability. Within the last five years neither the Borrower nor any member of the Controlled Group has engaged in a transaction which resulted in a Single Employer Plan with an Unfunded Liability being transferred out of the Controlled Group which could reasonably be expected to have a Material Adverse Effect. No Termination Event has occurred or is reasonably expected to occur with respect to any Plan which is subject to Title IV of ERISA which could reasonably be expected to have a Material Adverse Effect.

5.11. Defaults. No Default or Unmatured Default has occurred and is continuing.

5.12. Federal Reserve Regulations. Neither the Borrower nor any Subsidiary is engaged, directly or indirectly, principally, or as one of its important activities, in the business of extending, or arranging for the extension of, credit for the purpose of purchasing or carrying Margin Stock. No part of the proceeds of any Loan will be used in a manner which would violate, or result in a violation of, Regulation G, Regulation T, Regulation U or Regulation X. Neither the making of any Advance hereunder nor the use of the

5.13. Investment Company. Neither the Borrower nor any Subsidiary is, or after giving effect to any Advance will be, an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

5.14. Certain Fees. No broker's or finder's fee or commission was, is or will be payable by the Borrower or any Subsidiary with respect to any of the transactions contemplated by this Agreement, except as described in Section 9.5. The Borrowers hereby jointly and severally agree to indemnify the Agent and the Lenders against, and agree that they will hold each of them harmless from, any claim, demand or liability for broker's or finder's fees or commissions alleged to have been incurred by the Borrowers in connection with any of the transactions contemplated by this Agreement and any expenses (including, without limitation, attorneys' fees and time charges of attorneys for the Agent or any Lender, which attorneys may be employees of the Agent or any Lender) arising in connection with any such claim, demand or liability. No other similar fee or commissions will be payable by the Borrower or any Subsidiary for any other services rendered to the Borrower or any Subsidiary ancillary to any of the transactions contemplated by this Agreement.

5.15. Solvency. As of the date hereof, after giving effect to the consummation of the transactions contemplated by the Loan Documents and the payment of all fees, costs and expenses payable by the Borrower or its Subsidiaries with respect to the transactions contemplated by the Loan Documents and the Loans incurred by the Borrowers under this Agreement, each of the Borrower and the Subsidiary Borrower, each on a consolidated basis, is Solvent.

5.16. Material Agreements. Except as set forth in Schedule 5.16 and except for agreements or arrangements with regulatory agencies with regard to Insurance Subsidiaries or agreements of any Unrestricted Subsidiary, neither the Borrower nor any Subsidiary is a party to any agreement or instrument or subject to any charter or other corporate restriction which could reasonably be expected to have a Material Adverse Effect or which restricts or imposes conditions upon the ability of any Subsidiary to (a) pay dividends or make other distributions on its capital stock (b) make loans or advances to the Borrower, (c) repay loans or advances from Borrower or (d) grant Liens to the Agent to secure the Obligations. Neither the Borrower nor any Subsidiary is in default in the performance, observance or fulfillment of any of the obligations, covenants or conditions contained in any agreement to which it is a party, which default could reasonably be expected to have a Material Adverse Effect.

5.17. Environmental Laws. There are no claims, investigations, litigation, administrative proceedings, notices, requests for information (each a "Proceeding"), whether pending or threatened, or judgments or orders asserting violations of applicable federal, state and local environmental, health and safety statutes, regulations, ordinances, codes, rules, orders, decrees, directives and standards ("Environmental Laws") or relating to any toxic or hazardous waste, substance or chemical or any pollutant, contaminant, chemical or other substance defined or regulated pursuant to any Environmental Law, including, without limitation, asbestos, petroleum, crude oil or any fraction

thereof ("Hazardous Materials") asserted against the Borrower or any of its Subsidiaries other than in connection with an insurance policy issued in the ordinary course of business to any Person (other than the Borrower or any Subsidiary of the Borrower) which, in any case, could reasonably be expected to have a Material Adverse Effect. As of the date hereof, the Borrower and its Subsidiaries do not have liabilities exceeding \$500,000 in the aggregate for all of them with respect to compliance by them with applicable Environmental Laws or related to the generation, treatment, storage, disposal, release, investigation or cleanup by them of Hazardous Materials, and no facts or circumstances exist which could give rise to such liabilities with respect to compliance with applicable Environmental Laws and the generation, treatment, storage, disposal, release, investigation or cleanup of Hazardous Materials.

5.18. Insurance. The Borrower and its Subsidiaries maintain with financially sound and reputable insurance companies insurance on their Property in such amounts and covering such risks as is consistent with sound business practice.

5.19. Disclosure. No information, exhibit or report furnished by either Borrower or any of its Subsidiaries to the Agent or to any Lender in connection with the negotiation of, or compliance with, the Loan Documents contained any

material misstatement of fact or omitted to state a material fact or any fact necessary to make the statements contained therein not materially misleading. There is no fact known to the Borrowers (other than matters of a general economic or political nature) that has had or could reasonably be expected to have a Material Adverse Effect and that has not been disclosed herein or in such other documents, certificates and statements furnished to the Lenders for use in connection with the transactions contemplated by this Agreement.

ARTICLE VI

COVENANTS

During the term of this Agreement, unless the Required Lenders shall otherwise consent in writing:

6.1. Financial Reporting. The Borrower will maintain, for itself and each Subsidiary, a system of accounting established and administered in accordance with generally accepted accounting principles, consistently applied, and furnish to the Lenders:

(ai As soon as practicable and in any event within 100 days after the close of each of its Fiscal Years, an unqualified audit report certified by independent certified public accountants, acceptable to the Lenders, prepared in accordance with Agreement Accounting Principles on a consolidated and consolidating basis (consolidating statements need not be

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certified by such accountants) for itself and its Subsidiaries, including balance sheets as of the end of such period and related statements of income, retained earnings and cash flows.

(bi As soon as practicable and in any event within 60 days after the close of each of the first three Fiscal Quarters of each of its Fiscal Years, for itself and its Subsidiaries, consolidated and consolidating unaudited balance sheets as at the close of each such period and consolidated and consolidating statements of income, retained earnings and cash flows for the period from the beginning of such Fiscal Year to the end of such quarter, all certified by its chief financial officer.

(ci Together with the financial statements required by clauses (a) and (b) above, a compliance certificate in substantially the form of Exhibit B hereto signed by its chief financial officer showing the calculations necessary to determine compliance with this Agreement and stating that no Default or Unmatured Default exists, or if any Default or Unmatured Default exists, stating the nature and status thereof.

(di Promptly after available after the close of each Fiscal Year, a statement of the Unfunded Liabilities of each Single Employer Plan, certified as correct by an actuary enrolled under ERISA.

(ei As soon as possible and in any event within 10 days after the Borrower knows that any Termination Event has occurred with respect to any Plan, a statement, signed by the chief financial officer of the Borrower, describing said Termination Event and the action which the Borrower proposes to take with respect thereto.

(fi As soon as possible and in any event within 10 days after receipt by either Borrower, a copy of (i) any notice, claim, complaint or order to the effect that the Borrower or any of its Subsidiaries is or may be liable to any Person as a result of the release by the Borrower or any of its Subsidiaries of any Hazardous Materials into the environment or requiring that action be taken to respond to or clean up a Release of Hazardous Materials into the environment, and (ii) any notice, complaint or citation alleging any violation of any Environmental Law or Environmental Permit by the Borrower or any of its Subsidiaries. Within ten days of the Borrower or any Subsidiary having knowledge of the enactment or promulgation of any Environmental Law which could reasonably be expected to have a Material Adverse Effect, the Borrower shall provide the Agent with written notice thereof.

(gi Promptly upon the furnishing thereof to the shareholders of the Borrower, copies of all financial statements, reports and proxy statements so furnished.

(hi Promptly upon the filing thereof, copies of all registration statements and annual, quarterly, monthly or other regular reports which the Borrower or any of its

Subsidiaries files with the Securities and Exchange Commission.

(ii Promptly and in any event within ten (10) days after learning thereof, notification of (i) any tax assessment, demand, notice of proposed deficiency or notice of deficiency received by the Borrower or any other Consolidated Person or (ii) the filing of any tax Lien or commencement of any judicial proceeding by or against any such Consolidated Person, if any such assessment, demand, notice, Lien or judicial proceeding relates to tax liabilities in excess of ten percent (10%) of the net worth (determined according to generally accepted accounting standards and without reduction for any reserve for such liabilities) of the Borrower and its Subsidiaries taken as a whole.

(ji Promptly after the same becomes available, any management letter prepared by the accountants conducting the audit of the financial statements delivered pursuant to Section 6.1 (a).

(ki As soon as possible and in any event within 2 Business Days after either Borrower obtains knowledge thereof, notice of any change in the Applicable Credit Rating of S&P or Moody's.

(li Such other information (including non-financial information) as the Agent or any Lender may from time to time reasonably request.

6.2. Use of Proceeds. The Borrower will, and will cause each Subsidiary to, use the proceeds of the Advances to meet the working capital and general corporate needs of the Borrower and its Subsidiaries, including but not limited to the purchase of Finance Assets. The Borrower will not, nor will it permit any Subsidiary to, use any of the proceeds of the Advances in a manner which would violate, or result in a violation of, Regulation G, Regulation T, Regulation U or Regulation X, or to finance the Purchase of any Person which has not been approved and recommended by the board of directors (or functional equivalent thereof) of such Person.

6.3. Notice of Default. The Borrower will give prompt notice in writing to the Lenders of the occurrence of (a) any Default or Unmatured Default and (b) of any other event or development, financial or other, relating specifically to the Borrower or any of its Subsidiaries (and not of a general economic or political nature) which could reasonably be expected to have a Material Adverse Effect.

6.4. Conduct of Business. The Borrower will, and will cause each Subsidiary to, carry on and conduct its business in substantially the same manner and in substantially the same fields of as it is presently conducted, to not conduct any significant business except for financial services, and to do all things necessary to remain duly incorporated, validly existing and in good standing as a domestic corporation in its jurisdiction of incorporation and maintain all requisite authority to

conduct its business in each jurisdiction in which its business is conducted. The Borrower shall cause the Subsidiary Borrower to remain a Wholly-Owned Subsidiary unless and until the Subsidiary Borrower shall have irrevocably waived its right to be a borrower hereunder and shall have repaid all outstanding Advances and other Obligations of such Subsidiary Borrower.

6.5. Taxes. The Borrower will, and will cause each Subsidiary to, timely file complete and correct United States federal and applicable foreign, state and local tax returns required by applicable law and pay when due all taxes, assessments and governmental charges and levies upon it or its income, profits or Property, except those which are being contested in good faith by appropriate proceedings and with respect to which adequate reserves have been set aside.

6.6. Insurance. The Borrower will, and will cause each Subsidiary to, maintain with financially sound and reputable insurance companies insurance on all their Property in such amounts and covering such risks as is consistent with sound business practice, and the Borrower will furnish to the Agent and any Lender upon request full information as to the insurance carried.

6.7. Compliance with Laws. The Borrower will, and will cause each Subsidiary to, comply with all laws, rules, regulations, orders, writs, judgments, injunctions, decrees or awards to which it may be subject, the failure to comply with which could reasonably be expected to have a Material Adverse Effect.

6.8. Maintenance of Properties. The Borrower will, and will cause each Subsidiary to, do all things necessary to maintain, preserve, protect and keep its Property in good repair, working order and condition, and make all necessary

and proper repairs, renewals and replacements so that its business carried on in connection therewith may be properly conducted at all times.

6.9. Inspection. The Borrower will, and will cause each Subsidiary to, at reasonable times during normal business hours and upon reasonable notice, permit the Agent and the Lenders, by their respective representatives and agents, to inspect any of the Property, corporate books and financial records of the Borrower and each Subsidiary, to examine and make copies of the books of accounts and other financial records of the Borrower and each Subsidiary, and to discuss the affairs, finances and accounts of the Borrower and each Subsidiary with, and to be advised as to the same by, their respective officers at such reasonable times and intervals as the Lenders may designate. The Borrower will keep or cause to be kept, and cause each Subsidiary to keep or cause to be kept, appropriate records and books of account in which complete entries are to be made reflecting its and their business and financial transactions, such entries to be made in accordance with Agreement Accounting Principles.

6.10. Dividends. The Borrower will not declare or pay any dividends or make any distributions on its capital stock (other than dividends payable in its own capital stock) or redeem, repurchase or otherwise acquire or retire any of its capital stock or any options or other rights in

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respect thereof at any time outstanding, except that so long as no Default or Unmatured Default exists before or after giving effect to the declaration or payment of such dividends or distributions or repurchase or redemption of such stock or other transaction, the Borrower may declare and pay dividends, and make distributions, on its common stock and repurchase and redeem and otherwise acquire or retire its common stock and any options or other rights in respect thereof.

6.11. Indebtedness. The Borrower will not, nor will it permit any Subsidiary (other than an Unrestricted Subsidiary) to, create, incur or suffer to exist any Indebtedness, except:

(ai) the Loans;

(bi) Indebtedness existing on the date hereof and any renewals, extensions, refundings or refinancings of such Indebtedness;

(c) Indebtedness owing by (x) the Borrower or the Subsidiary Borrower to any Wholly-Owned Subsidiary and (y) any Wholly-Owned Subsidiary to a Wholly-Owned Subsidiary, the Subsidiary Borrower or the Borrower;

(d) Indebtedness (other than Indebtedness of the Subsidiary Borrower and its Subsidiaries) permitted under the White Mountains Credit Agreement and the Valley Credit Agreement; and

(e) other Indebtedness, so long as after giving effect to the incurrence of any such Indebtedness the covenants contained in Section 6.19 shall be complied with on a pro forma basis as of the date such Indebtedness was incurred.

6.12. Merger. The Borrower will not, nor will it permit any Significant Subsidiary to, merge or consolidate with or into any other Person, except that:

(a) a Wholly-Owned Subsidiary may merge into the Borrower or any Wholly-Owned Subsidiary of the Borrower;

(b) a Significant Subsidiary (other than the Subsidiary Borrower) may merge or consolidate with any Person so long as either (x) (i) no Default or Unmatured Default shall have occurred or be continuing before and after giving effect to such merger or consolidation and (ii) such Significant Subsidiary is the continuing or surviving corporation or (y) neither the Borrower, the Subsidiary Borrower nor any of their Subsidiaries hold any capital stock of such Significant Subsidiary after giving effect to such merger or consolidation;

(c) the Borrower may merge or consolidate with any other Person, so long as immediately thereafter (and after giving effect thereto), (i) no Default or Unmatured Default

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exists, (ii) the Borrower is the continuing or surviving corporation and

(iii) the covenants contained in Section 6.19 shall be complied with on a pro forma basis on the date of, and after giving effect to, such merger or consolidation; and

(d) the Subsidiary Borrower may merge or consolidate with any other Person, so long as immediately thereafter (and after giving effect thereto), (i) whether or not the Loans attributable to the Subsidiary Borrower are outstanding on the date of the consummation of such merger or consolidation, (x) no Default of Unmatured Default exists, (y) the Subsidiary Borrower is the continuing or surviving corporation and (z) the covenants contained in Section 6.19 shall be complied with on a pro forma basis on the date of, and after giving effect to, such merger or consolidation or (ii) in the event no Loans attributable to the Subsidiary Borrower are outstanding on the date of the consummation of such merger or consolidation, (x) no Default or Unmatured Default exists, (y) the Subsidiary Borrower shall have delivered written notice to the Lenders at least 15 days prior to the date of the consummation of such merger or consolidation and (z) the Subsidiary Borrower shall have delivered a certificate (in form and substance acceptable to the Agent and executed by an Authorized Officer) to the Agent on, and dated, the date of the consummation of such merger or consolidation (A) stating that it relinquishes its rights to request Loans under this Agreement and (B) confirming that the Subsidiary Borrower has paid in full all amounts then due and owing to any Lender under Sections 3.5 or 9.7 and under Section 15 to the extent the Borrower incurred Obligations of the type described in Sections 3.5 or 9.7 on or prior to the date of the consummation of such merger or consolidation, it being understood and agreed that upon the delivery of such certificate the Subsidiary Borrower shall cease to be one of the Borrowers hereunder and shall have no rights, duties or obligations under this Agreement and references to the Subsidiary Borrower as such in this Agreement shall be deemed to be deleted.

6.13. Contingent Obligations. The Borrower will not, nor will it permit any Subsidiary (other than an Unrestricted Subsidiary) to, make or suffer to exist any Contingent Obligation (including, without limitation, any Contingent Obligation with respect to the obligations of a Subsidiary), except (a) the issuance of financial guarantees in the ordinary course of business and consistent with past practices, (b) by endorsement of instruments for deposit or collection in the ordinary course of business, (c) for insurance policies issued in the ordinary course of business, (d) the issuance of intercompany guarantees so long as the primary obligation is permitted pursuant to this Agreement and (e) Contingent Obligations (other than Contingent Obligations of the Subsidiary Borrower and its Subsidiaries) permitted pursuant to the White Mountains Credit Agreement and the Valley Credit Agreement.

6.14. Liens. The Borrower will not, nor will it permit any Subsidiary to, create, incur, or suffer to exist any Lien in, of or on the Property (other than Margin Stock) of the Borrower or any of its Subsidiaries (other than an Unrestricted Subsidiary), except:

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(ai Liens for taxes, assessments or governmental charges or levies on its Property if the same shall not at the time be delinquent or thereafter can be paid without penalty, or are being contested in good faith and by appropriate proceedings and for which adequate reserves in accordance with generally accepted principles of accounting shall have been set aside on its books;

(bi Liens imposed by law, such as carriers', warehousemen's and mechanics' liens and other similar liens arising in the ordinary course of business which secure the payment of obligations not more than 60 days past due or which are being contested in good faith by appropriate proceedings and for which adequate reserves shall have been set aside on its books;

(ci Liens arising out of pledges or deposits under worker's compensation laws, unemployment insurance, old age pensions, or other social security or retirement benefits, or similar legislation;

(di Utility easements, building restrictions and such other encumbrances or charges against real property as are of a nature generally existing with respect to properties of a similar character and which do not in any material way affect the marketability of the same or interfere with the use thereof in the business of the Borrower or its Subsidiaries;

(ei Liens existing on the date hereof and described in Schedule 6.14 hereto;

(fi Liens in, of or on Property acquired after the date of this Agreement (by purchase, construction or otherwise), each of which Liens either (1) existed on such Property before the time of its acquisition and was not created in anticipation thereof, or (2) was created solely for the

purpose of securing Indebtedness representing, or incurred to finance, refinance or refund, the cost (including the cost of construction) of such Property; provided that no such Lien shall extend to or cover any Property of the Borrower or such Subsidiary other than the Property so acquired and improvements thereon; and provided, further, that the principal amount of Indebtedness secured by any such Lien shall at the time the Lien is incurred not exceed 75% of the fair market value (as determined in good faith by a financial officer of the Borrower and, in the case of such Property having a fair market value in excess of \$500,000, certified by such officer to the Agent, with a copy for each Lender) of the Property at the time it was so acquired;

(gi Liens not otherwise permitted by the foregoing clauses (a) through (f) securing any Indebtedness of the Borrowers, provided that the aggregate principal amount of Indebtedness secured by Liens permitted by this clause (g) shall not exceed \$5,000,000 at any time; and

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(hi Liens (other than Liens upon the assets of the Subsidiary Borrower and its Subsidiaries) permitted under the White Mountains Credit Agreement and the Valley Credit Agreement.

6.15. Affiliates. The Borrower will not, and will not permit any Subsidiary to, enter into any material transaction (including, without limitation, the purchase or sale of any Property or service) with, or make any payment or transfer to, any Affiliate (other than a Wholly-Owned Subsidiary), except in the ordinary course of business and pursuant to the reasonable requirements of the Borrower's or such Subsidiary's business and upon fair and reasonable terms no less favorable to the Borrower or such Subsidiary than the Borrower or such Subsidiary would obtain in a comparable arms-length transaction, except that any Unrestricted Subsidiary may make loans to the Borrower.

6.16. Environmental Matters. The Borrower shall and shall cause each of its Subsidiaries to (a) at all times comply in all material respects with all applicable Environmental Laws and (b) promptly take any and all necessary remedial actions in response to the presence, storage, use, disposal, transportation or Release of any Hazardous Materials on, under or about any real property owned, leased or operated by the Borrower or any of its Subsidiaries.

6.17. Change in Corporate Structure; Fiscal Year. The Borrower shall not, nor shall it permit any Subsidiary to, (a) permit any amendment or modification to be made to its certificate or articles of incorporation or by-laws which is materially adverse to the interests of the Lenders or (b) change its Fiscal Year to end on any date other than December 31 of each year.

6.18. Inconsistent Agreements. The Borrower shall not, nor shall it permit any Subsidiary (other than an Unrestricted Subsidiary) to, enter into any indenture, agreement, instrument or other arrangement which by its terms, (a) other than pursuant to the White Mountains Credit Agreement or the Valley Credit Agreement or pursuant to agreements or arrangements with regulatory agencies with regard to Insurance Subsidiaries, directly or indirectly contractually prohibits or restrains, or has the effect of contractually prohibiting or restraining, or contractually imposes materially adverse conditions upon, the incurrence of the Obligations, the granting of Liens to secure the Obligations, the amending of the Loan Documents or the ability of any Subsidiary to (i) pay dividends or make other distributions on its capital stock, (ii) make loans or advances to the Borrower or (iii) repay loans or advances from the Borrower or (b) contains any provision which would be violated or breached by the making of Advances or by the performance by the Borrower or any Subsidiary of any of its obligations under any Loan Document.

6.19. Financial Covenants.

6.19.1. Minimum Net Worth. The Borrower shall at all times after the date hereof, maintain a minimum Net Worth at least equal to

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the sum of (a) \$537,300,000 minus (b) an amount equal to the aggregate reduction in Net Worth attributable to all Stock Transfers made after March 31, 1997, plus (c) an amount equal to 90% of the cash and non-cash proceeds of any equity securities issued by the Borrower after March 31, 1997.

6.19.2. Leverage Ratio. The Borrower shall at all times after the date

hereof maintain a Leverage Ratio of not greater than 25%.

6.19.3. Finance Assets Ratio. At any time Loans are outstanding and the aggregate sum of cash and Money Market Investments of the Borrower and the Subsidiary Borrower at such time is less than the aggregate outstanding principal amount of Funded Indebtedness of the Borrower and the Subsidiary Borrower at such time, the Finance Assets Ratio shall not be less than 1.5:1.0.

6.20. Tax Consolidation. The Borrower will not and will not permit any of its Subsidiaries to (a) file or consent to the filing of any consolidated, combined or unitary income tax return with any Person other than the Borrower and its Subsidiaries or (b) amend, terminate or fail to enforce any existing tax sharing agreement or similar arrangement if such action would cause a Material Adverse Effect.

6.21. ERISA Compliance.

With respect to any Plan, neither the Borrower nor any Subsidiary shall:

(ai engage in any "prohibited transaction" (as such term is defined in Section 406 of ERISA or Section 4975 of the Code) for which a civil penalty pursuant to Section 502(i) of ERISA or a tax pursuant to Section 4975 of the Code in excess of \$500,000 could be imposed;

(bi incur any "accumulated funding deficiency" (as such term is defined in Section 302 of ERISA) in excess of \$500,000, whether or not waived, or permit any Unfunded Liability to exceed \$500,000;

(ci permit the occurrence of any Termination Event which could result in a liability to the Borrower or any other member of the Controlled Group in excess of \$500,000;

(di be an "employer" (as such term is defined in Section 3(5) of ERISA) required to contribute to any Multiemployer Plan or a "substantial employer" (as such term is defined in Section 4001(a)(2) of ERISA) required to contribute to any Multiple Employer Plan; or

(ei permit the establishment or amendment of any Plan or fail to comply with the applicable provisions of ERISA and the Code with respect to any Plan which could result in liability to the Borrower or any other member of the Controlled Group which, individually or in the aggregate, could reasonably be expected to have a Material Adverse Effect.

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ARTICLE VII

DEFAULTS

The occurrence of any one or more of the following events shall constitute a Default:

7.1. Any representation or warranty made or deemed made by or on behalf of the Borrower or any of its Subsidiaries to the Lenders or the Agent under or in connection with this Agreement, any other Loan Document, any Loan, or any certificate or information delivered in connection with this Agreement or any other Loan Document shall be false in any material respect on the date as of which made.

7.2. Nonpayment of (a) any principal of any Note when due, or (b) any interest upon any Note or any commitment fee or other fee or obligations under any of the Loan Documents within five days after the same becomes due.

7.3. The breach by either of the Borrowers of any of the terms or provisions of Section 6.2, Section 6.3(a) or Sections 6.10 through 6.15 or Section 6.17 through 6.21.

7.4. The breach by either of the Borrowers (other than a breach which constitutes a Default under Section 7.1, 7.2 or 7.3) of any of the terms or provisions of this Agreement which is not remedied within twenty (20) days after written notice from the Agent or any Lender.

7.5. The default by the Borrower or any of its Subsidiaries in the performance of any term, provision or condition contained in any agreement or agreements under which any Funded Indebtedness aggregating in excess of \$10,000,000 (\$20,000,000, or such lower cross-default threshold amount as is provided in the SOMSC Credit Agreement, in the case of SOMSC) was created or is governed, or the occurrence of any other event or existence of any other condition, the effect of any of which is to cause, or to permit the holder or

holders of such Funded Indebtedness to cause, such Funded Indebtedness to become due prior to its stated maturity; or any such Funded Indebtedness of the Borrower or any of its Subsidiaries shall be declared to be due and payable or required to be prepaid (other than by a regularly scheduled payment) prior to the stated maturity thereof.

7.6. The Borrower or any of its Significant Subsidiaries shall (a) have an order for relief entered with respect to it under the Federal bankruptcy laws as now or hereafter in effect, (b) make an assignment for the benefit of creditors, (c) apply for, seek, consent to, or acquiesce in, the appointment of a receiver, custodian, trustee, examiner, liquidator or similar official for it or any substantial portion of its Property, (d) institute any proceeding seeking an order for relief under the

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Federal bankruptcy laws as now or hereafter in effect or seeking to adjudicate it a bankrupt or insolvent, or seeking dissolution, winding up, liquidation, reorganization, arrangement, adjustment or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors or fail to file an answer or other pleading denying the material allegations of any such proceeding filed against it, (e) take any corporate action to authorize or effect any of the foregoing actions set forth in this Section 7.6, (f) fail to contest in good faith any appointment or proceeding described in Section 7.7 or (g) become unable to pay, not pay, or admit in writing its inability to pay, its debts generally as they become due.

7.7. Without the application, approval or consent of the Borrower or any of its Significant Subsidiaries, a receiver, trustee, examiner, liquidator or similar official shall be appointed for the Borrower or any of its Significant Subsidiaries or any substantial portion of its Property, or a proceeding described in Section 7.6(d) shall be instituted against the Borrower or any of its Significant Subsidiaries and such appointment continues undischarged or such proceeding continues undismissed or unstayed for a period of sixty consecutive days.

7.8. The Borrower or any of its Subsidiaries shall fail within thirty days to pay, bond or otherwise discharge any judgment or order for the payment of money in excess of \$2,000,000 (or multiple judgments or orders for the payment of an aggregate amount in excess of \$10,000,000), which is not stayed on appeal or otherwise being appropriately contested in good faith and as to which no enforcement actions have been commenced.

7.9. Any Change in Control shall occur.

ARTICLE VIII

ACCELERATION, WAIVERS, AMENDMENTS AND REMEDIES

8.1. Acceleration. If any Default described in Section 7.6 or 7.7 occurs with respect to either of the Borrowers, the obligations of the Lenders to make Loans hereunder shall automatically terminate and the Obligations shall immediately become due and payable without any election or action on the part of the Agent or any Lender. If any other Default occurs, the Required Lenders (or the Agent with the consent of the Required Lenders) may terminate or suspend the obligations of the Lenders to make Loans hereunder, or declare the Obligations to be due and payable, or both, whereupon the Obligations shall become immediately due and payable, without presentment, demand, protest or notice of any kind, all of which the Borrowers hereby expressly waive.

If, within ten Business Days after acceleration of the maturity of the Obligations or termination of the obligations of the Lenders to make Loans hereunder as a result of any Default

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(other than any Default as described in Section 7.6 or 7.7 with respect to either of the Borrowers) and before any judgment or decree for the payment of the Obligations due shall have been obtained or entered, the Required Lenders (in their sole discretion) shall so direct, the Agent shall, by notice to the Borrower, rescind and annul such acceleration and/or termination.

8.2. Amendments. Subject to the provisions of this Article VIII, the Required Lenders (or the Agent with the consent in writing of the Required Lenders) and the Borrowers may enter into agreements supplemental hereto for the purpose of adding or modifying any provisions to the Loan Documents or changing

in any manner the rights of the Lenders or the Borrowers hereunder or waiving any Default hereunder; provided, however, that no such supplemental agreement shall, without the consent of each Lender:

(a) Extend the final maturity of any Loan or Note or reduce the principal amount thereof, or reduce the rate or, subject to Section 2.10, extend the time of payment of interest or fees thereon;

(b) Reduce the percentage specified in the definition of Required Lenders;

(c) Increase the amount of the Commitment of any Lender hereunder;

(d) Extend the Revolver Termination Date or the Maturity Date;

(e) Amend this Section 8.2;

(f) Permit any assignment by either of the Borrowers of its Obligations or its rights hereunder;

(g) Release the Borrower from its obligations under Article XIV; or

(h) Except as permitted by Section 6.12(d)(ii), release the Subsidiary Borrower from its obligations under Article XV.

No amendment of any provision of this Agreement relating to the Agent shall be effective without the written consent of the Agent. The Agent may waive payment of the fee required under Section 12.3.2 without obtaining the consent of any other party to this Agreement.

8.3. Preservation of Rights. No delay or omission of the Lenders or the Agent to exercise any right under the Loan Documents shall impair such right or be construed to be a waiver of any Default or an acquiescence therein, and the making of a Loan notwithstanding the existence of a Default or the inability of the Borrowers to satisfy the conditions precedent to such Loan shall not constitute any waiver or acquiescence. Any single or partial exercise of any such right shall not preclude other or further exercise thereof or the exercise of any other right, and no waiver,

amendment or other variation of the terms, conditions or provisions of the Loan Documents whatsoever shall be valid unless in writing signed by the Lenders required pursuant to Section 8.2, and then only to the extent in such writing specifically set forth. All remedies contained in the Loan Documents or by law afforded shall be cumulative and all shall be available to the Agent and the Lenders until the Obligations have been paid in full.

ARTICLE IX

GENERAL PROVISIONS

9.1. Survival of Representations. All representations and warranties of the Borrowers contained in this Agreement or of the Borrower or any Subsidiary contained in any Loan Document shall survive delivery of the Notes and the making of the Loans herein contemplated.

9.2. Governmental Regulation. Anything contained in this Agreement to the contrary notwithstanding, no Lender shall be obligated to extend credit to the Borrowers in violation of any limitation or prohibition provided by any applicable statute or regulation.

9.3. Taxes. Any stamp, documentary or similar taxes, assessments or charges payable or ruled payable by any governmental authority in respect of the Loan Documents shall be paid by the Borrowers, together with interest and penalties, if any.

9.4. Headings. Section headings in the Loan Documents are for convenience of reference only, and shall not govern the interpretation of any of the provisions of the Loan Documents.

9.5. Entire Agreement. The Loan Documents embody the entire agreement and understanding among the Borrowers, the Agent and the Lenders and supersede all prior agreements and understandings among the Borrowers, the Agent and the Lenders relating to the subject matter thereof other than the fee letter, dated July 28, 1997, in favor of First Chicago.

9.6. Several Obligations; Benefits of this Agreement. The respective obligations of the Lenders hereunder are several and not joint and no Lender shall be the partner or agent of any other (except to the extent to which the Agent is authorized to act as such). The failure of any Lender to perform any of its obligations hereunder shall not relieve any other Lender from any of its

obligations hereunder. This Agreement shall not be construed so as to confer any right or benefit upon any Person other than the parties to this Agreement and their respective successors and assigns.

9.7. Expenses; Indemnification. The Borrowers shall reimburse the Agent for any reasonable costs, internal charges and out-of-pocket expenses (including attorneys' fees and time

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charges of attorneys for the Agent, which attorneys may be employees of the Agent) paid or incurred by the Agent in connection with the preparation, negotiation, execution, delivery, review, amendment, modification, and administration of the Loan Documents. The Borrowers also agree to reimburse the Agent and the Lenders for any reasonable costs, internal charges and out-of-pocket expenses (including attorneys' fees and time charges of attorneys for the Agent and the Lenders, which attorneys may be employees of the Agent or the Lenders) paid or incurred by the Agent or any Lender in connection with the collection and enforcement of the Loan Documents. The Borrowers further agree to indemnify the Agent and each Lender, its directors, officers and employees against all losses, claims, damages, penalties, judgments, liabilities and expenses (including, without limitation, all expenses of litigation or preparation therefor whether or not the Agent or any Lender is a party thereto) which any of them may pay or incur arising out of or relating to this Agreement, the other Loan Documents, the transactions contemplated hereby or thereby or the direct or indirect application or proposed application of the proceeds of any Loan hereunder arising from claims or assertions by third parties except to the extent that they arise out of the gross negligence or willful misconduct of the party seeking indemnification. The obligations of the Borrowers under this Section shall survive the termination of this Agreement.

9.8. Numbers of Documents. All statements, notices, closing documents, and requests hereunder shall be furnished to the Agent with sufficient counterparts so that the Agent may furnish one to each of the Lenders.

9.9. Accounting. Except as provided to the contrary herein, all accounting terms used herein shall be interpreted and all accounting determinations hereunder shall be made in accordance with Agreement Accounting Principles.

9.10. Severability of Provisions. Any provision in any Loan Document that is held to be inoperative, unenforceable, or invalid in any jurisdiction shall, as to that jurisdiction, be inoperative, unenforceable, or invalid without affecting the remaining provisions in that jurisdiction or the operation, enforceability, or validity of that provision in any other jurisdiction, and to this end the provisions of all Loan Documents are declared to be severable.

9.11. Nonliability of Lenders. The relationship between the Borrowers and the Lenders and the Agent shall be solely that of borrower and lender. Neither the Agent nor any Lender shall have any fiduciary responsibilities to the Borrowers. Neither the Agent nor any Lender undertakes any responsibility to the Borrowers to review or inform the Borrower of any matter in connection with any phase of the Borrowers' business or operations. The Borrowers shall rely entirely upon its own judgment with respect to its business, and any review, inspection or supervision of, or information supplied to the Borrowers by the Agent or the Lenders is for the protection of the Agent and the Lenders and neither of the Borrowers nor any other Person is entitled to rely thereon. Whether or not such damages are related to a claim that is subject to the waiver effected above and whether or not such waiver is effective, neither the Agent nor any Lender shall have any liability

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with respect to, and the Borrowers hereby waive, release and agree not to sue for, any special, indirect or consequential damages suffered by the Borrower in connection with, arising out of, or in any way related to the Loan Documents or the transactions contemplated thereby or the relationship established by the Loan Documents, or any act, omission or event occurring in connection therewith.

9.12. CHOICE OF LAW. THE LOAN DOCUMENTS (OTHER THAN THOSE CONTAINING A CONTRARY EXPRESS CHOICE OF LAW PROVISION) SHALL BE CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS, WITHOUT REGARD TO CONFLICT OF LAWS PROVISIONS, OF THE STATE OF ILLINOIS, BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS.

9.13. CONSENT TO JURISDICTION. THE BORROWERS HEREBY IRREVOCABLY SUBMIT TO THE NON-EXCLUSIVE JURISDICTION OF ANY UNITED STATES FEDERAL OR ILLINOIS STATE COURT SITTING IN CHICAGO IN ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATING TO ANY LOAN DOCUMENTS AND THE BORROWERS HEREBY IRREVOCABLY AGREE THAT ALL CLAIMS

IN RESPECT OF SUCH ACTION OR PROCEEDING MAY BE HEARD AND DETERMINED IN ANY SUCH COURT AND IRREVOCABLY WAIVE ANY OBJECTION IT MAY NOW OR HEREAFTER HAVE AS TO THE VENUE OF ANY SUCH SUIT, ACTION OR PROCEEDING BROUGHT IN SUCH A COURT OR THAT SUCH COURT IS AN INCONVENIENT FORUM. NOTHING HEREIN SHALL LIMIT THE RIGHT OF THE AGENT OR ANY LENDER TO BRING PROCEEDINGS AGAINST THE BORROWERS IN THE COURTS OF ANY OTHER JURISDICTION. ANY JUDICIAL PROCEEDING BY THE BORROWERS AGAINST THE AGENT OR ANY LENDER OR ANY AFFILIATE OF THE AGENT OR ANY LENDER INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH ANY LOAN DOCUMENT SHALL BE BROUGHT ONLY IN A COURT IN CHICAGO, ILLINOIS; PROVIDED, THAT SUCH PROCEEDINGS MAY BE BROUGHT IN OTHER COURTS IF JURISDICTION MAY NOT BE OBTAINED IN A COURT IN CHICAGO, ILLINOIS.

9.14. WAIVER OF JURY TRIAL. THE BORROWERS, THE AGENT AND EACH LENDER HEREBY WAIVE TRIAL BY JURY IN ANY JUDICIAL PROCEEDING INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER (WHETHER SOUNDING IN TORT, CONTRACT OR OTHERWISE) IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH ANY LOAN DOCUMENT OR THE RELATIONSHIP ESTABLISHED THEREUNDER.

9.15. Disclosure. The Borrowers and each Lender hereby (a) acknowledge and agree that First Chicago and/or its Affiliates from time to time may hold other investments in, make other loans to or have other relationships with the Borrowers, including, without limitation, in connection with any interest rate hedging instruments or agreements or swap transactions, and (b) waive any liability

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of First Chicago or such Affiliate to the Borrowers or any Lender, respectively, arising out of or resulting from such investments, loans or relationships other than liabilities arising out of the gross negligence or willful misconduct of First Chicago or its Affiliates to the extent that such liability would not have arisen but for First Chicago's status as Agent hereunder.

9.16. Counterparts. This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one agreement, and any of the parties hereto may execute this Agreement by signing any such counterpart. This Agreement shall be effective when it has been executed by the Borrower, the Agent and the Lenders and each party has notified the Agent that it has taken such action.

9.17. Certain Notices. The Borrowers, the Agent and the Lenders agree that notwithstanding any provisions herein to the contrary, (a) all notices and directions permitted or required to be given hereunder by or to the Subsidiary Borrower may be given by or to the Borrower, (b) the Agent and the Lenders may rely and act upon all such notices and directions given by the Borrower purportedly on behalf of the Subsidiary Borrower as if such notices and directions had been given by the Subsidiary Borrower itself and (c) the Agent may disburse the proceeds of Advances to the Subsidiary Borrower to the Borrower for the account of the Subsidiary Borrower or as the Borrower may otherwise direct.

9.18. Treatment of Certain Information: Confidentiality.

(a) Each Borrower acknowledges that (i) services may be offered or provided to it (in connection with this Agreement or otherwise) by each Lender or by one or more Subsidiaries or Affiliates of such Lender and (ii) information delivered to each Lender by such Borrower and its Subsidiaries may be provided to each such Subsidiary and Affiliate, it being understood that any such Subsidiary or Affiliate receiving such information shall be bound by the provisions of clause (b) below as if it were a Lender hereunder.

(b) Each Lender and the Agent agrees (on behalf of itself and each of its affiliates, directors, officers, employees and representatives) to use reasonable precautions to keep confidential, in accordance with their customary procedures for handling confidential information of this nature and in accordance with safe and sound banking practices, any non-public information supplied to it by either Borrower pursuant to this Agreement, provided that nothing herein shall limit the disclosure of any such information (i) to the extent required by statute, rule, regulation or judicial process, (ii) to counsel for any of the Lenders or the Agent, (iii) to bank examiners, auditors or accountants, (iv) to the Agent or any other Lender (or to First Chicago Capital Markets, Inc.), (v) in connection with any litigation to which any one or more of the Lenders or the Agent is a party, (vi) to a subsidiary or affiliate of such Lender as provided in clause (a) above, (vii) to any assignee or participant (or prospective assignee or participant) so long as such assignee or participant (or prospective assignee or participant) agrees with the respective Lender to keep such information

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confidential on substantially the terms set forth in this Section 9.18(b), (viii) to any other Person as may be reasonably required in the course of the enforcement of any Lender's rights or remedies hereunder or under any of such Lender's Note, or (ix) to any other creditor of either Borrower or any of its Subsidiaries at any time during the continuance of a Default; provided that in no event shall any Lender or the Agent be obligated or required to return any materials furnished by either Borrower.

ARTICLE X

THE AGENT

10.1. Appointment. First Chicago is hereby appointed Agent hereunder and under each other Loan Document, and each of the Lenders authorizes the Agent to act as the agent of such Lender. The Agent agrees to act as such upon the express conditions contained in this Article X. The Agent shall not have a fiduciary relationship in respect of the Borrowers or any Lender by reason of this Agreement.

10.2. Powers. The Agent shall have and may exercise such powers under the Loan Documents as are specifically delegated to the Agent by the terms of each thereof, together with such powers as are reasonably incidental thereto. The Agent shall have no implied duties to the Lenders, or any obligation to the Lenders to take any action thereunder, except any action specifically provided by the Loan Documents to be taken by the Agent.

10.3. General Immunity. Neither the Agent nor any of its directors, officers, agents or employees shall be liable to the Borrowers or any Lender for any action taken or omitted to be taken by it or them hereunder or under any other Loan Document or in connection herewith or therewith except for its or their own gross negligence or willful misconduct.

10.4. No Responsibility for Loans, Recitals, etc. Neither the Agent nor any of its directors, officers, agents or employees shall be responsible for or have any duty to ascertain, inquire into, or verify (a) any statement, warranty or representation made in connection with any Loan Document or any borrowing hereunder, (b) the performance or observance of any of the covenants or agreements of any obligor under any Loan Document, including, without limitation, any agreement by an obligor to furnish information directly to each Lender; (c) the satisfaction of any condition specified in Article IV, except receipt of items required to be delivered to the Agent and not waived at closing, or (d) the validity, effectiveness, sufficiency, enforceability or genuineness of any Loan Document or any other instrument or writing furnished in connection therewith. The Agent shall have no duty to disclose to the Lenders information that is not required to be furnished by the Borrowers to the Agent at such time, but is voluntarily furnished by the Borrowers to the Agent

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(either in its capacity as Agent or in its individual capacity).

10.5. Action on Instructions of Lenders. The Agent shall in all cases be fully protected in acting, or in refraining from acting, hereunder and under any other Loan Document in accordance with written instructions signed by the Required Lenders (or, to the extent required by Section 8.2, all Lenders), and such instructions and any action taken or failure to act pursuant thereto shall be binding on all of the Lenders and on all holders of Notes. The Agent shall be fully justified in failing or refusing to take any action hereunder and under any other Loan Document unless it shall first be indemnified to its satisfaction by the Lenders pro rata against any and all liability, cost and expense that it may incur by reason of taking or continuing to take any such action.

10.6. Employment of Agents and Counsel. The Agent may execute any of its duties as Agent hereunder and under any other Loan Document by or through employees, agents and attorneys-in-fact and shall not be answerable to the Lenders, except as to money or securities received by it or its authorized agents, for the default or misconduct of any such agents or attorneys-in-fact selected by it with reasonable care. The Agent shall be entitled to advice of counsel concerning all matters pertaining to the agency hereby created and its duties hereunder and under any other Loan Document.

10.7. Reliance on Documents; Counsel. The Agent shall be entitled to rely upon any Note, notice, consent, certificate, affidavit, letter, telegram, statement, paper or document believed by it to be genuine and correct and to have been signed or sent by the proper person or persons, and, in respect to legal matters, upon the opinion of counsel selected by the Agent, which counsel may be employees of the Agent.

10.8. Agent's Reimbursement and Indemnification. The Lenders agree to reimburse and indemnify the Agent ratably in proportion to their respective Commitments (or, if the Commitments have been terminated, in proportion to their Commitments immediately prior to such termination) (a) for any amounts not reimbursed by the Borrowers for which the Agent is entitled to reimbursement by the Borrowers under the Loan Documents, (b) for any other expenses incurred by the Agent on behalf of the Lenders, in connection with the preparation, execution, delivery, administration and enforcement of the Loan Documents, and (c) for any liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind and nature whatsoever which may be imposed on, incurred by or asserted against the Agent in any way relating to or arising out of the Loan Documents or any other document delivered in connection therewith or the transactions contemplated thereby, or the enforcement of any of the terms thereof or of any such other documents; provided, that no Lender shall be liable for any of the foregoing to the extent they arise from the gross negligence or willful misconduct of the Agent. The obligations of the Lenders under this Section 10.8 shall survive payment of the Obligations and termination of this Agreement.

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10.9. Notice of Default. The Agent shall not be deemed to have knowledge or notice of the occurrence of any Default or Unmatured Default hereunder unless the Agent has received written notice from a Lender or the Borrowers referring to this Agreement describing such Default or Unmatured Default and stating that such notice is a "notice of default". In the event that the Agent receives such a notice, the Agent shall give prompt notice thereof to the Lenders.

10.10. Rights as a Lender. In the event the Agent is a Lender, the Agent shall have the same rights and powers hereunder and under any other Loan Document as any Lender, including, without limitation, pursuant to Article XII hereof, and may exercise the same as though it were not the Agent, and the term "Lender" or "Lenders" shall, at any time when the Agent is a Lender, unless the context otherwise indicates, include the Agent in its individual capacity. The Agent may accept deposits from, lend money to, and generally engage in any kind of trust, debt, equity or other transaction, in addition to those contemplated by this Agreement or any other Loan Document, with the Borrowers or any of their respective Subsidiaries in which the Borrowers or such Subsidiary is not restricted hereby from engaging with any other Person.

10.11. Lender Credit Decision. Each Lender acknowledges that it has, independently and without reliance upon the Agent or any other Lender and based on the financial statements prepared by the Borrowers and such other documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement and the other Loan Documents. Each Lender also acknowledges that it will, independently and without reliance upon the Agent or any other Lender and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement and the other Loan Documents.

10.12. Successor Agent. The Agent may resign at any time by giving written notice thereof to the Lenders and the Borrowers, such resignation to be effective upon the appointment of a successor Agent or, if no successor Agent has been appointed, forty-five days after the retiring Agent gives notice of its intention to resign. Upon any such resignation, the Required Lenders shall have the right to appoint, on behalf of the Lenders, a successor Agent, which successor Agent, so long as no Default is continuing, shall be reasonably acceptable to the Borrowers. If no successor Agent shall have been so appointed by the Required Lenders and shall have accepted such appointment within thirty days after the resigning Agent's giving notice of its intention to resign, then the resigning Agent may appoint, on behalf of the Borrowers and the Lenders, a successor Agent, which successor Agent, so long as no Default is continuing, shall be reasonably acceptable to the Borrowers. If the Agent has resigned and no successor Agent has been appointed, the Lenders may perform all the duties of the Agent hereunder and the Borrowers shall make all payments in respect of the Obligations to the applicable Lender and for all other purposes shall deal directly with the Lenders. No successor Agent shall be deemed to be appointed hereunder until such successor Agent has accepted the appointment. Any such successor Agent shall be a commercial bank having capital and retained earnings of at least \$50,000,000 and with a Lending Installation in the United States

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of America. Upon the acceptance of any appointment as Agent hereunder by a successor Agent, such successor Agent shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the resigning

Agent. Upon the effectiveness of the resignation of the Agent, the resigning Agent shall be discharged from its duties and obligations hereunder and under the Loan Documents. After the effectiveness of the resignation of an Agent, the provisions of this Article X 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 the Agent hereunder and under the other Loan Documents.

ARTICLE XI

SETOFF; RATABLE PAYMENTS

11.1. Setoff. In addition to, and without limitation of, any rights of the Lenders under applicable law, if the Borrower or the Subsidiary Borrower becomes insolvent, however evidenced, or any Default or Unmatured Default occurs, any and all deposits (including all account balances, whether provisional or final and whether or not collected or available) and any other Indebtedness at any time held or owing by any Lender to or for the credit or account of the Borrower or the Subsidiary Borrower may be offset and applied toward the payment of the Obligations owing to such Lender, whether or not the Obligations, or any part hereof, shall then be due.

11.2. Ratable Payments. If any Lender, whether by setoff or otherwise, has payment made to it upon its Loans (other than payments received pursuant to Section 2.17, 3.1, 3.2 or 3.4) in a greater proportion than its pro-rata share of such Loans, such Lender agrees, promptly upon demand, to purchase a portion of the Loans held by the other Lenders so that after such purchase each Lender will hold its ratable proportion of Loans. If any Lender, whether in connection with setoff or amounts which might be subject to setoff or otherwise, receives collateral or other protection for its Obligations or such amounts which may be subject to setoff, such Lender agrees, promptly upon demand, to take such action necessary such that all Lenders share in the benefits of such collateral ratably in proportion to their Loans. In case any such payment is disturbed by legal process, or otherwise, appropriate further adjustments shall be made. If an amount to be setoff is to be applied to Indebtedness of the Borrowers to a Lender, other than Indebtedness evidenced by any of the Notes held by such Lender, such amount shall be applied ratably to such other Indebtedness and to the Indebtedness evidenced by such Notes.

ARTICLE XII

BENEFIT OF AGREEMENT; ASSIGNMENTS; PARTICIPATIONS

12.1. Successors and Assigns. The terms and provisions of the Loan Documents shall be binding upon and inure to the benefit of the Borrower and the Lenders and their respective successors and assigns, except that (a) the Borrowers shall not have the right to assign their respective rights or obligations under the Loan Documents, and (b) any assignment by any Lender must be made in compliance with Section 12.3. Notwithstanding clause (b) of the preceding sentence, any Lender may at any time, without the consent of the Borrowers or the Agent, assign all or any portion of its rights under this Agreement and its Notes to a Federal Reserve Bank; provided, however, that no such assignment to a Federal Reserve Bank shall release the transferor Lender from its obligations hereunder. The Agent may treat the payee of any Note as the owner thereof for all purposes hereof unless and until such payee complies with Section 12.3 in the case of an assignment thereof or, in the case of any other transfer, a written notice of the transfer is filed with the Agent. Any assignee or transferee of a Note agrees by acceptance thereof to be bound by all the terms and provisions of the Loan Documents. Any request, authority or consent of any Person, who at the time of making such request or giving such authority or consent is the holder of any Note, shall be conclusive and binding on any subsequent holder, transferee or assignee of such Note or of any Note or Notes issued in exchange therefor.

12.2. Participations.

12.2.1. Permitted Participants; Effect. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time sell to one or more banks or other entities ("Participants") participating interests in any Loan owing to such Lender, any Note held by such Lender, any Commitment of such Lender or any other interest of such Lender under the Loan Documents. In the event of any such sale by a Lender of participating interests to a Participant, such Lender's obligations under the Loan Documents shall remain unchanged, such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations, such Lender shall remain the holder of any such Note for all purposes under the Loan Documents, all amounts payable by the Borrowers under this Agreement shall be determined as if

such Lender had not sold such participating interests, and the Borrowers and the Agent shall continue to deal solely and directly with such Lender in connection with such Lender's rights and obligations under the Loan Documents.

12.2.2. Voting Rights. Each Lender shall retain the sole right to approve, without the consent of any Participant, any amendment, modification or waiver of any provision of the Loan Documents other than any amendment, modification or waiver which effects any of the modifications referenced in clauses (a) through (h) of Section 8.2.

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12.2.3. Benefit of Setoff. The Borrowers agree that each Participant shall be deemed to have the right of setoff provided in Section 11.1 in respect of its participating interest in amounts owing under the Loan Documents to the same extent as if the amount of its participating interest were owing directly to it as a Lender under the Loan Documents; provided, that each Lender shall retain the right of setoff provided in Section 11.1 with respect to the amount of participating interests sold to each Participant. The Lenders agree to share with each Participant, and each Participant, by exercising the right of setoff provided in Section 11.1, agrees to share with each Lender, any amount received pursuant to the exercise of its right of setoff, such amounts to be shared in accordance with Section 11.2 as if each Participant were a Lender.

12.3. Assignments.

12.3.1. Permitted Assignments. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time assign to one or more banks or other entities ("Purchasers") all or any part of its rights and obligations under the Loan Documents; provided, however, that in the case of an assignment to an entity which is not a Lender or an Affiliate of a lender, such assignment shall be in a minimum amount of \$5,000,000 (or, if less, the entire amount of such Lender's Commitment). Such assignment shall be substantially in the form of Exhibit C hereto or in such other form as may be agreed to by the parties thereto. The consent of the Agent and, so long as no Default under Section 7.2, 7.6 or 7.7 is continuing, the Borrowers, shall be required prior to an assignment becoming effective with respect to a Purchaser which is not a Lender or an Affiliate thereof. Such consent shall not be unreasonably withheld.

12.3.2. Effect; Effective Date. Upon (a) delivery to the Agent of a notice of assignment, substantially in the form attached as Exhibit I to Exhibit C hereto (a "Notice of Assignment"), together with any consents required by Section 12.3.1, and (b) payment of a \$3,000 fee to the Agent for processing such assignment, such assignment shall become effective on the effective date specified in such Notice of Assignment. On and after the effective date of such assignment, (a) such Purchaser shall for all purposes be a Lender party to this Agreement and any other Loan Document executed by the Lenders and shall have all the rights and obligations of a Lender under the Loan Documents, to the same extent as if it were an original party hereto, and (b) the transferor Lender shall be released with respect to the percentage of the Aggregate Commitment and Loans assigned to such Purchaser without any further consent or action by the Borrowers, the Lenders or the Agent. Upon the consummation of any assignment to a Purchaser pursuant to this Section 12.3.2, the transferor Lender, the Agent and the Borrowers shall make appropriate arrangements so that replacement Notes are issued to such transferor Lender and new Notes or, as appropriate, replacement Notes, are issued to such Purchaser, in each case in principal amounts reflecting their Commitment, as adjusted pursuant to such assignment.

12.4. Dissemination of Information. Subject to Section 9.18, the Borrowers authorize each Lender to disclose to any Participant or Purchaser or any other Person acquiring an interest in the

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Loan Documents by operation of law (each a "Transferee") and any prospective Transferee any and all information in such Lender's possession concerning the creditworthiness of the Borrower and its Subsidiaries.

12.5. Tax Treatment. If any interest in any Loan Document is transferred to any Transferee which is organized under the laws of any jurisdiction other than the United States or any State thereof, the transferor Lender shall cause such Transferee, concurrently with the effectiveness of such transfer, to comply with the provisions of Section 2.17.

ARTICLE XIII

NOTICES

13.1. Giving Notice. All notices and other communications provided to any party hereto under this Agreement or any other Loan Document shall be in writing, by facsimile, first class U.S. mail or overnight courier and addressed or delivered to such party at its address set forth below its signature hereto or at such other address as may be designated by such party in a notice to the other parties. Any notice, if mailed and properly addressed with first class postage prepaid, return receipt requested, shall be deemed given three (3) Business Days after deposit in the U.S. mail; any notice, if transmitted by facsimile, shall be deemed given when transmitted; and any notice given by overnight courier shall be deemed given when received by the addressee.

13.2. Change of Address. The Borrowers, the Agent and any Lender may each change the address for service of notice upon it by a notice in writing to the other parties hereto.

ARTICLE XIV

BORROWER GUARANTY

14.1. The Borrower hereby absolutely, irrevocably and unconditionally guarantees prompt, full and complete payment when due, whether at stated maturity, upon acceleration or otherwise, and at all times thereafter, of (a) the principal of and interest on the Advances made by the Lenders to, and the Notes held by the Lenders of, the Subsidiary Borrower and (b) all other amounts from time to time owing to the Lenders by the Subsidiary Borrower under this Agreement, the Notes and the other Loan Documents, including without limitation all Obligations of the Subsidiary Borrower (solely for purposes of this Article XIV, collectively referred to as the "Guaranteed Debt"). This is a guaranty of payment, not a guaranty of collection.

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14.2. The Borrower waives notice of the acceptance of this Article XIV (solely for purposes of this Article XIV, referred to as the "Guaranty") and of the extension or incurrence of the Guaranteed Debt or any part thereof. The Borrower further waives all setoffs and counterclaims and presentment, protest, notice, filing of claims with a court in the event of receivership, bankruptcy or reorganization of the Subsidiary Borrower, demand or action on delinquency in respect of the Guaranteed Debt or any part thereof, including any right to require the Agent or any Lender to sue the Subsidiary Borrower, or any other person obligated with respect to the Guaranteed Debt or any part thereof, or otherwise to enforce payment thereof against any collateral securing the Guaranteed Debt or any part thereof.

14.3. The Borrower hereby agrees that, to the fullest extent permitted by law, its obligations hereunder shall be continuing, absolute and unconditional under any and all circumstances and not subject to any reduction, limitation, impairment, termination, defense (other than indefeasible payment in full), setoff, counterclaim or recoupment whatsoever (all of which are hereby expressly waived by it to the fullest extent permitted by law), whether by reason of any claim of any character whatsoever, including, without limitation, any claim of waiver, release, surrender, alteration or compromise. The validity and enforceability of this Guaranty shall not be impaired or affected by any of the following: (a) any extension, modification or renewal of, or indulgence with respect to, or substitution for, the Guaranteed Debt or any part thereof or any agreement relating thereto at any time; (b) any failure or omission to perfect or maintain any lien on, or preserve rights to, any security or collateral or to enforce any right, power or remedy with respect to the Guaranteed Debt or any part thereof or any agreement relating thereto, or any collateral securing the Guaranteed Debt or any part thereof; (c) any waiver of any right, power or remedy or of any default with respect to the Guaranteed Debt or any part thereof or any agreement relating thereto or with respect to any collateral securing the Guaranteed Debt or any part thereof; (d) any release, surrender, compromise, settlement, waiver, subordination or modification, with or without consideration, of any collateral securing the Guaranteed Debt or any part thereof, any other guaranties with respect to the Guaranteed Debt or any part thereof, or any other obligations of any person or entity with respect to the Guaranteed Debt or any part thereof; (e) the enforceability or validity of the Guaranteed Debt or any part thereof or the genuineness, enforceability or validity of any agreement relating thereto or with respect to any collateral securing the Guaranteed Debt or any part thereof; (f) the application of payments received from any source to the payment of indebtedness other than the Guaranteed Debt, any part thereof or amounts which are not covered by this Guaranty even though the Agent or any Lender might lawfully have elected to

apply such payments to any part or all of the Guaranteed Debt or to amounts which are not covered by this Guaranty; (g) any change of ownership of the Subsidiary Borrower or the insolvency, bankruptcy or any other change in the legal status of the Subsidiary Borrower; (h) any change in, or the imposition of, any law, decree, regulation or other governmental act which does or might impair, delay or in any way affect the validity, enforceability or the payment when due of the Guaranteed Debt; (i) the failure of the Subsidiary Borrower to maintain in full force, validity or effect or to obtain or renew when required all governmental and other approvals, licenses or consents required in connection with the Guaranteed Debt or this

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Guaranty, or to take any other action required in connection with the performance of all obligations pursuant to the Guaranteed Debt or this Guaranty; (j) the existence of any claim, setoff or other rights which the Borrower may have at any time against the Subsidiary Borrower in connection herewith or with any unrelated transaction; (k) the Agent's or a Lender's election, in any case or proceeding instituted under chapter 11 of the Bankruptcy Code, of the application of section 1111(b)(2) of the Bankruptcy Code; (l) any borrowing, use of cash collateral, or grant of a security interest by the Subsidiary Borrower, as debtor in possession, under section 363 or 364 of the Bankruptcy Code; (m) the disallowance of all or any portion of the Agent's or a Lender's claims for repayment of the Guaranteed Debt under section 502 or 506 of the Bankruptcy Code; or (n) any other fact or circumstance which might otherwise constitute grounds at law or equity for the discharge or release of the Borrower from its obligations hereunder, all whether or not the Borrower shall have had notice or knowledge of any act or omission referred to in the foregoing clauses (a) through (n) of this paragraph. It is agreed that the Borrower's liability hereunder is independent of any other guaranties or other obligations at any time in effect with respect to the Guaranteed Debt or any part thereof and that the Borrower's liability hereunder may be enforced regardless of the existence, validity, enforcement or non-enforcement of any such other guaranties or other obligations or any provision of any applicable law or regulation purporting to prohibit payment by the Subsidiary Borrower of the Guaranteed Debt in the manner agreed upon between the Agent, the Lenders and the Subsidiary Borrower.

