

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, 1995

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  
(State or other jurisdiction of  
incorporation or organization)

94-2708455  
(I.R.S. Employer  
Identification No.)

80 South Main Street, Hanover, New Hampshire  
(Address of principal executive offices)

03755-2053  
(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
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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 X 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. [ X ]

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 25, 1996, was \$575,521,650.

As of March 25, 1996, 7,673,622 shares of Common Stock, par value of \$1.00 per  
share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's 1995 Annual Report to  
Shareholders (Parts II and IV).

Portions of the registrant's Notice of 1996 Annual Meeting of Shareholders  
and Proxy Statement dated March 29, 1996 (Part III)

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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") and Source One Mortgage Services Corporation and its subsidiaries ("Source One"). White Mountains is an insurance holding company principally engaged through its affiliates in the businesses of property and casualty insurance and financial guaranty insurance. Source One is one of the nation's largest mortgage banking companies. Fund American also owns a passive investment portfolio totaling \$415.3 million as of December 31, 1995. The Company's principal office is located at 80 South Main Street, Hanover, New Hampshire, 03755, and its telephone number is (603) 643-1567.

INSURANCE OPERATIONS

In 1995 the Company capitalized White Mountains with \$250.0 million of assets. White Mountains was formed to be the holding company for all of Fund American's insurance operating interests. As of December 31, 1995 White Mountains' principle holdings included investments in: Financial Security Assurance Holdings Ltd. ("FSA"), a leading Aaa/AAA writer of financial guaranty insurance; Main Street America Holdings, Inc. ("MSA"), an affiliate of National Grange Mutual Insurance Company which is a New Hampshire-based property and casualty insurer; and the wholly-owned subsidiaries described below.

On December 1, 1995 White Mountains acquired Valley Group, Inc. of Albany, Oregon, and its subsidiaries (collectively, "Valley") and Charter Group, Inc. of Dallas, Texas, and its subsidiaries (collectively, "Charter") for \$41.7 million in cash less \$3.0 million of purchase price adjustments. Valley's wholly-owned subsidiary, Valley Insurance Company, is an "A" rated, Northwest-based property and casualty company which writes personal and commercial lines. In 1995 Valley Insurance Company wrote \$73.1 million of gross premiums in Oregon, Washington and California. Charter's wholly-owned subsidiary, Charter Indemnity Company, wrote \$64.4 million of gross non-standard automobile insurance premiums in Texas during 1995.

White Mountains Insurance Company ("WMIC") is a New Hampshire licensed commercial property and casualty company which commenced its operations in September 1995 and wrote \$250,000 in premiums during the year. WMIC is expected to expand its operations to other states as additional state approvals are obtained.

All of White Mountains' insurance subsidiaries market their insurance products principally through independent agents.

MORTGAGE ORIGINATION AND SERVICING OPERATIONS

General

Source One is one of the largest mortgage banking companies in the United States. As of December 31, 1995 Source One had a mortgage loan servicing portfolio totaling \$31.8 billion, including \$4.0 billion of loans subserviced for others, which is serviced on behalf of approximately 320 institutional investors and numerous other security holders. As of December 31, 1995 Source One had 128 retail branch offices in 25 states and originated \$2.9 billion in mortgage loans for the year then ended.

Source One engages primarily in the business of producing, selling and servicing residential mortgage loans. 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 (including underwriting and appraisal fees). Through subsidiaries, Source One also markets credit-related insurance products (such as life, disability, health, accidental death and property and casualty insurance).

Source One was incorporated in 1972 and is the successor to Citizens Mortgage Corporation which was organized in 1946. Source One is a wholly-owned subsidiary of Fund American Enterprises, Inc. ("FAE") which is a wholly-owned subsidiary of the Company. Source One's principal office is located in Farmington Hills, Michigan.

#### 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 (i.e., 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, and offer the resulting mortgage-backed securities to the public through 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 these 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 (government loans). 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.

It is a policy of Source One to primarily produce fixed rate mortgage loans. As of December 31, 1995 approximately 6% of Source One's total mortgage loan servicing portfolio consisted of adjustable rate mortgage loans.

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

Millions	Year Ended December 31,				
	1995	1994	1993	1992	1991
Loan production by type of loan:					
FHA/VA insured	\$1,565	\$2,065	\$ 3,453	\$1,927	\$1,641
Conventional	1,287	2,521	7,999	5,664	2,386
<b>Total</b>	<b>\$2,852</b>	<b>\$4,586</b>	<b>\$11,452</b>	<b>\$7,591</b>	<b>\$4,027</b>
Loan production by origination source:					
Retail branch office originations	\$1,347	\$2,005	\$ 4,922	\$3,326	\$1,695
Correspondent network acquisitions	1,157	1,081	2,643	2,578	1,908
Mortgage broker originations	196	696	1,708	1,026	290
Specialized marketing program originations	152	804	2,179	661	134
<b>Total</b>	<b>\$2,852</b>	<b>\$4,586</b>	<b>\$11,452</b>	<b>\$7,591</b>	<b>\$4,027</b>

Retail Branch Offices. As of December 31, 1995 Source One had 128 retail branch offices in 25 states. 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.

As of December 31, 1995 Source One's retail branch offices were located in the following states:

State	Number of offices	State	Number of offices	State	Number of offices
California	29	Florida	5	Kansas	1
Washington	21	Missouri	4	Maryland	1
Texas	11	Ohio	4	Massachusetts	1
Illinois	7	Kentucky	3	Oregon	1
Nevada	7	New Jersey	2	Rhode Island	1
Arizona	6	Pennsylvania	2	Tennessee	1
Michigan	6	Alaska	1	Virginia	1
New York	6	Arkansas	1		
Colorado	5	Iowa	1		

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

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, 1995 there were approximately 200 participants in Source One's correspondent network, with no single participant or group of affiliated participants accounting for more than 10% of Source One's total mortgage loan originations.

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. Source One maintains an office to service this network in West Bloomfield, Michigan. As of December 31, 1995 there were approximately 400 active participants in Source One's mortgage broker network, with no single broker or group of affiliated brokers accounting for more than 10% 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 loans either through mortgage-backed securities issued pursuant to programs of GNMA, FNMA and FHLMC, or to 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. 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. During 1994 approximately 40.9%, 40.6% and 16.5% of the principal amount of Source One's loans were sold in pools through GNMA, FNMA and FHLMC, respectively. During 1993 approximately 29.4%, 44.5% and 25.3% 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.

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 note rate from the date of the loan payoff through the end of that calendar month without reimbursement.

Source One, through private placements and public offerings, has also sold mortgage loans through the issuance of mortgage pass-through certificates. Source One issued \$521.7 million of REMIC certificates through December 31, 1990. Source One is the primary servicer for these REMIC certificates, which were sold pursuant to five separate trusts that have no recourse provisions. Source One has not issued any mortgage-backed securities since 1990; however, Source One may offer additional mortgage-backed securities in the future if economic and market conditions warrant.

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

Source One's risk management function closely monitors the mortgage loan 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 seven approved dealers.

#### Loan Servicing

Source One currently retains the rights to service the majority of the mortgage loans it produces. 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 makes such purchases of 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 1995, Source One purchased the rights to service \$4.7 billion of mortgage loans.

Source One also sells servicing rights when management deems it economically advantageous. During 1995 Source One sold the rights to service \$11.0 billion of mortgage loans resulting in pretax gains of \$40.0 million. During 1994 Source One sold the rights to service \$3.9 billion of mortgage loans and continues to subservice these loans pursuant to a five-year subservicing agreement.

The following table summarizes the changes in Source One's mortgage loan servicing portfolio including loans subserviced, interim servicing contracts and those under contract to acquire, and excluding loans sold but not transferred:

Billions	Year Ended December 31,				
	1995	1994	1993	1992	1991
Balance at beginning of year	\$39.6	\$38.4	\$37.3	\$41.0	\$35.6
Mortgage loan production	2.9	4.6	11.5	7.6	4.0
Servicing acquisitions	4.7	3.7	6.4	2.3	6.8
Total servicing in	7.6	8.3	17.9	9.9	10.8
Regular payoffs	2.3	4.7	13.6	11.5	3.9
Sales of servicing	11.0	-	-	-	-
Principal amortization, servicing released and foreclosures	2.1	2.4	3.2	2.1	1.5
Total servicing out	15.4	7.1	16.8	13.6	5.4
Balance at end of year	\$31.8	\$39.6	\$38.4	\$37.3	\$41.0

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

Percent of total residential loans serviced:	December 31,				
	1995	1994	1993	1992	1991
Past due:					
31-59 days	3.99%	3.15%	3.41%	3.26%	3.56%
60-89 days	.70	.54	.58	.65	.61
90 days or more	.59	.38	.45	.48	.41
Total delinquencies	5.28%	4.07%	4.44%	4.39%	4.58%
Foreclosures	.80%	.77%	.92%	.77%	.74%

## 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. Insurance products are sold through (i) solicitation at the time of mortgage application, (ii) direct mail solicitation by Source One shortly after mortgage loan closing, (iii) solicitation by direct solicitors and (iv) resolicitation of Source One's mortgage loan servicing portfolio on an annual basis. At certain locations, personal solicitation by Source One staff is permitted by state regulations which determine allowable insurance sales practices. Total fees recognized under these programs for 1995 were \$4.8 million.

## INVESTMENT PORTFOLIO MANAGEMENT

The Company's passive investment portfolio is 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 its employees located in Norwich, Vermont. Beginning January 1, 1996 Fund American engaged First Manhattan Co. to provide discretionary investment advisory services with respect to a portfolio of investment securities totalling approximately \$21.0 at December 31, 1995. First Manhattan Co. is a registered investment advisor.

Fund American's philosophy is to invest all assets to maximize their 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 efforts and the entity's funds on a small number of quality companies selling at reasonable prices in the marketplace. While such an approach leads to a high concentration in a few securities, 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 at least a portion of its investment securities (or proceeds from sales thereof) 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 business and 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 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 loan 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 loan servicing portfolio because prepayments of mortgages decline and the average life of loan servicing rights is lengthened.

## COMPETITION

The principal competitive factors that affect White Mountains' insurance subsidiaries are: (i) pricing; (ii) underwriting; (iii) quality of claims and policyholder services; (iv) operating efficiencies; and (v) product differentiation and availability. 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.



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. 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. No single company or group of affiliated companies dominates the insurance industry.

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 must originate 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. In the opinion of management of Source One, no single mortgage lender dominates the industry.

#### REGULATION

White Mountains' insurance subsidiaries 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 rules for property and casualty companies. White Mountains' insurance subsidiaries were adequately capitalized under the NAIC's rules as of December 31, 1995.

Source One is subject to the rules and regulations of, and examinations by, FNMA, FHLMC, GNMA, FHA and VA with respect to the origination, processing, selling and servicing of mortgage loans. These rules and regulations, among other things, prohibit discrimination, provide for inspections and appraisals of properties, require credit reports on prospective borrowers and, in some cases, establish maximum interest rates, fees and loan amounts. Lenders are required to submit audited financial statements annually. FNMA and GNMA require the maintenance of specified net worth levels which vary depending on the amount of FNMA loans serviced and GNMA mortgage-backed securities issued by Source One. 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, 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.

Certain conventional mortgage loans are also subject to state usury statutes; FHA and VA loans are exempt from the effects of such statutes. 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.

#### EMPLOYEES

As of December 31, 1995 the Company employed 11 persons, FAE employed 1,681 persons (including 1,680 persons at Source One) and White Mountains employed 416 persons (including 231 at Valley and 178 at Charter). None of Fund American's employees are covered by a collective bargaining agreement. Management believes that Fund American's employee relations are good.

## 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. The lease on Valley's California property expires in 1998. Charter leases 48,400 square feet in Dallas, Texas, which lease expires in 1997. Source One owns its principal office in Farmington Hills, Michigan, which houses the majority of its employees. Source One also owns an office building in West Bloomfield, Michigan. 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 1995.

EXECUTIVE OFFICERS OF THE REGISTRANT AND ITS SUBSIDIARIES (as of March 25, 1996)

Name	Position	Age	Executive officer since
Terry L. Baxter	President and Secretary of FAE	50	1994
Dennis P. Beaulieu	Vice President and Secretary	48	1995
John J. Byrne	Chairman, President and Chief Executive Officer	63	1985
James A. Conrad	President and Chief Executive Officer of Source One	54	1986
K. Thomas Kemp	Executive Vice President	55	1991
Michael S. Paquette	Vice President and Controller	32	1993
Robert W. Richards	Chairman of Source One	53	1986
Allan L. Waters	Senior Vice President and Chief Financial Officer	38	1990

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. Baxter was elected President and Secretary of FAE in 1994. 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, White Mountains and WMIC.

Mr. Beaulieu was elected Vice President and Secretary in February 1995 and also serves as Vice President and Secretary of White Mountains and Chief Financial Officer of WMIC. Prior to joining Fund American in 1995, Mr. Beaulieu was Senior Vice President and Chief Financial Officer of New Dartmouth Bank. Mr. Beaulieu is a director of White Mountains and WMIC.

Mr. Byrne has served as Chairman, President and Chief Executive Officer since 1990, as Chairman and Chief Executive Officer from 1985 to 1990 and was Chairman and Chief Executive Officer of Fireman's Fund Insurance Company ("Fireman's Fund") from 1989 through January 2, 1991. Mr. Byrne is also Chairman of FSA, FAE and White Mountains.

Mr. Conrad has served as President and Chief Executive Officer of Source One since 1990, as Executive Vice President of its Production Division from 1987 to 1989, and as Corporate Vice President of its Wholesale Division from 1985 to 1987. Mr. Conrad is also a director of Source One.

Mr. Kemp has served as Vice President, Treasurer and Secretary since 1991, was elected Executive Vice President in 1993 and became a director of the Company in 1994. He is also President and Chief Executive Officer of White Mountains and WMIC. Mr. Kemp was a Vice President of Fireman's Fund from 1990 to January 2, 1991. Prior to joining Fireman's Fund, Mr. Kemp was President of Resolute Reinsurance Company. Mr. Kemp is Chairman of Valley, Charter and WMIC. Mr. Kemp is also a director of FSA, FAE, MSA and White Mountains.

Mr. Paquette was elected Vice President and Chief Accounting Officer in 1993 and was appointed Vice President and Controller in February 1995. Mr. Paquette is also Vice President and Controller of White Mountains and WMIC. He was formerly Secretary of FAE from 1990 to 1993 and has been a member of the Fund American organization since 1989. Mr. Paquette is a director of FAE, White Mountains and WMIC.

Mr. Richards has served as Chairman of Source One since 1989, as its President from 1987 to 1989, and as its Executive Vice President from 1985 to 1987.

Mr. Waters was elected Senior Vice President and Chief Financial Officer in 1993. Mr. Waters is also Senior Vice President and Chief Financial Officer of White Mountains. He was formerly Vice President and Controller of FAE from 1991 to 1993; was Vice President, Controller and Assistant Secretary of the Company from 1990 to 1991, and was Vice President, Finance of the Company from 1988 to 1990. Mr. Waters is a director of FSA, FAE, Source One, White Mountains and WMIC.

PART II

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

As of March 25, 1996 there were 606 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 Board of Directors reinstated a regular quarterly dividend on Shares of \$.20. However, the Board of Directors 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 remaining information called for by this item is reported as "Quarterly trading range for Shares of common stock" and "Stock Exchange Information" appearing on pages 66 and 72, respectively, of the Company's 1995 Annual Report to Shareholders, herein incorporated by reference.

Item 6. Selected Financial Data

Reported on page 18 of the Company's 1995 Annual Report to Shareholders, herein incorporated by reference.

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

Reported on pages 19 through 31 of the Company's 1995 Annual Report to Shareholders, herein incorporated by reference.

Item 8. Financial Statements and Supplementary Data

Reported in the consolidated financial statements of Fund American and the notes thereto and the report thereon of Ernst & Young LLP, independent auditors, appearing on pages 32 through 63 and 65 of the Company's 1995 Annual Report to Shareholders, herein incorporated by reference.

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

None.

PART III

Item 10. Directors and Executive Officers

a. Directors (as of March 25, 1996)

Reported under the caption "Election of Directors" on pages 3 through 5 of the Company's 1996 Proxy Statement, herein incorporated by reference.

b. Executive Officers (as of March 25, 1996)

Reported in Part I pursuant to General Instruction G to Form 10-K.

Item 11. Executive Compensation

Reported under the captions "Compensation of Executive Officers" on pages 8 through 10, "Reports of the Compensation Committees on Executive Compensation" on pages 10 through 13, "Shareholder Return Graph" on page 14, and "Compensation Plans" on pages 15 through 16 of the Company's 1996 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 6 through 7 of the Company's 1996 Proxy Statement, herein incorporated by reference.

Item 13. Certain Relationships and Related Transactions

Reported under the captions "Certain Transactions" on page 10 and "Compensation Committee Interlocks and Insider Participation in Compensation Decisions" on page 16 of the Company's 1996 Proxy Statement, herein incorporated by reference.

PART IV

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

a. (1) Financial Statements

The financial statements applicable to the Company and its consolidated affiliates have been incorporated by reference herein from the Company's 1995 Annual Report to Shareholders as they appear in the Index to Financial Statements and Financial Statement Schedules shown on page 12 of this report.

(2) Financial Statement Schedules

The financial statement schedules 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 Schedules appearing on page 12 of this report.

b. Reports on Form 8-K

On December 1, 1995, the registrant filed Form 8-K announcing that it had completed its acquisition of Valley and Charter.

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

	Annual Report page(s) *	Form 10-K page(s)
-----		
Financial statements:		
Consolidated balance sheets as of December 31, 1995 and 1994	32	
Consolidated income statements for each of the years ended December 31, 1995, 1994 and 1993	33	
Consolidated statements of shareholders' equity for each of the years ended December 31, 1995, 1994 and 1993	34	
Consolidated statements of cash flows for each of the years ended December 31, 1995, 1994 and 1993	35	
Notes to consolidated financial statements	36-63	
Other financial information:		
Report of independent auditors	65	
Selected quarterly financial data (unaudited)	66	
Financial statement schedules:		
III. Condensed financial information of registrant		13-14
=====		

\* The Company's 1995 Annual Report to Shareholders.

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

SCHEDULE III

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

CONDENSED BALANCE SHEETS

Millions	December 31,	
	1995	1994
<b>Assets:</b>		
Common equity securities and other investments	\$ 8.0	\$ 148.7
Short-term investments, at amortized cost	23.9	58.2
Cash	-	.1
Other assets	18.9	23.9
Investments in unconsolidated affiliates, at equity	2.5	69.7
Investments in wholly-owned subsidiaries	825.4	679.2
<b>Total assets</b>	<b>\$ 878.7</b>	<b>\$ 979.8</b>
<b>Liabilities:</b>		
Debt	\$ 115.3	\$ 153.8
Accounts payable and other liabilities	63.7	164.9
<b>Total liabilities</b>	<b>179.0</b>	<b>318.7</b>
Shareholders' equity	699.7	661.1
<b>Total liabilities and shareholders' equity</b>	<b>\$ 878.7</b>	<b>\$ 979.8</b>

CONDENSED INCOME STATEMENTS

Millions	Year Ended December 31,		
	1995	1994	1993
Revenues	\$ 28.7	\$ 14.2	\$ 11.1
Expenses	68.9	21.2	29.6
Pretax operating loss	(40.2)	(7.0)	(18.5)
Net realized investment gains	12.6	22.7	68.9
Change in net unrealized investment gains and losses	-	-	(61.3)
Net investment gains	12.6	22.7	7.6
Pretax earnings (loss)	(27.6)	15.7	(10.9)
Income tax provision (benefit)	(8.7)	7.6	14.3
Parent company only operating income (loss)	(18.9)	8.1	(25.2)
Equity in operating income of subsidiaries	37.4	13.0	95.6
Tax benefit from sale of discontinued operations	66.0	-	-
Loss on early extinguishment of debt, after tax	(.4)	-	-
Cumulative effect of accounting change - purchased mortgage servicing, after tax	-	(44.3)	-
<b>Consolidated net income (loss)</b>	<b>\$ 84.1</b>	<b>\$ (23.2)</b>	<b>\$ 70.4</b>

SCHEDULE III  
(continued)

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

CONDENSED STATEMENTS OF CASH FLOWS

Millions	Year Ended December 31,		
	1995	1994	1993
Net income (loss)	\$ 84.1	\$ (23.2)	\$ 70.4
Charges (credits) to reconcile net income to net cash from operations:			
Tax benefit from sale of discontinued operations	(66.0)	-	-
Loss on early extinguishment of debt, after tax	.4	-	-
Cumulative effect of accounting change - purchased mortgage servicing, after tax	-	44.3	-
Compensation expense resulting from warrant extension	46.2	-	-
Net investment gains	(12.6)	(22.7)	(7.6)
Equity in operating income of wholly-owned subsidiaries	(37.4)	(13.0)	(95.6)
Equity in operating income of unconsolidated affiliates	(9.0)	(2.5)	-
Dividends and return of capital distributions received from subsidiaries and unconsolidated affiliates	233.3	121.3	114.6
Changes in current income taxes receivable and payable	2.9	35.1	(10.3)
Deferred income tax (benefit) provision	(13.5)	2.8	21.0
Other, net	(4.1)	10.0	1.9
Net cash provided from operations	224.3	152.1	94.4
Cash flows from investing activities:			
Net decrease (increase) in short-term investments	34.3	69.6	(28.3)
Sales and maturities of common equity securities and other investments	45.1	73.3	216.7
Purchases of common equity securities and other investments	(41.3)	(60.3)	(314.6)
Purchase of Valley and Charter	(77.2)	-	-
Investments in unconsolidated affiliates	(33.8)	(44.0)	-
Other	-	-	(1.7)
Net cash (used for) provided from investing activities	(72.9)	38.6	(127.9)
Cash flows from financing activities:			
Decrease in short-term debt	-	-	(100.0)
Proceeds from issuances of long-term debt	-	-	178.0
Repayments of long-term debt	(7.9)	(23.9)	-
Redemption of preferred stock	(75.0)	(82.0)	-
Proceeds from issuances of common stock from treasury	3.3	2.8	2.1
Purchases of common stock retired	(65.5)	(78.8)	(41.8)
Dividends paid to shareholders	(6.4)	(10.8)	(12.2)
Net cash (used for) provided from financing activities	(151.5)	(192.7)	26.1
Net decrease in cash during year	(.1)	(2.0)	(7.4)
Cash balance at beginning of year	.1	2.1	9.5
Cash balance at end of year	\$ -	\$ .1	\$ 2.1



c. Exhibits

Exhibit number	Name
2	-- Distribution Agreement, effective September 24, 1993 among the Company and White River Corporation (incorporated by reference to Exhibit (2.1) of the Company's Report on Form 8-K dated December 6, 1993)
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(a) herein)
10	-- Material Contracts:
(a)	-- Credit Agreement dated June 2, 1994 among the Company, Fund American Enterprises, Inc., FFOG, Inc., the banks named therein and The Chase Manhattan Bank (incorporated by reference to Exhibit 10(a) of the Company's 1994 Annual Report on Form 10-K)
(b)	-- Amendment No. 1 to the Credit Agreement dated June 1, 1995 among the Company, Fund American Enterprises, Inc., FFOG, Inc., the banks named therein and The Chase Manhattan Bank(*)
(c)	-- Amendment No. 2 to the Credit Agreement dated August 2, 1995 among the Company, Fund American Enterprises, Inc., FFOG, Inc., the banks named therein and The Chase Manhattan Bank(*)
(d)	-- Amendment No. 3 to the Credit Agreement dated August 11, 1995 among the Company, Fund American Enterprises, Inc., FFOG, Inc., the banks named therein and The Chase Manhattan Bank(*)
(e)	-- Stock Purchase Agreement dated August 8, 1995 between the Company, Skandia U.S. Holding Corporation, and Skandia America Corporation(*)
(f)	-- 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)
(g)	-- 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)(*)
(h)	-- 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)**)
(i)	-- Loan Agreement between the Company and its Chairman, John J. Byrne, dated December 30, 1992 (incorporated by reference to Exhibit 10(s) of the Company's 1992 Annual Report on Form 10-K)**)
(j)	-- 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)**)
(k)	-- The Company's Voluntary Deferred Compensation Plan, as amended on November 10, 1995(*)**)
(l)	-- The Company's Deferred Benefit Plan, as amended on November 10, 1995(*)**)
(m)	-- 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)**)
(n)	-- Source One Mortgage Services Corporation's Long-Term Incentive Plan (incorporated by reference to Exhibit 10(n) of the Company's 1994 Annual Report on Form 10-K)**)
(o)	-- Source Once Mortgage Service Corporation's Voluntary Deferred Compensation Plan (incorporated by reference to Exhibit 10(s) of the Company's 1993 Annual Report on Form 10-K)**)

- (p) -- Source One Mortgage Service Corporation's Amended and Restated Executive Phantom Stock Plan (incorporated by reference to Exhibit 10(t) of the Company's 1993 Annual Report on Form 10-K)(\*\*)
  - (q) -- Source One Mortgage Services Corporation's Stock Appreciation Rights Plan (incorporated by reference to Exhibit 10(u) of the Company's 1993 Annual Report on Form 10-K)(\*\*)
  - (r) -- Investment Contract by and between Source One Mortgage Services Corporation and James A. Conrad (incorporated by reference to Exhibit 10(v) of the Company's 1993 Annual Report on Form 10-K)(\*\*)
  - (s) -- Investment Contract by and between Source One Mortgage Services Corporation and Robert W. Richards (incorporated by reference to Exhibit 10(w) of the Company's 1993 Annual Report on Form 10-K)(\*\*)
  - (t) -- Credit Agreement, dated December 13, 1993, among the Company and White River Corporation (incorporated by reference to Exhibit 10(x) of the Company's 1993 Annual Report on Form 10-K)(\*\*)
  - 11 -- Statement Re Computation of Per Share Earnings(\*)
  - 13 -- Fund American Enterprises Holdings, Inc. 1995 Annual Report to Shareholders. Such report, except portions which are expressly incorporated by reference in this report on Form 10-K, is furnished only for the information of the Securities and Exchange Commission and is not being "filed" as part hereof(\*)
  - 18 -- Letter from Ernst & Young LLP regarding change in accounting principle (incorporated by reference to Exhibit 18 of the Company's 1994 Annual Report on Form 10-K)
  - 21 -- Subsidiaries of the Registrant(\*)
  - 23 -- Consent of Independent Auditors(\*)
  - 24 -- Powers of Attorney(\*)
- =====

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.

By: /s/ MICHAEL S. PAQUETTE  
-----  
Michael S. Paquette  
Vice President and Controller

Date: March 25, 1996

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 -----
JOHN J. BYRNE* ----- John J. Byrne	Chairman, President and Chief Executive Officer	March 25, 1996
HOWARD L. CLARK* ----- Howard L. Clark	Director	March 25, 1996
HOWARD L. CLARK, JR.* ----- Howard L. Clark, Jr.	Director	March 25, 1996
ROBERT P. COCHRAN* ----- Robert P. Cochran	Director	March 25, 1996
GEORGE J. GILLESPIE, III* ----- George J. Gillespie, III	Director	March 25, 1996
/s/ K. THOMAS KEMP ----- K. Thomas Kemp	Executive Vice President and Director	March 25, 1996
GORDON S. MACKLIN* ----- Gordon S. Macklin	Director	March 25, 1996
MICHAEL S. PAQUETTE* ----- Michael S. Paquette	Vice President and Controller	March 25, 1996
ALLAN L. WATERS* ----- Allan L. Waters	Senior Vice President and Chief Financial Officer	March 25, 1996
ARTHUR ZANKEL* ----- Arthur Zankel	Director	March 25, 1996

\*By: /s/ K. THOMAS KEMP  
-----  
K. Thomas Kemp, Attorney-in-Fact

EXECUTION COPY

AMENDMENT NO. 1

AMENDMENT NO. 1 dated as of June 1, 1995 between FUND AMERICAN ENTERPRISES HOLDINGS, INC., a corporation duly organized and validly existing under the laws of the State of Delaware, FUND AMERICAN ENTERPRISES, INC., a corporation duly organized and validly existing under the laws of the State of Delaware, and FFOG, INC., a corporation duly organized and validly existing under the laws of the State of Delaware and THE CHASE MANHATTAN BANK (NATIONAL ASSOCIATION), a national banking association, as agent for each of the banks that is a signatory to the Credit Agreement defined below (the "Banks") (in such capacity, together with its successors in such capacity, the "Agent").

The Borrowers, the Banks and the Agent are parties to a Credit Agreement dated as of June 2, 1994 (as heretofore modified, supplemented, amended and in effect on the date hereof, the "Credit Agreement"), providing, subject to the terms and conditions thereof, for extensions of credit to be made by said Banks to the Borrowers. The Borrowers, the Banks and the Agent wish to amend the Credit Agreement in certain respects, and the Banks have consented to the execution and delivery by the Agent of this Amendment No. 1. Accordingly, the parties hereto hereby agree as follows:

Section 1. Definitions. Except as otherwise defined in this Amendment No. 1, terms defined in the Credit Agreement are used herein as defined therein.

Section 2. Amendment. Effective upon the execution and delivery hereof by the Borrowers and the Agent Section 1.01 of the Credit Agreement shall be amended by deleting the definition of Commitment Termination Date and inserting in place thereof the following definition:

"Commitment Termination Date" shall mean August 3, 1995, provided that if such day shall not be a Business Day, the Commitment Termination Date shall be the next preceding Business Day.

Section 3. Representations and Warranties. The Borrowers represent and warrant to the Banks and the Agent that the representations and warranties set forth in Section 8 of the Credit Agreement are true and complete on the date hereof as if made on and as of the date hereof.

Section 4. Miscellaneous. Except as herein provided, the Credit Agreement shall remain unchanged and in full force and effect. This Amendment No. 1 may be executed in counterparts,

which taken together shall constitute one and the same amendatory instrument.  
This Amendment No. 1 shall be governed by, and construed in accordance with, the  
law of the State of New York.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment No.  
1 to be duly executed as of the day and year first written above.

FUND AMERICAN ENTERPRISES  
HOLDINGS, INC.

By \_\_\_\_\_  
Name  
Title:

FUND AMERICAN ENTERPRISES, INC.

By \_\_\_\_\_  
Name:  
Title:

FFOG, INC.

By \_\_\_\_\_  
Name  
Title:

THE CHASE MANHATTAN BANK  
(NATIONAL ASSOCIATION), as Agent

By \_\_\_\_\_  
Name:  
Vice President

CONSENT

Dated as of May \_\_, 1995

Re: Amendment No. 1 to the Credit Agreement dated as of June 2, 1994  
with FUND AMERICAN ENTERPRISES HOLDINGS, INC.  
FUND AMERICAN ENTERPRISES, INC., and FFOG, INC.

The undersigned, as a Bank under and as defined in the Credit Agreement dated as of June 2, 1994 (the "Credit Agreement") among Fund American Enterprises Holdings, Inc., Fund American Enterprises, Inc., and FFOG, Inc., the Banks referred to therein and The Chase Manhattan Bank (National Association), as Agent, hereby consents to the execution and delivery by the Agent on or after June 1, 1995 of an Amendment No. 1 to the Credit Agreement in the form attached hereto as Exhibit A in respect of the Credit Agreement; provided, that the undersigned may withdraw such consent by prior written notice received by the Agent at any time prior to the execution and delivery by the Agent of said Amendment No. 1.

This Consent shall be effective only until June 1, 1995, unless extended by the undersigned.

By \_\_\_\_\_  
Name:  
Title:

EXECUTION COPY

AMENDMENT NO. 2

AMENDMENT NO. 2 dated as of August 2, 1995 between FUND AMERICAN ENTERPRISES HOLDINGS, INC., a corporation duly organized and validly existing under the laws of the State of Delaware, FUND AMERICAN ENTERPRISES, INC., a corporation duly organized and validly existing under the laws of the State of Delaware, and FFOG, INC., a corporation duly organized and validly existing under the laws of the State of Delaware and THE CHASE MANHATTAN BANK (NATIONAL ASSOCIATION), a national banking association, as agent for each of the Banks (as defined in the Credit Agreement referred to below) (in such capacity, together with its successors in such capacity, the "Agent").

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The Borrowers, the Banks and the Agent are parties to a Credit Agreement dated as of June 2, 1994 (as heretofore modified, supplemented and amended by Amendment No. 1 dated as of June 1, 1995 and in effect on the date hereof, the "Credit Agreement"), providing, subject to the terms and conditions

thereof, for extensions of credit to be made by said Banks to the Borrowers. The Borrowers, the Banks and the Agent wish to amend the Credit Agreement in certain respects, and the Banks have consented to the execution and delivery by the Agent of this Amendment No. 2. Accordingly, the parties hereto hereby agree as follows:

Section 1. Definitions. Except as otherwise defined in this

Amendment No. 2, terms defined in the Credit Agreement are used herein as defined therein.

Section 2. Amendment. Effective upon the execution and delivery

hereof by the Borrowers and the Agent Section 1.01 of the Credit Agreement shall be amended by deleting the definition of Commitment Termination Date and inserting in place thereof the following definition:

"Commitment Termination Date" shall mean August 17, 1995,

provided that if such day shall not be a Business Day, the Commitment Termination Date shall be the next preceding Business Day.

Section 3. Representations and Warranties. The Borrowers represent

and warrant to the Banks and the Agent that the representations and warranties set forth in Section 8 of the Credit Agreement are true and complete on the date hereof as if made on and as of the date hereof.

Section 4. Miscellaneous. Except as herein provided, the Credit

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Agreement shall remain unchanged and in full force and effect. This Amendment No. 2 may be executed in counterparts, which taken together shall constitute one and the same amendatory instrument. This Amendment No. 2 shall be governed by, and construed in accordance with, the law of the State of New York.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment No. 2 to be duly executed as of the day and year first written above.

FUND AMERICAN ENTERPRISES  
HOLDINGS, INC.

By \_\_\_\_\_  
Name  
Title:

FUND AMERICAN ENTERPRISES, INC.

By \_\_\_\_\_  
Name:  
Title:

FFOG, INC.

By \_\_\_\_\_  
Name  
Title:

THE CHASE MANHATTAN BANK  
(NATIONAL ASSOCIATION), as Agent

By \_\_\_\_\_  
Name:  
Vice President



CONSENT

Dated as of \_\_\_\_\_, 1995

Re: Amendment No. 2 to the Credit Agreement dated as of June 2, 1994  
with FUND AMERICAN ENTERPRISES HOLDINGS, INC.  
FUND AMERICAN ENTERPRISES, INC., and FFOG, INC.

The undersigned, as a Bank under and as defined in the Credit Agreement dated as of June 2, 1994 (as heretofore modified, supplemented and amended by Amendment No. 1 dated as of June 1, 1995 and in effect on the date hereof, (the "Credit Agreement") among Fund American Enterprises Holdings, Inc.,

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Fund American Enterprises, Inc., and FFOG, Inc., the Banks referred to therein and The Chase Manhattan Bank (National Association), as Agent, hereby consents to the execution and delivery by the Agent on or after August 2, 1995 of an Amendment No. 2 to the Credit Agreement in the form attached hereto as Exhibit A in respect of the Credit Agreement; provided, that the undersigned may withdraw such consent by prior written notice received by the Agent at any time prior to the execution and delivery by the Agent of said Amendment No. 2.

This Consent shall be effective only until August 2, 1995, unless extended by the undersigned.

By \_\_\_\_\_

Name:  
Title:

EXHIBIT A

AMENDMENT NO. 3

AMENDMENT NO. 3 dated as of August 11 1995 between FUND AMERICAN ENTERPRISES HOLDINGS, INC., a corporation duly organized and validly existing under the laws of the State of Delaware, FUND AMERICAN ENTERPRISES, INC., a corporation duly organized and validly existing under the laws of the State of Delaware, and FFOG, INC., a corporation duly organized and validly existing under the laws of the State of Delaware (collectively the "Borrowers") and THE

CHASE MANHATTAN BANK (NATIONAL ASSOCIATION), a national banking association, as agent for each of the Banks (as defined in the Credit Agreement referred to below) (in such capacity, the "Agent").

The Borrowers, the Banks and the Agent are parties to a Credit Agreement dated as of June 2, 1994 (as heretofore modified, supplemented and amended by Amendment No. 1 dated as of June 1, 1995 and by Amendment No. 2 dated as of August 2, 1995 and as in effect on the date hereof, the "Credit

Agreement"), providing, subject to the terms and conditions thereof, for extensions of credit to be made by the Banks to the Borrowers. The Borrowers, the Banks and the Agent wish to amend the Credit Agreement in certain respects, and the Banks have consented to the execution and delivery by the Agent of this Amendment No. 3. Accordingly, the parties hereto hereby agree as follows:

Section 1. Definitions. Except as otherwise defined in this Amendment No. 3, terms defined in the Credit Agreement are used herein as defined therein.

Section 2. Amendment. Effective upon the execution and delivery hereof by the Borrowers and the Agent:

(a) Section 1.01 of the Credit Agreement shall be amended as follows:

(i) by deleting the definition of Applicable Margin and inserting in place thereof the following definition:

"Applicable Margin" shall mean, with respect to each Type of Syndicated Loan, for any day, the percentage set forth below which corresponds to the Borrower's Rating Level for such day:

Borrower's Rating Level	Percentage
1 through 7	0.2250%

8 through 10      0.2750%  
11                    0.7500%

(ii) by deleting the definition of Commitment Termination Date and inserting in place thereof the following definition:

"Commitment Termination Date" shall mean August 9, 1996, or such  
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further date as the Commitment Termination Date may be extended to pursuant to Section 2.10, provided that if any such day shall not be a Business Day, the Commitment Termination Date shall be the next preceding Business Day.