14.4. Credit may be granted or continued from time to time by the Agent and/or any Lender to the Subsidiary Borrower without notice to or authorization from the Borrower regardless of the Subsidiary Borrower's financial or other condition at the time of any such grant or continuation. Neither the Agent nor any Lender shall have any obligation to disclose or discuss with the Borrower its assessment of the financial condition of the Subsidiary Borrower.

14.5. Until the irrevocable payment in full of the Obligations and termination of all commitments which could give rise to any Obligation, the Borrower shall have no right of subrogation with respect to the Guaranteed Debt and hereby waives any right to enforce any remedy which the Agent and/or the Lenders now has or may hereafter have against the Subsidiary Borrower, any endorser or any other guarantor of all or any part of the Guaranteed Debt, and the Borrower hereby waives any benefit of, and any right to participate in, any security or collateral given to the Agent and/or the Lenders to secure payment of the Guaranteed Debt or any part thereof or any other liability of the Subsidiary Borrower to the Agent and/or the Lenders.

14.6. The Borrower authorizes the Agent and the Lenders to take any action or exercise any remedy with respect to any collateral from time to time securing the Guaranteed Debt, which the Agent and the Lenders in their sole discretion (but subject, as applicable, to the terms of this Agreement and of any documentation pursuant to which a Lien in such collateral is granted) shall determine, without notice to the Borrower. Notwithstanding any reference herein to any collateral securing any of the Guaranteed Debt, it is acknowledged that, on the date hereof, neither

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the Borrower nor any of its Subsidiaries has granted, or has any obligation to grant, any security interest in or other lien on any of its property as security for the Guaranteed Debt.

14.7. In the event the Agent and/or the Lenders in their sole discretion elects to give notice of any action with respect to any collateral securing the Guaranteed Debt or any part thereof, ten (10) days' written notice mailed to the Borrower by ordinary mail at the address shown hereon shall be deemed reasonable notice of any matters contained in such notice. The Borrower consents and agrees that neither the Agent nor any Lender shall be under any

obligation to marshal any assets in favor of the Borrower or against or in payment of any or all of the Guaranteed Debt.

14.8. In the event that acceleration of the time for payment of any of the Guaranteed Debt is stayed upon the insolvency, bankruptcy or reorganization of the Subsidiary Borrower, or otherwise, all such amounts shall nonetheless be payable by the Borrower forthwith upon demand by Agent. The Borrower further agrees that, to the extent that the Subsidiary Borrower makes a payment or payments to the Agent or any Lender on the Guaranteed Debt, or the Agent or a Lender receive any proceeds of collateral securing the Guaranteed Debt, which payment or receipt of proceeds or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required to be returned or repaid to the Subsidiary Borrower, its estate, trustee, receiver, debtor in possession or any other party, including, without limitation, the Borrower, under any insolvency or bankruptcy law, state or federal law, common law or equitable cause, then to the extent of such payment, return or repayment, the obligation or part thereof which has been paid, reduced or satisfied by such amount shall be reinstated and continued in full force and effect as of the date when such initial payment, reduction or satisfaction occurred.

14.9. No delay on the part of the Agent or any Lender in the exercise of any right, power or remedy shall operate as a waiver thereof, and no single or partial exercise by the Agent or any Lender of any right, power or remedy shall preclude any further exercise thereof; nor shall any amendment, supplement, modification or waiver of any of the terms or provisions of this Guaranty be binding upon the Agent or any Lender, except as expressly set forth in a writing duly signed and delivered by the Agent and the Lenders. The failure by the Agent and/or the Lenders at any time or times hereafter to require strict performance by the Subsidiary Borrower or the Borrower of any of the provisions, warranties, terms and conditions contained in any promissory note, security agreement, agreement, guaranty, instrument or document now or at any time or times hereafter executed pursuant to the terms of, or in connection with, this Agreement by the Subsidiary Borrower or the Borrower and delivered to the Agent or any Lender shall not waive, affect or diminish any right of the Agent or any Lender at any time or times hereafter to demand strict performance thereof, and such right shall not be deemed to have been waived by any act or knowledge of the Agent or any Lender, its agents, officers or employees, unless such waiver is contained in an instrument in writing duly signed and delivered by the Agent or such Lender. No waiver by the Agent or any Lender of any default shall operate as a waiver of any other default or the same default on a future occasion, and no action by the Agent or any Lender permitted hereunder shall in any way affect or impair the

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Agent's or such Lender's rights or powers, or the obligations of the Borrower under this Guaranty. Any determination by a court of competent jurisdiction of the amount of any Guaranteed Debt owing by the Subsidiary Borrower to the Agent and the Lenders shall be conclusive and binding on the Borrower irrespective of whether the Borrower was a party to the suit or action in which such determination was made.

14.10. Subject to the provisions of Section 14.8, this guaranty shall continue in effect until this Agreement has terminated, the Guaranteed Debt has been paid in full and the other conditions of this guaranty have been satisfied.

ARTICLE XV

SUBSIDIARY GUARANTY

15.1. The Subsidiary Guarantor hereby absolutely, irrevocably and unconditionally guarantees prompt, full and complete payment when due, whether at stated maturity, upon acceleration or otherwise, and at all times thereafter, of (a) the principal of and interest on the Advances made by the Lenders to, and the Notes held by the Lenders of, the Borrower and (b) all other amounts from time to time owing to the Lenders by the Borrower under this Agreement, the Notes and the other Loan Documents, including without limitation all Obligations of the Borrower (solely for purposes of this Article XV, collectively referred to as the "Guaranteed Debt"). This is a guaranty of payment, not a guaranty of collection.

15.2. The Subsidiary Guarantor waives notice of the acceptance of this Article XV (solely for purposes of this Article XV, referred to as the "Guaranty") and of the extension or incurrence of the Guaranteed Debt or any part thereof. The Subsidiary Guarantor further waives all setoffs and counterclaims and presentment, protest, notice, filing of claims with a court in the event of receivership, bankruptcy or reorganization of the Borrower, demand or action on delinquency in respect of the Guaranteed Debt or any part thereof, including any right to require the Agent or any Lender to sue the Borrower, other person obligated with respect to the Guaranteed Debt or any part thereof, or otherwise to enforce payment thereof against any collateral securing the

Guaranteed Debt or any part thereof.

15.3. The Subsidiary Guarantor hereby agrees that, to the fullest extent permitted by law, its obligations hereunder shall be continuing, absolute and unconditional under any and all circumstances and not subject to any reduction, limitation, impairment, termination, defense (other than indefeasible payment in full), setoff, counterclaim or recoupment whatsoever (all of which are hereby expressly waived by it to the fullest extent permitted by law), whether by reason of any claim of any character whatsoever, including, without limitation, any claim of waiver, release, surrender,

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alteration or compromise. The validity and enforceability of this Guaranty shall not be impaired or affected by any of the following: (a) any extension, modification or renewal of, or indulgence with respect to, or substitution for, the Guaranteed Debt or any part thereof or any agreement relating thereto at any time; (b) any failure or omission to perfect or maintain any lien on, or preserve rights to, any security or collateral or to enforce any right, power or remedy with respect to the Guaranteed Debt or any part thereof or any agreement relating thereto, or any collateral securing the Guaranteed Debt or any part thereof; (c) any waiver of any right, power or remedy or of any default with respect to the Guaranteed Debt or any part thereof or any agreement relating thereto or with respect to any collateral securing the Guaranteed Debt or any part thereof; (d) any release, surrender, compromise, settlement, waiver, subordination or modification, with or without consideration, of any collateral securing the Guaranteed Debt or any part thereof, any other guaranties with respect to the Guaranteed Debt or any part thereof, or any other obligations of any person or entity with respect to the Guaranteed Debt or any part thereof; (e) the enforceability or validity of the Guaranteed Debt or any part thereof or the genuineness, enforceability or validity of any agreement relating thereto or with respect to any collateral securing the Guaranteed Debt or any part thereof; (f) the application of payments received from any source to the payment of indebtedness other than the Guaranteed Debt, any part thereof or amounts which are not covered by this Guaranty even though the Agent or any Lender might lawfully have elected to apply such payments to any part or all of the Guaranteed Debt or to amounts which are not covered by this Guaranty; (g) any change of ownership of the Borrower or the insolvency, bankruptcy or any other change in the legal status of the Borrower; (h) any change in, or the imposition of, any law, decree, regulation or other governmental act which does or might impair, delay or in any way affect the validity, enforceability or the payment when due of the Guaranteed Debt; (i) the failure of the Borrower to maintain in full force, validity or effect or to obtain or renew when required all governmental and other approvals, licenses or consents required in connection with the Guaranteed Debt or this Guaranty, or to take any other action required in connection with the performance of all obligations pursuant to the Guaranteed Debt or this Guaranty; (j) the existence of any claim, setoff or other rights which the Subsidiary Borrower may have at any time against the Borrower in connection herewith or with any unrelated transaction; (k) the Agent's or a Lender's election, in any case or proceeding instituted under chapter 11 of the Bankruptcy Code, of the application of section 1111(b)(2) of the Bankruptcy Code; (l) any borrowing, use of cash collateral, or grant of a security interest by the Borrower, as debtor in possession, under section 363 or 364 of the Bankruptcy Code; (m) the disallowance of all or any portion of the Agent's or a Lender's claims for repayment of the Guaranteed Debt under section 502 or 506 of the Bankruptcy Code; or (n) any other fact or circumstance which might otherwise constitute grounds at law or equity for the discharge or release of the Subsidiary Guarantor from its obligations hereunder, all whether or not the Subsidiary Guarantor shall have had notice or knowledge of any act or omission referred to in the foregoing clauses (a) through (n) of this paragraph. It is agreed that the Subsidiary Guarantor's liability hereunder is independent of any other guaranties or other obligations at any time in effect with respect to the Guaranteed Debt or any part thereof and that the Subsidiary Guarantor's liability hereunder may be enforced regardless of the existence, validity, enforcement or non-enforcement of any such other guaranties or other obligations

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or any provision of any applicable law or regulation purporting to prohibit payment by the Borrower of the Guaranteed Debt in the manner agreed upon between the Agent, the Lenders and the Borrower.

15.4. Credit may be granted or continued from time to time by the Agent and/or any Lender to the Borrower without notice to or authorization from the Subsidiary Guarantor regardless of the Borrower's financial or other

condition at the time of any such grant or continuation. Neither the Agent nor any Lender shall have any obligation to disclose or discuss with the Subsidiary Guarantor its assessment of the financial condition of the Borrower.

15.5. Until the irrevocable payment in full of the Obligations and termination of all commitments which could give rise to any Obligation, the Subsidiary Guarantor shall not have any right of subrogation with respect to the Guaranteed Debt and hereby waives any right to enforce any remedy which the Agent and/or any Lender now has or may hereafter have against the Borrower, any endorser or any other guarantor of all or any part of the Guaranteed Debt, and the Borrower hereby waives any benefit of, and any right to participate in, any security or collateral given to the Agent and/or the Lenders to secure payment of the Guaranteed Debt or any part thereof or any other liability of the Borrower to the Agent and/or the Lenders.

15.6. The Subsidiary Guarantor authorizes the Agent and the Lenders to take any action or exercise any remedy with respect to any collateral from time to time securing the Guaranteed Debt, which the Agent and Lenders in their sole discretion (but subject, as applicable, to the terms of this Agreement and of any documentation pursuant to which a Lien in such collateral is granted) shall determine, without notice to the Subsidiary Borrower. Notwithstanding any reference herein to any collateral securing any of the Guaranteed Debt, it is acknowledged that, on the date hereof, neither the Borrower nor any of its Subsidiaries has granted, or has any obligation to grant, any security interest in or other lien on any of its property as security for the Guaranteed Debt.

15.7. In the event the Agent and/or the Lenders in their sole discretion elects to give notice of any action with respect to any collateral securing the Guaranteed Debt or any part thereof, ten (10) days' written notice mailed to the Subsidiary Guarantor by ordinary mail at the address shown hereon shall be deemed reasonable notice of any matters contained in such notice. The Subsidiary Borrower consents and agrees that neither the Agent nor any Lender shall be under any obligation to marshal any assets in favor of the Subsidiary Borrower or against or in payment of any or all of the Guaranteed Debt.

15.8. In the event that acceleration of the time for payment of any of the Guaranteed Debt is stayed upon the insolvency, bankruptcy or reorganization of the Borrower, or otherwise, all such amounts shall nonetheless be payable by the Subsidiary Guarantor forthwith upon demand by the Agent. The Subsidiary Guarantor further agrees that, to the extent that the Borrower makes a

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payment or payments to the Agent or any Lender on the Guaranteed Debt, or the Agent or a Lender receive any proceeds of collateral securing the Guaranteed Debt, which payment or receipt of proceeds or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required to be returned or repaid to the Borrower, its estate, trustee, receiver, debtor in possession or any other party, including, without limitation, the Subsidiary Borrower, under any insolvency or bankruptcy law, state or federal law, common law or equitable cause, then to the extent of such payment, return or repayment, the obligation or part thereof which has been paid, reduced or satisfied by such amount shall be reinstated and continued in full force and effect as of the date when such initial payment, reduction or satisfaction occurred.

15.9. No delay on the part of the Agent or any Lender in the exercise of any right, power or remedy shall operate as a waiver thereof, and no single or partial exercise by the Agent or any Lender of any right, power or remedy shall preclude any further exercise thereof; nor shall any amendment, supplement, modification or waiver of any of the terms or provisions of this Guaranty be binding upon the Agent or any Lender, except as expressly set forth in a writing duly signed and delivered by the Agent and the Lenders. The failure by the Agent or any Lender at any time or times hereafter to require strict performance by the Subsidiary Borrower or the Borrower of any of the provisions, warranties, terms and conditions contained in any promissory note, security agreement, agreement, guaranty, instrument or document now or at any time or times hereafter executed pursuant to the terms of, or in connection with, this Agreement by the Subsidiary Borrower or the Borrower and delivered to the Agent or any Lender shall not waive, affect or diminish any right of the Agent or any Lender at any time or times hereafter to demand strict performance thereof, and such right shall not be deemed to have been waived by any act or knowledge of the Agent or any Lender, its agents, officers or employees, unless such waiver is contained in an instrument in writing duly signed and delivered by the Agent or such Lender. No waiver by the Agent or any Lender of any default shall operate as a waiver of any other default or the same default on a future occasion, and no action by the Agent or any Lender permitted hereunder shall in any way affect or impair the Agent or such Lender's rights or powers, or the obligations of the Subsidiary Guarantor under this Guaranty. Any determination by a court of competent jurisdiction of the amount of any Guaranteed Debt owing by the Borrower or the Subsidiary Borrower to the Agent and the Lenders shall be conclusive and binding on the Subsidiary Guarantor

irrespective of whether the Subsidiary Borrower was a party to the suit or action in which such determination was made.

15.10. Subject to the provisions of Section 15.8, this guaranty shall continue in effect until this Agreement has terminated, the Guaranteed Debt has been paid in full and the other conditions of this guaranty have been satisfied.

ARTICLE XVI

SALE OF SUBSIDIARY BORROWER

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16.1. In addition to the transactions permitted by Section 6.12(d), the Borrower may at any time permit White Mountains to sell, transfer or otherwise dispose of 100% of the capital stock of the Subsidiary Borrower in a single transaction so long as (a) no Loans attributable to the Subsidiary Borrower are outstanding on the date of the consummation of such transaction, (b) no Default or Unmatured Default exists, (c) the Borrower shall have delivered written notice to the Lenders at least 15 days prior to the date of the consummation of such transaction and (d) the Subsidiary Borrower shall have delivered a certificate (in form and substance acceptable to the Agent and executed by an Authorized Officer) to the Agent on, and dated, the date of the consummation of such transaction (i) stating that it relinquishes its rights to request Loans under this Agreement and (ii) confirming that the Subsidiary Borrower has paid in full all amounts then due and owing to any Lender under Sections 3.5 or 9.7 and under Section 15 to the extent the Borrower incurred Obligations of the type described in Sections 3.5 or 9.7 on or prior the date of the consummation of such transaction. Upon the delivery of such certificate, the Subsidiary Borrower shall cease to be one of the Borrowers hereunder and shall have no rights, duties or obligations under this Agreement and references to the Subsidiary Borrower as such in this Agreement shall be deemed to be deleted.

[signature pages to follow]

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IN WITNESS` WHEREOF, the Borrower, the Subsidiary Borrower, the Lenders and the Agent have executed this Agreement as of the date first above written.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.

By:

Print Name:

Title:

Address: 80 South Main Street
Hanover, New Hampshire
Attn:

Fax No.:

Tel. No.:

FUND AMERICAN ENTERPRISES, INC.

By:

Print Name:

Title:

Address: 80 South Main Street
Hanover, New Hampshire

Attn:

Fax No.:
Tel. No.:

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Commitments

Commitment \$ THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as Agent

By:

Print Name:

Title:

Address: 153 West 51st Street
New York, NY 10019
Attn: Samuel W. Bridges
First Vice President

Fax No.: (212) 373-1393
Tel. No.: (212) 373-1142

\$ [OTHER LENDERS]

Aggregate Initial
Commitment

\$

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\$50,000,000

AMENDED AND RESTATED

CREDIT AGREEMENT

AMONG

WHITE MOUNTAINS HOLDINGS, INC.,

as Borrower,

THE LENDERS NAMED HEREIN

and

THE FIRST NATIONAL BANK OF CHICAGO,

as Agent

DATED AS OF

July 30, 1997

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AMENDED AND RESTATED CREDIT AGREEMENT

This Amended and Restated Credit Agreement, dated as of July 30, 1997, is among WHITE MOUNTAINS HOLDINGS, INC., a New Hampshire corporation, the Lenders and THE FIRST NATIONAL BANK OF CHICAGO, individually and as Agent.

R E C I T A L S :

A. The Borrower has requested the Lenders to make financial accommodations to it in the aggregate principal amount of \$50,000,000, the proceeds of which the Borrower will use for the working capital and general corporate needs of the Borrower and its Subsidiaries and

B. The Lenders are willing to extend such financial accommodations on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Borrower, the Lenders and the Agent hereby agree as follows:

ARTICLE I

DEFINITIONS

As used in this Agreement:

"ABR Advance" means an Advance which bears interest at the Alternate Base Rate.

"Adjusted Net Worth" means, with respect to the Borrower, Net Worth of the Borrower (on a consolidated basis) on the date of determination (without duplication for amounts already excluded) minus the amount by which the aggregate book value of the Borrower's equity interest in FAE and SOMSC at such time exceeds \$75,000,000.

"Advance" means a borrowing pursuant to Section 2.1 consisting of the aggregate amount of the several Loans made on the same Borrowing Date by the Lenders to the Borrower of the same Type and, in the case of Eurodollar Advances, for the same Interest Period.

"Affiliate" of any Person means any other Person directly or indirectly controlling, controlled by or under common control with such Person. A Person shall be deemed to control another Person if the controlling Person owns 20% or more of any class of voting securities (or other ownership interests) of the controlled Person or possesses, directly or indirectly, the power

to direct or cause the direction of the management or policies of the controlled Person, whether through ownership of stock, by contract or otherwise.

"Agent" means First Chicago in its capacity as agent for the Lenders pursuant to Article X, and not in its individual capacity as a Lender, and any successor Agent appointed pursuant to Article X.

"Aggregate Commitment" means the aggregate of the Commitments of all the Lenders hereunder. The initial Aggregate Commitment is \$50,000,000.

"Agreement" means this Credit Agreement, as it may be amended, modified or restated and in effect from time to time.

"Agreement Accounting Principles" means generally accepted accounting principles as in effect from time to time; provided, however, that if any changes in accounting principles from those in effect on the date of this Agreement are adopted which result in a material change in the method of calculation of any of the financial covenants, standards or terms in this Agreement, the parties agree to enter into negotiations to determine whether such provisions require amendment and, if so, the terms of such amendment so as to equitably reflect such changes. Until a resolution thereof is reached, all calculations made for the purposes of determining compliance with the terms of this Agreement shall be made by application of generally accepted accounting principles in effect on the date of this Agreement applied, to the extent applicable, on a basis consistent with that used in the preparation of the Financial Statements furnished to the Lenders pursuant to Section 5.5 hereof.

"Alternate Base Rate" means, for any day, a rate of interest per annum equal to the higher of (a) the Corporate Base Rate for such day, and (b) the sum of the Federal Funds Effective Rate for such day plus 1/2% per annum, in each case changing when and as the Corporate Base Rate and the Federal Funds Effective Rate, as the case may be, changes.

"Annual Statement" means the annual statutory financial statement of any Insurance Subsidiary required to be filed with the insurance commissioner (or

similar authority) of its jurisdiction of incorporation, which statement shall be in the form required by such Insurance Subsidiary's jurisdiction of incorporation or, if no specific form is so required, in the form of financial statements permitted by such insurance commissioner (or such similar authority) to be used for filing annual statutory financial statements and shall contain the type of information permitted by such insurance commissioner (or such similar authority) to be disclosed therein, together with all exhibits or schedules filed therewith.

"Applicable Eurodollar Margin" has the meaning ascribed to it by, and shall be determined in accordance with, Schedule 1.

"Applicable Facility Fee Margin" has the meaning ascribed to it by, and shall be determined in accordance with, Schedule 1.

"Article" means an article of this Agreement unless another document is specifically referenced.

"Asset Disposition" means any sale, transfer or other disposition (outside the ordinary course of business) of any material asset of the Borrower in a single transaction or in a series of related transactions (other than the sale of (a) Margin Stock or (b) the sale of a Money Market Investment or of the Borrower's equity interests in FAE and SOMSC the proceeds of which, in the case of each of (a) and (b) are utilized to pay dividends permitted by Section 6.10), including any such sale, transfer or disposition by means of a transaction permitted by Section 6.12.

"Authorized Officer" means any of the chief executive officer, president, chief financial officer, treasurer or controller of the Borrower, acting singly.

"Bankruptcy Code" means Title 11, United States Code, sections 1 et seq., as the same may be amended from time to time, and any successor thereto or replacement therefor which may be hereafter enacted.

"Benefit Plan" means any deferred benefit plan for the benefit of present, future or former employees, whether or not such benefit plan is a Plan.

"Borrower" means White Mountains Holdings, Inc., a New Hampshire corporation, and its successors and assigns.

"Borrowing Date" means a date on which an Advance is made hereunder.

"Borrowing Notice" is defined in Section 2.8.

"Business Day" means (a) with respect to any borrowing, payment or rate selection of Eurodollar Advances, a day (other than a Saturday or Sunday) on which banks generally are open in Chicago for the conduct of substantially all of their commercial lending activities and on which dealings in United States dollars are carried on in the London interbank market, and (b) for all other purposes, a day (other than a Saturday or Sunday) on which banks generally are open in Chicago for the conduct of substantially all of their commercial lending activities.

"Capitalized Lease" of a Person means any lease of Property by such Person as lessee which would be capitalized on a balance sheet of such Person prepared in accordance with Agreement Accounting Principles.

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"Capitalized Lease Obligations" of a Person means the amount of the obligations of such Person under Capitalized Leases which would be shown as a liability on a balance sheet of such Person prepared in accordance with Agreement Accounting Principles.

"Change" is defined in Section 3.2.

"Change in Control" means (a) the acquisition by any "person" or "group" (as such terms are used in Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934, as amended) (other than Parent, any Wholly-Owned Subsidiary of Parent, John J. Byrne or any Plan or any Benefit Plan of Parent, the Borrower or any of their Subsidiaries), including without limitation any acquisition effected by means of any transaction contemplated by Section 6.12, of beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended) of 25% or more of the outstanding shares of voting stock of the Borrower; or (b) during any period of 12 consecutive calendar months, commencing on the date of the Agreement, the ceasing of those individuals (the "Continuing Directors") who (i) were directors of the Borrower on the first day of each such period or (ii) subsequently became directors of the Borrower and whose initial election or initial nomination for election subsequent to that date was approved by a majority of the Continuing Directors then on the board of directors of the Borrower to constitute a majority of the board of directors of the Borrower; or (c) during any period of 12 consecutive calendar months, commencing on the date of this Agreement, the ceasing of individuals who hold an office possessing the

title Senior Vice President or such title that ranks senior to a Senior Vice President (collectively, "Senior Management") of the Borrower on the first day of each such period to constitute a majority of the Senior Management of the Borrower. Notwithstanding the foregoing, the FAE Merger shall not be deemed in and of itself to constitute a Change in Control.

"Code" means the Internal Revenue Code of 1986, as amended, reformed or otherwise modified from time to time.

"Commitment" means, for each Lender, the obligation of such Lender to make Loans not exceeding the amount set forth opposite its signature below and as set forth in any Notice of Assignment relating to any assignment which has become effective pursuant to Section 12.3.2, as such amount may be modified from time to time pursuant to the terms hereof.

"Consolidated" or "consolidated", when used in connection with any calculation, means a calculation to be determined on a consolidated basis for a Person and its Subsidiaries in accordance with Agreement Accounting Principles.

"Consolidated Person" means, for the taxable year of reference, each Person which is a member of the affiliated group of the Borrower if Consolidated returns are or shall be filed for such affiliated group for federal income tax purposes or any combined or unitary group of which

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the Borrower is a member for state income tax purposes.

"Contingent Obligation" of a Person means any agreement, undertaking or arrangement by which such Person assumes, guarantees, endorses, contingently agrees to purchase or provide funds for the payment of, or otherwise becomes or is contingently liable upon, the obligation or liability of any other Person, or agrees to maintain the net worth or working capital or other financial condition of any other Person, or otherwise assures any creditor of such other Person against loss, including, without limitation, any comfort letter, operating agreement or take-or-pay contract or application for a Letter of Credit, excluding however (a) insurance policies and insurance contracts issued in the ordinary course of business and (b) any financial guarantees issued by Financial Security Assurance Holdings Ltd.

"Controlled Group" means all members of a controlled group of corporations and all trades or businesses (whether or not incorporated) under common control which, together with the Borrower or any of its Subsidiaries, are treated as a single employer under Section 414 of the Code.

"Conversion/Continuation Notice" is defined in Section 2.9.

"Corporate Base Rate" means a rate per annum equal to the corporate base rate of interest publicly announced by First Chicago from time to time, changing when and as said corporate base rate changes. The Corporate Base Rate is a reference rate and does not necessarily represent the lowest or best rate of interest actually charged to any customer. First Chicago may make commercial loans or other loans at rates of interest at, above or below the Corporate Base Rate.

"Default" means an event described in Article VII.

"Environmental Laws" is defined in Section 5.19.

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

"Eurodollar Advance" means an Advance which bears interest at the Eurodollar Rate.

"Eurodollar Base Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the rate determined by the Agent to be the rate at which deposits in U.S. dollars are offered by First Chicago to first-class banks in the London interbank market at approximately 11 a.m. (London time) two Business Days prior to the first day of such Interest Period, in the approximate amount of First Chicago's relevant Eurodollar Advance and having a maturity approximately equal to such Interest Period.

"Eurodollar Rate" means, with respect to a Eurodollar Advance for the relevant Interest

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Period, the sum of (a) the quotient of (i) the Eurodollar Base Rate applicable to such Interest Period, divided by (ii) one minus the Reserve Requirement (expressed as a decimal) applicable to such Interest Period, plus the Applicable Eurodollar Margin. The Eurodollar Rate shall be rounded to the next higher multiple of 1/100 of 1% if the rate is not such a multiple.

"Facility Fee" is defined in Section 2.4(a).

"Facility Termination Date" means July 30, 2002.

"FAE" means, at any time prior to the FAE Merger, Fund American Enterprises, Inc., a Delaware corporation and direct Wholly-Owned Subsidiary of Parent, and on and after the consummation of the FAE Merger, Fund American Enterprises, Inc. (f/k/a Fund American Enterprises II, Inc.), a Delaware corporation and direct Wholly-Owned Subsidiary of the Borrower.

"FAE Merger" means the merger of the corporation known as of the date of this Agreement as Fund American Enterprises, Inc. into the Borrower with Fund American Enterprises, Inc. surviving the merger and changing its name to White Mountain Holdings, Inc.

"Federal Funds Effective Rate" means, for any day, an interest rate per annum equal to the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published for such day (or, if such day is not a Business Day, for the immediately preceding Business Day) by the Federal Reserve Bank of New York, or, if such rate is not so published for any day which is a Business Day, the average of the quotations at approximately 10 a.m. (Chicago time) on such day on such transactions received by the Agent from three Federal funds brokers of recognized standing selected by the Agent in its sole discretion.

"Finance Assets" means each of the following: (a) investments in securities issued or fully guaranteed by the United States of America or any agency or instrumentality thereof (provided that the full faith and credit of the United States of America is pledged in support thereof), (b) investments in equity securities traded on the New York Stock Exchange, the American Stock Exchange or NASDAQ and securities convertible in to such equity securities, (c) investments in Investment Grade Obligations, (d) investments in money market funds substantially all the assets of which are comprised of securities of the types described in clauses (a) through (c) above, (e) investments in Wholly-Owned Subsidiaries of the Borrower, (f) investments in Main Street America Holdings, Inc., Folksamerica Holding Company Inc. and Financial Security Assurance Holdings Ltd. and (g) so long as put rights with respect thereto are available to the Borrower, investments in US West Preferred Stock; provided, that Finance Assets shall not include any securities pledged to secure any obligations (contingent or otherwise) or any Investments in FAE or SOMSC.

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"Finance Assets Ratio" means, at any time, the ratio of (a) Finance Assets of the Borrower at such time to (b) the excess of (i) Funded Indebtedness of the Borrower at such time over (ii) cash and Money Market Investments of the Borrower at such time. For purposes of this definition, Finance Assets shall be valued, without duplication, at fair market value to the extent there exists a readily ascertainable fair market value for such Finance Asset or, in the event there exists no such readily ascertainable fair market value for such Finance Assets, at book value, as calculated in accordance with Agreement Accounting Principles.

"Financial Statements" is defined in Section 5.5.

"First Chicago" means The First National Bank of Chicago in its individual capacity, and its successors.

"Fiscal Quarter" means one of the four three-month accounting periods comprising a Fiscal Year.

"Fiscal Year" means the twelve-month accounting period ending December 31 of each year.

"Fixed Charges Coverage Ratio" means, as of the end of any Fiscal Quarter, the ratio of:

(a) the sum, without duplication, of,

(i) investments of the Borrower and Valley in cash, Money Market Investments and clauses (a) through (d) of the definition "Finance Assets" as of the end of such Fiscal Quarter, plus
(ii) cash dividends received by the Borrower and Valley during the four Fiscal Quarters then ended from Financial Security Assurance Holdings Ltd., Folksamerica Holding Company Inc. and Main Street America Holdings, Inc., as long as such Person was not a Wholly-Owned Subsidiary of the Borrower or Valley at the time such payment was made and to the extent that such Person would not be restricted from paying such dividend during the succeeding four Fiscal Quarters, plus

(iii) an amount equal to the maximum amount of dividends and intercompany fees available to be paid to the Borrower and Valley without approval of any Governmental Authority by each Wholly-Owned Subsidiary of the Borrower and Valley (other than FAE, SOMSC and each Wholly-Owned Insurance Subsidiary) as of the end of such Fiscal Quarter, plus

(iv) an amount equal to the maximum amount of dividends and intercompany

fees available to be paid to the Borrower and Valley without approval of any Governmental Authority by each present and future Wholly-Owned Subsidiary of the Borrower that is a first-tier Insurance Subsidiary of either the Borrower or any of its Subsidiaries that is not an Insurance Subsidiary pursuant to applicable insurance statutes, rules and regulations of the applicable Governmental Authority during the succeeding four Fiscal Quarters,

to (b) Fixed Charges.

"Fixed Charges" means, with respect to the Borrower and Valley, as of the end of any Fiscal Quarter, the sum, without duplication, of (a) interest expenses payable on outstanding Indebtedness (determined by adjusting the principal amount of such Indebtedness for scheduled amortization payments as reflected in clauses (c), (d) and (e) below and assuming that the applicable interest rate in effect as of the date of determination would remain constant during the succeeding four Fiscal Quarter period), (b) dividends payable on preferred stock, (c) Indebtedness payable pursuant to the scheduled amortization of such Indebtedness, (d) Loans payable pursuant to Section 2.1(b) (determined by assuming that the principal amount of Loans as of the date of determination would remain constant during the succeeding four Fiscal Quarter period) as a result of reductions in the Aggregate Commitment occurring in any such period pursuant to Section 2.7(a) (other than on July 30, 2002), and (e) Loans (as defined in the Valley Credit Agreement) payable pursuant to Section 2.1(b) of the Valley Credit Agreement (determined by assuming that the outstanding principal amount of such Loans as of the date of determination would remain constant during the succeeding four Fiscal Quarter period) as a result of reductions in the Aggregate Commitment (as defined in the Valley Credit Agreement) occurring in any such period pursuant to Section 2.7(a) of the Valley Credit Agreement (other than on July 30, 2002), in each case for the period of four Fiscal Quarters immediately following the date of determination.

"Funded Indebtedness" means Indebtedness of the type described in clauses (a), (d), (e) and (h) of the definition "Indebtedness".

"Governmental Authority" means any government (foreign or domestic) or any state or other political subdivision thereof or any governmental body, agency, authority, department or commission (including without limitation any board of insurance, insurance department or insurance commissioner and any taxing authority or political subdivision) or any instrumentality or officer thereof (including without limitation any court or tribunal) exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government and any corporation, partnership or other entity directly or indirectly owned or controlled by or subject to the control of any of the foregoing.

"Hazardous Materials" is defined in Section 5.19.

"Indebtedness" of a Person means such Person's (a) obligations for borrowed money, (b) obligations representing the deferred purchase price of Property or services (other than accounts payable arising in the ordinary course of such Person's business payable on terms customary in the trade), (c) obligations, whether or not assumed, secured by Liens or payable out of the proceeds or production from Property now or hereafter owned or acquired by such Person, (d) obligations which are evidenced by notes, acceptances, or similar instruments, (e) Capitalized Lease Obligations, (f) Rate Hedging Obligations, (g) Contingent Obligations, (h) obligations for which such Person is obligated pursuant to or in respect of a Letter of Credit and (i) repurchase obligations or liabilities of such Person with respect to accounts or notes receivable sold by such Person.

"Insurance Subsidiary" means any Subsidiary which is engaged in the insurance business as an issuer or underwriter of insurance policies and/or insurance contracts.

"Interest Period" means, with respect to a Eurodollar Advance, a period of one, two, three or six months commencing on a Business Day selected by the Borrower pursuant to this Agreement. Such Interest Period shall end on (but exclude) the day which corresponds numerically to such date one, two, three or six months thereafter; provided, however, that if there is no such numerically corresponding day in such next, second, third or sixth succeeding month, such Interest Period shall end on the last Business Day of such next, second, third or sixth succeeding month. If an Interest Period would otherwise end on a day which is not a Business Day, such Interest Period shall end on the next succeeding Business Day; provided, however, that if said next succeeding Business Day falls in a new calendar month, such Interest Period shall end on the immediately preceding Business Day.

"Investment" of a Person means any loan, advance (other than commission, travel and similar advances to officers and employees made in the ordinary course of business), extension of credit (other than accounts receivable arising in the ordinary course of business on terms customary in the trade), deposit account or contribution of capital by such Person to any other Person or any

investment in, or purchase or other acquisition of, the stock, partnership interests, notes, debentures or other securities of any other Person made by such Person.

"Investment Grade Obligations" means, as of any date, investments having an NAIC investment rating of 1 or 2, or a Standard & Poor's rating within the range of ratings from AAA to BBB-, or a Moody's rating within the range of ratings from Aaa to Baa3.

"Lenders" means the lending institutions listed on the signature pages of this Agreement and their respective successors and assigns.

"Lending Installation" means, with respect to a Lender or the Agent, any office, branch, subsidiary or affiliate of such Lender or the Agent.

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"Letter of Credit" of a Person means a letter of credit or similar instrument which is issued upon the application of such Person or upon which such Person is an account party or for which such Person is in any way liable.

"Leverage Ratio" means, at any time, the ratio of (a) the consolidated Funded Indebtedness of the Borrower and its Subsidiaries, other than FAE and SOMSC, at such time to (b) the sum of the consolidated Funded Indebtedness of the Borrower and its Subsidiaries, other than FAE and SOMSC, at such time plus Net Worth (without giving effect to the Borrower's equity interests in FAE and SOMSC) at such time, in all cases determined in accordance with Agreement Accounting Principles.

"License" means any license, certificate of authority, permit or other authorization which is required to be obtained from any Governmental Authority in connection with the operation, ownership or transaction of insurance business.

"Lien" means any security interest, lien (statutory or other), mortgage, pledge, hypothecation, assignment, deposit arrangement, encumbrance or preference, priority or other security agreement or preferential arrangement of any kind or nature whatsoever (including, without limitation, the interest of a vendor or lessor under any conditional sale, Capitalized Lease or other title retention agreement), save in respect of liabilities and obligations arising out of the underwriting of insurance policies and contracts of insurance.

"Loan" means, with respect to a Lender, such Lender's portion of any Advance and "Loans" means, with respect to the Lenders, the aggregate of all Advances.

"Loan Documents" means this Agreement, the Notes and the other documents and agreements contemplated hereby and executed by the Borrower in favor of the Agent or any Lender.

"Margin Stock" has the meaning assigned to that term under Regulation U.

"Material Adverse Effect" means a material adverse effect on (a) the business, Property, condition (financial or other), performance, results of operations, or prospects of the Borrower and its Subsidiaries taken as a whole, (b) the ability of the Borrower or any Subsidiary to perform its obligations under the Loan Documents, or (c) the validity or enforceability of any of the Loan Documents or the rights or remedies of the Agent or the Lenders thereunder.

"Money Market Investments" means (a) direct obligations of the United States of America, or of any agency thereof, or obligations guaranteed as to principal and interest by the United States of America, or of any agency thereof, in either case maturing not more than one year from the date of acquisition thereof; (b) certificates of deposit issued by any bank or trust

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company organized under the laws of the United States of America or any state thereof and having capital, surplus and undivided profits of at least \$500,000,000, maturing not more than 90 days from the date of acquisition thereof; (c) commercial paper rated A-1 or better P-1 or better by Standard & Poor's Ratings Group or Moody's Investors Services, Inc., respectively, maturing not more than 90 days from the date of acquisition thereof; and (d) shares in an open-end management investment company with U.S. dollar denominated investments in fixed income obligations, including repurchase agreements, fixed time deposits and other obligations, with a dollar weighted average maturity of not more than one year, and for the calculation of this dollar weighted average maturity, certain instruments which have a variable rate of interest readjusted no less frequently than annually are deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate.

"Multiemployer Plan" means a Plan maintained pursuant to a collective bargaining agreement or any other arrangement to which the Borrower or any member of the Controlled Group is a party to which more than one employer is obligated to make contributions.

"NAIC" means the National Association of Insurance Commissioners or any successor thereto, or in lieu thereof, any other association, agency or other organization performing advisory, coordination or other like functions among insurance departments, insurance commissioners and similar Governmental Authorities of the various states of the United States toward the promotion of uniformity in the practices of such Governmental Authorities.

"Net Available Proceeds" means (a) with respect to any Asset Disposition, the sum of cash or readily marketable cash equivalents received (including by way of a cash generating sale or discounting of a note or account receivable) therefrom, whether at the time of such disposition or subsequent thereto, in excess in the case of any Asset Disposition of any amounts derived from such sale used (and permitted by this Agreement to be used) within five Business Days after such sale to make a Permitted Reinvestment, or (b) with respect to any sale or issuance of equity securities of the Borrower, cash or readily marketable cash equivalents received therefrom, whether at the time of such sale or issuance or subsequent thereto, net, in either case, of all legal, title and recording tax expenses, commissions and other fees and all costs and expenses incurred, including, without limitation, incremental income taxes resulting from such transaction.

"Net Worth" means, with respect to any Person, at any date the consolidated shareholders' equity of such Person and its Consolidated Subsidiaries determined in accordance with Agreement Accounting Principles (but excluding the effect of Statement of Financial Accounting Standards No. 115).

"Non-Excluded Taxes" is defined in Section 2.18(a).

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"Note" means a promissory note in substantially the form of Exhibit A hereto, with appropriate insertions, duly executed and delivered to the Agent by the Borrower and payable to the order of a Lender in the amount of its Commitment, including any amendment, modification, renewal or replacement of such promissory note.

"Notice of Assignment" is defined in Section 12.3.2.

"Obligations" means all unpaid principal of and accrued and unpaid interest on the Notes, all accrued and unpaid fees and all expenses, reimbursements, indemnities and other obligations of the Borrower to the Lenders or to any Lender, the Agent or any indemnified party hereunder arising under any of the Loan Documents.

"Parent" means Fund American Enterprises Holdings, Inc., a Delaware corporation.

"Parent Credit Agreement" means the Credit Agreement to be entered into among Parent, FAE (as defined after giving effect to the FAE Merger), the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented or otherwise modified from time to time.

"Participants" is defined in Section 12.2.1.

"Payment Date" means the last day of each March, June, September and December.

"PBGC" means the Pension Benefit Guaranty Corporation or any successor thereto.

"Permitted Reinvestment" means an Investment in a Finance Asset or any other Investment approved by the Required Lenders.

"Person" means any natural person, corporation, firm, joint venture, partnership, association, enterprise, trust or other entity or organization, or any government or political subdivision or any agency, department or instrumentality thereof.

"Plan" means an employee pension benefit plan, as defined in Section 3(2) of ERISA, as to which the Borrower or any member of the Controlled Group may have any liability.

"Proceeding" is defined in Section 5.19.

"Property" of a Person means any and all property, whether real, personal, tangible, intangible, or mixed, of such Person, or other assets owned, leased or operated by such Person.

"pro-rata" means, when used with respect to a Lender, and any described aggregate or total amount, an amount equal to such Lender's pro-rata share or portion based on its percentage

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of the Aggregate Commitment or if the Aggregate Commitment has been terminated, its percentage of the aggregate principal amount of outstanding Advances.

"Purchase" means any transaction, or any series of related transactions, consummated on or after the date of this Agreement, by which the Borrower or any of its Subsidiaries (a) acquires any going business or all or substantially all of the assets of any firm, corporation or division or line of business thereof, whether through purchase of assets, merger or otherwise, or (b) directly or indirectly acquires (in one transaction or as the most recent transaction in a series of transactions) at least a majority (in number of votes) of the securities of a corporation which have ordinary voting power for the election of directors (other than securities having such power only by reason of the happening of a contingency) or a majority (by percentage or voting power) of the outstanding partnership interests of a partnership.

"Purchasers" is defined in Section 12.3.1.

"Quarterly Statement" means the quarterly statutory financial statement of any Insurance Subsidiary required to be filed with the insurance commissioner (or similar authority) of its jurisdiction of incorporation or, if no specific form is so required, in the form of financial statements permitted by such insurance commissioner (or such similar authority) to be used for filing quarterly statutory financial statements and shall contain the type of financial information permitted by such insurance commissioner (or such similar authority) to be disclosed therein, together with all exhibits or schedules filed therewith.

"Rate Hedging Obligations" of a Person means any and all obligations of such Person, whether absolute or contingent and howsoever and whensoever created, arising, evidenced or acquired (including all renewals, extensions and modifications thereof and substitutions therefor), under (a) any and all agreements, devices or arrangements designed to protect at least one of the parties thereto from the fluctuations of interest rates, exchange rates or forward rates applicable to such party's assets, liabilities or exchange transactions, including, but not limited to, dollar-denominated or cross-currency interest rate exchange agreements, forward currency exchange agreements, interest rate cap or collar protection agreements, forward rate currency or interest rate options, puts and warrants, and (b) any and all cancellations, buy backs, reversals, terminations or assignments of any of the foregoing.

"Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of Governors relating to reserve requirements applicable to depository institutions.

"Regulation G" means Regulation G of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or

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official interpretation of said Board of Governors relating to the extension of credit by Persons other than banks, brokers and dealers for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation T" means Regulation T of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of such Board of Governors relating to the extension of credit by securities brokers and dealers for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation U" means Regulation U of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by banks for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation X" means Regulation X of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by the specified lenders for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Release" is defined in the Comprehensive Environmental Response, Compensation and Liability Act, as amended, 42 U.S.C. 39601 et seq.

"Reportable Event" means a reportable event as defined in Section 4043 of ERISA and the regulations issued under such section, with respect to a Plan, excluding, however, such events as to which the PBGC has by regulation waived the requirement of Section 4043(a) of ERISA that it be notified within 30 days of the occurrence of such event; provided, that a failure to meet the minimum funding standard of Section 412 of the Code and of Section 302 of ERISA shall be a Reportable Event regardless of the issuance of any such waiver of the notice requirement in accordance with either Section 4043(a) of ERISA or Section 412(d) of the Code.

"Required Lenders" means Lenders in the aggregate having at least 66-2/3%

of the Aggregate Commitment or, if the Aggregate Commitment has been terminated, Lenders in the aggregate holding at least 66-2/3% of the aggregate unpaid principal amount of the outstanding Loans.

"Reserve Requirement" means, with respect to an Interest Period, the maximum aggregate reserve requirement (including all basic, supplemental, marginal and other reserves) which is imposed under Regulation D on Eurocurrency liabilities.

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"Restatement Effective Date" means the date on which all conditions precedent set forth in Section 4.1 are satisfied or waived by all of the Lenders.

"Risk-Based Capital Guidelines" is defined in Section 3.2.

"SAP" means, with respect to any Insurance Subsidiary, the statutory accounting practices prescribed or permitted by the insurance commissioner (or other similar authority) in the jurisdiction of such Person for the preparation of annual statements and other financial reports by insurance companies of the same type as such Person in effect from time to time; provided, however, that if any changes in statutory accounting practices from those in effect on the date of this Agreement are adopted which result in a material change in the method of calculation of any of the financial covenants, standards or terms in this Agreement, the parties agree to enter into negotiations to determine whether such provisions require amendment and, if so, the terms of such amendment so as to equitably reflect such changes. Until a resolution thereof is reached, all calculations made for the purposes of determining compliance with the terms of this Agreement shall be made by application of statutory accounting practices in effect on the date of this Agreement applied, to the extent applicable, on a basis consistent with that used in the preparation of the Financial Statements furnished to the Lenders pursuant to Section 5.5 (g) and (h) hereof.

"Section" means a numbered section of this Agreement, unless another document is specifically referenced.

"Significant Subsidiary" shall mean and include, at any time, each Subsidiary of the Borrower to the extent that the Net Worth of such Subsidiary is equal to or greater than \$5,000,000.

"Single Employer Plan" means a Plan subject to Title IV of ERISA maintained by the Borrower or any member of the Controlled Group for employees of the Borrower or any member of the Controlled Group, other than a Multiemployer Plan.

"Solvent" means, when used with respect to a Person, that (a) the fair saleable value of the assets of such Person is in excess of the total amount of the present value of its liabilities (including for purposes of this definition all liabilities (including loss reserves as determined by such Person), whether or not reflected on a balance sheet prepared in accordance with Agreement Accounting Principles and whether direct or indirect, fixed or contingent, secured or unsecured, disputed or undisputed), (b) such Person is able to pay its debts or obligations in the ordinary course as they mature and (c) such Person does not have unreasonably small capital to carry out its business as conducted and as proposed to be conducted. "Solvency" shall have a correlative meaning.

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"SOMSC" means Source One Mortgage Services Corporation, a Delaware corporation.

"SOMSC Credit Agreement" means the credit agreement or credit agreements from time to time in effect among SOMSC, the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented, restated, replaced or otherwise modified from time to time (and, subsequent to the termination thereof, as in effect on the date of such termination).

"Statutory Surplus" means, with respect to any Insurance Subsidiary at any time, the statutory capital and surplus of such Insurance Subsidiary at such time, as determined in accordance with SAP ("Liabilities, Surplus and Other Funds" statement, page 3, line 25 of the Annual Statement for the 1995 Fiscal Year entitled "Surplus as Regards Policyholders").

"Subsidiary" of a Person means (a) any corporation more than 50% of the outstanding securities having ordinary voting power of which shall at the time be owned or controlled, directly or indirectly, by such Person or by one or more of its Subsidiaries or by such Person and one or more of its Subsidiaries, or (b) any partnership, association, joint venture, limited liability company or similar business organization more than 50% of the ownership interests having ordinary voting power of which shall at the time be so owned or controlled. Unless otherwise expressly provided, all references herein to a "Subsidiary" shall mean a Subsidiary of the Borrower.

"Termination Event" means, with respect to a Plan which is subject to Title IV of ERISA, (a) a Reportable Event, (b) the withdrawal of the Borrower or any other member of the Controlled Group from such Plan during a plan year in which the Borrower or any other member of the Controlled Group was a "substantial employer" as defined in Section 4001(a)(2) of ERISA or was deemed such under Section 4068(f) of ERISA, (c) the termination of such Plan, the filing of a notice of intent to terminate such Plan or the treatment of an amendment of such Plan as a termination under Section 4041 of ERISA, (d) the institution by the PBGC of proceedings to terminate such Plan or (e) any event or condition which might constitute grounds under Section 4042 of ERISA for the termination of, or appointment of a trustee to administer, such Plan.

"Transferee" is defined in Section 12.4.

"Type" means, with respect to any Advance, its nature as an ABR Advance or Eurodollar Advance.

"Unfunded Liability" means the amount (if any) by which the present value of all vested and unvested accrued benefits under a Single Employer Plan exceeds the fair market value of assets allocable to such benefits, all determined as of the then most recent valuation date for such Plans using PBGC actuarial assumptions for single employer plan terminations.

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"Unmatured Default" means an event which but for the lapse of time or the giving of notice, or both, would constitute a Default.

"Unrestricted Subsidiary" means SOMSC and its Subsidiaries and, following the FAE Merger, FAE and its Subsidiaries.

"US West Preferred Stock" means the US West Series B cumulative redeemable preferred stock \$1.00 par value per share purchased by Parent pursuant to and subject to the terms of the Securities Purchase Agreement dated April 10, 1994 among Parent, US West, Inc., US West Capital Corporation and Financial Security Assurance Holdings, Ltd. (as such agreement may be amended from time to time).

"Valley Credit Agreement" means the Credit Agreement, dated as of July 30, 1997, among Valley, the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented or otherwise modified from time to time.

"Valley" means Valley Group, Inc., an Oregon corporation.

"Wholly-Owned Subsidiary" of a Person means (a) any Subsidiary all of the outstanding voting securities of which (other than directors' qualifying or similar shares) shall at the time be owned or controlled, directly or indirectly, by such Person or one or more Wholly-Owned Subsidiaries of such Person, or by such Person and one or more Wholly-Owned Subsidiaries of such Person, or (b) any partnership, association, joint venture, limited liability company or similar business organization 100% of the ownership interests having ordinary voting power of which (other than directors' qualifying or similar shares) shall at the time be so owned or controlled.

The foregoing definitions shall be equally applicable to both the singular and plural forms of the defined terms. References herein to particular columns, lines or sections of any Person's Annual Statement shall be deemed, where appropriate, to be references to the corresponding column, line or section of such Person's Quarterly Statement, or if no such corresponding column, line or section exists or if any report form changes, then to the corresponding item referenced thereby. In the event that the columns, lines or sections of the Annual Statement referenced herein are changed or renumbered, all such references shall be deemed references to such column, line or section as so renumbered or changed. Each accounting term used herein which is not otherwise defined herein shall be defined in accordance with Agreement Accounting Principles or SAP, as applicable, unless otherwise specified.

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ARTICLE II

THE CREDITS

2.1. Advances. (a) From and including the date hereof to but excluding the Facility Termination Date, each Lender severally (and not jointly) agrees, on the terms and conditions set forth in this Agreement, to make Advances to the Borrower from time to time in amounts not to exceed in the aggregate at any one time outstanding the amount of its pro-rata share of the Aggregate Commitment existing at such time. Subject to the terms of this Agreement, the Borrower may borrow, repay and reborrow Advances at any time prior to the Facility Termination Date.

(b) The Borrower hereby agrees that if at any time, as a result of reductions in the Aggregate Commitment pursuant to Section 2.7 or otherwise, the

aggregate balance of the Loans exceeds the Aggregate Commitment, the Borrower shall repay immediately its then outstanding Loans in such amount as may be necessary to eliminate such excess.

(c) The Borrower's obligation to pay the principal of, and interest on, the Loans shall be evidenced by the Notes. Although the Notes shall be dated the date of this Agreement, interest in respect thereof shall be payable only for the periods during which the Loans evidenced thereby are outstanding and, although the stated amount of each Note shall be equal to the applicable Lender's Commitment, each Note shall be enforceable, with respect to the Borrower's obligation to pay the principal amount thereof, only to the extent of the unpaid principal amount of the Loans at the time evidenced thereby.

(d) All Advances and all Loans shall mature, and the principal amount thereof and the unpaid accrued interest thereon shall be due and payable, on the Facility Termination Date.

2.2. Ratable Loans. Each Advance hereunder shall consist of Loans made from the several Lenders ratably in proportion to the ratio that their respective Commitments bear to the Aggregate Commitment.

2.3. Types of Advances. The Advances may be ABR Advances or Eurodollar Advances, or a combination thereof, selected by the Borrower in accordance with Sections 2.8 and 2.9.

2.4. Facility Fee; Reductions in Aggregate Commitment. (a) The Borrower agrees to pay to the Agent for the account of each Lender a facility fee ("Facility Fee") in an amount equal to the Applicable Facility Fee Margin per annum times the daily average Commitment of such Lender from the date hereof to and including the Facility Termination Date, payable on

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each Payment Date hereafter and on the Facility Termination Date. All accrued Facility Fees shall be payable on the effective date of any termination of the obligations of the Lenders to make Loans hereunder.

(b) The Borrower may permanently reduce the Aggregate Commitment in whole, or in part ratably among the Lenders in a minimum aggregate amount of \$2,000,000 upon at least three (3) Business Days' written notice to the Agent, which notice shall specify the amount of any such reduction; provided, however, that the amount of the Aggregate Commitment may not be reduced below the aggregate principal amount of the outstanding Advances. Such reductions shall be in addition to reductions occurring pursuant to Section 2.7(b). Voluntary commitment reductions pursuant to this Section 2.4(b) shall be applied to the mandatory commitment reductions required to be made pursuant to Section 2.7(a) in direct order of maturity.

2.5. Minimum Amount of Each Advance. Each Advance shall be in the minimum amount of \$2,000,000 (and in integral multiples of \$500,000 if in excess thereof); provided, however, that (a) any ABR Advance may be in the amount of the unused Aggregate Commitment and (b) in no event shall more than six (6) Eurodollar Advances be permitted to be outstanding at any time.

2.6. Optional Principal Payments. The Borrower may from time to time pay, without penalty or premium, all outstanding ABR Advances, or, in a minimum aggregate amount of \$2,000,000 any portion of the outstanding ABR Advances upon two Business Days' prior notice to the Agent. Subject to Section 3.4 and upon like notice, a Eurodollar Advance may be paid prior to the last day of the applicable Interest Period in a minimum amount of \$2,000,000 or an integral multiple of \$500,000 in excess thereof.

2.7. Mandatory Commitment Reductions. (a) The Aggregate Commitment shall be automatically and permanently reduced by the following amounts (or such lesser amount as a result of reductions pursuant to Section 2.7(c)) on the following dates:

Date	Reduction Amount
-----	-----
June 30, 1999	\$3,000,000
June 30, 2000	\$3,000,000
June 30, 2001	\$4,000,000
July 30, 2002	\$40,000,000

(b) The Aggregate Commitment shall also be automatically and permanently reduced in the amounts and at the times set forth below:

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(i) within 5 Business Days after the receipt in the form of cash or cash equivalents thereof by the Borrower, 100% of the aggregate Net

Available Proceeds in excess of \$1,000,000 realized upon all Asset Dispositions in any Fiscal Year of the Borrower; and

(ii) within 5 Business Days after the receipt in the form of cash or cash equivalents thereof by the Borrower, 85% of the Net Available Proceeds realized upon the sale by the Borrower of any equity securities issued by it after the date of this Agreement in excess of an aggregate amount of \$1,000,000 (other than a sale of common stock of the Borrower to Parent).

(c) Mandatory commitment reductions under Section 2.7(b) shall be cumulative and in addition to reductions occurring pursuant to Section 2.4(b). Any mandatory commitment reductions under Section 2.7(b) shall be applied to the mandatory commitment reductions required to be made pursuant to Section 2.7(a) in the inverse order of maturity.

(d) Any reduction in the Aggregate Commitment pursuant to this Section 2.7 or otherwise shall ratably reduce the Commitment of each Lender.

2.8. Method of Selecting Types and Interest Periods for New Advances. The Borrower shall select the Type of Advance and, in the case of each Eurodollar Advance, the Interest Period applicable to each Advance from time to time; provided, however, that in the event Loans are incurred on the date of this Agreement, all Loans incurred on such date shall be ABR Advances. The Borrower shall give the Agent irrevocable notice (a "Borrowing Notice") not later than 10:00 a.m. (Chicago time) on the Borrowing Date of each ABR Advance and at least three (3) Business Days before the Borrowing Date for each Eurodollar Advance, specifying:

- (a) the Borrowing Date of such Advance, which shall be a Business Day;
- (b) the aggregate amount of such Advance;
- (c) the Type of Advance selected;
- (d) in the case of each Eurodollar Advance, the Interest Period applicable thereto, which shall end on or prior to the Facility Termination Date; and
- (e) any changes to money transfer instructions previously delivered to the Agent.

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Not later than noon (Chicago time) on each Borrowing Date, each Lender shall make available its Loan or Loans, in funds immediately available in Chicago, to the Agent at its address specified pursuant to Article XIII. The Agent will make the funds so received from the Lenders available to the Borrower at the Agent's aforesaid address or at such account at such other institution in the United States of America as the Borrower may indicate in the Borrowing Notice.

2.9. Conversion and Continuation of Outstanding Advances. ABR Advances shall continue as ABR Advances unless and until such ABR Advances are converted into Eurodollar Advances. Each Eurodollar Advance shall continue as a Eurodollar Advance until the end of the then applicable Interest Period therefor, at which time such Eurodollar Advance shall be automatically converted into an ABR Advance unless the Borrower shall have given the Agent a Conversion/Continuation Notice requesting that, at the end of such Interest Period, such Eurodollar Advance continue as a Eurodollar Advance for the same or another Interest Period. Subject to the terms of Section 2.5, the Borrower may elect from time to time to convert all or any part of an Advance of any Type into any other Type or Types of Advances; provided, however, that any conversion of any Eurodollar Advance shall be made on, and only on, the last day of the Interest Period applicable thereto. The Borrower shall give the Agent irrevocable notice (a "Conversion/Continuation Notice") of each conversion of an ABR Advance or continuation of a Eurodollar Advance not later than 10:00 a.m. (Chicago time) on the conversion date, in the case of a conversion into an ABR Advance, or at least three (3) Business Days, in the case of a conversion into or continuation of a Eurodollar Advance, prior to the date of the requested conversion or continuation, specifying:

- (a) the requested date of such conversion or continuation, which shall be a Business Day;
- (b) the aggregate amount and Type of the Advance which is to be converted or continued; and
- (c) the amount and Type(s) of Advance(s) into which such Advance is to be converted or continued and, in the case of a conversion into or continuation of a Eurodollar Advance, the duration of the Interest Period applicable thereto, which shall end on or prior to the Facility Termination Date.

2.10. Changes in Interest Rate, etc. Each ABR Advance shall bear interest at the Alternate Base Rate from and including the date of such Advance or the date on which such Advance was converted into an ABR Advance to (but not

including) the date on which such ABR Advance is paid or converted to a Eurodollar Advance. Changes in the rate of interest on that portion of any Advance maintained as an ABR Advance will take effect simultaneously with

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each change in the Alternate Base Rate. Each Eurodollar Advance shall bear interest from and including the first day of the Interest Period applicable thereto to, but not including, the last day of such Interest Period at the Eurodollar Rate determined as applicable to such Eurodollar Advance plus the Applicable Eurodollar Margin. No Interest Period may end after the Facility Termination Date. The Borrower shall select Interest Periods so that it is not necessary to repay any portion of a Eurodollar Advance prior to the last day of the applicable Interest Period in order to make a mandatory repayment required pursuant to Section 2.7(a).

2.11. Rates Applicable After Default. Notwithstanding anything to the contrary contained in Section 2.8 or 2.9, no Advance may be made as, converted into or continued as a Eurodollar Advance (except with the consent of the Agent and the Required Lenders) when any Default or Unmatured Default has occurred and is continuing. During the continuance of a Default the Required Lenders may, at their option, by notice to the Borrower (which notice may be revoked at the option of the Required Lenders notwithstanding any provision of Section 8.2 requiring unanimous consent of the Lenders to changes in interest rates), declare that each Eurodollar Advance and ABR Advance shall bear interest (for the remainder of the applicable Interest Period in the case of Eurodollar Advances) at a rate per annum equal to the rate otherwise applicable plus two percent (2%) per annum; provided, however, that such increased rate shall automatically and without action of any kind by the Lenders become and remain applicable until revoked by the Required Lenders in the event of a Default described in Section 7.6 or 7.7.

2.12. Method of Payment. All payments of the Obligations hereunder shall be made, without setoff, deduction or counterclaim, in immediately available funds to the Agent at the Agent's address specified pursuant to Article XIII, or at any other Lending Installation of the Agent specified in writing by the Agent to the Borrower (at least two Business Days in advance) by noon (Chicago time) on the date when due and shall be applied ratably by the Agent among the Lenders. Each payment delivered to the Agent for the account of any Lender shall be delivered promptly by the Agent to such Lender in the same type of funds that the Agent received at its address specified pursuant to Article XIII or at any Lending Installation specified in a notice received by the Agent from such Lender. The Agent is hereby authorized to charge the account of the Borrower maintained with the Agent for each payment of principal, interest and fees as it becomes due hereunder.

2.13. Notes. Each Lender is hereby authorized to record the principal amount of each of its Loans and each repayment on the schedule attached to its Note; provided, however, that neither the failure to so record nor any error in such recordation shall affect the Borrower's obligations under such Note.

2.14. Interest Payment Dates; Interest and Fee Basis. Interest accrued on each ABR Advance shall be payable on each Payment Date, commencing with the first such date to occur

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after the date hereof, on any date on which an ABR Advance is prepaid, whether due to acceleration or otherwise, and at maturity. Interest accrued on that portion of the outstanding principal amount of any ABR Advance converted into a Eurodollar Advance on a day other than a Payment Date shall be payable on the date of conversion. Interest accrued on each Eurodollar Advance shall be payable on the last day of its applicable Interest Period, on any date on which the Eurodollar Advance is prepaid, whether by acceleration or otherwise, and at maturity. Interest accrued on each Eurodollar Advance having an Interest Period longer than three months shall also be payable on the last day of each three-month interval during such Interest Period. Interest and commitment fees shall be calculated for actual days elapsed on the basis of a 360-day year. Interest shall be payable for the day an Advance is made but not for the day of any payment on the amount paid if payment is received prior to noon (Chicago time) at the place of payment. If any payment of principal or interest on an Advance shall become due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and, in the case of a principal payment, such extension of time shall be included in computing interest in connection with such payment.

2.15. Notification of Advances, Interest Rates, Prepayments and Commitment Reductions. Promptly after receipt thereof, the Agent will notify each Lender of the contents of each Aggregate Commitment reduction notice, Borrowing Notice, Conversion/Continuation Notice, and repayment notice received by it hereunder. The Agent will notify each Lender of the interest rate applicable to each Eurodollar Advance promptly upon determination of such interest rate and will give each Lender prompt notice of each change in the Alternate Base Rate.

2.16. Lending Installations. Each Lender may book its Loans at any Lending Installation selected by such Lender and may change its Lending Installation from time to time. All terms of this Agreement shall apply to any such Lending Installation and the Notes shall be deemed held by each Lender for the benefit of such Lending Installation. Each Lender may, by written or telex notice to the Agent and the Borrower, designate a Lending Installation through which Loans will be made by it and for whose account Loan payments are to be made.

2.17. Non-Receipt of Funds by the Agent. Unless the Borrower or a Lender, as the case may be, notifies the Agent prior to the date on which it is scheduled to make payment to the Agent of (a) in the case of a Lender, the proceeds of a Loan, or (b) in the case of the Borrower, a payment of principal, interest or fees to the Agent for the account of the Lenders, that it does not intend to make such payment, the Agent may assume that such payment has been made. The Agent may, but shall not be obligated to, make the amount of such payment available to the intended recipient in reliance upon such assumption. If the Borrower has not in fact made such payment to the Agent, the Lenders shall, on demand by the Agent, repay to the Agent the amount so made available together with interest thereon in respect of each day during the period commencing on the date such amount was so made available by the Agent until the date the Agent recovers such amount at a rate per annum equal to the Federal Funds Effective Rate for

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such day. If any Lender has not in fact made such payment to the Agent, such Lender or the Borrower shall, on demand by the Agent, repay to the Agent the amount so made available together with interest thereon in respect of each day during the period commencing on the date such amount was so made available by the Agent until the date the Agent recovers such amount at a rate per annum equal to (a) in the case of payment by a Lender, the Federal Funds Effective Rate for such day, or (b) in the case of payment by the Borrower, the interest rate applicable to the relevant Loan.

2.18. Taxes. (a) Any payments made by the Borrower under this Agreement shall be made free and clear of, and without deduction or withholding for or on account of, any present or future income, stamp or other taxes, levies, imposts, duties, charges, fees, deductions or withholdings, now or hereafter imposed, levied, collected, withheld or assessed by any Governmental Authority, excluding net income taxes and franchise taxes or any other tax based upon any income imposed on the Agent or any Lender by the jurisdiction in which the Agent or such Lender is incorporated or has its principal place of business or maintains its Lending Installation. If any such non-excluded taxes, levies, imposts, duties, charges, fees, deductions or withholdings ("Non-Excluded Taxes") are required to be withheld from any amounts payable to the Agent or any Lender hereunder, the amounts so payable to the Agent or such Lender shall be increased to the extent necessary to yield to the Agent or such Lender (after payment of all Non-Excluded Taxes) interest or any such other amounts payable hereunder at the rates or in the amounts specified in or pursuant to this Agreement; provided, however, that the Borrower shall not be required to increase any such amounts payable to any Lender that is not organized under the laws of the U.S. or a state thereof if such Lender fails to comply with the requirements of paragraph (b) of this Section 2.18. Whenever any Non-Excluded Taxes are payable by the Borrower, as promptly as practicable thereafter the Borrower shall send to the Agent for its own account or for the account of such Lender, as the case may be, a certified copy of an original official receipt received by the Borrower showing payment thereof. If the Borrower fails to pay any Non-Excluded Taxes when due to the appropriate taxing authority or fails to remit to the Agent the required receipts or other required documentary evidence, the Borrower shall indemnify the Agent and the Lenders for any incremental taxes, interest or penalties that may become payable by any Agent or any Lender as a result of any such failure. The agreements in this Section 2.18 shall survive the termination of this Agreement and the payment of all other amounts payable hereunder.

(b) At least five Business Days prior to the first date on which interest or fees are payable hereunder for the account of any Lender, each Lender that is not incorporated under the laws of the United States of America, or a state thereof, agrees that it will deliver to each of the Borrower and the Agent two duly completed and properly executed copies of United States Internal Revenue Service Form 1001 or 4224 (or a successor form), certifying in either case that such Lender is entitled to receive payments under this Agreement and the Notes without deduction or withholding of any United States federal income taxes. Each Lender which so

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delivers a Form 1001 or 4224 (or a successor form) further undertakes to deliver to each of the Borrower and the Agent two additional duly completed and properly executed copies of such form (or a successor form) on or before the date that such form expires (currently, three successive calendar years for Form 1001 and each tax year for Form 4224) or becomes obsolete or after the occurrence of any event requiring a change in the most recent forms so delivered by it, and such amendments thereto or extensions or renewals thereof as may be reasonably

requested by the Borrower or the Agent, in each case certifying that such Lender is entitled to receive payments under this Agreement and the Notes without deduction or withholding of any United States federal income taxes, unless an event (including, without limitation, any change in treaty, law or regulation) has occurred prior to the date on which any such delivery would otherwise be required which renders all such forms inapplicable or which would prevent such Lender from duly completing and delivering any such form with respect to it and such Lender advises the Borrower and the Agent that it is not capable of receiving payments without any deduction or withholding of United States federal income tax.

2.19. Agent's Fees. The Borrower shall pay to the Agent those fees, in addition to the Facility Fees referenced in Section 2.4(a), in the amounts and at the times separately agreed to between the Agent and the Borrower.

ARTICLE III

CHANGE IN CIRCUMSTANCES

3.1. Yield Protection. If, after the date hereof, the adoption of or any change in any law or any governmental or quasi-governmental rule, regulation, policy, guideline or directive (whether or not having the force of law), or any new interpretation thereof, or the compliance of any Lender with such adoption, change or interpretation,

(a) subjects any Lender or any applicable Lending Installation to any tax, duty, charge or withholding on or from payments due from the Borrower (excluding taxation of the overall net income of any Lender or applicable Lending Installation imposed by the jurisdiction in which such Lender or Lending Installation is incorporated or has its principal place of business), or changes the basis of taxation of principal, interest or any other payments to any Lender or Lending Installation in respect of its Loans or other amounts due it hereunder, or

(b) imposes or increases or deems applicable any reserve, assessment, insurance charge, special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by, any Lender or any applicable Lending

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Installation (other than reserves and assessments taken into account in determining the interest rate applicable to Eurodollar Advances), or

(ci) imposes any other condition the result of which is to increase the cost to any Lender or any applicable Lending Installation of making, funding or maintaining Loans or reduces any amount receivable by any Lender or any applicable Lending Installation in connection with any Loans, or requires any Lender or any applicable Lending Installation to make any payment calculated by reference to the amount of Loans held, or interest received by it, by an amount deemed material by such Lender,

then, within 15 days of demand by such Lender, the Borrower shall pay such Lender that portion of such increased expense incurred or resulting in an amount received which such Lender determines is attributable to making, funding and maintaining its Loans and its Commitment.

3.2. Changes in Capital Adequacy Regulations. If a Lender determines the amount of capital required or expected to be maintained by such Lender, any Lending Installation of such Lender or any corporation controlling such Lender is increased as a result of a Change, then, within 15 days of demand by such Lender, the Borrower shall pay such Lender the amount necessary to compensate for any shortfall in the rate of return on the portion of such increased capital which such Lender determines is attributable to this Agreement, its Loans or its obligation to make Loans hereunder (after taking into account such Lender's policies as to capital adequacy). "Change" means (a) any change after the date of this Agreement in the Risk-Based Capital Guidelines, or (b) any adoption of or change in any other law, governmental or quasi-governmental rule, regulation, policy, guideline, interpretation, or directive (whether or not having the force of law) after the date of this Agreement which affects the amount of capital required or expected to be maintained by any Lender or any Lending Installation or any corporation controlling any Lender. "Risk-Based Capital Guidelines" means (a) the risk-based capital guidelines in effect in the United States on the date of this Agreement and (b) the corresponding capital regulations promulgated by regulatory authorities outside the United States implementing the July 1988 report of the Basle Committee on Banking Regulation and Supervisory Practices entitled "International Convergence of Capital Measurements and Capital Standards" and any amendments to such regulations adopted prior to the date of this Agreement.

3.3. Availability of Types of Advances. If any Lender determines that maintenance of its Eurodollar Loans at a suitable Lending Installation would violate any applicable law, rule, regulation, or directive, whether or not having the force of law, or if the Required Lenders determine that (a) deposits of a type and maturity appropriate to match fund Eurodollar Advances are not

available, or (b) the interest rate applicable to a Eurodollar Advance does not accurately or fairly reflect the cost of making or maintaining such Advance, then the Agent shall suspend the availability of the Eurodollar Advances until such circumstance no longer exists and require any Eurodollar Advances to be repaid.

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3.4. Funding Indemnification. If any payment of a Eurodollar Advance occurs on a date which is not the last day of the applicable Interest Period, whether because of acceleration, prepayment or otherwise, or a Eurodollar Advance is not made on the date specified by the Borrower for any reason other than default by the Lenders, the Borrower will indemnify the Agent and each Lender for any loss or cost incurred by it resulting therefrom, including, without limitation, any loss or cost in liquidating or employing deposits acquired to fund or maintain the Eurodollar Advance.

3.5. Lender Statements; Survival of Indemnity. To the extent reasonably possible, each Lender shall designate an alternate Lending Installation with respect to its Eurodollar Advances to reduce any liability of the Borrower to such Lender under Sections 2.18, 3.1 and 3.2 or to avoid the unavailability of a Type of Advance under Section 3.3, so long as such designation is not disadvantageous to such Lender. Each Lender shall deliver a written statement of such Lender to the Borrower (with a copy to the Agent) as to the amount due, if any, under Section 3.1, 3.2 or 3.4. Such written statement shall set forth in reasonable detail the calculations upon which such Lender determined such amount and shall be final, conclusive and binding on the Borrower in the absence of manifest error. Determination of amounts payable under such Sections in connection with a Eurodollar Advance shall be calculated as though each Lender funded its Eurodollar Advances through the purchase of a deposit of the type and maturity corresponding to the deposit used as a reference in determining the Eurodollar Rate applicable to such Loan, whether in fact that is the case or not. Unless otherwise provided herein, the amount specified in the written statement of any Lender shall be payable on demand after receipt by the Borrower of the written statement. The obligations of the Borrower under Sections 3.1, 3.2 and 3.4 shall survive payment of the Obligations and termination of this Agreement.

ARTICLE IV

CONDITIONS PRECEDENT

4.1. Initial Loans. The Lenders shall not be required to make the initial Advance hereunder unless the Borrower has furnished the following to the Agent with sufficient copies for the Lenders and the other conditions set forth below have been satisfied:

(ai Charter Documents; Good Standing Certificates. Copies of the certificate of incorporation of the Borrower, together with all amendments thereto, both certified by the appropriate governmental officer in its jurisdiction of incorporation, together with a good standing certificate issued by the Secretary of State of the jurisdiction of its incorporation and such other jurisdictions as shall be reasonably requested by the Agent.

(bi By-Laws and Resolutions. Copies, certified by the Secretary or Assistant

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Secretary of the Borrower, of its by-laws and of its Board of Directors' resolutions authorizing the execution, delivery and performance of the Loan Documents to which the Borrower is a party.

(ci Secretary's Certificate. An incumbency certificate, executed by the Secretary or Assistant Secretary of the Borrower, which shall identify by name and title and bear the signature of the officers of the Borrower authorized to sign the Loan Documents and to make borrowings hereunder, upon which certificate the Agent and the Lenders shall be entitled to rely until informed of any change in writing by the Borrower.

(di Officer's Certificate. A certificate signed by an Authorized Officer of the Borrower, in form and substance satisfactory to the Agent, to the effect that on the Restatement Effective Date (both before and after giving effect to the consummation of the transactions contemplated hereby and the making of the Loans hereunder, if any, being made on such date): (i) no Default or Unmatured Default has occurred and is continuing; (ii) no injunction or temporary restraining order which would prohibit the making of any Loans or other litigation which could reasonably be expected to have a Material Adverse Effect is pending or, to the best of such Person's knowledge, threatened; (iii) all orders, consents, approvals, licenses, authorizations, or validations of, or filings, recordings or registrations with, or exemptions by, any Governmental Authority required in connection with the execution, delivery and performance of this Agreement have been or, prior to the time required, will have been, obtained, given, filed or

taken and are or will be in full force and effect (or the Borrower has obtained effective judicial relief with respect to the application thereof) and all applicable waiting periods have expired; (iv) each of the representations and warranties set forth in Article V of this Agreement is true and correct on and as of the Restatement Effective Date; and (v) since December 31, 1996, no event or change has occurred that has caused or evidences a Material Adverse Effect.

(ei Legal Opinion. A written opinion of Brobeck, Phleger & Harrison LLP, counsel to the Borrower, addressed to the Agent and the Lenders in form and substance acceptable to the Agent and its counsel.

(fi Notes. Notes payable to the order of each of the Lenders duly executed by the Borrower.

(gi Loan Documents. Executed originals of this Agreement and each of the Loan Documents, which shall be in full force and effect, together with all schedules, exhibits, certificates, instruments, opinions, documents and financial statements required to be delivered pursuant hereto and thereto.

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(hi Letters of Direction. Written money transfer instructions with respect to the initial Advances and to future Advances in form and substance acceptable to the Agent and its counsel addressed to the Agent and signed by an Authorized Officer, together with such other related money transfer authorizations as the Agent may have reasonably requested.

(ii Solvency Certificate. A written solvency certificate from the chief financial officer of the Borrower in form and content satisfactory to the Agent with respect to the value, Solvency and other factual information, or relating to, as the case may be of the Borrower on a consolidated basis.

(ji Regulatory Matters. Receipt of any required regulatory approvals from any Governmental Authority.

(ki Investment Policy Guidelines. Certified copy of the investment policy guidelines adopted by the finance committee of the board of directors of the Borrower.

(li Other. Such other documents as the Agent, any Lender or their counsel may have reasonably requested.

4.2. Each Future Advance. The Lenders shall not be required to make any Advance unless on the applicable Borrowing Date:

(ai There exists no Default or Unmatured Default and none would result from such Advance;

(bi The representations and warranties contained in Article V are true and correct as of such Borrowing Date (except to the extent such representations and warranties are expressly made as of a specified date, in which event such representations and warranties shall be true and correct as of such specified date);

(ci A Borrowing Notice shall have been properly submitted; and

(di All legal matters incident to the making of such Advance shall be satisfactory to the Lenders and their counsel.

Each Borrowing Notice with respect to each such Advance shall constitute a representation and warranty by the Borrower that the conditions contained in Section 4.2(a), (b) and (c) have been satisfied. Any Lender may require a duly completed compliance certificate in substantially the form of Exhibit B hereto as a condition to making an Advance.

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ARTICLE V

REPRESENTATIONS AND WARRANTIES

The Borrower represents and warrants to the Lenders that:

5.1. Corporate Existence and Standing. Each of the Borrower and each Subsidiary is a corporation duly incorporated, validly existing and in good standing under the laws of its respective jurisdiction of incorporation and is duly qualified and in good standing as a foreign corporation and is duly authorized to conduct its business in each jurisdiction in which its business is conducted or proposed to be conducted, except where the failure to be so

qualified could not reasonably be expected to have a Material Adverse Effect.

5.2. Authorization and Validity. The Borrower has all requisite power and authority (corporate and otherwise) and legal right to execute and deliver each of the Loan Documents and to perform its obligations thereunder. The execution and delivery by the Borrower of the Loan Documents and the performance of its obligations thereunder have been duly authorized by proper corporate proceedings and the Loan Documents constitute legal, valid and binding obligations of the Borrower enforceable against the Borrower in accordance with their terms, except as enforceability may be limited by bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally.

5.3. Compliance with Laws and Contracts. The Borrower and its Subsidiaries have complied in all material respects with all applicable statutes, rules, regulations, orders and restrictions of any domestic or foreign government or any instrumentality or agency thereof, having jurisdiction over the conduct of their respective businesses or the ownership of their respective properties, except where the failure to so comply could not reasonably be expected to have a Material Adverse Effect. Neither the execution and delivery by the Borrower of the Loan Documents, the application of the proceeds of the Loans or the consummation of the transactions contemplated in the Loan Documents, nor compliance with the provisions of the Loan Documents will, or at the relevant time did, (a) violate any law, rule, regulation (including Regulations G, T, U and X), order, writ, judgment, injunction, decree or award binding on the Borrower or any Subsidiary or the Borrower's or any Subsidiary's charter, articles or certificate of incorporation or by-laws, (b) violate the provisions of or require the approval or consent of any party to any indenture, instrument or agreement to which the Borrower or any Subsidiary is a party or is subject, or by which it, or its property, is bound, or conflict with or constitute a default thereunder, or result in the creation or imposition of any Lien (other than Liens permitted by, the Loan Documents) in, of or on the property of the Borrower or any Subsidiary pursuant to the terms of any such indenture, instrument or agreement, or (c) require any consent of the stockholders of any Person, except for approvals or consents which will be obtained on or before

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the initial Advance and are disclosed on Schedule 5.3, except for any violation of, or failure to obtain an approval or consent required under, any such indenture, instrument or agreement that could not reasonably be expected to have a Material Adverse Effect.

5.4. Governmental Consents. No order, consent, approval, qualification, license, authorization, or validation of, or filing, recording or registration with, or exemption by, or other action in respect of, any court, governmental or public body or authority, or any subdivision thereof, any securities exchange or other Person is or at the relevant time was required to authorize, or is or at the relevant time was required in connection with the execution, delivery, consummation or performance of, or the legality, validity, binding effect or enforceability of, any of the Loan Documents or the application of the proceeds of the Loans or any other transaction contemplated in the Loan Documents. Neither the Borrower nor any Subsidiary is in default under or in violation of any foreign, federal, state or local law, rule, regulation, order, writ, judgment, injunction, decree or award binding upon or applicable to the Borrower or such Subsidiary, in each case the consequences of which default or violation could reasonably be expected to have a Material Adverse Effect.

5.5. Financial Statements. The Borrower has heretofore furnished to each of the Lenders (a) the December 31, 1996 unaudited consolidated financial statements of the Borrower and its Subsidiaries, (b) the unaudited consolidated financial statements of the Borrower and its Subsidiaries as of March 31, 1997, (c) the December 31, 1996 audited financial statements of Charter Group, Inc. and its Subsidiaries, (d) the December 31, 1996 audited financial statements of Valley Insurance Co. and its Subsidiaries, (e) the December 31, 1996 audited financial statements of Valley and its Subsidiaries, (f) the December 31, 1996 audited financial statements of SOMSC and its Subsidiaries, (g) the December 31, 1996 audited financial statements of Parent and its Subsidiaries, (h) the March 31, 1997 unaudited balance sheets and income statements of Parent, the Borrower, Valley (excluding White Mountains Insurance Company related transactions), White Mountains Insurance Company (as if no business was reinsured through Valley Insurance Company), SOMSC, Financial Security Assurance Holdings Ltd., Folksamerica Holding Company, Inc. and Main Street America Holdings, Inc.; (i) the December 31, 1996 Annual Statement of each Insurance Subsidiary and (j) the March 31, 1997 Quarterly Statement of each Insurance Subsidiary (collectively, the "Financial Statements"). Each of the Financial Statements (other than as described in clause (h)) was prepared in accordance with Agreement Accounting Principles or SAP, as applicable, and fairly presents the consolidated financial condition and operations of the Person which is the subject of such Financial Statements at such dates and the consolidated results of their operations for the respective periods then ended (except, in the case of such unaudited statements, for normal year-end audit adjustments).

5.6. Material Adverse Change. No material adverse change in the business, Property, condition (financial or otherwise), performance, prospects or results of operations of

the Borrower and its Subsidiaries has occurred since December 31, 1996, except as specifically disclosed in the Financial Statements.

5.7. Taxes. Neither the Borrower nor any of its Subsidiaries is required to file United States federal, foreign, state or local tax returns. As of the date hereof, the United States income tax returns of Parent on a consolidated basis have been audited by the Internal Revenue Service through its fiscal period ending December 31, 1985, and all tax years beginning on or after January 1, 1986 are currently being audited or are subject to audit. No tax liens have been filed and no claims are being asserted with respect to any taxes of Parent which could reasonably be expected to have a Material Adverse Effect. The charges, accruals and reserves on the books of Parent in respect of any taxes or other governmental charges of Parent are in accordance with Agreement Accounting Principles.

5.8. Litigation and Contingent Obligations. There is no litigation, arbitration, proceeding, inquiry or governmental investigation pending or, to the knowledge of any of their officers, threatened against or affecting the Borrower or any Subsidiary or any of their respective properties which could reasonably be expected to have a Material Adverse Effect or to prevent, enjoin or unduly delay the making of the Loans under this Agreement. Neither the Borrower nor any Subsidiary has any material contingent obligations incurred outside of the ordinary course of its business except as set forth on Schedule 5.16 or disclosed in the Financial Statements or in financial statements required to be delivered under Section 6.1(a) and (b) and as permitted under this Agreement.

5.9. Capitalization. Schedule 5.9 hereto contains (a) an accurate description of the Borrower's capitalization as of March 31, 1997 (after giving effect to the application of the proceeds of Loans incurred by the Borrower on the initial Borrowing Date and to the FAE Merger) and (b) an accurate list of all of the existing Subsidiaries as of the date of this Agreement, setting forth their respective jurisdictions of incorporation and the percentage of their capital stock owned by the Borrower or other Subsidiaries. All of the issued and outstanding shares of capital stock of the Borrower and of each Subsidiary have been duly authorized and validly issued, are fully paid and non-assessable, and are free and clear of all Liens. No authorized but unissued or treasury shares of capital stock of the Borrower or any Subsidiary are subject to any option, warrant, right to call or commitment of any kind or character. Except as set forth on Schedule 5.9 or pursuant to management incentive plans implemented after the date of this Agreement, neither the Borrower nor any Subsidiary has any outstanding stock or securities convertible into or exchangeable for any shares of its capital stock, or any right issued to any Person (either preemptive or other) to subscribe for or to purchase, or any options for the purchase of, or any agreements providing for the issuance (contingent or otherwise) of, or any calls, commitments or claims of any character relating to any of its capital stock or any stock or securities convertible into or exchangeable for any of its capital stock other than as expressly set forth in the certificate or articles of incorporation of the Borrower or such Subsidiary. Neither

the Borrower nor any Subsidiary is subject to any obligation (contingent or otherwise) to repurchase or otherwise acquire or retire any shares of its capital stock or any convertible securities, rights or options of the type described in the preceding sentence except as otherwise set forth on Schedule 5.9 or pursuant to management incentive plans implemented after the date of this Agreement.

5.10. ERISA. Except as disclosed on Schedule 5.10, neither the Borrower nor any other member of the Controlled Group maintains any Single Employer Plans, and no Single Employer Plan has any Unfunded Liability. Neither the Borrower nor any other member of the Controlled Group maintains, or is obligated to contribute to, any Multiemployer Plan or has incurred, or is reasonably expected to incur, any withdrawal liability to any Multiemployer Plan. Each Plan complies in all material respects with all applicable requirements of law and regulations other than any such failure to comply which could not reasonably be expected to have a Material Adverse Effect. Neither the Borrower nor any member of the Controlled Group has, with respect to any Plan, failed to make any contribution or pay any amount required under Section 412 of the Code or Section 302 of ERISA or the terms of such Plan. There are no pending or, to the knowledge of the Borrower, threatened claims, actions, investigations or lawsuits against any Plan, any fiduciary thereof, or the Borrower or any member of the Controlled Group with respect to a Plan. Neither the Borrower nor any member of the Controlled Group has engaged in any prohibited transaction (as defined in Section 4975 of the Code or Section 406 of ERISA) in connection with any Plan which would subject such Person to any material liability. Within the last five years neither the Borrower nor any member of the Controlled Group has engaged in a transaction which resulted in a Single Employer Plan with an Unfunded Liability being transferred out of the Controlled Group which could reasonably be expected to have a Material Adverse Effect. No Termination Event has occurred or is reasonably expected to occur with respect to any Plan which is subject to Title IV of ERISA which could reasonably be expected to have a Material Adverse Effect.

5.11. Defaults. No Default or Unmatured Default has occurred and is continuing.

5.12. Federal Reserve Regulations. Neither the Borrower nor any Subsidiary is engaged, directly or indirectly, principally, or as one of its important activities, in the business of extending, or arranging for the extension of, credit for the purpose of purchasing or carrying Margin Stock. No part of the proceeds of any Loan will be used in a manner which would violate, or result in a violation of, Regulation G, Regulation T, Regulation U or Regulation X. Neither the making of any Advance hereunder nor the use of the proceeds thereof will violate or be inconsistent with the provisions of Regulation G, Regulation T, Regulation U or Regulation X.

5.13. Investment Company. Neither the Borrower nor any Subsidiary is, or after giving effect to any Advance will be, an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

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5.14. Certain Fees. No broker's or finder's fee or commission was, is or will be payable by the Borrower or any Subsidiary with respect to any of the transactions contemplated by this Agreement, except as described in Section 9.5. The Borrower hereby agrees to indemnify the Agent and the Lenders against and agrees that it will hold each of them harmless from any claim, demand or liability for broker's or finder's fees or commissions alleged to have been incurred by the Borrower in connection with any of the transactions contemplated by this Agreement and any expenses (including, without limitation, attorneys' fees and time charges of attorneys for the Agent or any Lender, which attorneys may be employees of the Agent or any Lender) arising in connection with any such claim, demand or liability. No other similar fee or commissions will be payable by the Borrower or any Subsidiary for any other services rendered to the Borrower or any Subsidiary ancillary to any of the transactions contemplated by this Agreement.

5.15. Solvency. As of the date hereof, after giving effect to the consummation of the transactions contemplated by the Loan Documents and the payment of all fees, costs and expenses payable by the Borrower or its Subsidiaries with respect to the transactions contemplated by the Loan Documents and the application of the proceeds of Loans incurred by the Borrower on the initial Borrowing Date, each of the Borrower and each Subsidiary is Solvent.

5.16. Indebtedness. Attached hereto as Schedule 5.16 is a complete and correct list of all Indebtedness of the Borrower and its Subsidiaries outstanding on the date of this Agreement (other than Indebtedness in a principal amount not exceeding \$500,000 for a single item of Indebtedness and \$2,000,000 in the aggregate for all such Indebtedness listed, it being understood and agreed that any such Indebtedness shall be permitted to exist pursuant to Section 6.11(b) notwithstanding the absence thereof on Schedule 5.16), showing the aggregate principal amount which was outstanding on such date after giving effect to the application of the proceeds of Loans incurred by the Borrower on the initial Borrowing Date.

5.17. Insurance Licenses. Schedule 5.17 hereto lists all of the jurisdictions in which any Insurance Subsidiary holds a License and is authorized to and does transact insurance business as of the date of this Agreement. No such License, the loss of which could reasonably be expected to have a Material Adverse Effect, is the subject of a proceeding for suspension or revocation. To the Borrower's knowledge, there is no sustainable basis for such suspension or revocation, and no such suspension or revocation has been threatened by any Governmental Authority.

5.18. Material Agreements. Except as set forth in Schedule 5.18 and except for agreements or arrangements with regulatory agencies with regard to Insurance Subsidiaries, neither the Borrower nor any Subsidiary is a party to any agreement or instrument or subject to any charter or other corporate restriction which could reasonably be expected to have a Material

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Adverse Effect or which restricts or imposes conditions upon the ability of any Subsidiary (other than an Unrestricted Subsidiary) to (a) pay dividends or make other distributions on its capital stock (b) make loans or advances to the Borrower, (c) repay loans or advances from Borrower or (d) grant Liens to the Agent to secure the Obligations. Neither the Borrower nor any Subsidiary is in default in the performance, observance or fulfillment of any of the obligations, covenants or conditions contained in any agreement to which it is a party, which default could reasonably be expected to have a Material Adverse Effect.

5.19. Environmental Laws. There are no claims, investigations, litigation, administrative proceedings, notices, requests for information (each a "Proceeding"), whether pending or threatened, or judgments or orders asserting violations of applicable federal, state and local environmental, health and

safety statutes, regulations, ordinances, codes, rules, orders, decrees, directives and standards ("Environmental Laws") or relating to any toxic or hazardous waste, substance or chemical or any pollutant, contaminant, chemical or other substance defined or regulated pursuant to any Environmental Law, including, without limitation, asbestos, petroleum, crude oil or any fraction thereof ("Hazardous Materials") asserted against the Borrower or any of its Subsidiaries, other than in connection with an insurance policy issued in the ordinary course of business to any Person (other than Parent or any Subsidiary of Parent), which, in any case, could reasonably be expected to have a Material Adverse Effect. As of the date hereof, the Borrower and its Subsidiaries do not have liabilities exceeding \$100,000 in the aggregate for all of them with respect to compliance with applicable Environmental Laws or related to the generation, treatment, storage, disposal, release, investigation or cleanup of Hazardous Materials, and no facts or circumstances exist which could give rise to such liabilities with respect to compliance with applicable Environmental Laws and the generation, treatment, storage, disposal, release, investigation or cleanup of Hazardous Materials.

5.20. Insurance. The Borrower and its Subsidiaries maintain with financially sound and reputable insurance companies insurance on their Property in such amounts and covering such risks as is consistent with sound business practice.

5.21. Disclosure. No information, exhibit or report furnished by the Borrower or any of its Subsidiaries to the Agent or to any Lender in connection with the negotiation of, or compliance with, the Loan Documents contained any material misstatement of fact or omitted to state a material fact or any fact necessary to make the statements contained therein not materially misleading. There is no fact known to the Borrower (other than matters of a general economic or political nature) that has had or could reasonably be expected to have a Material Adverse Effect and that has not been disclosed herein or in such other documents, certificates and statements furnished to the Lenders for use in connection with the transactions contemplated by this Agreement.

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ARTICLE VI

COVENANTS

During the term of this Agreement, unless the Required Lenders shall otherwise consent in writing:

6.1. Financial Reporting. The Borrower will maintain, for itself and each Subsidiary, a system of accounting established and administered in accordance with generally accepted accounting principles, consistently applied, and furnish to the Lenders:

(ai) As soon as practicable and in any event within 100 days after the close of each of its Fiscal Years, an unqualified audit report certified by independent certified public accountants, acceptable to the Lenders, prepared in accordance with Agreement Accounting Principles on a consolidated and consolidating basis (consolidating statements need not be certified by such accountants) for itself and its Subsidiaries, including balance sheets as of the end of such period and related statements of income, retained earnings and cash flows accompanied by a certificate of said accountants that, in the course of the examination necessary for their certification of the foregoing, they have obtained no knowledge of any Default or Unmatured Default, or if, in the opinion of such accountants, any Default or Unmatured Default shall exist, stating the nature and status thereof.

(bi) As soon as practicable and in any event within 60 days after the close of each of the first three Fiscal Quarters of each of its Fiscal Years, for itself and its Subsidiaries, consolidated and consolidating unaudited balance sheets as at the close of each such period and consolidated and consolidating statements of income, retained earnings and cash flows for the period from the beginning of such Fiscal Year to the end of such quarter, all certified by its chief financial officer.

(ci) (i) Upon the earlier of (A) fifteen (15) days after the regulatory filing date or (B) seventy-five (75) days after the close of each fiscal year of each Insurance Subsidiary, copies of the unaudited Annual Statement of such Insurance Subsidiary, certified by the chief financial officer or the treasurer of such Insurance Subsidiary, all such statements to be prepared in accordance with SAP and (ii) no later than each June 15, copies of financial statements prepared in accordance with SAP, or generally accepted accounting principles with a reconciliation to SAP, and certified by independent certified public accountants of recognized national standing.

(di) Upon the earlier of (i) ten (10) days after the regulatory filing date or (ii) sixty (60) days after the close of each of the first three (3) fiscal quarters of each fiscal

year of each Insurance Subsidiary, copies of the unaudited Quarterly Statement of each of the Insurance Subsidiaries, certified by the chief financial officer or the treasurer of such Insurance Subsidiary, all such statements to be prepared in accordance with SAP.

(ei Promptly and in any event within ten (10) days after (i) learning thereof, notification of any changes after the date of this Agreement in the rating given by A.M. Best & Co. in respect of any Insurance Subsidiary and (ii) receipt thereof, copies of any ratings analysis by A.M. Best & Co. relating to any Insurance Subsidiary.

(fi Copies of any outside actuarial reports prepared with respect to any valuation or appraisal of any Insurance Subsidiary, promptly after the receipt thereof.

(gi Together with the financial statements required by clauses (a) and (b) above, a compliance certificate in substantially the form of Exhibit B hereto signed by the Borrower's chief financial officer showing the calculations necessary to determine compliance with this Agreement and stating that no Default or Unmatured Default exists, or if any Default or Unmatured Default exists, stating the nature and status thereof.

(hi Promptly after the same becomes available after the close of each Fiscal Year, a statement of the Unfunded Liabilities of each Single Employer Plan, certified as correct by an actuary enrolled under ERISA.

(ii As soon as possible and in any event within 10 days after the Borrower knows that any Termination Event has occurred with respect to any Plan, a statement, signed by the chief financial officer of the Borrower, describing said Termination Event and the action which the Borrower proposes to take with respect thereto.

(ji As soon as possible and in any event within 10 days after receipt by the Borrower, a copy of (i) any notice, claim, complaint or order to the effect that the Borrower or any of its Subsidiaries is or may be liable to any Person as a result of the release by the Borrower or any of its Subsidiaries of any Hazardous Materials into the environment or requiring that action be taken to respond to or clean up a Release of Hazardous Materials into the environment, and (ii) any notice, complaint or citation alleging any violation of any Environmental Law or Environmental Permit by the Borrower or any of its Subsidiaries. Within ten days of the Borrower or any Subsidiary having knowledge of the enactment or promulgation of any Environmental Law which could reasonably be expected to have a Material Adverse Effect, the Borrower shall provide the Agent with written notice thereof.

(ki Promptly upon the furnishing thereof to the shareholders of the Borrower, copies of all financial statements, reports and proxy statements so furnished.

(li Promptly upon the filing thereof, copies of all registration statements and annual, quarterly, monthly or other regular reports which the Borrower or any of its Subsidiaries files with the Securities and Exchange Commission, the National Association of Securities Dealers, any securities exchange, the NAIC or any insurance commission or department or analogous Governmental Authority (including any filing made by the Borrower or any Subsidiary pursuant to any insurance holding company act or related rules or regulations), but excluding routine or non-material filings with the NAIC, any insurance commissioner or department or analogous Governmental Authority.

(mi Promptly and in any event within ten (10) days after learning thereof, notification of (i) any material tax assessment, demand, notice of proposed deficiency or notice of deficiency received by Parent or any other Consolidated Person or (ii) the filing of any tax Lien or commencement of any judicial proceeding by or against any such Consolidated Person, if any such assessment, demand, notice, Lien or judicial proceeding relates to tax liabilities in excess of ten percent (10%) of the net worth (determined according to generally accepted accounting standards and without reduction for any reserve for such liabilities) of the Borrower and its Subsidiaries taken as a whole.

(ni Promptly after available, any management letter prepared by the accountants conducting the audit of the financial statements delivered pursuant to Section 6.1(a).

(oi Promptly after reviewed by the board of directors of the Borrower, a copy of the Borrower's investment policy compliance report.

(pi Such other information (including, without limitation, the annual

Best's Advance Report Service report prepared with respect to each Insurance Subsidiary rated by A.M. Best & Co. and non-financial information) as the Agent or any Lender may from time to time reasonably request.

6.2. Use of Proceeds. The Borrower will, and will cause each Subsidiary to, use the proceeds of the Advances to meet the working capital and general corporate needs of the Borrower and its Subsidiaries, including but not limited to the purchase of Finance Assets. The Borrower will not, nor will it permit any Subsidiary to, use any of the proceeds of the Advances in any manner which would violate, or result in the violation of, Regulation G, Regulation T, Regulation U or Regulation X or to finance the Purchase of any Person which has not been approved and recommended by the board of directors (or functional equivalent thereof) of such Person.

6.3. Notice of Default. The Borrower will give prompt notice in writing to the Lenders of the occurrence of (a) any Default or Unmatured Default, (b) of any other event or

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development, financial or other, relating specifically to the Borrower or any of its Subsidiaries (and not of a general economic or political nature) which could reasonably be expected to have a Material Adverse Effect, (c) receipt by the Borrower or any Subsidiary of any notice from any Governmental Authority of the expiration without renewal, revocation or suspension of, or the institution of any proceedings to revoke or suspend, any License now or hereafter held by any Insurance Subsidiary which is required to conduct insurance business in compliance with all applicable laws and regulations and the expiration, revocation or suspension of which could reasonably be expected to have a Material Adverse Effect, (d) receipt by the Borrower or any Subsidiary of any notice from any Governmental Authority of the institution of any disciplinary proceedings against or in respect of any Insurance Subsidiary, or the issuance of any order, the taking of any action or any request for an extraordinary audit for cause by any Governmental Authority which, if adversely determined, could reasonably be expected to have a Material Adverse Effect, (e) any material judicial or administrative order of which the Borrower or any Subsidiary is aware limiting or controlling the insurance business of any Insurance Subsidiary (and not the insurance industry generally) which has been issued or adopted or (f) the commencement of any litigation of which the Borrower or any Subsidiary is aware which could reasonably be expected to create a Material Adverse Effect.

6.4. Conduct of Business. The Borrower will, and will cause each Subsidiary to, (a) carry on and conduct its business in substantially the same manner as it is presently conducted, (b) not conduct any significant business except for financial services, (c) do all things necessary to remain duly incorporated, validly existing and in good standing as a domestic corporation in its jurisdiction of incorporation and maintain all requisite authority to conduct its business in each jurisdiction in which its business is conducted except where the failure to maintain such authority could not reasonably be expected to have a Material Adverse Effect and (d) do all things necessary to renew, extend and continue in effect all Licenses which may at any time and from time to time be necessary for any Insurance Subsidiary to operate its insurance business in compliance with all applicable laws and regulations except for any License the loss of which could not reasonably be expected to have a Material Adverse Effect; provided, that any Insurance Subsidiary may withdraw from one or more states (other than its state of domicile) as an admitted insurer if such withdrawal is determined by the Borrower's Board of Directors to be in the best interest of the Borrower and could not reasonably be expected to have a Material Adverse Effect.

6.5. Taxes. At any time on and after the date the Borrower or any of its Subsidiaries is required to do so, the Borrower will, and will cause each Subsidiary to, timely file complete and correct United States federal and applicable foreign, state and local tax returns required by applicable law and pay when due all taxes, assessments and governmental charges and levies upon it or its income, profits or Property, except those which are being contested in good faith by appropriate proceedings and with respect to which adequate reserves have been set aside in accordance with generally accepted accounting principles or SAP, as applicable.

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6.6. Insurance. The Borrower will, and will cause each Subsidiary to, maintain with financially sound and reputable insurance companies insurance on all their Property in such amounts and covering such risks as is consistent with sound business practice, and the Borrower will furnish to the Agent and any Lender upon request full information as to the insurance carried.

6.7. Compliance with Laws. The Borrower will, and will cause each Subsidiary to, comply with all laws, rules, regulations, orders, writs, judgments, injunctions, decrees or awards to which it may be subject, the

failure to comply with which could reasonably be expected to have a Material Adverse Effect.

6.8. Maintenance of Properties. The Borrower will, and will cause each Subsidiary to, do all things necessary to maintain, preserve, protect and keep its Property in good repair, working order and condition, and make all necessary and proper repairs, renewals and replacements so that its business carried on in connection therewith may be properly conducted at all times.

6.9. Inspection. The Borrower will, and will cause each Subsidiary to, at reasonable times during normal business hours and upon reasonable notice, permit the Agent and the Lenders, by their respective representatives and agents, to inspect any of the Property, corporate books and financial records of the Borrower and each Subsidiary, to examine and make copies of the books of accounts and other financial records of the Borrower and each Subsidiary, and to discuss the affairs, finances and accounts of the Borrower and each Subsidiary with, and to be advised as to the same by, their respective officers at such reasonable times and intervals as the Lenders may designate. The Borrower will keep or cause to be kept, and cause each Subsidiary to keep or cause to be kept, appropriate records and books of account in which complete entries are to be made reflecting its and their business and financial transactions, such entries to be made in accordance with Agreement Accounting Principles or SAP, as applicable.

6.10. Dividends. The Borrower will not declare or pay any dividends or make any distributions on its capital stock (other than dividends payable in its own capital stock) or redeem, repurchase or otherwise acquire or retire any of its capital stock or any options or other rights in respect thereof at any time outstanding, except that so long as no Default or Unmatured Default exists before or after giving effect to the declaration or payment of such dividends or distributions or repurchase or redemption of such stock or other transaction, (a) the Borrower may declare and pay dividends, and make distributions, on its common stock and repurchase and redeem and otherwise acquire or retire its common stock and any options or other rights thereof in an aggregate amount not to exceed (i) during the Borrower's 1997 Fiscal Year, 1% of Adjusted Net Worth as of December 31, 1996, (ii) during the Borrower's 1998 Fiscal Year, 2% of Adjusted Net Worth as of December 31, 1997, and (iii) during any Fiscal Year thereafter, 3% of Adjusted Net Worth as of the end of the Fiscal Year preceding the Fiscal Year during which such

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transaction is consummated and (b) in addition to any dividends, distributions, repurchases, redemptions, acquisitions or retirements which may be declared, paid or made pursuant to the preceding clause (a), the Borrower may declare and pay dividends, and make distributions, on its common stock and repurchase and redeem and otherwise acquire or retire its common stock, and any options or rights thereof, (x) in an amount equal to the proceeds received by the Borrower from dividends, sales, transfers or other dispositions of its equity interests in FAE (as defined after giving effect to the FAE Merger) and SOMSC and (y) utilizing its equity interests in SOMSC.

6.11. Indebtedness. The Borrower will not, nor will it permit any Subsidiary (other than an Unrestricted Subsidiary) to, create, incur or suffer to exist any Indebtedness, except:

(ai) the Loans;

(bi) Indebtedness existing on the date hereof and described in Schedule 5.16 hereto and any renewals, extensions, refundings or refinancings of such Indebtedness; provided that the amount thereof is not increased and the maturity of principal thereof is not shortened (unless to a maturity occurring after the Facility Termination Date);

(ci) Indebtedness owing by (x) the Borrower to any Wholly-Owned Subsidiary and (y) any Wholly-Owned Subsidiary to a Wholly-Owned Subsidiary or the Borrower;

(di) Indebtedness permitted under the Valley Credit Agreement;

(ei) Indebtedness secured by Liens permitted pursuant to Section 6.15(f); and

(fi) other Indebtedness of the Borrower or any Subsidiary to the extent not otherwise included in subparagraphs (a) through (e) of this Section 6.11 or in Section 6.14, in an aggregate amount outstanding at any one time not to exceed \$5,000,000.

6.12. Merger. The Borrower will not, nor will it permit any Significant Subsidiary to, merge or consolidate with or into any other Person, except that;

(a) a Wholly-Owned Subsidiary may merge with (i) the Borrower, (ii) any Wholly-Owned Subsidiary of the Borrower or (iii) any other Person so long as no Default or Unmatured Default shall have occurred or be

continuing before and after giving effect to such merger and the surviving entity of such merger is a Wholly-Owned Subsidiary of the Borrower;

(b) a Significant Subsidiary (other than Valley and FAE (as defined after giving effect to the FAE Merger)) may merge or consolidate with any Person so long as

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neither the Borrower nor any of its Subsidiaries shall hold any capital stock of such Significant Subsidiary after giving effect to such merger or consolidation;

(c) the Borrower or Valley may merge into any Person so long as (i) the Borrower or Valley, as the case may be, is the surviving entity of such merger, (ii) no Default or Unmatured Default shall have occurred or be continuing before and after giving effect to such merger and (iii) the covenants contained in Section 6.20 shall be complied with on a pro forma basis on the date of, and after giving effect to, such merger;

(d) the FAE Merger shall be permitted so long as:

(i) no Default or Unmatured Default shall have occurred or be continuing before and after giving effect to the FAE Merger;

(ii) the Agent shall have received on or prior to the date thereof (x) a certificate from the chief financial officer of FAE (as defined before giving effect to the FAE Merger) demonstrating that the covenants contained in Section 6.20 shall be complied with on a pro forma basis on the date of, and after giving effect to, the FAE Merger, (y) a certificate from the Secretary or Assistant Secretary of FAE (as defined before giving effect to the FAE Merger) certifying a true and correct copy of the agreement and plan of merger in connection with such merger, true and correct copies of all resolutions passed by the Board of Directors of the Persons subject to such merger, incumbency of officers and a true and correct copy of the certificate of incorporation and by-laws of the surviving Person, and (z) a legal opinion of Cravath, Swaine & Moore addressed to the Agent and the Lenders, in form and substance acceptable to the Agent and its counsel, with respect to such merger;

(iii) Parent shall have satisfied all of the conditions precedent contained in Section 4.1 of the Parent Credit Agreement, and a fully executed copy of the Parent Credit Agreement, in form and substance as to FAE (as defined after giving effect to the FAE Merger) acceptable to the Lenders, shall have been delivered to the Lenders; and

(iv) FAE, as survivor of the merger with the Borrower, shall enter into an agreement in the form of Exhibit C hereto, assuming the obligations and liabilities of the "Borrower" under this Agreement; and

(e) after the consummation of the FAE Merger, FAE and any Subsidiary of FAE may merge or consolidate with any other Person.

6.13. Investments and Purchases. The Borrower will not, and will not permit any

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Subsidiary (other than an Unrestricted Subsidiary) to, make or suffer to exist any Investments (including, without limitation, loans and advances to, and other Investments in, Subsidiaries), or commitments therefor, or create any Subsidiary or become or remain a partner in any partnership or joint venture, or make any Purchases, except:

(a) Investments in existence on the date hereof;

(b) loans and advances to employees in the ordinary course of business and consistent with past practices;

(c) Investments made in Subsidiaries and in Main Street America Holdings, Inc., Folksamerica Holding Company Inc. and Financial Security Assurance Holdings Ltd.;

(d) Purchases of businesses or entities engaged in the insurance and/or insurance services business which do not constitute hostile takeovers;

(e) other Investments, so long as any such Investment is materially consistent with the Borrower's investment policy guidelines as approved from time to time by the finance committee of the board of directors

of the Borrower (a copy of the current version of such guidelines having been delivered to each Lender); provided that any change from the guidelines previously submitted to the Lenders shall not materially adversely affect the Lenders.

6.14. Contingent Obligations. The Borrower will not, nor will it permit any Subsidiary (other than an Unrestricted Subsidiary) to, make or suffer to exist any Contingent Obligation (including, without limitation, any Contingent Obligation with respect to the obligations of a Subsidiary), except (a) the issuance of financial guarantees in the ordinary course of business, (b) by endorsement of instruments for deposit or collection in the ordinary course of business, (c) for insurance policies issued in the ordinary course of business and (d) the issuance of intercompany guarantees so long as the primary obligation is permitted under this Agreement.

6.15. Liens. The Borrower will not, nor will it permit any Subsidiary (other than an Unrestricted Subsidiary) to, create, incur, or suffer to exist any Lien in, of or on the Property (other than Margin Stock) of the Borrower or any of its Subsidiaries (other than an Unrestricted Subsidiary), except:

(a) Liens for taxes, assessments or governmental charges or levies on its Property if the same shall not at the time be delinquent or thereafter can be paid without penalty, or are being contested in good faith and by appropriate proceedings and for which adequate reserves in accordance with generally accepted principles of accounting

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shall have been set aside on its books;

(b) Liens imposed by law, such as carriers', warehousemen's and mechanics' liens and other similar liens arising in the ordinary course of business which secure the payment of obligations not more than 60 days past due or which are being contested in good faith by appropriate proceedings and for which adequate reserves shall have been set aside on its books;

(c) Liens arising out of pledges or deposits under worker's compensation laws, unemployment insurance, old age pensions, or other social security or retirement benefits, or similar legislation;

(d) Utility easements, building restrictions and such other encumbrances or charges against real property as are of a nature generally existing with respect to properties of a similar character and which do not in any material way affect the marketability of the same or interfere with the use thereof in the business of the Borrower or its Subsidiaries;

(e) Liens existing on the date hereof and described in Schedule 6.15 hereto;

(f) Liens in, of or on Property acquired after the date of this Agreement (by purchase, construction or otherwise), each of which Liens either (1) existed on such Property before the time of its acquisition and was not created in anticipation thereof, or (2) was created solely for the purpose of securing Indebtedness representing, or incurred to finance, refinance or refund, the cost (including the cost of construction) of such Property; provided that no such Lien shall extend to or cover any Property of the Borrower or such Subsidiary other than the Property so acquired and improvements thereon; and provided, further, that the principal amount of Indebtedness secured by any such Lien shall at the time the Lien is incurred not exceed 75% of the fair market value (as determined in good faith by a financial officer of the Borrower and, in the case of such Property having a fair market value in excess of \$500,000, certified by such officer to the Agent, with a copy for each Lender) of the Property at the time it was so acquired; and

(g) Liens not otherwise permitted by the foregoing clauses (a) through (f) securing any Indebtedness of the Borrower, provided that the aggregate principal amount of Indebtedness secured by Liens permitted by this clause (g) shall not exceed \$3,000,000 at any time.

6.16. Affiliates. The Borrower will not, and will not permit any Subsidiary to, enter into any material transaction (including, without limitation, the purchase or sale of any Property or service) with, or make any payment or transfer to, any Affiliates (other than a Wholly-Owned

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Subsidiary), except in the ordinary course of business and pursuant to the reasonable requirements of the Borrower's or such Subsidiary's business and upon fair and reasonable terms no less favorable to the Borrower or such Subsidiary than the Borrower or such Subsidiary would obtain in a comparable arms-length transactions, except that any Unrestricted Subsidiary may make loans to Parent.

6.17. Environmental Matters. The Borrower shall and shall cause each of its Subsidiaries to (a) at all times comply in all material respects with all applicable Environmental Laws and (b) promptly take any and all necessary remedial actions in response to the presence, storage, use, disposal, transportation or Release of any Hazardous Materials on, under or about any real property owned, leased or operated by the Borrower or any of its Subsidiaries.

6.18. Change in Corporate Structure; Fiscal Year. The Borrower shall not, nor shall it permit any Subsidiary to, (a) permit any amendment or modification to be made to its certificate or articles of incorporation or by-laws which is materially adverse to the interests of the Lenders or (b) change its Fiscal Year to end on any date other than December 31 of each year.

6.19. Inconsistent Agreements. The Borrower shall not, nor shall it permit any Subsidiary (other than an Unrestricted Subsidiary) to, enter into any indenture, agreement, instrument or other arrangement which by its terms, (a) other than pursuant to the Valley Credit Agreement or pursuant to agreements or arrangements with regulatory agencies with regard to Insurance Subsidiaries, directly or indirectly contractually prohibits or restrains, or has the effect of contractually prohibiting or restraining, or contractually imposes materially adverse conditions upon, the incurrence of the Obligations, the granting of Liens to secure the Obligations, the amending of the Loan Documents or the ability of any Subsidiary to (i) pay dividends or make other distributions on its capital stock, (ii) make loans or advances to the Borrower or (iii) repay loans or advances from the Borrower or (b) contains any provision which would be violated or breached by the making of Advances or by the performance by the Borrower or any Subsidiary of any of its obligations under any Loan Document.

6.20. Financial Covenants. The Borrower shall (or, in the case of Section 6.20.5, shall cause its Insurance Subsidiaries to):

6.20.1 Minimum Adjusted Net Worth. At all times after the date hereof, maintain a minimum Adjusted Net Worth at least equal to the sum of (a) an amount equal to 85% of Net Worth (without giving effect to the Borrower's equity interests in FAE (as defined

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after giving effect to the FAE Merger) and SOMSC) as of July 31, 1997, plus (b) an amount equal to 85% of the cash and non-cash proceeds of any equity securities issued by the Borrower after July 30, 1997, plus (c) an amount equal to (i) \$75,000,000 minus (ii) the aggregate amount of mandatory commitment reductions pursuant to Section 2.7(b)(i) which occur after July 30, 1997 from the Net Available Proceeds of all sales by the Borrower of its equity interests in FAE (as defined after giving effect to the FAE Merger) or SOMSC minus (iii) the aggregate amount of Permitted Reinvestments made by the Borrower after July 30, 1997 utilizing proceeds of sales of its equity interests in FAE (as defined after giving effect to the FAE Merger) or SOMSC ("Specified Permitted Reinvestments"), plus (d) an amount equal to 85% of Specified Permitted Reinvestments made after July 30, 1997.

6.20.2. Leverage Ratio. At all times after the date hereof, maintain a Leverage Ratio of (a) not greater than 30% through and including December 31, 1999 and (b) not greater than 25% at all times thereafter.

6.20.3. Fixed Charges Coverage Ratio. As of the end of each Fiscal Quarter maintain a Fixed Charges Coverage Ratio of not less than 1.5:1.0

6.20.4. Finance Assets Ratio. At any time Loans are outstanding and the sum of cash and Money Market Investments of the Borrower is less than the aggregate outstanding principal amount of Funded Indebtedness of the Borrower at such time, maintain a Finance Assets Ratio of not less than 2.5:1.0.

6.20.5. Statutory Surplus. At all times, maintain Statutory Surplus for each Insurance Subsidiary in an amount not less than an amount equal to (a) 85% of the Statutory Surplus of each such Insurance Subsidiary on September 30, 1996, plus (b) 85% of all subsequent capital contributions to each such Insurance Subsidiary, less (c) in the event such Insurance Subsidiary dividends or otherwise distributes to its parent all the capital stock of a Wholly-Owned Insurance Subsidiary, 100% of the book value (calculated in accordance with SAP) of such Wholly-Owned Insurance Subsidiary at the time of such dividend or distribution.

6.21. Tax Consolidation. The Borrower will not and will not permit any of its Subsidiaries to (a) file or consent to the filing of any consolidated, combined or unitary income tax return with any Person other than Parent and its Subsidiaries or (b) amend, terminate or fail to enforce any existing tax sharing agreement or similar arrangement if such action would cause a Material Adverse Effect.

6.22. ERISA Compliance.

With respect to any Plan, neither the Borrower nor any Subsidiary shall:

(a) engage in any "prohibited transaction" (as such term is defined in Section 406 of ERISA or Section 4975 of the Code) for which a civil penalty pursuant to Section 502(i) of ERISA or a tax pursuant to Section 4975 of the Code in excess of \$100,000 could be imposed;

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(b) incur any "accumulated funding deficiency" (as such term is defined in Section 302 of ERISA) in excess of \$100,000, whether or not waived, or permit any Unfunded Liability to exceed \$100,000;

(c) permit the occurrence of any Termination Event which could result in a liability to the Borrower or any other member of the Controlled Group in excess of \$100,000;

(d) be an "employer" (as such term is defined in Section 3(5) of ERISA) required to contribute to any Multiemployer Plan or a "substantial employer" (as such term is defined in Section 4001(a)(2) of ERISA) required to contribute to any Multiple Employer Plan; or

(e) permit the establishment or amendment of any Plan or fail to comply with the applicable provisions of ERISA and the Code with respect to any Plan which could result in liability to the Borrower or any other member of the Controlled Group which, individually or in the aggregate, could reasonably be expected to have a Material Adverse Effect.

ARTICLE VII

DEFAULTS

The occurrence of any one or more of the following events shall constitute a Default:

7.1. Any representation or warranty made or deemed made by or on behalf of the Borrower or any of its Subsidiaries to the Lenders or the Agent under or in connection with this Agreement, any other Loan Document, any Loan, or any certificate or information delivered in connection with this Agreement or any other Loan Document shall be false in any material respect on the date as of which made.

7.2. Nonpayment of (a) any principal of any Note when due, or (b) any interest upon any Note or any commitment fee or other fee or obligations under any of the Loan Documents within five days after the same becomes due.

7.3. The breach by the Borrower of any of the terms or provisions of Section 6.2, Section 6.3(a) or Sections 6.10 through 6.16 or Sections 6.18 through 6.22.

7.4. The breach by the Borrower (other than a breach which constitutes a Default

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under Section 7.1, 7.2 or 7.3) of any of the terms or provisions of this Agreement which is not remedied within twenty (20) days after written notice from the Agent or any Lender.

7.5. The default by the Borrower or any of its Subsidiaries (or, at any time the Borrower is a Subsidiary of Parent, by Parent) in the performance of any term, provision or condition contained in any agreement or agreements under which any Funded Indebtedness aggregating in excess of \$2,000,000 (\$10,000,000 in the case of Parent and FAE and \$20,000,000, or such lower cross-default threshold amount as is provided in the SOMSC Credit Agreement, in the case of SOMSC) was created or is governed, or the occurrence of any other event or existence of any other condition, the effect of any of which is to cause, or to permit the holder or holders of such Funded Indebtedness to cause, such Funded Indebtedness to become due prior to its stated maturity; or any such Funded Indebtedness of the Borrower, any of its Subsidiaries or Parent shall be declared to be due and payable or required to be prepaid (other than by a regularly scheduled payment) prior to the stated maturity thereof.