(iii) by deleting the definition of Facility Fee Rate and inserting in place thereof the following definition:

"Facility Fee Rate" shall mean for any day, the percentage set forth  
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below which corresponds to the Borrower's Rating Level for such day:

Borrower's Rating Level	Percentage
-----	-----
1 through 7	0.1000%
8 through 10	0.1250%
11	0.3500%

(iv) by deleting the definition of Final Maturity Date and inserting in place thereof the following definition:

"Final Maturity Date" shall mean the date 3 months following the  
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then-applicable Commitment Termination Date.

(b) A new Section 2.10 shall be inserted in numerical order, to read as follows:

Section 2.10. Extension of Commitment Termination Date. (a)

-----  
Holdings may, by notice to the Agent (which shall promptly deliver a copy to each of the Banks) not less than 60 days and not more than 90 days prior to the Commitment Termination Date then in effect hereunder (the "Existing  
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Commitment Termination Date"), request that the Banks extend the Commitment  
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Termination Date for an additional 364 days from the Consent Date (as defined below). Each Bank, acting in its sole discretion shall, by notice to Holdings and the Agent given on the date (and subject to the proviso below, only on the date) 30 days prior to the Existing Commitment Termination Date (provided that if such date is not a Business Day, then such notice shall be given on the next succeeding Business Day) (the "Consent Date"), advise Holdings whether or not such Bank agrees to such  
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extension; provided that each Bank that determines not to extend the Commitment Termination Date (a "Non-extending Bank") shall notify the Agent  
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(which shall notify Holdings) of such fact promptly after such determination

(but in any event no later than the Consent Date) and any Bank that does not advise Holdings on or before the Consent Date shall be deemed to be a Non-extending Bank. The election of any Bank to agree to such extension shall not obligate any other Bank to agree.

(b) Holdings shall have the right on or before the Existing Commitment Termination Date to replace each Non-extending Bank with one or more other banks (which may include any Bank, each prior to the Existing Commitment Termination Date an "Additional Commitment Bank") with the

approval of the Agent (which approval shall not be unreasonably withheld), each of which Additional Commitment Banks shall have entered into an agreement in form and substance satisfactory to Holdings and the Agent pursuant to which such Additional Commitment Bank shall, effective as of the Existing Commitment Termination Date, undertake a Commitment (if any such Additional Commitment Bank is a Bank, its Commitment shall be in addition to such Bank's Commitment hereunder on such date).

(c) If (and only if) Banks holding Commitments that, together with the additional Commitments of the Additional Commitment Banks that will be come effective on the Existing Commitment Termination Date, aggregate at least 50% of the aggregate amount of the Commitments (not including the additional Commitments of the Additional Commitment Banks) on the Consent Date shall have agreed to extend the Existing Commitment Termination Date, then, effective as of the Existing Commitment Termination Date, the Existing Commitment Termination Date shall be extended to the date falling 364 days after the Consent Date (provided if such date is not a Business Day, then such Commitment Termination Date as so extended shall be the next preceding Business Day) and each Additional Commitment Bank shall thereupon become a "Bank" for all purposes of this Agreement.

Notwithstanding the foregoing, the extension of the Existing Commitment Termination Date shall not be effective with respect to any Bank unless:

(i) no Default shall have occurred and be continuing on each of the date of the notice requesting such extension, on the Consent Date or on the Existing Commitment Termination Date;

(ii) each of the representations and warranties of the Borrowers in Section 8 hereof shall be true and correct on and as of each of the date of the notice requesting such extension, on the Consent Date and on the Existing Commitment Termination Date with the same force and effect as if made on and as of each such date (or if any such representation or warranty is expressly stated to have been made as of a specific date, as of such specific date); and

(iii) each Non-extending Bank shall have been paid in full by the Borrowers all amounts owing to such Bank hereunder on or before the Existing Commitment Termination Date.

Even if the Existing Commitment Termination Date is extended as aforesaid, the Commitment of each Non-extending Bank shall terminate on the Existing Commitment Termination Date.

(c) Section 9.08(a) shall be amended to read in its entirety as follows:

(a) Minimum Consolidated Tangible Net Worth. Holdings will not permit Consolidated Tangible Net Worth to be less than \$475,000,000 at any time.

Section 3. Representations and Warranties. The Borrowers represent and warrant to the Banks and the Agent that the representations and warranties set forth in Section 8 of the Credit Agreement are true and complete on the date hereof as if made on and as of the date hereof.

Section 4. Miscellaneous. Except as herein provided, the Credit Agreement shall remain unchanged and in full force and effect. This Amendment No. 3 may be executed in counterparts, which taken together shall constitute one and the same amendatory instrument. This Amendment No. 3 shall be governed by, and construed in accordance with, the law of the State of New York.

IN WITNESS WHEREOF, the parties hereto have caused this Amendment No. 3 to be duly executed as of the day and year first written above.

FUND AMERICAN ENTERPRISES  
HOLDINGS, INC.

By \_\_\_\_\_  
Name  
Title:

FUND AMERICAN ENTERPRISES, INC.

By \_\_\_\_\_  
Name:  
Title:

FFOG, INC.

By \_\_\_\_\_  
Name  
Title:

THE CHASE MANHATTAN BANK  
(NATIONAL ASSOCIATION), as Agent

By \_\_\_\_\_  
Name:  
Vice President

CONSENT

Dated as of August \_\_, 1995

Re: Amendment No. 3 to the Credit Agreement dated as of June 2, 1994  
with FUND AMERICAN ENTERPRISES HOLDINGS, INC.  
FUND AMERICAN ENTERPRISES, INC., and FFOG, INC.

The undersigned, as a Bank under and as defined in the Credit Agreement dated as of June 2, 1994 as amended by Amendment No. 1 dated as of June 1, 1995 and by Amendment No. 2, dated as of August 2, 1995 the "Credit Agreement") among Fund American Enterprises Holdings, Inc., Fund American

Enterprises, Inc., and FFOG, Inc., the Banks referred to therein and The Chase Manhattan Bank (National Association), as Agent, hereby consents to the execution and delivery by the Agent on or after August 11, 1995 of an Amendment No. 3 to the Credit Agreement in the form attached hereto as Exhibit A in respect of the Credit Agreement; provided, that the undersigned may withdraw such consent by prior written notice received by the Agent at any time prior to the execution and delivery by the Agent of said Amendment No. 3.

This Consent shall be effective only until August 11, 1995, unless extended by the undersigned.

CIBC, INC.

By \_\_\_\_\_  
Name:  
Title:

=====

STOCK PURCHASE AGREEMENT

by and among

FUND AMERICAN ENTERPRISES HOLDINGS, INC.,

SKANDIA U.S. HOLDING CORPORATION,

and

SKANDIA AMERICA CORPORATION

dated as of August 8, 1995

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## EXHIBITS

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4.5	Legal Proceedings of the Purchaser
5.14	Intercompany Accounts and Affiliate Agreements

STOCK PURCHASE AGREEMENT  
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THIS STOCK PURCHASE AGREEMENT (this "Agreement") is made and entered into as of August 8, 1995, by and among FUND AMERICAN ENTERPRISES HOLDINGS, INC., a Delaware corporation (the "Purchaser"), SKANDIA U.S. HOLDING CORPORATION, a Delaware corporation ("Skandia U.S."), and SKANDIA AMERICA CORPORATION, a Delaware corporation ("Skandia America", and collectively together with Skandia U.S., the "Sellers").

R E C I T A L S

WHEREAS, Skandia U.S. owns all of the issued and outstanding capital stock of Skandia America; and

WHEREAS, Skandia America owns all of the issued and outstanding capital stock of each of (i) Valley Group, Inc., an Oregon corporation ("Valley"), (ii) Charter Group, Inc., a Texas corporation ("Charter"), and (iii) NCM Management Corporation, a Delaware corporation ("NCM"); and

WHEREAS, Charter is the holder of an Amended and Restated Surplus Debenture Bond due December 31, 2000, in the aggregate principal amount of \$3,500,000 (the "Charter Surplus Note") of Charter Indemnity Company, a Texas stock insurance company and a direct wholly owned subsidiary of Charter ("Charter Indemnity"); and

WHEREAS, NCM is the holder of a Surplus Debenture due July 1, 2010, in the aggregate principal amount of \$1,790,000 (the "Northern County Surplus Note") of Northern County Mutual Insurance Company, a Texas county mutual insurance company affiliated with the Sellers ("Northern County"); and

WHEREAS, NCM is also the "holder" of a General Agency Managerial Contract with Northern County, pursuant to which NCM is the exclusive general agent and manager of Northern County (as amended and extended to date, the "Northern County Management Contract"); and

WHEREAS, the Purchaser wishes to acquire Valley, Charter and NCM (collectively, the "Companies"), together with their subsidiaries, the Charter Surplus Note, the Northern County Surplus Note and the Northern County Management Contract, from the Sellers, and the Sellers wish to sell the Companies, together with their subsidiaries, the Charter Surplus Note, the Northern County Surplus Note and the Northern County Management Contract, to the Purchaser, upon the terms and subject to the conditions set forth herein; and

WHEREAS, concurrently herewith, Skandia Insurance Company Ltd (publ), a Swedish insurance company ("Skandia Ltd") and the ultimate parent company of the Sellers and the Companies, is entering into a Parent Support Agreement with the Purchaser, in order to induce the Purchaser to enter into this Agreement and consummate the transactions contemplated hereby;

NOW, THEREFORE, in consideration of the foregoing and the representations, warranties, covenants and agreements contained herein, and for other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree as follows:

## ARTICLE I

### DEFINITIONS

1.1 Definitions. The following terms when used in this Agreement

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(including the Schedules and Exhibits hereto) shall have the following respective meanings:

"Affiliate" of a Person means any other Person that directly or indirectly through one or more intermediaries controls, is controlled by or is under common control with such Person. For purposes of this definition and the definition of "Subsidiary" below, "control" (or "controlled", as the context may require) shall have the meaning set forth in section 1501(a)(2) of the New York Insurance Law, as in effect on the date hereof.

"Affiliate Agreements" has the meaning set forth in Section 3.23.

"Allocation" has the meaning set forth in Section 5.10(c).

"Alternative Transaction" and "Alternative Transaction Proposal" have the respective meanings set forth in Section 5.7.

"Basket Amount" has the meaning set forth in Section 8.2.

"Business Day" means any day other than a Saturday, Sunday or other day on which commercial banks in New York City are required or authorized by law to be closed.

"C&L" has the meaning set forth in Section 3.11.

"California Insurance Code" means the California Insurance Code and the regulations promulgated thereunder.

"California SAP" means the statutory accounting practices prescribed or permitted by the California Department of Insurance.

"Charter" has the meaning set forth in the recitals to this Agreement.

"Charter Agency" means Charter General Agency, Inc., a Texas corporation and a direct wholly owned Subsidiary of Charter.

"Charter Agency/Kennell Note" means the Unsecured Note made by Charter Agency to Kennell on June 30, 1995, in the principal amount of \$5,650,000, bearing interest at the annual rate of 6.5% and having a final maturity date of December 31, 1995. The term "Charter Agency/Kennell Note" shall also be deemed to include the foregoing Unsecured Note, as amended in accordance with the terms and provisions hereof.

"Charter Downstream Note" means the Unsecured Note made by Charter to Charter Agency on August 26, 1991, in the principal amount of \$2,000,000, bearing interest at the annual rate of 7.5% and having a final maturity date of August 26, 1996.

"Charter Financial Statements" means (i) the audited consolidated balance sheets of Charter and its subsidiaries at December 31, 1994, 1993 and 1992 and the related consolidated statements of operations, changes in stockholder's equity and cash flows of Charter and its subsidiaries for the periods then ended, including in each case the related notes and unqualified auditor's report thereon, and (ii) the unaudited consolidated balance sheet of Charter and its subsidiaries at March 31, 1995, and the related consolidated statements of operations, changes in stockholder's equity and cash flows of Charter and its subsidiaries for the quarterly period then ended.



"Charter Indemnity" has the meaning set forth in the recitals to this Agreement.

"Charter Indemnity Reinsurance Agreement" has the meaning set forth in Section 5.18.

"Charter Intercompany Notes" means the Charter Surplus Note, the Charter Upstream Note, the Charter Downstream Note and the Charter Agency/Kennell Note, collectively.

"Charter Shares" has the meaning set forth in Section 2.1.

"Charter Statutory Statements" means the Annual Statements and the Quarterly Statement of Charter Indemnity as filed with the Texas Department of Insurance for the years ended December 31, 1994, 1993 and 1992 and for the quarterly period ended March 31, 1995, in each case including all exhibits, interrogatories, notes and schedules thereto and any actuarial opinion, affirmation or certification filed in connection therewith.

"Charter Subsidiaries" means Charter Agency, L-P Premium, Charter Indemnity and Monarch, collectively.

"Charter Surplus Note" has the meaning set forth in the recitals to this Agreement.

"Charter Upstream Note" means the Promissory Note made by Charter to Skandia Direct Operations Corporation (which has since been merged with and into Skandia America) on December 31, 1993, in the principal amount of \$2,000,000, bearing interest at the annual rate of 5.6%, all payable upon demand.

"Closing" has the meaning set forth in Section 2.2.

"Closing Date" has the meaning set forth in Section 2.2.

"Code" means the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder.

"Companies" has the meaning set forth in the recitals to this Agreement.

"Consents" has the meaning set forth in Section 3.4.

"Contracts" means all written or oral contracts, agreements, undertakings, indentures, notes, debentures, bonds, loans, instruments, leases, mortgages, commitments or other binding arrangements.

"Employee" shall mean each current full time or part time employee of the Companies or the Company Subsidiaries, including any such employee who is on disability or leave of absence.

"Environmental Laws" means the Federal Comprehensive Environmental Response, Compensation and Liability Act, the Federal Water Pollution Control Act, the Safe Drinking Water Act, the Federal Clean Water Act, the Federal Clean Air Act, the Federal Resource Conservation and Recovery Act, the Hazardous Materials Transportation Act, the Federal Solid Waste Disposal Act, the Federal Toxic Substances Control Act, the Federal Insecticide, Fungicide and Rodenticide Act, and the Occupational Safety and Health Act, each as amended, and all other environmental statutes enacted by any Governmental Entity, and any executive order, ordinances, rules or regulations promulgated under any of the foregoing.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended, and the rules and regulations promulgated thereunder.

"Estimated Tax Payments" means the sum of (i) the estimated Tax payments made by the Companies and their Subsidiaries (excluding Northern County) with respect to their federal income Tax for the Taxable Period beginning January 1, 1995, and ending on the Closing Date and (ii) any credits against such Tax that are attributable to the Companies and/or their Subsidiaries (excluding Northern County).

"Executive Officers" means, with respect to any corporation, the chairman of the board of directors, the chief executive officer, the president, the chief financial and principal accounting officer, any executive or senior vice presidents, the corporate secretary and the treasurer of such corporation (and any other individuals performing comparable functions), and with respect to each of the Companies and their Subsidiaries, shall also include the vice presidents thereof.

"Financial Statements" means the Charter Financial Statements, the NCM Financial Statements and the Valley Financial Statements, collectively.

"GAAP" means United States generally accepted accounting principles.

"Governmental Entity" means any federal, state, local or foreign government, political subdivision, legislature, court, agency, department, bureau, commission or other governmental or regulatory authority, body or instrumentality, including any insurance or securities regulatory authority and any industry or other non-governmental self-regulatory organizations.

"HSR Act" means the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules and regulations promulgated thereunder.

"Indemnified Party" and "Indemnifying Party" have the respective meanings set forth in Section 8.2.

"Indemnity Claim" has the meaning set forth in Section 8.3(d).

"Independent Actuary" has the meaning set forth in Section 2.4.

"Insurance Company" and "Insurance Companies" have the meanings set forth in Section 3.18.

"Insurance Permit" means any Permit in any jurisdiction to issue, underwrite, assume, place, sell or otherwise transact insurance or reinsurance, or to engage in premium finance activities.

"Intellectual Property" has the meaning set forth in Section 3.25.

"Interim Financial Statements" has the meaning set forth in Section 5.8.

"Interim Statutory Statements" has the meaning set forth in Section 5.8.

"Investment Guidelines" has the meaning set forth in Section 3.26.

"IRS" means the United States Internal Revenue Service.

"Kennell" means Kennell Premium Services, Inc., a Texas corporation and an indirect wholly owned Subsidiary of Skandia America.

"Knowledge" means, with respect to any Person, the actual knowledge (in the case of the Sellers, after reasonable inquiry of the Executive Officers of each of the Companies and their Subsidiaries) of the Executive Officers of such Person.

"Liabilities" has the meaning set forth in Section 3.12.

"Lien or Encumbrance" means any lien, pledge, mortgage, security interest, claim, lease, charge, option, right, easement, servitude, transfer limit, restriction or other encumbrance.

"Losses" has the meaning set forth in Section 8.2.

"L-P Premium" means L-P Premium Funding, Inc., a Texas corporation and a direct wholly owned Subsidiary of Charter.

"Material" means material to the business, operations, assets, Properties, financial condition, results of operations, Insurance Permits or other material Permits of (i) Valley and its Subsidiaries, taken as a whole, or (ii) Charter, NCM and their Subsidiaries (including Northern County), taken as a whole; provided, however, that, for purposes hereof, insofar as Charter, NCM and their

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Subsidiaries (including Northern County) are concerned, any matter, occurrence or other item individually or in the aggregate involving an amount, or having a value, of at least \$1,000,000 shall be deemed to be so material (and any matter, occurrence or other item individually and in the aggregate involving an amount, or having a value, of less than \$1,000,000 shall be deemed not to be so material).

"Material Adverse Effect" means any material adverse effect on the business, operations, assets, Properties, financial condition, results of operations, Insurance Permits or other material Permits of (i) Valley and its Subsidiaries, taken as a whole, or (ii) Charter, NCM and their Subsidiaries (including Northern County), taken as a whole; provided, however, that, for

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purposes hereof, insofar as Charter, NCM and their Subsidiaries (including Northern County) are concerned, any adverse effect thereon individually or in the aggregate involving an amount, or having a value, of at least \$1,000,000 shall be deemed to be such a material adverse effect (and any adverse effect thereon individually and in the aggregate involving an amount, or having a value, of less than \$1,000,000 shall be deemed not to be such a material adverse effect).

"Monarch" means Monarch Premium Funding, Inc., a Texas corporation and a direct wholly owned Subsidiary of Charter Agency.

"Monarch Note" means the Promissory Note in Favour of Skandia Capital AB (Renewal), issued by Monarch to Skandia Capital AB (publ) on May 24, 1995, in the principal amount of \$14,000,000, bearing interest at the rate of 7.8%

per annum and having a maturity date of August 22, 1995. The term "Monarch Note" shall also be deemed to include any note issued in replacement of the foregoing Promissory Note in Favour of Skandia Capital AB (publ) in accordance with the terms and provisions hereof.

"NCM" has the meaning set forth in the recitals to this Agreement.

"NCM Shares" has the meaning set forth in Section 2.1.

"NCM Financial Statements" means the unaudited balance sheets of NCM at December 31, 1994 and March 31, 1995, and the related statements of income of NCM for the year and quarterly period (respectively) then ended.

"Net Losses" means all losses and loss adjustment expenses (including, without limitation, incurred but not reported losses), net of ceded reinsurance.

"New Charter Agency Note" has the meaning set forth in Section 5.13.

"1994 Loss Reserves" has the meaning set forth in Section 2.4.

"1996 Loss Reserve Development" has the meaning set forth in Section 2.4.

"1996 Valley Statutory Statement" has the meaning set forth in Section 2.4.

"Northern County", "Northern County Surplus Note" and "Northern County Management Contract" have the respective meanings set forth in the recitals to this Agreement.

"Northern County Guaranty" has the meaning set forth in Section 5.18.

"Northern County Statutory Statements" means the Annual Statements and the Quarterly Statement of Northern County as filed with the Texas Department of Insurance for the years ended December 31, 1994, 1993 and 1992 and for the quarterly period ended March 31, 1995, in each case including all exhibits, interrogatories, notes and schedules thereto and any actuarial opinion, affirmation or certification filed in connection therewith.

"Notice of Disagreement" has the meaning set forth in Section 2.4.

"PBGC" means the Pension Benefits Guaranty Corporation.

"Permits" means all licenses, certificates of authority, permits, orders, consents, approvals, registrations, authorizations, qualifications and filings under any federal, state, local or foreign laws or with any Governmental Entities.

"Person" means any individual, corporation, partnership, limited liability company, firm, joint venture, association, joint stock company, trust, unincorporated organization, Governmental Entity or other entity or organization.

"Plan" means "any employee benefit plan" (as that term is defined in section 3(3) of ERISA), as well as any other formal or informal plan, arrangement or contract involving direct or indirect compensation, in which any current or former officers or employees of any of the Companies, their Subsidiaries or Northern County participate, or to which any of the Companies, their Subsidiaries or Northern County has any liability or under which any of the Companies, their Subsidiaries or Northern County has any present or future obligations or liability on behalf of their respective employees or former employees or their dependents or beneficiaries, including but not limited to, each retirement, pension, profit-sharing, thrift, savings, target benefit, employee stock ownership, cash or deferred, multiple employer, multiemployer or other similar plan or program, each other deferred or incentive compensation, bonus, stock option, employee stock purchase, "phantom stock" or stock appreciation right plan, each other program providing payment or reimbursement for or of medical, dental or visual care, psychiatric counselling, or vacation, sick, disability or severance pay and each other "fringe benefit" plan or arrangement.

"Property" means any real, personal or mixed property, whether tangible or intangible.

"Prior Bidders" has the meaning set forth in Section 5.7.

"Purchaser" has the meaning set forth in the first paragraph of this Agreement.

"Reinsurance Contracts" has the meaning set forth in Section 3.22.

"Representatives" has the meaning set forth in Section 5.2.

"SARC" means Skandia America Reinsurance Corporation, a Delaware stock insurance company and a direct wholly owned subsidiary of Skandia America.

"SARC Reinsurance Advance" has the meaning set forth in Section 3.9.

"Seller's Retirement Plan" shall mean the Skandia Direct Operations Corporation Retirement Plan.

"Seller's Defined Contribution Plan" shall mean the Skandia Direct Operations Employee Savings Plan.

"Sellers" has the meaning set forth in the first paragraph of this Agreement.

"Sellers Group" has the meaning set forth in Section 3.32(a).

"Shares" has the meaning set forth in Section 2.2.

"Short Period Tax" means the consolidated federal income Tax that would be imposed on the Companies and the Subsidiaries (excluding Northern County) for their Taxable Period that begins January 1, 1995, and ends on the Closing Date determined as if: (i) the Companies and their Subsidiaries file a consolidated federal income Tax Return for such Taxable Period; (ii) such Tax Return includes only the items of income, gain, loss, deduction, and credit realized by these corporations during such period (determined on a closing of the books method) plus items of deduction, loss, or credit that carryover to these corporations from prior Taxable Periods; and (iii) the items of income, gain, loss, and deduction attributable to the 338 Elections, if any, and all transactions contemplated by this Agreement, are disregarded.

"Skandia America" and "Skandia U.S." have the respective meanings set forth in the first paragraph of this Agreement.

"Skandia Ltd" has the meaning set forth in the recitals to this Agreement.

"Statutory Statements" means the Charter Statutory Statements and the Valley Statutory Statements, collectively.

"Subsidiary" means, with respect to any Person, any entity controlled by such Person. For purposes of this Agreement, Northern County shall be deemed to be a Subsidiary of NCM except where otherwise indicated herein.

"Successor Plan" shall mean a defined contribution plan qualified under Code Section 401(a), established no later than January 1, 1996, providing immediate participation for Employees.

"Tax" and "Taxes" mean all income, profits, gains, gross receipts, net worth, premium, value added, ad valorem, sales, use, excise, stamp, transfer, franchise, withholding, payroll, employment, occupation, workers' compensation, disability, severance, unemployment insurance, social security and property taxes, and all other taxes of any kind whatsoever, together with any interest, penalties and additions thereto imposed by any federal, state, local or foreign government or any agency or political subdivision of any such government, including all amounts imposed as a result of being a member of an affiliated or combined group.

"Tax Claim" has the meaning set forth in Section 8.3(d).

"Tax Closing Agreement" means any written and legally binding agreement with a taxing authority relating to Taxes.

"Tax Reserve" has the meaning given to such term in Section 3.32(c).

"Tax Return" means all returns, reports, elections, estimates, declarations, information statements and other forms and documents (including all schedules, exhibits, and other attachments thereto) relating to, and required to be filed in connection with, any Taxes (including estimated Taxes).

"Tax Ruling" means any written ruling by a taxing authority relating to Taxes.

"Tax Settlement Auditor" has the meaning set forth in Section 8.3(d).

"Taxable Period" means any taxable year or any other period that is treated as a taxable year (including any taxable period ending on the Closing Date or beginning on the day following the Closing Date) with respect to which any Tax may be imposed under any statute, rule, or regulation.

"Texas Insurance Code" means the Texas Insurance Code and the regulations promulgated thereunder.

"Texas SAP" means the statutory accounting practices prescribed or permitted by the Texas Department of Insurance.



"338 Elections" has the meaning given to such term in Section 5.10(a).

"338 Tax Cost" means the excess, if any, of (i) the consolidated federal income Tax that is projected to be incurred by the Sellers Group for its Taxable Period that includes the Closing Date over (ii) the projected consolidated federal income Tax that would have been incurred by the Sellers Group for such Taxable Period if the 338 Elections were not made. The projected Taxes in both (i) and (ii) above shall be determined without regard to items of deduction, loss, and credit that, in the absence of the 338 Elections, would reduce the taxable income of the Sellers Group below zero.

"Third Party Claim" has the meaning set forth in Section 8.2.

"Valley" has the meaning set forth in the recitals to this Agreement.

"Valley Financial Statements" means (i) the audited consolidated balance sheets of Valley and its subsidiaries at December 31, 1994 and 1993 and the related consolidated statements of income, changes in stockholder's equity and cash flows of Valley and its subsidiaries for the years then ended, including in each case the related notes and unqualified auditor's report thereon, and (ii) the unaudited consolidated balance sheet of Valley and its subsidiaries at March 31, 1995, and the related consolidated statements of income, changes in stockholder's equity and cash flows of Valley and its subsidiaries for the quarterly period then ended.

"Valley Insurance" means Valley Insurance Company, a California stock insurance company and a direct wholly owned Subsidiary of Valley.

"Valley Shares" has the meaning set forth in Section 2.1.

"Valley Statutory Statements" means the Annual Statements and the Quarterly Statement of Valley Insurance as filed with the California Department of Insurance for the years ended December 31, 1994, 1993 and 1992 and for the quarterly period ended March 31, 1995, including in each case all exhibits, interrogatories, notes and schedules thereto and any actuarial opinion, affirmation or certification filed in connection therewith.

"Valley Subsidiaries" means Valley Insurance and Valley Pacific Inc., an Oregon corporation, collectively.

"WARN" shall mean the Worker Adjustment and Retraining Notification Act of 1988.

## ARTICLE II

### PURCHASE AND SALE OF THE SHARES

2.1 Purchase and Sale of the Shares. (a) Upon the terms and subject to

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the conditions set forth in this Agreement, the Purchaser agrees to purchase from Skandia America, and Skandia America agrees to (and Skandia U.S. agrees to cause Skandia America to) sell, assign, transfer and deliver to the Purchaser, all of the outstanding capital stock of Valley (the "Valley Shares"), free and clear of all Liens or Encumbrances, for a cash purchase price equal to \$37,790,928.

(b) Upon the terms and subject to the conditions set forth in this Agreement, the Purchaser agrees to purchase from Skandia America, and Skandia America agrees to (and Skandia U.S. agrees to cause Skandia America to) sell, assign, transfer and deliver to the Purchaser, (i) all of the outstanding capital stock of Charter (the "Charter Shares") and (ii) all of the outstanding capital stock of NCM (the "NCM Shares"), in each case free and clear of all Liens or Encumbrances, for an aggregate cash purchase price equal to \$3,269,885.

2.2 The Closing. Subject to the satisfaction or waiver of all of the

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conditions to closing set forth in Articles VI and VII, the closing (the "Closing") of the purchase and sale of the Valley Shares, the NCM Shares and the Charter Shares (collectively, the "Shares") hereunder shall take place at the offices of Dewey Ballantine, 1301 Avenue of the Americas, New York, New York at 10:00 a.m., New York City time, on the fifth Business Day after the satisfaction or waiver of the conditions set forth in Article VI and VII, or at such other time or place as may be mutually agreed upon by the parties hereto. The date on which the Closing occurs is referred to herein as the "Closing Date."

2.3 Deliveries at the Closing. At the Closing:

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(a) Skandia America shall (and Skandia U.S. shall cause Skandia America to) deliver to the Purchaser certificates representing the Shares, duly endorsed in blank for transfer or accompanied by stock powers duly endorsed in blank;

(b) the Sellers shall deliver to the Purchaser all other documents and instruments required hereunder to be

delivered by the Sellers to the Purchaser at the Closing; and

(c) the Purchaser shall (i) pay to Skandia America the aggregate purchase price for the Shares (as provided in Section 2.1(a) and (b)) by wire transfer of immediately available funds to an account or accounts designated by Skandia America in a written notice delivered to the Purchaser not later than two (2) Business Days prior to the Closing Date, and (ii) deliver to the Sellers all other documents and instruments required hereunder to be delivered by the Purchaser to the Sellers at the Closing.

2.4 Purchase Price Adjustment. The purchase price for the Valley Shares, -----  
as provided in Section 2.1(a), shall be subject to post-Closing adjustment as follows:

(a) As promptly as reasonably practicable after it becomes available, the Purchaser shall deliver to Skandia America a true and complete copy of the Annual Statement of Valley Insurance as filed with the California Department of Insurance (or other appropriate insurance regulatory authority) for the year ended December 31, 1996 (the "1996 Valley Statutory Statement"), together with any actuarial opinion, affirmation or certification filed in connection therewith and all work papers and actuarial memoranda used by Valley Insurance in establishing the 1996 Loss Reserve Development (it being understood that neither the Purchaser nor Valley Insurance shall be required to prepare any such work papers or actuarial memoranda outside the ordinary course of business). The 1996 Valley Statutory Statement will be prepared in conformity with California SAP (or any other then applicable statutory accounting practices) and the books and records of Valley Insurance, and will present fairly the statutory financial position of Valley Insurance as of December 31, 1996 and the statutory results of operations of Valley Insurance for the period then ended.

(b) Following the delivery of the 1996 Valley Statutory Statement to Skandia America, the Purchaser will cause Valley Insurance to allow the Sellers to have reasonable access to the books, records and work papers of Valley Insurance relating to the 1996 Loss Reserve Development referred to below. In the event that the Sellers have any disagreement with the 1996 Loss Reserve Development reflected in the 1996 Valley Statutory Statement, the Sellers shall give written notice of all such disagreements (a "Notice of Disagreement") to the Purchaser within twenty (20) Business Days after the delivery of the 1996 Valley Statutory Statement to Skandia America. Any Notice of Disagreement shall set forth each item in disagreement, shall provide reasonable specificity as to the basis for each disagreement, and shall specify the total

adjustment to the 1996 Loss Reserve Development proposed by the Sellers as a result of such items in disagreement.

(c) If the Purchaser does not receive a Notice of Disagreement within such twenty Business Day period, the 1996 Loss Reserve Development reflected in the 1996 Valley Statutory Statement shall be final and binding upon the parties hereto. If, on the other hand, the Purchaser receives a Notice of Disagreement within such period, the parties shall negotiate in good faith to resolve all disagreements specified therein as promptly as practicable. If the parties are unable to resolve all such disagreements within fifteen (15) days of the receipt by the Purchaser of the Notice of Disagreement, then all unresolved disagreements shall be submitted to an independent actuarial firm of national standing and reputation as the parties shall jointly select and retain (the "Independent Actuary") for resolution in accordance with this Agreement. In the event that the parties are unable to jointly select an Independent Actuary, each of the Purchaser, on the one hand, and the Sellers, on the other hand, shall select an independent certified public accounting firm of national standing and reputation, which firms shall jointly select the Independent Actuary for joint retention by the parties. The parties shall, and the Purchaser shall cause Valley Insurance to, cooperate in good faith with the Independent Actuary and shall give the Independent Actuary access to all books, records, work papers and other information and documents relating to the items in disagreement as the Independent Actuary may reasonably request for purposes of such resolution. The Independent Actuary shall, within thirty (30) days after its engagement, deliver to the parties a conclusive written resolution of all disagreements submitted to it, which written resolution shall be in accordance with this Agreement and shall be final and binding upon the parties hereto. The 1996 Loss Reserve Development reflected in the 1996 Valley Statutory Statement shall be adjusted accordingly to reflect any such resolution and, as so adjusted, shall be deemed final for purposes of the purchase price adjustment provided in the next paragraph. The Sellers, on the one hand, and the Purchaser, on the other hand, shall each pay one-half of the fees and expenses of the Independent Actuary.

(d) If (i) the aggregate amount of reserves as of December 31, 1996 for Net Losses, together with the aggregate amount of Net Losses paid during the period from January 1, 1995 until December 31, 1996, in each case with respect to insurance and reinsurance business issued, underwritten, assumed or renewed on or prior to December 31, 1994 (the "1996 Loss Reserve Development") is less than (ii) the aggregate amount of reserves for Net Losses reflected in the December 31, 1994 Valley Statutory Statement for such

insurance and reinsurance business (the "1994 Loss Reserves"), the Purchaser shall pay to Skandia America the amount of such deficiency (in an amount not to exceed \$3,000,000). If the 1996 Loss Reserve Development is greater than the 1994 Loss Reserves, the Sellers will pay to the Purchaser the amount of such excess (in an amount not to exceed \$3,000,000). All payments under this Section shall be made not later than twenty (20) Business Days following the Purchaser's delivery of the 1996 Valley Statutory Statements to Skandia America (or, in the case of any amounts due as a result of the resolution of any disagreements, not later than five (5) Business Days following the resolution of all such disagreements), by wire transfer of immediately available funds to an account or accounts designated by the payee to the payor in the manner specified herein for delivery of notices. Any amount payable under this Section 2.4(d) shall constitute an adjustment to the purchase price paid by the Purchaser for the Valley Shares.

(e) From the Closing Date until December 31, 1996, the Purchaser agrees to cause Valley Insurance to (i) pay and settle claims with respect to insurance and reinsurance business issued, underwritten, assumed or renewed by Valley Insurance on or prior to December 31, 1994, generally in accordance with past practice, and (ii) establish reserves for Net Losses with respect to such insurance and reinsurance business in accordance with generally accepted actuarial standards.

### ARTICLE III

#### REPRESENTATIONS AND WARRANTIES OF THE SELLERS

The Sellers hereby jointly and severally represent and warrant to the Purchaser as follows:

3.1 Organization of the Sellers. Each of the Sellers is a corporation

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duly organized, validly existing and in good standing under the laws of the state or jurisdiction of its incorporation, and has all requisite corporate power and authority to own, lease and operate its assets and Properties (including, without limitation, the Shares) and to conduct its business as currently being conducted, except where the failure to have such corporate power and authority would not, individually or in the aggregate, have a Material Adverse Effect. Each of the Sellers is duly qualified and in good standing as a foreign corporation in all jurisdictions in which the nature of its business or the ownership of its Properties makes such qualification necessary, except where the failure to be so qualified or in good standing would not, individually or in

the aggregate, have a Material Adverse Effect or a material adverse effect on the ability of any of the Sellers to execute and deliver this Agreement, perform its obligations hereunder or consummate the transactions contemplated hereby. Skandia U.S. is a direct wholly owned Subsidiary of Skandia Ltd, and Skandia America is a direct wholly owned Subsidiary of Skandia U.S. The Sellers have heretofore delivered to the Purchaser true and complete copies of the certificate or articles of incorporation (or other charter or organization documents), including all amendments thereto, and by-laws, as currently in effect, of each of the Sellers.

3.2 Authorization, Validity and Enforceability. Each of the Sellers has

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all requisite corporate power and authority to execute and deliver this Agreement, to perform its obligations hereunder and to consummate the transactions contemplated hereby, including, without limitation, the sale of the Shares hereunder. The execution, delivery and performance of this Agreement by the Sellers and the consummation of the transactions contemplated hereby by the Sellers have been duly and validly authorized by all necessary corporate action on the part of the Sellers and no other corporate proceedings on the part of any of the Sellers (including any proceedings of stockholders of the Sellers) are necessary to authorize the execution, delivery and performance of this Agreement or the consummation of any of the transactions contemplated hereby. This Agreement has been duly executed and delivered by each of the Sellers and constitutes the legal, valid and binding obligation of each of the Sellers, enforceable against each of the Sellers in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy, insolvency or other similar laws affecting creditors' rights generally and except as rights to specific enforcement may be limited by the application of equitable principles (whether such equitable principles are applied in a proceeding at law or in equity).

3.3 No Conflicts. The execution and delivery by the Sellers of this

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Agreement, the performance by the Sellers of their obligations hereunder and the consummation of the transactions contemplated hereby do not and will not conflict with, result in any breach or violation of, constitute a default under (or an event which with the giving of notice or the lapse of time or both would constitute a default under), give rise to any right of termination or acceleration of any right or obligation of any of the Sellers, the Companies or the Subsidiaries of any of the Companies (including Northern County) under (assuming for such purposes that the Consents required under the HSR Act and the Consents set forth in Schedule 3.4 are duly made, obtained or given, as the case may be), or result in

the creation or imposition of any Lien or Encumbrance upon any assets or Properties of any of the Companies or the Subsidiaries of any of the Companies (including Northern County) by reason of the terms of, (a) the certificate or articles of incorporation, by-laws or other charter or organization documents of any of the Sellers, the Companies or the Subsidiaries of any of the Companies (including Northern County), (b) any of the Shares, the Charter Intercompany Notes, the Northern County Surplus Note, the Monarch Note or the Northern County Management Contract, (c) any Contract to which any of the Sellers, the Companies or the Subsidiaries of any of the Companies (including Northern County) is a party or by or to which any of them or their assets or Properties (including, without limitation, the Shares, the Charter Intercompany Notes and the Northern County Surplus Note) may be bound or subject, (d) any applicable order, writ, judgment, injunction, award, decree, law, statute, ordinance, rule or regulation or (e) any Insurance Permit or other material Permit of any of them, other than, in the case of clause (c) only, any conflict, breach, violation, default, termination or acceleration which would not, individually or in the aggregate together with all such other conflicts, breaches, violations, defaults, terminations and accelerations, have a Material Adverse Effect or a material adverse effect on the ability of any of the Sellers to execute and deliver this Agreement, perform its obligations hereunder or consummate the transactions contemplated hereby.

3.4 Consents and Approvals. Except as required under the HSR Act and as

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set forth in Schedule 3.4 hereto, no consent, approval, authorization, license or order of, registration or filing with, or notice to, any federal, state, local, foreign or other Governmental Entity or any other Person (collectively, "Consents") is necessary to be obtained, made or given by any of the Sellers, SARC, the Companies or the Subsidiaries of any of the Companies (including Northern County) in connection with the execution and delivery by the Sellers of this Agreement, the performance by the Sellers of their obligations hereunder and the consummation of the transactions contemplated hereby.

3.5 Organization of the Companies. Each of the Companies is a corporation

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duly organized, validly existing and in good standing under the laws of the state of its incorporation, and has all requisite power and authority to own, lease and operate its assets and Properties (including, in the case of Charter, the Charter Surplus Note and, in the case of NCM, the Northern County Surplus Note) and to conduct its business as currently being conducted. Each of the Companies is duly qualified and in good standing as a foreign corporation in all jurisdictions in which the nature

of its business or the ownership of its Properties makes such qualification necessary, except where the failure to be so qualified or in good standing would not, individually or in the aggregate, have a Material Adverse Effect. All such jurisdictions are listed in Schedule 3.5 hereto. No other jurisdiction has claimed, in writing, that any of the Companies is required to hold a Permit issued by any Governmental Entity therein, and none of the Companies files or is required to file any Tax Returns, or owns or leases real Property, in any other jurisdictions. The Sellers have heretofore delivered to the Purchaser true and complete copies of the certificate or articles of incorporation (or other charter or organization documents), including all amendments thereto, and by-laws, as currently in effect, of each of the Companies.

3.6 Subsidiaries. (a) The Companies have no Subsidiaries other than the

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Valley Subsidiaries, the Charter Subsidiaries and Northern County. Each of the Valley Subsidiaries and the Charter Subsidiaries is a corporation duly organized, validly existing and in good standing under the laws of the state of its incorporation, and has all requisite power and authority to own, lease and operate its assets and Properties and to conduct its business as currently being conducted. Each of the Valley Subsidiaries and the Charter Subsidiaries is duly qualified and in good standing as a foreign corporation in all jurisdictions in which the nature of its business or the ownership of its Properties makes such qualification necessary, except where the failure to be so qualified or in good standing would not, individually or in the aggregate, have a Material Adverse Effect. All such jurisdictions are listed in Schedule 3.6 hereto. No other jurisdiction has claimed, in writing, that any of the Valley Subsidiaries or the Charter Subsidiaries is required to hold a Permit issued by any Governmental Entity therein, and none of the Valley Subsidiaries or the Charter Subsidiaries files or is required to file any Tax Returns, or owns or leases real Property, in any other jurisdictions. Except for the Valley Subsidiaries and the Charter Subsidiaries and as set forth in Schedule 3.6 hereto, none of the Companies directly or indirectly owns any interest in any other Person; without limiting the foregoing, none of the Valley Subsidiaries or the Charter Subsidiaries directly or indirectly owns any interest in any other Person other than, in the case of Charter Agency, Monarch. The Sellers have heretofore delivered to the Purchaser true and complete copies of the certificate or articles of incorporation (or other charter or organization documents), including all amendments thereto, and by-laws, as currently in effect, of each of the Valley Subsidiaries and the Charter Subsidiaries.



(b) Schedule 3.6 hereto sets forth the designation, par value and the number of authorized, issued and outstanding shares of each class or series of capital stock of each of the Valley Subsidiaries and the Charter Subsidiaries. Except for the Monarch Note, the Charter Agency/Kennell Note and as set forth in Schedule 3.6, no preferred stock, bonds, debentures, notes, debt instruments, evidences of indebtedness or other securities of any kind, of any of the Valley Subsidiaries or the Charter Subsidiaries are authorized, issued or outstanding. All of the outstanding capital stock of each of the Valley Subsidiaries and the Charter Subsidiaries is duly authorized, validly issued, fully paid and non-assessable. All of the outstanding capital stock of each of the Valley Subsidiaries is owned of record and beneficially by Valley, all of the outstanding capital stock of the Charter Subsidiaries (other than Monarch) is owned of record and beneficially by Charter, and all of the outstanding capital stock of Monarch is owned of record and beneficially by Charter Agency, in each case free and clear of any Lien or Encumbrance.

(c) None of the Valley Subsidiaries or the Charter Subsidiaries has issued any securities in violation of any preemptive or similar rights, and there are no subscriptions, options, warrants, calls, commitments, preemptive rights or other rights of any kind (absolute, contingent or otherwise) to purchase or otherwise receive, nor any securities or instruments of any kind convertible into or exchangeable for, any capital stock (including, without limitation, outstanding, authorized but unissued, unauthorized, treasury or other shares thereof) or other equity interest or any debt security or instrument of any of the Valley Subsidiaries or the Charter Subsidiaries. Except as set forth in Schedule 3.6 or as provided in the HSR Act, the California Insurance Code, the California General Corporation Law, the Texas Insurance Code or the Texas Business Corporation Act, there are no restrictions upon the voting or transfer of, or the declaration or payment of any dividend or distribution on, any shares of capital stock of any of the Valley Subsidiaries or the Charter Subsidiaries.

3.7 Capitalization. (a) Schedule 3.7 hereto sets forth the designation,  
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par value and the number of authorized, issued and outstanding shares of each class or series of capital stock of each of the Companies. Except for the Charter Intercompany Notes and as set forth in Schedule 3.7, no preferred stock, bonds, debentures, notes, debt instruments, evidences of indebtedness or other securities of any kind, of any of the Companies are authorized, issued or outstanding. All of the Shares are duly authorized, validly issued, fully paid and non-assessable, and are owned of record and beneficially by

Skandia America, free and clear of any Lien or Encumbrance (other than restrictions on the transferability of the Shares provided in the California Insurance Code or the Texas Insurance Code).

(b) True and complete copies of the Charter Intercompany Notes and the Monarch Note (as each of the same may have been amended or modified) have heretofore been delivered by the Sellers to the Purchaser. Schedule 3.7 hereto sets forth the principal, interest and all other amounts outstanding (specifying accrued and unpaid amounts as of a date not earlier than (10) Business Days prior hereto) under each of the Charter Intercompany Notes and the Monarch Note. The Charter Surplus Note is duly authorized, validly issued, fully paid and non-assessable, and is owned of record and beneficially by Charter, free and clear of any Lien or Encumbrance. The Charter Upstream Note is owned of record and beneficially by Skandia America, the Charter Downstream Note is owned of record and beneficially by Charter Agency, the Charter Agency/Kennell Note is owned of record and beneficially by Kennell, and the Monarch Note is owned of record and beneficially by Skandia Capital AB (publ), in each case free and clear of any Lien or Encumbrance. None of the borrowers under the Charter Intercompany Notes or the Monarch Note is in default thereunder (including, without limitation, in the payment of principal or interest).

(c) None of the Companies has issued any securities in violation of any preemptive or similar rights and, except for this Agreement, there are no subscriptions, options, warrants, calls, commitments, preemptive rights or other rights of any kind (absolute, contingent or otherwise) to purchase or otherwise receive, nor any securities or instruments of any kind convertible into or exchangeable for, any capital stock (including, without limitation, outstanding, authorized but unissued, unauthorized, treasury or other shares thereof) or other equity interest or any debt security or instrument of the Companies. Except as set forth in Schedule 3.7 or as provided in the HSR Act, the California Insurance Code, the California General Corporation Law, the Texas Insurance Code or the Texas Business Corporation Act, there are no restrictions upon the voting or transfer of, or the declaration or payment of any dividend or distribution on, any shares of capital stock of any of the Companies.

3.8 Title to Shares. The sale and delivery of the Shares as contemplated

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by this Agreement are not subject to any preemptive right, right of first refusal or other right or restriction (other than restrictions on transferability of the Shares provided in the HSR Act, the California Insurance Code and the Texas Insurance Code).

Upon the delivery of the Shares as provided in Section 2.3, the Purchaser will acquire good and marketable title to each of the Shares, free and clear of any Lien or Encumbrance (other than any Liens or Encumbrances created by the Purchaser and any restrictions on transferability of the Shares provided in the California Insurance Code and the Texas Insurance Code), and will be entitled to all the rights of a holder of such Shares.

3.9 Northern County; Charter Indemnity. (a) Northern County is a county

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mutual insurance company duly organized, validly existing and in good standing under the laws of the State of Texas, and has all requisite power and authority to own, lease and operate its assets and Properties and to conduct its business as currently being conducted. Northern County is duly licensed as a county mutual insurance company under Chapter 17 of the Texas Insurance Code to transact property and casualty insurance anywhere in the State of Texas, and is not licensed or qualified to do business under any other Texas law or in any other jurisdiction. No jurisdiction other than Texas has claimed, in writing, that Northern County is required to hold a Permit issued by any Governmental Entity therein, and Northern County neither files nor is required to file any Tax Returns in any jurisdiction other than Texas. Northern County has no Subsidiaries and owns no direct or indirect interest in any other Person. The Sellers have heretofore delivered to the Purchaser a true and complete copy of the charter and any other organization documents, including all amendments thereto, of Northern County.

(b) Except for the Northern County Surplus Note (a true and complete copy of which has heretofore been delivered by the Sellers to the Purchaser) and the reinsurance advance from SARC described in Schedule 3.9 (the "SARC Reinsurance Advance"), no bonds, debentures, notes, debt instruments, evidences of indebtedness or other securities of any kind of Northern County are authorized, issued or outstanding. The Northern County Surplus Note is duly authorized, validly issued, fully paid, non-assessable and enforceable against Northern County in accordance with its terms, and is owned of record and beneficially by NCM, free and clear of any Lien or Encumbrance (other than pursuant to any Contracts and undertakings specified in Schedule 3.9 and as provided in the Texas Insurance Code). Schedule 3.9 contains a true and complete copy of all Contracts (other than the Northern County Surplus Note itself and this Agreement) relating, in whole or in part, to the Northern County Surplus Note. Northern County is not in default under the Northern County Surplus Note (including, without limitation, in the payment of principal or interest which has been approved for payment pursuant to the terms

thereof), and NCM is not in default under any such Contract or undertaking relating thereto.

(c) The Sellers have heretofore delivered to the Purchaser a true and complete copy of the Northern County Management Contract, including all amendments and extensions thereto. The Northern County Management Contract is in full force and effect, and constitutes the legal, valid and binding obligation of each party thereto, enforceable against each such party in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy, insolvency or other similar laws affecting creditors' rights generally and except as rights to specific performance may be limited by the application of equitable principles (whether such equitable principles are applied in a proceeding at law or in equity). Neither Northern County nor NCM is in default under the Northern County Management Contract, nor does any condition exist that with notice or lapse of time or both would constitute such a default thereunder. By virtue of the Northern County Management Contract, NCM has the sole and exclusive right and power to manage the business and operations of Northern County. Except for the directors of NCM (solely in their capacities as such) and as specified in Schedule 3.9, NCM is the only Person who performs services for, or is entitled to compensation from, Northern County. Assuming the Texas Insurance Commissioner approves the transactions contemplated hereby, the Northern County Management Contract will not be terminable or, subject to Section 6.10, otherwise modified by reason of the transactions contemplated by this Agreement. Other than the consent of the Board of Directors of Northern County and as provided in the Texas Insurance Code, there is no limitation or restriction on, or Consent required for, the assignment or delegation by NCM of any of its rights, duties, powers or privileges under or in respect of the Northern County Management Contract.

(d) From the date of its incorporation until December 29, 1994, NCM engaged in no business or activities other than in connection with its organization. Since the latter date, NCM has engaged in no business or activities other than acting as the general managerial agent of Northern County pursuant to the Northern County Management Contract.

(e) All insurance and reinsurance issued, underwritten, assumed or renewed by Charter Indemnity on or before the date hereof consists solely of (and all insurance and reinsurance issued, underwritten, assumed or renewed by Charter Indemnity on or prior to the Closing Date will consist solely of) insurance or reinsurance of (i) private passenger automobile liability and physical damage risks and

(ii) mobile home and personal dwelling fire property risks, in each case retroceded by SARC to Charter Indemnity.

3.10 Corporate Minutes. The Sellers have heretofore made available to the

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Purchaser true and complete copies, or the complete original, minute books of each of the Companies and their Subsidiaries (including Northern County). The minute books of each of the Companies and their Subsidiaries (including Northern County) accurately reflect in all material respects all actions taken at meetings, or by written consent in lieu of meetings, of the stockholders, boards of directors and all committees of such boards of directors of each of the Companies and their Subsidiaries (including Northern County), respectively, and (in the case of Northern County) the policyholders of Northern County, since January 1, 1990. Since such date, all material corporate actions taken by the Companies and their Subsidiaries (including Northern County) have been duly authorized, and no such corporate actions have been taken in breach or violation of the certificate or articles of incorporation, by-laws or other charter or organization documents of any of the Companies or their Subsidiaries (including Northern County).

3.11 Financial Statements. (a) The Sellers have heretofore delivered to

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the Purchaser true and complete copies of the Valley Financial Statements, the Valley Statutory Statements, the Charter Financial Statements, the Charter Statutory Statements, the NCM Financial Statements and the Northern County Statutory Statements.

(b) The Valley Financial Statements were prepared in accordance with GAAP consistently applied throughout the periods involved, were prepared in accordance with the books and records of Valley and its Subsidiaries, have been audited by Coopers & Lybrand LLP, certified public accountants ("C&L"), and present fairly the financial position of Valley and its Subsidiaries at the respective dates thereof and the results of operations of Valley and its Subsidiaries for the respective periods then ended (except that the quarterly Valley Financial Statements have not been audited and do not contain full footnote disclosures in accordance with GAAP and are subject to normal recurring year-end audit adjustments).

(c) The balance sheets of Valley and the related statements of income and cash flows included in the Valley Statutory Statements were prepared in conformity with California SAP consistently applied throughout the periods involved, were prepared in accordance with the books and records of Valley Insurance, have been audited by C&L, and present fairly the statutory financial position of Valley Insurance at the respective dates thereof and the statutory

results of operations of Valley Insurance for the respective periods then ended. The Valley Statutory Statements complied in all material respects with all applicable laws and were complete and correct in all material respects when filed, and no material deficiency has been asserted with respect to any of the Valley Statutory Statements by the California Department of Insurance.

(d) The Charter Financial Statements were prepared in accordance with GAAP consistently applied throughout the periods involved, were prepared in accordance with the books and records of Charter and its Subsidiaries, have been audited by C&L, and present fairly the financial position of Charter and its Subsidiaries at the respective dates thereof and the results of operations of Charter and its Subsidiaries for the respective periods then ended (except that the quarterly Charter Financial Statements have not been audited and do not contain full footnote disclosures in accordance with GAAP and are subject to normal recurring year-end audit adjustments).

(e) The balance sheets of Charter Indemnity and the related statements of income and cash flows included in the Charter Statutory Statements were prepared in conformity with Texas SAP consistently applied throughout the periods involved, were prepared in accordance with the books and records of Charter Indemnity, have been audited by C&L, and present fairly the statutory financial position of Charter Indemnity at the respective dates thereof and the statutory results of operations of Charter Indemnity for the respective periods then ended. The Charter Statutory Statements complied in all material respects with all applicable laws and were complete and correct in all material respects when filed, and no material deficiency has been asserted with respect to any of the Charter Statutory Statements by the Texas Department of Insurance.

(f) The NCM Financial Statements were prepared in accordance with GAAP consistently applied throughout the periods involved, were prepared in accordance with the books and records of NCM, and present fairly the financial position of NCM at the respective dates thereof and the results of operations of NCM for the respective periods then ended (except that the quarterly NCM Financial Statements do not contain full footnote disclosures in accordance with GAAP and are subject to normal recurring year-end adjustments). No financial statements of NCM have been audited.

(g) The balance sheets of Northern County and the related statements of income and cash flows included in the Northern County Statutory Statements were prepared in conformity with Texas SAP consistently applied throughout

the periods involved, were prepared in accordance with the books and records of Northern County, have been audited by C&L, and present fairly the statutory financial position of Northern County at the respective dates thereof and the statutory results of operations of Northern County for the respective periods then ended. The Northern County Statutory Statements complied in all material respects with all applicable laws and were complete and correct in all material respects when filed, and no material deficiency has been asserted with respect to any of the Northern County Statutory Statements by the Texas Department of Insurance. Northern County has not prepared any GAAP financial statements during any of the periods covered by the Northern County Statutory Statements.

3.12 Liabilities. (a) Neither Valley nor any of its Subsidiaries has any

direct or indirect debt, obligation, loss, damages, deficiency or other liability of any nature, whether absolute, accrued, contingent or otherwise ("Liability"), required by GAAP or California SAP to be set forth in a financial statement other than (i) Liabilities set forth in the Valley Financial Statements and the balance sheets included in the Valley Statutory Statements and (ii) Liabilities incurred by Valley and its Subsidiaries since March 31, 1995 in the ordinary course of business consistent with past practice.

(b) Neither Charter nor any of its Subsidiaries has any Liability required by GAAP or Texas SAP to be set forth in a financial statement other than (i) Liabilities set forth in the Charter Financial Statements and the balance sheets included in the Charter Statutory Statements and (ii) Liabilities incurred by Charter and its Subsidiaries since March 31, 1995 in the ordinary course of business consistent with past practice.

(c) NCM does not have any Liability required by GAAP to be set forth in a financial statement other than (i) Liabilities set forth in the NCM Financial Statements and (ii) Liabilities incurred by NCM since March 31, 1995 in the ordinary course of business consistent with past practice.

(d) Northern County does not have any Liability required by Texas SAP to be set forth in a financial statement other than (i) Liabilities set forth in the balance sheets included in the Northern County Statutory Statements and (ii) Liabilities incurred by Northern County since March 31, 1995 in the ordinary course of business consistent with past practice.

3.13 Absence of Changes. (a) Since March 31, 1995, there has been no

material adverse change in the business, operations, assets, Properties, financial

condition, results of operations, Insurance Permits or other material Permits of (i) Valley and its Subsidiaries, taken as a whole, or (ii) Charter, NCM and their Subsidiaries (including Northern County), taken as a whole; provided,

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however, that, for purposes hereof, insofar as Charter, NCM and their

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Subsidiaries (including Northern County) are concerned, any adverse change therein individually or in the aggregate involving an amount, or having a value, of at least \$1,000,000 shall be deemed to be such a material adverse change (and any adverse change therein individually and in the aggregate involving an amount, or having a value, of less than \$1,000,000 shall be deemed not to be such a material adverse change).

(b) Except as set forth in Schedule 3.13 hereto and for the transactions contemplated hereby, since March 31, 1995, the Companies and their Subsidiaries (including Northern County) have operated their businesses only in the ordinary course of business consistent with past practice (except that L-P Premium is an inactive company and has had no operations in such period or since the date of its incorporation) and none of the Companies or their Subsidiaries (including Northern County) has:

(i) amended its certificate or articles of incorporation, by-laws or other charter or organization document, or merged with or into or consolidated with any other Person, subdivided or in any way reclassified any shares of its capital stock or changed or agreed to change in any manner the rights of its outstanding capital stock;

(ii) issued or sold, or issued or sold any options, warrants, calls or other rights of any kind to purchase or otherwise receive, or issued or sold any securities or instruments convertible into or exchangeable for, or entered into any contract or commitment to issue or sell, any capital stock or other equity interest or any bonds, debentures, notes, debt instruments, evidences of indebtedness or other securities of any kind, including, without limitation, any stock appreciation rights;

(iii) declared, paid or set aside any sum for any dividends or declared or made any other distributions of any kind (whether in cash, stock, Property, any combination thereof or otherwise) to its stockholders, or made any direct or indirect redemption, retirement, purchase or other acquisition of any shares of its capital stock or other equity interests or any bonds, debentures, notes, debt instruments, evidences of indebtedness or other securities of any kind;



(iv) incurred any indebtedness for borrowed money or entered into any commitment to borrow money or guarantee any Liability for borrowed money; or incurred or assumed any Liability or series of related Liabilities in excess of \$100,000 (other than ordinary course obligations to policyholders arising pursuant to the terms of insurance policies issued by Valley Insurance, Charter Indemnity or Northern County in the ordinary course of business consistent with past practice);

(v) made any change in its accounting or reserving methods or practices (including, without limitation, any change with respect to establishment of reserves for unearned premiums, losses (including incurred but not reported losses) and loss adjustment expenses) or made any change in depreciation or amortization policies or rates adopted by it;

(vi) made any change in its business, underwriting, billing, reserving, reinsurance, investment or claims adjustment policies and practices or any change in any activity which (A) has had the effect of accelerating the recording and billing of premiums or accounts receivable or delaying the payment of expenses or the establishment of loss and loss adjustment expense and other reserves in connection with the business or any material accounts of any of the Companies, their Subsidiaries or Northern County or (B) has had the effect of materially altering, modifying or changing the historic financial or accounting practices or policies of any of the Companies, their Subsidiaries or Northern County, including accruals of and reserves for Tax Liabilities;

(vii) suffered any damage, destruction, casualty or loss, whether or not covered by insurance, affecting any of its Property, the total amount of which was or will be greater than \$100,000;

(viii) allowed the creation of any Lien or Encumbrance on any tangible or intangible asset or Property, or any sale, transfer, assignment, lease or abandonment of any interest in any tangible or intangible asset or Property, other than sales, transfers, assignments and leases in the ordinary course of business consistent with past practice of assets of Property having an aggregate fair market value below \$100,000;

(ix) entered into any Contract, commitment or transaction (including, without limitation, any capital expenditure, capital contribution, capital

financing, or purchase, lease, acquisition, sale or disposition of assets or Properties) which requires or could require payments in excess of \$100,000 with respect to any individual Contract, commitment or transaction or series of related Contracts, commitments and transactions;

(x) terminated, failed to renew, received any written notice (that was not subsequently withdrawn) to terminate or fail to renew, amended, altered, modified, suffered the occurrence of any default under, failed to perform any Liabilities or obligations under, or waived or released any rights under, any Contract which is Material;

(xi) forgiven or permitted any cancellation of any claim, debt or account receivable, other than cancellations in the ordinary course of business consistent with past practice of any claim, debt or account receivable in an amount below \$100,000;

(xii) directly or indirectly made any payment, discharge or satisfaction of any Liability in excess of \$50,000 before the same became due in accordance with its terms, other than in the ordinary course of business consistent with past practice and as reflected or reserved against in the Financial Statements and the Statutory Statements;

(xiii) accelerated the collection, or sale to any other Person, of any of its receivables, or delayed the payment of any of its payables, other than accelerations or delays in the ordinary course of business consistent with past practice involving amounts below \$100,000;

(xiv) except for unrealized gains or losses with respect to investment assets (not resulting from any write-down, write-off or change in the basis of valuation thereof), made any revaluation of any assets or Properties, or write-down or write-off of the value of any assets or Properties (including, without limitation, any receivables), in an amount in excess of \$100,000;

(xv) made any loan or advance to any Person, other than loans or advances made in the ordinary course of business consistent with past practice in an amount below \$10,000;

(xvi) made any acquisition of all or any substantial part of the assets, Properties, securities or business of any other Person;

(xvii) except in the ordinary course of business consistent with past practice, hired any new employees, consultants, agents or other representatives or entered into any employment or consulting agreements (other than those terminable without severance, without penalty and without cause on not more than thirty (30) days notice), or terminated, or made any change in the employment terms or conditions of, any officers, directors, employees, consultants, agents or other representatives;

(xviii) except in the ordinary course of business consistent with past practice, increased or agreed to increase any salary, wages, bonus, severance, compensation, pension or other benefits payable or to become payable, or granted any severance or termination payments or benefits, to any of its current or former officers, directors, employees, consultants, agents or other representatives;

(xix) entered into any collective bargaining agreement or any other Contract with any labor union or association representing any employee, or been subjected to any strike, picket, work stoppage, work slowdown, labor dispute or other labor trouble;

(xx) considered or adopted a plan of complete or partial liquidation, dissolution, rehabilitation, restructuring, recapitalization, demutualization, redomestication or other reorganization; or

(xxi) entered into any Contract, commitment or transaction to do any of the foregoing.

3.14 Legal Proceedings. (a) Except as set forth in Schedule 3.14

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hereto, there is no action, suit, claim, proceeding or investigation pending or, to the Knowledge of the Sellers, threatened against or affecting any of the Companies or their Subsidiaries (including Northern County), or any of the directors, officers, employees, assets or Properties of any of them, by or before any court, other Governmental Entity or arbitrator (other than ordinary course insurance claims of policyholders arising pursuant to the terms of insurance policies issued by Valley Insurance, Charter Indemnity or Northern County in the ordinary course of business consistent with past practice). Except as set forth in Schedule 3.14, there is no outstanding order, writ, judgment, injunction, award or decree of any court, other Governmental Entity or arbitrator against or affecting any of the Companies, their Subsidiaries, Northern County, or any of the directors, officers, employees, assets or Properties of any of them.

(b) Except as set forth in Schedule 3.14 hereto, there is no action, suit, claim, proceeding or investigation pending or, to the knowledge of the Sellers, threatened against or affecting any of the Sellers by or before any court, other Governmental Entity or arbitrator which, individually or in the aggregate, is reasonably likely to have a material adverse effect on the ability of any of the Sellers to execute and deliver this Agreement, perform its obligations hereunder or consummate the transactions contemplated hereby. Except as set forth in Schedule 3.14 hereto, there is no outstanding order, writ, judgment, injunction or decree of any court, other Governmental Entity or arbitrator against or affecting any of the Sellers which, individually or in the aggregate, is reasonably likely to have a material adverse effect on the ability of any of the Sellers to execute and deliver this Agreement perform its obligations hereunder or consummate the transactions contemplated hereby.

3.15 Compliance with Laws. Each of the Companies and their

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Subsidiaries (including Northern County) is in compliance with (a) the terms of its certificate or articles of incorporation, by-laws or other charter or organization documents, (b) all applicable laws, statutes, ordinances, rules, regulations or other legal requirements, whether federal, state, local or foreign, (c) all applicable orders, writs, judgments, injunctions, awards and decrees of any court, other Governmental Entity or arbitrator and (d) its Permits, except in the case of clauses (b) and (c) where the failure to comply would not, individually or in the aggregate, have a Material Adverse Effect. None of the Sellers, the Companies or their Subsidiaries (including Northern County) has received notice of any violation by any of the Companies or their Subsidiaries (including Northern County) of, or default by any of the Companies or their Subsidiaries (including Northern County) under, its certificate or articles of incorporation, by-laws or other charter or organization document, any law, statute, ordinance, rule, regulation or other legal requirement, any order, writ, injunction, award or decree of any court, other Governmental Entity or arbitrator, or any of its Permits, except for such violations or defaults which would not, individually or in the aggregate, have a Material Adverse Effect.

3.16 Licenses and Permits. Each of the Companies and their

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Subsidiaries (including Northern County) possesses all Permits necessary for the ownership of its assets and Properties and the conduct of its businesses. Schedule 3.16 hereto sets forth a true and complete list of all such Permits of the Companies and their Subsidiaries (including Northern County), including the jurisdictions in which any such Persons possess Permits to conduct insurance, insurance

agency or brokerage and premium finance businesses. The Sellers have heretofore made available to the Purchaser true and complete copies of all such Permits as currently in effect. All such Permits are valid and in full force and effect. There is no action, proceeding, inquiry or investigation pending or, to the Knowledge of the Sellers, threatened for or contemplating the suspension, modification, limitation, cancellation, revocation or nonrenewal of any such Permit, and the Sellers have no Knowledge of any existing fact or circumstance which (with or without notice or lapse of time or both) is reasonably likely to result in the suspension, modification, limitation, cancellation, revocation or nonrenewal of any such Permit. To the Knowledge of the Sellers, assuming the insurance regulatory authorities of the States of California and Texas approve the transactions contemplated hereby, the consummation of the transactions contemplated hereby will not result in the suspension, modification, cancellation, revocation or nonrenewal of any such Permit. None of the Companies or their Subsidiaries (including Northern County) is engaged in any insurance, insurance agency or brokerage or premium finance business in any jurisdiction in which it is not duly authorized or qualified to transact such business. Except for compliance with periodic renewal procedures, and assuming the insurance regulatory authorities of the State of California and Texas approve the transactions contemplated hereby, no approvals or authorizations are required to permit the Companies, their Subsidiaries and Northern County to continue its business as presently conducted, following the Closing.

3.17 Regulatory Matters. (a) Except as set forth in Schedule 3.17

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hereto, each of the Companies and their Subsidiaries (including Northern County) has filed all material reports, statements, registrations, applications, filings or other documents and submissions required to be filed with, or provided to, the California Department of Insurance, the Texas Department of Insurance or any other Governmental Entity. Except as set forth in Schedule 3.17, all such reports, statements, registrations, applications, filings, documents and submissions were in compliance in all material respects with all applicable law, statutes, ordinances, rules or regulations when filed, and no material deficiencies have been asserted by any Governmental Entity with respect thereto. Except as set forth in the above-mentioned Schedule 3.14, there is no action, proceeding, dispute, controversy, inquiry or investigation pending or, to the Knowledge of the Sellers, threatened by any such Governmental Entity relating to any of the Companies, their Subsidiaries or Northern County.

(b) Except for regular periodic assessments in the ordinary course of business and except as set forth in

the above-mentioned Schedule 3.14, no claim or assessment is pending nor, to the Knowledge of the Sellers, threatened against any of the Companies, their Subsidiaries or Northern County by any state insurance guaranty association in connection with that association's fund relating to insolvent insurers.

(c) The Sellers have furnished to the Purchaser true and complete copies of all annual and quarterly statements filed with or submitted to any state insurance regulatory authority and all reports of examinations (whether financial, market conduct or other) issued by any state insurance regulatory authorities in respect of any of the Companies or their Subsidiaries (including Northern County) covering, in whole or in part, any period on or after January 1, 1990, together with true and complete copies of all written responses submitted by or on behalf of any of the Sellers, the Companies or their Affiliates in respect of any such report of examination. In addition, the Sellers have made, or have caused the Companies and their Subsidiaries and Northern County to make, available to the Purchaser all files of the Sellers, the Companies or their Subsidiaries (including Northern County) relating to correspondence with insurance regulatory authorities and other Governmental Entities.

3.18 Policy Forms and Rates. Except as set forth in Schedule 3.18,  
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all policies and Contracts of insurance, reinsurance or retrocessional coverage issued by Valley Insurance, Charter Indemnity, Northern County or any of the other Companies or their Subsidiaries which is an insurance company (each an "Insurance Company" and collectively the "Insurance Companies") or which are being issued by any such Insurance Company are in compliance (and at their respective dates of issuance were in compliance) with all applicable laws and, to the extent required under applicable laws, are on forms approved by applicable insurance regulatory authorities and other Governmental Entities in the jurisdiction where issued or have been filed with and not objected to by such regulatory authorities and other Governmental Entities within the period provided for objection. Any premium rates with respect to policies and Contracts of insurance, reinsurance or retrocession currently issued by any of the Insurance Companies which are required to be filed with or approved by insurance regulatory authorities or other Governmental Entities have been so filed or approved and premiums charged conform thereto. No outstanding policies or Contracts of insurance, reinsurance or retrocession issued, underwritten, reinsured or assumed by any of the Insurance Companies entitles the holder thereof or any other Person to receive any dividends, distributions or other benefits based on the revenues or

earnings of any of the Companies or their Subsidiaries (including Northern County).

3.19 Agents and Producers. Schedule 3.19 hereto lists all agents,

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brokers, producers, managing general agents, underwriting managers and other Persons through whom any of the Insurance Companies has written or sold any insurance, reinsurance or retrocessional coverage since January 1, 1994, and who were paid at least \$25,000 in commissions by any of the Companies, their Subsidiaries or Northern County during the year ended December 31, 1994, including the total amount of commissions paid to such Persons in such year. Each of the Companies, their Subsidiaries and Northern County generally enjoys good relations with the Persons listed on Schedule 3.19 as a whole, and also generally enjoys good relations with its other insurance agents, brokers, producers and managing general agents as a whole. To the Knowledge of the Sellers, all Persons listed on Schedule 3.19 are duly licensed to act as agents, brokers, producers or managing general agent in the jurisdictions where they engage in such activities. Except as set forth in Schedule 3.19, none of the Companies, their Subsidiaries or Northern County is a party to any fronting or similar arrangement to write or sell insurance or reinsurance for any other insurer.

3.20 Threats of Cancellation. Except as set forth in Schedule 3.20

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hereto, since January 1, 1995, no policyholder or group of policyholders under a group policy, or agent, broker, producer or other Person writing, selling or producing insurance, reinsurance or retrocessional coverage, which, individually or in the aggregate together with other related policyholders, agents, brokers and producers, accounted for one percent (1%) or more of the aggregate gross premiums written by any of the Insurance Companies in the year ended December 31, 1994 has terminated or given written notice of termination of its relationship with any of the Insurance Companies. The Sellers have received no notice that any such policyholder, group of policyholders, agent, broker, producer or other such Person will or is reasonably likely to terminate such relationship as a result of the transactions contemplated by this Agreement.

3.21 Reserves. Schedule 3.21 hereto sets forth the respective

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methodologies used by each of the Insurance Companies in establishing reserves for claims, losses (including, without limitation, incurred but not reported losses) and loss adjustment expenses (whether allocated or unallocated) as reflected in each of the Statutory Statements. All such reserves reflected in such Statutory Statements (a) were computed in accordance with commonly accepted actuarial standards consistently applied and were

fairly stated in accordance with sound actuarial principles, (b) were based on actuarial assumptions which were in accordance with those called for in relevant policy and contract provisions, and (c) met the requirements of all applicable insurance laws, rules and regulations. Such reserves were adequate to cover the total amount of Liabilities under all outstanding policies and Contracts of insurance, reinsurance and retrocession as of the dates of such Statutory Statements (it being understood that no representation or warranty is made herein to the effect that such reserves will in fact be adequate to cover the actual amount of such Liabilities that are eventually paid after the date hereof). Each of the Insurance Companies owns assets that qualify as admitted assets under applicable insurance laws in an amount at least equal to the sum of such reserves plus its minimum statutory capital and surplus as required under applicable insurance laws, rules and regulations.

3.22 Reinsurance. (a) Schedule 3.22 hereto contains a true and

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complete list of all Contracts, treaties or arrangements regarding reinsurance, coinsurance, excess insurance, retrocession, ceding of insurance or assumption of insurance ("Reinsurance Contracts") to which any of the Insurance Companies is a party or by or to which any of them are bound or subject, as each such Reinsurance Contract may have been amended, modified or supplemented. Each of the foregoing Reinsurance Contracts is valid and binding in accordance with its terms, and is in full force and effect. None of the Insurance Companies nor, to the Knowledge of the Sellers, any other party thereto is in default in any material respect with respect to any such Reinsurance Contract, nor to the Knowledge of the Sellers does any condition exist that with notice or lapse of time or both would constitute such a material default thereunder. Except as set forth in Schedule 3.22, no such Reinsurance Contract contains any provision providing that any such other party thereto may terminate, cancel or commute the same by reason of the transactions contemplated by this Agreement or any other provision which would be altered or otherwise become applicable by reason of such transactions, and no party has given notice of termination, cancellation or commutation of any such Reinsurance Contract or that it intends to terminate, cancel or commute any such Reinsurance Contract as a result of the transactions contemplated hereby.

(b) Except as set forth in Schedule 3.22, each of the Insurance Companies is entitled under applicable law to take full credit in its statutory financial statements for all amounts recoverable by it pursuant to the Reinsurance Contracts listed in such Schedule, and all such amounts recoverable have been properly recorded in the books and records of account of the Insurance Companies and are



properly reflected in the statutory financial statements of the Insurance Companies (including, without limitation, those included in the Statutory Statements). The Sellers have no Knowledge that any such amounts are not fully collectible in due course, and have no Knowledge of any disputes as to reinsurance coverage under, or any terms or provisions of, any such Reinsurance Contract. To the Knowledge of the Sellers, the financial condition of any other party to any such Reinsurance Contract is not impaired to the extent that a default thereunder is reasonably anticipated.