7.6. The Borrower or any of its Significant Subsidiaries shall (a) have an order for relief entered with respect to it under the Federal bankruptcy laws as now or hereafter in effect, (b) make an assignment for the benefit of creditors, (c) apply for, seek, consent to, or acquiesce in, the appointment of a receiver, custodian, trustee, examiner, liquidator or similar official for it or any substantial portion of its Property, (d) institute any proceeding seeking an order for relief under the Federal bankruptcy laws as now or hereafter in effect or seeking to adjudicate it a

bankrupt or insolvent, or seeking dissolution, winding up, liquidation, reorganization, arrangement, adjustment or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors or fail to file an answer or other pleading denying the material allegations of any such proceeding filed against it, (e) take any corporate action to authorize or effect any of the foregoing actions set forth in this Section 7.6, (f) fail to contest in good faith any appointment or proceeding described in Section 7.7 or (g) become unable to pay, not pay, or admit in writing its inability to pay, its debts generally as they become due.

7.7. Without the application, approval or consent of the Borrower or any of its Significant Subsidiaries, a receiver, trustee, examiner, liquidator or similar official shall be appointed for the Borrower or any of its Significant Subsidiaries or any substantial portion of its Property, or a proceeding described in Section 7.6(d) shall be instituted against the Borrower or any of its Significant Subsidiaries and such appointment continues undischarged or such proceeding continues undismissed or unstayed for a period of sixty consecutive days.

7.8. The Borrower or any of its Subsidiaries shall fail within thirty days to pay, bond or otherwise discharge any judgment or order for the payment of money in excess of \$1,000,000 (or multiple judgments or orders for the payment of an aggregate amount in excess of \$5,000,000), which is not stayed on appeal or otherwise being appropriately contested in good

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faith and as to which no enforcement actions have been commenced.

7.9. Any Change in Control shall occur.

7.10. The occurrence of any "default", as defined in any Loan Document (other than this Agreement or the Notes) or the breach of any of the terms or provisions of any Loan Document (other than this Agreement or the Notes), which default or breach continues beyond any period of grace therein provided.

7.11. Any License of any Insurance Subsidiary (a) shall be revoked by the Governmental Authority which issued such License, or any action (administrative or judicial) to revoke such License shall have been commenced against such Insurance Subsidiary and shall not have been dismissed within thirty (30) days after the commencement thereof, (b) shall be suspended by such Governmental Authority for a period in excess of thirty (30) days or (c) shall not be reissued or renewed by such Governmental Authority upon the expiration thereof following application for such reissuance or renewal of such Insurance Subsidiary, which, in any case, could reasonably be expected to have a Material Adverse Effect.

7.12. Any Insurance Subsidiary shall be the subject of a final non-appealable order imposing a fine by or at the request of any state insurance regulatory agency as a result of the violation by such Insurance Subsidiary of such state's applicable insurance laws or the regulations promulgated in connection therewith which could reasonably be expected to have a Material Adverse Effect.

7.13. Any Insurance Subsidiary shall become subject to any conservation, rehabilitation or liquidation order, directive or mandate issued by any Governmental Authority or any Insurance Subsidiary shall become subject to any other directive or mandate issued by any Governmental Authority in either case which could reasonably be expected to have a Material Adverse Effect and which is not stayed within thirty (30) days.

ARTICLE VIII

ACCELERATION, WAIVERS, AMENDMENTS AND REMEDIES

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8.1. Acceleration. If any Default described in Section 7.6 or 7.7 occurs with respect to the Borrower, the obligations of the Lenders to make Loans hereunder shall automatically terminate and the Obligations shall immediately become due and payable without any election or action on the part of the Agent or any Lender. If any other Default occurs, the Required Lenders (or the Agent with the consent of the Required Lenders) may terminate or suspend the obligations of the Lenders to make Loans hereunder, or declare the Obligations to be due and payable, or both, whereupon the Obligations shall become immediately due and payable, without presentment, demand, protest or notice of any kind, all of which the Borrower hereby expressly waives.

If, within ten Business Days after acceleration of the maturity of the Obligations or termination of the obligations of the Lenders to make Loans hereunder as a result of any Default (other than any Default as described in

Section 7.6 or 7.7 with respect to the Borrower) and before any judgment or decree for the payment of the Obligations due shall have been obtained or entered, the Required Lenders (in their sole discretion) shall so direct, the Agent shall, by notice to the Borrower, rescind and annul such acceleration and/or termination.

8.2. Amendments. Subject to the provisions of this Article VIII, the Required Lenders (or the Agent with the consent in writing of the Required Lenders) and the Borrower may enter into agreements supplemental hereto for the purpose of adding or modifying any provisions to the Loan Documents or changing in any manner the rights of the Lenders or the Borrower hereunder or waiving any Default hereunder; provided, however, that no such supplemental agreement shall, without the consent of each Lender:

(a) Extend the final maturity of any Loan or Note or reduce the principal amount thereof, or, subject to Section 2.11, reduce the rate or extend the time of payment of interest or fees thereon;

(b) Reduce the percentage specified in the definition of Required Lenders;

(c) Reduce the amount of or extend the date for the mandatory payments and commitment reductions required under Section 2.1(b) or 2.7, or increase the amount of the Commitment of any Lender hereunder;

(d) Extend the Facility Termination Date or reduce the amount or extend the time of any mandatory commitment reduction required by Section 2.7;

(e) Amend this Section 8.2;

(f) Permit any assignment by the Borrower of its Obligations or its rights hereunder.

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No amendment of any provision of this Agreement relating to the Agent shall be effective without the written consent of the Agent. The Agent may waive payment of the fee required under Section 12.3.2 without obtaining the consent of any other party to this Agreement.

8.3. Preservation of Rights. No delay or omission of the Lenders or the Agent to exercise any right under the Loan Documents shall impair such right or be construed to be a waiver of any Default or an acquiescence therein, and the making of a Loan notwithstanding the existence of a Default or the inability of the Borrower to satisfy the conditions precedent to such Loan shall not constitute any waiver or acquiescence. Any single or partial exercise of any such right shall not preclude other or further exercise thereof or the exercise of any other right, and no waiver, amendment or other variation of the terms, conditions or provisions of the Loan Documents whatsoever shall be valid unless in writing signed by the Lenders required pursuant to Section 8.2, and then only to the extent in such writing specifically set forth. All remedies contained in the Loan Documents or by law afforded shall be cumulative and all shall be available to the Agent and the Lenders until the Obligations have been paid in full.

ARTICLE IX

GENERAL PROVISIONS

9.1. Survival of Representations. All representations and warranties of the Borrower contained in this Agreement or of the Borrower or any Subsidiary contained in any Loan Document shall survive delivery of the Notes and the making of the Loans herein contemplated.

9.2. Governmental Regulation. Anything contained in this Agreement to the contrary notwithstanding, no Lender shall be obligated to extend credit to the Borrower in violation of any limitation or prohibition provided by any applicable statute or regulation.

9.3. Taxes. Any stamp, documentary or similar taxes, assessments or charges payable or ruled payable by any governmental authority in respect of the Loan Documents shall be paid by the Borrower, together with interest and penalties, if any.

9.4. Headings. Section headings in the Loan Documents are for convenience of reference only, and shall not govern the interpretation of any of the provisions of the Loan Documents.

9.5. Entire Agreement. The Loan Documents embody the entire agreement and understanding among the Borrower, the Agent and the Lenders and supersede all prior agreements and understandings among the Borrower, the Agent and the Lenders relating to the

subject matter thereof other than the fee letter, dated July 30, 1997, in favor of First Chicago.

9.6. Several Obligations; Benefits of this Agreement. The respective obligations of the Lenders hereunder are several and not joint and no Lender shall be the partner or agent of any other (except to the extent to which the Agent is authorized to act as such). The failure of any Lender to perform any of its obligations hereunder shall not relieve any other Lender from any of its obligations hereunder. This Agreement shall not be construed so as to confer any right or benefit upon any Person other than the parties to this Agreement and their respective successors and assigns.

9.7. Expenses; Indemnification. The Borrower shall reimburse the Agent for any reasonable costs, internal charges and out-of-pocket expenses (including attorneys' fees and time charges of attorneys for the Agent, which attorneys may be employees of the Agent) paid or incurred by the Agent in connection with the preparation, negotiation, execution, delivery, review, amendment, modification, and administration of the Loan Documents. The Borrower also agrees to reimburse the Agent and the Lenders for any reasonable costs, internal charges and out-of-pocket expenses (including attorneys' fees and time charges of attorneys for the Agent and the Lenders, which attorneys may be employees of the Agent or the Lenders) paid or incurred by the Agent or any Lender in connection with the collection and enforcement of the Loan Documents. The Borrower further agrees to indemnify the Agent and each Lender, its directors, officers and employees against all losses, claims, damages, penalties, judgments, liabilities and expenses (including, without limitation, all expenses of litigation or preparation therefor whether or not the Agent or any Lender is a party thereto) which any of them may pay or incur arising out of or relating to this Agreement, the other Loan Documents, the transactions contemplated hereby or thereby or the direct or indirect application or proposed application of the proceeds of any Loan hereunder arising from claims or assertions by third parties except to the extent that they arise out of the gross negligence or willful misconduct of the party seeking indemnification. The obligations of the Borrower under this Section shall survive the termination of this Agreement.

9.8. Numbers of Documents. All statements, notices, closing documents, and requests hereunder shall be furnished to the Agent with sufficient counterparts so that the Agent may furnish one to each of the Lenders.

9.9. Accounting. Except as provided to the contrary herein, all accounting terms used herein shall be interpreted and all accounting determinations hereunder shall be made in accordance with Agreement Accounting Principles.

9.10. Severability of Provisions. Any provision in any Loan Document that is held to be inoperative, unenforceable, or invalid in any jurisdiction shall, as to that jurisdiction, be inoperative, unenforceable, or invalid without affecting the remaining provisions in that

jurisdiction or the operation, enforceability, or validity of that provision in any other jurisdiction, and to this end the provisions of all Loan Documents are declared to be severable.

9.11. Nonliability of Lenders. The relationship between the Borrower and the Lenders and the Agent shall be solely that of borrower and lender. Neither the Agent nor any Lender shall have any fiduciary responsibilities to the Borrower. Neither the Agent nor any Lender undertakes any responsibility to the Borrower to review or inform the Borrower of any matter in connection with any phase of the Borrower's business or operations. The Borrower shall rely entirely upon its own judgment with respect to its business, and any review, inspection or supervision of, or information supplied to the Borrower by the Agent or the Lenders is for the protection of the Agent and the Lenders and neither the Borrower nor any other Person is entitled to rely thereon. Whether or not such damages are related to a claim that is subject to the waiver effected above and whether or not such waiver is effective, neither the Agent nor any Lender shall have any liability with respect to, and the Borrower hereby waives, releases and agrees not to sue for, any special, indirect or consequential damages suffered by the Borrower in connection with, arising out of, or in any way related to the Loan Documents or the transactions contemplated thereby or the relationship established by the Loan Documents, or any act, omission or event occurring in connection therewith.

9.12. CHOICE OF LAW. THE LOAN DOCUMENTS (OTHER THAN THOSE CONTAINING A CONTRARY EXPRESS CHOICE OF LAW PROVISION) SHALL BE CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS, WITHOUT REGARD TO CONFLICT OF LAWS PROVISIONS, OF THE STATE OF ILLINOIS, BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS.

9.13. CONSENT TO JURISDICTION. THE BORROWER HEREBY IRREVOCABLY SUBMITS

TO THE NON-EXCLUSIVE JURISDICTION OF ANY UNITED STATES FEDERAL OR ILLINOIS STATE COURT SITTING IN CHICAGO IN ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATING TO ANY LOAN DOCUMENTS AND THE BORROWER HEREBY IRREVOCABLY AGREES THAT ALL CLAIMS IN RESPECT OF SUCH ACTION OR PROCEEDING MAY BE HEARD AND DETERMINED IN ANY SUCH COURT AND IRREVOCABLY WAIVES ANY OBJECTION IT MAY NOW OR HEREAFTER HAVE AS TO THE VENUE OF ANY SUCH SUIT, ACTION OR PROCEEDING BROUGHT IN SUCH A COURT OR THAT SUCH COURT IS AN INCONVENIENT FORUM. NOTHING HEREIN SHALL LIMIT THE RIGHT OF THE AGENT OR ANY LENDER TO BRING PROCEEDINGS AGAINST THE BORROWER IN THE COURTS OF ANY OTHER JURISDICTION. ANY JUDICIAL PROCEEDING BY THE BORROWER AGAINST THE AGENT OR ANY LENDER OR ANY AFFILIATE OF THE AGENT OR ANY LENDER INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH ANY LOAN DOCUMENT SHALL BE BROUGHT ONLY IN A COURT IN CHICAGO, ILLINOIS;

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PROVIDED, THAT SUCH PROCEEDINGS MAY BE BROUGHT IN OTHER COURTS IF JURISDICTION MAY NOT BE OBTAINED IN A COURT IN CHICAGO, ILLINOIS.

9.14. WAIVER OF JURY TRIAL. THE BORROWER, THE AGENT AND EACH LENDER HEREBY WAIVE TRIAL BY JURY IN ANY JUDICIAL PROCEEDING INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER (WHETHER SOUNDING IN TORT, CONTRACT OR OTHERWISE) IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH ANY LOAN DOCUMENT OR THE RELATIONSHIP ESTABLISHED THEREUNDER.

9.15. Disclosure. The Borrower and each Lender hereby (a) acknowledge and agree that First Chicago and/or its Affiliates from time to time may hold other investments in, make other loans to or have other relationships with the Borrower, including, without limitation, in connection with any interest rate hedging instruments or agreements or swap transactions, and (b) waive any liability of First Chicago or such Affiliate to the Borrower or any Lender, respectively, arising out of or resulting from such investments, loans or relationships other than liabilities arising out of the gross negligence or willful misconduct of First Chicago or its Affiliates to the extent that such liability would not have arisen but for First Chicago's status as Agent hereunder.

9.16. Counterparts. This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one agreement, and any of the parties hereto may execute this Agreement by signing any such counterpart. This Agreement shall be effective when it has been executed by the Borrower, the Agent and the Lenders and each party has notified the Agent that it has taken such action.

9.17. Treatment of Certain Information: Confidentiality.

(a) The Borrower acknowledges that (i) services may be offered or provided to it (in connection with this Agreement or otherwise) by each Lender or by one or more subsidiaries or affiliates of such Lender and (ii) information delivered to each Lender by the Borrower and its Subsidiaries may be provided to each such Subsidiary and Affiliate, it being understood that any such Subsidiary or Affiliate receiving such information shall be bound by the provisions of clause (b) below as if it were a Lender hereunder.

(b) Each Lender and the Agent agrees (on behalf of itself and each of its affiliates, directors, officers, employees and representatives) to use reasonable precautions to keep confidential, in accordance with their customary procedures for handling confidential information of this nature and in accordance with safe and sound banking practices, any non-public information supplied to it by the Borrower pursuant to this Agreement, provided that nothing herein shall limit the disclosure of any such information (i) to the extent required by

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statute, rule, regulation or judicial process, (ii) to counsel for any of the Lenders or the Agent, (iii) to bank examiners, auditors or accountants, (iv) to the Agent or any other Lender (or to First Chicago Capital Markets, Inc.), (v) in connection with any litigation to which any one or more of the Lenders or the Agent is a party, (vi) to a subsidiary or affiliate of such Lender as provided in clause (a) above, (vii) to any assignee or participant (or prospective assignee or participant) so long as such assignee or participant (or prospective assignee or participant) agrees with the respective Lender to keep such information confidential on substantially the terms set forth in this Section 9.17(b), (viii) to any other Person as may be reasonably required in the course of the enforcement of any Lender's rights or remedies hereunder or under any of such Lender's Note, or (ix) to any other creditor of the Borrower or any of its Subsidiaries at any time during the continuance of a Default; provided that in no event shall any Lender or the Agent be obligated or required to return any materials furnished by the Borrower.

ARTICLE X

10.1. Appointment. First Chicago is hereby appointed Agent hereunder and under each other Loan Document, and each of the Lenders authorizes the Agent to act as the agent of such Lender. The Agent agrees to act as such upon the express conditions contained in this Article X. The Agent shall not have a fiduciary relationship in respect of the Borrower or any Lender by reason of this Agreement.

10.2. Powers. The Agent shall have and may exercise such powers under the Loan Documents as are specifically delegated to the Agent by the terms of each thereof, together with such powers as are reasonably incidental thereto. The Agent shall have no implied duties to the Lenders, or any obligation to the Lenders to take any action thereunder, except any action specifically provided by the Loan Documents to be taken by the Agent.

10.3. General Immunity. Neither the Agent nor any of its directors, officers, agents or employees shall be liable to the Borrower or any Lender for any action taken or omitted to be taken by it or them hereunder or under any other Loan Document or in connection herewith or therewith except for its or their own gross negligence or willful misconduct.

10.4. No Responsibility for Loans, Recitals, etc. Neither the Agent nor any of its directors, officers, agents or employees shall be responsible for or have any duty to ascertain, inquire into, or verify (a) any statement, warranty or representation made in connection with any Loan Document or any borrowing hereunder, (b) the performance or observance of any of the covenants or agreements of any obligor under any Loan Document, including, without limitation,

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any agreement by an obligor to furnish information directly to each Lender; (c) the satisfaction of any condition specified in Article IV, except receipt of items required to be delivered to the Agent and not waived at closing, or (d) the validity, effectiveness, sufficiency, enforceability or genuineness of any Loan Document or any other instrument or writing furnished in connection therewith. The Agent shall have no duty to disclose to the Lenders information that is not required to be furnished by the Borrower to the Agent at such time, but is voluntarily furnished by the Borrower to the Agent (either in its capacity as Agent or in its individual capacity).

10.5. Action on Instructions of Lenders. The Agent shall in all cases be fully protected in acting, or in refraining from acting, hereunder and under any other Loan Document in accordance with written instructions signed by the Required Lenders (or, to the extent required by Section 8.2, all Lenders), and such instructions and any action taken or failure to act pursuant thereto shall be binding on all of the Lenders and on all holders of Notes. The Agent shall be fully justified in failing or refusing to take any action hereunder and under any other Loan Document unless it shall first be indemnified to its satisfaction by the Lenders pro rata against any and all liability, cost and expense that it may incur by reason of taking or continuing to take any such action.

10.6. Employment of Agents and Counsel. The Agent may execute any of its duties as Agent hereunder and under any other Loan Document by or through employees, agents and attorneys-in-fact and shall not be answerable to the Lenders, except as to money or securities received by it or its authorized agents, for the default or misconduct of any such agents or attorneys-in-fact selected by it with reasonable care. The Agent shall be entitled to advice of counsel concerning all matters pertaining to the agency hereby created and its duties hereunder and under any other Loan Document.

10.7. Reliance on Documents; Counsel. The Agent shall be entitled to rely upon any Note, notice, consent, certificate, affidavit, letter, telegram, statement, paper or document believed by it to be genuine and correct and to have been signed or sent by the proper person or persons, and, in respect to legal matters, upon the opinion of counsel selected by the Agent, which counsel may be employees of the Agent.

10.8. Agent's Reimbursement and Indemnification. The Lenders agree to reimburse and indemnify the Agent ratably in proportion to their respective Commitments (or, if the Commitments have been terminated, in proportion to their Commitments immediately prior to such termination) (a) for any amounts not reimbursed by the Borrower for which the Agent is entitled to reimbursement by the Borrower under the Loan Documents, (b) for any other expenses incurred by the Agent on behalf of the Lenders, in connection with the preparation, execution, delivery, administration and enforcement of the Loan Documents, and (c) for any liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind and nature whatsoever which may be imposed on, incurred by or

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asserted against the Agent in any way relating to or arising out of the Loan Documents or any other document delivered in connection therewith or the transactions contemplated thereby, or the enforcement of any of the terms thereof or of any such other documents; provided, that no Lender shall be liable for any of the foregoing to the extent they arise from the gross negligence or willful misconduct of the Agent. The obligations of the Lenders under this Section 10.8 shall survive payment of the Obligations and termination of this Agreement.

10.9. Notice of Default. The Agent shall not be deemed to have knowledge or notice of the occurrence of any Default or Unmatured Default hereunder unless the Agent has received written notice from a Lender or the Borrower referring to this Agreement describing such Default or Unmatured Default and stating that such notice is a "notice of default". In the event that the Agent receives such a notice, the Agent shall give prompt notice thereof to the Lenders.

10.10. Rights as a Lender. In the event the Agent is a Lender, the Agent shall have the same rights and powers hereunder and under any other Loan Document as any Lender, including, without limitation, pursuant to Article XII hereof, and may exercise the same as though it were not the Agent, and the term "Lender" or "Lenders" shall, at any time when the Agent is a Lender, unless the context otherwise indicates, include the Agent in its individual capacity. The Agent may accept deposits from, lend money to, and generally engage in any kind of trust, debt, equity or other transaction, in addition to those contemplated by this Agreement or any other Loan Document, with the Borrower or any of its Subsidiaries in which the Borrower or such Subsidiary is not restricted hereby from engaging with any other Person.

10.11. Lender Credit Decision. Each Lender acknowledges that it has, independently and without reliance upon the Agent or any other Lender and based on the financial statements prepared by the Borrower and such other documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement and the other Loan Documents. Each Lender also acknowledges that it will, independently and without reliance upon the Agent or any other Lender and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement and the other Loan Documents.

10.12. Successor Agent. The Agent may resign at any time by giving written notice thereof to the Lenders and the Borrower, such resignation to be effective upon the appointment of a successor Agent or, if no successor Agent has been appointed, forty-five days after the retiring Agent gives notice of its intention to resign. Upon any such resignation, the Required Lenders shall have the right to appoint, on behalf of the

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Lenders, a successor Agent, which successor Agent, so long as no Default is continuing, shall be reasonably acceptable to the Borrower. If no successor Agent shall have been so appointed by the Required Lenders and shall have accepted such appointment within thirty days after the resigning Agent's giving notice of its intention to resign, then the resigning Agent may appoint, on behalf of the Borrower and the Lenders, a successor Agent, which successor Agent, so long as no Default is continuing, shall be reasonably acceptable to the Borrower. If the Agent has resigned and no successor Agent has been appointed, the Lenders may perform all the duties of the Agent hereunder and the Borrower shall make all payments in respect of the Obligations to the applicable Lender and for all other purposes shall deal directly with the Lenders. No successor Agent shall be deemed to be appointed hereunder until such successor Agent has accepted the appointment. Any such successor Agent shall be a commercial bank having capital and retained earnings of at least \$50,000,000 and with a Lending Installation in the United States of America. Upon the acceptance of any appointment as Agent hereunder by a successor Agent, such successor Agent shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the resigning Agent. Upon the effectiveness of the resignation of the Agent, the resigning Agent shall be discharged from its duties and obligations hereunder and under the Loan Documents. After the effectiveness of the resignation of an Agent, the provisions of this Article X 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 the Agent hereunder and under the other Loan Documents.

ARTICLE XI

SETOFF; RATABLE PAYMENTS

11.1. Setoff. In addition to, and without limitation of, any rights of the Lenders under applicable law, if the Borrower becomes insolvent, however evidenced, or any Default or Unmatured Default occurs, any and all deposits (including all account balances, whether provisional or final and whether or not collected or available) and any other Indebtedness at any time held or owing by

any Lender to or for the credit or account of the Borrower may be offset and applied toward the payment of the Obligations owing to such Lender, whether or not the Obligations, or any part hereof, shall then be due.

11.2. Ratable Payments. If any Lender, whether by setoff or otherwise, has payment made to it upon its Loans (other than payments received pursuant to Section 2.18, 3.1, 3.2 or 3.4) in a greater proportion than its pro-rata share of such Loans, such Lender agrees, promptly upon demand, to purchase a portion of the Loans held by the other Lenders so that after such purchase each Lender will hold its ratable proportion of Loans. If any Lender, whether in connection with setoff or amounts which might be subject to setoff or otherwise, receives collateral or other protection for its Obligations or such amounts which may be subject to setoff, such Lender agrees, promptly upon demand, to take such action necessary such that all Lenders share in the benefits of such collateral ratably in proportion to their Loans. In case any such payment is disturbed by legal process, or otherwise, appropriate further adjustments shall be made. If an amount to be setoff is to be applied to Indebtedness of the Borrower to a Lender, other than

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Indebtedness evidenced by any of the Notes held by such Lender, such amount shall be applied ratably to such other Indebtedness and to the Indebtedness evidenced by such Notes.

ARTICLE XII

BENEFIT OF AGREEMENT; ASSIGNMENTS; PARTICIPATIONS

12.1. Successors and Assigns. The terms and provisions of the Loan Documents shall be binding upon and inure to the benefit of the Borrower and the Lenders and their respective successors and assigns, except that (a) the Borrower shall not have the right to assign its rights or obligations under the Loan Documents, and (b) any assignment by any Lender must be made in compliance with Section 12.3. Notwithstanding clause (b) of the preceding sentence, any Lender may at any time, without the consent of the Borrower or the Agent, assign all or any portion of its rights under this Agreement and its Notes to a Federal Reserve Bank; provided, however, that no such assignment to a Federal Reserve Bank shall release the transferor Lender from its obligations hereunder. The Agent may treat the payee of any Note as the owner thereof for all purposes hereof unless and until such payee complies with Section 12.3 in the case of an assignment thereof or, in the case of any other transfer, a written notice of the transfer is filed with the Agent. Any assignee or transferee of a Note agrees by acceptance thereof to be bound by all the terms and provisions of the Loan Documents. Any request, authority or consent of any Person, who at the time of making such request or giving such authority or consent is the holder of any Note, shall be conclusive and binding on any subsequent holder, transferee or assignee of such Note or of any Note or Notes issued in exchange therefor.

12.2. Participations.

12.2.1. Permitted Participants; Effect. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time sell to one or more banks or other entities ("Participants") participating interests in any Loan owing to such Lender, any Note held by such Lender, any Commitment of such Lender or any other interest of such Lender under the Loan Documents. In the event of any such sale by a Lender of participating interests to a Participant, such Lender's obligations under the Loan Documents shall remain unchanged, such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations, such Lender shall remain the holder of any such Note for all purposes under the Loan Documents, all amounts payable by the Borrower under this Agreement shall be determined as if such Lender had not sold such participating interests, and the Borrower and the Agent shall continue to deal solely and directly with such Lender in connection with such Lender's rights and obligations under the Loan Documents.

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12.2.2. Voting Rights. Each Lender shall retain the sole right to approve, without the consent of any Participant, any amendment, modification or waiver of any provision of the Loan Documents other than any amendment, modification or waiver which effects any of the modifications referenced in clauses (a) through (f) of Section 8.2.

12.2.3. Benefit of Setoff. The Borrower agrees that each Participant shall be deemed to have the right of setoff provided in Section 11.1 in respect of its participating interest in amounts owing under the Loan Documents to the same extent as if the amount of its participating interest were owing directly to it as a Lender under the Loan Documents; provided, that each Lender shall retain the right of setoff provided in Section 11.1 with respect to the amount

of participating interests sold to each Participant. The Lenders agree to share with each Participant, and each Participant, by exercising the right of setoff provided in Section 11.1, agrees to share with each Lender, any amount received pursuant to the exercise of its right of setoff, such amounts to be shared in accordance with Section 11.2 as if each Participant were a Lender.

12.3. Assignments.

12.3.1. Permitted Assignments. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time assign to one or more banks or other entities ("Purchasers") all or any part of its rights and obligations under the Loan Documents; provided, however, that in the case of an assignment to an entity which is not a Lender or an Affiliate of a Lender, such assignment shall be in a minimum amount (when added to the amount of the assignment of such Lender's obligations under the Valley Credit Agreement) of \$5,000,000 (or, if less, the entire amount of such Lender's Commitment). Such assignment shall be substantially in the form of Exhibit D hereto or in such other form as may be agreed to by the parties thereto. The consent of the Agent and, so long as no Default under Section 7.2, 7.6 or 7.7 is continuing, the Borrower, shall be required prior to an assignment becoming effective with respect to a Purchaser which is not a Lender or an Affiliate thereof. Such consent shall not be unreasonably withheld. Notwithstanding anything to the contrary contained herein, any assignment by a Lender of its rights and obligations under the Loan Documents shall be accompanied by an assignment to the same assignee of the same ratable share of the rights and obligations of such Lender under the Valley Credit Agreement in respect of its obligations thereunder.

12.3.2. Effect; Effective Date. Upon (a) delivery to the Agent of a notice of assignment, substantially in the form attached as Exhibit I to Exhibit D hereto (a "Notice of Assignment"), together with any consents required by Section 12.3.1, and (b) payment of a \$3,000 fee to the Agent for processing such assignment, such assignment shall become effective on the effective date specified in such Notice of Assignment. On and after the effective date of such assignment, (a) such Purchaser shall for all purposes be a Lender party to this Agreement and any other Loan Document executed by the Lenders and shall have all the rights and

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obligations of a Lender under the Loan Documents, to the same extent as if it were an original party hereto, and (b) the transferor Lender shall be released with respect to the percentage of the Aggregate Commitment and Loans assigned to such Purchaser without any further consent or action by the Borrower, the Lenders or the Agent. Upon the consummation of any assignment to a Purchaser pursuant to this Section 12.3.2, the transferor Lender, the Agent and the Borrower shall make appropriate arrangements so that replacement Notes are issued to such transferor Lender and new Notes or, as appropriate, replacement Notes, are issued to such Purchaser, in each case in principal amounts reflecting their Commitment, as adjusted pursuant to such assignment.

12.4. Dissemination of Information. Subject to Section 9.17(b), the Borrower authorizes each Lender to disclose to any Participant or Purchaser or any other Person acquiring an interest in the Loan Documents by operation of law (each a "Transferee") and any prospective Transferee any and all information in such Lender's possession concerning the creditworthiness of the Borrower and its Subsidiaries.

12.5. Tax Treatment. If any interest in any Loan Document is transferred to any Transferee which is organized under the laws of any jurisdiction other than the United States or any State thereof, the transferor Lender shall cause such Transferee, concurrently with the effectiveness of such transfer, to comply with the provisions of Section 2.18.

ARTICLE XIII

NOTICES

13.1. Giving Notice. All notices and other communications provided to any party hereto under this Agreement or any other Loan Document shall be in writing, by facsimile, first class U.S. mail or overnight courier and addressed or delivered to such party at its address set forth below its signature hereto or at such other address as may be designated by such party in a notice to the other parties. Any notice, if mailed and properly addressed with first class postage prepaid, return receipt requested, shall be deemed given three (3) Business Days after deposit in the U.S. mail; any notice, if transmitted by facsimile, shall be deemed given when transmitted; and any notice given by overnight courier shall be deemed given when received by the addressee.

13.2. Change of Address. The Borrower, the Agent and any Lender may each change the address for service of notice upon it by a notice in writing to the other parties hereto.

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ARTICLE XIV

AMENDMENT AND RESTATEMENT

14.1. (a) This Agreement amends and restates in its entirety the Credit Agreement, dated as of November 26, 1996, among the Borrower, the financial institutions from time to time party thereto and First Chicago, as agent (as amended, supplemented or otherwise modified through the date hereof, the "Prior Credit Agreement") and, upon the Restatement Effective Date, the terms and provisions of Prior Credit Agreement shall, subject to this Article XIV, be superseded hereby and thereby. Prior to the Restatement Effective Date, the Prior Credit Agreement shall continue to govern the making of any Loans and any outstanding Loans and Obligations.

(b) Notwithstanding the amendment and restatement of the Prior Credit Agreement by this agreement, the Loans under, and as defined in, the Prior Credit Agreement ("Continuing Loans") and all accrued interest, fees and expenses owing to First Chicago and Fleet National Bank by the Borrower shall remain outstanding as of the Restatement Effective Date and constitute continuing Obligations under this Agreement. The Continuing Loans shall in all respects be continuing, and this Agreement shall not be deemed to evidence or result in a novation or repayment and re-borrowing of the Continuing Loans. In furtherance of and without limiting the foregoing (i) all interest, fees and expenses which have arisen under the Prior Agreement shall be paid on the applicable due date therefor specified in this Agreement and (ii) from and after the Restatement Effective Date, the terms, conditions and covenants governing the Continuing Loans shall be solely as set forth in this Agreement, which shall supersede the Prior Credit Agreement to the extent provided in this Article XIV.

[signature pages to follow]

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IN WITNESS WHEREOF, the Borrower, the Lenders and the Agent have executed this Agreement as of the date first above written.

WHITE MOUNTAINS HOLDINGS, INC.

By:

Print Name:

Title:

Address: 80 South Main Street
Hanover, New Hampshire 03755
Attn:

Fax No.:
Tel. No.:

Commitments

Commitment \$ THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as Agent

By:

Print Name:

Title:

Address: 153 West 51st Street
New York, NY 10019
Attn: Samuel W. Bridges
First Vice President

Fax No.: (212) 373-1393
Tel. No.: (212) 373-1142

\$ [OTHER LENDERS]

Aggregate Initial
Commitment \$

SCHEDULE 1
TO CREDIT AGREEMENT

MARGINS

"Applicable Eurodollar Margin" and "Applicable Facility Fee Margin" means, for any period, the applicable of the following percentages in effect with such period based on the Leverage Ratio and the Fixed Charges Coverage Ratio as follows:

	I	II	III	IV
Leverage Ratio is:	GREATER THAN 15%	\$15%	LESS THAN 15%	\$15%
If Fixed Charges Coverage Ratio is:	GREATER THAN 2:1	GREATER THAN 2:1	#2:1	#2:1
The applicable margin will be:				
Applicable Facility Fee Margin	.150%	.175%	.175%	.200%
Applicable Eurodollar Margin	.350%	.450%	.450%	.550%

The Leverage Ratio and Fixed Charges Coverage Ratio shall be calculated by the Borrower as of the end of each of its Fiscal Quarters commencing September 30, 1997 and shall be reported to the Agent pursuant to a certificate executed by an authorized officer of the Borrower and delivered in accordance with Section 6.1(g) of the Agreement. The foregoing margins shall be adjusted, if necessary, quarterly as of the fifth day after the delivery of the certificate provided for above; provided that if such certificate, together with the financial statements to which such certificate relates, are not delivered by the fifth day after the due date therefor specified in Section 6.1(g), then until the fifth day after such delivery, each of the margins specified above shall be as set forth in Column IV above. Until adjusted as described above after September 30, 1997, the Applicable Eurodollar Margin and Applicable Facility Fee Margin, as the case may be, shall be as specified in Column II above.

\$15,000,000

AMENDED AND RESTATED
CREDIT AGREEMENT

AMONG

VALLEY GROUP, INC.,

as Borrower,

WHITE MOUNTAINS HOLDINGS, INC.,

as Guarantor,

THE LENDERS NAMED HEREIN

and

THE FIRST NATIONAL BANK OF CHICAGO,

as Agent

DATED AS OF

July 30, 1997

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EXHIBITS

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AMENDED AND RESTATED CREDIT AGREEMENT

This Amended and Restated Credit Agreement, dated as of July 30, 1997, is among VALLEY GROUP, INC., an Oregon corporation, WHITE MOUNTAINS HOLDINGS, INC., a New Hampshire corporation, the Lenders and THE FIRST NATIONAL BANK OF CHICAGO, individually and as Agent.

R E C I T A L S:

A. The Borrower has requested the Lenders to make financial accommodations to it in the aggregate principal amount of \$15,000,000, the proceeds of which the Borrower will use for the working capital and general corporate needs of the Borrower and its Subsidiaries; and

B. The Lenders are willing to extend such financial accommodations on the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual covenants and undertakings herein contained, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, each Loan Party, the Lenders and the Agent hereby agree as follows:

ARTICLE I

DEFINITIONS

As used in this Agreement:

"ABR Advance" means an Advance which bears interest at the Alternate Base Rate.

"Adjusted Net Worth" means, with respect to Parent, Net Worth of Parent (on a consolidated basis) on the date of determination (without duplication for amounts already excluded) minus the amount by which the aggregate book value of Parent's equity interest in FAE and SOMSC at such time exceeds \$75,000,000.

"Advance" means a borrowing pursuant to Section 2.1 consisting of the aggregate amount of the several Loans made on the same Borrowing Date by the Lenders to the Borrower of the same Type and, in the case of Eurodollar Advances, for the same Interest Period.

"Affiliate" of any Person means any other Person directly or indirectly controlling, controlled by or under common control with such Person. A Person shall be deemed to control another Person if the controlling Person owns 20% or more of any class of voting securities (or other ownership interests) of the controlled Person or possesses, directly or indirectly, the power

to direct or cause the direction of the management or policies of the controlled Person, whether through ownership of stock, by contract or otherwise.

"Agent" means First Chicago in its capacity as agent for the Lenders pursuant to Article X, and not in its individual capacity as a Lender, and any successor Agent appointed pursuant to Article X.

"Aggregate Commitment" means the aggregate of the Commitments of all the Lenders hereunder. The initial Aggregate Commitment is \$15,000,000.

"Agreement" means this Credit Agreement, as it may be amended, modified or restated and in effect from time to time.

"Agreement Accounting Principles" means generally accepted accounting principles as in effect from time to time; provided, however, that if any changes in accounting principles from those in effect on the date of this Agreement are adopted which result in a material change in the method of calculation of any of the financial covenants, standards or terms in this Agreement, the parties agree to enter into negotiations to determine whether such provisions require amendment and, if so, the terms of such amendment so as to equitably reflect such changes. Until a resolution thereof is reached, all calculations made for the purposes of determining compliance with the terms of this Agreement shall be made by application of generally accepted accounting principles in effect on the date of this Agreement applied, to the extent applicable, on a basis consistent with that used in the preparation of the Financial Statements furnished to the Lenders pursuant to Section 5.5 hereof.

"Alternate Base Rate" means, for any day, a rate of interest per annum equal to the higher of (a) the Corporate Base Rate for such day, and (b) the sum of the Federal Funds Effective Rate for such day plus 1/2% per annum, in each case changing when and as the Corporate Base Rate and the Federal Funds Effective Rate, as the case may be, changes.

"Annual Statement" means the annual statutory financial statement of any Insurance Subsidiary required to be filed with the insurance commissioner (or similar authority) of its jurisdiction of incorporation, which statement shall be in the form required by such Insurance Subsidiary's jurisdiction of incorporation or, if no specific form is so required, in the form of financial statements permitted by such insurance commissioner (or such similar authority) to be used for filing annual statutory financial statements and shall contain the type of information permitted by such insurance commissioner (or such similar authority) to be disclosed therein, together with all exhibits or schedules filed therewith.

"Applicable Eurodollar Margin" has the meaning ascribed to it by, and shall be determined in accordance with, Schedule 1.

"Applicable Facility Fee Margin" has the meaning ascribed to it by, and shall be

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determined in accordance with, Schedule 1.

"Article" means an article of this Agreement unless another document is specifically referenced.

"Asset Disposition" means any sale, transfer or other disposition (outside the ordinary course of business) of any material asset of the Borrower in a single transaction or in a series of related transactions (other than the sale of Margin Stock or the sale of a Money Market Investment the proceeds of which are utilized to pay dividends permitted by Section 6.10).

"Authorized Officer" means, with respect to either Loan Party, any of the chief executive officer, president, chief financial officer, treasurer or controller of such Loan Party, acting singly.

"Bankruptcy Code" means Title 11, United States Code, sections 1 et seq., as the same may be amended from time to time, and any successor thereto or replacement therefor which may be hereafter enacted.

"Benefit Plan" means any deferred benefit plan for the benefit of present, future or former employees, whether or not such benefit plan is a Plan.

"Borrower" means Valley Group, Inc., an Oregon corporation, and its successors and assigns.

"Borrowing Date" means a date on which an Advance is made hereunder.

"Borrowing Notice" is defined in Section 2.8.

"Business Day" means (a) with respect to any borrowing, payment or rate selection of Eurodollar Advances, a day (other than a Saturday or Sunday) on which banks generally are open in Chicago for the conduct of substantially all of their commercial lending activities and on which dealings in United States dollars are carried on in the London interbank market, and (b) for all other purposes, a day (other than a Saturday or Sunday) on which banks generally are open in Chicago for the conduct of substantially all of their commercial lending activities.

"Capitalized Lease" of a Person means any lease of Property by such Person as lessee which would be capitalized on a balance sheet of such Person prepared in accordance with Agreement Accounting Principles.

"Capitalized Lease Obligations" of a Person means the amount of the obligations of such Person under Capitalized Leases which would be shown as a liability on a balance sheet of such Person prepared in accordance with Agreement Accounting Principles.

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"Change" is defined in Section 3.2.

"Change in Control" means (a) the acquisition by any "person" or "group" (as such terms are used in Section 13(d) and 14(d)(2) of the Securities Exchange Act of 1934, as amended) (other than Holdings, any Wholly-Owned Subsidiary of Holdings, John J. Byrne or any Plan or any Benefit Plan of Holdings, Parent, the Borrower or any of their Subsidiaries), including without limitation any acquisition effected by means of any transaction contemplated by Section 6.12, of beneficial ownership (within the meaning of Rule 13d-3 of the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended) of 25% or more of the outstanding shares of voting stock of the Borrower; or (b) during any period of 12 consecutive calendar months, commencing on the date of the Agreement, the ceasing of those individuals (the "Continuing Directors") who (i) were directors of the Borrower on the first day of each such period or (ii) subsequently became directors of the Borrower and whose initial election or initial nomination for election subsequent to that date was approved by a majority of the Continuing Directors then on the board of directors of the Borrower to constitute a majority of the board of directors of the Borrower; or (c) during any period of 12 consecutive calendar months, commencing on the date of this Agreement, the ceasing of individuals who hold an office possessing the title Senior Vice President or such title that ranks senior to a Senior Vice President (collectively, "Senior Management") of the Borrower on the first day of each such period to constitute a majority of the Senior Management of the Borrower. Notwithstanding the foregoing, the FAE Merger shall not be deemed in and of itself to constitute a Change in Control.

"Code" means the Internal Revenue Code of 1986, as amended, reformed or otherwise modified from time to time.

"Commitment" means, for each Lender, the obligation of such Lender to make Loans not exceeding the amount set forth opposite its signature below and as set forth in any Notice of Assignment relating to any assignment which has become effective pursuant to Section 12.3.2, as such amount may be modified from time to time pursuant to the terms hereof.

"Consolidated" or "consolidated", when used in connection with any calculation, means a calculation to be determined on a consolidated basis for a Person and its Subsidiaries in accordance with Agreement Accounting Principles.

"Consolidated Person" means, for the taxable year of reference, each Person which is a member of the affiliated group of Parent if Consolidated returns are or shall be filed for such affiliated group for federal income tax purposes or any combined or unitary group of which Parent is a member for state income tax purposes.

"Contingent Obligation" of a Person means any agreement, undertaking or arrangement by which such Person assumes, guarantees, endorses, contingently agrees to purchase or provide

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funds for the payment of, or otherwise becomes or is contingently liable upon, the obligation or liability of any other Person, or agrees to maintain the net worth or working capital or other financial condition of any other Person, or otherwise assures any creditor of such other Person against loss, including, without limitation, any comfort letter, operating agreement or take-or-pay contract or application for a Letter of Credit, excluding however (a) insurance policies and insurance contracts issued in the ordinary course of business and (b) any financial guarantees issued by Financial Security Assurance Holdings Ltd.

"Controlled Group" means all members of a controlled group of corporations and all trades or businesses (whether or not incorporated) under common control which, together with either Loan Party or any of its Subsidiaries, are treated as a single employer under Section 414 of the Code.

"Conversion/Continuation Notice" is defined in Section 2.9.

"Corporate Base Rate" means a rate per annum equal to the corporate base rate of interest publicly announced by First Chicago from time to time, changing when and as said corporate base rate changes. The Corporate Base Rate is a reference rate and does not necessarily represent the lowest or best rate of interest actually charged to any customer. First Chicago may make commercial loans or other loans at rates of interest at, above or below the Corporate Base Rate.

"Default" means an event described in Article VII.

"Environmental Laws" is defined in Section 5.19.

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

"Eurodollar Advance" means an Advance which bears interest at the Eurodollar Rate.

"Eurodollar Base Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the rate determined by the Agent to be the rate at which deposits in U.S. dollars are offered by First Chicago to first-class banks in the London interbank market at approximately 11 a.m. (London time) two Business Days prior to the first day of such Interest Period, in the approximate amount of First Chicago's relevant Eurodollar Advance and having a maturity approximately equal to such Interest Period.

"Eurodollar Rate" means, with respect to a Eurodollar Advance for the relevant Interest Period, the sum of (a) the quotient of (i) the Eurodollar Base Rate applicable to such Interest Period, divided by (ii) one minus the Reserve Requirement (expressed as a decimal) applicable to such Interest Period, plus the Applicable Eurodollar Margin. The Eurodollar Rate shall be rounded to the next higher multiple of 1/100 of 1% if the rate is not such a multiple.

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"Facility Fee" is defined in Section 2.4(a).

"Facility Termination Date" means July 30, 2002.

"FAE" means, at any time prior to the FAE Merger, Fund America Enterprises, Inc., a Delaware corporation and direct Wholly-Owned Subsidiary of Holdings, and on and after the consummation of the FAE Merger, Fund American Enterprises, Inc. (f/k/a Fund American Enterprises II, Inc.), a Delaware corporation and direct Wholly-Owned Subsidiary of Parent.

"FAE Merger" means the merger of the corporation known as of the date of this Agreement as Fund American Enterprises, Inc. into Parent with Fund American Enterprises, Inc. surviving the merger and changing its name to White Mountain Holdings, Inc.

"Federal Funds Effective Rate" means, for any day, an interest rate per annum equal to the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers on such day, as published for such day (or, if such day is not a Business Day, for the immediately preceding Business Day) by the Federal Reserve Bank of New York, or, if such rate is not so published for any day which is a Business Day, the average of the quotations at approximately 10 a.m. (Chicago time) on such day on such transactions received by the Agent from three Federal funds brokers of recognized standing selected by the Agent in its sole discretion.

"Finance Assets" means each of the following: (a) investments in securities issued or fully guaranteed by the United States of America or any agency or instrumentality thereof (provided that the full faith and credit of the United States of America is pledged in support thereof), (b) investments in equity securities traded on the New York Stock Exchange, the American Stock Exchange or NASDAQ and securities convertible in to such equity securities, (c) investments in Investment Grade Obligations, (d) investments in money market funds substantially all the assets of which are comprised of securities of the types described in clauses (a) through (c) above, (e) investments in Wholly-Owned Subsidiaries of either Loan Party, (f) investments in Main Street America Holdings, Inc., Folksamerica Holding Company Inc. and Financial Security Assurance Holdings Ltd. and (g) so long as put rights with respect thereto are available to either Loan Party, investments in US West Preferred Stock; provided, that Finance Assets shall not include any securities pledged to secure any obligations (contingent or otherwise) or any Investments in FAE or SOMSC.

"Finance Assets Ratio" means, at any time, the ratio of (a) Finance Assets of Parent at such time to (b) the excess of (i) Funded Indebtedness of Parent at such time over (ii) cash and Money Market Investments of Parent at such time. For purposes of this definition, Finance Assets shall be valued, without duplication, at fair market value to the extent there exists a readily ascertainable fair market value for such Finance Asset or, in the event there exists no such

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readily ascertainable fair market value for such Finance Assets, at book value, as calculated in accordance with Agreement Accounting Principles.

"Financial Statements" is defined in Section 5.5.

"First Chicago" means The First National Bank of Chicago in its individual capacity, and its successors.

"Fiscal Quarter" means one of the four three-month accounting periods comprising a Fiscal Year.

"Fiscal Year" means the twelve-month accounting period ending December 31 of each year.

"Fixed Charges Coverage Ratio" means, as of the end of any Fiscal Quarter, the ratio of:

(a) the sum, without duplication, of,

(i) investments of Parent and the Borrower in cash, Money Market Investments and clauses (a) through (d) of the definition "Finance Assets" as of the end of such Fiscal Quarter, plus

(ii) cash dividends received by Parent and the Borrower during the four Fiscal Quarters then ended from Financial Security Assurance Holdings, Ltd., Folksamerica Holding Company Inc. and Main Street America Holdings, Inc., as long as such Person was not a Wholly-Owned Subsidiary of Parent or the Borrower at the time such payment was made and to the extent that such Person would not be restricted from paying such dividend during the succeeding four Fiscal Quarters, plus

(iii) an amount equal to the maximum amount of dividends and intercompany fees available to be paid to Parent and the Borrower without approval of any Governmental Authority by each Wholly-Owned Subsidiary of Parent and the Borrower (other than FAE, SOMSC and each Wholly-Owned Insurance Subsidiary) as of the end of such Fiscal Quarter, plus

(iv) an amount equal to the maximum amount of dividends and intercompany fees available to be paid to Parent and the Borrower without approval of any Governmental Authority by each present and future Wholly-Owned Subsidiary of Parent that is a first-tier Insurance Subsidiary of either Parent or any of its Subsidiaries that is not an Insurance Subsidiary pursuant to applicable insurance

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statutes, rules and regulations of the applicable Governmental Authority during the succeeding four Fiscal Quarters,

to (b) Fixed Charges.

"Fixed Charges" means, with respect to Parent and the Borrower, as of the end of any Fiscal Quarter, the sum, without duplication, of (a) interest expenses payable on outstanding Indebtedness (determined by adjusting the principal amount of such Indebtedness for scheduled amortization payments as reflected in clauses (c), (d) and (e) below and assuming that the applicable interest rate in effect as of the date of determination would remain constant during the succeeding four Fiscal Quarter period), (b) dividends payable on preferred stock, (c) Indebtedness payable pursuant to the scheduled amortization of such Indebtedness, (d) Loans payable pursuant to Section 2.1(b) (determined by assuming that the principal amount of Loans as of the date of determination would remain constant during the succeeding four Fiscal Quarter period) as a result of reductions in the Aggregate Commitment occurring in any such period pursuant to Section 2.7(a) (other than on July 30, 2002), and (e) Loans (as defined in the White Mountains Credit Agreement) payable pursuant to Section 2.1(b) of the White Mountains Credit Agreement (determined by assuming that the outstanding principal amount of such Loans as of the date of determination would remain constant during the succeeding four Fiscal Quarter period) as a result of reductions in the Aggregate Commitment (as defined in the White Mountains Credit Agreement) occurring in any such period pursuant to Section 2.7(a) of the White Mountains Credit Agreement (other than on July 30, 2002), in each case for the period of four Fiscal Quarters immediately following the date of determination.

"Funded Indebtedness" means Indebtedness of the type described in clauses (a), (d), (e) and (h) of the definition "Indebtedness".

"Governmental Authority" means any government (foreign or domestic) or any state or other political subdivision thereof or any governmental body, agency, authority, department or commission (including without limitation any board of insurance, insurance department or insurance commissioner and any taxing authority or political subdivision) or any instrumentality or officer thereof (including without limitation any court or tribunal) exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government and any corporation, partnership or other entity directly or indirectly owned or controlled by or subject to the control of any of the foregoing.

"Guaranty" means the Guaranty of Parent pursuant to Article XIV.

"Hazardous Materials" is defined in Section 5.19.

"Holdings" means Fund American Enterprises Holdings, Inc., a Delaware corporation.

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"Indebtedness" of a Person means such Person's (a) obligations for borrowed money, (b) obligations representing the deferred purchase price of Property or services (other than accounts payable arising in the ordinary course of such Person's business payable on terms customary in the trade), (c) obligations, whether or not assumed, secured by Liens or payable out of the proceeds or production from Property now or hereafter owned or acquired by such Person, (d) obligations which are evidenced by notes, acceptances, or similar instruments, (e) Capitalized Lease Obligations, (f) Rate Hedging Obligations, (g) Contingent Obligations, (h) obligations for which such Person is obligated pursuant to or in respect of a Letter of Credit and (i) repurchase obligations or liabilities of such Person with respect to accounts or notes receivable sold by such Person.

"Insurance Subsidiary" means any Subsidiary which is engaged in the insurance business as an issuer or underwriter of insurance policies and/or insurance contracts.

"Interest Period" means, with respect to a Eurodollar Advance, a period of one, two, three or six months commencing on a Business Day selected by the Borrower pursuant to this Agreement. Such Interest Period shall end on (but exclude) the day which corresponds numerically to such date one, two, three or six months thereafter; provided, however, that if there is no such numerically corresponding day in such next, second, third or sixth succeeding month, such Interest Period shall end on the last Business Day of such next, second, third or sixth succeeding month. If an Interest Period would otherwise end on a day which is not a Business Day, such Interest Period shall end on the next succeeding Business Day; provided, however, that if said next succeeding Business Day falls in a new calendar month, such Interest Period shall end on the immediately preceding Business Day.

"Investment" of a Person means any loan, advance (other than commission, travel and similar advances to officers and employees made in the ordinary course of business), extension of credit (other than accounts receivable arising in the ordinary course of business on terms customary in the trade), deposit account or contribution of capital by such Person to any other Person or any investment in, or purchase or other acquisition of, the stock, partnership interests, notes, debentures or other securities of any other Person made by such Person.

"Investment Grade Obligations" means, as of any date, investments having an NAIC investment rating of 1 or 2, or a Standard & Poor's rating within the range of ratings from AAA to BBB-, or a Moody's rating within the range of ratings from Aaa to Baa3.

"Lenders" means the lending institutions listed on the signature pages of this Agreement and their respective successors and assigns.

"Lending Installation" means, with respect to a Lender or the Agent, any office, branch,

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subsidiary or affiliate of such Lender or the Agent.

"Letter of Credit" of a Person means a letter of credit or similar instrument which is issued upon the application of such Person or upon which such Person is an account party or for which such Person is in any way liable.

"Leverage Ratio" means, at any time, the ratio of (a) the consolidated Funded Indebtedness of Parent and its Subsidiaries, other than FAE and SOMSC, at such time to (b) the sum of the consolidated Funded Indebtedness of Parent and its Subsidiaries, other than FAE and SOMSC, at such time plus Net Worth (without giving effect to Parent's equity interests in FAE and SOMSC) at such time, in all cases determined in accordance with Agreement Accounting Principles.

"License" means any license, certificate of authority, permit or other authorization which is required to be obtained from any Governmental Authority in connection with the operation, ownership or transaction of insurance business.

"Lien" means any security interest, lien (statutory or other), mortgage, pledge, hypothecation, assignment, deposit arrangement, encumbrance or preference, priority or other security agreement or preferential arrangement of any kind or nature whatsoever (including, without limitation, the interest of a vendor or lessor under any conditional sale, Capitalized Lease or other title retention agreement), save in respect of liabilities and obligations arising out of the underwriting of insurance policies and contracts of insurance.

"Loan" means, with respect to a Lender, such Lender's portion of any Advance and "Loans" means, with respect to the Lenders, the aggregate of all

Advances.

"Loan Documents" means this Agreement, the Notes and the other documents and agreements contemplated hereby and executed by either Loan Party in favor of the Agent or any Lender.

"Loan Party" means each and either of the Borrower or Parent.

"Margin Stock" has the meaning assigned to that term under Regulation U.

"Material Adverse Effect" means a material adverse effect on (a) the business, Property, condition (financial or other), performance, results of operations, or prospects of Parent and its Subsidiaries taken as a whole, (b) the ability of Parent, the Borrower or any Subsidiary of Parent or the Borrower to perform its obligations under the Loan Documents, or (c) the validity or enforceability of any of the Loan Documents or the rights or remedies of the Agent or the Lenders thereunder.

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"Money Market Investments" means (a) direct obligations of the United States of America, or of any agency thereof, or obligations guaranteed as to principal and interest by the United States of America, or of any agency thereof, in either case maturing not more than one year from the date of acquisition thereof; (b) certificates of deposit issued by any bank or trust company organized under the laws of the United States of America or any state thereof and having capital, surplus and undivided profits of at least \$500,000,000, maturing not more than 90 days from the date of acquisition thereof; (c) commercial paper rated A-1 or better P-1 or better by Standard & Poor's Ratings Group or Moody's Investors Services, Inc., respectively, maturing not more than 90 days from the date of acquisition thereof; and (d) shares in an open-end management investment company with U.S. dollar denominated investments in fixed income obligations, including repurchase agreements, fixed time deposits and other obligations, with a dollar weighted average maturity of not more than one year, and for the calculation of this dollar weighted average maturity, certain instruments which have a variable rate of interest readjusted no less frequently than annually are deemed to have a maturity equal to the period remaining until the next readjustment of the interest rate.

"Multiemployer Plan" means a Plan maintained pursuant to a collective bargaining agreement or any other arrangement to which either Loan Party or any member of the Controlled Group is a party to which more than one employer is obligated to make contributions.

"NAIC" means the National Association of Insurance Commissioners or any successor thereto, or in lieu thereof, any other association, agency or other organization performing advisory, coordination or other like functions among insurance departments, insurance commissioners and similar Governmental Authorities of the various states of the United States toward the promotion of uniformity in the practices of such Governmental Authorities.

"Net Available Proceeds" means (a) with respect to any Asset Disposition, the sum of cash or readily marketable cash equivalents received (including by way of a cash generating sale or discounting of a note or account receivable) therefrom, whether at the time of such disposition or subsequent thereto, in excess in the case of any Asset Disposition of any amounts derived from such sale used (and permitted by this Agreement to be used) within five Business Days after such sale to make a Permitted Reinvestment, or (b) with respect to any sale or issuance of equity securities of the Borrower, cash or readily marketable cash equivalents received therefrom, whether at the time of such sale or issuance or subsequent thereto, net, in either case, of all legal, title and recording tax expenses, commissions and other fees and all costs and expenses incurred, including, without limitation, incremental income taxes resulting from such transaction.

"Net Worth" means, with respect to any Person, at any date the consolidated shareholders' equity of such Person and its Consolidated Subsidiaries determined in accordance with Agreement Accounting Principles (but excluding the effect of Statement of Financial Accounting

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Standards No. 115).

"Non-Excluded Taxes" is defined in Section 2.18(a).

"Note" means a promissory note in substantially the form of Exhibit A hereto, with appropriate insertions, duly executed and delivered to the Agent by the Borrower and payable to the order of a Lender in the amount of its Commitment, including any amendment, modification, renewal or replacement of such promissory note.

"Notice of Assignment" is defined in Section 12.3.2.

"Obligations" means all unpaid principal of and accrued and unpaid interest on the Notes, all accrued and unpaid fees and all expenses, reimbursements, indemnities and other obligations of each Loan Party to the Lenders or to any Lender, the Agent or any indemnified party hereunder arising under any of the Loan Documents.

"Parent" means, at any time prior to FAE Merger, White Mountains Holdings, Inc., a New Hampshire corporation, and on and after the consummation of the FAE Merger, Fund American Enterprises, Inc., a Delaware corporation, surviving the merger and changing its name to White Mountains Holdings, Inc.

"Participants" is defined in Section 12.2.1.

"Payment Date" means the last day of each March, June, September and December.

"PBGCC" means the Pension Benefit Guaranty Corporation or any successor thereto.

"Permitted Reinvestment" means an Investment in a Finance Asset or any other Investment approved by the Required Lenders.

"Person" means any natural person, corporation, firm, joint venture, partnership, association, enterprise, trust or other entity or organization, or any government or political subdivision or any agency, department or instrumentality thereof.

"Plan" means an employee pension benefit plan, as defined in Section 3(2) of ERISA, as to which either Loan Party or any member of the Controlled Group may have any liability.

"Proceeding" is defined in Section 5.19.

"Property" of a Person means any and all property, whether real, personal, tangible, intangible, or mixed, of such Person, or other assets owned, leased or operated by such Person.

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"pro-rata" means, when used with respect to a Lender, and any described aggregate or total amount, an amount equal to such Lender's pro-rata share or portion based on its percentage of the Aggregate Commitment or if the Aggregate Commitment has been terminated, its percentage of the aggregate principal amount of outstanding Advances.

"Purchase" means any transaction, or any series of related transactions, consummated on or after the date of this Agreement, by which either Loan Party or any of its Subsidiaries (a) acquires any going business or all or substantially all of the assets of any firm, corporation or division or line of business thereof, whether through purchase of assets, merger or otherwise, or (b) directly or indirectly acquires (in one transaction or as the most recent transaction in a series of transactions) at least a majority (in number of votes) of the securities of a corporation which have ordinary voting power for the election of directors (other than securities having such power only by reason of the happening of a contingency) or a majority (by percentage or voting power) of the outstanding partnership interests of a partnership.

"Purchasers" is defined in Section 12.3.1.

"Quarterly Statement" means the quarterly statutory financial statement of any Insurance Subsidiary required to be filed with the insurance commissioner (or similar authority) of its jurisdiction of incorporation or, if no specific form is so required, in the form of financial statements permitted by such insurance commissioner (or such similar authority) to be used for filing quarterly statutory financial statements and shall contain the type of financial information permitted by such insurance commissioner (or such similar authority) to be disclosed therein, together with all exhibits or schedules filed therewith.

"Rate Hedging Obligations" of a Person means any and all obligations of such Person, whether absolute or contingent and howsoever and whensoever created, arising, evidenced or acquired (including all renewals, extensions and modifications thereof and substitutions therefor), under (a) any and all agreements, devices or arrangements designed to protect at least one of the parties thereto from the fluctuations of interest rates, exchange rates or forward rates applicable to such party's assets, liabilities or exchange transactions, including, but not limited to, dollar-denominated or cross-currency interest rate exchange agreements, forward currency exchange agreements, interest rate cap or collar protection agreements, forward rate currency or interest rate options, puts and warrants, and (b) any and all cancellations, buy backs, reversals, terminations or assignments of any of the foregoing.

"Regulation D" means Regulation D of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor thereto or other regulation or official interpretation of said Board of

Governors relating to reserve requirements applicable to depository institutions.

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"Regulation G" means Regulation G of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by Persons other than banks, brokers and dealers for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation T" means Regulation T of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of such Board of Governors relating to the extension of credit by securities brokers and dealers for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation U" means Regulation U of the Board of Governors of the Federal Reserve System as from time to time in effect and any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by banks for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Regulation X" means Regulation X of the Board of Governors of the Federal Reserve System as from time to time in effect and shall include any successor or other regulation or official interpretation of said Board of Governors relating to the extension of credit by the specified lenders for the purpose of purchasing or carrying margin stocks applicable to such Persons.

"Release" is defined in the Comprehensive Environmental Response, Compensation and Liability Act, as amended, 42 U.S.C. 39601 et seq.

"Reportable Event" means a reportable event as defined in Section 4043 of ERISA and the regulations issued under such section, with respect to a Plan, excluding, however, such events as to which the PBGC has by regulation waived the requirement of Section 4043(a) of ERISA that it be notified within 30 days of the occurrence of such event; provided, that a failure to meet the minimum funding standard of Section 412 of the Code and of Section 302 of ERISA shall be a Reportable Event regardless of the issuance of any such waiver of the notice requirement in accordance with either Section 4043(a) of ERISA or Section 412(d) of the Code.

"Required Lenders" means Lenders in the aggregate having at least 66-2/3% of the Aggregate Commitment or, if the Aggregate Commitment has been terminated, Lenders in the aggregate holding at least 66-2/3% of the aggregate unpaid principal amount of the outstanding Loans.

"Reserve Requirement" means, with respect to an Interest Period, the maximum aggregate reserve requirement (including all basic, supplemental, marginal and other reserves)

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which is imposed under Regulation D on Eurocurrency liabilities.

"Restatement Effective Date" means the date on which all conditions precedent set forth in Section 4.1 are satisfied or waived by all of the Lenders.

"Risk-Based Capital Guidelines" is defined in Section 3.2.

"SAP" means, with respect to any Insurance Subsidiary, the statutory accounting practices prescribed or permitted by the insurance commissioner (or other similar authority) in the jurisdiction of such Person for the preparation of annual statements and other financial reports by insurance companies of the same type as such Person in effect from time to time; provided, however, that if any changes in statutory accounting practices from those in effect on the date of this Agreement are adopted which result in a material change in the method of calculation of any of the financial covenants, standards or terms in this Agreement, the parties agree to enter into negotiations to determine whether such provisions require amendment and, if so, the terms of such amendment so as to equitably reflect such changes. Until a resolution thereof is reached, all calculations made for the purposes of determining compliance with the terms of this Agreement shall be made by application of statutory accounting practices in effect on the date of this Agreement applied, to the extent applicable, on a basis consistent with that used in the preparation of the Financial Statements furnished to the Lenders pursuant to Section 5.5(h) and (i) hereof.

"Section" means a numbered section of this Agreement, unless another document is specifically referenced.

"Significant Subsidiary" shall mean and include, at any time, each Subsidiary of the Borrower to the extent that the Net Worth of such

Subsidiary is equal to or greater than \$5,000,000.

"Single Employer Plan" means a Plan subject to Title IV of ERISA maintained by either Loan Party or any member of the Controlled Group for employees of either Loan Party or any member of the Controlled Group, other than a Multiemployer Plan.

"Solvent" means, when used with respect to a Person, that (a) the fair saleable value of the assets of such Person is in excess of the total amount of the present value of its liabilities (including for purposes of this definition all liabilities (including loss reserves as determined by such Person), whether or not reflected on a balance sheet prepared in accordance with Agreement Accounting Principles and whether direct or indirect, fixed or contingent, secured or unsecured, disputed or undisputed), (b) such Person is able to pay its debts or obligations in the ordinary course as they mature and (c) such Person does not have unreasonably small capital to carry out its business as conducted and as proposed to be conducted. "Solvency" shall have a correlative

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meaning.

"SOMSC" means Source One Mortgage Service Corporation, a Delaware corporation.

"SOMSC Credit Agreement" means the credit agreement or credit agreements from time to time in effect among SOMSC, the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented, restated, replaced or otherwise modified from time to time (and, subsequent to the termination thereof, as in effect on the date of such termination).

"Statutory Surplus" means, with respect to any Insurance Subsidiary at any time, the statutory capital and surplus of such Insurance Subsidiary at such time, as determined in accordance with SAP ("Liabilities, Surplus and Other Funds" statement, page 3, line 25 of the Annual Statement for the 1995 Fiscal Year entitled "Surplus as Regards Policyholders").

"Subsidiary" of a Person means (a) any corporation more than 50% of the outstanding securities having ordinary voting power of which shall at the time be owned or controlled, directly or indirectly, by such Person or by one or more of its Subsidiaries or by such Person and one or more of its Subsidiaries, or (b) any partnership, association, joint venture, limited liability company or similar business organization more than 50% of the ownership interests having ordinary voting power of which shall at the time be so owned or controlled. Unless otherwise expressly provided, all references herein to a "Subsidiary" shall mean a Subsidiary of the Borrower.

"Termination Event" means, with respect to a Plan which is subject to Title IV of ERISA, (a) a Reportable Event, (b) the withdrawal of either Loan Party or any other member of the Controlled Group from such Plan during a plan year in which either Loan Party or any other member of the Controlled Group was a "substantial employer" as defined in Section 4001(a)(2) of ERISA or was deemed such under Section 4068(f) of ERISA, (c) the termination of such Plan, the filing of a notice of intent to terminate such Plan or the treatment of an amendment of such Plan as a termination under Section 4041 of ERISA, (d) the institution by the PBGC of proceedings to terminate such Plan or (e) any event or condition which might constitute grounds under Section 4042 of ERISA for the termination of, or appointment of a trustee to administer, such Plan.

"Transferee" is defined in Section 12.4.

"Type" means, with respect to any Advance, its nature as an ABR Advance or Eurodollar Advance.

"Unfunded Liability" means the amount (if any) by which the present value of all vested

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and unvested accrued benefits under a Single Employer Plan exceeds the fair market value of assets allocable to such benefits, all determined as of the then most recent valuation date for such Plans using PBGC actuarial assumptions for single employer plan terminations.

"Unmatured Default" means an event which but for the lapse of time or the giving of notice, or both, would constitute a Default.

"Unrestricted Subsidiary" means SOMSC and its Subsidiaries and, following the FAE Merger, FAE and its Subsidiaries.

"US West Preferred Stock" means the US West Series B cumulative redeemable preferred stock \$1.00 par value per share purchased by Holdings

pursuant to and subject to the terms of the Securities Purchase Agreement dated April 10, 1994 among Holdings, US West, Inc., US West Capital Corporation and Financial Security Assurance Holdings Ltd (as such agreement may be amended from time to time).

"White Mountains Credit Agreement" means the Amended and Restated Credit Agreement, dated as of July 30, 1997, among Parent, the financial institutions from time to time party thereto and First Chicago, as agent, as the same may be amended, supplemented or otherwise modified from time to time (and, subsequent to the termination thereof, as in effect on the date of such termination).

"Wholly-Owned Subsidiary" of a Person means (a) any Subsidiary all of the outstanding voting securities of which (other than directors' qualifying or similar shares) shall at the time be owned or controlled, directly or indirectly, by such Person or one or more Wholly-Owned Subsidiaries of such Person, or by such Person and one or more Wholly-Owned Subsidiaries of such Person, or (b) any partnership, association, joint venture, limited liability company or similar business organization 100% of the ownership interests having ordinary voting power of which (other than directors' qualifying or similar shares) shall at the time be so owned or controlled.

The foregoing definitions shall be equally applicable to both the singular and plural forms of the defined terms. References herein to particular columns, lines or sections of any Person's Annual Statement shall be deemed, where appropriate, to be references to the corresponding column, line or section of such Person's Quarterly Statement, or if no such corresponding column, line or section exists or if any report form changes, then to the corresponding item referenced thereby. In the event that the columns, lines or sections of the Annual Statement referenced herein are changed or renumbered, all such references shall be deemed references to such column, line or section as so renumbered or changed. Each accounting term used herein which is not otherwise defined herein shall be defined in accordance with Agreement Accounting Principles or SAP, as applicable, unless otherwise specified.

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ARTICLE II

THE CREDITS

2.1. Advances. (a) From and including the date hereof to but excluding the Facility Termination Date, each Lender severally (and not jointly) agrees, on the terms and conditions set forth in this Agreement, to make Advances to the Borrower from time to time in amounts not to exceed in the aggregate at any one time outstanding the amount of its pro-rata share of the Aggregate Commitment existing at such time. Subject to the terms of this Agreement, the Borrower may borrow, repay and reborrow Advances at any time prior to the Facility Termination Date.

(b) The Borrower hereby agrees that if at any time, as a result of reductions in the Aggregate Commitment pursuant to Section 2.7 or otherwise, the aggregate balance of the Loans exceeds the Aggregate Commitment, the Borrower shall repay immediately its then outstanding Loans in such amount as may be necessary to eliminate such excess.

(c) The Borrower's obligation to pay the principal of, and interest on, the Loans shall be evidenced by the Notes. Although the Notes shall be dated the date of this Agreement, interest in respect thereof shall be payable only for the periods during which the Loans evidenced thereby are outstanding and, although the stated amount of each Note shall be equal to the applicable Lender's Commitment, each Note shall be enforceable, with respect to the Borrower's obligation to pay the principal amount thereof, only to the extent of the unpaid principal amount of the Loans at the time evidenced thereby.

(d) All Advances and all Loans shall mature, and the principal amount thereof and the unpaid accrued interest thereon shall be due and payable, on the Facility Termination Date.

2.2. Ratable Loans. Each Advance hereunder shall consist of Loans made from the several Lenders ratably in proportion to the ratio that their respective Commitments bear to the Aggregate Commitment.

2.3. Types of Advances. The Advances may be ABR Advances or Eurodollar Advances, or a combination thereof, selected by the Borrower in accordance with Sections 2.8 and 2.9.

2.4. Facility Fee; Reductions in Aggregate Commitment. (a) The Borrower agrees to pay to the Agent for the account of each Lender a facility fee ("Facility Fee") in an amount equal to the Applicable Facility Fee Margin per annum times the daily average Commitment of

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such Lender from the date hereof to and including the Facility Termination Date, payable on each Payment Date hereafter and on the Facility Termination Date. All accrued Facility Fees shall be payable on the effective date of any termination of the obligations of the Lenders to make Loans hereunder.

(b) The Borrower may permanently reduce the Aggregate Commitment in whole, or in part ratably among the Lenders in a minimum aggregate amount of \$1,000,000 upon at least three (3) Business Days' written notice to the Agent, which notice shall specify the amount of any such reduction; provided, however, that the amount of the Aggregate Commitment may not be reduced below the aggregate principal amount of the outstanding Advances. Such reductions shall be in addition to reductions occurring pursuant to Section 2.7(b). Voluntary commitment reductions pursuant to this Section 2.4(b) shall be applied to the mandatory commitment reductions required to be made pursuant to Section 2.7(a) in direct order of maturity.

2.5. Minimum Amount of Each Advance. Each Advance shall be in the minimum amount of \$1,000,000 (and in integral multiples of \$500,000 if in excess thereof); provided, however, that (a) any ABR Advance may be in the amount of the unused Aggregate Commitment and (b) in no event shall more than six (6) Eurodollar Advances be permitted to be outstanding at any time.

2.6. Optional Principal Payments. The Borrower may from time to time pay, without penalty or premium, all outstanding ABR Advances, or, in a minimum aggregate amount of \$1,000,000 any portion of the outstanding ABR Advances upon two Business Days' prior notice to the Agent. Subject to Section 3.4 and upon like notice, a Eurodollar Advance may be paid prior to the last day of the applicable Interest Period in a minimum amount of \$1,000,000 or an integral multiple of \$500,000 in excess thereof.

2.7. Mandatory Commitment Reductions. (a) The Aggregate Commitment shall be automatically and permanently reduced by the following amounts (or such lesser amount as a result of reductions pursuant to Section 2.7(c)) on the following dates:

Date	Reduction Amount
June 30, 1999	\$ 1,000,000
June 30, 2000	\$ 2,000,000
June 30, 2001	\$ 2,000,000
July 30, 2002	\$10,000,000

(b) The Aggregate Commitment shall also be automatically and permanently reduced in the amounts and at the times set forth below:

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(i) within 5 Business Days after the receipt in the form of cash or cash equivalents thereof by the Borrower, 100% of the aggregate Net Available Proceeds in excess of \$1,000,000 realized upon all Asset Dispositions in any Fiscal Year of the Borrower; and

(ii) within 5 Business Days after the receipt in the form of cash or cash equivalents thereof by the Borrower, 85% of the Net Available Proceeds realized upon the sale by the Borrower of any equity securities issued by it after the date of this Agreement in excess of an aggregate amount of \$1,000,000 (other than a sale of common stock of the Borrower to Parent).

(c) Mandatory commitment reductions under Section 2.7(b) shall be cumulative and in addition to reductions occurring pursuant to Section 2.4(b). Any mandatory commitment reductions under Section 2.7(b) shall be applied to the mandatory commitment reductions required to be made pursuant to Section 2.7(a) in the inverse order of maturity.

(d) Any reduction in the Aggregate Commitment pursuant to this Section 2.7 or otherwise shall ratably reduce the Commitment of each Lender.

2.8. Method of Selecting Types and Interest Periods for New Advances. The Borrower shall select the Type of Advance and, in the case of each Eurodollar Advance, the Interest Period applicable to each Advance from time to time; provided, however, that in the event Loans are incurred on the date of this Agreement, all Loans incurred on such date shall be ABR Advances. The Borrower shall give the Agent irrevocable notice (a "Borrowing Notice") not later than 10:00 a.m. (Chicago time) on the Borrowing Date of each ABR Advance and at least three (3) Business Days before the Borrowing Date for each Eurodollar Advance, specifying:

(a) the Borrowing Date of such Advance, which shall be a Business Day;

- (b) the aggregate amount of such Advance;
- (c) the Type of Advance selected;
- (d) in the case of each Eurodollar Advance, the Interest Period applicable thereto, which shall end on or prior to the Facility Termination Date; and
- (e) any changes to money transfer instructions previously delivered to the Agent.

Not later than noon (Chicago time) on each Borrowing Date, each Lender shall make available

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its Loan or Loans, in funds immediately available in Chicago, to the Agent at its address specified pursuant to Article XIII. The Agent will make the funds so received from the Lenders available to the Borrower at the Agent's aforesaid address or at such account at such other institution in the United States of America as the Borrower may indicate in the Borrowing Notice.

2.9. Conversion and Continuation of Outstanding Advances. ABR Advances shall continue as ABR Advances unless and until such ABR Advances are converted into Eurodollar Advances. Each Eurodollar Advance shall continue as a Eurodollar Advance until the end of the then applicable Interest Period therefor, at which time such Eurodollar Advance shall be automatically converted into an ABR Advance unless the Borrower shall have given the Agent a Conversion/Continuation Notice requesting that, at the end of such Interest Period, such Eurodollar Advance continue as a Eurodollar Advance for the same or another Interest Period. Subject to the terms of Section 2.5, the Borrower may elect from time to time to convert all or any part of an Advance of any Type into any other Type or Types of Advances; provided, however, that any conversion of any Eurodollar Advance shall be made on, and only on, the last day of the Interest Period applicable thereto. The Borrower shall give the Agent irrevocable notice (a "Conversion/Continuation Notice") of each conversion of an ABR Advance or continuation of a Eurodollar Advance not later than 10:00 a.m. (Chicago time) on the conversion date, in the case of a conversion into an ABR Advance, or at least three (3) Business Days, in the case of a conversion into or continuation of a Eurodollar Advance, prior to the date of the requested conversion or continuation, specifying:

- (a) the requested date of such conversion or continuation, which shall be a Business Day;
- (b) the aggregate amount and Type of the Advance which is to be converted or continued; and
- (c) the amount and Type(s) of Advance(s) into which such Advance is to be converted or continued and, in the case of a conversion into or continuation of a Eurodollar Advance, the duration of the Interest Period applicable thereto, which shall end on or prior to the Facility Termination Date.

2.10. Changes in Interest Rate, etc. Each ABR Advance shall bear interest at the Alternate Base Rate from and including the date of such Advance or the date on which such Advance was converted into an ABR Advance to (but not including) the date on which such ABR Advance is paid or converted to a Eurodollar Advance. Changes in the rate of interest on that portion of any Advance maintained as an ABR Advance will take effect simultaneously with each change in the Alternate Base Rate. Each Eurodollar Advance shall bear interest from and

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including the first day of the Interest Period applicable thereto to, but not including, the last day of such Interest Period at the Eurodollar Rate determined as applicable to such Eurodollar Advance plus the Applicable Eurodollar Margin. No Interest Period may end after the Facility Termination Date. The Borrower shall select Interest Periods so that it is not necessary to repay any portion of a Eurodollar Advance prior to the last day of the applicable Interest Period in order to make a mandatory repayment required pursuant to Section 2.7(a).

2.11. Rates Applicable After Default. Notwithstanding anything to the contrary contained in Section 2.8 or 2.9, no Advance may be made as, converted into or continued as a Eurodollar Advance (except with the consent of the Agent and the Required Lenders) when any Default or Unmatured Default has occurred and is continuing. During the continuance of a Default the Required Lenders may, at their option, by notice to the Borrower (which notice may be revoked at the option of the Required Lenders notwithstanding any provision of Section 8.2 requiring unanimous consent of the Lenders to changes in interest rates), declare that each Eurodollar Advance and ABR Advance shall bear interest (for the remainder of the applicable Interest Period in the case of Eurodollar Advances) at a rate per annum equal to the rate otherwise applicable plus two percent (2%) per annum; provided, however,

that such increased rate shall automatically and without action of any kind by the Lenders become and remain applicable until revoked by the Required Lenders in the event of a Default described in Section 7.6 or 7.7.

2.12. Method of Payment. All payments of the Obligations hereunder shall be made, without setoff, deduction or counterclaim, in immediately available funds to the Agent at the Agent's address specified pursuant to Article XIII, or at any other Lending Installation of the Agent specified in writing by the Agent to the Borrower (at least two Business Days in advance) by noon (Chicago time) on the date when due and shall be applied ratably by the Agent among the Lenders. Each payment delivered to the Agent for the account of any Lender shall be delivered promptly by the Agent to such Lender in the same type of funds that the Agent received at its address specified pursuant to Article XIII or at any Lending Installation specified in a notice received by the Agent from such Lender. The Agent is hereby authorized to charge the account of the Borrower maintained with the Agent for each payment of principal, interest and fees as it becomes due hereunder.

2.13. Notes. Each Lender is hereby authorized to record the principal amount of each of its Loans and each repayment on the schedule attached to its Note; provided, however, that neither the failure to so record nor any error in such recordation shall affect the Borrower's obligations under such Note.

2.14. Interest Payment Dates; Interest and Fee Basis. Interest accrued on each ABR Advance shall be payable on each Payment Date, commencing with the first such date to occur after the date hereof, on any date on which an ABR Advance is prepaid, whether due to

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acceleration or otherwise, and at maturity. Interest accrued on that portion of the outstanding principal amount of any ABR Advance converted into a Eurodollar Advance on a day other than a Payment Date shall be payable on the date of conversion. Interest accrued on each Eurodollar Advance shall be payable on the last day of its applicable Interest Period, on any date on which the Eurodollar Advance is prepaid, whether by acceleration or otherwise, and at maturity. Interest accrued on each Eurodollar Advance having an Interest Period longer than three months shall also be payable on the last day of each three-month interval during such Interest Period. Interest and commitment fees shall be calculated for actual days elapsed on the basis of a 360-day year. Interest shall be payable for the day an Advance is made but not for the day of any payment on the amount paid if payment is received prior to noon (Chicago time) at the place of payment. If any payment of principal or interest on an Advance shall become due on a day which is not a Business Day, such payment shall be made on the next succeeding Business Day and, in the case of a principal payment, such extension of time shall be included in computing interest in connection with such payment.

2.15. Notification of Advances, Interest Rates, Prepayments and Commitment Reductions. Promptly after receipt thereof, the Agent will notify each Lender of the contents of each Aggregate Commitment reduction notice, Borrowing Notice, Conversion/Continuation Notice, and repayment notice received by it hereunder. The Agent will notify each Lender of the interest rate applicable to each Eurodollar Advance promptly upon determination of such interest rate and will give each Lender prompt notice of each change in the Alternate Base Rate.

2.16. Lending Installations. Each Lender may book its Loans at any Lending Installation selected by such Lender and may change its Lending Installation from time to time. All terms of this Agreement shall apply to any such Lending Installation and the Notes shall be deemed held by each Lender for the benefit of such Lending Installation. Each Lender may, by written or telex notice to the Agent and the Borrower, designate a Lending Installation through which Loans will be made by it and for whose account Loan payments are to be made.

2.17. Non-Receipt of Funds by the Agent. Unless the Borrower or a Lender, as the case may be, notifies the Agent prior to the date on which it is scheduled to make payment to the Agent of (a) in the case of a Lender, the proceeds of a Loan, or (b) in the case of the Borrower, a payment of principal, interest or fees to the Agent for the account of the Lenders, that it does not intend to make such payment, the Agent may assume that such payment has been made. The Agent may, but shall not be obligated to, make the amount of such payment available to the intended recipient in reliance upon such assumption. If the Borrower has not in fact made such payment to the Agent, the Lenders shall, on demand by the Agent, repay to the Agent the amount so made available together with interest thereon in respect of each day during the period commencing on the date such amount was so made available by the Agent until the date the Agent recovers such amount at a rate per annum equal to the Federal Funds Effective Rate for such day. If any Lender has not in fact made such payment to the Agent, such Lender or the

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Borrower shall, on demand by the Agent, repay to the Agent the amount so made

available together with interest thereon in respect of each day during the period commencing on the date such amount was so made available by the Agent until the date the Agent recovers such amount at a rate per annum equal to (a) in the case of payment by a Lender, the Federal Funds Effective Rate for such day, or (b) in the case of payment by the Borrower, the interest rate applicable to the relevant Loan.

2.18. Taxes. (a) Any payments made by either Loan Party under this Agreement or any other Loan Document shall be made free and clear of, and without deduction or withholding for or on account of, any present or future income, stamp or other taxes, levies, imposts, duties, charges, fees, deductions or withholdings, now or hereafter imposed, levied, collected, withheld or assessed by any Governmental Authority, excluding net income taxes and franchise taxes or any other tax based upon any income imposed on the Agent or any Lender by the jurisdiction in which the Agent or such Lender is incorporated or has its principal place of business or maintains its Lending Installation. If any such non-excluded taxes, levies, imposts, duties, charges, fees, deductions or withholdings ("Non-Excluded Taxes") are required to be withheld from any amounts payable to the Agent or any Lender hereunder, the amounts so payable to the Agent or such Lender shall be increased to the extent necessary to yield to the Agent or such Lender (after payment of all Non-Excluded Taxes) interest or any such other amounts payable hereunder at the rates or in the amounts specified in or pursuant to this Agreement; provided, however, that no Loan Party shall be required to increase any such amounts payable to any Lender that is not organized under the laws of the U.S. or a state thereof if such Lender fails to comply with the requirements of paragraph (b) of this Section 2.18. Whenever any Non-Excluded Taxes are payable by either Loan Party, as promptly as practicable thereafter such Loan Party shall send to the Agent for its own account or for the account of such Lender, as the case may be, a certified copy of an original official receipt received by such Loan Party showing payment thereof. If either Loan Party fails to pay any Non-Excluded Taxes when due to the appropriate taxing authority or fails to remit to the Agent the required receipts or other required documentary evidence, each Loan Party shall indemnify the Agent and the Lenders for any incremental taxes, interest or penalties that may become payable by any Agent or any Lender as a result of any such failure. The agreements in this Section 2.18 shall survive the termination of this Agreement and the payment of all other amounts payable hereunder.

(b) At least five Business Days prior to the first date on which interest or fees are payable hereunder for the account of any Lender, each Lender that is not incorporated under the laws of the United States of America, or a state thereof, agrees that it will deliver to each of the Borrower and the Agent two duly completed and properly executed copies of United States Internal Revenue Service Form 1001 or 4224 (or a successor form), certifying in either case that such Lender is entitled to receive payments under this Agreement and the Notes without deduction or withholding of any United States federal income taxes. Each Lender which so delivers a Form 1001 or 4224 (or a successor form) further undertakes to deliver to each of the

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Borrower and the Agent two additional duly completed and properly executed copies of such form (or a successor form) on or before the date that such form expires (currently, three successive calendar years for Form 1001 and each tax year for Form 4224) or becomes obsolete or after the occurrence of any event requiring a change in the most recent forms so delivered by it, and such amendments thereto or extensions or renewals thereof as may be reasonably requested by the Borrower or the Agent, in each case certifying that such Lender is entitled to receive payments under this Agreement and the Notes without deduction or withholding of any United States federal income taxes, unless an event (including, without limitation, any change in treaty, law or regulation) has occurred prior to the date on which any such delivery would otherwise be required which renders all such forms inapplicable or which would prevent such Lender from duly completing and delivering any such form with respect to it and such Lender advises the Borrower and the Agent that it is not capable of receiving payments without any deduction or withholding of United States federal income tax.

2.19. Agent's Fees. The Borrower shall pay to the Agent those fees, in addition to the Facility Fees referenced in Section 2.4(a), in the amounts and at the times separately agreed to between the Agent and the Borrower.

ARTICLE III

CHANGE IN CIRCUMSTANCES

3.1. Yield Protection. If, after the date hereof, the adoption of or any change in any law or any governmental or quasi-governmental rule, regulation, policy, guideline or directive (whether or not having the force of law), or any new interpretation thereof, or the compliance of any Lender with such adoption, change or interpretation,

(ai subjects any Lender or any applicable Lending Installation to any tax, duty, charge or withholding on or from payments due from the

Borrower (excluding taxation of the overall net income of any Lender or applicable Lending Installation imposed by the jurisdiction in which such Lender or Lending Installation is incorporated or has its principal place of business), or changes the basis of taxation of principal, interest or any other payments to any Lender or Lending Installation in respect of its Loans or other amounts due it hereunder, or

(bi imposes or increases or deems applicable any reserve, assessment, insurance charge, special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by, any Lender or any applicable Lending Installation (other than reserves and assessments taken into account in determining the interest rate applicable to Eurodollar Advances), or

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(ci imposes any other condition the result of which is to increase the cost to any Lender or any applicable Lending Installation of making, funding or maintaining Loans or reduces any amount receivable by any Lender or any applicable Lending Installation in connection with any Loans, or requires any Lender or any applicable Lending Installation to make any payment calculated by reference to the amount of Loans held, or interest received by it, by an amount deemed material by such Lender,

then, within 15 days of demand by such Lender, the Borrower shall pay such Lender that portion of such increased expense incurred or resulting in an amount received which such Lender determines is attributable to making, funding and maintaining its Loans and its Commitment.

3.2. Changes in Capital Adequacy Regulations. If a Lender determines the amount of capital required or expected to be maintained by such Lender, any Lending Installation of such Lender or any corporation controlling such Lender is increased as a result of a Change, then, within 15 days of demand by such Lender, the Borrower shall pay such Lender the amount necessary to compensate for any shortfall in the rate of return on the portion of such increased capital which such Lender determines is attributable to this Agreement, its Loans or its obligation to make Loans hereunder (after taking into account such Lender's policies as to capital adequacy). "Change" means (a) any change after the date of this Agreement in the Risk-Based Capital Guidelines, or (b) any adoption of or change in any other law, governmental or quasi-governmental rule, regulation, policy, guideline, interpretation, or directive (whether or not having the force of law) after the date of this Agreement which affects the amount of capital required or expected to be maintained by any Lender or any Lending Installation or any corporation controlling any Lender. "Risk-Based Capital Guidelines" means (a) the risk-based capital guidelines in effect in the United States on the date of this Agreement and (b) the corresponding capital regulations promulgated by regulatory authorities outside the United States implementing the July 1988 report of the Basle Committee on Banking Regulation and Supervisory Practices entitled "International Convergence of Capital Measurements and Capital Standards" and any amendments to such regulations adopted prior to the date of this Agreement.

3.3. Availability of Types of Advances. If any Lender determines that maintenance of its Eurodollar Loans at a suitable Lending Installation would violate any applicable law, rule, regulation, or directive, whether or not having the force of law, or if the Required Lenders determine that (a) deposits of a type and maturity appropriate to match fund Eurodollar Advances are not available, or (b) the interest rate applicable to a Eurodollar Advance does not accurately or fairly reflect the cost of making or maintaining such Advance, then the Agent shall suspend the availability of the Eurodollar Advances until such circumstance no longer exists and require any Eurodollar Advances to be repaid.

3.4. Funding Indemnification. If any payment of a Eurodollar Advance occurs on a date which is not the last day of the applicable Interest Period, whether because of acceleration,

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prepayment or otherwise, or a Eurodollar Advance is not made on the date specified by the Borrower for any reason other than default by the Lenders, the Borrower will indemnify the Agent and each Lender for any loss or cost incurred by it resulting therefrom, including, without limitation, any loss or cost in liquidating or employing deposits acquired to fund or maintain the Eurodollar Advance.

3.5. Lender Statements; Survival of Indemnity. To the extent reasonably possible, each Lender shall designate an alternate Lending Installation with respect to its Eurodollar Advances to reduce any liability of the Borrower to such Lender under Sections 2.18, 3.1 and 3.2 or to avoid the unavailability of a Type of Advance under Section 3.3, so long as such designation is not disadvantageous to such Lender. Each Lender shall deliver a written statement of such Lender to the Borrower (with a copy to the Agent) as to the amount due, if any, under Section 3.1, 3.2 or 3.4. Such written statement shall set forth in reasonable detail the calculations upon which such Lender

determined such amount and shall be final, conclusive and binding on the Borrower in the absence of manifest error. Determination of amounts payable under such Sections in connection with a Eurodollar Advance shall be calculated as though each Lender funded its Eurodollar Advances through the purchase of a deposit of the type and maturity corresponding to the deposit used as a reference in determining the Eurodollar Rate applicable to such Loan, whether in fact that is the case or not. Unless otherwise provided herein, the amount specified in the written statement of any Lender shall be payable on demand after receipt by the Borrower of the written statement. The obligations of the Borrower under Sections 3.1, 3.2 and 3.4 shall survive payment of the Obligations and termination of this Agreement.

ARTICLE IV

CONDITIONS PRECEDENT

4.1. Initial Loans. The Lenders shall not be required to make the initial Advance hereunder unless each Loan Party has furnished the following to the Agent with sufficient copies for the Lenders and the other conditions set forth below have been satisfied:

(ai Charter Documents; Good Standing Certificates. Copies of the certificate of incorporation of each Loan Party, together with all amendments thereto, both certified by the appropriate governmental officer in its jurisdiction of incorporation, together with a good standing certificate issued by the Secretary of State of the jurisdiction of its incorporation and such other jurisdictions as shall be reasonably requested by the Agent.

(bi By-Laws and Resolutions. Copies, certified by the Secretary or Assistant Secretary of the relevant Loan Party, of its by-laws and of its Board of Directors' resolutions authorizing the execution, delivery and performance of the Loan Documents

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to which it is a party.

(ci Secretary's Certificate. An incumbency certificate, executed by the Secretary or Assistant Secretary of the relevant Loan Party, which shall identify by name and title and bear the signature of the officers of such Loan Party authorized to sign the Loan Documents and, in the case of the Borrower, to make borrowings hereunder, upon which certificate the Agent and the Lenders shall be entitled to rely until informed of any change in writing by the Borrower.

(di Officer's Certificate. A certificate signed by an Authorized Officer of the Borrower, in form and substance satisfactory to the Agent, to the effect that on the Restatement Effective Date (both before and after giving effect to the consummation of the transactions contemplated hereby and the making of the Loans hereunder, if any, being made on such date): (i) no Default or Unmatured Default has occurred and is continuing; (ii) no injunction or temporary restraining order which would prohibit the making of any Loans or other litigation which could reasonably be expected to have a Material Adverse Effect is pending or, to the best of such Person's knowledge, threatened; (iii) all orders, consents, approvals, licenses, authorizations, or validations of, or filings, recordings or registrations with, or exemptions by, any Governmental Authority required in connection with the execution, delivery and performance of this Agreement have been or, prior to the time required, will have been, obtained, given, filed or taken and are or will be in full force and effect (or the relevant Loan Party has obtained effective judicial relief with respect to the application thereof) and all applicable waiting periods have expired; (iv) each of the representations and warranties set forth in Article V of this Agreement is true and correct on and as of the Restatement Effective Date; and (v) since December 31, 1996, no event or change has occurred that has caused or evidences a Material Adverse Effect.

(ei Legal Opinion. A written opinion of Brobeck, Phleger & Harrison LLP., counsel to each Loan Party, addressed to the Agent and the Lenders in form and substance acceptable to the Agent and its counsel.

(fi Notes. Notes payable to the order of each of the Lenders duly executed by the Borrower.

(gi Loan Documents. Executed originals of this Agreement and each of the Loan Documents, which shall be in full force and effect, together with all schedules, exhibits, certificates, instruments, opinions, documents and financial statements required to be delivered pursuant hereto and thereto.

(hi Letters of Direction. Written money transfer instructions with respect to

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the initial Advances and to future Advances in form and substance acceptable to the Agent and its counsel addressed to the Agent and signed by an Authorized Officer, together with such other related money transfer authorizations as the Agent may have reasonably requested.

(ii Solvency Certificate. A written solvency certificate from the chief financial officer of the relevant Loan Party in form and content satisfactory to the Agent with respect to the value, Solvency and other factual information, or relating to, as the case may be, of such Loan Party on a consolidated basis.

(ji Regulatory Matters. Receipt of any required regulatory approvals from any Governmental Authority.

(ki Investment Policy Guidelines. Certified copy of the investment policy guidelines adopted by the finance committee of the board of directors of Parent and the board of directors of the Borrower.

(li Other. Such other documents as the Agent, any Lender or their counsel may have reasonably requested.

4.2. Each Future Advance. The Lenders shall not be required to make any Advance unless on the applicable Borrowing Date:

(ai There exists no Default or Unmatured Default and none would result from such Advance;

(bi The representations and warranties contained in Article V are true and correct as of such Borrowing Date (except to the extent such representations and warranties are expressly made as of a specified date, in which event such representations and warranties shall be true and correct as of such specified date);

(ci A Borrowing Notice shall have been properly submitted; and

(di All legal matters incident to the making of such Advance shall be satisfactory to the Lenders and their counsel.

Each Borrowing Notice with respect to each such Advance shall constitute a representation and warranty by each Loan Party that the conditions contained in Section 4.2(a), (b) and (c) have been satisfied. Any Lender may require a duly completed compliance certificate in substantially the form of Exhibit B hereto as a condition to making an Advance.

ARTICLE V

REPRESENTATIONS AND WARRANTIES

Each Loan Party represents and warrants to the Lenders that:

5.1. Corporate Existence and Standing. Each Loan Party and each of its Subsidiaries is a corporation duly incorporated, validly existing and in good standing under the laws of its respective jurisdiction of incorporation and is duly qualified and in good standing as a foreign corporation and is duly authorized to conduct its business in each jurisdiction in which its business is conducted or proposed to be conducted, except where the failure to be so qualified could not reasonably be expected to have a Material Adverse Effect.

5.2. Authorization and Validity. Each Loan Party has all requisite power and authority (corporate and otherwise) and legal right to execute and deliver each of the Loan Documents to which it is a party and to perform its obligations thereunder. The execution and delivery by each Loan Party of the Loan Documents to which it is a party and the performance of its obligations thereunder have been duly authorized by proper corporate proceedings and the Loan Documents constitute legal, valid and binding obligations of such Loan Party enforceable against it in accordance with their terms, except as enforceability may be limited by bankruptcy, insolvency or similar laws affecting the enforcement of creditors' rights generally.

5.3. Compliance with Laws and Contracts. Each Loan Party and each of its Subsidiaries have complied in all material respects with all applicable statutes, rules, regulations, orders and restrictions of any domestic or foreign government or any instrumentality or agency thereof, having jurisdiction over the conduct of their respective businesses or the ownership of their respective properties, except where the failure to so comply could not reasonably be expected to have a Material Adverse Effect. Neither the execution and delivery by either Loan Party of the Loan Documents to which it is party, the application of the proceeds of the Loans or the consummation of the transactions contemplated in the Loan Documents, nor compliance with the provisions of the Loan Documents will, or at the relevant time did, (a) violate any law, rule, regulation (including Regulations G, T, U and X), order, writ, judgment, injunction, decree or award binding on such Loan Party

or any of its Subsidiaries or the charter, articles or certificate of incorporation or by-laws of such Loan Party or any of its Subsidiaries, (b) violate the provisions of or require the approval or consent of any party to any indenture, instrument or agreement to which such Loan Party or any of its Subsidiaries is a party or is subject, or by which it, or its property, is bound, or conflict with or constitute a default thereunder, or result in the creation or imposition of any Lien (other than Liens permitted by, the Loan Documents) in, of or on the property of such Loan Party or any of its Subsidiaries pursuant to the terms of any such indenture, instrument or agreement, or (c) require any consent of the stockholders of any Person, except for approvals or consents which will be obtained on or before the initial Advance

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and are disclosed on Schedule 5.3, except for any violation of, or failure to obtain an approval or consent required under, any such indenture, instrument or agreement that could not reasonably be expected to have a Material Adverse Effect.

5.4. Governmental Consents. No order, consent, approval, qualification, license, authorization, or validation of, or filing, recording or registration with, or exemption by, or other action in respect of, any court, governmental or public body or authority, or any subdivision thereof, any securities exchange or other Person is or at the relevant time was required to authorize, or is or at the relevant time was required in connection with the execution, delivery, consummation or performance of, or the legality, validity, binding effect or enforceability of, any of the Loan Documents or the application of the proceeds of the Loans or any other transaction contemplated in the Loan Documents. No Loan Party nor any of its Subsidiaries is in default under or in violation of any foreign, federal, state or local law, rule, regulation, order, writ, judgment, injunction, decree or award binding upon or applicable to such Loan Party or such Subsidiary, in each case the consequences of which default or violation could reasonably be expected to have a Material Adverse Effect.

5.5. Financial Statements. The Borrower has heretofore furnished to each of the Lenders (a) the December 31, 1996 unaudited consolidated financial statements of Parent and its Subsidiaries, (b) the unaudited consolidated financial statements of Parent and its Subsidiaries as of March 31, 1997, (c) the December 31, 1996 audited financial statements of Charter Group, Inc. and its Subsidiaries, (d) the December 31, 1996 audited financial statements of Valley Insurance Co. and its Subsidiaries, (e) the December 31, 1996 audited balance sheet of the Borrower and its Subsidiaries, (f) the March 31, 1997 unaudited balance sheets and income statements of Parent, the Borrower (excluding White Mountains Insurance Company related transactions), White Mountains Insurance Company (as if no business was reinsured through Valley Insurance Company), SOMSC, Financial Security Assurance Holdings Ltd., Folksamerica Holding Company, Inc. and Main Street America Holdings, Inc., (g) the December 31, 1996 unaudited consolidated financial statements of the Borrower and its Subsidiaries, (h) the December 31, 1996 Annual Statement of each Insurance Subsidiary and (i) the March 31, 1997 Quarterly Statement of each Insurance Subsidiary (collectively, the "Financial Statements"). Each of the Financial Statements (other than as described in clause (f)) was prepared in accordance with Agreement Accounting Principles or SAP, as applicable, and fairly presents the consolidated financial condition and operations of the Person which is the subject of such Financial Statements at such dates and the consolidated results of their operations for the respective periods then ended (except, in the case of such unaudited statements, for normal year-end audit adjustments).

5.6. Material Adverse Change. No material adverse change in the business, Property, condition (financial or otherwise), performance, prospects or results of operations of the Borrower and its Subsidiaries has occurred since December 31, 1996, except as specifically

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disclosed in the Financial Statements.

5.7. Taxes. Neither Loan Party nor any of its Subsidiaries is required to file United States federal, foreign, state or local tax returns. As of the date hereof, the United States income tax returns of Holdings on a consolidated basis have been audited by the Internal Revenue Service through its fiscal period ending December 31, 1985, and all tax years beginning on or after January 1, 1986 are currently being audited or are subject to audit. No tax liens have been filed and no claims are being asserted with respect to any taxes of Holdings which could reasonably be expected to have a Material Adverse - Effect. The charges, accruals and reserves on the books of Holdings in respect of any taxes or other governmental charges of Holdings are in accordance with Agreement Accounting Principles.

5.8. Litigation and Contingent Obligations. There is no litigation, arbitration, proceeding, inquiry or governmental investigation pending or, to the knowledge of any of their officers, threatened against or affecting either Loan Party or any of its Subsidiaries or any of their respective properties which could reasonably be expected to have a Material Adverse

Effect or to prevent, enjoin or unduly delay the making of the Loans under this Agreement. No Loan Party nor any of its Subsidiaries has any material contingent obligations incurred outside of the ordinary course of its business except as set forth on Schedule 5.16 or disclosed in the Financial Statements or in the financial statements required to be delivered under Section 6.1(a) and (b) and as permitted under this Agreement.

5.9. Capitalization. Schedule 5.9 hereto contains (a) an accurate description of each Loan Party's capitalization as of March 31, 1997 (after giving effect to the application of the proceeds of Loans incurred by the Borrower on the initial Borrowing Date and to the FAE Merger) and (b) an accurate list of all of the existing Subsidiaries of each Loan Party as of the date of this Agreement, setting forth their respective jurisdictions of incorporation and the percentage of their capital stock owned by such Loan Party or its other Subsidiaries. All of the issued and outstanding shares of capital stock of each Loan Party and of each Subsidiary of such Loan Party have been duly authorized and validly issued, are fully paid and non-assessable, and are free and clear of all Liens. No authorized but unissued or treasury shares of capital stock of each Loan Party or any of its Subsidiaries are subject to any option, warrant, right to call or commitment of any kind or character. Except as set forth on Schedule 5.9 or pursuant to management incentive plans implemented after the date of this Agreement, no Loan Party nor any of its Subsidiaries has any outstanding stock or securities convertible into or exchangeable for any shares of its capital stock, or any right issued to any Person (either preemptive or other) to subscribe for or to purchase, or any options for the purchase of, or any agreements providing for the issuance (contingent or otherwise) of, or any calls, commitments or claims of any character relating to any of its capital stock or any stock or securities convertible into or exchangeable for any of its capital stock other than as expressly set forth in the certificate or articles of incorporation of such Loan Party or such Subsidiary. No Loan Party nor any of its Subsidiaries is subject to any obligation (contingent or otherwise) to repurchase or otherwise

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acquire or retire any shares of its capital stock or any convertible securities, rights or options of the type described in the preceding sentence except as otherwise set forth on Schedule 5.9 or pursuant to management incentive plans implemented after the date of this Agreement.

5.10. ERISA. Except as disclosed on Schedule 5.10, no Loan Party nor any other member of the Controlled Group maintains any Single Employer Plans, and no Single Employer Plan has any Unfunded Liability. No Loan Party nor any other member of the Controlled Group maintains, or is obligated to contribute to, any Multiemployer Plan or has incurred, or is reasonably expected to incur, any withdrawal liability to any Multiemployer Plan. Each Plan complies in all material respects with all applicable requirements of law and regulations other than any such failure to comply which could not reasonably be expected to have a Material Adverse Effect. No Loan Party nor any member of the Controlled Group has, with respect to any Plan, failed to make any contribution or pay any amount required under Section 412 of the Code or Section 302 of ERISA or the terms of such Plan. There are no pending or, to the knowledge of either Loan Party, threatened claims, actions, investigations or lawsuits against any Plan, any fiduciary thereof, or either Loan Party or any member of the Controlled Group with respect to a Plan. No Loan Party nor any member of the Controlled Group has engaged in any prohibited transaction (as defined in Section 4975 of the Code or Section 406 of ERISA) in connection with any Plan which would subject such Person to any material liability. Within the last five years no Loan Party nor any member of the Controlled Group has engaged in a transaction which resulted in a Single Employer Plan with an Unfunded Liability being transferred out of the Controlled Group which could reasonably be expected to have a Material Adverse Effect. No Termination Event has occurred or is reasonably expected to occur with respect to any Plan which is subject to Title IV of ERISA which could reasonably be expected to have a Material Adverse Effect.

5.11. Defaults. No Default or Unmatured Default has occurred and is continuing.

5.12. Federal Reserve Regulations. No Loan Party nor any of its Subsidiaries is engaged, directly or indirectly, principally, or as one of its important activities, in the business of extending, or arranging for the extension of, credit for the purpose of purchasing or carrying Margin Stock. No part of the proceeds of any Loan will be used in a manner which would violate, or result in a violation of, Regulation G, Regulation T, Regulation U or Regulation X. Neither the making of any Advance hereunder nor the use of the proceeds thereof will violate or be inconsistent with the provisions of Regulation G, Regulation T, Regulation U or Regulation X.

5.13. Investment Company. No Loan Party nor any of its Subsidiaries is, or after giving effect to any Advance will be, an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940, as amended.

5.14. Certain Fees. No broker's or finder's fee or commission was, is or will be

payable by either Loan Party or any of its Subsidiaries with respect to any of the transactions contemplated by this Agreement, except as described in Section 9.5. Each Loan Party hereby agrees to indemnify the Agent and the Lenders against and agrees that it will hold each of them harmless from any claim, demand or liability for broker's or finder's fees or commissions alleged to have been incurred by either Loan Party in connection with any of the transactions contemplated by this Agreement and any expenses (including, without limitation, attorneys' fees and time charges of attorneys for the Agent or any Lender, which attorneys may be employees of the Agent or any Lender) arising in connection with any such claim, demand or liability. No other similar fee or commissions will be payable by either Loan Party or any of its Subsidiaries for any other services rendered to such Loan Party or such Subsidiary ancillary to any of the transactions contemplated by this Agreement.

5.15. Solvency. As of the date hereof, after giving effect to the consummation of the transactions contemplated by the Loan Documents and the payment of all fees, costs and expenses payable by each Loan Party or any of its Subsidiaries with respect to the transactions contemplated by the Loan Documents and the application of the proceeds of Loans incurred by the Borrower on the initial Borrowing Date, each Loan Party and each of its Subsidiaries is Solvent.

5.16. Indebtedness. Attached hereto as Schedule 5.16 is a complete and correct list of all Indebtedness of each Loan Party and each of its Subsidiaries outstanding on the date of this Agreement (other than Indebtedness in a principal amount not exceeding \$100,000 for a single item of Indebtedness and \$1,000,000 in the aggregate for all such Indebtedness listed, it being understood and agreed that any such Indebtedness shall be permitted to exist pursuant to Section 6.11(b) notwithstanding the absence thereof on Schedule 5.16), showing the aggregate principal amount which was outstanding on such date after giving effect to the application of the proceeds of Loans incurred by the Borrower on the initial Borrowing Date.

5.17. Insurance Licenses. Schedule 5.17 hereto lists all of the jurisdictions in which any Insurance Subsidiary holds a License and is authorized to and does transact insurance business as of the date of this Agreement. No such License, the loss of which could reasonably be expected to have a Material Adverse Effect, is the subject of a proceeding for suspension or revocation. To each Loan Party's knowledge, there is no sustainable basis for such suspension or revocation, and no such suspension or revocation has been threatened by any Governmental Authority.

5.18. Material Agreements. Except as set forth in Schedule 5.18 and except for agreements or arrangements with regulatory agencies with regard to Insurance Subsidiaries, no Loan Party nor any of its Subsidiaries is a party to any agreement or instrument or subject to any charter or other corporate restriction which could reasonably be expected to have a Material Adverse Effect or which restricts or imposes conditions upon the ability of any Subsidiary of a

Loan Party (other than Unrestricted Subsidiary) to (a) pay dividends or make other distributions on its capital stock (b) make loans or advances to either Loan Party, (c) repay loans or advances from either Loan Party or (d) grant Liens to the Agent to secure the Obligations. No Loan Party nor any of its Subsidiaries is in default in the performance, observance or fulfillment of any of the obligations, covenants or conditions contained in any agreement to which it is a party, which default could reasonably be expected to have a Material Adverse Effect.

5.19. Environmental Laws. There are no claims, investigations, litigation, administrative proceedings, notices, requests for information (each a "Proceeding"), whether pending or threatened, or judgments or orders asserting violations of applicable federal, state and local environmental, health and safety statutes, regulations, ordinances, codes, rules, orders, decrees, directives and standards ("Environmental Laws") or relating to any toxic or hazardous waste, substance or chemical or any pollutant, contaminant, chemical or other substance defined or regulated pursuant to any Environmental Law, including, without limitation, asbestos, petroleum, crude oil or any fraction thereof ("Hazardous Materials") asserted against either Loan Party or any of its Subsidiaries, other than in connection with an insurance policy issued in the ordinary course of business to any Person (other than Holdings or any Subsidiary of Holdings), which, in any case, could reasonably be expected to have a Material Adverse Effect. As of the date hereof, Parent and its Subsidiaries do not have liabilities exceeding \$100,000 in the aggregate for all of them with respect to compliance with applicable Environmental Laws or related to the generation, treatment, storage, disposal, release, investigation or cleanup of Hazardous Materials, and no facts or circumstances exist which could give rise to such liabilities with respect to compliance with applicable Environmental Laws and the generation, treatment, storage, disposal, release, investigation or cleanup of Hazardous Materials.

5.20. Insurance. Each Loan Party and each of its Subsidiaries maintain with financially sound and reputable insurance companies insurance on their Property in such amounts and covering such risks as is consistent with sound business practice.

5.21. Disclosure. No information, exhibit or report furnished by either Loan Party or any of its Subsidiaries to the Agent or to any Lender in connection with the negotiation of, or compliance with, the Loan Documents contained any material misstatement of fact or omitted to state a material fact or any fact necessary to make the statements contained therein not materially misleading. There is no fact known to either Loan Party (other than matters of a general economic or political nature) that has had or could reasonably be expected to have a Material Adverse Effect and that has not been disclosed herein or in such other documents, certificates and statements furnished to the Lenders for use in connection with the transactions contemplated by this Agreement.

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ARTICLE VI

COVENANTS

During the term of this Agreement, unless the Required Lenders shall otherwise consent in writing:

6.1. Financial Reporting. Parent will maintain, for itself and each of its Subsidiaries, a system of accounting established and administered in accordance with generally accepted accounting principles, consistently applied, and furnish to the Lenders:

(ai) As soon as practicable and in any event within 100 days after the close of each of its Fiscal Years, an unqualified audit report certified by independent certified public accountants, acceptable to the Lenders, prepared in accordance with Agreement Accounting Principles on a consolidated and consolidating basis (consolidating statements need not be certified by such accountants) for itself and its Subsidiaries, including balance sheets as of the end of such period and related statements of income, retained earnings and cash flows accompanied by a certificate of said accountants that, in the course of the examination necessary for their certification of the foregoing, they have obtained no knowledge of any Default or Unmatured Default, or if, in the opinion of such accountants, any Default or Unmatured Default shall exist, stating the nature and status thereof.

(bi) As soon as practicable and in any event within 60 days after the close of each of the first three Fiscal Quarters of each of its Fiscal Years, for itself and its Subsidiaries, consolidated and consolidating unaudited balance sheets as at the close of each such period and consolidated and consolidating statements of income, retained earnings and cash flows for the period from the beginning of such Fiscal Year to the end of such quarter, all certified by its chief financial officer.

(ci) (i) Upon the earlier of (A) fifteen (15) days after the regulatory filing date or (B) seventy-five (75) days after the close of each fiscal year of each Insurance Subsidiary of the Parent, copies of the unaudited Annual Statement of such Insurance Subsidiary, certified by the chief financial officer or the treasurer of such Insurance Subsidiary, all such statements to be prepared in accordance with SAP and (ii) no later than each June 15, copies of financial statements prepared in accordance with SAP, or generally accepted accounting principles with a reconciliation to SAP, and certified by independent certified public accountants of recognized national standing.

(di) Upon the earlier of (i) ten (10) days after the regulatory filing date or (ii) sixty (60) days after the close of each of the first three (3) fiscal quarters of each fiscal

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year of each Insurance Subsidiary of the Parent, copies of the unaudited Quarterly Statement of each of the Insurance Subsidiaries of the Parent, certified by the chief financial officer or the treasurer of such Insurance Subsidiary, all such statements to be prepared in accordance with SAP.

(ei) Promptly and in any event within ten (10) days after (i) learning thereof, notification of any changes after the date of this Agreement in the rating given by A.M. Best & Co. in respect of any Insurance Subsidiary of the Parent and (ii) receipt thereof, copies of any ratings analysis by A.M. Best & Co. relating to any Insurance Subsidiary of the Parent.

(fi) Copies of any outside actuarial reports prepared with respect

to any valuation or appraisal of any Insurance Subsidiary of the Parent, promptly after the receipt thereof.

(gi Together with the financial statements required by clauses (a) and (b) above, a compliance certificate in substantially the form of Exhibit B hereto signed by the Borrower's chief financial officer showing the calculations necessary to determine compliance with this Agreement and stating that no Default or Unmatured Default exists, or if any Default or Unmatured Default exists, stating the nature and status thereof.

(hi Promptly after the same becomes available after the close of each Fiscal Year, a statement of the Unfunded Liabilities of each Single Employer Plan, certified as correct by an actuary enrolled under ERISA.

(ii As soon as possible and in any event within 10 days after such Loan Party knows that any Termination Event has occurred with respect to any Plan, a statement, signed by the chief financial officer of such Loan Party, describing said Termination Event and the action which such Loan Party proposes to take with respect thereto.

(ji As soon as possible and in any event within 10 days after receipt by such Loan Party, a copy of (i) any notice, claim, complaint or order to the effect that such Loan Party or any of its Subsidiaries is or may be liable to any Person as a result of the release by such Loan Party or any of its Subsidiaries of any Hazardous Materials into the environment or requiring that action be taken to respond to or clean up a Release of Hazardous Materials into the environment, and (ii) any notice, complaint or citation alleging any violation of any Environmental Law or Environmental Permit by such Loan Party or any of its Subsidiaries. Within ten days of such Loan Party or any of its Subsidiaries having knowledge of the enactment or promulgation of any Environmental Law which could reasonably be expected to have a Material Adverse Effect, such Loan Party shall provide the Agent with written notice thereof.

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(ki Promptly upon the furnishing thereof to the shareholders of such Loan Party, copies of all financial statements, reports and proxy statements so furnished.

(li Promptly upon the filing thereof, copies of all registration statements and annual, quarterly, monthly or other regular reports which such Loan Party or any of its Subsidiaries files with the Securities and Exchange Commission, the National Association of Securities Dealers, any securities exchange, the NAIC or any insurance commission or department or analogous Governmental Authority (including any filing made by such Loan Party or any of its Subsidiaries pursuant to any insurance holding company act or related rules or regulations), but excluding routine or non-material filings with the NAIC, any insurance commissioner or department or analogous Governmental Authority.

(mi Promptly and in any event within ten (10) days after learning thereof, notification of (i) any material tax assessment, demand, notice of proposed deficiency or notice of deficiency received by Holdings or any other Consolidated Person or (ii) the filing of any tax Lien or commencement of any judicial proceeding by or against any such Consolidated Person, if any such assessment, demand, notice, Lien or judicial proceeding relates to tax liabilities in excess of ten percent (10%) of the net worth (determined according to generally accepted accounting standards and without reduction for any reserve for such liabilities) of such Loan Party and its Subsidiaries taken as a whole.

(ni Promptly after available, any management letter prepared by the accountants conducting the audit of the financial statements delivered pursuant to Section 6.1(a).

(oi Promptly after reviewed by the relevant board of directors, a copy of the Borrower's and Parent's investment policy compliance report.

(pi Such other information (including, without limitation, the annual Best's Advance Report Service report prepared with respect to each Insurance Subsidiary of the Parent rated by A.M. Best & Co. and non-financial information) as the Agent or any Lender may from time to time reasonably request.

6.2. Use of Proceeds. The Borrower will, and will cause each of its Subsidiaries to, use the proceeds of the Advances to meet the working capital and general corporate needs of the Borrower and its Subsidiaries, including but not limited to the purchase of Finance Assets. The Borrower will not, nor will it permit any of its Subsidiaries to, use any of the proceeds of the Advances in any manner which would violate, or result in the violation of, Regulation G, Regulation T, Regulation U or Regulation X or to finance the Purchase of any Person which has

not been approved and recommended by the board of directors (or functional equivalent thereof) of such Person.

6.3. Notice of Default. The Borrower will give prompt notice in writing to the Lenders of the occurrence of (a) any Default or Unmatured Default, (b) of any other event or development, financial or other, relating specifically to either Loan Party or any of its Subsidiaries (and not of a general economic or political nature) which could reasonably be expected to have a Material Adverse Effect, (c) receipt by either Loan Party or any of its Subsidiaries of any notice from any Governmental Authority of the expiration without renewal, revocation or suspension of, or the institution of any proceedings to revoke or suspend, any License now or hereafter held by any Insurance Subsidiary of the Parent which is required to conduct insurance business in compliance with all applicable laws and regulations and the expiration, revocation or suspension of which could reasonably be expected to have a Material Adverse Effect, (d) receipt by either Loan Party or any of its Subsidiaries of any notice from any Governmental Authority of the institution of any disciplinary proceedings against or in respect of any Insurance Subsidiary of the Parent, or the issuance of any order, the taking of any action or any request for an extraordinary audit for cause by any Governmental Authority which, if adversely determined, could reasonably be expected to have a Material Adverse Effect, (e) any material judicial or administrative order of which either Loan Party or any of its Subsidiaries is aware limiting or controlling the insurance business of any Insurance Subsidiary (and not the insurance industry generally) which has been issued or adopted or (f) the commencement of any litigation of which either Loan Party or any of its Subsidiaries is aware which could reasonably be expected to create a Material Adverse Effect.

6.4. Conduct of Business. Each Loan Party will, and will cause each of its Subsidiaries to, (a) carry on and conduct its business in substantially the same manner as it is presently conducted, (b) not conduct any significant business except for financial services, (c) do all things necessary to remain duly incorporated, validly existing and in good standing as a domestic corporation in its jurisdiction of incorporation and maintain all requisite authority to conduct its business in each jurisdiction in which its business is conducted except where the failure to maintain such authority could not reasonably be expected to have a Material Adverse Effect and (d) do all things necessary to renew, extend and continue in effect all Licenses which may at any time and from time to time be necessary for any Insurance Subsidiary of the Parent to operate its insurance business in compliance with all applicable laws and regulations except for any License the loss of which could not reasonably be expected to have a Material Adverse Effect; provided, that any Insurance Subsidiary of the Parent may withdraw from one or more states (other than its state of domicile) as an admitted insurer if such withdrawal is determined by such Loan Party's Board of Directors to be in the best interest of such Loan Party and could not reasonably be expected to have a Material Adverse Effect.