3.23 Contracts. (a) Schedule 3.23 contains a true and complete list

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of all of the following Contracts (excluding insurance policies issued by the Insurance Companies in the ordinary course of business consistent with past practice) to which any of the Companies or their Subsidiaries (including Northern County) is a party or by or to which any of them or their assets or Properties are or may be bound or subject, as each such Contract may have been amended, modified or supplemented:

(i) all standard forms of agency and brokerage Contracts and all material deviations therefrom; and all agency, brokerage or other similar insurance sales or marketing Contracts which accounted for one percent (1%) or more of the aggregate gross written premiums of any of the Insurance Companies for the year ended December 31, 1994 or one percent (1%) or more of the aggregate revenues of any other Company or Subsidiary thereof in such year;

(ii) all Material underwriting management, third party administration, managing general agency, profit-sharing or similar Contracts (pursuant to which any underwriting, claims settlement or distribution authority is delegated);

(iii) partnership or joint venture Contracts;

(iv) Contracts containing any covenant or provision limiting the freedom or ability of any Person to engage in any line of business, engage in business in any geographical area or compete with any other Person;

(v) Contracts relating to the borrowing of money, or the direct or indirect guaranty of any obligation for, or Contract to service the repayment of, borrowed money or any other Liability in respect of indebtedness for borrowed money of any other Person, including, without limitation, any Contract relating to

(A) the maintenance of compensating balances, (B) any lines of credit, (C) the advance of any funds to any other Person outside the ordinary course of business, (D) the payment for Property, products or services which are not conveyed, delivered or rendered to any such party, (E) any obligation to keep-well, make-whole or maintain working capital or earnings or perform similar requirements, or (F) the guaranty of any lease or other similar periodic payments to be made by any such other Person;

(vi) all lease, sublease, rental or other Contracts under which any of the Companies, their Subsidiaries or Northern County is a lessor or lessee of any real Property;

(vii) lease, sublease, rental, licensing, use or similar Contracts with respect to personal Property used by any of the Companies, their Subsidiaries or Northern County in the conduct of its business, operations or affairs and providing for annual rental or use payments in excess of \$25,000;

(viii) Contracts for the purchase or sale of materials, supplies or equipment (including, without limitation, computer hardware and software), or the provision of services (including, without limitation, data processing services), involving annual payments of more than \$25,000 or containing any escalation, renegotiation or redetermination provisions, which Contracts are not terminable at will without liability, premium or penalty;

(ix) Contracts for the purchase, acquisition, sale or disposition of any assets or Properties outside the ordinary course of business or for the grant to any Person (including any of the Companies, their Subsidiaries and Northern County) of any option or preferential rights to purchase any assets or Properties;

(x) Contracts relating to the future disposition or acquisition of any investment or any interest in any Person, and all Contracts for the purchase of any security outside the ordinary course of business;

(xi) Contracts relating to licenses of trademarks, trade names, service marks or other similar Property rights;

(xii) employment and other Contracts with any current or former officer, director, employee,

consultant, agent or other representative providing for compensation or other payments of \$50,000 or more per annum (the name, position or capacity and rate of compensation of each such Person and the expiration date of each such Contract being accurately set forth in Schedule 3.23);

(xiii) collective bargaining agreements and any other Contracts with any labor union or association representing any employee;

(xiv) Contracts between or among (A) any of the Companies, their Subsidiaries and Northern County, on the one hand, and (B) any of the Sellers or their other Affiliates, or any of the officers or directors of any of the Sellers, the Companies, their Affiliates and Northern County, on the other hand ("Affiliate Agreements");

(xv) Contracts under which any of the Companies, their Subsidiaries or Northern County agrees to indemnify any Person;

(xvi) any powers of attorney granted by any of the Companies, their Subsidiaries or Northern County to any Person;

(xvii) Contracts pursuant to which there is either a current or future obligation or right of any of the Companies, their Subsidiaries or Northern County to make payments in excess of \$100,000 in any twelve-month period (other than Contracts relating to investments of the Insurance Companies in the ordinary course of business); or

(xviii) any other Contracts which are Material.

(b) The Sellers have heretofore delivered or made available to the Purchaser true and complete copies of all of the written Contracts required to be set forth in Schedule 3.23 or in any other Schedule hereto. Each such Contract is valid and binding in accordance with its terms, and is in full force and effect. Except as specified in Schedule 3.23, none of the Companies or their Subsidiaries (including Northern County) is in default in any material respect with respect to any such Contract, nor does any condition exist that with notice or lapse of time or both would constitute such a material default thereunder. Except as specified in Schedule 3.23, to the Knowledge of the Sellers, no other party to any such Contract is in default in any material respect with respect to any such Contract. Except as set forth in Schedule 3.23, no such Contract

contains any provision providing that any such other party thereto may terminate or cancel the same by reason of the transactions contemplated by this Agreement or any other provision which would be altered or otherwise become applicable by reason of such transactions, and no party has given notice of termination or cancellation of any such Contract or that it intends to terminate or cancel any such Contract as a result of the transactions contemplated hereby.

3.24 Property. Schedule 3.24 contains a true and complete list

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(designating the relevant owners, lessors and lessees) of (a) all real Property owned or leased by any of the Companies or their Subsidiaries (including Northern County) and all buildings and other structures located on such real Property, and (b) all personal Property owned or leased by any such Person which, in the case of clause (b) only, is material to any of the Companies or their Subsidiaries (including Northern County). The Properties owned or leased by such Persons are sufficient to conduct the business and operations of such Persons as currently conducted, and the foregoing personal Properties are in sound operating condition and repair, normal wear and tear excepted. Each of the Companies and their Subsidiaries (including Northern County) has good and marketable title to all of their respective assets and Properties, in each case free and clear of any Lien or Encumbrance except (i) for assets and Properties which have been disposed of in the ordinary course of business since March 31, 1995, (ii) as set forth in Schedule 3.24A and (iii) Liens or Encumbrances which in the aggregate do not materially detract from the value of the assets or Properties subject thereto (as carried on the most recent applicable Financial Statements and financial statements included in the Statutory Statements) or interfere with the present use of such assets or Properties.

3.25 Intellectual Property. Schedule 3.25 contains a true and

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complete list of all trade names, trademarks, service marks, logos, copyrights, patents, similar rights (including registrations and applications to register or renew the registration of any of the foregoing), trade secrets, computer software and other similar intellectual property rights ("Intellectual Property") material to any of the Companies or their Subsidiaries (including Northern County) in connection with the conduct of its business (excluding computer software commercially available to the general public and readily replaceable at costs not material to any of the Companies or their Subsidiaries), including (a) whether such Intellectual Property is owned or licensed thereby and (b) which of the foregoing Persons is the owner or licensee of such Intellectual Property. Each of the Companies and their

Subsidiaries (including Northern County) owns, or has registered or valid rights to use, free and clear of any Lien or Encumbrance, all such Intellectual Properties which are material to such Persons. None of the Sellers, the Companies or their Subsidiaries (including Northern County) has received written notice that, and none of the Sellers have any Knowledge that, any of the Companies, their Subsidiaries or Northern County is infringing or otherwise in conflict with the rights of any other Person in respect of Intellectual Property. There is no Affiliate of the Sellers having a name including the words "Valley", "Charter", "NCM", "Northern" or "Northern County" or any derivation or variation thereof, or substantially resembling or confusingly similar in whole or in part to, the name of any of the Companies or their Subsidiaries (including Northern County).

3.26 Investments. Schedule 3.26 contains (a) a true and complete

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list of all securities and other investments owned by each of the Companies and their Subsidiaries (including Northern County) as of the end of the most recent calendar month, including the date of purchase, book value or amortized cost, market value and carrying value thereof on the books and records of account of such Persons as of such date and (b) a written statement of the current investment programs (which contain the investment policies and guidelines) of each such Person (the "Investment Guidelines"). Except as set forth in Schedule 3.26, none of the securities and other investments owned by such Persons is in default in the payment of principal or interest or dividends. All such securities and other investments substantially comply with the Investment Guidelines and all insurance laws and regulations of each of the jurisdictions to which the Companies and their Subsidiaries (including Northern County) are subject with respect thereto.

3.27 Accounts Receivable. The accounts receivable (including,

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without limitation, premium receivables) of the Companies and their Subsidiaries (including Northern County) as reflected in the most recent Financial Statements and Statutory Statements, to the extent uncollected on the date hereof, and the accounts receivable reflected on the books and records of account of such Persons as of the end of the month immediately preceding the date hereof and as will be reflected at the end of the month immediately preceding the Closing Date, are and will be valid and existing and represent and will represent monies due, and each of the Companies and their Subsidiaries (including Northern County) has established and will establish reserves reasonably considered adequate for receivables not collectible in the ordinary course of business, and (subject to the aforesaid reserves) no

material amounts are subject to refunds or other adjustments or to any defenses, rights of setoff, assignments, restrictions, encumbrances or conditions enforceable by third parties on or affecting them, except for such refunds or other adjustments arising from policy cancellations in the ordinary course of business as would not, individually or in the aggregate, have a Material Adverse Effect.

3.28 Employee Benefit Plans. (a) Schedule 3.28 contains a true and  
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complete list of all Plans. The Sellers have delivered or made available to the Purchaser, or will deliver or make available to the Purchaser prior to Closing, true and complete copies of the following documents, as they may have been amended to the date hereof, embodying or relating to the Plans: (i) each of the Plans listed in Schedule 3.28, including all amendments thereto, any related trust agreements, group annuity contracts, insurance policies or other funding agreements or arrangements; (ii) the most recent determination letter, if any, as to qualification under section 401(a) or 403(a) of the Code received from the IRS with respect to each of the Plans; (iii) the actuarial valuation, if any, prepared with respect to each of the Plans for the three most recent plan years; (iv) the current summary plan description, if any, for each of the Plans; and (v) the annual return/report on Form 5500, 5500-C or 5500-R, if any, for each of the Plans for the three most recent plan years.

(b) Except as shown on Schedule 3.28, since December 31, 1994, none of the Companies or their Subsidiaries (including Northern County) has adopted, entered into, or amended any Plan, or made any change in the actuarial methods or assumptions used in funding any defined benefit pension plan, or made any change in the assumptions or factors used in determining benefit equivalencies thereunder, in each case other than as required by the applicable Plan or in accordance with Contracts expressly identified elsewhere in this Agreement.

(c) Except as set forth in Schedule 3.28: (i) the written terms of each of the Plans and any related trust agreement, group annuity contract, insurance policy or other funding arrangement are in compliance with the applicable requirements, if any, of ERISA and the Code, and each of the Plans has been administered in compliance with such requirements and in accordance with its terms and the provisions of any applicable collective bargaining agreements and the terms of each plan may be enforced by the Companies and Northern County and any changes in plan terms or benefits are and have been permitted by law, Contract and plan terms; (ii) all contributions which were due and payable on or before the Closing Date to the Plans have been made in full and in proper form, and adequate accruals have

been provided for in the financial statements of the Companies and their Subsidiaries (including Northern County) for all other contributions or amounts as may be required to be paid to the Plans with respect to the periods which include the Closing Date or ended prior thereto and in the case of any plan years including the Closing Date, for the portion of such contributions or amounts, including contributions or amounts required to provide for the payment of claims for workers' compensation, weekly indemnity, life, hospital, medical, surgical and dental benefits which arise, within the meaning of any of the Plans, prior to the Closing Date and are payable under the terms and conditions thereof; (iii) none of the Companies or their Subsidiaries (including Northern County) have made or agreed to make, nor are any of them required (in order to bring any of the Plans into substantial compliance with the applicable requirements, if any, of ERISA and the Code) to make, any change in benefits which would materially increase the costs of maintaining any of the Plans; (iv) no "disqualified person" or "party in interest" (as defined in section 4975 of the Code and section 3(14) of ERISA, respectively) with respect to any Plan has engaged in any "prohibited transaction," as such term is defined in section 4975 of the Code or section 406 of ERISA, for which there was not available an exemption or which could subject any of the Companies, their Subsidiaries or Northern County to the tax or penalty imposed under section 4975 of the Code or Title I of ERISA; (v) each of the Plans for which any of the Companies, their Subsidiaries or Northern County has claimed a deduction under section 404 of the Code, as if such Plan were qualified under section 401(a) or 403(a) of the Code, has received a favorable determination letter from the IRS as to the tax qualification of such Plan, and such favorable determination has not been modified, revoked or limited by failure to satisfy any condition thereof or by a subsequent amendment to, or failure to amend, or by operation of such Plan, and an application for a determination letter that such Plan satisfies the requirements of sections 401(a)(4) and 410(b) of the Code has been filed under the procedures established by IRS Revenue Procedure 93-39, as modified; (vi) there are no actions, suits, disputes, arbitrations or claims (other than routine claims for benefits) or legal, administrative or other proceedings or governmental investigations pending or, to the Knowledge of the Sellers, threatened against any Plan or against the assets of any Plan; (vii) no Plan and no employee benefit plan (as that term is defined in section 3(3) of ERISA) sponsored by a member of a controlled group including any of the Companies or their Subsidiaries (including Northern County) which is subject to Part III of Subtitle B of Title I of ERISA or section 412 of the Code has incurred any "accumulated funding deficiency" (as defined in section 412(a) of the Code), whether or not waived; (viii) no Plan which is subject to Title IV of ERISA

has been terminated and, to the Knowledge of the Sellers, no proceeding has been initiated to terminate any Plan or to terminate any employee benefit plan (as that term is defined in section 3(3) of ERISA) sponsored by a member of a controlled group including any of the Companies or their Subsidiaries (including Northern County), and each of the Companies and their Subsidiaries (including Northern County) has paid all premiums (and interest charges and penalties for late payment), if any, due the PBGC as of the Closing Date with respect to the Plans and none of the Companies, their Subsidiaries or Northern County has incurred, or reasonably expects to incur, any liability to the PBGC, to a "Section 4042 trustee" (within the meaning of section 4042 of ERISA), or any liability under section 4069 of ERISA, except for required premium payments to the PBGC; (ix) to the Knowledge of the Sellers, each of the Companies, their Subsidiaries and Northern County has satisfied any bond coverage requirement of ERISA and all reporting and disclosure obligations under ERISA and the Code with respect to each of the Plans and the related trust, group annuity contract, insurance policy or other funding arrangement; (x) no "reportable event" within the meaning of section 4043(b)(1)-(9) of ERISA has occurred with respect to any Plan subject to ERISA (other than those with respect to which the reporting requirement is waived by rule or regulations promulgated by the PBGC and those which may result from the transactions contemplated by this Agreement); (xi) no Plan currently maintained by any of the Companies or their Subsidiaries (including Northern County), and no other employee benefit plan within the meaning of section 3(3) of ERISA under which any of the Companies or their Subsidiaries (including Northern County) has any liabilities or other obligations is, or was, a "multiple employer plan" within the meaning of section 413(c) of the Code or ERISA or the regulations promulgated thereunder, or a "multi-employer plan" as defined in section 3(37) of ERISA; (xii) the present value of all accrued benefits (whether or not vested) under each Plan and each employee benefit plan (as that term is defined in section 3(3) of ERISA) sponsored by a member of a controlled group including any of the Sellers, the Companies or their Subsidiaries (including Northern County) subject to Title IV of ERISA did not exceed, as of the most recent Plan valuation date, and will not exceed, as of the Closing Date, the then current fair market value of the assets of such Plan; (xiii) no Plan is a welfare benefit fund within the meaning of Code (S) 419(e); and (xiv) the transactions contemplated by this Agreement (other than Section 5.10) will not increase any benefit or accelerate the vesting or payment of any benefit. For purposes of determining the present value of accrued benefits under the Plans and the existence of any "accumulated funding deficiency" as used in this Section



3.27, the actuarial assumptions and methods used under each Plan for the most recent Plan valuation shall be used.

3.29 Employee Relations. No strike, picket, work stoppage, work

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slowdown, lockout, labor dispute, material labor arbitration or grievance or other labor trouble, and no application for certification of a collective bargaining agent, is pending or, to the Knowledge of the Sellers, threatened against or affecting any of the Companies or their Subsidiaries (including Northern County). No employees of any of the Companies or their Subsidiaries (including Northern County) are covered by any collective bargaining agreement or any other Contract with any labor union or association. Each of the Companies and their Subsidiaries (including Northern County) has complied in all material respects with all laws, statutes, ordinances, rules and regulations relating to the employment and safety of labor, including provisions relating to wages, hours, benefits, collective bargaining, the payment of social security and similar Taxes, workers' compensation, civil rights, and all applicable occupational safety and health acts and regulations.

3.30 Officers, Directors and Key Employees. Schedule 3.30 hereto set

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forth (a) the name and total compensation (payable by any of the Companies or their Subsidiaries, including Northern County) of each officer and director of each of the Companies, their Subsidiaries and Northern County and of each other employee thereof whose total compensation (so payable) for the year ended December 31, 1994 equaled or exceeded \$50,000, or who will receive compensation for the fiscal year ending December 31, 1995 equal to or in excess of \$50,000, (b) all bonuses and other incentive compensation received by such Persons since January 1, 1994, and any accrual for such bonuses and incentive compensation, and (c) all Contracts or commitments by the Companies, their Subsidiaries and Northern County to increase the compensation or to modify the conditions or terms of employment of any of their respective officers or directors, or employees whose total compensation exceeds \$50,000 per annum. To the Knowledge of the Sellers, none of the officers and directors of any of the Companies, their Affiliates or Northern County, nor any member of any such Person's immediately family, is directly or indirectly a party to any Contract or arrangement with any of the Companies, their Subsidiaries or Northern County providing for the furnishing of services by, the purchase, acquisition, lease or rental of Property from, or otherwise requiring payments to any such officer, director or family member (other than for service in such respective capacities).

3.31 Insurance. Schedule 3.31 contains a true and complete list of

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all liability, property and casualty, workers compensation, directors and officers liability, surety bonds (other than appeal bonds with respect to policy claims in the ordinary course of business), key man or corporate owned life insurance, vehicular and other insurance policies and Contracts (including the insurers, types of coverage, expiration dates, annual premiums, coverage limits, deductibles or self-insured or net retentions and other material terms thereof, and the aggregate amounts paid thereunder and any pending claim thereunder in excess of \$50,000) that insure the business, operations, directors, officers, employees, assets, Properties or affairs of any of the Companies or their Subsidiaries (including Northern County) or are held by or on behalf of any of them. All such insurance policies and Contracts are valid and binding in accordance with their terms and will remain in full force and effect at all times until the Closing. To the Knowledge of the Sellers, no party to any such insurance policy or Contract is in default with respect thereto, nor does any condition exist that with notice or lapse of time or both would constitute such a default by any party thereunder. To the Knowledge of the Sellers, none of the Companies or their Subsidiaries (including Northern County) has failed to give any notice or present any claim under any such insurance policy or Contract in due or timely fashion or as required thereby in a manner which may jeopardize full recovery thereunder. To the Knowledge of the Sellers, all such insurance policies and Contracts provide coverage in amounts and upon terms that are, in all material respects, reasonable and adequate for Persons having similar businesses, operations, Properties and locales as those of the Companies and their Subsidiaries (including Northern County).

3.32 Tax Matters. (a) Skandia U.S. is the "common parent" of an

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"affiliated group" of corporations (as those terms are used in section 1504(a) of the Code and the Treasury Regulations promulgated under section 1502 of the Code) that includes each of the Companies and their Subsidiaries (excluding Northern County) (the "Sellers Group"). The Sellers Group was and is eligible to file a consolidated federal income Tax Return for each Taxable Period ending on or before the date hereof for which the statute of limitations for the assessment of an income Tax has not lapsed; and each of the Companies and their Subsidiaries (excluding Northern County) will be eligible to file a consolidated federal income Tax Return with the Sellers Group for their Taxable Period ending on the Closing Date.

(b) All material Tax Returns required to be filed with respect to the Companies and their Subsidiaries for all

Taxable Periods ending on or before the date hereof have been timely filed (taking into account extensions of time to file). All such Tax Returns: (i) were prepared in the manner required by applicable law; (ii) are true, correct, and complete in all material respects; and (iii) reflect the liability for Taxes of the Companies and their Subsidiaries for the Taxable Periods comprised in such Tax Returns. All Taxes shown to be payable on such Tax Returns, and all assessments of Tax made with respect to such Tax Returns, have been paid when due. Except as set forth in Schedule 3.32(b), none of the Companies or their Subsidiaries is required to file or join in the filing of a consolidated, combined, unitary or group income, franchise, or premium Tax Return except the consolidated federal income Tax Return of the Sellers Group.

(c) All Taxes of each of the Companies and their Subsidiaries for all Taxable Periods or portions thereof ending on or before the date of each Financial Statement and Interim Financial Statement (and, with respect to Northern County, the Northern County Statutory Statements) have been paid or adequately provided for in a reserve account, which includes deferred Tax assets and liabilities (the "Tax Reserve"), set forth on each such statement. Such Taxes paid or provided for include those Taxes for which a Company or one of its Subsidiaries may be liable in its own right or as the transferee of the assets of, or as successor to, any other corporation, association, partnership, joint venture, or other entity. Schedule 3.32(c) lists, for each of the Companies and their Subsidiaries, each Tax accrued in the Tax Reserve of the Financial Statement of such corporation dated December 31, 1994, and, with respect to Northern County, the Northern County Statutory Statement dated December 31, 1994.

(d) Each of the Companies and their Subsidiaries has timely withheld from its employees, customers and other payees (and timely paid) all amounts required to be withheld and paid by the Tax withholding provisions of applicable federal, state, local and foreign laws, statutes, rules and regulations (including, without limitation, income, social security, and employment tax withholding for all types of compensation, and withholding on payments to non-United States Persons) for all payments made through the date hereof.

(e) Schedule 3.32(e) sets forth, for each Taxable Period ending during the three-year period beginning January 1, 1992, and ended December 31, 1994, all jurisdictions in which any of the Companies or their Subsidiaries (i) has filed an income, franchise or premium Tax Return or (ii) has been included in a consolidated, combined, group, or unitary income, franchise or premium Tax

Return. Except as set forth in Schedule 3.32(e), none of the Companies or their Subsidiaries has waived or extended any statute of limitations for the assessment or collection of Taxes of any of the Companies or their Subsidiaries, and no request for any such waiver or extension is currently pending.

(f) To the Knowledge of the Sellers, there is no power of attorney currently in force granted by or for any of the Companies or their Subsidiaries with respect to any Taxes.

(g) Except for the Tax Allocation Agreement dated January 1, 1990, as amended, there is no Contract or agreement under which any of the Companies or their Subsidiaries has, or may at any time in the future have, an obligation to assume, share, or contribute to the payment of any portion of a Tax (or any amount calculated with reference to any portion of a Tax) determined on a consolidated, combined, group, or unitary basis with respect to an affiliated group or other group of corporations of which any of the Companies or their Subsidiaries is or was a member.

(h) None of the Companies or their Subsidiaries is a party to any contract, agreement, plan, or arrangement, which, individually or collectively with respect to any Person, could give rise to the payment of any amount that would not be deductible by any of the Companies or their Subsidiaries by reason of section 280G of the Code.

(i) To the Knowledge of the Sellers, the Companies and their Subsidiaries have made all payments of estimated Taxes required to be made under the Code and any state, local or foreign law. No penalties or other charges are or will become due with respect to the late filing of any Tax Return of the Companies or their Subsidiaries required to be filed on or before the Closing Date.

(j) During the period that they have been members of the Sellers Group (or affiliated with the Sellers in the case of Northern County), none of the Companies or their Subsidiaries has received or requested any Tax Ruling or entered into any Tax Closing Agreement with any taxing authority (foreign or domestic).

(k) No action, suit, proceeding, investigation, arbitration, audit, claim or assessment is presently pending or, to the Knowledge of the Sellers, proposed to be asserted or commenced by any taxing authority with regard to any Taxes that relate to the Companies or their Subsidiaries for which any of them may be liable. No issue has arisen in any examination of any of the Companies or their Subsidiaries by

any taxing authority that, if raised with respect to the same or substantially similar facts arising in any other period not so examined, would result in a deficiency for such other period, if upheld.

(l) No election under any of sections 108, 168, 338, 441, 472, 1017, 1033 or 4977 of the Code (or any predecessor provisions) is in effect with respect to any of the Companies or their Subsidiaries. None of the assets of the Companies or their Subsidiaries is an asset or property that is required to be treated as being (i) owned by any Person other than the Companies or their Subsidiaries, as the case may be, pursuant to the provisions of section 168(f)(8) of the Internal Revenue Code of 1954, as amended and in effect immediately before the enactment of the Tax Reform Act of 1986, or (ii) tax-exempt use property within the meaning of section 168(h)(1) of the Code.

(m) Except as set forth on Schedule 3.32(m), (i) none of the Companies or their Subsidiaries is required to make any adjustment pursuant to section 481 of the Code (or any similar provision of other laws or regulations) by reason of a change in accounting method or otherwise, (ii) neither the IRS nor any other taxing authority has proposed any such adjustment or change in accounting method which proposal is currently pending, and (iii) none of the Companies or their Subsidiaries has an application pending with any taxing authority requesting permission for any change in accounting method that relates to its business or operations.

(n) Skandia America is not a "foreign person" within the meaning of section 1445(f)(3) of the Code and Treasury Regulations section 1.1445-2(b)(2)(i) (or any corresponding provision of state, local or foreign Tax law). The Purchaser will not be required to deduct or withhold any amount pursuant to section 1445 of the Code upon the consummation of the transactions contemplated hereby.

(o) With respect to the Companies and their Subsidiaries, Schedule 3.32(o) contains a list of all countries, states, provinces, cities, territories, and other jurisdictions (whether foreign or domestic) in which any of such Persons is required to file a Tax Return or currently is subject to a Tax. There is no unresolved claim by a taxing authority in any jurisdiction where any of the Companies or their Subsidiaries does not file Tax Returns that any of them is or may be subject to taxation by such jurisdiction.

(p) There are no liens for Taxes (other than for Taxes not yet due and payable) upon the assets of any of the Companies or their Subsidiaries.

(q) None of the Companies or their Subsidiaries has disposed of any property in any transaction currently being accounted for under the installment method pursuant to section 453 of the Code.

(r) None of the Companies or their Subsidiaries has participated in or cooperated with an "international boycott" within the meaning of section 999 of the Code. None of the Companies or their Subsidiaries has filed a consent under section 341(f)(1) of the Code or any comparable provision of state revenue statutes, or agreed under section 341(f)(3) of the Code to have the provisions of section 341(f)(2) of the Code applied to the sale of its capital stock.

(s) None of the Companies or their Subsidiaries is a partner or a member of any partnership or joint venture, or any other entity classified as a partnership for federal income tax purposes.

(t) Except as provided in Schedule 3.32(t), the Companies and their Subsidiaries (excluding Northern County) have no deferred intercompany gains or losses as defined in Treasury Regulations section 1.1502-13 (nor any gains or losses treated as deferred intercompany gains or losses for income tax purposes).

(u) Schedule 3.32(u) hereto sets forth the individual tax bases of the assets of the Companies and their Subsidiaries as of December 31, 1994, other than the tax bases of the stock of the Companies' Subsidiaries.

(v) Except as set forth in Schedule 3.32(v) none of the Companies or their Subsidiaries is liable under Treasury Regulations section 1.1502-6 for the federal income Tax of any corporation other than the members of the Sellers Group or the members of a consolidated return group for which a Company was the common parent.

(w) The Companies and their Subsidiaries have (i) timely paid all guaranty fund assessments that are due, or claimed or asserted by any insurance regulatory authority to be due, from such entities or (ii) provided for all such assessments in the Financial Statements or Interim Financial Statements.

3.33 Environmental Matters. To the Knowledge of the Sellers, each of

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the Companies and their Subsidiaries (including Northern County) is in compliance with all Environmental Laws, the failure to comply with which could have a Material Adverse Effect. None of the Sellers, the Companies or their Subsidiaries (including Northern County) have received notice of any material violation by any of the

Companies or their Subsidiaries (including Northern County) of, or material default by the same under, any Environmental Law, and the Sellers have no Knowledge of any existing facts or circumstances that are likely to result in any such violation or default. There is no action, suit, claim, proceeding or investigation pending or, to the Knowledge of the Sellers, threatened against any of the Companies or their Subsidiaries (including Northern County) that alleges or would allege any violation of any Environmental Law.

3.34 Bank Accounts. Schedule 3.34 contains a true and complete list  
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of (a) the names and locations of all banks, trust companies, securities brokers and other financial institutions at which any of the Companies or their Subsidiaries (including Northern County) has an account or safe deposit box or maintains a banking, custodial, trading or other similar relationship, (b) a true and complete list and description of each such account, box and relationship and (c) the name of every Person authorized to draw thereon or having access thereto.

3.35 No Brokers. No broker, finder or investment banker has been  
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retained or engaged on behalf of any of the Sellers, the Companies, Northern County or any Affiliate of any of them or is entitled to any brokerage, finder's or other fee, compensation or commission from any such Person in connection with the transactions contemplated by this Agreement.

3.36 Full Disclosure. The Sellers, the Companies and the  
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Subsidiaries of the Companies (including Northern County) have complied in good faith with all requests of the Purchaser and its representatives for documents, papers and information relating to the Companies and their Subsidiaries (including Northern County) in connection with the transactions contemplated hereby, and have not knowingly withheld any document, paper or other information requested by the Purchaser or any of its representatives in connection therewith. No representation or warranty by any of the Sellers contained in this Agreement (including the Exhibits and Schedules hereto), or in any documents or papers furnished to the Purchaser by or on behalf of any of the Sellers, the Companies or their Subsidiaries (including Northern County) pursuant to this Agreement, contains any untrue statement of a material fact by any of them or omits to state a material fact required to be stated therein or necessary to make the statements contained therein by any of them, in light of the circumstances under which it was made, not false or misleading.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF THE PURCHASER

The Purchaser hereby represents and warrants to the Sellers as follows:

4.1 Organization of the Purchaser. The Purchaser is a corporation

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duly organized, validly existing and in good standing under the laws of the State of Delaware and has all requisite corporate power and authority to execute and deliver this Agreement, to perform its obligations hereunder and to consummate the transactions contemplated hereby.

4.2 Authorization, Validity and Enforceability. The execution,

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delivery and performance of this Agreement by the Purchaser and the consummation of the transactions contemplated hereby by the Purchaser have been duly and validly authorized by all necessary corporate action on the part of the Purchaser and no other corporate proceeding on the part of the Purchaser is necessary to authorize the execution, delivery and performance of this Agreement or the consummation of any of the transactions contemplated hereby. This Agreement has been duly executed and delivered by the Purchaser and constitutes the legal, valid and binding obligation of the Purchaser, enforceable against the Purchaser in accordance with its terms, except as such enforceability may be limited by applicable bankruptcy, insolvency or other similar laws affecting creditors' rights generally and except as rights to specific enforcement may be limited by the application of equitable principles (whether such equitable principles are applied in a proceeding at law or in equity).

4.3 No Conflicts. Assuming the Consents contemplated by clauses (a)

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through (c) of Section 4.4 are duly made, obtained or given (as the case may be), the execution and delivery by the Purchaser of this Agreement, the performance by the Purchaser of its obligations hereunder and the consummation of the transactions contemplated hereby do not and will not conflict with, result in any breach or violation of, constitute a default under (or an event which with the giving of notice or the lapse of time or both would constitute a default under), (a) the certificate of incorporation, by-laws or other charter or organization documents of the Purchaser, (b) any Contract to which the Purchaser is a party or by or to which it or its assets or Properties may be bound or subject, (c) any applicable order, writ, judgment, injunction, award, decree, law, statute, ordinance, rule or regulation or (d) any material Permit of the Purchaser, other than, in the case of



clause (b) only, any conflict, breach, violation or default which would not, individually or in the aggregate together with all such other conflicts, breaches, violations or defaults, have a material adverse effect on the ability of the Purchaser to execute and deliver this Agreement, perform its obligations hereunder or consummate the transactions contemplated hereby.

4.4 Consents and Approvals. Except (a) as required under the HSR

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Act, (b) as required under the insurance laws of the States of California, Oregon and Texas and (c) as set forth in Schedule 4.4 hereto, no Consent of any Governmental Entity or other Person is necessary to be obtained, made or given by the Purchaser in connection with the execution and delivery by the Purchaser of this Agreement, the performance by the Purchaser of its obligations hereunder and the consummation of the transactions contemplated hereby.

4.5 Legal Proceedings. Except as set forth in Schedule 4.5 hereto,

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there is no action, suit, claim, proceeding or investigation pending or, to the Knowledge of the Purchaser, threatened against or affecting the Purchaser by or before any court, other Governmental Entity or arbitrator which, individually or in the aggregate, is reasonably likely to have a material adverse effect on the ability of the Purchaser to execute and deliver this Agreement, perform its obligations hereunder or consummate the transactions contemplated hereby. Except as set forth in Schedule 4.5, there is no outstanding order, writ, judgment, injunction, award or decree of any court, other Governmental Entity or arbitrator against or affecting the Purchaser which, individually or in the aggregate, is reasonably likely to have a material adverse effect on the ability of the Purchaser to execute and deliver this Agreement, perform its obligations hereunder or consummate the transactions contemplated hereby.

4.6 Investment Intent. The Shares will be acquired by the Purchaser

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for its own account without a view to a distribution or resale thereof, it being understood that the Purchaser shall have the right to sell or otherwise dispose of any of the Shares pursuant to a registration or an exemption therefrom under the Securities Act of 1933, as amended, and any applicable state securities laws.

4.7 No Brokers. No broker, finder or investment banker has been

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retained or engaged on behalf of the Purchaser or is entitled to any brokerage, finder's or other fee, compensation or commission from the Purchaser in connection with the transactions contemplated by this Agreement.

ARTICLE V

COVENANTS

5.1 Conduct of Business. (a) From the date hereof to and including

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the Closing Date, the Sellers will cause the Companies and their Subsidiaries (including Northern County) to (i) conduct their operations in the ordinary course of business consistent with past practice and use their best efforts to preserve intact their business organizations, goodwill and Permits, to keep available the services of their officers and employees and to maintain existing relationships with customers, policyholders, managers, agents, brokers, distributors, suppliers and others having business dealings with any of them, (ii) maintain insurance coverages and their books, records and accounts in the usual manner consistent with prior practice, (iii) comply in all material respects with all laws, statutes, ordinances, rules and regulations of Governmental Entities applicable to them, (iv) maintain and keep its Properties and equipment in good repair, working order and condition, normal wear and tear excepted, and (v) perform in all material respects its obligations under all Contracts and commitments to which it is a party or by or to which it is bound or subject.

(b) From the date hereof to and including the Closing Date, the Sellers will not permit any of the Companies or their Subsidiaries (including Northern County) to directly or indirectly (i) amend or modify its certificate or articles of incorporation, by-laws or other charter or organization documents, (ii) except as expressly required hereby, authorize for issuance, issue, sell, deliver or agree or commit to issue, sell or deliver (whether through the issuance or granting of options, warrants, call, commitments, subscriptions, rights to purchase or otherwise) any stock of any class or series or any other equity interest, or any bonds, debentures, notes, surplus notes, debt instruments, evidences of indebtedness or other securities of any kind, including, without limitation, any stock options or stock appreciation rights, (iii) split, combine or reclassify any shares of its capital stock, or declare, pay or set aside any sum for any dividend or other distribution (whether in cash, stock or Property, any combination thereof or otherwise) in respect of its capital stock, or redeem, purchase or otherwise acquire (or agree to redeem, purchase or otherwise acquire) any Common Stock or any of its other securities or any securities of its Subsidiaries, (iv) adopt a plan of complete or partial liquidation, dissolution, rehabilitation, merger, consolidation, restructuring, recapitalization, demutualization, redomestication or other reorganization, (v) make any material change in any financial reporting,

Tax, accounting, actuarial or reserving methods or practices or in the Investment Guidelines, (vi) make any Tax election or settle or compromise any federal, state, local or foreign income Tax liability either not in accordance with past practice or which would have a Material Adverse Effect, (vii) purchase or sell securities or other investments, or invest or reinvest income and proceeds in respect thereof, other than in accordance with the Investment Guidelines and applicable law, (viii) contribute to any Plan amounts in excess of normal and ordinary contributions, determined in the case of a defined benefit plan in accordance with the actuarial assumptions and methodologies used in the most recent formal annual actuarial valuation of the plan, or accelerate any contribution or payment to or on behalf of any Plan, or accelerate any payment to be made under any Plan, or adopt a new Plan, amend any Plan or permit any Plan to enter into any Contract, insurance arrangement or funding obligation to increase present or future benefits or the present or future cost of providing benefits, or (ix) without the prior written consent of the Purchaser, take any of the other actions described in Section 3.13(b) or take any action, or omit to do any act, that individually or in the aggregate would, or would be reasonably likely to, result in (A) any of the representations and warranties set forth in Article III of this Agreement not being true in all material respects (or, in the case of any such representations or warranties which are qualified as to materiality, true in all respects) or (B) any of the conditions set forth in Articles VI and VII not being satisfied or (C) any breach of any covenant or obligation hereunder or (D) a Material Adverse Effect.

5.2 Access to Information; Consultation; Confidentiality. (a) From

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the date hereof until the Closing, the Sellers will, and will cause each of the Companies, their Subsidiaries and Northern County to, (i) allow the Purchaser and its officers, employees, counsel, accountants, consultants and other authorized representatives ("Representatives") to have reasonable access to the books, records, Contracts, facilities, management and personnel of the Companies, their Subsidiaries and Northern County, (ii) furnish promptly to the Purchaser and its Representatives all information and documents concerning the Companies, their Subsidiaries and Northern County as the Purchaser or its Representatives may reasonably request, and (iii) cause the respective officers, employees and Representatives of the Sellers, the Companies, their Subsidiaries and Northern County to cooperate in good faith with the Purchaser and its Representatives in connection with all such access. In addition, the Sellers will, and will cause each of the Companies and their Subsidiaries (including Northern County) to, use reasonable efforts to consult with the Purchaser a reasonable period of

time prior to entering into any transaction or arrangement or taking any action which is Material, in a manner which will allow the Purchaser a reasonable opportunity to evaluate and present its views to the Sellers regarding such transaction, arrangement or action (it being understood that the Sellers, the Companies and their Subsidiaries shall have the sole authority to make all final decisions with respect thereto prior to the Closing). No investigation or review by the Purchaser or any of its Representatives shall affect or be deemed to modify any of the representations, warranties, covenants or agreements of the Sellers under this Agreement or otherwise; it being understood that, notwithstanding any right of the Purchaser fully to investigate the affairs of the Companies and their Subsidiaries (including Northern County), and notwithstanding any knowledge of facts determined or determinable by the Purchaser pursuant to any such investigation or right of investigation, the Purchaser has the right to rely fully upon the representations, warranties, covenants and agreements of the Sellers contained in this Agreement.

(b) All information and documents provided under this Section 5.2 shall be kept confidential by the Purchaser and its Representatives, unless any such information or documents (i) is or becomes generally available to the public (other than as a result of a disclosure by the Purchaser or any of its Representatives), (ii) was already known by or available on a non-confidential basis to the Purchaser prior to being furnished by or on behalf of the Sellers, the Companies and their Subsidiaries (including Northern County) hereunder, or (iii) is or becomes available to the Purchaser from a third party not bound by any contractual obligation to the Sellers, the Companies and their Subsidiaries (including Northern County) to keep such information confidential. In the event of the termination of this Agreement pursuant to Section 9.1, the Purchaser will, upon the request of the Sellers, promptly deliver to the Sellers all written information and documents provided under Section 5.2(a) in the possession of the Purchaser or any of its personnel, including all copies, reproductions, summaries, analyses and extracts thereof or based thereon.

5.3 Cooperation and Reasonable Best Efforts. Subject to the terms

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and conditions hereof, (a) each of the parties hereto shall cooperate with each other, and the Sellers will cause the Companies, their Subsidiaries and Northern County to cooperate with the Purchaser, in connection with consummating the transactions contemplated by this Agreement and the Exhibits hereto (including, without limitation, the extension of the Northern County Management Contract as contemplated by Section 6.10 and the subrogation rights of Skandia Ltd contained in section 4 of

the Northern County Guaranty), and (b) each of the parties hereto agrees to, and the Sellers will cause each of the Companies and their Subsidiaries (including Northern County), to, use its reasonable best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, all things necessary, proper or advisable under applicable laws and regulations to consummate and make effective the transactions contemplated by this Agreement (including, without limitation, the foregoing extension of the Northern County Management Contract). For purposes of this Section 5.3, the covenant of the parties to use their "reasonable best efforts" shall not require any party to (i) incur any unreasonable expenses, (ii) agree to materially limit the conduct of its business or (iii) divest itself of any material assets or Properties, in each case except as otherwise contemplated hereunder.

5.4 Consents and Approvals. As soon as practicable after the

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execution of this Agreement, each of the parties hereto shall, and the Sellers shall cause the Companies and their Subsidiaries (including Northern County to, use its reasonable best efforts to obtain any necessary Consents of, and make any filing with or give any notice to, any Governmental Entities and other Persons (including, without limitation, the insurance regulatory authorities of the States of California, Oregon and Texas and, pursuant to the HSR Act, the Federal Trade Commission and the United States Department of Justice) as are required to be obtained, made or given by such party to consummate the transactions contemplated by this Agreement. The parties hereto shall cooperate with one another in exchanging such information and reasonable assistance as may be required by any such Governmental Entity or as any other party may request in connection with the foregoing.

5.5 Notification of Certain Matters. Each of the Sellers, on the one

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hand, and the Purchaser, on the other hand, shall give prompt notice to the other of (a) the occurrence or nonoccurrence of any event, the occurrence or nonoccurrence of which would be likely to cause any representation or warranty of the Sellers or the Purchaser, respectively, contained in this Agreement to be untrue or inaccurate in any material respect (or, in the case of any representation or warranty which is qualified as to materiality, untrue or inaccurate in any respect) at or prior to the Closing and (b) any material failure of any of the Sellers or the Purchaser, respectively, to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder; provided, however, that the delivery of any notice pursuant to

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this Section 5.5 shall not cure such failure or limit or otherwise affect the remedies available hereunder to the parties receiving such notice. Without limiting the

generality of the foregoing, from the date hereof through the Closing Date, each of the Sellers, on the one hand, and the Purchaser, on the other hand, shall promptly notify the other of any action, suit, claim, proceeding or investigation of the type required to be described in Schedule 3.14 or Schedule 4.5 hereof that is commenced or, to its Knowledge, threatened, and of any request for additional information or documentary materials by any Governmental Entity in connection with the transactions contemplated hereby.

5.6 Public Announcements. Each party hereto shall notify the other

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parties hereto prior to issuing any press release or making any public statement pertaining to this Agreement or the transactions contemplated hereby, and shall not issue any such press release or make any such public statement without obtaining the reasonable approval of the other parties prior thereto, except that each party will in any event have the right to issue any such release or statement upon advice of its counsel that such issuance is required in order to comply with applicable law or stock exchange rules.

5.7 No Solicitation. The Sellers, the Companies, their Affiliates

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(including Northern County) and their respective officers, directors, employees, Representatives and agents shall immediately cease any existing discussions, communications or negotiations, if any, with any Persons ("Prior Bidders"), other than the Purchaser and its Representatives, conducted heretofore with respect to any direct or indirect acquisition of all or any material portion of the assets or Properties of, or any capital stock (including, without limitation, the Shares) or other equity interest in, any of the Companies and their Subsidiaries (including Northern County) or any business combination with any of the Companies, their Subsidiaries or Northern County (whether by merger, consolidation, bulk or assumption reinsurance, demutualization or otherwise) or any other transaction inconsistent with consummation of, or similar in whole or in part to, the transactions contemplated herein, including, without limitation, any transaction involving a change of control of any of the Sellers (any of the foregoing, an "Alternative Transaction"), and will not, directly or indirectly, solicit, encourage, participate in or initiate discussions or negotiations with, or provide any information or documents to, or otherwise cooperate in any way with, any Person (other than the Purchaser and its Representatives) concerning any Alternative Transaction. The Sellers shall notify the Purchaser orally and in writing if any proposal relating to an Alternative Transaction (an "Alternative Transaction Proposal") is received by any of them, the Companies, their Affiliates or Northern County, or if any inquiry is received by, any information is requested

from, or any discussions or negotiations are sought to be initiated or continued with, any of the foregoing Persons in connection with an Alternative Transaction or Alternative Transaction Proposal, immediately after receipt of such Alternative Transaction Proposal, inquiry, request or other communication. Such written notification shall include the identity of the Person making such Alternative Transaction Proposal, inquiry, request or other communication and such other information with respect thereto as is reasonably necessary to apprise the Purchaser of the precise nature of such inquiry, request or other communication, or the material terms of such Alternative Transaction Proposal, and all other material information relating thereto. The Sellers shall use their best efforts to cause all confidential or proprietary materials relating to any of the Companies and their Subsidiaries (including Northern County) previously furnished to Prior Bidders or other Persons in connection with an Alternative Transaction to be promptly returned to the Sellers. At the Closing, the Sellers shall assign to the Purchaser the non-exclusive right to enforce the rights of the Sellers and their Affiliates under any and all confidentiality agreements entered into with Prior Bidders and other prospective acquirors of any of the Companies or their Subsidiaries, upon terms and pursuant to an instrument in form and substance reasonably satisfactory to the Purchaser.

5.8 Interim Financial Statements and Investment Reports. (a) From

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the date hereof until the Closing Date, as soon as practicable after they become available (and in any event within forty-five (45) days after the end of each calendar quarter or, in the case of monthly financial statements, within twenty (20) days after the end of each calendar month), the Sellers shall deliver to the Purchaser true and complete copies of:

(i) (A) the consolidated balance sheet of Valley and its subsidiaries as at the end of each quarterly period ending on or after the date hereof, and the related consolidated statements of income, changes in stockholder's equity and cash flows of Valley and its subsidiaries for such quarterly period and the portion of the fiscal year through the end of such quarterly period, (B) the consolidated balance sheet of Charter and its subsidiaries as at the end of each quarterly period ending on or after the date hereof, and the related consolidated statements of operations, changes in stockholder's equity and cash flows of Charter and its subsidiaries for such quarterly period and the portion of the fiscal year through the end of such quarterly period, (C) the balance sheet of NCM as at the end of each quarterly period ending on or after the date hereof, and the related statements of income,

changes in stockholder's equity and cash flows of NCM for such quarterly period and the portion of the fiscal year through the end of such quarterly period, (D) the balance sheet of Northern County as at the end of each quarterly period ending on or after the date hereof, and the related statements of operations and cash flows of Northern County for such quarterly period and the portion of the fiscal year through the end of such quarterly period and (E) to the extent prepared, all monthly GAAP financial statements of the Companies or their Subsidiaries, including Northern County (collectively, the "Interim Financial Statements"); and

(ii) (A) the statutory quarterly statement of each of the Insurance Companies as filed with the insurance regulatory authorities in their respective states of domicile for each quarterly period ending on or after the date hereof, including in each case all exhibits, interrogatories, notes and schedules thereto and any actuarial opinion, affirmation or certification filed in connection therewith and (B) to the extent prepared, all monthly statutory-basis financial statements of the Insurance Companies (collectively, the "Interim Statutory Statements").

In addition, during such period, if and when available, the Sellers shall deliver to the Purchaser true and complete copies of any budgets, business plans and financial projections, or modifications thereof, prepared by or on behalf of any of the Sellers or their Affiliates relating to any of the Companies and their Subsidiaries (including Northern County).

(b) The Interim Financial Statements will each be prepared in accordance with GAAP consistently applied throughout the periods involved (and on a basis consistent with the relevant Financial Statements) and in accordance with the books and records of the Company and its Subsidiaries (if any) to which it relates, and will present fairly the financial position of such Company and its Subsidiaries (if any) as at the respective dates thereof and the results of operations of such Company and its Subsidiaries (if any) for the respective periods then ended, except that quarterly and monthly Interim Financial Statements will not be required to contain full footnote disclosures in accordance with GAAP and may be subject to normal recurring year-end audit adjustments. The financial statements included in the Interim Statutory Statements will each be prepared in conformity with California SAP or Texas SAP, as appropriate, consistently applied throughout the periods involved (and on a basis consistent with the financial statements included in the Statutory Statements) and in accordance with the books and records of the



Insurance Company to which they relate, and will present fairly the statutory financial position of such Insurance Company as at the respective dates thereof and the statutory results of operations of such Insurance Company for the respective periods then ended. The Interim Statutory Statements will comply in all material respects with all applicable laws and will be complete and correct in all material respects when filed.

(c) From the date hereof until the Closing Date, as soon as practicable after it becomes available (and in any event within twenty (20) days after the end of each calendar month, the Sellers shall deliver to the Purchaser a true and complete list of all purchases, acquisitions, sales and dispositions during the previous month of investments owned by any of the Companies, their Subsidiaries and Northern County, and all investments and reinvestments of income and proceeds in respect thereof, including the dates of such transactions and the book value or amortized cost, market value and carrying value thereof on the books and records of account of such Persons as of the end of the previous month.

5.9 Tax Matters. (a) The Sellers shall, or shall cause the

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Companies and/or their Subsidiaries to, prepare and file all Tax Returns of or including the Companies and/or their Subsidiaries that are required to be filed (with extensions) on or before the Closing Date. All such Tax Returns will be made and filed by the Sellers, the Companies, and their Subsidiaries in a manner consistent with the prior practice of the Sellers, the Companies and their Subsidiaries. The Sellers shall prevent the Companies and their Subsidiaries from making any new tax elections after the execution of this Agreement and through the Closing Date without obtaining the prior written consent of the Purchaser.

(b) The Sellers shall file a consolidated federal income Tax Return which includes, and reports the operations from, the Companies and their Subsidiaries (other than Northern County) for the period beginning January 1, 1995, and ending on the Closing Date, subject to the prior review of the Purchaser with respect to the proposed treatment of any item in such Tax Return that affects the Purchaser's liability under Section 8.3(b) of this Agreement. The Companies and their Subsidiaries (other than Northern County) shall cooperate with the Sellers and the Purchaser to the extent reasonably necessary to prepare such Tax Return. The Purchaser shall, or shall cause the Companies and/or their Subsidiaries to, file a federal income Tax Return which includes, and reports the operations from, the Companies and their Subsidiaries (other than Northern County) for the Taxable Period beginning on the day

following the Closing Date. All Tax Returns referred to in this Section 5.9(b) shall be prepared by the Purchaser and the Sellers in accordance with Treasury Regulations section 1.1502-76 based on a closing of the books of the Companies and their Subsidiaries as of the end of the Closing Date.

(c) Other than the Tax Returns covered by section 5.9(b), all Tax Returns of or including the Companies and their Subsidiaries with respect to Tax Periods beginning after December 31, 1994 shall be prepared and filed by the Purchaser, the Companies or their Subsidiaries, as the case may be, provided,

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however, that the filing of any such Tax Return that includes or covers some or

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all of the period from January 1, 1995 through the Closing Date shall be subject to the prior review of the Sellers with respect to the proposed treatment of any item in such Tax Returns that affects the Sellers' liability under Section 8.3(a).

(d) If either party shall disagree with or object to the proposed treatment of any item in a Tax Return that such party is entitled to review in accordance with Sections 5.9(b) or (c) of this Agreement, then the parties shall negotiate in good faith to resolve such disagreement or objection. If such matter cannot be resolved by mutual agreement prior to the due date (with extensions) for the filing of the pertinent Tax Return, then the Tax Return shall be filed on a timely basis by the party responsible for the filing of such Tax Return in accordance with Sections 5.9(b) or (c) of this Agreement, and the other party shall be entitled to submit the matter to the Tax Settlement Auditor, whose resolution of such matter shall be binding on both parties.

(e) As soon as reasonably practicable after the Closing Date (with respect to the 338 Tax Cost, after the final resolution of the Tax Schedules pursuant to Section 5.10(c)), the Purchaser shall compute the Short Period Tax, the Estimated Tax Payments, and the 338 Tax Cost. The Purchaser's computation of these items shall be subject to the review and consent of Skandia America, which consent shall not be unreasonably withheld. If Skandia America reasonably disputes the Purchaser's computation of the Short Period Tax, the Estimated Tax Payments, or the 338 Tax Cost (if any), then Skandia America and the Purchaser shall negotiate in good faith to resolve the dispute. Any dispute that cannot be resolved by Skandia America and the Purchaser shall be resolved by the Tax Settlement Auditor, whose resolution of such dispute shall be binding on both parties. The amounts of the Short Period Tax, the Estimated Tax Payments, and the 338 Tax Cost (if any) as finally determined in accordance with this Section 5.9(e) shall be final and binding on the parties and shall not be revised after such final determination.

(f) The Purchaser shall pay to Skandia America the excess, if any, of the Short Period Tax over the Estimated Tax Payments or Skandia America shall pay to the Purchaser the excess, if any, of the Estimated Tax Payments over the Short Period Tax. The payment required by this Section 5.9(f) shall be paid within five (5) Business Days after the first to occur of (i) Skandia America's consent to the Purchaser's computation of the Short Period Tax and the Estimated Tax Payments and (ii) the final resolution by the Tax Settlement Auditor of any dispute between the parties concerning the computation of the Short Period Tax and/or the Estimated Tax Payments.

(g) If the Purchaser and Skandia U.S. make the 338 Elections, the Purchaser shall pay to Skandia America the 338 Tax Cost (if any) within five (5) Business Days after the filing of the 338 Elections with the IRS.

(h) The payments required by Sections 5.9(f) and (g), if any, shall also include such additional amounts as required to "gross-up" such payments for any tax liability resulting from such payments being treated as a purchase price adjustment or otherwise as taxable income to Skandia America. The determination of the taxability of such payments shall be made by the parties prior to any payment and any dispute shall be resolved by the Tax Settlement Auditor.

(i) All transfer, sales, use, recordation, stamp or similar Taxes required to be paid in connection with the transactions contemplated herein, including the sale and delivery to the Purchaser of the Shares, shall be paid by the party upon whom such Taxes are imposed by any law or regulation. At the Closing, the Sellers shall cause all appropriate stock transfer tax stamps to be affixed to the certificate or certificates representing the Shares so sold and delivered.

(j) To the extent available in the records of the Sellers, the Companies, or their Subsidiaries, true and complete copies of all Tax Returns and all schedules thereto (or relevant portions thereof) filed by, on behalf of, or with respect to each of the Companies and their Subsidiaries with any taxing authority for all Taxable Periods ending on or before the Closing Date, and all written communications relating to all such Tax Returns (including revenue agent's reports, settlement agreements, compromise agreements, and the like), will be made available to the Purchaser by the Sellers for inspection upon its request. After the Closing Date, the Purchaser, on the one hand, and the Sellers, on the other hand, each shall make available (or cause their respective Affiliates to make available) to the other, as reasonably requested, and to any taxing authority, all

information, records or documents relating to Taxes of the Companies and their Subsidiaries for all periods ending on or before the Closing Date, and shall preserve (or shall cause the Companies and their Subsidiaries to preserve) all such information, records and documents in accordance with their generally applicable record retention policy.

(k) The Tax Allocation Agreement dated January 1, 1990, as amended, shall terminate with respect to each Company and its Subsidiaries as of the Closing Date, and each Company and its Subsidiaries shall thereafter be released from any liability thereunder.

(l) After the Closing, the Seller and the Purchaser shall provide, and shall cause each of their Affiliates to provide, to the other party and its Affiliates such information (including access to books and records) relating to the Companies, their Subsidiaries, and the Sellers as the Sellers or the Purchaser may reasonably request in order to permit (i) the filing of any Tax Return, amended Tax Return, or claim for refund; (ii) the determination of any Tax liability, right to the refund of Taxes, or the amount of any foreign Tax credit; (iii) the determination of the amount of any payment required under this Agreement; and (iv) the conduct or defense of any audit, claim, suit, or other proceeding in respect of Taxes. The Purchaser and the Sellers shall cooperate with each other in the conduct of any audit, claim, suit, or other proceeding involving the Companies and/or their Subsidiaries for any Tax purpose.

(m) If a Company or one of its Subsidiaries incurs a net operating loss that may be carried back and absorbed in a Tax Return of the Sellers Group, then an election under section 172(b)(2) of the Code shall be made by or on behalf of such Company or Subsidiary with respect to such net operating loss. If, for a Taxable Period beginning after the Closing Date, a Company or a Subsidiary of a Company incurs a capital loss, a general business credit, or other item (excluding a net operating loss) that must be carried back to a consolidated federal income Tax Return of the Sellers Group for a Taxable Period ending before or including the Closing Date, Skandia U.S. shall amend such prior period Tax Return and claim a refund or credit of Tax attributable to the carryback of such item. If the claim for the overpayment of Tax attributable to the carryback item is allowed to the Sellers Group, the Sellers shall pay the amount of the reduction in Tax for the prior period (plus interest, if applicable), less the reasonable costs and expenses incurred by Skandia U.S. in connection with the preparation of such amended Tax Return, to the Company or the Subsidiary, as the case may be. In the event that (i) the Sellers Group incurs a net operating loss, a

capital loss, a general business credit, or other item during a Taxable Period beginning after the Closing Date; (ii) such item could or should be carried back to a Taxable Period with respect to which a Company or a Subsidiary previously received a payment pursuant to this Section 5.9(1); (iii) such net operating loss, capital loss, general business credit, or other item incurred by the Sellers Group is reasonably expected to expire unused by any member corporation of the Sellers Group; and (iv) such item would not have expired unused to a member of the Sellers Group in the absence of the reduction of Tax attributable to the previous carryback adjustment attributable to a Company or one of its Subsidiaries, then such Company or Subsidiary shall pay to the Sellers the amount of the reduction of Tax for such carryback year that would have been credited or refunded to the Sellers Group in the absence of the carryback from the Company or the Subsidiary. The amount of the payment provided by the immediately preceding sentence shall not exceed the amount of the payment previously made by the Sellers to the Company or Subsidiary with respect to such carryback Taxable Period.

(n) The Sellers shall not make or allow to be made an election under Treasury Regulations section 1.1502-20(g) with respect to the net operating loss of any Company or one or more of its Subsidiaries.

(o) The Sellers shall deliver to the Purchaser all appropriate additions and revisions to the Schedules described in Section 3.32 as soon as reasonably practicable after such additions or revisions are required to be disclosed under the terms of this Agreement.

(p) For purposes of this Section 5.9, prior to and including the Closing Date, the Companies and their Subsidiaries shall be considered Affiliates of the Sellers, and after the Closing Date the Companies and their Subsidiaries shall be considered Affiliates of the Purchaser. The Purchaser or the Sellers, as the case may be, shall cause their respective Affiliates to perform any covenant, agreement, obligation or other duty imposed on such Affiliates under the terms of this Section 5.9.

5.10 338 Elections. (a) The Purchaser shall have the right, but not

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the obligation, to require Skandia U.S. to join with the Purchaser in making the elections provided for in section 338(g) and section 338(h)(10) of the Code and the Treasury Regulations promulgated thereunder (the "338 Elections") with respect to the Purchaser's acquisition of the Valley Shares from Skandia America. If the Purchaser causes Skandia U.S. to make the 338 Elections, the Purchaser and Skandia U.S. (and their Affiliates), at the option of the Purchaser, shall make such other similar

elections as may be necessary for state and local income Tax purposes provided that such elections achieve substantially the same result to the Purchaser and Skandia U.S. as the 338 Elections achieve for federal income Tax purposes and, for purposes of this Agreement, the term "338 Elections" shall be deemed to include any such state and local income Tax elections.

(b) The Purchaser shall have the right under Section 5.10(a) to make the 338 Elections with respect to Valley and with respect to any one or more of its Subsidiaries with no obligation to make the 338 Elections with respect to any other Valley Subsidiaries (if applicable).

(c) If the Purchaser preliminarily elects to cause Skandia U.S. to make the 338 Elections, within five (5) months of the Closing Date the Purchaser shall provide to Skandia U.S. schedules setting forth (A) the tax basis of each of the assets of Valley and its Subsidiaries as of the Closing Date (determined without giving effect to any 338 Elections), (B) the "Adjusted Grossed Up Basis" of the assets of Valley and its Subsidiaries (as such term is defined in Treasury Regulations section 1.338(b)-1(c)), (C) the fair market value of the assets of Valley and its Subsidiaries as of the Closing Date, (D) an allocation of the Adjusted Grossed Up Basis among such assets pursuant to Treasury Regulations section 1.338(b)-2T and, if applicable, section 1.338(b)-3T, (E) the acquisition costs incurred by the Purchaser in connection with the acquisition of the Valley Shares hereunder as defined in Treasury Regulations section 1.338(h)(10)-1(f)(4) ("Purchaser's Costs"), (F) the modified ADSP (MADSP) (as such term is defined in Treasury Regulations section 1.338(h)(10)-1(f)), and (G) an allocation of the MADSP among the assets of Valley and its Subsidiaries in accordance with Treasury Regulations section 1.338(h)(10)-1(f) (the schedules set forth in clauses (A)-(G), the "Tax Schedules"). The Purchaser shall provide to Skandia U.S. any information reasonably requested by Skandia U.S. promptly after receipt of the Tax Schedules to substantiate the Tax Schedules and the computation thereof. Within twenty (20) Business days after receipt of the Tax Schedules, Skandia U.S. shall notify the Purchaser in writing of any objections to the Purchaser's computation of the Tax Schedules, including a detailed explanation of the basis for such objections. If Skandia U.S. fails to so object in writing to the Tax Schedules within such time, the Tax Schedules shall be deemed to be final and binding upon the parties with respect to the making of the 338 Elections. If Skandia U.S. makes such a timely written objection to the Tax Schedules, however, then the Purchaser and Skandia U.S. shall negotiate in good faith to resolve any matters in dispute with respect thereto. If the Purchaser and Skandia

U.S. are unable to resolve any such matters in dispute within ten (10) Business Days after the Purchaser's receipt of Skandia U.S.'s written objections to the Tax Schedules, then the Purchaser and Skandia U.S. shall submit any such disputed matters to the Tax Settlement Auditor for resolution and the Tax Settlement Auditor shall resolve any disputed items as soon as practicable after being retained to resolve such disputed items. The Tax Schedules will become final and binding upon agreement by Skandia U.S. and the Purchaser or upon the resolution of any disputes by the Tax Settlement Auditor. Upon the final resolution of the 338 Tax Cost, the Purchaser may elect to have the 338 elections filed, or not filed, in the sole discretion of Purchaser. If the Purchaser elects to file the 338 Elections, the Purchaser and Skandia U.S. shall act in accordance with Tax Schedules in the preparation and filing of all the Tax Returns and in the course of any tax audit, appeal, or litigation relating thereto, and each party shall notify the other as soon as reasonably practicable of any audit adjustment or proposed audit adjustment by any taxing authority that affects the Tax Schedules.

(d) The Purchaser and Skandia U.S. shall comply fully with all filing and other requirements necessary to effectuate the 338 Elections on a timely basis and shall cooperate in good faith with each other in the preparation and timely filing of all Tax Returns required to be filed in connection with the making of the 338 Elections, including the exchange of information and the joint preparation, execution, and filing of Form 8023-A (including related schedules).

(e) All items of income, gain, loss, and deduction recognized by the Companies and their Subsidiaries as a result of, and in accordance with, the deemed asset sale resulting from the making of the 338 Elections shall be included in the consolidated federal income Tax Return of the Sellers Group for its Taxable Period that includes the Closing Date. The consolidated federal income Tax liability resulting from the 338 Elections shall be timely paid by the Sellers subject to the Purchaser's obligation to pay Skandia America for the 338 Tax Cost.

5.11 Employee Benefit Matters.  
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(a) Retirement Plan.  
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(i) Employees shall cease to accrue any benefits under the Seller's Retirement Plan as of the Closing Date or as soon thereafter as may be practical in accordance with ERISA.

(ii) The Seller's Retirement Plan shall be amended to: (i) provide that Employees are fully vested in their accrued benefits attributable to their service prior to the Closing Date; (ii) preserve any rights to early retirement benefits for which such an Employee is eligible as of the Closing Date; and (iii) provide for (subject to the provisions of the Code and ERISA) distribution of benefits accrued through the date described in (i) above.

(iii) The Sellers shall retain all liabilities, including but not limited to liabilities for benefits, unfunded liabilities and contributions, under the Seller's Retirement Plan, whether incurred before, on, or after the Closing Date, except liabilities for contributions with respect to normal costs accrued or reserved for in the ordinary course of business on the balance sheets contained in the Interim Financial Statements as of the end of the calendar month immediately preceding the Closing Date in accordance with GAAP and actuarial methodologies applied consistently with the practices of the Companies and their Subsidiaries immediately prior to the date of this Agreement.

(b) Defined Contribution Plan.  
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(i) The Seller's Defined Contribution Plan shall be amended to provide that contributions thereto in respect of Employees shall cease as of the Closing Date and any rights to contributions on or after the Closing Date shall be determined in accordance with the terms of the Successor Plan. No later than January 1, 1996, the Successor Plan shall include as participants the Employees (other than any terminated non-vested participants) who were participants in the Seller's Defined Contribution Plan immediately prior to the Closing Date. Other Employees shall become participants in the Successor Plan in accordance with its terms.

(ii) As soon as practicable following December 31, 1995, the Defined Contribution Plan shall be amended (A) to fully vest the Employees in their Account Balances and (B) to distribute all account balances of Employees (including, as applicable, all employee and employer contributions, all earnings attributable to such contributions and participant promissory notes), such balances to be determined as of the first day of the month preceding the distribution, and such distribution to be made in accordance with procedures prescribed by the Code, ERISA, and the applicable Plan document(s).

(iii) The Sellers shall retain all liabilities, including but not limited to liabilities for benefits, unfunded liabilities and contributions, under the Seller's Defined Contribution Plan, whether incurred before, on, or



after the Closing Date, except liabilities for contributions with respect to costs accrued or reserved for in the ordinary course of business on the balance sheets contained in the Interim Financial Statements as of the end of the calendar month immediately preceding the Closing Date in accordance with GAAP applied consistently with the practices of the Companies and their Subsidiaries immediately prior to the date of this Agreement.

(c) Bonuses. The Companies shall retain all obligations and

liabilities for bonuses and incentive payments in connection with the relevant Employee Benefit Plans in effect immediately prior to the Closing Date and shall cause the payment of such bonuses or incentive payments, if any, to be made in accordance with the terms of such Employee Benefit Plans.

(d) Welfare Benefits. With respect to each Employee, the Purchaser

shall cause the Companies to assume the obligation and liability for claims by any such individual (or his or her covered dependent or COBRA beneficiary) under employee welfare benefit plans (within the meaning of section 3(1) of ERISA) of the Companies, whether incurred prior to, on or after the Closing Date; provided, however, that the Sellers shall cooperate in good faith with the

Purchaser to arrange for payment of any claims incurred prior to the Closing Date to the extent such claims are covered under any insurance policy held by the Sellers for the purpose of payment of such claims. The Purchaser shall cause the Companies to provide for the waiver under the Purchaser's welfare benefit plans covering Employees on and after the Closing Date of any conditions to coverage with respect to preexisting medical conditions and shall credit Employees with any amounts paid prior to the Closing Date in order to satisfy applicable deductible amounts and co-payment minimums under the corresponding welfare plans of the Purchaser.

(e) Credit. The Purchaser shall cause the Companies and their

Subsidiaries to credit for all purposes under any benefit plans covering the Employees, including the Successor Plan, the service credited through the Closing Date under the Parent's or the Seller's benefits plans as if such service had been rendered to the Purchaser.

(f) WARN. The Purchaser shall cause the Companies and their

Subsidiaries to comply with the requirements of WARN and any similar state notification laws with respect to any loss of employment concerning the Affected Employees that takes place on or after the Closing Date.

(g) Third-Party Rights. No provision of this Section 5.10 shall

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create any third-party beneficiary rights in any employee or former employee (including any beneficiary or dependent thereof) of the Sellers, any of their Affiliates, or the Companies in respect of continued employment (or resumed employment) for any specified period of any nature or kind whatsoever, and no provision of this Section 5.10 shall create such third-party beneficiary rights in any such persons in respect of any benefits that may be provided, directly or indirectly, under any employee benefit plan or arrangement, including the current Plans.

5.12 Insurance Coverage. The Sellers will cooperate with the

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Purchaser in obtaining, at the expense of the Purchaser or the Companies, continued or replacement insurance coverage, effective as of the Closing Date, providing coverage to each of the Companies, their Subsidiaries and Northern County comparable to that provided by the policies and Contracts listed on Schedule 3.31 which policies and Contracts are not issued directly to any of the Companies and their Subsidiaries (including Northern County). Without limiting the generality of the foregoing, the Sellers will provide such information, and cause the Companies, their Subsidiaries and Northern County to complete and execute such applications, as may be reasonably necessary to arrange for such continuation or replacement insurance coverage.

5.13 Debt Restructuring. The indebtedness of Charter and its

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Subsidiaries will be restructured as follows:

(a) Prior to the maturity or due date thereof, and before the Closing, the Sellers will cause the Monarch Note to be replaced with a promissory note (in form and substance reasonably satisfactory to the Purchaser) made by Monarch to Skandia Capital AB (publ), (i) in a principal amount no greater than the principal amount currently outstanding under the Monarch Note, (ii) providing for payment of such principal in installments not to exceed \$2,400,000, on the first day of each calendar month from January 1, 1995 until payment in full (no later than June 1, 1996), (iii) bearing interest, payable monthly together with the foregoing principal installments, on unpaid principal amounts at an interest rate equal to 6.5% per annum, and (iv) except for any security for repayment as contemplated in paragraph (c) below, otherwise on terms no less favorable to Monarch than those contained in the currently outstanding Monarch Note.

(b) Prior to the maturity or due date thereof, and before the Closing, the Sellers will cause the Charter Agency/Kennell Note to be amended (pursuant to an instrument

in form and substance reasonably satisfactory to the Purchaser) to (i) extend its maturity date to September 30, 1996, (ii) provide for payment of \$1,000,000 in outstanding principal thereunder on each of July 1, August 1 and September 1, 1996, and (iii) permit any principal outstanding thereunder at maturity to be discharged by execution and delivery of the New Charter Agency Note as provided below. The Charter Agency/Kennell Note shall otherwise continue in effect, if at all, upon terms identical to those currently in effect.

(c) Prior to the Closing, the Sellers shall be entitled to cause Monarch to advance its available funds to Charter Agency, to the extent necessary for Charter Agency to pay any premiums or other amounts due under the 100% quota share reinsurance agreements of Northern County which are currently in effect. Any such advance (i) shall be made in consideration for the grant by Charter Agency to Monarch of a security interest in an equal amount of direct bill premium receivables owned by Charter Agency relating to policies and contracts of insurance written prior to the Closing Date, as security for the repayment of such advance, and (ii) shall be repayable in its original principal amount, without interest or premium thereon, as and when such direct bill premium receivables are collected by Charter Agency. Each of the foregoing advances and security arrangements shall be undertaken pursuant to written instruments in form and substance reasonably satisfactory to the Purchaser.

In addition, prior to the Closing, the Sellers shall be entitled (A) to cause Monarch to pledge outstanding premium finance notes (evidencing premium finance obligations of Northern County policyholders to Monarch) and all other funds owned by Monarch and the proceeds and products thereof (including amounts collected thereunder), and (B) to cause Charter Agency to pledge any and all direct bill premium receivables owned by Charter Agency relating to policies and contracts of insurance written prior to the Closing Date (other than any of the same pledged as security for the repayment of advances by Monarch to Charter Agency as contemplated in the immediately preceding paragraph) and the proceeds and products thereof (including amounts collected thereunder), in the case of each of clauses (A) and (B) as security for payment of the following obligations (in order of priority):

(1) commissions, fees, claims payments and other amounts payable to or by Charter Agency in its capacity as a managing general agent of Northern County, while the Monarch Note, Charter Agency/Kennell Note or New Charter Agency Note remain outstanding (it being understood that those commissions and fees will be

sufficient, without any additional capital infusions, to pay the reasonably anticipated operating costs of Charter Agency);

(2) any premiums or other amounts due under the 100% quota share reinsurance agreements of Northern County which are currently in effect;

(3) any amounts due under the Monarch Note; and

(4) any amounts due under the Charter Agency/Kennell Note or the New Charter Agency Note.

The foregoing pledge arrangements shall be undertaken pursuant to written instruments in form and substance reasonably satisfactory to the Purchaser. The Sellers shall bear the fees and expenses of any pledge or collateral agent related to any such pledge arrangements. The Purchaser shall be entitled to any premium finance collectibles, direct bill premium receivables, funds and proceeds therefrom remaining after satisfaction in full of the Monarch Note, the Charter Agency/Kennell Note and the New Charter Agency Note.

(d) Prior to the Closing, the Sellers will not permit (i) any demand to be made for payment of principal, prepayment of interest or payment of any other amounts pursuant to the Monarch Note or any of the Charter Intercompany Notes, (ii) any payment or other default to occur under the Monarch Note or any of the Charter Intercompany Notes, (iii) except as contemplated above in this Section 5.13, any amendment, modification, cancellation or change to the terms of any of the Charter Intercompany Notes or (iv) any repayment or refunding by Northern County or Charter Agency of the SARC Reinsurance Advance. Prior to the Closing, the Sellers will cause Monarch, Charter Agency and Charter to make all payments of principal and interest as and when due under the Monarch Note and each of the Charter Intercompany Notes (to which it is an obligor or party), respectively, and not to make any other payments in respect thereof.

(e) At the Closing: (i) the Sellers will cause Charter and Charter Agency to pay to the respective holders of each of the Charter Intercompany Notes (to which it is an obligor or party) other than the Charter/Kennell Note, all accrued and unpaid interest thereunder through the Closing Date; and (ii) in consideration for the Purchaser's purchase of the NCM Shares (including the Northern County Management Contract), (A) the Sellers will cause SARC to transfer its rights and interests in and to the SARC Reinsurance Advance to Skandia America, which in turn shall (and Skandia U.S. shall cause Skandia America to) make a capital contribution

to Charter of such rights and interests in and to the SARC Reinsurance Advance, and (B) Skandia America will, and Skandia U.S. will cause Skandia America to, make a capital contribution to Charter of the Charter Upstream Note, in the case of each of clauses (A) and (B) without repayment of amounts owed thereon and pursuant to documentation in form and substance reasonably satisfactory to the Purchaser.