6.5. Taxes. At any time on and after the date Parent or any of its Subsidiaries is

required to do so, each Loan Party will, and will cause each of its Subsidiaries to, timely file complete and correct United States federal and applicable foreign, state and local tax returns required by applicable law and pay when due all taxes, assessments and governmental charges and levies upon it or its income, profits or Property, except those which are being contested in good faith by appropriate proceedings and with respect to which adequate reserves have been set aside in accordance with generally accepted accounting principles or SAP, as applicable.

6.6. Insurance. Each Loan Party will, and will cause each of its Subsidiaries to, maintain with financially sound and reputable insurance companies insurance on all their Property in such amounts and covering such risks as is consistent with sound business practice, and the Borrower will furnish to the Agent and any Lender upon request full information as to the insurance carried.

6.7. Compliance with Laws. Each Loan Party will, and will cause each of its Subsidiaries to, comply with all laws, rules, regulations, orders, writs, judgments, injunctions, decrees or awards to which it may be subject, the failure to comply with which could reasonably be expected to have a Material Adverse Effect.

6.8. Maintenance of Properties. Each Loan Party will, and will cause each of its Subsidiaries to, do all things necessary to maintain, preserve, protect and keep its Property in good repair, working order and condition, and make all necessary and proper repairs, renewals and replacements so that its business carried on in connection therewith may be properly conducted at all times.

6.9. Inspection. Each Loan Party will, and will cause each of its Subsidiaries to, at reasonable times during normal business hours and upon

reasonable notice, permit the Agent and the Lenders, by their respective representatives and agents, to inspect any of the Property, corporate books and financial records of such Loan Party and such Subsidiary, to examine and make copies of the books of accounts and other financial records of such Loan Party and such Subsidiary, and to discuss the affairs, finances and accounts of such Loan Party and such Subsidiary with, and to be advised as to the same by, their respective officers at such reasonable times and intervals as the Lenders may designate. Each Loan Party will keep or cause to be kept, and cause each of its Subsidiaries to keep or cause to be kept, appropriate records and books of account in which complete entries are to be made reflecting its and their business and financial transactions, such entries to be made in accordance with Agreement Accounting Principles or SAP, as applicable.

6.10. Dividends. The Borrower may declare and pay dividends or make distributions to Parent.

6.11. Indebtedness. No Loan Party will, nor will it permit any of its Subsidiaries

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(other than an Unrestricted Subsidiary) to, create, incur or suffer to exist any Indebtedness, except:

(a) the Loans;

(b) Indebtedness existing on the date hereof and described in Schedule 5.16 hereto and any renewals, extensions, refundings or refinancings of such Indebtedness; provided that the amount thereof is not increased and the maturity of principal thereof is not shortened (unless to a maturity occurring after the Facility Termination Date);

(c) Indebtedness owing by (x) either Loan Party to any Wholly-Owned Subsidiary of a Loan Party and (y) any Wholly-Owned Subsidiary to a Wholly-Owned Subsidiary of a Loan Party or either Loan Party;

(d) Indebtedness permitted under the White Mountains Credit Agreement and the SOMSC Credit Agreement;

(e) Indebtedness secured by Liens permitted pursuant to Section 6.15(f); and

(f) other Indebtedness of either Loan Party or any of its Subsidiaries to the extent not otherwise included in subparagraphs (a) through (e) of this Section 6.11, or in Section 6.14, in an aggregate amount outstanding at any one time not to exceed \$5,000,000.

6.12. Merger. No Loan Party will, nor will it permit any Significant Subsidiary to, merge or consolidate with or into any other Person, except that:

(a) a Wholly-Owned Subsidiary may merge with (i) either Loan Party, (ii) any Wholly-Owned Subsidiary of either Loan Party or (iii) any other Person so long as no Default or Unmatured Default shall have occurred or be continuing before and after giving effect to such merger and the surviving entity of such merger is a Wholly-Owned Subsidiary of either Loan Party;

(b) a Significant Subsidiary (other than the Borrower and FAE (as defined after giving effect to the FAE Merger)) may merge or consolidate with any Person so long as neither Parent, the Borrower, nor any of their Subsidiaries shall hold any capital stock of such Significant Subsidiary after giving effect to such merger or consolidation;

(c) either Loan Party may merge into any Person so long as (i) such Loan Party is the surviving entity of such merger, (ii) no Default or Unmatured Default shall have occurred or be continuing before and after giving effect to such merger and (iii) the

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covenants contained in Section 6.20 shall be complied with on a pro forma basis on the date of, and after giving effect to, such merger;

(d) the FAE Merger shall be permitted; and

(e) after consummation of the FAE Merger, FAE and any subsidiary of FAE may merge or consolidate with any other Person.

6.13. Investments and Purchases. No Loan Party will, and will not permit any of its Subsidiaries (other than an Unrestricted Subsidiary) to, make or suffer to exist any Investments (including, without limitation, loans and advances to, and other Investments in, Subsidiaries of either Loan Party), or commitments therefor, or create any Subsidiary or become or remain a partner in any partnership or joint venture, or make any Purchases, except:

- (a) Investments in existence on the date hereof;
- (b) loans and advances to employees in the ordinary course of business and consistent with past practices;
- (c) Investments made in Subsidiaries and in Main Street America Holdings, Inc., Folksamerica Holding Company Inc. and Financial Security Assurance Holdings Ltd.;
- (d) Purchases of businesses or entities engaged in the insurance and/or insurance services business which do not constitute hostile takeovers; and
- (e) other Investments, so long as any such Investment is materially consistent with such Loan Party's investment policy guidelines as approved from time to time by the finance committee of the board of directors of Parent and the board of directors of the Borrower (a copy of the current version of such guidelines having been delivered to each Lender); provided that any change from the guidelines previously submitted to the Lenders shall not materially adversely affect the Lenders.

6.14. Contingent Obligations. No Loan Party will, nor will it permit any of its Subsidiaries (other than an Unrestricted Subsidiary) to, make or suffer to exist any Contingent Obligation (including, without limitation, any Contingent Obligation with respect to the obligations of a Subsidiary of either Loan Party), except (a) the issuance of financial guarantees in the ordinary course of business, (b) by endorsement of instruments for deposit or collection in the ordinary course of business, (c) for insurance policies issued in the ordinary course of business and (d) the issuance of intercompany guarantees so long as the primary obligation is permitted under this Agreement.

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6.15. Liens. No Loan Party will, nor will it permit any of its Subsidiaries (other than an Unrestricted Subsidiary) to, create, incur, or suffer to exist any Lien in, of or on the Property (other than Margin Stock) of such Loan Party or any of its Subsidiaries (other than an Unrestricted Subsidiary), except:

- (a) Liens for taxes, assessments or governmental charges or levies on its Property if the same shall not at the time be delinquent or thereafter can be paid without penalty, or are being contested in good faith and by appropriate proceedings and for which adequate reserves in accordance with generally accepted principles of accounting shall have been set aside on its books;
- (b) Liens imposed by law, such as carriers', warehousemen's and mechanics' liens and other similar liens arising in the ordinary course of business which secure the payment of obligations not more than 60 days past due or which are being contested in good faith by appropriate proceedings and for which adequate reserves shall have been set aside on its books;
- (c) Liens arising out of pledges or deposits under worker's compensation laws, unemployment insurance, old age pensions, or other social security or retirement benefits, or similar legislation;
- (d) Utility easements, building restrictions and such other encumbrances or charges against real property as are of a nature generally existing with respect to properties of a similar character and which do not in any material way affect the marketability of the same or interfere with the use thereof in the business of such Loan Party or any of its Subsidiaries;
- (e) Liens existing on the date hereof and described in Schedule 6.15 hereto;
- (f) Liens in, of or on Property acquired after the date of this Agreement (by purchase, construction or otherwise) by either Loan Party or any of its Subsidiaries, each of which Liens either (1) existed on such Property before the time of its acquisition and was not created in anticipation thereof, or (2) was created solely for the purpose of securing Indebtedness representing, or incurred to finance, refinance or refund, the cost (including the cost of construction) of such Property; provided that no such Lien shall extend to or cover any Property of such Loan Party or such Subsidiary other than the Property so acquired and improvements thereon; and provided, further, that the principal amount of Indebtedness secured by any such Lien shall at the time the Lien is incurred not exceed 75% of the fair market value (as determined in good faith by a financial officer of such Loan Party and, in the case of any Property having a fair market value in excess of \$500,000, certified by such officer to the Agent, with a copy for each Lender)

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of the Property at the time it was so acquired; and

(g) Liens not otherwise permitted by the foregoing clauses (a) through (f) securing any Indebtedness of either Loan Party, provided that the aggregate principal amount of Indebtedness secured by Liens permitted by this clause (g) shall not exceed \$3,000,000 at any time.

6.16. Affiliates. No Loan Party will, and will not permit any of its Subsidiaries to, enter into any material transaction (including, without limitation, the purchase or sale of any Property or service) with, or make any payment or transfer to, any Affiliates (other than a Wholly-Owned Subsidiary of either Loan Party), except in the ordinary course of business and pursuant to the reasonable requirements of such Loan Party's or such Subsidiary's business and upon fair and reasonable terms no less favorable to such Loan Party or such Subsidiary than such Loan Party or such Subsidiary would obtain in a comparable arms-length transactions, except that any Unrestricted Subsidiary may make loans to Holdings.

6.17. Environmental Matters. Each Loan Party shall and shall cause each of its Subsidiaries to (a) at all times comply in all material respects with all applicable Environmental Laws and (b) promptly take any and all necessary remedial actions in response to the presence, storage, use, disposal, transportation or Release of any Hazardous Materials on, under or about any real property owned, leased or operated by such Loan Party or any of its Subsidiaries.

6.18. Change in Corporate Structure; Fiscal Year. No Loan Party shall, nor shall it permit any of its Subsidiaries to, (a) permit any amendment or modification to be made to its certificate or articles of incorporation or by-laws which is materially adverse to the interests of the Lenders or (b) change its Fiscal Year to end on any date other than December 31 of each year.

6.19. Inconsistent Agreements. No Loan Party shall, nor shall it permit any of its Subsidiaries (other than an Unrestricted Subsidiary) to, enter into any indenture, agreement, instrument or other arrangement which by its terms (a) other than pursuant to the White Mountains Credit Agreement or pursuant to agreements or arrangements with regulatory agencies with regard to Insurance Subsidiaries, directly or indirectly contractually prohibits or restrains, or has the effect of contractually prohibiting or restraining, or contractually imposes materially adverse conditions upon, the incurrence of the Obligations, the granting of Liens to secure the Obligations, the amending of the Loan Documents or the ability of any Subsidiary to (i) pay dividends or make other distributions on its capital stock, (ii) make loans or advances to such Loan Party or (iii) repay loans or advances from such Loan Party or (b) contains any provision which would be violated or breached by the making of Advances or by the performance by such Loan Party or any of its Subsidiaries of any of its obligations under any Loan Document.

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6.20. Financial Covenants. Parent shall (or, in the case of Section 6.20.5, shall cause its Insurance Subsidiaries to):

6.20.1. Minimum Adjusted Net Worth. At all times after the date hereof, maintain a minimum Adjusted Net Worth at least equal to the sum of (a) an amount equal to 85% of Net Worth (without giving effect to Parent's equity interests in FAE (as defined after giving effect to the FAE Merger) and SOMSC) as of July 31, 1997, plus (b) an amount equal to 85% of the cash and non-cash proceeds of any equity securities issued by Parent after July 30, 1997, plus (c) an amount equal to (i) \$75,000,000 minus (ii) the aggregate amount of mandatory commitment reductions pursuant to Section 2.7(b)(i) of the White Mountains Credit Agreement which occur after July 30, 1997 from the Net Available Proceeds (as defined in the White Mountains Credit Agreement) of all sales by Parent of its equity interests in FAE (as defined after giving effect to the FAE Merger) or SOMSC minus (iii) the aggregate amount of Permitted Reinvestments made by Parent after July 30, 1997 utilizing proceeds of sales of its equity interests in FAE (as defined after giving effect to the FAE Merger) or SOMSC ("Specified Permitted Reinvestments"), plus (d) an amount equal to 85% of Specified Permitted Reinvestments made after July 30, 1997.

6.20.2. Leverage Ratio. At all times after the date hereof, maintain a Leverage Ratio of not greater than 30% through and including December 31, 1999 and (b) not greater than 25% at all times thereafter.

6.20.3. Fixed Charges Coverage Ratio. As of the end of each Fiscal Quarter maintain a Fixed Charges Coverage Ratio of not less than 1.5:1.0

6.20.4 Finance Assets Ratio. At any time Loans are outstanding and the sum of cash and Money Market Investments of Parent is less than the aggregate outstanding principal amount of Funded Indebtedness of Parent at such time, maintain a Finance Assets Ratio of not less than 2.5:1.0.

6.20.5 Statutory Surplus. At all times, maintain Statutory Surplus for each Insurance Subsidiary of Parent in an amount not less than an amount equal to (a) 85% of the Statutory Surplus of each such Insurance Subsidiary on September 30, 1996, plus (b) 85% of all subsequent capital contributions to each such Insurance Subsidiary, less (c) in the event such Insurance Subsidiary dividends or otherwise distributes to its parent all the capital stock of a Wholly-Owned Insurance Subsidiary, 100% of the book value (calculated in accordance with SAP) of such Wholly-Owned Insurance Subsidiary at the time of

such dividend or distribution.

6.21. Tax Consolidation. No Loan Party will and will not permit any of its Subsidiaries to (a) file or consent to the filing of any consolidated, combined or unitary income tax return with any Person other than Holdings and its Subsidiaries or (b) amend, terminate or fail to enforce any existing tax sharing agreement or similar arrangement if such action would

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cause a Material Adverse Effect.

6.22. ERISA Compliance.

With respect to any Plan, no Loan Party nor any of its Subsidiaries shall:

(a) engage in any "prohibited transaction" (as such term is defined in Section 406 of ERISA or Section 4975 of the Code) for which a civil penalty pursuant to Section 502(i) of ERISA or a tax pursuant to Section 4975 of the Code in excess of \$100,000 could be imposed;

(b) incur any "accumulated funding deficiency" (as such term is defined in Section 302 of ERISA) in excess of \$100,000, whether or not waived, or permit any Unfunded Liability to exceed \$100,000;

(c) permit the occurrence of any Termination Event which could result in a liability to either Loan Party or any other member of the Controlled Group in excess of \$100,000;

(d) be an "employer" (as such term is defined in Section 3(5) of ERISA) required to contribute to any Multiemployer Plan or a "substantial employer" (as such term is defined in Section 4001(a)(2) of ERISA) required to contribute to any Multiple Employer Plan; or

(e) permit the establishment or amendment of any Plan or fail to comply with the applicable provisions of ERISA and the Code with respect to any Plan which could result in liability to either Loan Party or any other member of the Controlled Group which, individually or in the aggregate, could reasonably be expected to have a Material Adverse Effect.

ARTICLE VII

DEFAULTS

The occurrence of any one or more of the following events shall constitute a Default:

7.1. Any representation or warranty made or deemed made by or on behalf of either Loan Party or any of its Subsidiaries to the Lenders or the Agent under or in connection with this Agreement, any other Loan Document, any Loan, or any certificate or information delivered in connection with this Agreement or any other Loan Document shall be false in any material

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respect on the date as of which made.

7.2. Nonpayment of (a) any principal of any Note when due, or (b) any interest upon any Note or any commitment fee or other fee or obligations under any of the Loan Documents within five days after the same becomes due.

7.3. The breach by either Loan Party of any of the terms or provisions of Section 6.2, Section 6.3(a) or Sections 6.10 through 6.16 or Section 6.18 through 6.22.

7.4. The breach by either Loan Party (other than a breach which constitutes a Default under Section 7.1, 7.2 or 7.3) of any of the terms or provisions of this Agreement which is not remedied within twenty (20) days after written notice from the Agent or any Lender.

7.5. The default by either Loan Party or any of its Subsidiaries (or, at any time Parent is a Subsidiary of Holdings, by Holdings) in the performance of any term, provision or condition contained in any agreement or agreements under which any Funded Indebtedness aggregating in excess of \$2,000,000 (\$10,000,000 in the case of Holdings and FAE and \$20,000,000, or such lower cross default threshold amount as is provided in the SOMSC Credit Agreement, in the case of SOMSC) was created or is governed, or the occurrence of any other event or existence of any other condition, the effect of any of which is to cause, or to permit the holder or holders of such Funded Indebtedness to cause, such Funded Indebtedness to become due prior to its stated maturity; or any such Funded Indebtedness of either Loan Party or any of its Subsidiaries or Holdings shall be declared to be due and payable or required to be prepaid (other than by a regularly scheduled payment) prior to the stated maturity thereof.

7.6. Either Loan Party or any of its Significant Subsidiaries shall (a) have an order for relief entered with respect to it under the Federal bankruptcy laws as now or hereafter in effect, (b) make an assignment for the benefit of creditors, (c) apply for, seek, consent to, or acquiesce in, the appointment of a receiver, custodian, trustee, examiner, liquidator or similar official for it or any substantial portion of its Property, (d) institute any proceeding seeking an order for relief under the Federal bankruptcy laws as now or hereafter in effect or seeking to adjudicate it a bankrupt or insolvent, or seeking dissolution, winding up, liquidation, reorganization, arrangement, adjustment or composition of it or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors or fail to file an answer or other pleading denying the material allegations of any such proceeding filed against it, (e) take any corporate action to authorize or effect any of the foregoing actions set forth in this Section 7.6, (f) fail to contest in good faith any appointment or proceeding described in Section 7.7 or (g) become unable to pay, not pay, or admit in writing its inability to pay, its debts generally as they become due.

7.7. Without the application, approval or consent of the relevant Loan Party or any of

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its Significant Subsidiaries, a receiver, trustee, examiner, liquidator or similar official shall be appointed for either Loan Party or any of its Significant Subsidiaries or any substantial portion of its Property, or a proceeding described in Section 7.6(d) shall be instituted against either Loan Party or any of its Significant Subsidiaries and such appointment continues undischarged or such proceeding continues undismissed or unstayed for a period of sixty consecutive days.

7.8. Either Loan Party or any of its Subsidiaries shall fail within thirty days to pay, bond or otherwise discharge any judgment or order for the payment of money in excess of \$1,000,000 (or multiple judgments or orders for the payment of an aggregate amount in excess of \$5,000,000), which is not stayed on appeal or otherwise being appropriately contested in good faith and as to which no enforcement actions have been commenced.

7.9. Any Change in Control shall occur.

7.10. The occurrence of any "default", as defined in any Loan Document (other than this Agreement or the Notes) or the breach of any of the terms or provisions of any Loan Document (other than this Agreement or the Notes), which default or breach continues beyond any period of grace therein provided.

7.11. Any License of any Insurance Subsidiary of Parent (a) shall be revoked by the Governmental Authority which issued such License, or any action (administrative or judicial) to revoke such License shall have been commenced against such Insurance Subsidiary and shall not have been dismissed within thirty (30) days after the commencement thereof, (b) shall be suspended by such Governmental Authority for a period in excess of thirty (30) days or (c) shall not be reissued or renewed by such Governmental Authority upon the expiration thereof following application for such reissuance or renewal of such Insurance Subsidiary, which in any case, could reasonably be expected to have a Material Adverse Effect.

7.12. Any Insurance Subsidiary of Parent shall be the subject of a final non-appealable order imposing a fine by or at the request of any state insurance regulatory agency as a result of the violation by such Insurance Subsidiary of such state's applicable insurance laws or the regulations promulgated in connection therewith which could reasonably be expected to have a Material Adverse Effect.

7.13. Any Insurance Subsidiary of Parent shall become subject to any conservation, rehabilitation or liquidation order, directive or mandate issued by any Governmental Authority or any Insurance Subsidiary shall become subject to any other directive or mandate issued by any Governmental Authority in either case which could reasonably be expected to have a Material Adverse Effect and which is not stayed within thirty (30) days.

7.14. The Guaranty shall fail to remain in full force or effect or any action shall be

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taken to discontinue or to assert the invalidity or unenforceability of the Guaranty, or Parent shall fail to comply with any of the terms or provisions of the Guaranty, or shall deny, or give notice to such effect, that it has any further liability under the Guaranty.

ARTICLE VIII

ACCELERATION, WAIVERS, AMENDMENTS AND REMEDIES

8.1. Acceleration. If any Default described in Section 7.6 or 7.7

occurs with respect to the Borrower, the obligations of the Lenders to make Loans hereunder shall automatically terminate and the Obligations shall immediately become due and payable without any election or action on the part of the Agent or any Lender. If any other Default occurs, the Required Lenders (or the Agent with the consent of the Required Lenders) may terminate or suspend the obligations of the Lenders to make Loans hereunder, or declare the Obligations to be due and payable, or both, whereupon the Obligations shall become immediately due and payable, without presentment, demand, protest or notice of any kind, all of which the Borrower hereby expressly waives.

If, within ten Business Days after acceleration of the maturity of the Obligations or termination of the obligations of the Lenders to make Loans hereunder as a result of any Default (other than any Default as described in Section 7.6 or 7.7 with respect to the Borrower) and before any judgment or decree for the payment of the Obligations due shall have been obtained or entered, the Required Lenders (in their sole discretion) shall so direct, the Agent shall, by notice to the Borrower, rescind and annul such acceleration and/or termination.

8.2. Amendments. Subject to the provisions of this Article VIII, the Required Lenders (or the Agent with the consent in writing of the Required Lenders) and the Loan Parties may enter into agreements supplemental hereto for the purpose of adding or modifying any provisions to the Loan Documents or changing in any manner the rights of the Lenders or either Loan Party hereunder or waiving any Default hereunder; provided, however, that no such supplemental agreement shall, without the consent of each Lender:

- (a) Extend the final maturity of any Loan or Note or reduce the principal amount thereof, or, subject to Section 2.11, reduce the rate or extend the time of payment of interest or fees thereon;
- (b) Reduce the percentage specified in the definition of Required Lenders;
- (c) Reduce the amount of or extend the date for the mandatory payments and commitment reductions required under Section 2.1(b) or 2.7, or increase the amount of

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the Commitment of any Lender hereunder;

- (d) Extend the Facility Termination Date or reduce the amount or extend the time of any mandatory commitment reduction required by Section 2.7;
- (e) Amend this Section 8.2;
- (f) Release Parent from the Guaranty; or
- (g) Permit any assignment by either Loan Party of its Obligations or its rights hereunder.

No amendment of any provision of this Agreement relating to the Agent shall be effective without the written consent of the Agent. The Agent may waive payment of the fee required under Section 12.3.2 without obtaining the consent of any other party to this Agreement.

8.3. Preservation of Rights. No delay or omission of the Lenders or the Agent to exercise any right under the Loan Documents shall impair such right or be construed to be a waiver of any Default or an acquiescence therein, and the making of a Loan notwithstanding the existence of a Default or the inability of either Loan Party to satisfy the conditions precedent to such Loan shall not constitute any waiver or acquiescence. Any single or partial exercise of any such right shall not preclude other or further exercise thereof or the exercise of any other right, and no waiver, amendment or other variation of the terms, conditions or provisions of the Loan Documents whatsoever shall be valid unless in writing signed by the Lenders required pursuant to Section 8.2, and then only to the extent in such writing specifically set forth. All remedies contained in the Loan Documents or by law afforded shall be cumulative and all shall be available to the Agent and the Lenders until the Obligations have been paid in full.

ARTICLE IX

GENERAL PROVISIONS

9.1. Survival of Representations. All representations and warranties of each Loan Party contained in this Agreement or either Loan Party or any of its Subsidiaries contained in any Loan Document shall survive delivery of the Notes and the making of the Loans herein contemplated.

9.2. Governmental Regulation. Anything contained in this Agreement to the contrary notwithstanding, no Lender shall be obligated to extend credit to the Borrower in violation of any limitation or prohibition provided by any applicable statute or regulation.

9.3. Taxes. Any stamp, documentary or similar taxes, assessments or charges payable or ruled payable by any governmental authority in respect of the Loan Documents shall be paid by the Borrower, together with interest and penalties, if any.

9.4. Headings. Section headings in the Loan Documents are for convenience of reference only, and shall not govern the interpretation of any of the provisions of the Loan Documents.

9.5. Entire Agreement. The Loan Documents embody the entire agreement and understanding among the Loan Parties, the Agent and the Lenders and supersede all prior agreements and understandings among the Borrower, the Agent and the Lenders relating to the subject matter thereof other than the fee letter, dated July 30, 1997, in favor of First Chicago.

9.6. Several Obligations; Benefits of this Agreement. The respective obligations of the Lenders hereunder are several and not joint and no Lender shall be the partner or agent of any other (except to the extent to which the Agent is authorized to act as such). The failure of any Lender to perform any of its obligations hereunder shall not relieve any other Lender from any of its obligations hereunder. This Agreement shall not be construed so as to confer any right or benefit upon any Person other than the parties to this Agreement and their respective successors and assigns.

9.7. Expenses; Indemnification. Each Loan Party agrees to reimburse the Agent for any costs, internal charges and out-of-pocket expenses (including attorneys' fees and time charges of attorneys for the Agent, which attorneys may be employees of the Agent) paid or incurred by the Agent in connection with the preparation, negotiation, execution, delivery, review, amendment, modification, and administration of the Loan Documents. Each Loan Party also agrees to reimburse the Agent and the Lenders for any reasonable costs, internal charges and out-of-pocket expenses (including attorneys' fees and time charges of attorneys for the Agent and the Lenders, which attorneys may be employees of the Agent or the Lenders) paid or incurred by the Agent or any Lender in connection with the collection and enforcement of the Loan Documents. Each Loan Party further agrees to indemnify the Agent and each Lender, its directors, officers and employees against all losses, claims, damages, penalties, judgments, liabilities and expenses (including, without limitation, all expenses of litigation or preparation therefor whether or not the Agent or any Lender is a party thereto) which any of them may pay or incur arising out of or relating to this Agreement, the other Loan Documents, the transactions contemplated hereby or thereby or the direct or indirect application or proposed application of the proceeds of any Loan hereunder arising from claims or assertions by third parties except to the extent that they arise out of the gross negligence or willful misconduct of the party seeking indemnification. The obligations of each Loan Party under this Section shall survive the termination of this Agreement.

9.8. Numbers of Documents. All statements, notices, closing documents, and requests hereunder shall be furnished to the Agent with sufficient counterparts so that the Agent may furnish one to each of the Lenders.

9.9. Accounting. Except as provided to the contrary herein, all accounting terms used herein shall be interpreted and all accounting determinations hereunder shall be made in accordance with Agreement Accounting Principles.

9.10. Severability of Provisions. Any provision in any Loan Document that is held to be inoperative, unenforceable, or invalid in any jurisdiction shall, as to that jurisdiction, be inoperative, unenforceable, or invalid without affecting the remaining provisions in that jurisdiction or the operation, enforceability, or validity of that provision in any other jurisdiction, and to this end the provisions of all Loan Documents are declared to be severable.

9.11. Nonliability of Lenders. The relationship between the Borrower and the Lenders and the Agent shall be solely that of borrower and lender. Neither the Agent nor any Lender shall have any fiduciary responsibilities to either Loan Party. Neither the Agent nor any Lender undertakes any responsibility to either Loan Party to review or inform either Loan Party of any matter in connection with any phase of either Loan Party's business or operations. Each Loan Party shall rely entirely upon its own judgment with respect to its business, and any review, inspection or supervision of, or information supplied to either Loan Party by the Agent or the Lenders is for the protection of the Agent and the Lenders and no Loan Party nor any other Person is entitled to rely thereon. Whether or not such damages are related to a claim that is subject to the waiver effected above and whether or not such waiver is effective, neither the Agent nor any Lender shall have any liability with respect to, and each Loan Party hereby waives, releases and agrees not to sue for, any special, indirect or consequential damages suffered by either Loan Party in connection with, arising out of, or in any way related to the Loan Documents or the transactions contemplated thereby or the relationship

established by the Loan Documents, or any act, omission or event occurring in connection therewith.

9.12. CHOICE OF LAW. THE LOAN DOCUMENTS (OTHER THAN THOSE CONTAINING A CONTRARY EXPRESS CHOICE OF LAW PROVISION) SHALL BE CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS, WITHOUT REGARD TO CONFLICT OF LAWS PROVISIONS, OF THE STATE OF ILLINOIS, BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS.

9.13. CONSENT TO JURISDICTION. EACH LOAN PARTY HEREBY IRREVOCABLY SUBMITS TO THE NON-EXCLUSIVE JURISDICTION OF ANY UNITED STATES FEDERAL OR ILLINOIS STATE COURT SITTING IN CHICAGO IN ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATING TO ANY LOAN DOCUMENTS AND EACH LOAN PARTY HEREBY IRREVOCABLY AGREES THAT ALL CLAIMS IN RESPECT OF SUCH ACTION OR PROCEEDING MAY BE HEARD AND

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DETERMINED IN ANY SUCH COURT AND IRREVOCABLY WAIVES ANY OBJECTION IT MAY NOW OR HEREAFTER HAVE AS TO THE VENUE OF ANY SUCH SUIT, ACTION OR PROCEEDING BROUGHT IN SUCH A COURT OR THAT SUCH COURT IS AN INCONVENIENT FORUM. NOTHING HEREIN SHALL LIMIT THE RIGHT OF THE AGENT OR ANY LENDER TO BRING PROCEEDINGS AGAINST EITHER LOAN PARTY IN THE COURTS OF ANY OTHER JURISDICTION. ANY JUDICIAL PROCEEDING BY EITHER LOAN PARTY AGAINST THE AGENT OR ANY LENDER OR ANY AFFILIATE OF THE AGENT OR ANY LENDER INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH ANY LOAN DOCUMENT SHALL BE BROUGHT ONLY IN A COURT IN CHICAGO, ILLINOIS; PROVIDED, THAT SUCH PROCEEDINGS MAY BE BROUGHT IN OTHER COURTS IF JURISDICTION MAY NOT BE OBTAINED IN A COURT IN CHICAGO, ILLINOIS.

9.14. WAIVER OF JURY TRIAL. EACH LOAN PARTY, THE AGENT AND EACH LENDER HEREBY WAIVE TRIAL BY JURY IN ANY JUDICIAL PROCEEDING INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER (WHETHER SOUNDING IN TORT, CONTRACT OR OTHERWISE) IN ANY WAY ARISING OUT OF, RELATED TO, OR CONNECTED WITH ANY LOAN DOCUMENT OR THE RELATIONSHIP ESTABLISHED THEREUNDER.

9.15. Disclosure. Each Loan Party and each Lender hereby (a) acknowledge and agree that First Chicago and/or its Affiliates from time to time may hold other investments in, make other loans to or have other relationships with either Loan Party, including, without limitation, in connection with any interest rate hedging instruments or agreements or swap transactions, and (b) waive any liability of First Chicago or such Affiliate to either Loan Party or any Lender, respectively, arising out of or resulting from such investments, loans or relationships other than liabilities arising out of the gross negligence or willful misconduct of First Chicago or its Affiliates to the extent that such liability would not have arisen but for First Chicago's status as Agent hereunder.

9.16. Counterparts. This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one agreement, and any of the parties hereto may execute this Agreement by signing any such counterpart. This Agreement shall be effective when it has been executed by each Loan Party, the Agent and the Lenders and each party has notified the Agent that it has taken such action.

9.17. Treatment of Certain Information: Confidentiality.

(a) Each Loan Party acknowledges that (i) services may be offered or provided to it (in connection with this Agreement or otherwise) by each Lender or by one or more subsidiaries or affiliates of such Lender and (ii) information delivered to each Lender by

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such Loan Party and its Subsidiaries may be provided to each such Subsidiary and Affiliate, it being understood that any such Subsidiary or Affiliate receiving such information shall be bound by the provisions of clause (b) below as if it were a Lender hereunder.

(b) Each Lender and the Agent agrees (on behalf of itself and each of its affiliates, directors, officers, employees and representatives) to use reasonable precautions to keep confidential, in accordance with their customary procedures for handling confidential information of this nature and in accordance with safe and sound banking practices, any non-public information supplied to it by either Loan Party pursuant to this Agreement, provided that nothing herein shall limit the disclosure of any such information (i) to the extent required by statute, rule, regulation or judicial process, (ii) to counsel for any of the Lenders or the Agent, (iii) to bank examiners, auditors or accountants, (iv) to the Agent or any other Lender (or to First Chicago Capital Markets, Inc.), (v) in connection with any litigation to which any one or more of the Lenders or the Agent is a party, (vi) to a subsidiary or affiliate of such Lender as provided in clause (a) above, (vii) to any assignee or participant (or prospective assignee or participant) so long as such assignee or participant (or prospective assignee or participant) agrees with the respective Lender to keep such information confidential on substantially the terms set forth in this Section 9.17(b), (viii) to any other Person as may be reasonably required in the course of the enforcement of any Lender's rights or remedies hereunder or under any of such Lender's Note, or (ix) to any other creditor of either Loan Party or any of

its Subsidiaries at any time during the continuance of a Default; provided that in no event shall any Lender or the Agent be obligated or required to return any materials furnished by either Loan Party.

ARTICLE X

THE AGENT

10.1. Appointment. First Chicago is hereby appointed Agent hereunder and under each other Loan Document, and each of the Lenders authorizes the Agent to act as the agent of such Lender. The Agent agrees to act as such upon the express conditions contained in this Article X. The Agent shall not have a fiduciary relationship in respect of either Loan Party or any Lender by reason of this Agreement.

10.2. Powers. The Agent shall have and may exercise such powers under the Loan Documents as are specifically delegated to the Agent by the terms of each thereof, together with such powers as are reasonably incidental thereto. The Agent shall have no implied duties to the Lenders, or any obligation to the Lenders to take any action thereunder, except any action specifically provided by the Loan Documents to be taken by the Agent.

10.3. General Immunity. Neither the Agent nor any of its directors, officers, agents or employees shall be liable to either Loan Party or any Lender for any action taken or omitted to be

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taken by it or them hereunder or under any other Loan Document or in connection herewith or therewith except for its or their own gross negligence or willful misconduct.

10.4. No Responsibility for Loans, Recitals, etc. Neither the Agent nor any of its directors, officers, agents or employees shall be responsible for or have any duty to ascertain, inquire into, or verify (a) any statement, warranty or representation made in connection with any Loan Document or any borrowing hereunder, (b) the performance or observance of any of the covenants or agreements of any obligor under any Loan Document, including, without limitation, any agreement by an obligor to furnish information directly to each Lender; (c) the satisfaction of any condition specified in Article IV, except receipt of items required to be delivered to the Agent and not waived at closing, or (d) the validity, effectiveness, sufficiency, enforceability or genuineness of any Loan Document or any other instrument or writing furnished in connection therewith. The Agent shall have no duty to disclose to the Lenders information that is not required to be furnished by either Loan Party to the Agent at such time, but is voluntarily furnished by either Loan Party to the Agent (either in its capacity as Agent or in its individual capacity).

10.5. Action on Instructions of Lenders. The Agent shall in all cases be fully protected in acting, or in refraining from acting, hereunder and under any other Loan Document in accordance with written instructions signed by the Required Lenders (or, to the extent required by Section 8.2, all Lenders), and such instructions and any action taken or failure to act pursuant thereto shall be binding on all of the Lenders and on all holders of Notes. The Agent shall be fully justified in failing or refusing to take any action hereunder and under any other Loan Document unless it shall first be indemnified to its satisfaction by the Lenders pro rata against any and all liability, cost and expense that it may incur by reason of taking or continuing to take any such action.

10.6. Employment of Agents and Counsel. The Agent may execute any of its duties as Agent hereunder and under any other Loan Document by or through employees, agents and attorneys-in-fact and shall not be answerable to the Lenders, except as to money or securities received by it or its authorized agents, for the default or misconduct of any such agents or attorneys-in-fact selected by it with reasonable care. The Agent shall be entitled to advice of counsel concerning all matters pertaining to the agency hereby created and its duties hereunder and under any other Loan Document.

10.7. Reliance on Documents; Counsel. The Agent shall be entitled to rely upon any Note, notice, consent, certificate, affidavit, letter, telegram, statement, paper or document believed by it to be genuine and correct and to have been signed or sent by the proper person or persons, and, in respect to legal matters, upon the opinion of counsel selected by the Agent, which counsel may be employees of the Agent.

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10.8. Agent's Reimbursement and Indemnification. The Lenders agree to reimburse and indemnify the Agent ratably in proportion to their respective Commitments (or, if the Commitments have been terminated, in proportion to their Commitments immediately prior to such termination) (a) for any amounts not reimbursed by either Loan Party for which the Agent is entitled to reimbursement by such Loan Party under the Loan Documents, (b) for any other expenses incurred by the Agent on behalf of the Lenders, in connection with the preparation, execution, delivery, administration and enforcement of the Loan Documents, and (c) for any liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind and nature

whatsoever which may be imposed on, incurred by or asserted against the Agent in any way relating to or arising out of the Loan Documents or any other document delivered in connection therewith or the transactions contemplated thereby, or the enforcement of any of the terms thereof or of any such other documents; provided, that no Lender shall be liable for any of the foregoing to the extent they arise from the gross negligence or willful misconduct of the Agent. The obligations of the Lenders under this Section 10.8 shall survive payment of the Obligations and termination of this Agreement.

10.9. Notice of Default. The Agent shall not be deemed to have knowledge or notice of the occurrence of any Default or Unmatured Default hereunder unless the Agent has received written notice from a Lender or the Borrower referring to this Agreement describing such Default or Unmatured Default and stating that such notice is a "notice of default". In the event that the Agent receives such a notice, the Agent shall give prompt notice thereof to the Lenders.

10.10. Rights as a Lender. In the event the Agent is a Lender, the Agent shall have the same rights and powers hereunder and under any other Loan Document as any Lender, including, without limitation, pursuant to Article XII hereof, and may exercise the same as though it were not the Agent, and the term "Lender" or "Lenders" shall, at any time when the Agent is a Lender, unless the context otherwise indicates, include the Agent in its individual capacity. The Agent may accept deposits from, lend money to, and generally engage in any kind of trust, debt, equity or other transaction, in addition to those contemplated by this Agreement or any other Loan Document, with either Loan Party or any of its Subsidiaries in which such Loan Party or such Subsidiary is not restricted hereby from engaging with any other Person.

10.11. Lender Credit Decision. Each Lender acknowledges that it has, independently and without reliance upon the Agent or any other Lender and based on the financial statements prepared by the Loan Parties and such other documents and information as it has deemed appropriate, made its own credit analysis and decision to enter into this Agreement and the other Loan Documents. Each Lender also acknowledges that it will, independently and without reliance upon the Agent or any other Lender and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement and the other Loan Documents.

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10.12. Successor Agent. The Agent may resign at any time by giving written notice thereof to the Lenders and the Borrower, such resignation to be effective upon the appointment of a successor Agent or, if no successor Agent has been appointed, forty-five days after the retiring Agent gives notice of its intention to resign. Upon any such resignation, the Required Lenders shall have the right to appoint, on behalf of the Lenders, a successor Agent, which successor Agent, so long as no Default is continuing, shall be reasonably acceptable to the Borrower. If no successor Agent shall have been so appointed by the Required Lenders and shall have accepted such appointment within thirty days after the resigning Agent's giving notice of its intention to resign, then the resigning Agent may appoint, on behalf of the Borrower and the Lenders, a successor Agent, which successor Agent, so long as no Default is continuing, shall be reasonably acceptable to the Borrower. If the Agent has resigned and no successor Agent has been appointed, the Lenders may perform all the duties of the Agent hereunder and the Borrower shall make all payments in respect of the Obligations to the applicable Lender and for all other purposes shall deal directly with the Lenders. No successor Agent shall be deemed to be appointed hereunder until such successor Agent has accepted the appointment. Any such successor Agent shall be a commercial bank having capital and retained earnings of at least \$50,000,000 and with a Lending Installation in the United States of America. Upon the acceptance of any appointment as Agent hereunder by a successor Agent, such successor Agent shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the resigning Agent. Upon the effectiveness of the resignation of the Agent, the resigning Agent shall be discharged from its duties and obligations hereunder and under the Loan Documents. After the effectiveness of the resignation of an Agent, the provisions of this Article X 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 the Agent hereunder and under the other Loan Documents.

ARTICLE XI

SETOFF; RATABLE PAYMENTS

11.1. Setoff. In addition to, and without limitation of, any rights of the Lenders under applicable law, if the Borrower becomes insolvent, however evidenced, or any Default or Unmatured Default occurs, any and all deposits (including all account balances, whether provisional or final and whether or not collected or available) and any other Indebtedness at any time held or owing by any Lender to or for the credit or account of the Borrower may be offset and applied toward the payment of the Obligations owing to such Lender, whether or not the Obligations, or any part hereof, shall then be due.

11.2. Ratable Payments. If any Lender, whether by setoff or otherwise, has payment made to it upon its Loans (other than payments received pursuant to

demand, to purchase a portion of the Loans held by the other Lenders so that after such purchase each Lender will hold its ratable proportion of Loans. If any Lender, whether in connection with setoff or amounts which might be subject to setoff or otherwise, receives collateral or other protection for its Obligations or such amounts which may be subject to setoff, such Lender agrees, promptly upon demand, to take such action necessary such that all Lenders share in the benefits of such collateral ratably in proportion to their Loans. In case any such payment is disturbed by legal process, or otherwise, appropriate further adjustments shall be made. If an amount to be setoff is to be applied to Indebtedness of the Borrower to a Lender, other than Indebtedness evidenced by any of the Notes held by such Lender, such amount shall be applied ratably to such other Indebtedness and to the Indebtedness evidenced by such Notes.

ARTICLE XII

BENEFIT OF AGREEMENT; ASSIGNMENTS; PARTICIPATIONS

12.1. Successors and Assigns. The terms and provisions of the Loan Documents shall be binding upon and inure to the benefit of each Loan Party and the Lenders and their respective successors and assigns, except that (a) no Loan Party shall have the right to assign its rights or obligations under the Loan Documents, and (b) any assignment by any Lender must be made in compliance with Section 12.3. Notwithstanding clause (b) of the preceding sentence, any Lender may at any time, without the consent of either Loan Party or the Agent, assign all or any portion of its rights under this Agreement and its Notes to a Federal Reserve Bank; provided, however, that no such assignment to a Federal Reserve Bank shall release the transferor Lender from its obligations hereunder. The Agent may treat the payee of any Note as the owner thereof for all purposes hereof unless and until such payee complies with Section 12.3 in the case of an assignment thereof or, in the case of any other transfer, a written notice of the transfer is filed with the Agent. Any assignee or transferee of a Note agrees by acceptance thereof to be bound by all the terms and provisions of the Loan Documents. Any request, authority or consent of any Person, who at the time of making such request or giving such authority or consent is the holder of any Note, shall be conclusive and binding on any subsequent holder, transferee or assignee of such Note or of any Note or Notes issued in exchange therefor.

12.2. Participations.

12.2.1. Permitted Participants; Effect. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time sell to one or more banks or other entities ("Participants") participating interests in any Loan owing to such Lender, any Note held by such Lender, any Commitment of such Lender or any other interest of such Lender under the Loan Documents. In the event of any such sale by a Lender of participating interests to a Participant, such Lender's obligations under the Loan Documents shall remain unchanged, such Lender shall remain solely responsible to the other parties hereto for the performance of such obligations, such Lender shall remain the holder of any such Note for all purposes under the Loan Documents, all amounts payable by the Borrower under this Agreement shall be determined as if such Lender had not sold such participating interests, and each Loan Party and the Agent shall continue to deal solely and directly with such Lender in connection with such Lender's rights and obligations under the Loan Documents.

12.2.2. Voting Rights. Each Lender shall retain the sole right to approve, without the consent of any Participant, any amendment, modification or waiver of any provision of the Loan Documents other than any amendment, modification or waiver which effects any of the modifications referenced in clauses (a) through (f) of Section 8.2.

12.2.3. Benefit of Setoff. The Borrower agrees that each Participant shall be deemed to have the right of setoff provided in Section 11.1 in respect of its participating interest in amounts owing under the Loan Documents to the same extent as if the amount of its participating interest were owing directly to it as a Lender under the Loan Documents; provided, that each Lender shall retain the right of setoff provided in Section 11.1 with respect to the amount of participating interests sold to each Participant. The Lenders agree to share with each Participant, and each Participant, by exercising the right of setoff provided in Section 11.1, agrees to share with each Lender, any amount received pursuant to the exercise of its right of setoff, such amounts to be shared in accordance with Section 11.2 as if each Participant were a Lender.

12.3. Assignments.

12.3.1. Permitted Assignments. Any Lender may, in the ordinary course of its business and in accordance with applicable law, at any time assign to one or more banks or other entities ("Purchasers") all or any part of its rights and obligations under the Loan Documents; provided, however, that in the case of an assignment to an entity which is not a Lender or an Affiliate of a Lender, such assignment shall be in a minimum amount (when added to the amount of the assignment of such Lender's obligations under the White Mountains Credit Agreement) of \$5,000,000 (or, if less, the entire amount of such Lender's Commitment). Such assignment shall be substantially in the form of Exhibit C hereto or in such other form as may be agreed to by the parties thereto. The consent of the Agent and, so long as no Default under Section 7.2, 7.6 or 7.7 is continuing, the Borrower, shall be required prior to an assignment becoming effective with respect to a Purchaser which is not a Lender or an Affiliate thereof. Such consent shall not be unreasonably withheld. Notwithstanding anything to the contrary contained herein, any assignment by a Lender of its rights and obligations under the Loan Documents shall be accompanied by an assignment to the same assignee of the same ratable share of the rights and obligations of such Lender under the White Mountains Credit Agreement in respect of its obligations thereunder.

12.3.2. Effect; Effective Date. Upon (a) delivery to the Agent of a notice of assignment, substantially in the form attached as Exhibit I to Exhibit C hereto (a "Notice of Assignment"), together with any consents required by Section 12.3.1, and (b) payment of a \$3,000 fee to the Agent for processing such assignment, such assignment shall become effective on the effective date specified in such Notice of Assignment. On and after the effective date of such assignment, (a) such Purchaser shall for all purposes be a Lender party to this Agreement and any other Loan Document executed by the Lenders and shall have all the rights and obligations of a Lender under the Loan Documents, to the same extent as if it were an original party hereto, and (b) the transferor Lender shall be released with respect to the percentage of the Aggregate Commitment and Loans assigned to such Purchaser without any further consent or action by the Borrower, the Lenders or the Agent. Upon the consummation of any assignment to a Purchaser pursuant to this Section 12.3.2, the transferor Lender, the Agent and the Borrower shall make appropriate arrangements so that replacement Notes are issued to such transferor Lender and new Notes or, as appropriate, replacement Notes, are issued to such Purchaser, in each case in principal amounts reflecting their Commitment, as adjusted pursuant to such assignment.

12.4. Dissemination of Information. Subject to Section 9.18(b), each Loan Party authorizes each Lender to disclose to any Participant or Purchaser or any other Person acquiring an interest in the Loan Documents by operation of law (each a "Transferee") and any prospective Transferee any and all information in such Lender's possession concerning the creditworthiness of such Loan Party and its Subsidiaries.

12.5. Tax Treatment. If any interest in any Loan Document is transferred to any

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Transferee which is organized under the laws of any jurisdiction other than the United States or any State thereof, the transferor Lender shall cause such Transferee, concurrently with the effectiveness of such transfer, to comply with the provisions of Section 2.18.

ARTICLE XIII

NOTICES

13.1. Giving Notice. All notices and other communications provided to any party hereto under this Agreement or any other Loan Document shall be in writing, by facsimile, first class U.S. mail or overnight courier and addressed or delivered to such party at its address set forth below its signature hereto or at such other address as may be designated by such party in a notice to the other parties. Any notice, if mailed and properly addressed with first class postage prepaid, return receipt requested, shall be deemed given three (3) Business Days after deposit in the U.S. mail; any notice, if transmitted by facsimile, shall be deemed given when transmitted; and any notice given by overnight courier shall be deemed given when received by the addressee.

13.2. Change of Address. Either Loan Party, the Agent and any Lender may each change the address for service of notice upon it by a notice in writing to the other parties hereto.

ARTICLE XIV

GUARANTY

14.1. Parent hereby absolutely, irrevocably and unconditionally guarantees prompt, full and complete payment when due, whether at stated maturity, upon acceleration or otherwise, and at all times thereafter, of (a) the principal of and interest on the Advances made by the Lenders to, and the Notes held by the Lenders of, the Borrower and (b) all other amounts from time to time owing to the Lenders by the Borrower under this Agreement, the Notes and

the other Loan Documents, including without limitation all Obligations of the Borrower (solely for purposes of this Article XIV, collectively referred to as the "Guaranteed Debt"). This is a guaranty of payment, not a guaranty of collection.

14.2. Parent waives notice of the acceptance of this Article XIV (solely for purposes of this Article XIV, referred to as the "Guaranty") and of the extension or incurrence of the Guaranteed Debt or any part thereof. Parent further waives all setoffs and counterclaims and presentment, protest, notice, filing of claims with a court in the event of receivership, bankruptcy or reorganization of the Borrower, demand or action on delinquency in respect of the Guaranteed

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Debt or any part thereof, including any right to require the Agent or any Lender to sue the Borrower, or any other person obligated with respect to the Guaranteed Debt or any part thereof, or otherwise to enforce payment thereof against any collateral securing the Guaranteed Debt or any part thereof.

14.3. Parent hereby agrees that, to the fullest extent permitted by law, its obligations hereunder shall be continuing, absolute and unconditional under any and all circumstances and not subject to any reduction, limitation, impairment, termination, defense (other than infeasible payment in full), setoff, counterclaim or recoupment whatsoever (all of which are hereby expressly waived by it to the fullest extent permitted by law), whether by reason of any claim of any character whatsoever, including, without limitation, any claim of waiver, release, surrender, alteration or compromise. The validity and enforceability of this Guaranty shall not be impaired or affected by any of the following: (a) any extension, modification or renewal of, or indulgence with respect to, or substitution for, the Guaranteed Debt or any part thereof or any agreement relating thereto at any time; (b) any failure or omission to perfect or maintain any lien on, or preserve rights to, any security or collateral or to enforce any right, power or remedy with respect to the Guaranteed Debt or any part thereof or any agreement relating thereto, or any collateral securing the Guaranteed Debt or any part thereof; (c) any waiver of any right, power or remedy or of any default with respect to the Guaranteed Debt or any part thereof or any agreement relating thereto or with respect to any collateral securing the Guaranteed Debt or any part thereof; (d) any release, surrender, compromise, settlement, waiver, subordination or modification, with or without consideration, of any collateral securing the Guaranteed Debt or any part thereof, any other guaranties with respect to the Guaranteed Debt or any part thereof, or any other obligations of any person or entity with respect to the Guaranteed Debt or any part thereof; (e) the enforceability or validity of the Guaranteed Debt or any part thereof or the genuineness, enforceability or validity of any agreement relating thereto or with respect to any collateral securing the Guaranteed Debt or any part thereof; (f) the application of payments received from any source to the payment of indebtedness other than the Guaranteed Debt, any part thereof or amounts which are not covered by this Guaranty even though the Agent or any Lender might lawfully have elected to apply such payments to any part or all of the Guaranteed Debt or to amounts which are not covered by this Guaranty; (g) any change of ownership of the Borrower or the insolvency, bankruptcy or any other change in the legal status of the Borrower; (h) any change in, or the imposition of, any law, decree, regulation or other governmental act which does or might impair, delay or in any way affect the validity, enforceability or the payment when due of the Guaranteed Debt; (i) the failure of the Borrower to maintain in full force, validity or effect or to obtain or renew when required all governmental and other approvals, licenses or consents required in connection with the Guaranteed Debt or this Guaranty, or to take any other action required in connection with the performance of all obligations pursuant to the Guaranteed Debt or this Guaranty; (j) the existence of any claim, setoff or other rights which Parent may have at any time against the Borrower in connection herewith or with any unrelated transaction; (k) the Agent's or any Lender's election, in any case or proceeding instituted under chapter 11 of the

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Bankruptcy Code, of the application of section 1111(b)(2) of the Bankruptcy Code; (l) any borrowing, use of cash collateral, or grant of a security interest by the Borrower, as debtor in possession, under section 363 or 364 of the United States Bankruptcy Code; (m) the disallowance of all or any portion of the Lender's claims for repayment of the Guaranteed Debt under section 502 or 506 of the United States Bankruptcy Code; or (n) any other fact or circumstance which might otherwise constitute grounds at law or equity for the discharge or release of Parent from its obligations hereunder, all whether or not Parent shall have had notice or knowledge of any act or omission referred to in the foregoing clauses (a) through (n) of this paragraph. It is agreed that Parent's liability hereunder is independent of any other guaranties or other obligations at any time in effect with respect to the Guaranteed Debt or any part thereof and that Parent's liability hereunder may be enforced regardless of the existence, validity, enforcement or non-enforcement of any such other guaranties or other obligations or any provision of any applicable law or regulation purporting to prohibit payment by the Borrower of the Guaranteed Debt in the manner agreed upon between the Agent, the Lenders and the Borrower.

14.4. Credit may be granted or continued from time to time by the Agent

and/or any Lender to the Borrower without notice to or authorization from Parent regardless of the Borrower's financial or other condition at the time of any such grant or continuation. Neither the Agent nor any Lender shall have any obligation to disclose or discuss with Parent its assessment of the financial condition of the Borrower.

14.5. Until the irrevocable payment in full of the Obligations and termination of all commitments which could give rise to any Obligation, Parent shall have no right of subrogation with respect to the Guaranteed Debt and hereby waives any right to enforce any remedy which the Agent and/or the Lenders now has or may hereafter have against the Borrower, any endorser or any other guarantor of all or any part of the Guaranteed Debt, and Parent hereby waives any benefit of, and any right to participate in, any security or collateral given to the Agent and/or the Lenders to secure payment of the Guaranteed Debt or any part thereof or any other liability of the Borrower to the Agent and/or the Lenders.

14.6. Parent authorizes the Agent and the Lenders to take any action or exercise any remedy with respect to any collateral from time to time securing the Guaranteed Debt, which the Agent and the Lenders in their sole discretion (but subject, as applicable, to the terms of this Agreement and of any documentation pursuant to which a Lien in such collateral is granted) shall determine, without notice to Parent. Notwithstanding any reference herein to any collateral securing any of the Guaranteed Debt, it is acknowledged that, on the date hereof, neither Parent nor any of its Subsidiaries has granted, or has any obligation to grant, any security interest in or other lien on any of its property as security for the Guaranteed Debt.

14.7. In the event the Agent and the Lenders in their sole discretion elect to give notice

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of any action with respect to any collateral securing the Guaranteed Debt or any part thereof, ten (10) days' written notice mailed to Parent by ordinary mail at the address shown hereon shall be deemed reasonable notice of any matters contained in such notice. Parent consents and agrees that neither the Agent nor any Lender shall be under any obligation to marshal any assets in favor of Parent or against or in payment of any or all of the Guaranteed Debt.

14.8. In the event that acceleration of the time for payment of any of the Guaranteed Debt is stayed upon the insolvency, bankruptcy or reorganization of the Borrower, or otherwise, all such amounts shall nonetheless be payable by Parent forthwith upon demand by the Agent. Parent further agrees that, to the extent that the Borrower makes a payment or payments to the Agent or any Lender on the Guaranteed Debt, or the Agent or any Lender receives any proceeds of collateral securing the Guaranteed Debt, which payment or receipt of proceeds or any part thereof is subsequently invalidated, declared to be fraudulent or preferential, set aside or required to be returned or repaid to the Borrower, its estate, trustee, receiver, debtor in possession or any other party, including, without limitation, Parent, under any insolvency or bankruptcy law, state or federal law, common law or equitable cause, then to the extent of such payment, return or repayment, the obligation or part thereof which has been paid, reduced or satisfied by such amount shall be reinstated and continued in full force and effect as of the date when such initial payment, reduction or satisfaction occurred.

14.9. No delay on the part of the Agent or any Lender in the exercise of any right, power or remedy shall operate as a waiver thereof, and no single or partial exercise by the Agent or any Lender of any right, power or remedy shall preclude any further exercise thereof; nor shall any amendment, supplement, modification or waiver of any of the terms or provisions of this Guaranty be binding upon the Agent or any Lender, except as expressly set forth in a writing duly signed and delivered by the Agent and the Lenders. The failure by the Agent or any Lender at any time or times hereafter to require strict performance by the Borrower or Parent of any of the provisions, warranties, terms and conditions contained in any promissory note, security agreement, agreement, guaranty, instrument or document now or at any time or times hereafter executed pursuant to the terms of, or in connection with, this Agreement by the Borrower or Parent and delivered to the Agent or any Lender shall not waive, affect or diminish any right of the Agent or any Lender at any time or times hereafter to demand strict performance thereof, and such right shall not be deemed to have been waived by any act or knowledge of the Agent or any Lender, its agents, officers or employees, unless such waiver is contained in an instrument in writing duly signed and delivered by the Agent or such Lender. No waiver by the Agent or any Lender of any default shall operate as a waiver of any other default or the same default on a future occasion, and no action by the Agent or any Lender permitted hereunder shall in any way affect or impair the Agent's or such Lender's rights or powers, or the obligations of Parent under this Guaranty. Any determination by a court of competent jurisdiction of the amount of any Guaranteed Debt owing by the Borrower to the Agent and the Lender shall be conclusive and binding on Parent irrespective of whether Parent was a party to the suit or action in which such

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determination was made.

14.10. Subject to the provisions of Section 14.8, this guaranty shall continue in effect until this Agreement has terminated, the Guaranteed Debt has been paid in full and the other conditions of this guaranty have been satisfied.

ARTICLE XV

AMENDMENT AND RESTATEMENT

15.1. (a) This Agreement amends and restates in its entirety the Credit Agreement, dated as of November 26, 1996, among Parent, the Borrower, the financial institutions from time to time party thereto and First Chicago, as agent (as amended, supplemented or otherwise modified through the date hereof, the "Prior Credit Agreement") and, upon the Restatement Effective Date, the terms and provisions of the Prior Credit Agreement shall, subject to this Article XV, be superseded hereby and thereby. Prior to the Restatement Effective Date, the Prior Credit Agreement shall continue to govern the making of any Loans and any outstanding Loans and Obligations.

(b) Notwithstanding the amendment and restatement of the Prior Credit Agreement by this Agreement, the Loans under, and as defined in, the Prior Credit Agreement ("Continuing Loans") and all accrued interest, fees and expenses owing to First Chicago and Fleet National Bank by the Borrower shall remain outstanding as of the Restatement Effective Date and constitute continuing Obligations under this Agreement. The Continuing Loans shall in all respects be continuing, and this Agreement shall not be deemed to evidence or result in a novation or repayment and re-borrowing of the Continuing Loans. In furtherance of and without limiting the foregoing (i) all interest, fees and expenses which have arisen under the Prior Credit Agreement shall be paid on the applicable due date therefor specified in this Agreement and (ii) from and after the Restatement Effective Date, the terms, conditions and covenants governing the Continuing Loans shall be solely as set forth in this Agreement, which shall supersede the Prior Credit Agreement to the extent provided in this Article XV.

[signature pages to follow]

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IN WITNESS WHEREOF, each Loan Party, the Lenders and the Agent have executed this Agreement as of the date first above written.

VALLEY GROUP, INC.

By:

Print Name:

Title:

Address: 80 South Main Street
Hanover, New Hampshire 03755

Attn:

Fax No.:
Tel. No.:

WHITE MOUNTAINS HOLDINGS, INC.

By:

Print Name:

Title:

Address: 80 South Main Street
Hanover, New Hampshire 03755

Attn:

Fax No.:
Tel. No.:

Commitments

Commitment \$ THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as Agent

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By:

Print Name:

Title:

Address: 153 West 51st Street
New York, NY 10019
Attn: Samuel W. Bridges
First Vice President

Fax No.: (212) 373-1393
Tel. No.: (212) 373-1142

\$ [OTHER LENDERS]

Aggregate Initial
Commitment \$

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Schedule 1
To Credit Agreement

Margins

"Applicable Eurodollar Margin" and "Applicable Facility Fee Margin" means, for any period, the applicable of the following percentages in effect with such period based on the Leverage Ratio and the Fixed Charges Coverage Ratio as follows:

	I	II	III	IV
Leverage Ratio is:	LESS THAN 15%	\$15%	LESS THAN 15%	\$15%
If Fixed Charges Coverage Ratio is:	GREATER THAN 2:1	GREATER THAN 2:1	#2:1	#2:1
The applicable margin will be:				
Applicable Facility Fee Margin	.150%	.175%	.175%	.200%
Applicable Eurodollar Margin	.350%	.450%	.450%	.550%

The Leverage Ratio and Fixed Charges Coverage Ratio shall be calculated by Parent as of the end of each of its Fiscal Quarters commencing September 30, 1997 and shall be reported to the Agent pursuant to a certificate executed by an authorized officer of Parent and delivered in accordance with Section 6.1(g) of the Agreement. The foregoing margins shall be adjusted, if necessary, quarterly as of the fifth day after the delivery of the certificate provided for above; provided that if such certificate, together with the financial statements to which such certificate relates, are not delivered by the fifth day after the due date therefor specified in Section 6.1(g), then until the fifth day after such delivery, each of the margins specified above shall be as set forth in Column IV above. Until adjusted as described above after September 30, 1997, the Applicable Eurodollar Margin and Applicable Facility Fee Margin, as the case may be, shall be as specified in Column II above.