(f) The Purchaser will cause the Charter Agency/Kennell Note to remain in full force and effect from the Closing until September 30, 1996. In the event that all principal amounts outstanding under the Charter Agency/Kennell Note are not satisfied pursuant to the above arrangements on or before September 30, 1996, the Purchaser will cause Charter Agency to execute and deliver to Kennell a new promissory note, substantially in the form attached hereto as Exhibit A (a "New Charter Agency Note"), pursuant to which Charter Agency will repay to Kennell a third of such remaining principal amount on September 30 of each of 1997, 1998 and 1999. Any New Charter Agency Note shall be deemed to discharge the Charter Agency/Kennell Note, and shall be guaranteed by Charter pursuant to an instrument of guaranty in form and substance reasonably satisfactory to the Sellers. There shall be no recourse to any Person, or the assets or Property of any Person, other than Charter Agency and Charter in respect of any New Charter Agency Note. From the Closing until satisfaction in full of the Monarch Note, the Charter Agency/Kennell Note and any New Charter Agency Note, the Purchaser will cause each of Monarch and Charter Agency not to declare, pay or set aside any sum for any dividend or other distribution, or redeem, purchase or otherwise acquire any capital stock or other securities of Monarch or Charter Agency.

(g) The Sellers hereby represent and warrant to, and covenant and agree with, the Purchaser that, after giving effect to the Closing, none of the Companies or their Subsidiaries (including Northern County) will have any Liability or indebtedness for borrowed or advanced money or funds, other than pursuant to the Charter Surplus Note, the Northern County Surplus Note, the Monarch Note and the Charter Agency/Kennell Note as described herein.

5.14 Intercompany Accounts; Affiliate Agreements. Except as set

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forth in Schedule 5.14 hereto and as provided in Section 5.13, the Sellers shall cause all intercompany accounts receivable or payable (whether or not currently due or payable) between (a) any of the Companies or their Subsidiaries (including Northern County), on the one hand, and (b) any of the Sellers or their other Affiliates, or any of the officers or directors of any of the Sellers, the Companies, their Affiliates and Northern County, on the other hand, to be settled in full (without any premium or

penalty, and at values mutually agreed upon by the parties hereto) at or prior to the Closing. Except as set forth in Schedule 5.14 hereto and as provided in Section 5.13, all Affiliate Agreements shall be terminated without any further Liability or obligation thereunder effective at or prior to the Closing, upon terms and pursuant to instruments reasonably satisfactory to the Purchaser, and the Sellers will cause each of its Affiliates party to any Affiliate Agreements (other than the Companies, their Subsidiaries (including Northern County)) to execute and deliver to the Purchaser, the Companies and their Subsidiaries (including Northern County) a Release and Discharge with respect thereto, dated as of the Closing Date and substantially in the form attached hereto as Exhibit D.

5.15 Corporate Records. At or prior to the Closing, the Sellers

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shall deliver to the appropriate Companies all minute books, stock ledgers, stock books, cancelled or unused stock certificates, corporate seals, books, records, files, policy forms, stationery, software, data, documents and Properties of the Companies, their Subsidiaries (including Northern County) that are in the possession of any of the Sellers or their other Affiliates.

5.16 Instruments. Any monies, checks, drafts, money orders, postal

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notes and other instruments received after the Closing by any of the Sellers or their Affiliates (other than the Companies and their Subsidiaries) in payment of any amounts due any of the Companies or their Subsidiaries shall be forthwith after receipt by any of the Sellers or such Affiliates thereof be transferred and delivered by the Sellers and such Affiliates to the appropriate Company or Subsidiary thereof, and any such instruments made payable to any of the Sellers or such Affiliates when so delivered shall bear all endorsements required to effectuate the transfer of the same to the appropriate Company or Subsidiary thereof.

5.17 Trade Names. At all times following the Closing, (a) the

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Sellers will not, and will not permit their Affiliates to, use any name which includes the words "Valley", "Charter", "NCM" or "Northern County" or any derivations or variations thereof, or any name substantially resembling or confusingly similar in whole or in part to the name of any of the Companies and their Subsidiaries (including Northern County), in connection with any trade or business activity and (b) the Purchaser will not, and will not permit their Affiliates to, use any name which includes the word "Skandia" or any derivations or variations thereof, or any name substantially resembling or confusingly similar in whole or in part to the name "Skandia" or the existing Skandia logo with the likeness of the umbrella, in connection with any trade or business activity.

5.18 Reinsurance Arrangements. (a) The Sellers will cause the 100%

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quota share reinsurance agreements of Northern County which are currently in effect to remain in full force and effect at all times until the later of December 31, 1995 or the Closing Date, without any amendment, modification,

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cancellation or other change thereto which is not approved in writing by the Purchaser. Between the date hereof and the Closing Date, the Sellers will not permit Northern County or Charter Indemnity to enter into any reinsurance, coinsurance, retrocession, underwriting management, managing general agency or similar Contracts.

(b) At the Closing, the Sellers will cause Skandia Ltd to (i) unconditionally guarantee the full performance of all liabilities and obligations of each reinsurer and assuming company, and indemnify Northern County for the full collectibility of all amounts recoverable, under all reinsurance agreements of Northern County (whether in force or in run-off) relating to periods on or prior to the later of December 31, 1995 or the Closing

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Date (or, in the case of non-affiliate reinsurance, on or prior to the Closing Date), pursuant to a Guaranty Agreement dated as of the Closing Date substantially in the form of Exhibit B (the "Northern County Guaranty"), and (ii) provide excess of loss reinsurance coverage to Charter Indemnity with respect to insurance business issued, underwritten, assumed or renewed by Charter Indemnity on or before the Closing Date, pursuant to an Aggregate Excess of Loss Reinsurance Agreement dated as of the Closing Date substantially in the form of Exhibit C (the "Charter Indemnity Reinsurance Agreement").

(c) The Sellers hereby represent and warrant to, and covenant and agree with, the Purchaser that (i) after giving effect to the Closing and the execution of the Northern County Guaranty, Northern County will not retain for its own account any net liability under any insurance or reinsurance issued, underwritten, assumed or renewed by it on or prior to the Closing Date and (ii) after giving effect to the Closing and the execution of the Charter Indemnity Reinsurance Agreement, subject to the limitations expressly set forth therein, Charter Indemnity will not have any net liability in respect of any insurance, reinsurance or retrocession business issued, underwritten, assumed or renewed by it on or prior to the Closing Date (other than for losses and loss adjustment expenses incurred prior to the Closing Date, in an aggregate amount not to exceed the reserves for such losses and loss adjustment expenses held by Charter Indemnity, and certified to the Purchaser as such, on the Closing Date).

5.19 Non-Solicitation Covenant. At all times from the Closing Date

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until the third anniversary thereof, (a) the Sellers will not, and will cause their Affiliates not to, directly or indirectly seek or solicit to employ or engage any officer or employee of any of the Companies and their Subsidiaries (including Northern County) who is such on the Closing Date and (b) the Purchaser will not, and will cause their Affiliates not to, directly or indirectly solicit to employ or engage any officer or employee of any of the Sellers and their Subsidiaries (other than the Companies and their Subsidiaries, including Northern County) who is such on the Closing Date.

ARTICLE VI

CONDITIONS TO THE OBLIGATION  
OF THE PURCHASER TO CLOSE

The obligation of the Purchaser to purchase the Shares at the Closing shall be subject to the satisfaction of the following conditions at or prior to the Closing:

6.1 Representations, Warranties and Covenants. The representations

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and warranties of the Sellers contained in this Agreement which are qualified as to materiality shall be true and correct in all respects, and those not so qualified shall be true and correct in all material respects, as of the date of this Agreement and, except for any such representations and warranties which are made as of and relate solely to a particular date other than the date hereof, as of the Closing Date with the same force and effect as though made on and as of the Closing Date. Each of the Sellers shall have performed and complied in all material respects with all covenants and agreements required to be performed or complied with by such parties hereunder on or prior to the Closing Date. In addition, the representations and warranties of Skandia Ltd contained in the Parent Support Agreement referred to in the recitals to this Agreement shall be true and correct in all material respects as of the date hereof and as of the Closing Date with the same force and effect as though made on and as of the Closing Date.

6.2 Consents. All Consents required in connection with the purchase

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and sale of the Shares and the consummation of the Closing (other than non-material Consents from third parties which are not Governmental Entities) shall have been duly obtained, made or given and shall be in full force and effect, without the imposition upon the Purchaser, the Companies and their Subsidiaries (including Northern County) of any material condition, restriction or required undertaking (other than conditions,



restrictions or undertakings customarily required by insurance regulatory authorities in transactions such as the Purchaser's acquisition of the Shares) not expressly set forth in applicable statutes and regulations. Without limiting the generality of the foregoing, the Purchaser shall have obtained the approvals of the insurance regulatory authorities of the States of California, Oregon and Texas for the consummation of the transactions contemplated hereby (including the purchase of the Shares) under all applicable laws and regulations, and such approvals shall be valid and in full force and effect, and no such approval shall impose upon the Purchaser or any of the Companies and their Subsidiaries (including Northern County) any conditions or restrictions which adversely impair the ability of any of them to conduct their business in substantially the same manner as such business is now being conducted.

6.3 No Injunction or Illegality. No injunction, order, decree or

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judgment shall have been issued by any Governmental Entity of competent jurisdiction and be in effect, and no statute, rule or regulation shall have been enacted or promulgated by any Governmental Entity and be in effect, which in each case restrains or prohibits the consummation of the purchase and sale of the Shares.

6.4 HSR Act. The required waiting period applicable to the purchase

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and sale of the Shares under the HSR Act shall have expired or been earlier terminated.

6.5 Opinions of Counsel to the Sellers. The Purchaser shall have

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received opinions, each dated the Closing Date, of Cadwalader, Wickersham & Taft, special counsel to the Sellers, and such other counsel of the Sellers and/or their Affiliates as may be reasonably acceptable to the Purchaser, substantially to the effect of the matters set forth in Exhibit E hereto.

6.6 Certificates. The Sellers shall each have delivered to the

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Purchaser (a) a copy of the resolutions adopted by its Board of Directors and (if applicable) stockholders, certified by the corporate Secretaries thereof, authorizing and approving this Agreement and the transactions contemplated hereby (including, without limitation, the sale of the Shares), and (b) a certificate dated the Closing Date, signed by an executive officer thereof, certifying as to the fulfillment of the conditions set forth in Section 6.1 and 6.11. Skandia Ltd shall have delivered to the Purchaser (i) a copy of any corporate resolutions or action on the part of Skandia Ltd, certified by the corporate secretary thereof, relating to the transactions contemplated hereby and (ii) a certificate dated the Closing Date, signed by an executive officer

thereof, certifying as to the fulfillment of the conditions set forth in the last sentence of Section 6.1. In addition, the Sellers and Skandia Ltd shall have furnished the Purchaser with such other certificates and closing documents as the Purchaser may reasonably request and as are customary for transactions such as those contemplated hereby.

6.7 Resignation of Directors. All of the directors of the Companies

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and their Subsidiaries (including Northern County) who are designated by the Purchaser for replacement, shall have delivered to the Purchaser their written resignations as directors of such companies, and those Persons designated by the Purchaser as nominees to the Board of Directors of Northern County shall have been duly elected or appointed to the Northern County Board, in each case effective upon the Closing.

6.8 Debt Restructuring. The intercompany debt restructuring

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contemplated by Section 5.13 shall have been consummated in accordance with the terms thereof.

6.9 Reinsurance Arrangements. Skandia Ltd shall have duly executed

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and delivered the Northern County Guaranty and the Charter Indemnity Reinsurance Agreement.

6.10 Northern County Management Contract. The Northern County

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Management Contract shall have been extended for a period of twenty (20) years, upon terms no less favorable to NCM than those in effect on the date of this Agreement (and upon terms otherwise satisfactory to the Purchaser).

6.11 Ratings. None of the claims-paying ability ratings assigned by

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A.M. Best & Co. or Standard & Poor's Corporation to any of the Insurance Companies, as in effect on the date of this Agreement, shall have been lowered, on or prior to the Closing Date.

6.12 Transfer Taxes. The Sellers shall have caused all appropriate

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stock transfer Tax stamps to be affixed to the certificate or certificates representing the Shares so sold and delivered.

#### ARTICLE VII

##### CONDITIONS TO THE OBLIGATIONS OF THE SELLERS TO CLOSE

The obligations of Skandia America to sell the Shares at the Closing shall be subject to the satisfaction of the following conditions at or prior to the Closing:

7.1 Representations, Warranties and Covenants. The representations

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and warranties of the Purchaser contained in this Agreement which are qualified as to materiality shall be true and correct in all respects, and those not so qualified shall be true and correct in all material respects, as of the date of this Agreement and, except for any such representations and warranties which are made as of and relate solely to a particular date other than the date hereof, as of the Closing Date with the same force and effect as though made on and as of the Closing Date. The Purchaser shall have performed and complied in all material respects with all covenants and agreements required to be performed or complied with by the Purchaser hereunder on or prior to the Closing Date.

7.2 Consents. All Consents required in connection with the purchase

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and sale of the Shares and the consummation of the Closing (other than non-material Consents from third parties which are not Governmental Entities) shall have been duly obtained, made or given and shall be in full force and effect, without the imposition upon the Sellers of any material condition, restriction or required undertaking (other than conditions, restrictions or undertakings customarily required by insurance regulatory authorities in transactions such as the Purchaser's acquisition of the Shares) not expressly set forth in applicable statutes and regulations.

7.3 No Injunction or Illegality. No injunction, order, decree or

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judgment shall have been issued by any Governmental Entity of competent jurisdiction and be in effect, and no statute, rule or regulation shall have been enacted or promulgated by any Governmental Entity and be in effect, which in each case restrains or prohibits the consummation of the purchase and sale of the Shares.

7.4 HSR Act. The required waiting period applicable to the purchase

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and sale of the Shares under the HSR Act shall have expired or been earlier terminated.

7.5 Opinion of Counsel to the Purchaser. The Sellers shall have

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received the opinion of Dewey Ballantine, special counsel to the Purchaser, dated the Closing Date, substantially in the form attached hereto as Exhibit F.

7.6 Certificates. The Purchaser shall have delivered to the Sellers

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(a) a copy of the resolutions adopted by its Board of Directors, certified by the corporate Secretary thereof, authorizing and approving this Agreement and the transactions contemplated hereby (including, without limitation, the purchase of the Shares), and (b) a certificate dated the Closing Date, signed by an

executive officer thereof, certifying as to the fulfillment of the conditions set forth in Section 7.1.

ARTICLE VIII  
INDEMNIFICATION

8.1 Survival. The representations and warranties of the parties

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contained in this Agreement, or in any Schedule or Exhibit hereto or any certificate delivered pursuant hereto, shall survive until the third anniversary of the Closing Date; provided, however, that (a) the representations and

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warranties set forth in the second and third sentence of Section 3.21 (Reserves), insofar as they relate to the loss and loss adjustment expense reserves of Northern County and Charter Indemnity, shall expire upon the Closing, (b) the representations and warranties set forth in Sections 3.28 (Employee Benefit Plans) and 3.32 (Tax Matters) with respect to any Tax shall survive to the extent set forth in Section 8.4(a), (c) the other representations and warranties set forth in Section 3.28 (Employee Benefit Plans) shall expire upon expiration of the applicable statute of limitations, and (d) the representations and warranties set forth in Sections 3.6(b) (Subsidiaries) (last two sentences only), 3.7(a) (Capitalization), 3.8 (Title to Shares), 3.9(c) and (e) (Northern County; Charter Indemnity), 3.24 (Properties) (last sentence only), and 5.18(c) (Reinsurance Arrangements) shall survive forever.

8.2 Indemnification. (a) The Sellers hereby jointly and severally

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agree to indemnify, defend and hold harmless the Purchaser (and its directors, officers, Affiliates, successors and assigns) from and against any losses, liabilities, damages, costs or expenses, including, without limitation, interest, penalties and reasonable fees and expenses of counsel (collectively, "Losses"), asserted during the survival periods referred to in Section 8.1, based upon, arising out of or otherwise resulting from (i) any inaccuracy in any representation or breach of any warranty of any of the Sellers (without regard to any qualification as to materiality or Material Adverse Effect) contained in this Agreement or in any Schedule hereto or certificate delivered pursuant hereto or (ii) the breach or nonfulfillment of any covenant, agreement or other obligation of any of the Sellers under this Agreement; provided, however, that,

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except with respect to any breach of any representation or warranty set forth in Sections 3.6(b) (Subsidiaries) (last two sentences only), 3.7(a) (Capitalization), 3.8 (Title to Shares) and 3.9(e) (Charter Indemnity), (A) the Purchaser (and its directors, officers, Affiliates, successors and assigns) shall be entitled to indemnification under this Section 8.2 only when the

aggregate amount of all such Losses exceeds \$1,000,000 (the "Basket Amount"), in which event the Purchaser (and its directors, officers, Affiliates, successors and assigns) shall be entitled to indemnification for all such Losses (including the Basket Amount), and (B) the Purchaser (and its directors, officers, Affiliates, successors and assigns) shall only be entitled to indemnification under this Section 8.2 for fees and expenses of the counsel of one such Person (determined by the Purchaser) arising from Third Party Claims.

(b) The Purchaser hereby agrees to indemnify, defend and hold harmless the Sellers (and their directors, officers, Affiliates, successors and assigns) from and against any Losses asserted during the survival periods referred to in Section 8.1, based upon, arising out of or otherwise resulting from (i) any inaccuracy in any representation or breach of any warranty of the Purchaser (without regard to any qualification as to materiality) contained in this Agreement or in any Schedule hereto or certificate delivered pursuant hereto or (ii) the breach or nonfulfillment of any covenant, agreement or other obligation of the Purchaser under this Agreement; provided, however, that (A)

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the Sellers (and their directors, officers, Affiliates, successors and assigns) shall be entitled to indemnification under this Section 8.2 only when the aggregate amount of all such Losses exceeds the Basket Amount, in which event the Sellers shall be entitled to indemnification for all such Losses (including the Basket Amount), and (B) the Sellers (and their directors, officers, Affiliates, successors and assigns) shall only be entitled to indemnification under this Section 8.2 for fees and expenses of the counsel of one such Person (determined by the Sellers) arising from Third Party Claims.

(c) Promptly after the receipt by any party hereto of notice of any third party claim or the commencement of any third party action, suit or proceeding subject to indemnification hereunder (a "Third Party Claim"), such party (the "Indemnified Party") will, if a claim in respect thereto is to be made against any party obligated to provide indemnification hereunder (the "Indemnifying Party"), give such Indemnifying Party reasonable written notice of such Third Party Claim; provided, however, that the failure to provide such

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notice will not relieve the Indemnifying Party of any of its obligations, or impair the right of the Indemnified Party to indemnification, pursuant to this Section 8.2 unless, and only to the extent that, such failure materially prejudices the Indemnifying Party's opportunity to defend or compromise the Third Party Claim. Such Indemnifying Party shall have the right, at its option, to defend at its own expense and by its own counsel any Third Party Claim, provided that (i)

the Indemnifying Party acknowledges in writing (at the time it elects to assume such defense) its obligation under this Section 8.2 to indemnify the Indemnified Party with respect to such Third Party Claim, (ii) such counsel is reasonably satisfactory to the Indemnified Party, (iii) the Indemnified Party is kept fully informed of all developments, and is furnished with copies of all documents and papers, related thereto and is given the right to participate in the defense and investigation thereof as provided below, and (iv) such counsel proceeds with diligence and in good faith with respect thereto. If any Indemnifying Party shall undertake to defend any Third Party Claim, it shall notify the Indemnified Party of its intention to do so promptly (and in any event no later than thirty (30) days) after receipt of notice of the Third Party Claim, and the Indemnified Party agrees to cooperate in good faith with the Indemnifying Party and its counsel in the defense of such Third Party Claim. Notwithstanding the foregoing, the Indemnified Party shall have the right to participate in the defense and investigation of any Third Party Claim with its own counsel at its own expense, except that the Indemnifying Party shall bear the expense of such separate counsel if (A) in the written opinion of counsel to the Indemnified Party reasonably acceptable to the Indemnifying Party, use of counsel of the Indemnifying Party's choice would be expected to give rise to a conflict of interest, (B) there are or may be legal defenses available to the Indemnified Party that are different from or additional to those available to the Indemnifying Party, (C) the Indemnifying Party shall not have employed counsel to represent the Indemnified Party within a reasonable time after notice of the Third Party Claim is given to the Indemnifying Party or notice that the Indemnifying Party intends to assume the defense of the Third Party Claim is given to the Indemnified Party or (D) the Indemnifying Party shall authorize the Indemnified Party to employ separate counsel at the expense of the Indemnifying Party. The Indemnifying Party shall not settle any Third Party Claim without the prior written consent of the Indemnified Party, which shall not be unreasonably withheld; provided, however, that an Indemnified Party shall not be

required to consent to any settlement involving the imposition of equitable remedies.

(d) Notwithstanding anything in Section 8.1 or this Section 8.2 to the contrary, the rights and obligations of the parties with respect to the representations and warranties set forth in Section 3.32 (Tax Matters), and Section 5.10 (Section 338) the covenants and agreements set forth in Section 5.9 (Tax Matters), and the indemnification for Taxes shall be governed by Section 8.3.

8.3 Tax Indemnification. (a) The Sellers hereby jointly and severally

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agree to indemnify, defend, and hold harmless the Purchaser, the Companies, and their Subsidiaries (and their respective officers, directors, employees, Affiliates, successors, and assigns) from and against:

(i) any and all Taxes and any guaranty fund assessments arising from or in connection with any inaccuracy in any representation or breach of any warranty made in Section 3.32 of this Agreement, for which purpose the representations and warranties set forth in Section 3.32 shall be deemed to have been made with no exception for items disclosed in the Schedules described in Section 3.32 (other than Schedules 3.32 (b) and 3.32(m));

(ii) any and all Taxes arising from or in connection with the nonfulfillment by the Sellers of any covenant or agreement relating to Taxes that is contained in this Agreement;

(iii) any and all Taxes, imposed on the Companies and/or their Subsidiaries, directly or indirectly, for any Taxable Period or portion thereof ending on or before December 31, 1994, to the extent the aggregate amount of such Taxes exceeds the aggregate amount of Taxes accrued in the Tax Reserve (without regard to deferred Tax assets and liabilities) set forth in the Financial Statements made for the Companies and their Subsidiaries as of December 31, 1994 (and, with respect to Northern County, the Northern County Statutory Statements dated December 31, 1994);

(iv) any and all federal income Tax imposed on the Companies and their Subsidiaries (excluding Northern County) for the Taxable Period beginning January 1, 1995, and ending on the Closing Date, subject to Skandia America's right to receive payment from the Purchaser for (A) the excess, if any, of the Short Period Tax over the Estimated Tax Payments and (B), if the 338 Elections are made, the 338 Tax Cost.

(v) any and all state, local, or foreign (and, with respect to Northern County, federal) income or franchise Tax imposed on the Companies and their Subsidiaries for the Taxable Period beginning January 1, 1995, and ending on the Closing Date in excess of the amount of such Tax imposed on the earnings of the Companies and their Subsidiaries generated in the ordinary course of their trades or businesses during such period. Such ordinary course earnings and

associated Taxes shall be determined with regard to the 338 Elections (if any) but without regard to the other transactions contemplated by this Agreement;

(vi) any and all Taxes resulting from the Companies or their Subsidiaries ceasing to be included in the consolidated federal income Tax Return filed by the Sellers Group for its Taxable Period that includes the Closing Date, including, without limitation, any Taxes attributable to the restoration of a "deferred intercompany transaction" within the meaning of Treasury Regulations section 1.1502-13(a)(2), and the recognition of excess loss accounts.

(vii) any and all federal income Taxes attributable to any income or gain recognized as a result of, and in accordance with, the making of the 338 Elections (if any), subject to Skandia America's right to receive payment from the Purchaser for the 338 Tax Costs;

(viii) any and all federal, state, local, and foreign income or franchise Taxes incurred in Taxable Periods beginning after December 31, 1994, but attributable to any item of income or gain of a partnership that is properly allocable to a Taxable Period (or portion thereof) ending on or before such date;

(ix) any and all unpaid federal, state, local, or foreign Taxes imposed on a Company or a Subsidiary directly or indirectly, whether determined on a separate, consolidated, combined, unitary, or group basis, (A) pursuant to Treasury Regulations section 1.1502-6 or any comparable provisions of state, local, or foreign law by reason of a Company or a Subsidiary having been a member of a consolidated, combined, unitary, or group Tax Return for a Taxable Period ending on or before the Closing Date, or (B) pursuant to any guaranty, indemnification, or similar agreement made on or before the Closing Date relating to the sharing of liability for, or payment of, Taxes; or (C) arising out of, resulting from, or attributable to any transaction contemplated by this Agreement (including, but not limited to, any transaction described or set forth in Sections 5.12, 5.13, 5.17, and 6.10) other than the 338 Elections;

(x) any and all Taxes imposed on the Purchaser, the Companies, and/or their Subsidiaries pursuant to sections 1441 and 1442 of the Code (concerning withholding of Tax on nonresident aliens and foreign corporations), section 1445 (concerning the



imposition of tax on the disposition of United States real property interests), and Subchapter A, Chapter 24, of the Code (concerning withholding from wages) with respect to any payment made by the Purchaser, a Company, or a Subsidiary to one of more of the Sellers pursuant to this Agreement or any other agreement made by and between the parties in connection with the transactions contemplated herein; and

(xi) any reasonable expense (including attorneys' and accountants' fees) incurred by the Purchaser, a Company, a Subsidiary, or any of their successors or assigns in connection with any Tax described in this Section 8.3(a) taking into consideration the provisions of Section 8.3(c)(iii).

(b) The Purchaser agrees to indemnify, defend, and hold harmless the Sellers (and their respective officers, directors, employees, Affiliates, successors, and assigns) from and against: (i) any federal income Tax imposed on the Companies or their Subsidiaries for Taxable Periods beginning after the Closing Date; (ii) any and all Taxes (other than federal income Taxes) imposed on the Companies and/or their Subsidiaries for Taxable Periods beginning after December 31, 1994; and (iii) any reasonable expense (including attorneys' and accountants' fees) incurred by the Sellers or any of their successors or assigns in connection with any Tax described in this Section 8.3(b) taking into consideration the provisions of Section 8.3(c)(iii), provided, however, that the

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Purchaser shall not be liable to the Sellers for a Tax described in either clause (i) or (ii) hereof to the extent that the Sellers are liable for such Tax under Section 8.3(a).

(c) (i) Unless otherwise provided herein, any party seeking an indemnity payment pursuant to this Section 8.3 from another party, shall deliver to the other party written notice of claim for such indemnity payment, which notice shall include a detailed calculation of the amount of the requested indemnity payment (the "Indemnity Claim"). To the extent that the notified party objects to the computation of the indemnity payment requested, the notified party shall provide a written objection to the party seeking an indemnity payment within ten (10) Business Days after receipt of the Indemnity Claim from the party seeking an indemnity payment, which notice shall include any objection to the computation of the indemnity amount. Both parties shall agree to the calculation of the indemnity payment and both parties shall negotiate in good faith to resolve any matters in dispute. If the Sellers and the Purchaser are unable to resolve any matters in dispute within ten (10) Business Days after the receipt by the party seeking an indemnity payment of the other party's objection to the

calculation of the indemnity amount, such disputes shall be submitted to the Tax Settlement Auditor for resolution. Any amount owing under Section 8.3 shall be paid before the earlier of (x) in the absence of a dispute with respect to the calculation of the payment due, ten (10) Business Days after a party receives an Indemnity Claim, or (y) in the case of a dispute, within five (5) Business Days after the parties settle any such dispute or receive the Tax Settlement Auditor's determination with respect to any dispute submitted to the Tax Settlement Auditor. The parties shall cooperate with each other and promptly make available to each other all data and other information as may be reasonably requested by each party to substantiate any Indemnity Claim.

(ii) Each party to this Agreement shall promptly notify the other party in writing of the commencement of any claim, audit, examination, or other proposed change or adjustment of which it or any of their Affiliates have been informed of by any taxing authority which may affect the liability of the other party under this Section 8.3 (each a "Tax Claim"). Such notice shall describe the asserted Tax Claim in reasonable detail and shall include copies of any notices and other documents received from any taxing authority in respect of any such asserted Tax Claim.

(iii) At the Sellers' expense, the Sellers shall have the sole right to represent the Companies' and their Subsidiaries' interests with respect to any issue in any tax audit or administrative or court proceeding relating to Taxes for which the Sellers are responsible hereunder, to employ counsel of their choice, to settle such issues and take any other actions in their discretion in connection with such issues; provided, however, that, the Sellers  
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shall not agree to any settlement of an issue without the consent of the Purchaser, which consent shall not be unreasonably withheld, to the extent that such settlement would have an effect on the Purchaser, the Companies or their Subsidiaries with respect to any Taxes which are the responsibility of the Purchaser hereunder or with respect to any Taxable Period (or portion thereof) beginning after December 31, 1994.

(d) For any Taxable Period that begins on or before and ends after the Closing Date (or the date of any Financial Statement, Interim Financial Statement, or Statutory Financial Statement), for purposes of apportioning a Tax to the portion of such Taxable Period that ends on the Closing Date (or such other date), (i) the parties shall treat that date as the last day of such Taxable Period, and (ii) the Tax for the Taxable Period that is allocable to the portion of the Taxable Period ending on such date shall be (A), in the case of a Tax that is not based on income or

gross receipts, the total Tax for the Taxable Period multiplied by a fraction, the numerator of which is the number of days in the Taxable Period ending on (and including) such date and the denominator of which is the total number of days in such Taxable Period, and (B), in the case of a Tax that is based on income or gross receipts, the Tax that would be due with respect to the period ending on (and including) such date, based on actual operations of the Company and the Subsidiaries during such period as shown on their permanent books and records.

8.4 Miscellaneous. (a) All representations and warranties contained

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in Section 3.28 (Employee Benefits) and Section 3.32 (Tax Matters) with respect to any Tax shall survive the Closing and shall terminate and expire on the later to occur of (i) the lapse of the statute of limitations with respect to the assessment of such Tax (including any extensions thereof) and (ii) sixty (60) days after the final administrative or judicial determination thereof, and no claim may be asserted thereafter with the exception of claims arising out of any fact, circumstance, action, or proceeding to which the Purchaser shall have given notice to the Sellers prior to the termination of such period of the reasonable belief that a misrepresentation or breach of a warranty had occurred and that a Tax will arise therefrom.

(b) For purposes of Section 8.3, all Taxes of the Companies and their Subsidiaries for all Taxable Periods ending on or before December 31, 1994 shall be determined without regard to the carryback of any net operating loss, capital loss, general business credit, or other Tax attribute from a Taxable Period beginning after December 31, 1994.

(c) Any indemnity payment made pursuant to Section 8.2 or Section 8.3 or other payment made pursuant to this Agreement shall be treated by the parties and their Affiliates on their Tax Returns as an adjustment to the consideration being provided for the Shares hereunder unless such treatment would be inconsistent with a judgment which has been rendered in any judicial or administrative proceeding governing such treatment, in which case the indemnifying party shall also indemnify the indemnified party for any increase in liability for Taxes that is imposed on the indemnified party, any Company, and/or any Subsidiary, which is attributable to the indemnity payment or other payment made by the indemnifying party being treated as currently taxable. This Section 8.4(c) shall not bind the parties, however, with respect to the tax treatment by the Sellers Group for the Short Period Tax and the 338 Tax Costs.

(d) For purposes of this Agreement, "Tax Settlement Auditor" shall mean a nationally recognized accounting firm or a law firm mutually acceptable to the Purchaser and the Sellers; provided, that, if the Purchaser and the

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Sellers are unable to agree as to a Tax Settlement Auditor within five (5) Business Days then each of the Sellers and the Purchaser shall select their own nationally recognized accounting firm or law firm within an additional three (3) Business Days, which two firms shall within an additional five (5) Business Days select a third nationally recognized accounting firm or law firm to act as Tax Settlement Auditor. Unless otherwise indicated, the Tax Settlement Auditor's resolution of any disputed item under this Agreement shall in each case be reflected in a written report which will be delivered to the Purchaser and the Sellers (on the same day) as soon as reasonably practicable after the dispute was submitted to the Tax Settlement Auditor. The Tax Settlement Auditor's resolution of any dispute will be final and binding upon the Sellers and the Purchaser and the Sellers and the Purchaser will each pay one-half of the fees and expenses of the Tax Settlement Auditor. The Sellers and the Purchaser will fully cooperate with the Tax Settlement Auditor to resolve any disputed matters.

#### ARTICLE IX

##### TERMINATION

9.1 Termination of Agreement. This Agreement may be terminated prior to the Closing:

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(a) by either the Purchaser, on the one hand, or by Skandia U.S., on the other hand, upon written notice to the other if, without fault of the terminating party, the Closing shall not have occurred on or before December 31, 1995; provided, however, that if all conditions to the

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obligations of the Purchaser to consummate the Closing (as set forth in Article VI hereof), other than obtaining requisite Consents of insurance regulatory authorities for the transactions contemplated by this Agreement, have then been satisfied, and the Purchaser is diligently seeking to obtain such insurance regulatory Consents, then the right to terminate this Agreement pursuant to this clause (a) shall not be available to any party hereto, and the obligations hereunder of the parties hereto shall be extended, until March 31, 1996; or

(b) at any time by mutual agreement in writing of the parties hereto.

9.2 Effect of Termination. In the event of the termination of this

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Agreement pursuant to Section 9.1, this Agreement shall thereafter become void and have no effect, and no party hereto shall have any liability or obligation to any other party hereto in respect of this Agreement, except that the provisions of Section 5.2(b) (Confidentiality), Section 5.6 (Public Announcements), Article X (Miscellaneous), this Section 9.2 and, solely for purposes of the next sentence, Sections 8.2 (Indemnification) and 8.3 (Tax Indemnification) shall survive any such termination. Nothing herein shall relieve any party from liability for any breach of any of its representations, warranties, covenants or agreements contained in this Agreement prior to termination of this Agreement or any obligations hereunder.

ARTICLE X

MISCELLANEOUS

10.1 Notices. Any notices and other communications required to be

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given pursuant to this Agreement shall be in writing and shall be effective upon delivery by hand or upon receipt if sent by certified or registered mail (postage prepaid and return receipt requested) or by a nationally recognized overnight courier service (appropriately marked for overnight delivery) or upon transmission if sent by telex or facsimile (with request for immediate confirmation of receipt in a manner customary for communications of such respective type and with physical delivery of the communication being made by one of the other means specified in this Section 10.1 as promptly as practicable thereafter). Notices are to be addressed as follows:

(a) If to any of the Sellers to:

Skandia America Corporation  
One Liberty Plaza  
New York, New York 10006  
Attention: General Counsel  
Telecopy No.: (212) 571-3630

with a copy to:

Cadwalader, Wickersham & Taft  
100 Maiden Lane  
New York, New York 10038  
Attention: Lou Bevilacqua, Esq.  
Telecopy No.: (212) 504-6666

and

Skandia Insurance Company Ltd (publ)  
S-103 50 Stockholm  
Sweden 44  
Attention: General Counsel  
Telecopy No.: 46-8-788 16 80

(b) If to the Purchaser to:

Fund American Enterprises Holdings, Inc.  
The 1820 House  
Main Street  
Norwich, Vermont 05055  
Attention: Allan L. Waters  
Telecopy No.: (802) 649-2240

with a copy to:

Dewey Ballantine  
1301 Avenue of the Americas  
New York, NY 10019  
Attention: William W. Rosenblatt, Esq.  
Telecopy No.: (212) 259-6333

or to such other respective addresses as any of the parties hereto shall designate to the others by like notice, provided that notice of a change of address shall be effective only upon receipt thereof.

10.2 Fees and Expenses. Except as provided herein, each of the

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parties hereto shall pay its own respective fees and expenses (including, without limitation, the fees of any attorneys, accountants, investment bankers or other Representatives) incurred in connection with this Agreement and the transactions contemplated hereby, whether or not such transactions are consummated.

10.3 Specific Performance. The Sellers acknowledge and agree that in

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the event of any breach or default by the Sellers under this Agreement, the Purchaser would be irreparably and immediately harmed and could not be made whole by monetary damages. It is accordingly agreed that the parties hereto will (i) waive, in any action, suit or proceeding for specific performance or other relief referred to in this paragraph, the defense of adequacy of money damages or a remedy at law, and (ii) be entitled, in addition to any other remedy to which any of them may be entitled at law or in equity, to compel specific performance of this Agreement or to obtain a temporary restraining order, preliminary and permanent injunction or other

equitable relief or remedy, in any action, suit or proceeding instituted in any state or federal court.

10.4 Consent to Jurisdiction; Service of Process. Any action, suit

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or proceeding arising out of or relating to this Agreement may be instituted in any United States Federal court or any state court located in Boston, Massachusetts, and each party agrees not to assert, by way of motion, as a defense or otherwise, in any such action, suit or proceeding, any claim it may now or hereafter have that it is not subject personally to the jurisdiction of such court, that the action, suit or proceeding is brought in an inconvenient forum, that the venue of the action, suit or proceeding is improper or that this Agreement or the subject matter hereof may not be enforced in or by such court. Each party further irrevocably submits to the jurisdiction of such court in any such action, suit or proceeding, and irrevocably agrees to be bound by any final judgment rendered thereby in connection with this Agreement from which no appeal has been taken or is available. Any and all service of process and any other notice in any such action, suit or proceeding shall be effective against any party if given personally or by registered or certified mail, postage prepaid and return receipt requested, or by personal service on such party. Nothing contained herein shall be deemed to affect the right of any party to serve process in any manner permitted by law or to commence legal proceedings or otherwise proceed against any other party in any other jurisdiction.

10.5 Entire Agreement; Waivers and Amendments. This Agreement

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(including the Exhibits and Schedules hereto and the documents and instruments referred to herein) contains the entire agreement and understanding of the parties with respect to the subject matter hereof and supersedes all prior written or oral agreements and understandings with respect thereto. This Agreement may only be amended or modified, and the terms hereof may only be waived, by a writing signed by all parties hereto or, in the case of a waiver, by the party entitled to the benefit of the terms being waived.

10.6 Assignment; Binding Effect. This Agreement may not be assigned

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or delegated, in whole or in part, by any party hereto without the prior written consent of all other parties hereto, except that the Purchaser shall have the right at any time, without such consent, to assign its right hereunder to purchase any or all of the Shares to any wholly owned Subsidiary of the Purchaser (in which event, the Purchaser shall guarantee the performance by such Subsidiary of the Purchaser's obligation hereunder to purchase such Shares). Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of

the parties hereto and their respective successors and assigns.

10.7 Severability. In the event that any provision of this Agreement

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shall be declared invalid or unenforceable by a court of competent jurisdiction in any jurisdiction, such provision shall, as to such jurisdiction, be ineffective to the extent declared invalid or unenforceable without affecting the validity or enforceability of the other provisions of this Agreement, and the remainder of this Agreement shall remain binding on the parties hereto. However, in the event that any such provision shall be declared unenforceable due to its scope, breadth or duration, then it shall be modified to the scope, breadth or duration permitted by law or Governmental Entities and shall continue to be fully enforceable as so modified.

10.8 No Third Party Beneficiaries. This Agreement is for the benefit

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of the parties hereto and is not intended to confer upon any other Person any rights or remedies hereunder.

10.9 Governing Law. This Agreement shall be governed by and

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construed in accordance with the internal laws of the State of New York, without giving effect to the principles of conflicts of law thereof.

10.10 Interpretation. This Agreement is the result of arms-length

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negotiations between the parties hereto and has been prepared jointly by the parties. In applying and interpreting the provisions of this Agreement, there shall be no presumption that the Agreement was prepared by any one party or that the Agreement shall be construed in favor of or against any one party.

10.11 Captions. The Article and Section Headings in this Agreement

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are inserted for convenience of reference only, and shall not affect the interpretation of this Agreement.

10.12 Counterparts. This Agreement may be executed in two or more

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counterparts, each of which shall be deemed an original and all of which together shall be considered one and the same agreement.



IN WITNESS WHEREOF, each of the parties has executed this Agreement as of the date first written above.

FUND AMERICAN ENTERPRISES  
HOLDINGS, INC.

By: \_\_\_\_\_  
Name:  
Title:

SKANDIA U.S. HOLDING CORPORATION

By: \_\_\_\_\_  
Name:  
Title:

SKANDIA AMERICA CORPORATION

By: \_\_\_\_\_  
Name:  
Title:

CONSENTS OF THE PURCHASER  
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None

LEGAL PROCEEDINGS OF THE PURCHASER  
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None

FUND AMERICAN

VOLUNTARY DEFERRED COMPENSATION PLAN

(As Adopted April 9, 1992)  
(Revised November 10, 1995)

FUND AMERICAN  
VOLUNTARY DEFERRED COMPENSATION PLAN

(Adopted April 9, 1992)  
(Revised November 10, 1995)

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FUND AMERICAN  
VOLUNTARY DEFERRED COMPENSATION PLAN  
(Adopted April 9, 1992)  
(Revised November 10, 1995)

ARTICLE I

PURPOSE OF PLAN

- 1.1 The purpose of this Plan is to provide eligible Directors, Officers and Key Employees of Fund American with the opportunity to defer compensation. The Plan is also intended to establish a method of attracting and retaining persons whose abilities, experience and judgement can contribute to the long-term strategic objectives of Fund American.
- 1.2 The Committee intends that the Plan be an unfunded non-qualified deferred compensation plan maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees of Fund American, and that contributions to the Plan shall be deductible by Fund American pursuant to Section 404 (a)(5) of the Internal Revenue Code of 1986, as amended (the "IRC").

ARTICLE II  
DEFINITIONS

As used in this Plan, the following terms shall have the meanings hereinafter set forth:

- 2.1 "Base Salary" means the annual salary paid to Fund American Officers and Key Employees which is paid bi-weekly (or other regular interval) during the calendar year.
- 2.2 "Beneficiary" means any person(s) or legal entity(ies) designated by the Participant or otherwise determined in accordance with ARTICLE V.
- 2.3 "Board of Directors" means the Board of Directors of the Company.
- 2.4 "Committee" means the Executive Compensation Committee as initially appointed by the Board of Directors and as appointed from time to time by written action of the Board of Directors.

- 2.5 "Company" means Fund American Enterprises Holdings, Inc. (formerly The Fund American Companies, Inc.), a Delaware corporation, and its successors and assigns.
- 2.6 "Compensation" means, by type, Base Salary, cash bonuses, performance units, stock appreciation rights, performance shares, restricted stock, Director's Fees, warrants, stock options and other qualifying remuneration paid or otherwise payable by Fund American, as determined by the Committee.
- 2.7 "Deferral Period" means the Plan Year(s) in which the Participant would otherwise receive Compensation but for the election made to defer such Compensation pursuant to ARTICLE IV.
- 2.8 "Deferred Compensation" means Compensation deferred pursuant to this Plan.
- 2.9 "Deferred Compensation Account" means the individual account maintained under the Plan for a Participant.
- 2.10 "Deferred Compensation Election Form" means the standardized election form that each Participant must execute in accordance with ARTICLE IV in order to participate in the Plan, an example of which is attached hereto as EXHIBIT # 1.
- 2.11 "Director" means a director of the Company who is not an employee of Fund American.
- 2.12 "Director's Fees" means any annual retainer amount plus all fees for meetings attended of the Company.
- 2.13 "Eligible Participant" means Directors, Officers and Key Employees of Fund American designated by the Committee as eligible to participate in the Plan.
- 2.14 "FFC Share(s)" means a share(s) of Fund American Enterprises Holdings, Inc., common stock (\$1.00 par value) as listed on the New York Stock Exchange (symbol FFC).
- 2.15 "Fund American" means the Company, its wholly owned subsidiary, Fund American Enterprises, Inc., a Delaware corporation, White Mountains Holdings, Inc., White Mountains Insurance Company and other affiliates designated by the Committee or the Board of Directors.
- 2.16 "Investment Option" means an option made available to Participants under ARTICLE VI.
- 2.17 "Investment Option Election" means a Participant election made under ARTICLE VI.

- 2.18 "Key Employee" means any executive employee or other overtime-exempt employee of Fund American that the Committee in its sole discretion decides is important to the ongoing business objectives of Fund American.
- 2.19 "Market Price of FFC Share(s)" means the closing price per share of FFC listed on the NYSE composite tape or, if the NYSE is closed for a particular day, the closing NYSE price of FFC on the previous day.
- 2.20 "Officer" means an officer of Fund American as defined in the Corporate By-Laws.
- 2.21 "Participant" for any Plan Year means an Eligible Participant who elects to participate in the Plan in accordance with the procedures set forth in ARTICLE IV.
- 2.22 "Plan" means the Fund American Voluntary Deferred Compensation Plan as embodied herein and as amended from time to time.
- 2.23 "Plan Year" means the twelve (12) month calendar year beginning January 1 and ending December 31, or shorter period as the case may be in the year the Plan is adopted or terminated.
- 2.24 "Valuation Date" means the last business day of either a calendar year or calendar quarter, as the Committee will determine from time to time.
- 2.25 Construction. The masculine pronoun shall be deemed to include the -----  
feminine, and the singular number shall be deemed to include the plural unless a different meaning is plainly required by the context.

ARTICLE III  
ELIGIBILITY

Each Director who receives Director's Fees, and each Officer and Key Employee who receives Compensation as an employee of Fund American, shall be eligible to participate in the Plan if selected by the Committee. The Committee has total discretion to determine who is eligible to defer Compensation on a Plan Year by Plan Year basis.

ARTICLE IV  
PARTICIPATION



4.1 Election To Participate. Subject to Sections 4.2, in order to participate  
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in the Plan for a particular Plan Year, an eligible Director, Officer, or  
Key Employee must make a valid election by executing and filing with the  
Committee, before the commencement of such Plan Year, a Deferred  
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Compensation Election Form, an example of which is attached hereto as  
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EXHIBIT # 1.

4.2 (i) New Participant. Notwithstanding Section 4.1, but subject to section  
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4.2(ii), a newly appointed Director, or newly hired Officer or Key  
Employee, who becomes an Eligible Participant after the first day of the  
Plan Year, may elect to participate in the Plan for such Plan Year with  
respect to future Compensation by filing a Deferred Compensation Election  
Form within fifteen (15) days after his initial date of appointment or  
employment.

(ii) 365 Day Existing Option Timing Election. Notwithstanding Section  
-----  
4.1, and solely for purposes of the transition rule for converting Existing  
Options (see Section 6.9 herein), an election to convert Existing Options  
must be made on a Deferred Compensation Election Form at least 365 calendar  
days prior to the date (the "Trigger Date") on which such Existing  
Option(s) either:

- 1) becomes no longer subject to a risk of forfeiture (e.g. restricted  
stock);
- 2) lapses or is no longer exercisable (e.g. options, warrants, SARs);  
or
- 3) is deemed earned and payable by the Board of Directors (e.g.  
performance shares/units).

4.3 Election Not Revocable. Except as provided in Section 8.5, a Deferred  
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Compensation Election Form, once executed and filed with the Committee,  
cannot be revoked for such Compensation elected to be deferred pursuant to  
such form.

4.4 Vesting. A Participant will be vested in his entire Deferred Compensation  
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Account balance at all times and will not be subject to forfeiture for any  
reason.

4.5 New Elections Permitted for Each Year. A Participant is not required to  
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defer future Compensation by reason of making an election to defer  
Compensation for current or prior Plan Years. Future Compensation can only  
be deferred by filing a Deferred Compensation Election Form for the  
appropriate Plan Year.

4.6 Minimum Amounts. The minimum amount of Compensation which may be deferred  
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by an Eligible Participant for any Plan Year is \$5,000 for each particular  
type of Compensation. The maximum amount of Compensation which may be  
deferred for any Plan Year is 100% of an Eligible Participant's  
Compensation for such Plan Year.

4.7 Rounding. Subject to the minimum deferral requirement (Section 4.6), if a  
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Participant elects to defer less than 100% of a particular type of  
Compensation for such Plan Year, such deferral will be limited to even  
dollar amounts rounded to the closest \$5,000 increment. In situations where  
the dollar amount of such particular type of Compensation is not yet fixed  
or determinable, Participants can elect to defer a stated percentage (%) of  
such Compensation in 10% increments, subject to rounding to the closest  
\$5,000 increment.

ARTICLE V  
GENERAL PROVISIONS

5.1 No Right to Payment Except as Provided in Plan. No Participant, or other  
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Eligible Participant or Beneficiary, shall have any right to any payment or  
benefit hereunder except to the extent provided in the Plan.

5.2 Employment Rights. The employment rights of any Participant or other  
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Eligible Participant shall not be enlarged, guaranteed or affected by  
reason of the provisions of the Plan.

5.3 Recipient Under a Disability. If the Committee determines that any person  
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to whom a payment is due hereunder is a minor, or is adjudicated  
incompetent by reason of physical or mental disability, the Committee shall  
have the power to cause the payments becoming due to such person to be made  
to the legal guardian for the benefit of the minor or incompetent, without  
responsibility of Fund American or the Committee to see to the application  
of such payment, unless prior to such payment claim is made therefor by a  
duly appointed legal representative. Payments made pursuant to such power  
shall operate as a complete discharge of Fund American and the Committee.

5.4 Designation of Beneficiary. Each Participant may designate any person(s)  
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or legal entity(ies), including his estate, as his Beneficiary under the  
Plan in writing to the Committee. A Participant may at any time

revoke or change his designation of Beneficiary by writing to the Committee. If no person or legal entity shall be designated by a Participant as his Beneficiary, or if no designated Beneficiary survives him, his estate shall be his Beneficiary.

- 5.5 Elections. Any election made or notice given by a Participant pursuant to -----  
the Plan shall be in writing to the Committee, or to such representative as may be designated by the Committee for such purpose. Notice shall be deemed to have been made or given on the date received by the Committee or its designated representative.
- 5.6 Effect on Other Plans. No amount of Compensation withheld under the terms -----  
of this Plan shall be included as compensation under any tax-qualified plan sponsored by Fund American.
- 5.7 Controlling Law. The validity of the Plan or any of its provisions shall -----  
be determined under, and it shall be construed and administered according to, the laws of the State of Vermont.

ARTICLE VI  
DEFERRED COMPENSATION ACCOUNTS

- 6.1 Accounts. Upon receipt of a Participant's valid election, the Committee -----  
shall establish, as a bookkeeping entry only, a Deferred Compensation Account for such Participant. The Committee shall thereafter record to each Participant's Deferred Compensation Account for a Plan Year, the amount(s) which he elected to defer in accordance with ARTICLE IV, which would have otherwise been paid to the Participant during the Plan Year.
- 6.2 Adjustments To Accounts. The balance in a Participant's Deferred -----  
Compensation Account at any time will be calculated on a daily basis by: i) aggregating all current or prior Plan Years Deferred Compensation elected pursuant to ARTICLE IV; ii) adding (subtracting) thereto the cumulative interest equivalent, whether positive or negative, earned on such Deferred Compensation computed in accordance with the rules of Sections 6.3, 6.4 and 6.5.; and iii) from such total obtained, subtracting the aggregate payments made to the Participant in current or prior Plan Years in accordance with ARTICLE VIII and ARTICLE X.

- 6.3 Investment of Deferred Compensation. Deferred Compensation shall be  
 -----  
 "theoretically invested" under any Investment Options described below as  
 elected by the Participant.
- 6.4 Prime Rate Investment Option. Interest equivalents, equal to the product  
 -----  
 of: i) Daily Prime Rate; multiplied by ii) the Deferred Compensation  
 balance existing as of the end of the previous day in the Prime Rate  
 Investment Option, shall be credited each day to a Participant's Deferred  
 Compensation Account.
- 6.4(a) Daily Prime Rate. Expressed as a percentage, the "Daily Prime Rate" as  
 -----  
 described in Section 6.4 will be calculated by dividing the "base rate"  
 of interest announced publicly by Citibank, N.A. in New York, N.Y. (or  
 prime or base rate of another large commercial bank selected by the  
 Committee), as in effect on the last business day of each month, by 360.
- 6.5 Phantom Share Investment Option. Interest equivalents shall be credited  
 -----  
 to (subtracted from) amounts in the Phantom Share Investment Option on a  
 daily basis. Such daily interest equivalents shall be calculated as  
 follows: i) take the aggregate number of Phantom Shares in a  
 Participant's Phantom Share Investment Option at the close of business on  
 the preceding calendar day; multiplied by ii) the difference between the  
 -----  
 FFC Share closing Market Price on the current calendar day, plus  
 -----  
 dividends paid or the FFC Share closing Market Price on the preceding  
 -----  
 calendar day. For purposes of comparability, the above calculation shall  
 be adjusted for any stock splits or stock dividends occurring during the  
 current calendar day which affects the number of Phantom Shares a  
 Participant held on the preceding calendar day.  
 -----
- 6.5(a) Phantom Shares Granted to Participant. Unless the transition rule for  
 -----  
 exchanging existing stock rights applies (pursuant to Section 6.9), and  
 subject to the Phantom Share Cumulative Dollar Limitation contained at  
 Section 6.10(b), the number of Phantom Shares granted to a Participant  
 will be determined by dividing the dollar amount of Deferred Compensation  
 allocated to the Phantom Share Investment Option by the Conversion Price.  
 Such total amount of Phantom Shares determined will then be rounded to  
 the next one-tenth (1/10) Phantom Share.

6.5(b) Conversion Price. Other than Compensation being deferred pursuant to

-----  
Section 6.9, the Conversion Price of FFC Shares used to calculate the number of Phantom Shares to be added to a Participant's Deferred Compensation Account will be the closing Market Price of FFC Shares at the end of the business day within the Plan Year where such Deferred Compensation would otherwise have been paid to the Participant if he had not elected to participate in the Plan.

6.5(c) Dividends Reinvested in Phantom Share Investment Option. For purposes of

-----  
Section 6.5, dividends "paid or payable" shall mean either in cash or property, but shall exclude stock dividends or stock splits, as the case may be. Further, dividends paid or declared payable on the preceding day will be treated as automatically reinvested in FFC Shares as of the end of such day at the closing Market Price of FFC Shares; provided the Participant's account held Phantom Shares on the last day the Company declares as the date stockholders of record are entitled to receive such dividend on FFC Shares (i.e. the "ex-dividend" date).

6.5(d) Other Dilutive and Anti-dilutive Transactions Affecting Phantom Shares.

-----  
In addition to Section 6.5(c), and subject to other provisions in the Plan, the Committee has the discretion to make appropriate adjustments to a Participant's account invested in the Phantom Share Investment Option where a "capital transaction" or "corporate reorganization" has the affect of changing the economic equivalent number of Phantom Shares that a Participant has been credited under this Plan.

The Committee shall make an adjustment to each Participant's account so affected (if any), either positive or negative as the case may be, to ensure that neither unintended economic benefits nor detriments are conferred on a Participant solely by reason of such capital transaction or corporate reorganization.

6.5(e) Capital Transaction or Corporate Reorganization. Solely for purposes of

-----  
Section 6.5(d), a "capital transaction" or "corporate reorganization" shall not be limited to its ordinary meaning if in fact a Participant would be conferred an economic benefit or detriment by some other corporate transaction which is not literally considered a capital transaction or corporate reorganization under common business usage of said terms.

- 6.6 Equity Fund Investment Option. Interest equivalents, equal to the  
-----  
product of: i) the daily published total return for the Oakmark Fund;  
multiplied by ii) the Deferred Compensation balance existing as of the  
end of the previous day in the Equity Fund Investment Option, shall be  
credited each day to a Participant's Deferred Compensation Account.
- 6.7 Fixed-Income Fund Investment Option. Interest equivalents, equal to the  
-----  
product of: i) the daily published total return for the PIMCo Total  
Return Fund; multiplied by ii) the Deferred Compensation balance existing  
as of the end of the previous day in the Fixed-Income Fund Investment  
Option, shall be credited each day to a Participant's Deferred  
Compensation Account.
- 6.8 Other Investment Options. The Committee may make other Investment  
-----  
Options available under the Plan from time to time. Earnings (loss) shall  
be credited to (subtracted from) amounts invested in such other  
Investment Options on a daily basis as determined by the Committee.
- 6.9 Transition Rule for Converting Existing Rights (or Derivative Rights) to  
-----  
FFC Shares. For purposes of establishing a Participant's Deferred  
-----  
Compensation Account, a transition rule shall apply for Participants  
electing to exchange and convert stock options, SARs, warrants and other  
rights to FFC Shares (or derivative rights) granted pursuant to the 1985  
Long-Term Incentive Plan or other contractual agreement between Fund  
American and the Participant (collectively "Existing Options").
- 6.9(a) Election to Exchange and Convert Existing Options. Eligible Participants  
-----  
can, upon written election, choose to exchange and convert their Existing  
Options either for Phantom Shares granted pursuant to this Plan and  
calculated as set forth in the "Phantom Share Conversion Formula"  
contained in Section 6.9(c) or alternatively, or in combination with the  
Phantom Share Conversion Option, elect to exchange and convert Existing  
Options into the Prime Rate Investment Option, calculated as set forth in  
the "Prime Rate Dollar Equivalent Conversion Formula" contained in  
Section 6.9(d). Such conversion privilege is still subject to all other  
provisions of this Plan, including the minimum deferral rules of Article  
IV and Article VIII, the 365 day advance notice requirement in Section  
4.2(ii) and the Phantom Share Cumulative Dollar Limitation in Section  
6.10(b).

6.9(b) Conversion Price for Exchanging Existing Options. Solely for purposes of

-----  
Section 6.9, and in addition to the irrevocable election to exchange and convert Existing Options pursuant to Section 6.9(a), the Conversion Price of FFC Shares used to calculate the number of Phantom Shares to be added to a Participant's Deferred Compensation Account will be the closing Market Price of FFC Shares at the end of the business day elected by the Participant and stated in the Deferred Compensation Election Form filed with the Committee. Each Participant must select one of two allowable dates to calculate the amount of Compensation being converted into this Plan:

- 1) the same date the election to irrevocably convert Existing Options is made pursuant to Section 6.9(a); or
- 2) Depending on the type of Compensation being converted, the appropriate "Trigger Date" as the term is defined in Section 4.2(ii).

6.9(c) Phantom Share Conversion Formula.

-----  
$$([A - \$B] / \$A) \times C = D$$

Where A = Conversion Price of FFC Shares as defined in Section 6.5(b) or 6.9(b)  
Where B = Weighted average exercise price for FFC Shares under Existing Options  
Where C = Total FFC Shares Participant could have purchased using Existing Options  
Where D = Total Phantom Shares issued to Participant in exchange for Existing Options

6.9(d) Prime Rate Dollar Equivalent Conversion Formula.

-----  
$$[\$A - \$B] \times C = D$$

Where A = Conversion Price of FFC Shares as defined in Section 6.5(b) or 6.9(b)  
Where B = Weighted average exercise price for FFC Shares under Existing Options  
Where C = Total FFC Shares Participant could have purchased using Existing Options  
Where D = Total Dollar Equivalent credited to Prime Rate Investment Option

6.9(e) Legal Rights after Exchanging Existing Options. Notwithstanding anything to the contrary, a Participant who makes an irrevocable election to convert Existing Options pursuant to Section 6.9 herein understands

that they are forfeiting all legal rights to such Existing Options that they held immediately prior to making the election to convert such Existing Options into this Plan.

6.10 Investment Option Election. Except as provided in this Section 6.10,

amounts invested in the Phantom Share Investment Option may not be transferred to another Investment Option by the Participant although amounts invested in any other Investment Option may be transferred annually among any available Investment Option (including a transfer to the Phantom Share Investment Option) in accordance with procedures established by the Committee. Such transfer election may be made only within the 10-business day period commencing on the third business day following release of the Company's third quarter financial information.

The foregoing limitation on transfers of amounts invested in the Phantom Share Investment Option has been included in this Plan so that amounts invested in the Phantom Share Investment Option shall be excluded from the definition of "derivative securities" contained in Rule 16a-1(c) (3) (or any successor) issued under the Securities Exchange Act of 1934. If such rule is withdrawn, amended or reinterpreted so that the foregoing limitation is no longer required to disqualify such amounts as derivative securities, the foregoing limitation shall be rescinded.

An Investment Option election shall remain in effect for future Deferred Compensation (including amounts deferred in subsequent Plan Years) unless and until a new Investment Option Election is filed with the Committee.

6.10(a) Investment Option Allocation. Subject to the Phantom Share Cumulative

Dollar Limitation contained at Section 6.10(b), each Participant can elect to allocate each type of Deferred Compensation for a particular Plan Year among the available Investment Options as described in Sections 6.4, 6.5, 6.6, 6.7 and 6.8. However, if more than one Investment Option is selected for a type of Deferred Compensation such allocation cannot be less than \$5,000 with respect to any one Investment Option so elected.

6.10(b) Phantom Share Cumulative Dollar Limitation. Notwithstanding a

Participant's ability to allocate Deferred Compensation among the available Investment Options, a Participant's election to invest Deferred



Compensation in the Phantom Share Investment Option may be limited (either in whole or in part) as described herein:

- (i) Without requiring authorization from the Board of Directors, but subject to all other provisions in this Plan, a Participant may continue to invest Deferred Compensation in the Phantom Share Investment Option to the extent the portion of a Participant's Deferred Compensation Account balance invested in the Phantom Share Investment Option does not have a fair market value which exceeds twenty million dollars (\$20 million).
- (ii) Unless authorized by the Board of Directors, a Participant is precluded from investing additional Deferred Compensation in the Phantom Share Investment Option if the portion of a Participant's Deferred Compensation Account balance previously invested in the Phantom Share Investment Option has a fair market value which exceeds twenty million dollars (\$20 million).

6.11 Deletion of Investment Options. Except as provided in Section 15.2, the  
-----  
Committee cannot delete or alter the terms of an available Investment Option without the written permission of those Participants affected by such proposed amendment whose Deferred Compensation is invested in such Investment Option.

6.12 Effect On Other Plans. If, because of a Participant's deferral of  
-----  
Compensation under this Plan, a Participant's benefits in any other Fund American plan (either qualified or nonqualified) are reduced, Fund American shall provide a supplemental credit. Such supplemental credit however, shall not be provided through this Plan but through some other plan, agreement or other mechanism as the Committee deems appropriate.

ARTICLE VII  
PARTICIPANTS' RIGHTS UNSECURED

7.1 Unsecured Creditors. Amounts credited to Deferred Compensation Accounts  
-----  
shall be dealt with in all respects as working capital of Fund American, therefore the right of a Participant to receive any distribution hereunder shall be an unsecured claim against the general assets of Fund American.

7.2 No Actual Investment Required. Subject to ARTICLE XVI, no assets of Fund

-----  
American shall in any way be held in trust for, or be subject to, any prior claim by a Director, an Officer, or a Key Employee, or his Beneficiary under the Plan. Further, neither Fund American nor the Committee shall have any duty whatsoever to invest any amounts credited to any Deferred Compensation Accounts established under the Plan.

ARTICLE VIII  
PAYMENT OF DEFERRED COMPENSATION

8.1 Commencement of Benefits. Subject to Section 8.1(a), when, and at the

-----  
same time, an Eligible Participant elects to defer Compensation for any particular Plan Year, he shall also elect on the "Deferred Compensation Election Form" to have the portion of his Deferred Compensation Account balance attributable to such current Plan Year deferral commence to be paid on the first day of the Plan Year following the Plan Year in which the earlier event occurs:  
-----

- (i) upon separation from service due to either termination, normal retirement, death or disability; or
- (ii) upon the date such Participant attains a selected age.

8.1(a) 365 Day Minimum Deferral Period. Notwithstanding the time elected for

-----  
the commencement of benefits pursuant to Section 8.1, commencement of benefits will not occur prior to the expiration of a 365 day period beginning the day after the date on which an election to defer compensation became effective as provided in this Plan.

8.2 Payment Method Election. At the time the deferral election is filed

-----  
pursuant to ARTICLE IV, Participants must also elect the method of receiving payment of their Deferred Compensation Account balance upon the first day of the Plan Year following the expiration of the elected deferral period. Each Participant shall elect to receive payment of their account either in:

- (i) one lump sum on the benefit commencement date;
- (ii) annual installments, with interest, over a specified period (determined in accordance with Section 8.3), beginning on the commencement date; or

(iii) an annual installment/lump-sum combination where 25%, 50% or 75% of the Deferred Compensation Account balance is paid in annual installments over a specified period (determined in accordance with Section 8.3), beginning on the commencement date, and the remaining balance paid in lump-sum, with accrued interest, at the end of the elected payment period.

8.2(a) Installment Payout Formula. If a Participant selects payment option

-----  
(ii) or (iii) of Section 8.2, the annual installment amount for a particular Plan Year will be computed as follows:

$$\$W = ( \$X / [Y - Z] )$$

Where W = Installment amount received by Participant in a particular Plan Year.

Where X = Participant's Deferred Compensation Account balance at end of prior Plan Year.

Where Y = Number of years originally elected by Participant for the payment period.

Where Z = Number of years in the elected payment period already elapsed.

8.3 Payment Period Election. At the time an Eligible Participant elects to

-----  
be a Participant for any Plan Year, he shall concurrently elect the number of years, up to a maximum of fifteen (15), over which his Deferred Compensation Account shall be paid out upon the expiration of the Deferral Period.

8.3(a) Automatic Payment Period Override. Notwithstanding the Participant's

-----  
payment period election pursuant to Section 8.3, in the case of termination for cause (Section 8.6) or death of Participant (ARTICLE X), such payment period election will be automatically changed to the lump-sum option contained at Section 8.2(i).

8.4 Payment Denomination. All payments made to Participants shall be paid

-----  
solely in cash.

8.5 Change of Prior Elections. Subject to the consent of the Committee, an

-----  
Eligible Participant may file a request to change his prior election with respect to the timing of commencement of benefits (Section 8.1), payment method (Section 8.2) and/or payment period (Section 8.3). Such new election must be filed with the Committee at least 365 days prior to the date on which payment of benefits would commence under either the original or the revised election. Only one such request will be approved with respect to any Participant.

8.6 Termination for Cause. Notwithstanding the payment period election made  
-----  
under Section 8.3, if a Participant is terminated for cause as determined by the Committee, payment of the entire amount remaining in his Deferred Compensation Account for all Plan Years shall be made in one lump sum on the first day after the end of the Plan Year in which termination occurred. Termination for cause shall include gross negligence, willful misconduct and fraud against the Company or any of its subsidiaries.

8.7 Hardship Withdrawal. Subject to the limitation in Section 8.7(a), upon  
-----  
application of any Participant and approval thereof by the Committee, the Participant may withdraw, by reason of hardship, part or all of his Deferred Compensation Account. "Hardship" shall mean an unanticipated emergency situation in the Participant's financial affairs beyond the Participant's control, including illness or an accident involving the Participant, his dependents or other members of his family, or other significant financial emergency, as determined by the Committee in its sole discretion.

8.7(a) Section 16 Limitation. Notwithstanding the Hardship Withdrawal provision  
-----  
contained in Section 8.7 above, such provision is not available for those Participants identified by the Committee as "insiders", as defined under Section 16 of the Securities Exchange Act of 1934 unless and until amounts invested in the Phantom Share Investment Option will be excluded from the definition of "derivative securities" contained in Rule 16a-1 (c)(3) (or any successor) issued under the Securities Exchange Act of 1934 even if such amounts may be subject to a Hardship Withdrawal.

8.8 Accrued Interest Period. For purposes of determining the benefits to be  
-----  
paid to Participants under ARTICLES VIII and X, interest on such Deferred Compensation Account balance will continue to accrue through the end of November in the Plan Year prior to the Plan Year in which payment of benefits will be made. Interest for the month of December in the Plan Year prior to the Plan Year in which payment of benefits will be made is calculated by using the following formula:

$$[ \$X \times Y\% ] \times 30 = \$Z$$

Where X = Participant's Deferred Compensation Account balance at  
November 30th

Where Y = Daily Prime Rate (see Section 6.4(a)) in effect on  
November 30th

Where Z = Additional accrued interest due Participant for the month  
of December

ARTICLE IX  
VALUATION DATE

9.1 Valuation. As of each Valuation Date, the Deferred Compensation Account  
-----  
of each Participant shall be valued by the Committee. The current value,  
and the change in value from the prior valuation (whether positive or  
negative), shall be communicated in writing to each Participant within  
forty-five (45) days after such Valuation Date.

9.2 Valuation Dates. A Valuation Date shall, at a minimum, be four times  
-----  
during a Plan Year ending on each of the quarterly periods March 31, June  
30, September 30 and December 31.

ARTICLE X  
DEATH OF PARTICIPANT

Notwithstanding the payment period election made under Section 8.3, a  
Participant's estate or designated Beneficiary shall be paid the value of  
his Deferred Compensation Account in one lump sum as of the first day  
after the end of the Plan Year in which his death occurred. Interest on  
such balance shall be determined in accordance with the rules contained  
in Section 8.8.

ARTICLE XI  
ALIENATION

Anticipation, alienation, sale, transfer, assignment, pledge or other  
encumbrance of any payments or benefits under the Plan shall not be  
permitted or recognized, and to the extent permitted by law, no such  
payments or benefits shall be subject to legal process or attachment for  
the payment of any claim of any person entitled to receive the same.

ARTICLE XII  
TAX WITHHOLDING

- 12.1 Withholding. Subject to Sections 12.2 and 12.3, Fund American shall  
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deduct from all payments under this Plan the Participant's share of any taxes required to be withheld by any Federal, state or local government. The Participants and their Beneficiaries, distributees and personal representatives will bear any and all Federal, foreign, state, local income taxes or any other taxes imposed on Participants on amounts under this Plan.
- 12.2 FICA Taxes. Pursuant to IRC Section 3121(v), Compensation deferred  
-----  
pursuant to this Plan is subject to FICA at the time of deferral rather than at the time of distribution to the Participant. Accordingly, all Participants who have not yet reached the maximum compensation levels subject to FICA at the time Compensation is deferred herein will be required to pay (by payroll deduction or check) to Fund American the Participant's share of FICA taxes due and payable.
- 12.3 Taxes Due at Deferral Date Other than FICA Taxes. If any of the taxes  
-----  
referred to in Section 12.1 are due at the time of deferral, instead of at the time of payout, the Participant will be required to pay (by payroll deduction or check) to Fund American the Participant's share of any such taxes due and payable.

ARTICLE XIII  
CONSENT

By electing to become a Participant, each Director, Officer and Key Employee shall be deemed conclusively to have accepted and consented to all terms of the Plan and all actions or decisions made by the Company, the Board or the Committee with regard to the Plan. Such terms and consent shall also apply to, and be binding upon, the Beneficiaries, distributees and personal representatives and other successors in interest of each Participant.

ARTICLE XIV  
SEVERABILITY

In the event any provision of this Plan would serve to invalidate the Plan, that provision shall be deemed to be null and void, and the Plan shall be construed as if it did not contain the particular provision that would make it invalid.

ARTICLE XV  
AMENDMENT AND TERMINATION

15.1 Board May Amend or Terminate. Subject to Sections 15.2 and 15.3, the  
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Board of Directors, may at any time modify or amend any or all of the provisions of the Plan or may at any time terminate the Plan.

15.2 (i) Investment Options. Notwithstanding Section 15.1, the Board of  
-----  
Directors cannot delete or alter the terms of the Investment Options, contained herein at Sections 6.4, 6.5, 6.6 and 6.7, without the written permission of those Participants, whose Deferred Compensation Account is invested in such Investment Option(s), who would be affected by such proposed amendment. However, nothing contained herein shall prevent the Board of Directors from substituting a new investment option for the Phantom Share Investment Option if the common stock of the Company (currently FFC Shares) is no longer publicly traded on a nationally recognized stock exchange. In the event of such an occurrence, the Board of Directors shall have the sole authority to substitute a new Investment Option and allow only those Participants affected to transfer their Phantom Share account balance to an existing Investment Option if the substituted Investment Option is not acceptable to the particular Participant.

(ii) Fiduciary Guidelines. Notwithstanding Section 15.1 and Section  
-----  
15.2(i), the Board of Directors will not make amendments or terminate the Plan if such amendments or termination would reduce a Participant's balance in his Deferred Compensation Account. Further, the Board of Directors will not make amendments which would in any way eliminate the express requirement in Section 16.1

requiring the establishment of a Rabbi Trust in the event of a Change of Control if one has not previously been established.

15.3 Termination. In the event of termination of the Plan, the Committee

-----  
shall give written notice to each Participant that the entire balance in his Deferred Compensation Account will be distributed in the manner initially elected by each Participant pursuant to ARTICLE VIII. Further, pursuant to the responsibility vested with the Committee as stated in Section 17.1, the Committee will evaluate the advisability of establishing a Rabbi Trust--if one does not already exist--in light of the circumstances that caused the Board of Directors to terminate the Plan.

ARTICLE XVI  
CHANGE OF CONTROL

16.1 Funding of Trust. Notwithstanding ARTICLE VII, upon a "Change of

-----  
Control" as defined in Section 16.2, the Board of Directors is required to cause the immediate contribution of funds to a trust--if not previously established--(i.e. "Rabbi Trust" established in accordance with Rev. Proc. 92-64 (or any successor) or other funding mechanism approved by the Internal Revenue Service which would not result in Plan Participants being in constructive receipt of income) for the benefit of each Plan Participant, as beneficiary. The assets of such trust shall at all times be subject to the claims of general creditors of Fund American. Such contribution will be equal to the balance in each Participant's Deferred Compensation Account as of the Change of Control date. Further, if the Plan is not terminated upon such Change of Control, Fund American will continue to contribute to the trust, on a monthly basis, the amount of Compensation being deferred by each Participant after the Change of Control.

16.2 Change of Control. For purposes of this Plan, a "Change of Control" shall

-----  
occur if:

- i) any person or group (within the meaning of Sections 13(d) and 14(d)(2) of the Securities Exchange Act of 1934), other than American Express Company or the Company, becomes the beneficial owner (within the meaning of Rule 13d-3 under such Exchange Act) of thirty-five percent (35%) or more of the Company's then outstanding FFC Shares;



- ii) As defined in Section 16.3, the "Incumbent Board of Directors", cease to constitute a majority of the Board of Directors of the Company; or
- iii) the business of the Company for which the Participant's services are principally performed is disposed of by the Company pursuant to a sale or other disposition of all or substantially all of the business or business related assets of the Company (including stock of a subsidiary of the Company).

16.3 Incumbent Board of Directors. Incumbent Board of Directors shall mean

-----  
those individuals who, as of April 9, 1992, constituted the Board of Directors or, alternatively, those members elected or nominated after April 9, 1992 who were approved for such election or nomination by a vote of at least a majority of the directors then comprising the Incumbent Board of Directors. Further, individuals shall be excluded whose initial assumption of office is or was in connection with an actual or threatened election contest relating to the election of the directors of the Company (as used in rule 14a-11 under the Securities Exchange Act of 1934).