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FIRST AMENDMENT TO CREDIT AGREEMENT

This First Amendment (this "Amendment") is entered into as November 20, 1997 by and among White Mountains Holdings, Inc., a New Hampshire corporation (the "Borrower"), The First National Bank of Chicago, individually and as agent (the "Agent"), and the other financial institutions signatory hereto (the "Lenders").

RECITALS

A. The Borrower, the Agent and the Lenders are party to that certain Amended and Restated Credit Agreement, dated as of July 30, 1997 (the "Credit Agreement"). Unless otherwise specified herein, capitalized terms used in this Amendment shall have the meanings ascribed to them by the Credit Agreement.

B. The Borrower, the Agent and the Lenders wish to amend the Credit Agreement on the terms and conditions set forth below.

Now, therefore, in consideration of the mutual execution hereof and other good and valuable consideration, the parties hereto agree as follows:

I. AMENDMENTS

1. Article I of the Credit Agreement is hereby amended by inserting the phrase ", ML (Bermuda) Holdings Ltd., TRG Associates, LLC" immediately after the phrase "Folksamerica Holding Company Inc." appearing in clause (ii) of the definition "Fixed Charges Covering Ratio" contained herein.

2. Section 6.11 of the Credit Agreement is amended by (i) deleting the word "and" appearing at the end of clause (e) contained therein and (ii) deleting clause (f) contained therein in its entirety and inserting in lieu thereof the following new clauses (f) and (g):

"(f) Contingent Obligations permitted under Section 6.14; and

(g) other Indebtedness of the Borrower or any Subsidiary to the extent not otherwise included in subparagraphs (a) through (f) of this Section 6.11, in an aggregate amount outstanding at any one time not to exceed \$5,000,000."

3. Section 6.14 of the Credit Agreement is amended by (i) deleting the word "and" appearing at the end of clause (c) contained therein in its entirety and inserting a comma in lieu thereof, (ii) deleting the period appearing at the end of clause (d) contained therein in its entirety

and inserting the word "and" in lieu thereof and (iii) inserting the following new clause (e):

"(e) issuance of financial guarantees to the holders of seller notes issued by ML (Bermuda) Holdings Ltd. or any of its Subsidiaries, provided that the aggregate principal amount of all such financial guarantees shall not at any time exceed 6,500,000 British Pounds."

II. MISCELLANEOUS

1. Representations and Warranties of the Borrower. The Borrower represents and warrants that:

(a) each of the representation and warranties set for in Article V of the Credit Agreement is true and correct in all material respects on the date hereof as if made on the date hereof; and

(b) immediately upon giving effect to this Amendment, no Default of Unmatured Default has occurred and is continuing.

2. Conditions to Occurrence of Effective Date. This Amendment shall become effective as of the date first written above upon the execution and delivery of this Amendment by the Borrower and the Required Lenders.

3. Reference to and Effect Upon the Credit Agreement.

(a) Except as specifically amended above, the Credit Agreement and the other Loan Documents shall remain in full force and effect and are hereby ratified and confirmed.

(b) The execution, delivery and effectiveness of this Amendment shall not operate as a waiver of any right, power or remedy of the Agent or any Lender under the Credit Agreement or any Loan Document, nor constitute a waiver of any provision of the Credit Agreement or any Loan Document. Upon

the effectiveness of the amendment to the Credit Agreement effected by this Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of similar import shall mean and be a reference to the Credit Agreement as amended hereby.

4. GOVERNING LAW. THIS AMENDMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS (AS OPPOSED TO CONFLICTS OF LAWS PROVISIONS) OF THE STATE OF ILLINOIS BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS.

5. Headings. Section headings in this Amendment are included herein for convenience of reference only and shall not constitute a part of this Amendment for any other purposed.

6. Counterparts. This Amendment may be executed in any number of counterparts, each of which when so executed shall be deemed an original but all such counterparts shall constitute one of the same instrument.

* * *

3

IN WITNESS WHEREOF, the parties have executed this Amendment as of the date and year first above written.

WHITE MOUNTAINS HOLDINGS, INC.

By _____

Title: _____

THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as Agent

By _____

Title: _____

FLEET NATIONAL BANK

By _____

Title _____

4

FIRST AMENDMENT TO CREDIT AGREEMENT

This First Amendment (this "Amendment") is entered into as November 20, 1997 by and among Valley Group, Inc., an Oregon corporation (the "Borrower"), White Mountains Holdings, Inc., a New Hampshire corporation ("Parent"), The First National Bank of Chicago, individually and as agent (the "Agent"), and the other financial institutions signatory hereto (the "Lenders").

RECITALS

A. The Borrower, Parent, the Agent and the Lenders are party to that certain Amended and Restated Credit Agreement, dated as of July 30, 1997 (the "Credit Agreement"). Unless otherwise specified herein, capitalized terms used in this Amendment shall have the meanings ascribed to them by the Credit Agreement.

B. The Borrower, Parent, the Agent and the Lenders wish to amend the Credit Agreement on the terms and conditions set forth below.

Now, therefore, in consideration of the mutual execution hereof and other good and valuable consideration, the parties hereto agree as follows:

I. AMENDMENTS

1. Article I of the Credit Agreement is hereby amended by inserting the phrase ", ML (Bermuda) Holdings Ltd., TRG Associates, LLC" immediately after the phrase "Folksamerica Holding Company Inc." appearing in clause (ii) of the definition "Fixed Charges Covering Ratio" contained herein.

2. Section 6.11 of the Credit Agreement is amended by (i) deleting the word "and" appearing at the end of clause (e) contained therein and (ii) deleting clause (f) contained therein in its entirety and inserting in lieu thereof the following new clauses (f) and (g):

"(f) Contingent Obligations permitted under Section 6.14; and

(g) other Indebtedness of either Loan Party or any of its Subsidiaries to the extent not otherwise included in subparagraphs (a) through (f) of this Section 6.11, in an aggregate amount outstanding at any one time not to exceed \$5,000,000."

3. Section 6.14 of the Credit Agreement is amended by (i) deleting the word "and" appearing at the end of clause (c) contained therein in its entirety and inserting a comma in lieu thereof, (ii) deleting the period appearing at the end of clause (d) contained therein in its entirety

and inserting the word "and" in lieu thereof and (iii) inserting the following new clause (e):

"(e) issuance by Parent of financial guarantees to the holders of seller notes issued by ML (Bermuda) Holdings Ltd. or any of its Subsidiaries, provided that the aggregate principal amount of all such financial guarantees shall not at any time exceed 6,500,000 British Pounds."

II. MISCELLANEOUS

1. Representations and Warranties of the Borrower and Parent. The Borrower and Parent each represent and warrant that:

(a) each of the representation and warranties set for in Article V of the Credit Agreement is true and correct in all material respects on the date hereof as if made on the date hereof; and

(b) immediately upon giving effect to this Amendment, no Default of Unmatured Default has occurred and is continuing.

2. Conditions to Occurrence of Effective Date. This Amendment shall become effective as of the date first written above upon the execution and delivery of this Amendment by the Borrower, Parent and the Required Lenders.

3. Reference to and Effect Upon the Credit Agreement.

(a) Except as specifically amended above, the Credit Agreement and the other Loan Documents shall remain in full force and effect and are hereby ratified and confirmed.

(b) The execution, delivery and effectiveness of this Amendment shall not operate as a waiver of any right, power or remedy of the Agent or any Lender under the Credit Agreement or any Loan Document, nor constitute a

waiver of any provision of the Credit Agreement or any Loan Document. Upon the effectiveness of the amendment to the Credit Agreement effected by this Amendment, each reference in the Credit Agreement to "this Agreement", "hereunder", "hereof", "herein" or words of similar import shall mean and be a reference to the Credit Agreement as amended hereby.

4. GOVERNING LAW. THIS AMENDMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE INTERNAL LAWS (AS OPPOSED TO CONFLICTS OF LAWS PROVISIONS) OF THE STATE OF ILLINOIS BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS.

5. Headings. Section headings in this Amendment are included herein for convenience of reference only and shall not constitute a part of this Amendment for any other purposed.

6. Counterparts. This Amendment may be executed in any number of counterparts, each of which when so executed shall be deemed an original but all such counterparts shall constitute one of the same instrument.

* * *

3

IN WITNESS WHEREOF, the parties have executed this Amendment as of the date and year first above written.

VALLEY GROUP, INC.

By _____
Title: _____

WHITE MOUNTAINS HOLDINGS, INC.

By _____
Title: _____

THE FIRST NATIONAL BANK OF CHICAGO,
Individually and as Agent

By _____
Title: _____

FLEET NATIONAL BANK

By _____
Title _____

4

SUBSCRIPTION AGREEMENT

This SUBSCRIPTION AGREEMENT (this "Agreement") is made and entered into in accordance with Section 503 of the New York Business Corporation Law as of the 6th day of November, 1997, by and among FOLKSAMERICA HOLDING COMPANY, INC., a New York corporation (the "Company"), FUND AMERICAN ENTERPRISES HOLDINGS, INC., a Delaware corporation, ("Fund American"), WHITE MOUNTAINS HOLDINGS, INC., a Delaware corporation ("White Mountains"; Fund American and White Mountains being collectively referred to herein as "Fund American"), FOLKSAM MUTUAL GENERAL INSURANCE COMPANY, an entity organized under the laws of Sweden ("Folksam Mutual"), FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (publ), an entity organized under the laws of Sweden ("Folksam International"; Folksam Mutual and Folksam International being collectively referred to herein as "Folksam"), WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG, a corporation organized under the laws of Austria ("Wiener"), P&V ASSURANCES S.C., a corporation organized under the laws of Belgium ("P&V"), and SAMVIRKE SKADEFORSIKRING AS, a corporation organized under the laws of the Kingdom of Norway ("SAMVIRKE"); (collectively Fund American, Folksam, Wiener, P&V and Samvirke are referred to herein as the "Shareholders").

WHEREAS, the Company has 20,760,000 authorized shares of common stock, par value \$.01 per share ("Common Stock"), of which 6,920,000 are issued and outstanding and 13,840,000 are currently reserved, and 20,760,000 shares of authorized Preferred Stock, par value \$.01 per share, of which 6,920,000 are issued and outstanding; and

WHEREAS, the Shareholders wish to amend the Company Charter to increase the number of authorized shares of Common Stock by 3,127,814; and

WHEREAS, the Shareholders wish to purchase 3,127,814 shares of newly issued Common Stock at a price of \$13.33 per share (the "New Shares"); and

WHEREAS, Folksam, P&V, Wiener and Samvirke collectively own of record and beneficially all of the issued and outstanding shares of the Company's Common Stock, and Fund American owns all of the issued and outstanding shares of the Company's Series B Preferred Stock, par value \$.01 per share ("Series B Preferred Stock"), which Common Stock and Series B Preferred Stock constitute all of the issued and outstanding voting capital stock of the Company; and

WHEREAS, Fund American also holds a Class A Warrant Certificate, pursuant to which it is the registered owner of 6,920,000 warrants to purchase the same number of shares of the

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Company's common stock;

WHEREAS, the Company and the Shareholders believe it is in the best interest of the Company to (i) increase the surplus of Folksamerica Reinsurance Company ("Folksamerica Reinsurance") and (ii) to reduce Company debt owed pursuant to a Loan Agreement between the Company and Swedbank (Sparbanken Sverige AB (publ)), New York Branch ("Swedbank"), dated November 12, 1991, as amended (the "Swedbank Loan") and (iii) to eliminate entirely the debt owed by the Company to Folksam pursuant to the Evidence of Indebtedness Agreement dated June 13, 1996 (the "Folksam Debt Agreement"); and

WHEREAS, the Company intends to apply \$14,446,900 of the \$41,693,760.50 aggregate proceeds from the sale of the New Shares towards the reduction of the Swedbank Loan; and

WHEREAS, the Shareholders, the Company and Swedbank have agreed to eliminate the Guarantee Obligations of P&V and Wiener, dated November 12, 1991, as confirmed by a reconfirmation letter dated April 25, 1996, and November 13, 1991, as confirmed by a reconfirmation letter dated May 17, 1996, respectively, supporting the Swedbank Loan and to reduce the Guarantee Obligation dated November 12, 1991, as confirmed by a reconfirmation letter dated November 25, 1995, of Samvirke to Swedbank (collectively, the "Guarantee Obligations"); and

WHEREAS, the Shareholders wish to amend (i) the Shareholders Agreement dated March 6, 1996 by and among the Company, Fund American, Folksam, Wiener, P&V and Samvirke (the "Fund American Shareholders Agreement"), (ii) the Amended and Restated Investor Stockholders' Agreement, dated as of June 19, 1996 by and among the Company, Folksam, Wiener, P&V and Samvirke (the "Investor Stockholders' Agreement") and (iii) the Registration Rights Agreement by and among the Company and the Shareholders, dated as of June 19, 1996 (the "Registration Rights Agreement"), and to make certain waivers in connection with the purchase of the New Shares.

NOW, THEREFORE, in consideration of the foregoing and for other good and valuable consideration the receipt and sufficiency of which are hereby

acknowledged, the parties hereto hereby agree as follows:

1. COMMON STOCK SUBSCRIPTION

The Shareholders hereby subscribe for and agree to purchase, severally and not jointly, the number of New Shares set forth opposite their names below and agree to pay therefore in cash, the sum of U.S. \$13.33 per share; provided, however, that Folksam shall pay for its New

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Shares by exchanging (capitalizing) the remaining indebtedness of U.S. \$4,000,000 due from the Company pursuant to the Folksam Debt Agreement (the aggregate payment by each Shareholder for their respective New Shares, or, in the case of Folksam, the aggregate amount of exchanged (capitalized) debt, is referred to herein as the "Purchase Price"). The Company shall pay to Folksam upon the Closing (as defined below) all accrued but unpaid interest through the date of the Closing.

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	NEW SHARES	ADDITIONAL SHAREHOLDER INVESTMENT	TOTAL VOTING SHARES*	VOTING %
Fund American.....	1,563,907	U.S. \$20,846,880.00	8,483,907	50.0
Folksam.....	300,075	4,000,000.00	3,585,075	21.1
P & V.....	472,618	6,299,997.90	1,877,618	11.1
Samvirke.....	138,551	1,846,884.80	763,551	4.5
Wiener.....	652,663	8,699,997.80	2,257,663	13.3
	3,127,814	U.S. \$41,693,760.50	16,967,814	100.0

* Following purchase of the New Shares

2. DELIVERY OF COMMON STOCK/USE OF PROCEEDS

a. On November 20, 1997 or as soon as practicable following the satisfaction or waiver of the conditions enumerated under Section 3 below (and in any event within 5 business days following satisfaction of the conditions listed in Section 3 below) a closing of the purchase of the New Shares shall be held (the "Closing") in the offices of the Company at One Liberty Plaza, 19th Floor, New York, New York 10006. At the Closing, (x) the Company shall issue a stock certificate or certificates to each Shareholder representing their respective New Shares (each stock certificate so delivered shall, to the extent applicable, bear the legend provided for in Section 5 of the Amended and Restated Investor Stockholders' Agreement dated June 19, 1996, (y) each of Fund American, P&V, Samvirke and Wiener shall pay their respective Purchase Prices by wire transfer of immediately available funds to the respective accounts designated at least five (5) business days prior to the Closing, by the Company and Swedbank and (z) Folksam shall deliver evidence satisfactory to the Company that the Folksam Debt Agreement has been terminated and that the underlying indebtedness has been forgiven in full.

b. The Company agrees to use \$14,446,900 of the Purchase Price received from P&V (\$6,299,997.90), Samvirke (\$1,846,884.80) and Wiener (\$6,300,017.30) in accordance with this Agreement to re-pay a portion of the Swedbank Loan (and in furtherance hereof the Company shall instruct such Shareholder to pay such portion of Purchase Price payable by them directly to Swedbank as necessary to effect such repayment) and the balance of the cash proceeds shall be used to increase the Surplus of Folksamerica Reinsurance as directed by the Board of Directors of the Company.

3. CONDITIONS TO PURCHASE AND DELIVERY OF COMMON STOCK

The Company shall issue, and each of the Shareholders (severally and not jointly) shall

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purchase in accordance with the terms hereof, the New Shares subscribed to herein upon the satisfaction or waiver of each of the following conditions:

a. Receipt by the Company from Fund American, P&V, Wiener and Samvirke of their respective Purchase Prices pursuant to Section 2(a)(y) and a

receipt from Folksam pursuant to Section 2(a)(z) of evidence satisfactory to the Company that the entire debt evidenced by the Folksam Debt Agreement has been extinguished in full.

b. Receipt by the Company and each of the Shareholders of a duly executed amendment to the Fund American Shareholders Agreement in the form attached hereto as Exhibit A.

c. Approval by the Board of Directors and the Shareholders of (i) an amendment to the Company Charter in the form attached hereto as Exhibit B, increasing the authorized shares of Common Stock by the amount necessary to issue the New Shares and (ii) the transactions contemplated herein as provided for in the resolutions attached as Exhibit C.

d. Prior to the closing, receipt, satisfactory to P&V and Wiener, of instruments evidencing that, upon payment of the portion of the Purchase Price payable by them to Swedbank, their respective Guarantee Obligations to Swedbank will be released and discharged and receipt satisfactory to Samvirke of an instrument evidencing that, upon payment of the portion of the Purchase Price payable by it to Swedbank, its Guarantee Obligation will be reduced to reflect Samvirke's purchase of 138,551 shares of Common Stock as provided herein.

e. Receipt by the Shareholders of the opinion of Donald A. Emeigh, Jr., General Counsel of the Company, in the form attached hereto as Exhibit D.

f. Receipt by the Company and the Shareholders of a duly executed amendment to the Registration Rights Agreement in the form attached hereto as Exhibit E.

g. Receipt by the Company and the Shareholders of a duly executed amendment to the Investor Stockholders' Agreement in the form attached hereto as Exhibit F.

h. In the case of the Shareholders, (i) the representations and warranties of the Company contained in this Agreement or in any certificate or documents delivered to the Shareholders pursuant hereto shall be deemed to have been made again at and as of the Closing of the transactions provided for herein and shall then be true in all material respects and (ii) the Company shall have performed and complied in all material respects with all agreements and covenants required by this Agreement to be performed or complied with by the Company prior to or at the Closing, and the Shareholders shall have been furnished with a certificate of an appropriate officer of the Company, dated the day of the Closing (the "Closing Date"), certifying to the effect of clauses (i) and (ii) of this Section 3(h).

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4. CERTAIN WAIVERS

The Company and the Shareholders, respectively, hereby agree as follows:

a. Fund American hereby agrees to the issuance of the New Shares and agrees in connection with the transactions contemplated by this Agreement to a one time waiver of (i) all requirements set forth in Section 8.3 of the Securities Purchase Agreement by and between Fund American and the Company dated March 6, 1996, relating to the issuance of Common Stock by the Company, (ii) any claim that the New Shares have been issued for an amount of consideration per share less than the fair market value per share as determined for purposes of Section 4 of the Class A Warrant Certificate, and (iii) the notice requirement set forth in Section 4(k) of the Class A Warrant Certificate. Fund American further acknowledges receipt of the notice (a copy of which is attached hereto as Exhibit G) required pursuant to Article Fourth, Clause A, Section, Section 3(d) of the Company's Certificate of Incorporation and agrees that the calculation set forth therein is correct.

b. The Company and the Shareholders each agree, in connection with the transactions contemplated by this Agreement, to a one-time waiver of (i) Section 8, Section 9(b) and Section 9(d) of the Fund American Shareholders Agreement and (ii) Section 1 of the Guarantee Fee Agreement to the extent necessary to permit the consummation of the transactions contemplated hereby. In addition, the Company, Folksam, P&V, Samvirke and Wiener each agrees, in connection with the transactions contemplated by this Agreement, to a one-time waiver of Section 7(vi) and Section 12 of the Investor Stockholders' Agreement to the extent necessary to permit the consummation of the transactions contemplated hereby.

5. REPRESENTATION/WARRANTIES

Each of the signatories for the Shareholders represents and warrants that he has been duly authorized to execute this Agreement, the amendment to the Fund American Shareholders' Agreement, the amendment to the Investor Stockholders Agreement and the amendment to the Registration Rights Agreement (collectively, the "Agreements") and that all corporate action necessary to complete the transactions contemplated herein has been authorized.

The Company represents and warrants to the Shareholders:

(a) Organization of the Company; Authority. The Company is a corporation duly organized, validly existing and in good standing under the laws of its state of organization and has all the requisite corporate power and authority to carry on its business as now being conducted and to own and use the properties owned and used by it. The Company is qualified to do business in each jurisdiction in which the nature of its business requires it to be so qualified. The Company has full corporate power and authority to enter into each of the Agreements and to consummate the transactions contemplated hereby and thereby. The execution and delivery of each of the Agreements and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all requisite corporate action on the part of the Company.

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Assuming the due authorization, execution and delivery hereof and thereof by the Shareholders, the Agreement has been (and each of the other Agreements will be at the Closing) duly executed and delivered by the Company and constitutes (and each of the other Agreements will constitute at the Closing) the valid, binding and enforceable obligation of the Company, except as such enforceability may be limited by bankruptcy, insolvency, reorganization or similar laws affecting creditors' rights generally or by general equitable principles.

(b) Capitalization of the Company; Ownership. The authorized, issued and outstanding capital stock of the Company prior to and immediately after giving effect to, the issuance of the New Shares is set forth on Schedule 1. All of the issued and outstanding shares of capital stock of the Company are duly authorized, validly issued, fully paid and non-assessable. Except for the Class A Warrant Certificate and the Series B Preferred Stock currently held by Fund American, there are not other outstanding options, warrants or rights of any kind to acquire any additional shares of capital stock of the Company or securities convertible into or exchangeable for, or which otherwise confer on the holder thereto, any right to acquire, any such additional shares, nor is the Company committed to issue any such option, warrant, right or securities.

(c) Ability to Carry Out the Agreements. Except as provided for herein and assuming the fulfillment of all of the conditions provided for under Section 3, the Company is not subject to or bound by any provision of:

- (i) any law, statute rule, regulation or judicial or administrative decision,
- (ii) the articles or certificate or incorporation or by-laws of the Company,
- (iii) any mortgage, deed of trust, lease, note, shareholders' agreement, partnership agreement, bond, indenture, license, permit, trust, or
- (iv) any judgment, order, writ, injunction or decree or any court, governmental body, administrative agency or arbitrator,

that would prevent or be violated by or under which there would be a default as a result of the execution of any of the Agreements nor is there required any consent of any person under any contract or agreement which has not been obtained for, the execution, delivery and performance by the Company of any of the Agreements and the transactions contemplated hereby, other than violations, defaults or failures to obtain consents which have not had and are not reasonably likely to have a material adverse effect on the ability of the Company to perform its obligations under any of the Agreements.

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7. COUNTERPARTS

This Agreement may be executed in one or more counterparts, and by different parties on separate counterparts each of which shall be deemed an original, but all of which will constitute one and the same instrument.

8. GOVERNING LAW

This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of New York applicable to contracts made and to be performed therein without reference to any applicable principals of conflicts of laws. The parties agree that the exclusive place of jurisdiction for any action brought hereunder shall be in the City and State of New York.

IN WITNESS WHEREOF, each of the parties has caused this Agreement to be executed on its behalf by its duly authorized officer as of the date first written above.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.

By: _____
Name:
Title:

WHITE MOUNTAINS HOLDINGS, INC.

By: _____
Name:
Title:

FOLKSAMERICA HOLDING COMPANY, INC.

By: _____
Name:
Title:

FOLKSAM MUTUAL GENERAL INSURANCE COMPANY

By: _____
Name:
Title:

By: _____
Name:

8

Title:

9

FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (Publ)

By: _____
Name:
Title:

By: _____
Name:
Title:

WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG

By: _____
Name:
Title:

By: _____
Name:
Title:

P&V ASSURANCES S.C.

By: _____
Name:
Title:

SAMVIRKE SKADEFORSIKRING AS

By: _____
Name:
Title:

10

SCHEDULE 1

FOLKSAMERICA HOLDING COMPANY, INC.

	PRESENT OWNERSHIP VOTING SHARES	%	NEW SHARES	REVISED OWNERSHIP VOTING SHARES	%
Fund American.....	6,920,000	50.0	1,563,907	8,483,907*	50.0
Folsam.....	3,285,000	23.7	300,075	3,585,075**	21.1

Source: WHITE MOUNTAINS INSU, 10-K, March 30, 1998

P&V Assurances.....	1,405,000	10.2	472,618	1,877,618	11.1
Samvirke.....	625,000	4.5	138,551	763,551	4.5
Wiener Staedtische.....	1,605,000	11.6	652,663	2,257,663	13.3
	-----		-----	-----	
	13,840,000	100.0	3,127,814	16,967,814	
100.0					

- -----
* Fund American

Series B Voting Preferred.....	6,920,000
Common Shares.....	1,563,907

Total Shares.....	8,483,907

- -----

**Folksam Mutual General-Common Shares.....	3,285,000
Folksam International-Common Shares.....	300,075

Total Shares.....	3,585,075

EXHIBIT A

AMENDMENT TO THE SHAREHOLDERS AGREEMENT

This Amendment to the Shareholders Agreement described below is entered into as of November 6, 1997 by and among FOLKSAMERICA HOLDING COMPANY, INC., a New York corporation (the "Company"), FUND AMERICAN ENTERPRISES HOLDINGS, INC., a Delaware corporation, ("Fund American"), WHITE MOUNTAINS HOLDINGS, INC., a Delaware corporation ("White Mountains"; Fund American and White Mountains being collectively referred to herein as "Fund American"), FOLKSAM MUTUAL GENERAL INSURANCE COMPANY, an entity organized under the laws of Sweden ("Folksam Mutual"), FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (publ), an entity organized under the laws of Sweden ("Folksam International"; Folksam Mutual and Folksam International being collectively referred to herein as "Folksam"), WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG, a corporation organized under the laws of Austria ("Wiener"), P&V ASSURANCES S.C., a corporation organized under the laws of Belgium ("P&V"), and SAMVIRKE SKADEFORSIKRING AS, a corporation organized under the laws of the Kingdom of Norway ("SAMVIRKE"); (collectively Fund American, Folksam, Wiener, P&V and Samvirke are referred to herein as the "Shareholders"). Capitalized terms used herein and not otherwise defined herein shall have the respective meanings assigned to them in the Shareholders Agreement.

WHEREAS, the Company and the Shareholders (other than White Mountains and Folksam International) entered into the Shareholders Agreement dated as of March 6, 1996 (the "Shareholders Agreement"); and

WHEREAS, in connection with the transactions contemplated by the Subscription Agreement dated as of November 6, 1997 among the Company and the Shareholders (the "Subscription Agreement"), the Company and the Shareholders desire to amend the Shareholders Agreement;

NOW, THEREFORE, in consideration of the foregoing and for other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Effective upon the consummation of the Closing under the Subscription Agreement, the Shareholders Agreement shall be automatically and without further act amended as follows:

a. All references to the "Purchaser" contained in the Shareholders Agreement shall be deemed to refer collectively to Fund American and White Mountains, and White

Mountains, by execution and delivery hereof, acknowledges that it is a party to the Shareholders Agreement and agrees to be bound by all obligations of the Purchaser thereunder.

b. All references to "Folksam" contained in the Shareholders Agreement, including with respect to the definition of Existing Shareholders, shall be deemed to refer collectively to Folksam Mutual and Folksam International, and Folksam International, by execution and delivery hereof, shall become a party to the Shareholders Agreement and agrees to be bound by all obligations of Folksam thereunder.

c. All references to "Equity Securities" contained in the Shareholders Agreement shall be deemed to include, in addition to the securities included therein as specified in the Shareholders Agreement, the New Shares (as defined in the Subscription Agreement) purchased by Fund American.

d. Section 2(b) of the Shareholders Agreement is hereby amended to delete the parenthetical clause contained in clause (i) thereof and substituting the following in lieu thereof:

"(but in no event shall the aggregate number of director designees for the Existing Shareholders taken as a whole exceed eight)".

e. All references contained in the Shareholders Agreement to the "Existing Shareholders Agreement" shall be deemed to be references to the "Amended and Restated Investor Stockholders' Agreement by and among the Company and the Existing Shareholders dated as of June 19, 1996, as the same may be amended from time to time".

f. The table contained in Section 2(b) of the Shareholders Agreement is hereby amended in its entirety to read as follows:

NUMBER OF EQUITY SECURITIES OWNED BENEFICIALLY	NUMBER OF PURCHASER DESIGNEES:	
	BOARD	EACH BOARD COMMITTEE
4,900,000 or more.....	Two	One
2,450,000 to 4,899,000.....	One	One
less than 2,450,000.....	None	None

g. Section 7 of the Shareholders Agreement is hereby amended by changing the reference to "six hundred and ninety two thousand (692,000)" to "eight hundred and forty eight thousand three hundred and ninety (848,390)."

h. All references to the "Existing Shareholders" contained in Section 9 of the Shareholders Agreement shall refer only to Folksam Mutual and Samvirke and shall expressly not be deemed to refer to Wiener or P&V.

i. Section 19 of the Shareholders Agreement is hereby amended by changing the reference to "five hundred thousand (500,000)" to "six hundred and thirteen thousand (613,000)".

2. This Agreement shall be of no force or effect if the Closing under the Subscription Agreement shall fail to occur.

3. This Agreement may be executed in one or more counterparts, and by different parties on separate counterparts each of which shall be deemed an original, but all of which will constitute one and the same instrument.

4. This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of New York applicable to contracts made and to be performed therein without reference to any applicable principles of conflicts of laws. The parties agree that the exclusive place of jurisdiction for any action brought hereunder shall be in the City and State of New York.

IN WITNESS WHEREOF, each of the parties has caused this Agreement to be executed on its behalf by its duly authorized officer as of the date first written above.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.

By: _____
Name:
Title:

WHITE MOUNTAINS HOLDINGS, INC.

By: _____
Name:
Title:

FOLKSAMERICA HOLDING COMPANY, INC.

By: _____
Name:

3

Title:

4

FOLKSAM MUTUAL GENERAL INSURANCE COMPANY

By: _____
Name:
Title:

By: _____
Name:
Title:

FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (Publ)

By: _____
Name:
Title:

By: _____
Name:
Title:

WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG

By: _____
Name:
Title:

By: _____
Name:
Title:

P&V ASSURANCES S.C.

By: _____
Name:
Title:

SAMVIRKE SKADEFORSIKRING AS

By: _____
Name:

5

Title:

6

EXHIBIT B

CERTIFICATE OF AMENDMENT OF
THE CERTIFICATE OF INCORPORATION
OF FOLKSAMERICA HOLDING COMPANY, INC.
UNDER SECTION 805 OF THE BUSINESS
CORPORATION LAW OF THE STATE OF NEW YORK

The undersigned, being the President and Secretary, respectively, of Folksamerica Holding Company, Inc. (the "Corporation"), a corporation organized and existing under the Business Corporation Law of the State of New York (the "BCL"), hereby certify and set forth the following:

1. The name of the Corporation is Folksamerica Holding Company, Inc.

2. The certificate of incorporation of the Corporation was filed by the Department of State of on April 10, 1985. A restated certificate of incorporation of the Corporation was filed by the Department of State on

December 16, 1993. A certificate of amendment of the certificate of incorporation of the Corporation was filed by the Department of State on June 17, 1996.

3. The certificate of incorporation of the Corporation, as heretofore amended, is hereby amended, pursuant to Section 501 of the BCL, to increase the number of shares which the Corporation is authorized to issue from 41,520,000 shares to 44,647,814 shares, of which 23,887,814 shares shall be designated as Common Stock, par value \$0.01 per share, and 20,760,000 shares shall be designated as Preferred Stock, par value \$0.01 per share.

4. To accomplish the foregoing amendment the certificate of incorporation of the Corporation, as heretofore amended, is amended by deleting the first sentence of Article FOURTH and substituting therefore the following:

"The number of shares which the Corporation is authorized to issue is 44,647,814 shares, of which 23,887,814 shares shall be designated as Common Stock, par value \$0.01 per share ("Common Stock"), and the remaining 20,760,000 shares shall be designated as Preferred Stock, par value \$0.01 per share ("Preferred Stock")."

5. The amendment referred to herein was authorized by a resolution adopted by a unanimous vote of the board of directors of the Corporation at a meeting of the board duly called and held on November 6, 1997, and adopted by the unanimous written consent of all of the shareholders of the Corporation dated November 6, 1997.

1

IN WITNESS WHEREOF, we have executed this Certificate on this 6th day of November, 1997 and do affirm the statements contained herein are true under the penalties of perjury.

Name: Steven E. Fass
Title: President & C.E.O.

Name: Donald A. Emeigh, Jr.
Title: S.V.P., General Counsel & Secretary

2

SHAREHOLDER UNANIMOUS
WRITTEN CONSENT IN LIEU OF MEETING
FOLKSAMERICA HOLDING COMPANY, INC.

THE UNDERSIGNED, which include all of the Shareholders of Folksamerica Holding Company, Inc., a New York corporation (the "Company" or "Folksamerica"), DO HEREBY CONSENT, pursuant to Section 615(a) of the New York Business Corporation Law, to the following resolutions as the duly adopted resolutions of the Shareholders of the Company, said resolutions to be and read as follows:

RESOLVED, that the form, terms and provisions of the Subscription Agreement attached as Exhibit A (the "Subscription Agreement") by and among the Company, White Mountains, Fund American, Folksam, Folksam International, Wiener, P&V and Samvirke, a copy of which has been presented to the Shareholders and filed with the records of the Company, with such changes, additions or deletions to any or all of the terms and provisions thereof as the officer executing the same may approve, the execution and delivery thereof to be conclusive evidence of such approval, (provided that (i) any such change, addition or deletion that is for the purpose of curing an ambiguity, omission, defect or inconsistency (an "Administrative Change") shall not require any further approval or authorization, (ii) any such change, addition or deletion which is not an Administrative Change, but which does not alter a material term shall be approved by a committee consisting of Thomas Kemp, Anders Henriksson and Peter Hagen (the "Approval Committee") and (iii) any such change, addition or deletion which alters a material term shall be approved by the Board of Directors of the Company), be, and the same hereby are, together with the transactions contemplated therein, authorized, approved and adopted in all respects and the Subscription Agreement as so executed and delivered be, and the same hereby is, authorized, approved and adopted; and further

RESOLVED, the Shareholders hereby ratify approve the issuance of the New Shares referenced in the Subscription Agreement for a price of U.S. \$13.33 per share, which price is acknowledged to represent a reasonable good faith judgement of the Directors of the fair market value per share, and further specifically acknowledge and approve that Folksam International Insurance Co. Ltd (publ) shall pay for the New Shares referenced in the Subscription Agreement by exchanging (capitalizing) the remaining indebtedness of \$4,000,000 due from

the Company; and further

RESOLVED, the Shareholders hereby approve the Certificate of Amendment to the Certificate of Incorporation attached as Exhibit B (the "Certificate of Amendment"), a copy of which

1

has been presented to the Shareholders and filed with the records of the Company, and, subject to the satisfaction of the conditions of delivery of the Common Stock as provided for in the Subscription Agreement, the officers of the Company be, and any one or more hereby are authorized, empowered and directed in the name and on behalf of the Company, to execute, acknowledge, file and record the Certificate of Amendment with the Secretary of State of the State of New York; and further

RESOLVED, upon (i) the filing of the Certificate of Amendment, and (ii) the satisfaction of the terms and conditions to closing set forth in the Subscription Agreement, 3,127,814 shares of authorized but unissued shares of the Company's Common Stock shall be issued to the Shareholders and the Company shall use the proceeds thereof as directed in the Subscription Agreement; and further

RESOLVED, that all officers of the Company be, and any one or more of them hereby are, authorized, empowered and directed to execute, in the name and on behalf of the Company, and to cause to be issued and delivered to the Shareholders, one or more certificates representing such shares, and when issued, such Common Stock will be duly authorized, validly issued, fully paid and (except with respect to claims pursuant to Section 630 of the New York Business Corporation Law) non-assessable; and further

RESOLVED, that in accordance with Article III, Section 11 of the Company By-Laws, Terry L. Baxter is hereby appointed to the Board of Directors in replacement of Allan L. Waters who is hereby removed as a director; and further

RESOLVED, that the officers of the Company be, and any one or more of them hereby are, authorized, empowered and directed, acting alone, in the name and on behalf of the Company, to do and perform all such further acts and things, to execute and deliver in the name and on behalf of the Company, and, if requested or required, under its corporate seal duly attested by the Secretary of the Company, and where necessary or appropriate, to file with the appropriate governmental authorities, all such further certificates, instruments, or other documents, and to make all such payments as in their judgment, or in the judgment of any one of them, shall be deemed necessary or advisable in order to carry out, comply with, and effectuate the intent and purposes of the foregoing resolutions, and any or all of the transactions contemplated therein or thereby, the authority therefor to be conclusively evidenced by the taking of such action;

RESOLVED, that the Shareholders hereby ratify and approve the actions of the Human Resources Committee and the Board of Directors in accordance with the Committees written consent of November 6, 1997; and further

RESOLVED, that the Secretary of the Company shall file this Written Consent in Lieu of

2

Meeting as a record of the minutes of the actions taken hereby.

3

IN WITNESS WHEREOF, the undersigned authorized signatories of the Shareholders have executed this written consent effective the date first written above. This Unanimous Consent in Lieu of Meeting may be signed in one or more counterparts, each of which shall be deemed an original, but all of which taken together shall be deemed one and the same Consent of the Shareholder.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.

By: _____
Name:
Title:

WHITE MOUNTAINS HOLDINGS, INC.

By: _____
Name:
Title:

FOLKSAMERICA HOLDING COMPANY, INC.

By: _____
Name:
Title:

FOLKSAM MUTUAL GENERAL INSURANCE COMPANY

By: _____
Name:
Title:

By: _____
Name:
Title:

WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG

By: _____
Name:
Title:

By: _____
Name:

4

Title:

P&V ASSURANCES S.C.

By: _____
Name:
Title:

SAMVIRKE SKADEFORSIKRING AS

By: _____
Name:
Title:

5

EXHIBIT C

Subject to the approval of the Shareholders of the Subscription Agreement and Charter Amendment as provided for in the "Consent in Lieu of Meeting", the Directors will be asked to approve the following resolutions:

RESOLVED, that the form, terms and provisions of the Subscription Agreement attached hereto as Exhibit A (the "Subscription Agreement") by and among the Company, White Mountains, Fund American, Folksam Mutual, Folksam International, Wiener, P&V and Samvirke, a copy of which has been presented to this Board of Directors and filed with the records of the Company, with such changes, additions or deletions to any or all of the terms and provisions thereof as the officer executing the same may approve, the execution and delivery thereof to be conclusive evidence of such approval (provided that (i) any such change, addition or deletion that is for the purpose of curing an ambiguity, omission, defect or inconsistency (an "Administrative Change") shall not require any further approval or authorization, (ii) any such change, addition or deletion which is not an Administrative Change, but which does not alter a material term shall be approved by a committee consisting of Thomas Kemp, Anders Henriksson and Peter Hagen (the "Approval Committee") and (iii) any such change, addition or deletion which alters a material term shall be approved by the Board of Directors of the Company), be, and the same hereby are, together with the transactions contemplated therein and the Exhibits attached thereto (including without limitation the Amendment to the Fund American Shareholders' Agreement, the Amendment to the Investor Stockholders' Agreement, the Amendment to the "Registration Rights Agreement" and the use of the proceeds from the sale of the New Shares as provided for in Provision 2(b) of the Subscription Agreement), authorized, approved and adopted in all respects and the Subscription Agreement as so executed and delivered be, and the same hereby is, authorized, approved and adopted; and further

RESOLVED, the Directors hereby approve the issuance of the New Shares referenced in the Subscription Agreement for a price of U.S. \$13.33 per share, which price represents a reasonable good faith judgement of the Directors of the fair market value per share, and further specifically acknowledge and approve that Folksam International Insurance Co. Ltd. (publ) shall pay for the New Shares referenced in the Subscription Agreement by exchanging the remaining

indebtedness of \$4,000,000 due from the Company; and further

1

RESOLVED, the Directors hereby approve the Certificate of Amendment to the Certificate of Incorporation attached hereto as Exhibit B (the "Certificate of Amendment"), a copy of which shall be presented to the Shareholders of the Company for approval, and subject to the satisfaction of the conditions of delivery of the Common Stock as provided for in the Subscription Agreement, the officers of the Company be, and any one or more hereby are, authorized, empowered and directed in the name and on behalf of the Company, to execute, acknowledge, file and record the Certificate of Amendment with the State of New York; and further

RESOLVED, that, pursuant to the Subscription Agreement and upon (i) the filing of the Certificate of Amendment, and (ii) the satisfaction of the terms and conditions to closing set forth in the Subscription Agreement, 3,127,814 shares of authorized but unissued shares of the Company's Common Stock shall be issued to the Shareholders, and that all officers of the Company be, and any one or more of them hereby are, authorized, empowered and directed to execute, in the name and on behalf of the Company, and to cause to be issued and delivered to the Shareholders, one or more certificates representing such shares, and when issued, such Common Stock will be duly authorized, validly issued, fully paid and (except with respect to claims pursuant to Section 630 of the New York Business Corporation Law) non-assessable;

RESOLVED, that the Board of Directors hereby ratify and approve the actions of the Human Resources Committee in accordance with the Committee's written consent of November 6, 1997; and further

RESOLVED, that the officers of the Company be, and any one or more of them hereby are, authorized, empowered and directed, acting alone, in the name and on behalf of the Company, to do and perform all such further acts and things, to execute and deliver in the name and on behalf of the Company, and, if requested or required, under its corporate seal duly attested by the Secretary of the Company, and where necessary or appropriate, to file with the appropriate governmental authorities, all such further certificates, instruments, or other documents, and to make all such payments as in their judgment, or in the judgment of any one of them, shall be deemed necessary or advisable in order to carry out, comply with, and effectuate the intent and purposes of the foregoing resolutions, and any or all of the transactions contemplated therein or thereby, the authority therefor to be conclusively evidenced by the taking of such action or the execution and delivery of such documents.

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EXHIBIT D

[Don Emeigh Legal Opinion]

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EXHIBIT D

[Don Emeigh Legal Opinion]

1

EXHIBIT E

AMENDMENT TO THE REGISTRATION RIGHTS AGREEMENT

This Amendment to the Registration Rights Agreement described below is entered into as of November 6, 1997 by and among FOLKSAMERICA HOLDING COMPANY, INC., a New York corporation (the "Company"), FUND AMERICAN ENTERPRISES HOLDINGS, INC., a Delaware corporation ("Fund American"), WHITE MOUNTAINS HOLDINGS, INC., a Delaware corporation ("White Mountains"; Fund American and White Mountains being collectively referred to herein as "Fund American"), FOLKSAM MUTUAL GENERAL INSURANCE COMPANY, an entity organized under the laws of Sweden ("Folksam Mutual"), FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (publ), an entity organized under the laws of Sweden ("Folksam International"; Folksam

Mutual and Folksam International being collectively referred to herein as "Folksam"), WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG, a corporation organized under the laws of Austria ("Wiener"), P&V ASSURANCES S.C., a corporation organized under the laws of Belgium ("P&V"), and SAMVIRKE SKADEFORSIKRING AS, a corporation organized under the laws of the Kingdom of Norway ("SAMVIRKE"); (collectively Fund American, Folksam, Wiener, P&V and Samvirke are referred to herein as the "Shareholders"). Capitalized terms used herein and not otherwise defined herein shall have the respective meanings assigned to them in the Registration Rights Agreement.

WHEREAS, the Company and the Shareholders (other than White Mountains and Folksam International) entered into the Registration Rights Agreement dated as of March 6, 1996 (the "Registration Rights Agreement"); and

WHEREAS, in connection with the transactions contemplated by the Subscription Agreement dated as of November 6, 1997 among the Company and the Shareholders (the "Subscription Agreement"), the Company and the Shareholders desire to amend the Registration Rights Agreement;

NOW, THEREFORE, in consideration of the foregoing and for other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1

1. Effective upon the consummation of the Closing under the Subscription Agreement, the Registration Rights Agreement shall be automatically and without further act amended as follows:

a. For all purposes of the Registration Rights Agreement, the definition of "Registrable Securities" contained in Section 1 of the Registration Rights Agreement shall be automatically amended without further act by including in each of clauses (i) and (ii) thereof (including, without limitation, for purposes of clause (iii) thereof) the New Shares (as defined in the Subscription Agreement), and the first proviso contained in such definition shall not apply to the New Shares.

b. All references to "Folksam" contained in the Registration Rights Agreement, including with respect to the definition of "Existing Shareholders," shall be deemed to refer collectively to Folksam Mutual and Folksam International, and Folksam International, by execution and delivery hereof, shall become a party to the Registration Rights Agreement and agrees to be bound by all obligations of Folksam thereunder.

2. This Agreement shall be of no force or effect if the Closing under the Subscription Agreement shall fail to occur.

3. This Agreement may be executed in one or more counterparts, and by different parties on separate counterparts each of which shall be deemed an original, but all of which will constitute one and the same instrument.

4. This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of New York applicable to contracts made and to be performed therein without reference to any applicable principles of conflicts of laws. The parties agree that the exclusive place of jurisdiction for any action brought hereunder shall be in the City and State of New York.

IN WITNESS WHEREOF, each of the parties has caused this Agreement to be executed on its behalf by its duly authorized officer as of the date first written above.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.

By: _____
Name:
Title:

WHITE MOUNTAINS HOLDINGS, INC.

2

By: _____
Name:
Title:

3

FOLKSAMERICA HOLDING COMPANY, INC.

By: _____

Name:
Title:

FOLKSAM MUTUAL GENERAL INSURANCE COMPANY

By: _____
Name:
Title:

By: _____
Name:
Title:

FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (Publ)

By: _____
Name:
Title:

By: _____
Name:
Title:

WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG

By: _____
Name:
Title:

By: _____
Name:
Title:

4

P&V ASSURANCES S.C.

By: _____
Name:
Title:

SAMVIRKE SKADEFORSIKRING AS

By: _____
Name:
Title:

5

EXHIBIT F

AMENDMENT TO THE AMENDED AND RESTATED
INVESTORS STOCKHOLDERS' AGREEMENT

This Amendment to the Amended and Restated Investor Stockholders' Agreement described below is entered into as of November 6, 1997 by and among FOLKSAMERICA HOLDING COMPANY, INC., a New York corporation (the "Company"), FOLKSAM MUTUAL GENERAL INSURANCE COMPANY, an entity organized under the laws of Sweden ("Folksam Mutual"), FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (publ), an entity organized under the laws of Sweden ("Folksam International"; Folksam Mutual and Folksam International being collectively referred to herein as "Folksam"), WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG, a corporation organized under the laws of Austria ("Wiener"), P&V ASSURANCES S.C., a corporation organized under the laws of Belgium ("P&V"), and SAMVIRKE SKADEFORSIKRING AS, a corporation organized under the laws of the Kingdom of Norway ("SAMVIRKE"); (collectively Folksam, Wiener, P&V and Samvirke are referred to herein as the "Shareholders"). Capitalized terms used herein and not otherwise defined herein shall have the respective meanings assigned to them in the Investor Stockholders' Agreement.

WHEREAS, the Company and the Shareholders (other than Folksam International) entered into the Amended and Restated Investor Stockholders' Agreement dated as of March 6, 1996 (the "Investor Stockholders' Agreement"); and

WHEREAS, in connection with the transactions contemplated by the Subscription Agreement dated as of November 6, 1997 among the Company, the Shareholders and certain other parties (the "Subscription Agreement"), the Company and the Shareholders desire to amend the Investor Stockholders' Agreement;

NOW, THEREFORE, in consideration of the foregoing and for other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Effective upon the consummation of the Closing under the Subscription Agreement, the Investor Stockholders' Agreement shall be automatically and without further act

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amended as follows:

a. All references to "FMGIC" contained in the Investor Stockholders' Agreement, including with respect to the definition of Investor Stockholders, shall be deemed to refer collectively to Folksam Mutual and Folksam International, and Folksam International, by execution and delivery hereof, shall become a party to the Investor Stockholders' Agreement and agrees to be bound by all obligations of FMGIC thereunder.

b. The definition of "Original Equity" contained in Section 1 thereof shall be amended to read as follows:

"Original Equity" shall mean the 8,483,907 shares of Common Stock issued and outstanding upon the Closing under the Subscription Agreement dated as of November 6, 1997 by and among the Company, the Investor Stockholders, FA and certain other parties and which are beneficially owned by the Investor Stockholders, and any shares issued with respect thereto as a stock dividend or in connection with any reclassification, stock split or recapitalization."

c. Section 2(a) thereof shall be amended to read in its entirety as follows:

"(a) Each Investor Stockholder hereby agrees that during the period commencing on the date hereof and ending upon the termination of this Agreement it will vote all of the shares of Voting Stock beneficially owned by it so as to elect and, during such period, to continue in office a Board of Directors of the Company consisting of not more than eleven members and which shall include the following:

(i) a number of designees of each Investor Stockholder at any time that most appropriately reflects the percentage of Original Equity beneficially owned by such Investor Stockholder as compared to the respective percentages of Original Equity beneficially owned by the other Investor Stockholders at such time; provided that the aggregate number of designees of the Investor Stockholders shall not exceed eight (8) designees; and provided further that each Investor Stockholder that beneficially owns 6.25% or more of the Original Equity shall be entitled to at least one designee; and

(ii) the designees of FA designated in accordance with the terms of the FA Stockholders Agreement;

Accordingly, pursuant to clause (i) of Section 2(a), as of the date of the closing

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under the Subscription Agreement (the "Subscription Closing Date") each of the Investor Stockholders is entitled to designate, based on the percentage of the Original Equity beneficially owned by it as of the Subscription Closing Date, the following number of designees:

- (I) 3 designees of FMGIC;
- (II) 2 designees of WSA;
- (III) 2 designees of PV and
- (IV) 1 designee of SS."

d. Section 2(d) thereof shall be amended to read in its entirety as follows:

"In the event that any Investor Stockholder becomes entitled to a lesser or greater number of designees under Section 2(a) than are then designated by such Investor Stockholder and acting as members of the Board of Directors, each Investor Stockholder shall vote all of the shares of Voting Stock beneficially owned by it so as to remove or add such director designated by such Investor Stockholder that is entitled to a lesser or greater number of designees and (to the extent necessary) to amend the By-laws to reduce or, subject to Section 2(a), increase the authorized number of members of the Board of Directors by the director or directors so removed or added; provided that each Investor Stockholder shall have the exclusive right to determine which of the directors previously designated by it shall be removed."

e. Section 2(e) thereof is amended by deleting said Section in its entirety and substituting therefor the following: "(e) [Reserved]".

f. Solely for purposes of Section 12 of the Investor Stockholders' Agreement, all references in said Section 12 shall be deemed to refer only to FMGIC and SS and shall be deemed expressly not to refer to WSA or P&V.

2. This Agreement shall be of no force or effect if the Closing under the Subscription Agreement shall fail to occur.

3. This Agreement may be executed in one or more counterparts, and by different parties on separate counterparts each of which shall be deemed an original, but all of which will

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constitute one and the same instrument.

4. This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of New York applicable to contracts made and to be performed therein without reference to any applicable principles of conflicts of laws. The parties agree that the exclusive place of jurisdiction for any action brought hereunder shall be in the City and State of New York.

4

IN WITNESS WHEREOF, each of the parties has caused this Agreement to be executed on its behalf by its duly authorized officer as of the date first written above.

FOLKSAMERICA HOLDING COMPANY, INC.

By: _____
Name:
Title:

FOLKSAM MUTUAL GENERAL INSURANCE COMPANY

By: _____
Name:
Title:

By: _____
Name:
Title:

FOLKSAM INTERNATIONAL INSURANCE CO. LTD. (Publ)

By: _____
Name:
Title:

By: _____
Name:
Title:

WIENER STAEDTISCHE ALLGEMEINE VERSICHERUNG AG

By: _____
Name:
Title:

By: _____
Name:
Title:

5

P&V ASSURANCES S.C.

By: _____
Name:
Title:

SAMVIRKE SKADEFORSIKRING AS

By: _____

Name:
Title:

EXHIBIT 21

SUBSIDIARIES OF THE REGISTRANT
AS OF DECEMBER 31, 1997

FULL NAME OF SUBSIDIARY -----	PLACE OF INCORPORATION -----
CHARTER INDEMNITY COMPANY	TEXAS, USA
FUND AMERICAN CASUALTY REINSURANCE, LTD.	ISLANDS OF BERMUDA
FUND AMERICAN ENTERPRISES, INC.	DELAWARE, USA
SOURCE ONE MORTGAGE SERVICES CORPORATION and subsidiaries	DELAWARE, USA
VALLEY INSURANCE COMPANY	CALIFORNIA, USA
VALLEY NATIONAL INSURANCE COMPANY	KANSAS, USA
VALLEY PROPERTY & CASUALTY INSURANCE COMPANY	OREGON, USA
WHITE MOUNTAINS HOLDINGS, INC.	DELAWARE, USA
WHITE MOUNTAINS INSURANCE COMPANY	NEW HAMPSHIRE, USA

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders
Fund American Enterprises Holdings, Inc.:

We consent to the incorporation by reference in the registration statements, as amended, No. 33-5287 on Form S-8 pertaining to the Long-Term Incentive Plan, No. 33-54006 on Form S-3 pertaining to the Medium-Term Notes Series A, No. 33-54749 on Form S-3 pertaining to Common Stock Warrants, No. 333-30233 on Form S-8 pertaining to Valley Group Employees' 401(k) Savings Plan, No. 333-13027 on Form S-8 pertaining to the Source One Mortgage Services Corporation Employee Stock Ownership and 401(k) Plan of our report dated January 29, 1998 with respect to the consolidated balance sheet of the Company as of December 31, 1997, and the related consolidated income statement and consolidated statements of shareholders' equity and cash flows and the related schedule for the year ended December 31, 1997, which report appears in the Company's 1997 Annual Report on Form 10-K.

/s/ KPMG Peat Marwick LLP

Hartford, Connecticut
March 27, 1998

EXHIBIT 23 (b)

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statements, as amended, pertaining to the Long-Term Incentive Plan (Form S-8, No. 33-5297), Medium-Term Notes Series A (Form S-3, No. 33-54006) and Common Stock Warrants (Form S-3, No. 33-54749) of Fund American Enterprises Holdings, Inc. and to the Source One Mortgage Services Corporation Employee Stock Ownership and 401(K) Plan (Form S-8, No. 333-13027) of our report dated March 21, 1997, with respect to the consolidated financial statements and schedules of Fund American Enterprises Holdings, Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 1996.

New York, New York
March 27, 1998

/s/ Ernst & Young LLP

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference (from the 1997 Annual Report on Form 10-K filed by Financial Security Assurance Holdings Ltd. ("FSA") -- in which filing our report was incorporated by reference from FSA's Annual Report to Shareholders) in the Registration Statements, as amended, pertaining to the Long-Term Incentive Plan (Form S-8, No. 33-5297), Medium-Term Notes Series A (Form S-3, No. 33-54006), Common Stock Warrants (Form S-3, No. 33-54749) and the Valley Group Employees' 401(K) Savings Plan (Form S-8, No. 333-30233) of Fund American Enterprises Holdings, Inc. and to the Source One Mortgage Services Corporation Employee Stock Ownership and 401(K) Plan (Form S-8, No. 333-13027) of our report dated January 26, 1998 with respect to the consolidated financial statements of Financial Security Assurance Holdings Ltd. and Subsidiaries as of December 31, 1997 and 1996 and for each of the three years in the period ended December 31, 1997 and to the incorporation by reference in such Registration Statements of our report dated February 14, 1997 with respect to the consolidated financial statements of Valley Group, Inc. and Subsidiaries as of December 31, 1996 and for the year then ended (which is included as an exhibit in this Annual Report on Form 10-K).

/s/ Coopers & Lybrand L.L.P.

New York, New York
March 27, 1998

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that John J. Byrne does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Raymond Barrette

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that John J. Byrne does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ John J. Byrne

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Howard L. Clark does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Patrick M. Byrne

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Howard L. Clark does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual

Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Howard L. Clark

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Howard L. Clark, Jr. does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Howard L. Clark, Jr.

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Robert P. Cochran does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Robert P. Cochran

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that George J. Gillespie III does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ George J. Gillespie III

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Gordon S. Macklin does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Gordon S. Macklin

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Frank A. Olson does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Frank A. Olson

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Michael S. Paquette does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Michael S. Paquette

FUND AMERICAN ENTERPRISES HOLDINGS, INC.
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Arthur Zankel does hereby make, constitute and appoint K. Thomas Kemp the true and lawful attorney-in-fact of the undersigned, with full power of substitution and revocation, for and in the name, place and stead of the undersigned, to execute and deliver the Annual Report on Form 10-K, and any and all amendments thereto; such Form 10-K and each such amendment to be in such form and to contain such terms and provisions as said attorney or substitute shall deem necessary or desirable; giving and granting unto said attorney, or to such person or persons as in any case may be appointed pursuant to the power of substitution herein given, full power and authority to do and perform any and every act and thing whatsoever requisite, necessary or, in the opinion of said attorney or substitute, able to be done in and about the premises as fully and to all intents and purposes as the undersigned might or could do if personally present, hereby ratifying and confirming all that said attorney or such substitute shall lawfully do or cause to be done by virtue hereof.

IN WITNESS WHEREOF, the undersigned has duly executed these presents this 24th day of February, 1998.

/s/ Arthur Zankel

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors
of Financial Security Assurance Holdings Ltd.:

We have audited the accompanying consolidated balance sheets of Financial Security Assurance Holdings Ltd. and Subsidiaries as of December 31, 1997 and 1996 and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Financial Security Assurance Holdings Ltd. and Subsidiaries as of December 31, 1997 and 1996, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles.

/s/ Coopers & Lybrand L.L.P.

New York, New York
January 26, 1998

FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

ASSETS	December 31, 1997	December 31, 1996
	-----	-----
Bonds at market value (amortized cost of \$1,230,479 and \$1,058,417)	\$ 1,268,158	\$ 1,072,439
Equity investments at market value (cost of \$29,430 and \$8,336)	30,539	8,336
Short-term investments	132,931	73,641
	-----	-----
Total investments	1,431,628	1,154,416
Cash	12,475	8,146
Deferred acquisition costs	171,098	146,233
Prepaid reinsurance premiums	173,123	151,224
Reinsurance recoverable on unpaid losses	30,618	29,875
Receivable for securities sold	20,623	--
Other assets	61,079	47,848
	-----	-----
TOTAL ASSETS	\$ 1,900,644	\$ 1,537,742
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deferred premium revenue	\$ 595,196	\$ 511,196
Losses and loss adjustment expenses	75,417	72,079
Deferred federal income taxes	56,872	41,167
Ceded reinsurance balances payable	11,199	12,599
Payable for securities purchased	72,979	14,390
Notes payable	130,000	30,000
Accrued expenses and other liabilities	76,621	55,051
	-----	-----
TOTAL LIABILITIES	1,018,284	736,482
	-----	-----
COMMITMENTS AND CONTINGENCIES		
Preferred stock (3,000,000 shares authorized; 2,000,000		

issued and outstanding; par value of \$.01 per share)	20	20
Common stock (50,000,000 shares authorized; 32,276,301 issued; par value of \$.01 per share)	323	323
Additional paid-in capital - preferred	680	680
Additional paid-in capital - common	693,851	695,118
Unrealized gain on investments (net of deferred income tax provision of \$13,575 and \$4,908)	25,212	9,114
Accumulated earnings	231,124	142,721
Deferred equity compensation	26,181	12,069
Less treasury stock at cost (3,521,847 and 2,303,407 shares held)	(95,031)	(58,785)
	-----	-----
TOTAL SHAREHOLDERS' EQUITY	882,360	801,260
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,900,644	\$ 1,537,742
	=====	=====

</TABLE>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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[Page 27 of 1997 Annual Report to Shareholders]

FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)

	Year Ended December 31,		
	1997	1996	1995
	----	----	----
REVENUES:			
Net premiums written (net of premiums ceded of \$63,513, \$55,965 and \$33,166, of which \$38,105, \$35,299 and \$20,582 were ceded to affiliates)	\$ 172,878	\$ 121,000	\$ 77,576
Increase in deferred premium revenue	(63,367)	(30,552)	(8,229)
	-----	-----	-----
Premiums earned (net of premiums ceded of \$41,198, \$38,723 and \$38,013)	109,511	90,448	69,347
Net investment income	72,085	65,064	48,965
Net realized gains	11,522	3,189	5,120
Other income	9,303	297	3,841
	-----	-----	-----
TOTAL REVENUES	202,421	158,998	127,273
	-----	-----	-----
EXPENSES:			
Losses and loss adjustment expenses:			
Related to Merger	--	--	15,400
Other (net of reinsurance recoveries of \$3,605, (\$2,249) and \$9,101, of which \$3,199, (\$3,084) and \$7,111 were ceded to affiliates)	9,156	6,874	6,258
Policy acquisition costs	27,962	23,829	16,888
Other operating expenses	26,804	18,524	13,685
	-----	-----	-----
TOTAL EXPENSES	63,922	49,227	52,231
	-----	-----	-----
INCOME BEFORE INCOME TAXES	138,499	109,771	75,042
	-----	-----	-----
Provision (benefit) for income taxes:			
Current	30,960	27,227	23,187
Deferred	7,037	1,784	(3,183)
	-----	-----	-----
Total provision	37,997	29,011	20,004
	-----	-----	-----
NET INCOME	\$ 100,502	\$ 80,760	\$ 55,038
	=====	=====	=====
Basic earnings per common share	\$ 3.35	\$ 2.64	\$ 2.13
	=====	=====	=====
Diluted earnings per common share	\$ 3.25	\$ 2.61	\$ 2.13
	=====	=====	=====

The accompanying Notes to Consolidated Financial Statements
are an integral part of these statements.

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[Page 28 of 1997 Annual Report to Shareholders]

FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Dollars in thousands, except per share data)

	Preferred Stock	Common Stock	Additional Paid-In Capital - Preferred	Additional Paid-In Capital - Common	Unrealized Gain (Loss) on Investment	Accumulated Earnings	Deferred Equity Compensation	Treasury Stock	Total
BALANCE, December 31, 1994	\$ 20	\$ 262	\$ 680	\$544,266	\$ (21,709)	\$ 25,647	\$ --	\$ (3,730)	\$545,436
Net income for the year						55,038			55,038
Net change in unrealized gain on investments (net of deferred income taxes of \$22,421)					41,640				41,640
Issuance of common stock - 6,051,661 shares		61		151,987					152,048
Dividends paid on common stock (\$0.32 per share)						(8,275)			(8,275)
Deferred equity compensation							6,504		6,504
Purchase of 591,714 shares of common stock								(14,444)	(14,444)
BALANCE, December 31, 1995	20	323	680	696,253	19,931	72,410	6,504	(18,174)	777,947
Net income for the year						80,760			80,760
Net change in unrealized loss on investments (net of deferred income tax benefit of \$5,823)					(10,817)				(10,817)
Dividends paid on common stock (\$0.35 per share)						(10,536)			(10,536)
Deferred equity compensation							5,565		5,565
Purchase of 1,529,131 shares of common stock								(40,611)	(40,611)
Other common stock transactions				(1,135)					(1,135)
Adjustment to prior-year disposal of subsidiary						87			87
BALANCE, December 31, 1996	20	323	680	695,118	9,114	142,721	12,069	(58,785)	801,260
Net income for the year						100,502			100,502
Net change in unrealized gain on investments (net of deferred income taxes of \$8,667)					16,098				16,098
Dividends paid on common stock (\$0.405 per share)						(12,099)			(12,099)
Deferred equity compensation							17,781		17,781
Deferred equity payout				187			(3,287)	56	(3,044)
Purchase of 162,573 shares of common stock								(5,434)	(5,434)
Issuance of 125,106 shares of treasury stock for options exercised				688			(382)	3,042	3,348
Forward share transactions: Settlements with employees and directors				(2,142)					(2,142)
Settlements with counterparties								(33,910)	(33,910)
BALANCE, December 31, 1997	\$ 20	\$ 323	\$ 680	\$693,851	\$ 25,212	\$231,124	\$ 26,181	\$(95,031)	\$882,360

The accompanying Notes to Consolidated Financial Statements
are an integral part of these statements.

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[Page 29 of 1997 Annual Report to Shareholders]

Source: WHITE MOUNTAINS INSU, 10-K, March 30, 1998

FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	Year Ended December 31,		
	1997	1996	1995
	-----	-----	-----
Cash flows from operating activities:			
Premiums received, net	\$ 171,145	\$ 124,540	\$ 85,481
Policy acquisition and other operating expenses paid, net	(43,279)	(32,266)	(36,067)
Recoverable advances received (paid)	(7,629)	10,213	(9,419)
Losses and loss adjustment expenses paid	(6,463)	(15,473)	(4,954)
Net investment income received	65,662	63,533	41,939
Federal income taxes paid	(19,797)	(34,595)	(15,890)
Interest paid	(5,158)	(2,115)	(95)
Other	(2,017)	(4,253)	9,872
	-----	-----	-----
Net cash provided by operating activities	152,464	109,584	70,867
	-----	-----	-----
Cash flows from investing activities:			
Proceeds from sales of bonds	1,078,226	1,117,473	624,802
Proceeds from maturities of bonds	32,468	2,965	606
Purchases of bonds	(1,254,274)	(1,150,024)	(713,799)
Net gain on sale of subsidiaries	7,986	--	--
Purchases of property and equipment	(3,097)	(2,188)	(999)
Payment for purchase of subsidiary, net of cash acquired	--	--	(11,447)
Net decrease (increase) in short-term investments	(55,551)	(18,586)	56,689
	-----	-----	-----
Net cash used for investing activities	(194,242)	(50,360)	(44,148)
	-----	-----	-----
Cash flows from financing activities:			
Issuance of notes payable, net	125,905	--	--
Repayment of notes payable	(30,000)	--	--
Dividends paid	(12,099)	(10,536)	(8,275)
Treasury stock, net	(36,246)	(41,660)	(14,444)
Payment of management notes	--	--	(5,624)
Other	(1,453)	--	--
	-----	-----	-----
Net cash provided by (used for) financing activities	46,107	(52,196)	(28,343)
	-----	-----	-----
Net increase (decrease) in cash	4,329	7,028	(1,624)
Cash at beginning of year	8,146	1,118	2,742
	-----	-----	-----
Cash at end of year	\$ 12,475	\$ 8,146	\$ 1,118
	=====	=====	=====

Continued

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(Dollars in thousands)

	Year Ended December 31,		
	1997	1996	1995
	-----	-----	-----

Reconciliation of net income to net cash flows

Source: WHITE MOUNTAINS INSU, 10-K, March 30, 1998

from operating activities:			
Net income	\$ 100,502	\$ 80,760	\$ 55,038
Decrease (increase) in accrued investment income	(2,504)	(578)	124
Increase in deferred premium revenue and related foreign exchange adjustment	62,101	29,622	8,141
Increase in deferred acquisition costs	(24,865)	(13,282)	(10,305)
Increase (decrease) in current federal income taxes payable	7,891	(7,368)	7,297
Increase (decrease) in unpaid losses and loss adjustment expenses	2,596	(8,023)	14,587
Increase in amounts withheld for others	133	52	30
Provision (benefit) for deferred income taxes	10,309	1,784	(3,183)
Net realized gains on investments	(11,522)	(3,189)	(5,120)
Deferred equity compensation	14,299	5,565	5,735
Depreciation and accretion of bond discount	(2,802)	(1,735)	(5,735)
Net gain on sale of subsidiaries	(7,986)	--	--
Change in other assets and liabilities	4,312	25,976	4,258
	-----	-----	-----
Cash provided by operating activities	\$ 152,464	\$ 109,584	\$ 70,867
	=====	=====	=====

Additional common stock was issued in relation to the Merger in 1995.

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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[Pages 30 - 44 of 1997 Annual Report to Shareholders]

FINANCIAL SECURITY ASSURANCE HOLDINGS LTD.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 1997, 1996 AND 1995

1. ORGANIZATION AND OWNERSHIP

Financial Security Assurance Holdings Ltd. (the Company) is a holding company incorporated in the State of New York. The Company is principally engaged (through its insurance subsidiaries) in providing financial guaranty insurance on asset-backed and municipal obligations. The Company's underwriting policy is to insure asset-backed and municipal obligations that it determines would be of investment-grade quality without the benefit of the Company's insurance. The asset-backed obligations insured 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 an ascertainable cash flow or market value. The municipal obligations insured 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. Financial guaranty insurance written by the Company guarantees payment when due of scheduled payments on an issuer's obligation. In the case of a payment default on an insured obligation, the Company is generally required to pay the principal, interest or other amounts due in accordance with the obligation's original payment schedule or, at its option, to pay such amounts on an accelerated basis.

The Company expects to continue to emphasize a diversified insured portfolio characterized by insurance of both asset-backed and municipal obligations, with a broad geographic distribution and a variety of revenue sources and transaction structures. The Company's insured portfolio consists primarily of asset-backed and municipal obligations originated in the United States, but the Company has also written and continues to pursue business in Europe and the Pacific Rim.

On December 20, 1995, a subsidiary of the Company merged (the Merger) with Capital Guaranty Corporation (CGC). The Merger provided for each CGC share to be exchanged for 0.6716 share of the Company's common stock and cash of \$5.69. The Company issued in the aggregate 6,051,661 common shares and paid aggregate cash consideration of \$51,300,000. At December 31, 1995, the Company was owned 50.3% by U S WEST, Inc. (U S WEST), 7.8% by Fund American Enterprises Holdings, Inc. (Fund American), 6.1% by The Tokio Marine and Fire Insurance Co., Ltd. (Tokio Marine) and 35.8% by the public and employees. At December 31, 1996, the Company was owned 40.4% by U S WEST, 11.5% by Fund American, 6.4% by Tokio Marine and 41.7% by the public and employees. At December 31, 1997, the Company was owned 42.1% by U S WEST, 12.0% by Fund American, 6.7% by Tokio Marine and 39.2% by the public and employees. These percentages are calculated based upon outstanding shares, which are reduced by treasury shares as presented in these financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Source: WHITE MOUNTAINS INSU, 10-K, March 30, 1998

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles (GAAP), which, for the insurance company subsidiaries, differ in certain material respects from the accounting practices prescribed or permitted by insurance regulatory authorities (see Note 6). The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities in the Company's consolidated balance sheets at December 31, 1997 and 1996 and the reported amounts of revenues and expenses in the consolidated statements of income during the years ended December 31, 1997, 1996 and 1995. Such estimates and assumptions include, but are not limited to, losses and loss adjustment expenses and the deferral and amortization of deferred policy acquisition costs. Actual results may differ from those estimates. Significant accounting policies under GAAP are as follows:

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Basis of Presentation

The consolidated financial statements include the accounts of the Company and its direct and indirect wholly owned subsidiaries, FSA Portfolio Management Inc., CGC, Transaction Services Corporation, Financial Security Assurance Inc. (FSA), FSA Insurance Company, Financial Security Assurance of Oklahoma, Inc. and Financial Security Assurance (U.K.) Limited (collectively, the Subsidiaries). All intercompany accounts and transactions have been eliminated. Certain prior-year balances have been reclassified to conform to the 1997 presentation. The Merger was accounted for on a purchase accounting basis. In view of the short period between the date of the Merger, December 20, 1995, and the year-end, the date of the Merger for accounting purposes is considered to be December 31, 1995. As a result, the accounting for the Merger has no effect on the Company's consolidated statement of income for the year ended December 31, 1995, except for the recording of \$15,400,000 in losses and loss adjustment expenses to increase FSA's general reserve to provide for the insured portfolio assumed by FSA in the Merger (see Notes 17 and 19).

Investments

Investments in debt securities designated as available for sale are carried at market value. Any resulting unrealized gain or loss is reflected as a separate component of shareholders' equity, net of applicable deferred income taxes. All of the Company's long-term investments are classified as available for sale.

Bond discounts and premiums are amortized on the effective yield method over the remaining terms of the securities acquired. For mortgage-backed securities, and any other holdings for which prepayment risk may be significant, assumptions regarding prepayments are evaluated periodically and revised as necessary. Any adjustments required due to the resulting change in effective yields are recognized in current income. Short-term investments, which are those investments with a maturity of less than one year at time of purchase, are carried at market value, which approximates cost. Realized gains or losses on sale of investments are determined on the basis of specific identification. Investment income is recorded as earned.

To manage adverse movements in interest rates, the Company uses exchange traded futures and options. Primarily, these contracts are designated as hedges of specific identified securities and any gains or losses on these hedges are deferred and included as part of the Company's unrealized gains or losses in stockholders' equity until the disposition of the hedged assets. The Company will discontinue to account for these contracts as hedges if there ceases to be a high correlation between the change in price of the hedged assets and the hedge. Other derivative positions, also in exchange traded futures contracts, that are not accounted for as hedges are marked-to-market on a daily basis, and any gains or losses are included in capital gains or losses.

Premium Revenue Recognition

Gross and ceded premiums are earned in proportion to the amount of risk outstanding over the expected period of coverage. Deferred premium revenue and prepaid reinsurance premiums represent the portion of premium that is applicable to coverage of risk to be provided in the future on policies in force. When an insured issue is retired or defeased prior to the end of the expected period of coverage, the remaining deferred premium revenue and prepaid reinsurance premium, less any amount credited to a refunding issue insured by the Company, are recognized.

Losses and Loss Adjustment Expenses

A case basis reserve for unpaid losses and loss adjustment expenses is recorded at the present value of the estimated loss when, in management's opinion, the likelihood of a future loss is probable and determinable at the balance sheet date. The estimated loss on a transaction is discounted using current risk-free rates.

The general reserve is calculated by applying a loss factor to the total net par amount outstanding of the Company's insured obligations over the term of

such insured obligations and discounting the result at risk-free rates. The loss factor used for this purpose has been determined based upon an independent rating agency study of bond defaults and the Company's portfolio characteristics and history. The general reserve is available to be applied against future additions or accretions to existing case basis reserves or to new case basis reserves to be established in the future.

Management of the Company periodically evaluates its estimates for losses and loss adjustment expenses and establishes reserves that management believes are adequate to cover the ultimate net cost of claims. The reserves are necessarily based on estimates, and there can be no assurance that the ultimate liability will not differ from such estimates. The Company will, on an

ongoing basis, monitor these reserves and may periodically adjust such reserves based on the Company's actual loss experience, its future mix of business, and future economic conditions.

Deferred Acquisition Costs

Deferred acquisition costs comprise those expenses that vary with and are primarily related to the production of business, including commissions paid on reinsurance assumed, compensation and related costs of underwriting and marketing personnel, certain rating agency fees, premium taxes and certain other underwriting expenses, reduced by ceding commission income on premiums ceded to reinsurers. Deferred acquisition costs and the cost of acquired business are amortized over the period in which the related premiums are earned. Recoverability of deferred acquisition costs is determined by considering anticipated losses and loss adjustment expenses.

Federal Income Taxes

The provision for income taxes consists of an amount for taxes currently payable and a provision for tax consequences deferred to future periods reflected at current income tax rates.

Earnings per Common Share

In 1997, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 128, Earnings Per Share (EPS), specifying the computation, presentation and disclosure requirements for EPS (see Note 20). The new standard defines "basic" and "diluted" earnings per share. Basic earnings per share are based on average basic shares outstanding, which is calculated by adding shares earned but not issued under the Company's equity bonus and performance share plans to the average common shares outstanding. Diluted earnings per share are based on average diluted shares outstanding, which is calculated by adding shares contingently issuable under stock options, the performance share plan and the Company's convertible preferred stock to the average basic shares outstanding. All earnings per share have been restated to reflect the adoption of SFAS No. 128.

3. INVESTMENTS

Bonds at amortized cost of \$11,025,000 and \$17,669,000 at December 31, 1997 and 1996, respectively, were on deposit with state regulatory authorities as required by insurance regulations.

Consolidated net investment income consisted of the following (in thousands):

	Year Ended December 31,		
	1997	1996	1995
	----	----	----
Bonds	\$ 65,422	\$ 61,740	\$ 43,789
Equity investments	1,393	928	--
Short-term investments	7,206	3,966	6,070
Investment expenses	(1,936)	(1,570)	(894)
	-----	-----	-----
Net investment income	\$ 72,085	\$ 65,064	\$ 48,965
	=====	=====	=====

The credit quality of the investment portfolio at December 31, 1997 was as follows:

Rating	Percent of Investment Portfolio
-----	-----
AAA	69.1%

AA	16.0
A	11.5
BBB	1.1
Other	2.3

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The amortized cost and estimated market value of bonds were as follows (in thousands):

December 31, 1997 -----	Gross Amortized Cost ----	Gross Unrealized Gains -----	Unrealized Losses -----	Estimated Market Value -----
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 122,817	\$ 799	\$ (454)	\$ 123,162
Obligations of states and political subdivisions	777,042	40,187	(135)	817,094
Foreign securities	48,078	--	(6,126)	41,952
Mortgage-backed securities	195,567	2,213	(27)	197,753
Corporate securities	66,014	1,375	(501)	66,888
Asset-backed securities	20,961	349	(1)	21,309
Total	<u>\$1,230,479</u>	<u>\$ 44,923</u>	<u>\$ (7,244)</u>	<u>\$1,268,158</u>
December 31, 1996				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 55,619	\$ 1,103	\$ (557)	\$ 56,165
Obligations of states and political subdivisions	661,831	15,208	(2,870)	674,169
Foreign securities	15,019	197	(71)	15,145
Mortgage-backed securities	177,818	1,432	(906)	178,344
Corporate securities	76,760	381	(403)	76,738
Asset-backed securities	71,370	680	(172)	71,878
Total	<u>\$1,058,417</u>	<u>\$ 19,001</u>	<u>\$ (4,979)</u>	<u>\$1,072,439</u>

The change in net unrealized gains (losses) consisted of (in thousands):

	Year Ended December 31, -----		
	1997 ----	1996 ----	1995 ----
Bonds	\$ 23,657	\$ (16,640)	\$ 64,061
Equity investments	1,109	--	--
Change in net unrealized gains (losses)	<u>\$ 24,766</u>	<u>\$ (16,640)</u>	<u>\$ 64,061</u>

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The amortized cost and estimated market value of bonds at December 31, 1997 and 1996, by contractual maturity, are shown below (in thousands). Actual maturities could differ from contractual maturities because borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

	December 31, 1997		December 31, 1996	
	Amortized Cost	Estimated Market Value	Amortized Cost	Estimated Market Value
Due in one year or less	\$ 4,009	\$ 4,007	\$ 38,305	\$ 38,626
Due after one year through five years	70,283	70,007	57,531	57,712
Due after five years through ten years	208,986	208,170	105,495	105,848
Due after ten years	730,673	766,912	607,898	620,031
Mortgage-backed securities (stated maturities of 4 to 39 years)	195,567	197,753	177,818	178,344
Asset-backed securities (stated maturities of 2 to 30 years)	20,961	21,309	71,370	71,878
Total	\$1,230,479	\$1,268,158	\$1,058,417	\$1,072,439

Proceeds from sales of bonds during 1997, 1996 and 1995 were \$1,131,317,000, \$1,118,112,000 and \$608,773,000, respectively. Gross gains of \$12,659,000, \$15,335,000 and \$12,434,000 and gross losses of \$1,440,000, \$12,146,000 and \$7,314,000 were realized on sales in 1997, 1996 and 1995, respectively.

To hedge against changes in yields on certain one-year corporate securities, the Company entered into a series of Eurodollar futures contracts, which were marked-to-market on a daily basis. These contracts were accounted for as hedges. At year-end 1996, the net unrealized loss on the contracts, included in the Company's unrealized gains in the stockholders' equity section, was not material. The aggregate notional amount of these contracts was \$83,728,000 as of December 31, 1996.

The Company held open positions in U.S. Treasury bond futures contracts with an aggregate notional amount of \$33,300,000 and \$20,600,000 as of December 31, 1997 and 1996, respectively. Such positions are marked-to-market on a daily basis, and for the years ended December 31, 1997 and 1996, the Company reported net realized gains of \$190,000 and \$923,000, respectively, which are included in gross realized capital gains, above.

4. DEFERRED ACQUISITION COSTS

Acquisition costs deferred for amortization against future income and the related amortization charged to expenses are as follows (in thousands):

	Year Ended December 31,		
	1997	1996	1995
Balance, beginning of period	\$ 146,233	\$ 132,951	\$ 91,839
Costs deferred during the period:			
Ceding commission income	(18,956)	(15,956)	(9,836)
Assumed commission expense	31	38	55
Premium taxes	5,554	3,718	2,537
Compensation and other acquisition costs	66,198	49,311	34,437
Total	52,827	37,111	27,193
Costs amortized during the period	(27,962)	(23,829)	(16,888)
Balance of acquired subsidiary	--	--	30,807
Balance, end of period	\$ 171,098	\$ 146,233	\$ 132,951

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5. OTHER OPERATING EXPENSES

Total salary expense and related benefits included in other operating expenses were \$19,796,000, \$14,596,000 and \$12,046,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

6. STATUTORY ACCOUNTING PRACTICES

GAAP for the Subsidiaries differs in certain significant respects from accounting practices prescribed or permitted by insurance regulatory authorities. The principal differences result from the following statutory accounting practices:

- Upfront premiums on municipal business are recognized as earned when related principal and interest have expired rather than over the expected coverage period;
- Acquisition costs are charged to operations as incurred rather than as related premiums are earned;
- A contingency reserve (rather than a general loss reserve) is computed based on the following statutory requirements:
 - (i) For all policies written prior to July 1, 1989, an amount equal to 50% of cumulative earned premiums less permitted reductions, plus;
 - (ii) For all policies written on or after July 1, 1989, an amount equal to the greater of 50% of premiums written for each category of insured obligation or a designated percentage of principal guaranteed for that category. These amounts are provided each quarter as either 1/60th or 1/80th of the total required for each category, less permitted reductions;
- Certain assets designated as "non-admitted assets" are charged directly to statutory surplus but are reflected as assets under GAAP;
- Federal income taxes are provided only on taxable income for which income taxes are currently payable;
- Accruals for deferred compensation are not recognized;
- Purchase accounting adjustments are not recognized;
- Bonds are carried at amortized cost;
- Surplus notes are recognized as surplus rather than a liability.

A reconciliation of net income for the calendar years 1997, 1996 and 1995 and shareholders' equity at December 31, 1997, 1996 and 1995, reported by the Company on a GAAP basis, to the amounts reported by the Subsidiaries on a statutory basis, is as follows (in thousands):

Net Income:	1997	1996	1995
	----	----	----
GAAP BASIS	\$ 100,502	\$ 80,760	\$ 55,038
Non-insurance companies net loss (gain)	(243)	95	(50)
Premium revenue recognition	(23,130)	(5,518)	(4,805)
Losses and loss adjustment expenses incurred	4,653	(2,138)	10,871
Deferred acquisition costs	(24,865)	(12,482)	(10,305)
Deferred income tax provision (benefit)	8,025	911	(3,055)
Amortization of bonds	56	566	1,195
Accrual of deferred compensation, net	26,681	12,737	5,663
Other	(61)	1,404	(1,580)
	-----	-----	-----
STATUTORY BASIS	\$ 91,618	\$ 76,335	\$ 52,972
	=====	=====	=====

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	December 31,		
	-----	-----	-----
Shareholders' Equity:	1997	1996	1995
	----	----	----
GAAP BASIS	\$ 882,360	\$ 801,260	\$ 777,947
Non-insurance companies liabilities, net	15,500	14,072	12,039
Premium revenue recognition	(74,863)	(51,760)	(46,248)
Loss and loss adjustment expense reserves	34,313	29,660	31,798
Deferred acquisition costs	(171,098)	(146,233)	(132,951)
Contingency reserve	(287,694)	(227,139)	(183,967)
Unrealized gain on investments, net of tax	(43,027)	(14,084)	(30,298)
Deferred income taxes	59,867	41,682	43,205
Accrual of deferred compensation	41,451	18,390	5,653
Surplus notes	50,000	--	--
Other	(12,841)	(17,043)	(16,492)
	-----	-----	-----
STATUTORY BASIS (SURPLUS)	\$ 493,968	\$ 448,805	\$ 460,686
	=====	=====	=====

Source: WHITE MOUNTAINS INSU, 10-K, March 30, 1998

SURPLUS PLUS CONTINGENCY RESERVE	\$ 781,661	\$ 675,944	\$ 644,653
	=====	=====	=====

7. FEDERAL INCOME TAXES

For periods prior to May 13, 1994, the date of the initial public offering when the Company became less than 80% owned by U S WEST, the Company and its Subsidiaries joined with U S WEST and its subsidiaries in filing a consolidated federal income tax return. Under a U S WEST practice, an income tax benefit or liability was allocated to the Company to the extent that benefits were usable or additional liabilities were incurred by U S WEST due to the Company's inclusion in the U S WEST tax returns. For each year since the Company's acquisition by U S WEST, the Company's resulting income tax provision has been the same as if the allocation of taxes were based on a separate return calculation. For the Subsidiaries, under a separate tax sharing agreement with U S WEST, the allocation of income taxes was based upon separate return calculations, which provided that benefits or liabilities created by the Subsidiaries were allocated to the Subsidiaries regardless of whether the benefits were usable or additional liabilities were incurred in the U S WEST tax returns. For periods subsequent to May 12, 1994, the Company and all members of its group elected to file consolidated federal income tax returns. The calculation of each member's tax benefit or liability was controlled by a tax sharing agreement that based the allocation of such benefit or liability upon a separate return calculation.

The cumulative balance sheet effects of deferred tax consequences are (in thousands):

	December 31,	
	1997	1996
	----	----
Deferred acquisition costs	\$ 59,884	\$ 51,182
Deferred premium revenue adjustments	8,424	3,520
Unrealized capital gains	15,618	7,952
Contingency reserves	38,037	30,893
Market discounts	2,016	1,950
	-----	-----
Total deferred tax liabilities	123,979	95,497
	-----	-----
Loss and loss adjustment expense reserves	(12,009)	(10,381)
Deferred compensation	(21,503)	(10,730)
Tax credits	(1,807)	(7,861)
Tax and loss bonds	(30,520)	(22,526)
Other, net	(1,268)	(2,832)
	-----	-----
Total deferred tax assets	(67,107)	(54,330)
	-----	-----
Total deferred income taxes	\$ 56,872	\$ 41,167
	=====	=====

No valuation allowance was necessary at December 31, 1997 or 1996.

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A reconciliation of the effective tax rate with the federal statutory rate follows:

	Year Ended December 31,		
	1997	1996	1995
	----	----	----
Tax at statutory rate	35.0%	35.0%	35.0%
Tax-exempt interest	(7.9)	(8.9)	(8.5)
Other	0.3	0.3	0.2
	----	----	----
Provision for income taxes	27.4%	26.4%	26.7%
	=====	=====	=====

8. SHAREHOLDERS' EQUITY

On September 2, 1994, the Company issued to Fund American 2,000,000 shares of Series A, non-dividend paying, voting, convertible preferred stock having an aggregate liquidation preference of \$700,000. The preferred stock is

convertible, at the option of the holder upon payment of the conversion price therefor, into an equal number of shares of common stock (subject to anti-dilutive adjustment). The conversion price per share (subject to anti-dilutive adjustment) is \$29.65. The preferred stock will be redeemed (if then outstanding) on May 13, 2004 at a redemption price of \$0.35 per share. Fund American is entitled to one vote per share of preferred stock, voting together as a single class with the holders of common stock on all matters upon which holders of common stock are entitled to vote. As the holder of the preferred stock, Fund American is not entitled to receive dividends or other distributions of any kind payable to shareholders of the Company, except that, in the event of the liquidation, dissolution or winding up of the Company, it is entitled to receive out of the assets of the Company available therefor, before any distribution or payment is made to the holders of common stock or to any other class of capital stock of the Company ranking junior to the Company's preferred stock, liquidation payments in the amount of \$0.35 per share. Fund American may not transfer the preferred stock, except to one of its majority-owned subsidiaries.

On December 20, 1995, CGC merged with a subsidiary of the Company. The Merger provided for each CGC share to be exchanged for 0.6716 share of the Company's common stock and cash of \$5.69. The Company issued in the aggregate 6,051,661 common shares and paid aggregate cash consideration of \$51,300,000.

In May 1996, the Company repurchased 1,000,000 shares of its common stock from U S WEST for a purchase price of \$26.50 per share. At the same time, the Company also entered into forward agreements with National Westminster Bank Plc and Canadian Imperial Bank of Commerce (the Counterparties) in respect of 1,750,000 shares (the Forward Shares) of the Company's common stock. Under the forward agreements, the Company has the obligation either: (i) to purchase the Forward Shares from the Counterparties for a price equal to \$26.50 per share plus carrying costs or (ii) to direct the Counterparties to sell the Forward Shares, with the Company receiving any excess or making up any shortfall between the sale proceeds and \$26.50 per share plus carrying costs in cash or additional shares, at its option. Simultaneous with the Company entering into the forward agreements, the Company made the economic benefit and risk of 750,000 of these shares available for subscription by certain of the Company's employees and directors. When an individual participant exercises Forward Shares under the subscription program, the Company settles with the participant but does not necessarily close out the corresponding forward share position with the Counterparties. The cost of these settlements during 1997 was \$2,142,000 and was charged to additional paid-in capital. By the fourth quarter of 1997, such exercises by participants had increased the number of shares allocated to the Company from 1,000,000 shares to 1,187,800 shares. During the fourth quarter of 1997, the Company purchased 1,187,800 Forward Shares for \$33,910,000 by exercising rights under the forward agreements. At December 31, 1997, as a result of the Company's exercise, the repurchased shares are held as treasury stock, and the remaining 562,200 Forward Shares were allocated to the subscription program.

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9. DIVIDENDS AND CAPITAL REQUIREMENTS

Under New York Insurance Law, FSA may pay a dividend to the Company without the prior approval of the Superintendent of the New York State Insurance Department only from earned surplus subject to the maintenance of a minimum capital requirement. In addition, the dividend, together with all dividends declared or distributed by FSA during the preceding twelve months, may not exceed the lesser of 10% of its policyholders' surplus shown on FSA's last filed statement, or adjusted net investment income, as defined, for such twelve-month period. As of December 31, 1997, FSA had \$49,846,000 available for the payment of dividends over the next twelve months. In addition, the New York Superintendent has approved the repurchase by FSA of up to \$75,000,000 of its shares from the Company through December 31, 1998, pursuant to which FSA has repurchased \$66,500,000 of its shares through December 31, 1997.

10. CREDIT ARRANGEMENTS AND ADDITIONAL CLAIMS-PAYING RESOURCES

The Company has a credit arrangement aggregating \$150,000,000 at December 31, 1997, which is provided by commercial banks and intended for general application to transactions insured by the Subsidiaries. At December 31, 1997, there were no borrowings under this arrangement, which expires on November 23, 1999. In addition, there are credit arrangements assigned to specific insured transactions. In August 1994, FSA entered into a facility agreement with Canadian Global Funding Corporation and Hambros Bank Limited. Under the agreement, FSA can arrange financing for transactions subject to certain conditions. The amount of this facility was \$186,911,000, of which \$100,911,000 was unutilized at December 31, 1997.

FSA has a standby line of credit commitment in the amount of \$240,000,000 with a group of international Aaa/AAA-rated banks to provide loans to FSA after it has incurred, during the term of the facility, cumulative municipal losses (net of any recoveries) in excess of the greater of \$230,000,000 or 5.75% of average annual debt service of the covered portfolio. The obligation to repay loans made under this agreement is a limited recourse obligation payable solely from, and collateralized by, a pledge of recoveries realized on defaulted insured obligations including certain installment premiums and other collateral.

This commitment has a term beginning on April 30, 1997 and expiring on April 30, 2004 and contains an annual renewal provision subject to approval by the banks. No amounts have been utilized under this commitment as of December 31, 1997.

In connection with the Merger, the Company assumed \$30,000,000 of CGC's senior notes. Interest on these notes was paid semiannually at the rate of 7.05% per annum. These notes were repaid in September 1997.

On September 18, 1997, the Company issued \$130,000,000 of 7.375% Senior Quarterly Income Debt Securities (Senior QUIDS) due September 30, 2097 and callable without premium or penalty on or after September 18, 2002. Interest on these notes is paid quarterly beginning on December 31, 1997. Debt issuance costs of \$4,300,000 are being amortized over the life of the debt. The Company used the proceeds to repay the CGC senior notes described above, to augment capital in the Subsidiaries, to repurchase Forward Shares (see Note 8) and for general corporate purposes.

11. EMPLOYEE BENEFIT PLANS

The Subsidiaries maintain both a qualified and a non-qualified non-contributory defined contribution pension plan for the benefit of all eligible employees. The Subsidiaries' contributions are based upon a fixed percentage of employee compensation. Pension expense, which is funded as accrued, amounted to \$2,535,000, \$2,215,000 and \$1,898,000 for the years ended December 31, 1997, 1996 and 1995, respectively.

The Subsidiaries have an employee retirement savings plan for the benefit of all eligible employees. The plan permits employees to contribute a percentage of their salaries up to limits prescribed by the Internal Revenue Service (IRS Code, Section 401(k)). The Subsidiaries' contributions are discretionary, and none have been made.

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During 1991, the Subsidiaries established the Profit Participation Plan as a long-term incentive compensation plan for the benefit of certain of its employees. Prior to the Company's initial public offering in 1994, the Company adopted a Supplemental Restricted Stock Plan. Pursuant to this plan, awards of outstanding units to existing employees under the Profit Participation Plan were valued at \$0.20 per dollar of award (\$0.70 per dollar of award in the case of 1994 regular units granted thereunder) and, at the election of each outstanding employee, were exchanged for restricted shares of common stock valued at the initial public offering price of \$20.00 per share. All employees of the Company, including all senior executives, exchanged their outstanding interests in the Profit Participation Plan for restricted shares of common stock at the public offering price under the Supplemental Restricted Stock Plan. In exchange for an accrued balance of \$7,126,000 in such Profit Participation Plan, the Company issued 356,345 shares of restricted stock. This transaction was treated as a non-cash financing transaction for cash flow purposes. The stock was restricted because ownership of the shares by employees required continued employment. The shares vested ratably over a three-year period on July 1, 1994, 1995 and 1996.

Pursuant to the 1993 Equity Participation Plan, 1,810,780 shares of common stock, subject to anti-dilutive adjustment, were reserved for awards of options, restricted shares of common stock, and performance shares to employees for the purpose of providing, through the grant of long-term incentives, a means to attract and retain key personnel and to provide to participating officers and other key employees long-term incentives for sustained high levels of performance. Shares available under the 1993 Equity Participation Plan were increased from 1,810,780 to 2,110,780 in May 1995. The 1993 Equity Participation Plan also contains provisions that permit the Human Resources Committee to pay all or a portion of an employee's bonuses in the form of shares of common stock credited to the employees at a 15% discount from current market value and paid to employees five years from the date of award. Up to an aggregate of 10,000,000 shares may be allocated to such equity bonuses. Common stock to pay performance shares, stock options and equity bonus awards is acquired by the Company through open-market purchases by a trust established for such purpose.

During 1994, under the Company's 1993 Equity Participation Plan, the Company granted to officers and employees, in respect of future performance, non-qualified options to purchase an aggregate of 1,099,000 shares of common stock, of which 39,000 were forfeited and 1,060,000 were still outstanding at December 31, 1994, substantially all of which have an exercise price of \$20.00 per share. (As described below, 1,025,500 of these options were converted to performance shares.) The foregoing options vest, subject to continuation of employment and other terms of the option grants, at the rate of 20% per year, for five one-year periods, with the first period ending on July 1, 1994. Such options expire ten years after the effective dates of their grant. In the fourth quarter of 1994, holders of outstanding stock options under the 1993 Equity Participation Plan were offered the right to exchange such stock options for an equal number of performance shares under such Plan. Also, as a result of the Merger, the Company granted stock options to acquire an aggregate of 169,956 shares of common stock with strike prices ranging from \$18.63 to \$23.53 per share to employees of CGC in exchange for outstanding stock options of CGC. During 1997, employees acquired 125,106 shares subject to options at an average strike price of \$22.32 per share and with an average market price of \$41.47 per share. In addition, options to purchase 20,194 shares were forfeited during

1997. Giving effect to such exchange and subsequent awards, at December 31, 1997, there were outstanding 1,366,375 performance shares and options to purchase 56,656 shares of common stock.

Performance shares granted under the 1993 Equity Participation Plan were as follows:

	Outstanding at Beginning of Year -----	Granted During the Year -----	Earned During the Year -----	Forfeited During the Year -----	Outstanding at End of Year -----	Market Price at Grant Date -----
1995	1,025,500	83,650	--	--	1,109,150	\$19.250
1996	1,109,150	282,490	--	17,300	1,374,340	25.250
1997	1,374,340	253,057	201,769	59,253	1,366,375	35.500

The Company applies APB Opinion 25 and related Interpretations in accounting for its performance shares. The Company estimates the final cost of these performance shares and accrues for this expense over the performance period. The accrued expense for the performance shares was \$29,500,000, \$13,741,000 and \$5,744,000 for the years ended December 31, 1997, 1996 and 1995, respectively. In tandem with this accrued expense, the Company estimates those performance shares that it expects to settle in stock and records this amount in stockholders' equity as deferred compensation. The remainder of the accrual, which represents the amount of performance shares that the Company estimates it will settle in cash, is recorded in accrued expenses and other liabilities. In 1996, the Company adopted disclosure provisions of SFAS No. 123. Had the compensation cost for the Company's performance shares been determined based upon the provisions of SFAS No. 123, there would have been no effect on the Company's reported net income and earnings per share.

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In November 1994, the Company appointed an independent trustee authorized to purchase shares of the Company's common stock in open market transactions, at times and prices determined by the trustee. These purchases are intended to fund future obligations relating to equity bonuses, performance shares and stock options under the 1993 Equity Participation Plan and are presented as treasury stock in these financial statements. During 1997, 1996 and 1995, the total number of shares purchased by the trust was 162,573, 529,131 and 591,714, respectively, at a cost of \$5,434,000, \$14,111,000 and \$14,444,000, respectively. In 1996 and 1995, the Company also repurchased stock from its employees in satisfaction of withholding taxes on shares distributed under its restricted stock plan.

The Company does not currently provide post-retirement benefits, other than under its defined contribution plans, to its employees, nor does it provide post-employment benefits to former employees.

12. COMMITMENTS AND CONTINGENCIES

The Company and its Subsidiaries lease office space and equipment under non-cancelable operating leases, which expire at various dates through 2005.

Future minimum rental payments are as follows (in thousands):

Year Ended December 31, -----	
1998	\$ 2,477
1999	2,440
2000	2,301
2001	2,014
2002	1,739
Thereafter	5,071

Total	\$16,042
	=====

Rent expense for the years ended December 31, 1997, 1996 and 1995 was \$4,067,000, \$3,816,000 and \$3,712,000, respectively.

During the ordinary course of business, the Subsidiaries have become parties to certain litigation. Management believes that these matters will be resolved with no material financial impact on the Company.

13. REINSURANCE

The Subsidiaries reinsure portions of their risks with affiliated (see Note 15) and unaffiliated reinsurers under quota share treaties and on a facultative basis. The Subsidiaries' principal ceded reinsurance program consisted in 1997 of two quota share treaties and three automatic facultative facilities. One treaty covered all of the Subsidiaries' approved regular lines of business, except U.S. municipal obligation insurance. Under this treaty in 1997, the Subsidiaries ceded 9.75% of each covered policy, up to a maximum of \$19,500,000 insured principal per policy. At their sole option, the Subsidiaries could have increased, and in certain instances did increase, the ceding percentage to 19.5% up to \$39,000,000 of each covered policy. A second treaty covered the Subsidiaries' U.S. municipal obligation insurance business. Under this treaty in 1997, the Subsidiaries ceded 9% of each covered policy that is classified by the Subsidiaries as providing U.S. municipal bond insurance as defined by Article 69 of the New York Insurance Law up to a limit of \$24,000,000 per single risk, which is defined by revenue source. At their sole option, the Subsidiaries could have increased, and in certain instances did increase, the ceding percentage to 35% up to \$93,333,000 per single risk. These cession percentages under both treaties were reduced on smaller-sized transactions. Under the three automatic facultative facilities in 1997, the Subsidiaries at their option could allocate up to a specified amount for each reinsurer (ranging from \$4,000,000 to \$50,000,000 depending on the reinsurer) for each transaction, subject to limits and exclusions, in exchange for which the Subsidiaries agreed to cede in the aggregate a specified percentage of gross par insured by the Subsidiaries. Each of the treaties and automatic facultative facilities allowed the Subsidiaries to withhold a ceding commission to defray their expenses. The Subsidiaries also employed non-treaty, quota share facultative reinsurance on various transactions in 1997 in keeping with prior practices. In 1997, the Subsidiaries also implemented facultative first-loss reinsurance on selected asset-backed transactions.

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In the event (which management considers to be highly unlikely) that any or all of the reinsuring companies were unable to meet their obligations to the Subsidiaries, the Subsidiaries would be liable for such defaulted amounts. The Subsidiaries have also assumed reinsurance of municipal obligations from unaffiliated insurers.

Amounts reinsured were as follows (in thousands):

	Year Ended December 31,		
	1997	1996	1995
	----	----	----
Written premiums ceded	\$ 63,513	\$ 55,965	\$ 33,166
Written premiums assumed	1,352	1,873	1,684
Earned premiums ceded	41,713	38,723	38,013
Earned premiums assumed	5,121	6,020	2,759
Loss and loss adjustment expense payments ceded	2,862	29,408	3,060
Loss and loss adjustment expense payments assumed	2	3	3
Incurred losses and loss adjustment expenses ceded	3,605	(2,249)	9,101
Incurred losses and loss adjustment expenses assumed	161	38	81
	December 31,		
	1997	1996	
	----	----	
Principal outstanding ceded	\$24,547,361	\$20,292,615	
Principal outstanding assumed	1,670,468	1,995,752	
Deferred premium revenue ceded	173,123	151,224	
Deferred premium revenue assumed	14,128	18,929	
Loss and loss adjustment expense reserves ceded	30,618	29,875	
Loss and loss adjustment expense reserves assumed	865	705	

14. OUTSTANDING EXPOSURE AND COLLATERAL

The Company's policies insure the scheduled payments of principal and interest on asset-backed and municipal obligations. The principal amount insured (in millions) as of December 31, 1997 and 1996 (net of amounts ceded to other insurers of \$10,129 and \$9,601 of asset-backed and \$14,418 and \$10,691 of municipal, respectively) and the terms to maturity are as follows:

Terms to Maturity	December 31, 1997		December 31, 1996	
	Asset-Backed	Municipal	Asset-Backed	Municipal
0 to 5 Years	\$ 7,553	\$ 2,230	\$ 7,424	\$ 1,571
5 to 10 Years	5,637	5,683	3,920	3,841
10 to 15 Years	2,858	8,257	1,461	6,272
15 to 20 Years	524	14,340	714	11,433
20 Years and Above	11,917	16,479	9,681	12,877
Total	\$28,489	\$46,989	\$23,200	\$35,994

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The principal amount ceded as of December 31, 1997 and 1996 and the terms to maturity are as follows (in millions):

Terms to Maturity	December 31, 1997		December 31, 1996	
	Asset-Backed	Municipal	Asset-Backed	Municipal
0 to 5 Years	\$ 3,828	\$ 965	\$ 3,695	\$ 769
5 to 10 Years	2,118	1,693	2,413	1,192
10 to 15 Years	553	2,078	452	1,479
15 to 20 Years	257	3,005	302	2,345
20 Years and Above	3,373	6,677	2,739	4,906
Total	\$10,129	\$14,418	\$ 9,601	\$10,691

The Company limits its exposure to losses from writing financial guarantees by underwriting investment-grade obligations, by diversifying its portfolio and by maintaining rigorous collateral requirements on asset-backed obligations. The gross principal amounts of insured obligations in the asset-backed insured portfolio are backed by the following types of collateral (in millions):

Types of Collateral	Net of Amounts Ceded December 31,		Ceded December 31,	
	1997	1996	1997	1996
Residential mortgages	\$12,928	\$10,987	\$ 3,665	\$ 3,077
Consumer receivables	10,659	7,548	4,601	3,735
Government securities	787	1,477	120	449
Pooled corporate obligations	3,004	1,663	540	852
Commercial mortgage portfolio:				
Commercial real estate	98	113	418	463
Corporate secured	55	66	481	619
Investor-owned utility obligations	643	791	229	266
Other asset-backed obligations	315	555	75	140
Total asset-backed obligations	\$28,489	\$23,200	\$10,129	\$ 9,601

The asset-backed insured portfolio, which aggregated \$38,618,244,000 principal before reinsurance at December 31, 1997, was collateralized by assets with an estimated fair value of \$44,382,716,000. At December 31, 1996, it aggregated \$32,792,722,000 principal before reinsurance and was collateralized by assets with an estimated fair value of \$38,323,180,000. Such estimates of fair value are calculated at the inception of each insurance policy and are changed only in proportion to changes in exposure. At December 31, 1997, the estimated fair value of collateral and reserves over the principal insured averaged from 100% for commercial real estate to 172% for corporate secured obligations. At December 31, 1996, the estimated fair value of collateral and reserves over the principal insured averaged from 100% for commercial real estate to 168% for corporate secured obligations. Collateral for specific transactions is generally not available to pay claims related to other transactions. The amounts of losses ceded to reinsurers are determined net of collateral.

The gross principal amount of insured obligations in the municipal insured portfolio includes the following types of issues (in millions):

Types of Issues	Net of Amounts Ceded December 31,		Ceded December 31,	
	1997	1996	1997	1996
General obligation bonds	\$17,101	\$12,523	\$ 3,182	\$ 2,423
Housing revenue bonds	1,770	1,794	955	1,033
Municipal utility revenue bonds	5,892	4,671	2,294	1,472
Health care revenue bonds	3,924	2,854	2,175	2,049
Tax-supported bonds (non-general obligation)	11,210	8,805	3,526	2,152
Transportation revenue bonds	1,972	1,479	1,041	436
Other municipal bonds	5,120	3,868	1,245	1,126
Total municipal obligations	\$46,989	\$35,994	\$14,418	\$10,691

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In its asset-backed business, the Company considers geographic concentration as a factor in underwriting insurance covering securitizations of pools of such assets as residential mortgages or consumer receivables. However, after the initial issuance of an insurance policy relating to such securitization, the geographic concentration of the underlying assets may not remain fixed over the life of the policy. In addition, in writing insurance for other types of asset-backed obligations, such as securities primarily backed by government or corporate debt, geographic concentration is not deemed by the Company to be significant given other more relevant measures of diversification such as issuer or industry.

The Company seeks to maintain a diversified portfolio of insured municipal obligations designed to spread its risk across a number of geographic areas. The following table sets forth, by state, those states in which municipalities located therein issued an aggregate of 2% or more of the Company's net par amount outstanding of insured municipal securities as of December 31, 1997:

State	Number of Issues	Net Par Amount Outstanding (in millions)	Percent of Total Municipal Net Par Amount Outstanding	Ceded Par Amount Outstanding (in millions)
California	403	\$ 7,832	16.7%	\$ 1,929
New York	281	4,307	9.2	2,163
Pennsylvania	231	3,125	6.6	650
New Jersey	207	2,730	5.8	1,260
Florida	103	2,669	5.7	817
Texas	294	2,472	5.3	669
Illinois	274	1,851	3.9	254
Massachusetts	101	1,460	3.1	553
Michigan	147	1,417	3.0	409
Minnesota	129	1,152	2.5	111
Wisconsin	179	1,138	2.4	206
All Other States	1,190	15,575	33.1	4,528
Non-U.S.	29	1,261	2.7	869
Total	3,568	\$46,989	100.0%	\$14,418

15. RELATED PARTY TRANSACTIONS

The Subsidiaries ceded premiums of \$21,216,000, \$19,890,000 and \$13,061,000 to Tokio Marine for the years ended December 31, 1997, 1996 and 1995, respectively. The amounts included in prepaid reinsurance premiums at December 31, 1997 and 1996 for reinsurance ceded to Tokio Marine were \$53,603,000 and \$44,634,000, respectively. Reinsurance recoverable on unpaid losses ceded to Tokio Marine was \$613,000 and \$477,000 at December 31, 1997 and 1996, respectively.

The Subsidiaries ceded premiums of \$16,890,000, \$15,409,000 and \$7,522,000 on a quota share basis to affiliates of U S WEST for the years ended December 31, 1997, 1996 and 1995, respectively, of which \$351,000, \$372,000 and \$629,000,

respectively, were ceded to Commercial Reinsurance Company (Commercial Re). The amounts included in prepaid reinsurance premiums for reinsurance ceded to these affiliates were \$51,980,000 and \$49,649,000 at December 31, 1997 and 1996, respectively, of which \$5,554,000 and \$8,728,000, respectively, were ceded to Commercial Re. The amounts of reinsurance recoverable on unpaid losses ceded to these affiliates at December 31, 1997 and 1996 were \$24,195,000 and \$23,473,000, respectively, of which \$20,335,000 and \$19,170,000, respectively, were ceded to Commercial Re. The Commercial Re reinsurance agreement was subject to, and received, the non-disapproval of the State of New York Insurance Department due to its nature as an affiliate transaction. FSA has taken credit for the reinsurance ceded to Commercial Re.

16. DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following estimated fair values have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is necessary to interpret the data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amount the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Bonds -- The carrying amount of bonds represents fair value. The fair value of bonds is based upon quoted market price.

Short-term investments -- The carrying amount is fair value, which approximates cost due to the short maturity of these instruments.

Cash, receivable for investments sold and payable for investments purchased -- The carrying amount approximates fair value because of the short maturity of these instruments.

Deferred premium revenue, net of prepaid reinsurance premiums -- The carrying amount of deferred premium revenue, net of prepaid reinsurance premiums, represents the Company's future premium revenue, net of reinsurance, on policies where the premium was received at the inception of the insurance contract. The fair value of deferred premium revenue, net of prepaid reinsurance premiums, is an estimate of the premiums that would be paid under a reinsurance agreement with a third party to transfer the Company's financial guaranty risk, net of that portion of the premiums retained by the Company to compensate it for originating and servicing the insurance contracts.

Installment premiums -- Consistent with industry practice, there is no carrying amount for installment premiums since the Company will receive premiums on an installment basis over the term of the insurance contract. Similar to deferred premium revenue, the fair value of installment premiums is the estimated present value of the future contractual premium revenues that would be paid under a reinsurance agreement with a third party to transfer the Company's financial guaranty risk, net of that portion of the premium retained by the Company to compensate it for originating and servicing the insurance contract.

Losses and loss adjustment expenses, net of reinsurance recoverable on unpaid losses -- The carrying amount is fair value, which is the present value of the expected cash flows for specifically identified claims and potential losses in the Company's insured portfolio.

(In thousands)	December 31, 1997		December 31, 1996	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Bonds	\$1,268,158	\$1,268,158	\$1,072,439	\$1,072,439
Short-term investments	132,931	132,931	73,641	73,641
Cash	12,475	12,475	8,146	8,146
Receivable for securities sold	20,623	20,623	--	--
Liabilities:				
Deferred premium revenue, net of prepaid reinsurance premiums	422,073	295,451	359,972	251,980
Losses and loss adjustment expenses, net of reinsurance recoverable on unpaid losses	44,799	44,799	42,204	42,204
Notes payable	130,000	131,612	30,000	30,000
Payable for investments purchased	72,979	72,979	14,390	14,390
Off-balance-sheet instruments:				
Installment premiums	--	116,888	--	102,988

17. LIABILITY FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

The Company's liability for losses and loss adjustment expenses consists of the case basis and general reserves. Activity in the liability for losses and loss adjustment expenses is summarized as follows (in thousands):

	Year Ended December 31,		
	1997	1996	1995
Balance at January 1	\$ 72,079	\$ 111,759	\$ 91,130
Less reinsurance recoverable	29,875	61,532	55,491
Net balance at January 1	42,204	50,227	35,639
Incurred losses and loss adjustment expenses:			
Current year	5,400	5,300	3,000
Prior years	3,756	1,574	3,258
Related to Merger	--	--	15,400
Paid losses and loss adjustment expenses:			
Current year	(2,850)	--	--
Prior years	(3,711)	(14,897)	(7,070)
Net balance December 31	44,799	42,204	50,227
Plus reinsurance recoverable	30,618	29,875	61,532
Balance at December 31	\$ 75,417	\$ 72,079	\$ 111,759

During 1995, the Company increased its general reserve by \$6,258,000, of which \$3,000,000 was for originations of new business and \$3,258,000 was to reestablish the general reserve for transfers from general reserves to case basis reserves. During 1995, the Company transferred \$10,788,000 from its general reserve to case basis reserves associated predominantly with certain residential mortgage and timeshare receivables transactions. Also in December 1995, FSA recognized a one-time increase of \$15,400,000 to the general reserve to provide for the insured portfolio it had assumed in the Merger with CGC in a manner consistent with the Company's reserving methodology. Prior to the Merger, CGC did not maintain a general reserve. Giving effect to all the 1995 events, the general reserve totaled \$31,798,000 at December 31, 1995.

During 1996, the Company increased its general reserve by \$6,874,000, of which \$5,300,000 was for originations of new business and \$1,574,000 was to reestablish a portion of the general reserve that had previously been transferred to case basis reserves. During 1996, the Company transferred \$9,012,000 from its general reserve to case basis reserves associated predominantly with certain residential mortgage and timeshare receivables transactions. Giving effect to these transfers, the general reserve totaled \$29,660,000 at December 31, 1996.

During 1997, the Company increased its general reserve by \$9,156,000, of which \$5,400,000 was for originations of new business and \$3,756,000 was to reestablish a portion of the general reserve that had previously been transferred to case basis reserves. During 1997, the Company transferred \$4,503,000 from its general reserve to case basis reserves associated predominantly with certain residential mortgage transactions. Giving effect to these transfers, the general reserve totaled \$34,313,000 at December 31, 1997.

Reserves for losses and loss adjustment expenses are discounted at risk-free rates. The amount of discount taken was approximately \$19,779,000, \$17,944,000 and \$15,276,000 at December 31, 1997, 1996 and 1995, respectively.

18. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(In thousands, except share data)	First	Second	Third	Fourth	Full Year
	-----	-----	-----	-----	-----
1997					
Gross premiums written	\$41,111	\$90,995	\$42,470	\$61,815	\$236,391
Net premiums written	27,184	67,495	28,911	49,288	172,878
Net premiums earned	24,774	27,561	27,204	29,972	109,511
Net investment income	16,361	17,121	17,920	20,683	72,085
Losses and loss adjustment expenses	2,285	2,156	2,426	2,289	9,156
Income before taxes	27,266	35,058	37,896	38,279	138,499

Net income	20,250	25,233	27,225	27,794	100,502
Basic earnings per common share	0.67	0.84	0.91	0.93	3.35
Diluted earnings per common share	0.66	0.82	0.88	0.90	3.25
1996					
Gross premiums written	\$52,580	\$44,762	\$38,994	\$40,630	\$176,966
Net premiums written	34,139	30,726	28,449	27,686	121,000
Net premiums earned	22,734	19,750	21,637	26,327	90,448
Net investment income	15,682	15,986	16,467	16,929	65,064
Losses and loss adjustment expenses	1,625	1,530	1,482	2,237	6,874
Income before taxes	26,234	25,211	22,948	35,378	109,771
Net income	19,544	18,748	17,210	25,258	80,760
Basic earnings per common share	0.62	0.61	0.57	0.84	2.64
Diluted earnings per common share	0.62	0.60	0.57	0.83	2.61

19. PRO FORMA RESULTS OF ACQUISITION (UNAUDITED)

The unaudited consolidated results of operations (in thousands, except per share data) on a pro forma basis as though the Merger had been consummated on January 1, 1995, excluding the effect of the one-time general reserve charge in 1995 of \$15,400, were as follows:

	December 31, 1995 ----
Total revenues	\$157,150
Total expenses	44,239
Earnings per common share	2.53

The pro forma information is presented for informational purposes only and is not necessarily indicative of the operating results that would have occurred had the Merger been consummated as of January 1, 1995, nor is it necessarily indicative of future operating results.

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20. EARNINGS PER SHARE

In 1997, the Company adopted SFAS No. 128 specifying the computation, presentation and disclosure requirements for EPS. The new standard defines "basic" and "diluted" earnings per share. Basic earnings per share are based on average basic shares outstanding, which is calculated by adding shares earned but not issued under the Company's equity bonus and performance share plans to the average common shares outstanding. Diluted earnings per share are based on average diluted shares outstanding, which is calculated by adding shares contingently issuable under stock options, the performance share plan and the Company's convertible preferred stock to the average basic shares outstanding. The calculations of average basic and diluted common shares outstanding are as follows (in thousands):

	Year Ended December 31, -----		
	1997 ----	1996 ----	1995 ----
Average common shares outstanding	29,858	30,547	25,797
Shares earned but unissued under stock-based compensation plans	170	80	59
Average basic common shares outstanding	30,028	30,627	25,856
Shares contingently issuable under:			
Stock-based compensation plans	395	268	43
Convertible preferred stock	490	--	--
Average diluted common shares outstanding	30,913	30,895	25,899

21. RECENTLY ISSUED ACCOUNTING STANDARDS

In February 1997, the Securities and Exchange Commission (SEC) issued Financial Reporting Release No. 48, Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments (FRR No. 48).

FRR No. 48 amends rules and forms for registrants and requires clarification and expansion of existing disclosures for derivative financial instruments, other financial instruments and derivative commodity instruments, as defined therein. The amendments require enhanced disclosure with respect to these derivative instruments in the footnotes to the financial statements. Additionally, the amendments expand existing disclosure requirements to include quantitative and qualitative discussions with respect to market risk inherent in market-risk-sensitive instruments such as equity and fixed-maturity securities, as well as derivative instruments.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 130, Reporting Comprehensive Income. SFAS No. 130 establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. Comprehensive income is defined as the change in stockholders' equity during a period from transactions and other events and circumstances from non-owner sources and includes net income and all changes in stockholders' equity except those resulting from investments by owners and distributions to owners.

SFAS No. 130 requires that an enterprise (i) classify items of other comprehensive income by their nature in a financial statement and (ii) display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the equity section of a statement of financial position.

SFAS No. 130 is effective for fiscal years beginning after December 15, 1997. Reclassification of financial statements for earlier periods provided for comparative purposes is required.

Also in June 1997, the Financial Accounting Standards Board issued SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information. SFAS No. 131 establishes standards for the way that public business enterprises report information about operating segments in annual and interim financial statements and requires presentation of a measure of profit or loss, certain specific revenue and expense items and segment assets. It also establishes standards for related disclosures about products and services, geographic areas and major customers, superseding most of SFAS No. 14, Financial Reporting for Segments of a Business Enterprise.

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SFAS No. 131 requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Generally, financial information is required to be reported on the basis that is used internally for evaluating segment performance and deciding how to allocate resources to segments. The enterprise must report information about revenues derived, major customers, and countries in which it earns revenues and holds assets, regardless of whether that information is used in making operating decisions. However, SFAS No. 131 does not require an enterprise to report information that is not prepared for internal use if reporting would be impracticable.

SFAS No. 131 is effective for financial statements for periods beginning after December 15, 1997. SFAS No. 131 need not be applied to interim financial statements in the initial year of its application, but comparative information for interim periods in the initial year of application is to be reported in financial statements of the interim periods in the third year of application.

The Company is in the process of determining the effect of these standards on its financial statements.

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