ARTICLE XVII  
PLAN ADMINISTRATION

17.1 Committee. The general administration of the Plan, the decision to

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establish a trust and the responsibility for carrying out its provisions shall be placed in the Committee.

17.2 Determinations of the Committee. Subject to the limitations of the Plan,

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the Committee shall from time to time establish rules for the administration and interpretation of the Plan and the transaction of its business. The determination of the Committee as to any disputed question shall be conclusive.

17.3 Majority Vote. Any act which the Plan authorizes or requires the

-----  
Committee to do may be done by a majority (expressed from time to time by a vote at a meeting or in writing without a meeting) and shall constitute the action of the Committee, and shall have the same effect for all purposes as if assented to by all members of the Committee.

17.4 Authorization of Committee Members. The members of the Committee may

authorize one or more of their number to execute or deliver any instrument, make any payment, or perform any other act which the Plan authorizes or requires the Committee to do.

17.5 Agents. The Committee may employ or retain agents to perform such

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clerical, accounting, and other services as they may require in carrying out the provisions of the Plan.

17.6 Costs. Any and all such costs in administering this Plan will be paid

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and incurred by Fund American.

17.7 Notices. All written notices or elections as required herein shall be

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sent either by U.S. mail, overnight carrier service or personal delivery to the address below:

Fund American Enterprises Holdings, Inc.  
c/o Fund American Enterprises, Inc.  
The 1820 House / Main Street  
Norwich VT 05055 Attention: Michael S. Paquette

FUND AMERICAN

DEFERRED BENEFIT PLAN

(As Adopted December 31, 1992)  
(Revised November 10, 1995)

FUND AMERICAN  
DEFERRED BENEFIT PLAN  
(Adopted December 31, 1992)  
(Revised November 10, 1995)

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FUND AMERICAN  
DEFERRED BENEFIT PLAN  
(December 31, 1992)  
(Revised November 10, 1995)

ARTICLE I

PURPOSE OF PLAN

- 1.1 The purpose of this Plan is to provide eligible Officers and Key Employees of Fund American with deferred retirement benefits. The Plan is also intended to establish a method of attracting and retaining persons whose abilities, experience and judgement can contribute to the long-term strategic objectives of Fund American.
- 1.2 The Committee intends that the Plan be an unfunded non-qualified deferred compensation plan maintained primarily for the purpose of providing deferred retirement benefits for a select group of management or highly compensated employees of Fund American, and that contributions to the Plan shall be deductible by Fund American pursuant to Section 404(a)(5) of the Internal Revenue Code of 1986, as amended (the "IRC").

ARTICLE II

DEFINITIONS

As used in this Plan, the following terms shall have the meanings hereinafter set forth:

- 2.1 "Base Salary" means the annual salary paid to Fund American Officers and Key Employees which is paid bi-weekly (or other regular interval) during the calendar year.
- 2.2 "Beneficiary" means any person(s) or legal entity(ies) designated by the Participant or otherwise determined in accordance with ARTICLE V.
- 2.3 "Board of Directors" means the Board of Directors of the Company.
- 2.4 "Cash Incentive Bonus" means the Participant's portion (if any) of Fund American's annual cash bonus pool normally awarded by the Board of Directors to Fund American employees shortly after the close of the calendar year, which is the relevant time frame used to judge such performance.

- 2.5 "Committee" means the Executive Compensation Committee as initially appointed by the Board of Directors and as appointed from time to time by written action of the Board of Directors.
- 2.6 "Company" means Fund American Enterprises Holdings, Inc. (formerly The Fund American Companies, Inc.), a Delaware corporation, and its successors and assigns.
- 2.7 "Compensation" has the same meaning, with one exception, as the definition contained in The Fund American Companies, Inc. Retirement Plan (terminated 10/31/92), e.g. Base Salary and Cash Incentive Bonuses (also overtime pay and military pay if applicable). Compensation specifically excludes performance units, stock appreciation rights, performance shares, restricted stock, warrants, stock options and other qualifying remuneration paid or otherwise payable by Fund American. The one difference in the definition of Compensation for this Plan is that all annual cash bonuses will be includible in Compensation in the year earned rather than paid.
- 2.8 "Deferral Period" means the total aggregate period of time, expressed in Plan Years, for which Deferred Retirement Benefits awarded for a particular Plan Year are to be invested in the Plan and not yet deemed payable to the Participant or his Beneficiary.
- 2.9 "Deferred Retirement Benefit" means the retirement benefit, expressed in U.S. dollars, deferred pursuant to ARTICLE VI of this Plan.
- 2.10 "Deferred Benefit Account" means the individual account maintained under the Plan for a Participant as determined under ARTICLE VI.
- 2.11 "Deferred Benefit Election Form" means the standardized election form that each Participant must execute in accordance with ARTICLE IV, a copy which is attached hereto as EXHIBIT # 1.
- 2.12 "Director" means a director of the Company who is not an employee of Fund American.
- 2.13 "FFC Share(s)" means a share(s) of Fund American Enterprises Holdings, Inc. Common Stock (\$1.00 par value) as listed on the New York Stock Exchange (symbol FFC).
- 2.14 "Final Average Pay" has the same meaning as the definition contained in The Fund American Companies, Inc. Retirement Plan (terminated 10/31/92), i.e. the highest average Compensation of an employee for any five (5) consecutive years falling within the ten (10) year period ending on the employee's service

separation date, but subject to an overall maximum cap of 135% of the average Base Salary for the same applicable five year averaging period.

- 2.15 "Fund American" means the Company, its wholly owned subsidiary, Fund American Enterprises, Inc., a Delaware corporation, and other affiliates designated by the Committee or the Board of Directors.
- 2.16 "Investment Option" means an option made available to Participants pursuant to ARTICLE VI.
- 2.17 "Investment Option Election" means a Participant election made pursuant to ARTICLE VI.
- 2.18 "Key Employee" means any executive employee or other overtime-exempt employee of Fund American that the Committee in its sole discretion decides is important to the ongoing business objectives of Fund American.
- 2.19 "Market Price of FFC Share(s)" means the closing price per share of FFC listed on the NYSE composite tape or, if the NYSE is closed for a particular day, the closing NYSE price of FFC on the previous day.
- 2.20 "Officer" means an officer of Fund American as defined in the Corporate Bylaws.
- 2.21 "Participant" for any Plan Year means an Officer or Key Employee of Fund American designated by the Committee as eligible to participate in the Plan.
- 2.22 "Plan" means the Fund American Deferred Benefit Plan as embodied herein and as amended from time to time.
- 2.23 "Plan Year" means the twelve (12) month calendar year beginning January 1 and ending December 31, or shorter period as the case may be in the year the Plan is adopted or terminated.
- 2.24 "Valuation Date" means the last business day of either a calendar year or calendar quarter, as the Committee will determine from time to time.
- 2.25 Construction. The masculine pronoun shall be deemed to include the -----  
feminine, and the singular number shall be deemed to include the plural unless a different meaning is plainly required by the context.

ARTICLE III

ELIGIBILITY

Each Officer and Key Employee of Fund American shall be eligible to participate in the Plan if selected by the Committee. The Committee has total discretion to determine who is eligible to participate on a Plan Year by Plan Year basis.

ARTICLE IV

PARTICIPATION

4.1 Election Form. Subject to Sections 4.2 and 4.3, an eligible Officer

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or Key Employee should make a valid election by executing and filing with the Committee, before the commencement of such Plan Year, a Deferred Benefit Election Form, a copy of which is attached hereto as EXHIBIT # 1.  
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4.2 New Employees. Notwithstanding Section 4.1, a newly hired Officer

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or Key Employee who becomes a Participant after the first day of the current Plan Year, may file a Deferred Benefit Election Form within fifteen (15) days after his initial date of employment with respect to the Deferred Retirement Benefit calculated on Compensation not yet earned for the remaining portion of the Plan Year.

4.3 Default Elections. If a Participant fails to file a timely

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Deferred Benefit Election Form in accordance with either Section 4.1 or 4.2, such Participant will forego all opportunity to make an Investment Option Election (Section 6.11), a Payment Method Election (Section 8.2) and a Payment Period Election (Section 8.3). Accordingly, failure to file a timely Deferred Benefit Election Form for a particular Plan Year will result in default elections being automatically triggered, which provide that:

- (i) the current Plan Year's calculated Deferred Retirement Benefit will be invested solely in the Prime Rate Investment Option.
- (ii) commencement of benefits will occur upon the first day of the Plan Year following the Plan Year in which termination of employment (for any reason) occurs.
- (iii) the sole method of benefit payment to Participant will be a lump sum.

- 4.4 Election Not Revocable. Except as provided in Section 8.5, a Deferred Benefit Election Form, once executed and filed with the Committee, cannot be revoked for such current Plan Year's calculated Deferred Retirement Benefit.
- 4.5 Vesting. A Participant will be vested in his entire Deferred Benefit Account balance at all times and will not be subject to forfeiture for any reason.
- 4.6 Participation in Deferred Compensation Plan Not Required. A Participant need not also participate in the Fund American Voluntary Deferred Compensation Plan in order to participate in this Plan for a particular Plan Year.
- 4.7 New Elections Permitted for each year. All elections made on a Deferred Benefit Election Form for a particular Plan Year have no effect on, nor are affected by, elections made for future or past Plan Years. Each Plan Year elections stand on their own.

## ARTICLE V

### GENERAL PROVISIONS

- 5.1 No Right To Payment Except as Provided in Plan. No Participant or Beneficiary shall have any right to any payment or benefit hereunder except to the extent provided in the Plan.
- 5.2 Employment Rights. The employment rights of any Participant shall not be enlarged, guaranteed or affected by reason of the provisions of the Plan.
- 5.3 Initial Participating Companies. Initially, no subsidiary other than Fund American Enterprises, Inc. is currently permitted to participate in the Plan. However, the Committee can decide at a future date to allow inclusion of a new or previously excluded subsidiary(ies).
- 5.4 Recipient Under a Disability. If the Committee determines that any person to whom a payment is due hereunder is a minor, or is adjudicated incompetent by reason of physical or mental disability, the Committee shall have the power to cause the payments becoming due to such person to be made to the legal guardian for the benefit of the minor or incompetent, without responsibility of Fund American or the Committee to see to the application of such payment, unless prior to such payment claim is made



therefor by a duly appointed legal representative. Payments made pursuant to such power shall operate as a complete discharge of Fund American and the Committee.

5.5 Designation of Beneficiary. Each Participant may designate any

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person(s) or legal entity(ies), including his estate, as his Beneficiary under the Plan in writing to the Committee. A Participant may at any time revoke or change his designation of Beneficiary by writing to the Committee. If no person or legal entity shall be designated by a Participant as his Beneficiary, or if no designated Beneficiary survives him, his estate shall be his Beneficiary.

5.6 Elections. Any election made or notice given by a Participant pursuant

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to the Plan shall be in writing to the Committee, or to such representative as may be designated by the Committee for such purpose. Notice shall be deemed to have been made or given on the date received by the Committee or its designated representative.

5.7 Controlling Law. The validity of the Plan or any of its provisions

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shall be determined under, and it shall be construed and administered according to, the laws of the State of Vermont.

ARTICLE VI

DEFERRED BENEFIT ACCOUNTS

6.1 Accounts. Upon receipt of a Participant's valid Deferred Benefit

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Election Form, the Committee shall establish, as a bookkeeping entry only, a Deferred Benefit Account for such Participant. The Committee shall thereafter record to each Participant's Deferred Benefit Account, as of the first day of the current Plan Year, the Deferred Retirement Benefit amount calculated pursuant to Section 6.3.

6.2 Adjustments To Accounts. The balance in a Participant's Deferred Benefit

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Account at any time will be calculated on a daily basis by: i) aggregating all current or prior Plan Year Deferred Retirement Benefit amounts calculated pursuant to Section 6.3; ii) adding (subtracting) thereto the cumulative interest equivalent, whether positive or negative, earned on such Deferred Retirement Benefit amounts computed in accordance with the rules of Sections 6.4, 6.5 and 6.6, 6.7 and 6.8; and iii) from such total obtained, subtracting the aggregate payments made to the Participant in current or prior Plan Years in accordance with ARTICLE VIII and ARTICLE X.

6.3 Deferred Retirement Benefit. A Participant's total Deferred Retirement

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Benefit amount for the current Plan Year shall be the sum of the following components, each of which is considered a separate Deferred Retirement Benefit solely for purposes of a Participant making an Investment Option Election pursuant to Section 6.11:

(i) five percent (5%) of a Participant's Base Salary determined as of the beginning of a Plan Year, subject to an inflation adjusted, maximum annual dollar amount (\$9,240 for 1995) as published by the Internal Revenue Service for a tax qualified plan commonly referred to as a 401(k) plan; and,

(ii) the excess of: a) the lump sum present value equivalent of the normal retirement benefit (i.e. a monthly annuity starting at age 65) computed as of the end of the current Plan Year, over b) the lump sum

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present value equivalent of the normal retirement benefit computed as of the end of the prior Plan Year.  
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Solely for purposes of this Section 6.3(ii), the calculation of each Plan Year's normal retirement benefit shall employ recognized actuarial principles and such other reasonable assumptions deemed necessary by the Committee to achieve the stated objective of providing each Participant with a retirement benefit which approximates the benefit that a Participant would have been entitled under The Fund American Companies, Inc. Retirement Plan, but assuming that the mandatory "Top Heavy" rules and maximum compensation limits imposed on all qualified plans did not exist. Further, the removal of compensation limits does not change the definition of Compensation as it is used in calculating Final Average Pay as such term is defined in The Fund American Companies, Inc. Retirement Plan (i.e. eligible compensation is limited to the lesser of Base Salary plus 100% of Cash Incentive Bonuses, or 135% of Base Salary).

6.3(a) Prospective Catch-up Adjustment. In

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recognition of the fact that the calculation of the Deferred Retirement Benefit for a particular Plan Year is based on estimates made as of the beginning of a Plan Year as to what a Participant's Compensation will be for an entire Plan Year, a prospective catch-up adjustment, either positive or negative, shall be made if a Participant's actual Compensation differs from estimated Compensation. Accordingly, such difference will be considered an additional Deferred

Retirement Benefit or Detriment, as the case may be, but will be taken into account solely in determining the Deferred Retirement Benefit amount for the Plan Year following the Plan Year to which the adjustment relates.

6.4 Investment of Deferred Retirement Benefits. Deferred Retirement Benefit amounts shall be "theoretically invested" under any of the Investment Options described below, as elected by the Participant.

6.5 Prime Rate Investment Option. Interest equivalents, equal to the product of: i) Daily Prime Rate; multiplied by ii) the portion of the Deferred Benefit Account balance existing as of the end of the previous day in the Prime Rate Investment Option, shall be credited each day to a Participant's Deferred Benefit Account.

6.5(a) Daily Prime Rate. Expressed as a percentage, the "Daily Prime Rate" as described in Section 6.5 will be calculated by dividing the "base rate" of interest announced publicly by Citibank, N.A. in New York, N.Y. (or prime or base rate of another large commercial bank selected by the Committee), as in effect on the last business day of each month, by 360.

6.6 Phantom Share Investment Option. Interest equivalents shall be credited to (subtracted from) amounts in the Phantom Share Investment Option on a daily basis. Such daily interest equivalents shall be calculated as follows: i) take the aggregate number of Phantom Shares in a Participant's Phantom Share Investment Option at the close of business on the preceding calendar day; multiplied by ii) the difference between the FFC Share closing Market Price on the current calendar day, plus dividends paid or payable, as defined in Section 6.6(c), with respect to a single FFC Share, and the FFC Share closing Market Price on the preceding calendar day. For purposes of comparability, the above calculation shall be adjusted for any stock splits or stock dividends occurring during the current calendar day which affects the number of Phantom Shares a Participant held on the preceding calendar day.

6.6(a) Phantom Shares Granted to Participant. Subject to the Phantom Share Cumulative Dollar Limitation contained at Section 6.11(b), the number of Phantom Shares granted to a Participant will be determined by dividing the dollar amount of Deferred Retirement Benefit allocated to the Phantom Share Investment

Option by the Conversion Price. Such total amount of Phantom Shares determined will then be rounded to the next one-tenth (1/10) Phantom Share.

6.6(b) Conversion Price. The Conversion Price of FFC Shares used to calculate

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the number of Phantom Shares to be added to a Participant's Deferred Benefit Account as of the beginning of a Plan Year will be the closing Market Price of FFC Shares at the end of the last business day of the immediately preceding Plan Year.

6.6(c) Dividends Reinvested in Phantom Share Investment Option.

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For purposes of Section 6.6, dividends "paid or payable" shall mean either in cash or property, but shall exclude stock dividends or stock splits, as the case may be. Further, dividends paid or declared payable on the preceding day will be treated as automatically reinvested in FFC Shares as of the end of such day at the closing Market Price of FFC Shares; provided the Participant's account held Phantom Shares on the last day the Company declares as the date stockholders of record are entitled to receive such dividend on FFC Shares (i.e. the "ex-dividend" date).

6.6(d) Other Dilutive and Anti-dilutive Transactions Affecting Phantom Shares.

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In addition to Section 6.6(c), and subject to other provisions in the Plan, the Committee has the discretion to make appropriate adjustments to a Participant's account invested in the Phantom Share Investment Option where a "capital transaction" or "corporate reorganization" has the affect of changing the economic equivalent number of Phantom Shares that a Participant has been credited under this Plan. The Committee shall make an adjustment to the portion of each Participant's Deferred Benefit Account invested in the Phantom Share Investment Option so affected (if any), either positive or negative as the case may be, to ensure that neither unintended economic benefits nor detriments are conferred on a Participant solely by reason of such capital transaction or corporate reorganization.

6.6(e) Capital Transaction or Corporate Reorganization. Solely for purposes

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of Section 6.6(d), a "capital transaction" or "corporate reorganization" shall not be limited to its ordinary meaning if in fact a Participant would be conferred an economic benefit or detriment by some other corporate transaction

which is not literally considered a capital transaction or corporate reorganization under common business usage of said terms.

- 6.7 Equity Fund Investment Option. Interest equivalents, equal to the  
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product of: i) the daily published total return for the Oakmark Fund; multiplied by ii) the Deferred Compensation balance existing as of the end of the previous day in the Equity Fund Investment Option, shall be credited each day to a Participant's Deferred Compensation Account.
- 6.8 Fixed-Income Fund Investment Option. Interest equivalents, equal to  
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the product of: i) the daily published total return for the PIMCo Total Return Fund; multiplied by ii) the Deferred Compensation balance existing as of the end of the previous day in the Fixed-Income Fund Investment Option, shall be credited each day to a Participant's Deferred Compensation Account.
- 6.9 Other Investment Options. The Committee may make other Investment  
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Options available under the Plan from time to time. Earnings (loss) shall be credited to (subtracted from) amounts invested in such other Investment Options on a daily basis as determined by the Committee.
- 6.10 Converting Accrued & Vested Benefits From Other Fund American  
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Non-Qualified Plans. For purposes of establishing a Participant's  
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Deferred Benefit Account, benefits accrued as of December 31, 1992 on behalf of Plan Participants who were also participating in one or more of the terminated Fund American non-qualified plans (i.e. The Fund American Companies, Inc. Retiree Medical Plan, Supplemental Pension Plan and Survivor Benefit Plan), shall be transferred as of January 1, 1993 to this Plan and invested in accordance with Section 6.11 and the elections made by such Participants as indicated on the Deferred Benefit Election Form. Such transferred balances shall be considered an additional Deferred Retirement Benefit amount for the 1993 Plan Year in addition to the Deferred Retirement Benefit calculated pursuant to Section 6.3.
- 6.11 Investment Option Election. Except as provided in this Section 6.11,  
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amounts invested in the Phantom Share Investment Option may not be transferred to another Investment Option by the Participant although amounts invested in any other Investment Option may be transferred annually among any available Investment Option (including a transfer to the Phantom Share Investment Option) in accordance with

procedures established by the Committee. Such transfer election may be made only within the 10-business day period commencing on the third business day following release of the Company's third quarter financial information.

The foregoing limitation on transfers of amounts invested in the Phantom Share Investment Option has been included in this Plan so that amounts invested in the Phantom Share Investment Option shall be excluded from the definition of "derivative securities" contained in Rule 16a-1(c) (3) (or any successor) issued under the Securities Exchange Act of 1934. If such rule is withdrawn, amended or reinterpreted so that the foregoing limitation is no longer required to disqualify such amounts as derivative securities, the foregoing limitation shall be rescinded.

An Investment Option election shall remain in effect for future Deferred Compensation (including amounts deferred in subsequent Plan Years) unless and until a new Investment Option Election is filed with the Committee.

6.11(a) Investment Option Allocation. Subject to the Phantom Share

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Cumulative Dollar Limitation contained at Section 6.11(b), each Participant can elect to allocate each component of a Plan Year's total Deferred Retirement Benefit among the available Investment Options as described in Sections 6.5, 6.6, 6.7, 6.8 and 6.9.

6.11(b) Phantom Share Cumulative Dollar Limitation. Notwithstanding a

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Participant's ability to allocate Deferred Retirement Benefits for a Plan Year among the available Investment Options, a Participant's election to invest Deferred Retirement Benefits in the Phantom Share Investment Option may be limited (either in whole or in part) as described herein: (i) Without requiring authorization from the Board of Directors, but subject to all other provisions in this Plan, a Participant may continue to invest Deferred Retirement Benefits in the Phantom Share Investment Option to the extent the portion of a Participant's Deferred Benefit Account balance invested in the Phantom Share Investment Option does not have a fair market value which exceeds twenty million dollars (\$20 million).

(ii) Unless authorized by the Board of Directors, a Participant is precluded from investing additional Deferred Retirement Benefits in the Phantom Share Investment Option if the portion

of a Participant's Deferred Benefit Account balance previously invested in the Phantom Share Investment Option has a fair market value which exceeds twenty million dollars (\$20 million).

- 6.12 Deletion of Investment Options. Except as provided in Section 15.2,  
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the Committee cannot delete or alter the terms of an existing Investment Option without the written permission of those Participants affected by such proposed amendment whose Deferred Retirement Benefits is invested in such Investment Option.

#### ARTICLE VII

##### PARTICIPANTS' RIGHTS UNSECURED

- 7.1 Unsecured Creditors. Amounts credited to Deferred Benefit Accounts  
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shall be dealt with in all respects as working capital of Fund American, therefore the right of a Participant to receive any distribution hereunder shall be an unsecured claim against the general assets of Fund American.
- 7.2 No Actual Investment Required. Subject to ARTICLE XVI, no assets of  
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Fund American shall in any way be held in trust for, or be subject to, any prior claim by an Officer or a Key Employee or his Beneficiary under the Plan. Further, neither Fund American nor the Committee shall have any duty whatsoever to invest any amounts credited to any Deferred Benefit Accounts established under the Plan.

#### ARTICLE VIII

##### PAYMENT OF DEFERRED RETIREMENT BENEFITS

- 8.1 Commencement of Benefits. Subject to Sections 4.3 and 8.1(a),  
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when, and at the same time, an eligible Participant elects to invest Deferred Retirement Benefits for any particular Plan Year, he shall also elect on the Deferred Retirement Benefits Election Form to have the portion of his Deferred Benefit Account balance attributable to such current Plan Year commence to be paid on the first day of the Plan Year following the Plan Year in which the earlier event occurs:  
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(i) upon separation from service due to either termination, normal retirement, death or disability; or  
  
(ii) upon the date such Participant attains a selected age.

8.1(a) 365 Day Minimum Deferral Period. Notwithstanding the time for the commencement of benefits pursuant to Section 8.1, commencement of benefits will not occur prior to the expiration of a 365 day period beginning the day after the date on which a Deferred Retirement Benefit is awarded as provided in this Plan.

8.2 Payment Method Election. At the time the Deferred Benefit Election Form is filed pursuant to ARTICLE IV, Participants must also elect the method of receiving payment of their Deferred Benefit Account balance upon the first day of the Plan Year following the expiration of the elected Deferral Period. Each Participant shall elect to receive payment of his account either in:

- (i) one lump sum on the benefit commencement date;
- (ii) annual installments, with interest, over a specified period (determined in accordance with Section 8.3), beginning on the commencement date; or
- (iii) an annual installment/lump-sum combination where 25%, 50% or 75% of the Deferred Benefit Account balance is paid in annual installments over a specified period (determined in accordance with Section 8.3), beginning on the commencement date, and the remaining balance paid in lump-sum, with accrued interest, at the end of the elected payment period.

8.2(a) Installment Payout Formula. If a Participant selects payment option (ii) or (iii) of Section 8.2, the annual installment amount for a particular Plan Year will be computed as follows:

$$\$W = ( \$X / [Y - Z] )$$

Where W = Installment amount received by Participant in a particular Plan Year.

Where X = Participant's Deferred Benefit Account balance at end of the prior Plan Year.

Where Y = Number of years originally elected by Participant for the payment period.

Where Z = Number of years in the elected payment period already elapsed.

8.3 Payment Period Election. At the time an Eligible Participant elects to be a Participant for any Plan Year, he shall concurrently elect on the Deferred Benefit Election Form the number of years, up to a



maximum of fifteen (15), over which his Deferred Benefit Account shall be paid out upon the expiration of the Deferral Period.

8.3(a) Automatic Payment Period Override. Notwithstanding the Participant's

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payment period election pursuant to Section 8.3, in the case of termination for cause (Section 8.6) or death of the Participant (ARTICLE X), such payment period election will be automatically changed to the lump-sum option contained at Section 8.2(i).

8.4 Payment Denomination. All payments made to Participants shall be

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paid solely in cash.

8.5 Change of Prior Elections. Subject to the consent of the Committee, a

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Participant may file a request to change his prior election with respect to the timing of commencement of benefits (Section 8.1), payment method (Section 8.2) and/or payment period (Section 8.3). Such new election must be filed with the Committee at least 365 days prior to the date on which payment of benefits would commence under either the original or the revised election. Only one such request will be approved with respect to any Participant.

8.6 Termination for Cause. Notwithstanding the payment period election made

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under Section 8.3, if a Participant is terminated for cause as determined by the Committee, payment of the entire amount remaining in his Deferred Benefit Account for all Plan Years shall be made in one lump sum on the first day after the end of the Plan Year in which termination occurred. Termination for cause shall include gross negligence, willful misconduct and fraud against the Company or any of its subsidiaries.

8.7 Hardship Withdrawal. Subject to the limitation in Section 8.7(a), upon

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application of any Participant and approval thereof by the Committee, the Participant may withdraw, by reason of hardship, part or all of his Deferred Benefit Account. "Hardship" shall mean an unanticipated emergency situation in the Participant's financial affairs beyond the Participant's control, including illness or an accident involving the Participant, his dependents or other members of his family, or other significant financial emergency, as determined by the Committee in its sole discretion.

8.7(a) Section 16 Limitation. Notwithstanding the Hardship withdrawal

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provision contained in Section 8.7 above, such provision is not available for those Participants identified by the Committee as "insiders",

as defined under Section 16 of the Securities Exchange Act of 1934 unless or until amounts invested in the Phantom Share Investment Option will be excluded from the definition of "derivative securities" contained in Rule 16a-1(c)(3) (or any successor) issued under the Securities Exchange Act of 1934 even if such amounts may be subject to a Hardship withdrawal.

8.8 Accrued Interest Period. For purposes of determining the benefits to be -----

paid to Participants under ARTICLES VIII and X, interest on such Deferred Benefit Account balance will continue to accrue through the end of November in the Plan Year prior to the Plan Year in which payment of benefits will be made. Interest for the month of December in the Plan Year prior to the Plan Year in which payment of benefits will be made is calculated by using the following formula:

$$[ \$X \times Y\% ] \times 30 = \$Z$$

Where X = Participant's Deferred Benefit Account balance at November 30th

Where Y = Daily Prime Rate (see Section 6.5(a)) in effect on November 30th

Where Z = Additional accrued interest due Participant for the month of December

#### ARTICLE IX

##### VALUATION DATE

9.1 Valuation. Valuation Date, the Deferred Benefit Account balance of each -----

Participant shall be valued by the Committee. The current value, and the change in value from the prior Valuation Date (whether positive or negative), shall be communicated in writing to each Participant within forty-five (45) days after such Valuation Date.

9.2 Valuation Dates. A Valuation Date, shall, at a minimum, be four times -----

during a Plan Year ending on each of the quarterly periods March 31, June 30, September 30 and December 31.

#### ARTICLE X

##### DEATH OF PARTICIPANT

Notwithstanding the payment period election made under Section 8.3, a Participant's estate or designated Beneficiary shall be paid the value of his Deferred Benefit Account in one lump sum on

the first day after the end of the Plan Year in which his death occurred. Interest on such balance shall be determined in accordance with the rules contained in Section 8.8.

ARTICLE XI

ALIENATION

Other than as provided in ARTICLE X, anticipation, alienation, sale, transfer, assignment, pledge or other encumbrance of any payments or benefits under the Plan shall not be permitted or recognized, and to the extent permitted by law, no such payments or benefits shall be subject to legal process or attachment for the payment of any claim of any person entitled to receive the same.

ARTICLE XII

TAX WITHHOLDING

- 12.1 Withholding. Subject to Sections 12.2 and 12.3, Fund American shall -----  
deduct from all payments under this Plan each Participant's share of any taxes required to be withheld by any Federal, state or local government. The Participants and their Beneficiaries, distributees and personal representatives will bear any and all Federal, foreign, state, local income taxes or any other taxes imposed on Participants on amounts under this Plan.
- 12.2 FICA Taxes. Pursuant to IRC Section 3121(v), Compensation deferred -----  
pursuant to this Plan is subject to FICA at the time of deferral rather than at the time of distribution to the Participant. Accordingly, each Participant who has not yet reached the maximum compensation levels subject to FICA at the time Compensation is deferred herein will be required to pay (by payroll deduction or check) to Fund American his share of FICA taxes due and payable.
- 12.3 Taxes Due at Deferral Date Other than FICA Taxes. If any of the taxes -----  
referred to in Section 12.1 are due at the time of deferral, instead of at the time of payout, the Participant will be required to pay (by payroll deduction or check) to Fund American the Participant's share of any such taxes due and payable.

ARTICLE XIII

CONSENT

By electing to become a Participant, each Officer and Key Employee shall be deemed conclusively to have accepted and consented to all terms of the Plan and all actions or decisions made by the Company, the Board or the Committee with regard to the Plan. Such terms and consent shall also apply to, and be binding upon, the Beneficiaries, distributees and personal representatives and other successors in interest of each Participant.

ARTICLE XIV

SEVERABILITY

In the event any provision of this Plan would serve to invalidate the Plan, that provision shall be deemed to be null and void, and the Plan shall be construed as if it did not contain the particular provision that would make it invalid.

ARTICLE XV

AMENDMENT AND TERMINATION

15.1 Board May Amend or Terminate. Subject to Sections 15.2 and 15.3, the

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Board of Directors, may at any time modify or amend any or all of the provisions of the Plan or may at any time terminate the Plan.

15.2 (i) Investment Options. Notwithstanding Section 15.1, the Board of

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Directors cannot delete or alter the terms of the Investment Options, contained herein at Sections 6.5 and 6.6, without the written permission of those Participants, whose Deferred Benefit Account is invested in such Investment Option(s), who would be affected by such proposed amendment. However, nothing contained herein shall prevent the Board of Directors from substituting a new investment option for the Phantom Share Investment Option if the common stock of the Company (currently FFC Shares) is no longer publicly traded on a nationally recognized stock exchange. In the event of such an occurrence, the Board of Directors shall have the sole authority to substitute a new Investment Option and allow only those

Participants affected to transfer their Phantom Share account balance to an existing Investment Option if the substituted Investment Option is not acceptable to the particular Participant.

(ii) Fiduciary Guidelines. Notwithstanding Section 15.1 and

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Section 15.2(i), the Board of Directors will not make amendments or terminate the Plan if such amendments or termination would reduce a Participant's balance in his Deferred Benefit Account. Further, the Board of Directors will not make amendments which would in any way eliminate the express requirement in Section 16.1 requiring the establishment of a Rabbi Trust in the event of a Change of Control if one has not previously been established.

15.3 Termination. In the event of termination of the Plan, the Committee

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shall give written notice to each Participant that the entire balance in his Deferred Benefit Account will be distributed in the manner initially elected by each Participant pursuant to ARTICLE VIII. Further, pursuant to the responsibility vested with the Committee as stated in Section 17.1, the Committee will evaluate the advisability of establishing a Rabbi Trust--if one does not already exist--in light of the circumstances that caused the Board of Directors to terminate the Plan.

#### ARTICLE XVI

##### CHANGE OF CONTROL

16.1 Funding of Trust. Notwithstanding ARTICLE VII, upon a "Change of

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Control" as defined in Section 16.2, the Board of Directors is required to cause the immediate contribution of funds to a trust--if not previously established--(i.e. "Rabbi Trust" established in accordance with Rev. Proc. 92-64 (or any successor) or other funding mechanism approved by the Internal Revenue Service which would not result in Plan Participants being in constructive receipt of income) for the benefit of each Plan Participant, as beneficiary. The assets of such trust shall at all times be subject to the claims of general creditors of Fund American. Such contribution will be equal to the balance in each Participant's Deferred Benefit Account as of the Change of Control date. Further, if the Plan is not terminated upon such Change of Control, Fund American will continue to contribute to the trust, on an annual

basis, an amount of cash equal to the Deferred Retirement Benefit awarded to each Participant after the Change of Control.

16.2 Change of Control. For purposes of this Plan, a "Change of Control"

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shall occur if:

- i) any person or group (within the meaning of Sections 13(d) and 14(d)(2) of the Securities Exchange Act of 1934), other than American Express Company or the Company, becomes the beneficial owner (within the meaning of Rule 13d-3 under such Exchange Act) of thirty-five percent (35%) or more of the Company's then outstanding FFC Shares;
- ii) as defined in Section 16.3, the "Incumbent Board of Directors", cease to constitute a majority of the Board of Directors of the Company; or
- iii) the business of the Company for which the Participant's services are principally performed is disposed of by the Company pursuant to a sale or other disposition of all or substantially all of the business or business related assets of the Company (including stock of a subsidiary of the Company).

16.3 Incumbent Board of Directors. Incumbent Board of Directors shall mean

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those individuals who, as of April 9, 1992, constituted the Board of Directors or, alternatively, those members elected or nominated after April 9, 1992 who were approved for such election or nomination by a vote of at least a majority of the directors then comprising the Incumbent Board of Directors. Further, individuals shall be excluded whose initial assumption of office is or was in connection with an actual or threatened election contest relating to the election of the directors of the Company (as used in rule 14a-11 under the Securities Exchange Act of 1934).

ARTICLE XVII

PLAN ADMINISTRATION

17.1 Committee. The general administration of the Plan, the decision to

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establish a trust and the responsibility for carrying out its provisions shall be placed in the Committee.

- 17.2 Determinations of the Committee. Subject to the limitations of the  
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Plan, the Committee shall from time to time establish rules for the  
administration and interpretation of the Plan and the transaction of its  
business. The determination of the Committee as to any disputed question  
shall be conclusive.
- 17.3 Majority Vote. Any act which the Plan authorizes or requires the  
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Committee to do may be done by a majority (expressed from time to time by  
a vote at a meeting or in writing without a meeting) and shall constitute  
the action of the Committee, and shall have the same effect for all  
purposes as if assented to by all members of the Committee.
- 17.4 Authorization of Committee Members. The members of the Committee may  
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authorize one or more of their number to execute or deliver any  
instrument, make any payment, or perform any other act which the Plan  
authorizes or requires the Committee to do.
- 17.5 Agents. The Committee may employ or retain agents to perform such  
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clerical, accounting, and other services as it may require in carrying  
out the provisions of the Plan.
- 17.6 Any and all such costs in administering this Plan will be paid and  
incurred by Fund American.
- 17.7 Notices. All written notices or elections as required herein shall be  
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sent either by U.S. mail, overnight carrier service or personal delivery  
to the address below:

Fund American Enterprises Holdings, Inc.  
c/o Fund American Enterprises, Inc.  
The 1820 House/Main Street  
Norwich, VT 05055 Attention: Mr. Michael S. Paquette

FUND AMERICAN ENTERPRISES HOLDINGS, INC.  
STATEMENT RE COMPUTATION OF PER SHARE EARNINGS

	Year Ended December 31,		
	1995	1994	1993
<b>Primary earnings per share:</b>			
Per share numerator (in millions):			
After tax earnings	\$ 18.5	\$ 21.1	\$ 70.4
Less dividends on preferred stock	(3.8)	(9.9)	(12.2)
After tax earnings applicable to common stock	14.7	11.2	58.2
Tax benefit from sale of discontinued operations	66.0	-	-
Loss on early extinguishment of debt, after tax	(.4)	-	-
Cumulative effect of accounting change - purchased mortgage servicing, after tax	-	(44.3)	-
Net income (loss) for per share computation	\$ 80.3	\$ (33.1)	\$ 58.2
<b>Per share denominator (in thousands):</b>			
Average common shares outstanding	7,794	8,874	9,593
Dilutive options, warrants and performance shares	788	531	655
Shares for per share computation	8,582	9,405	10,248
<b>Per share earnings (in dollars):</b>			
After tax earnings	\$ 1.71	\$ 1.20	\$ 5.68
Tax benefit from sale of discontinued operations	7.69	-	-
Loss on early extinguishment of debt, after tax	(.04)	-	-
Cumulative effect of accounting change - purchased mortgage servicing, after tax	-	(4.71)	-
Net income (loss)	\$ 9.36	\$ (3.51)	\$ 5.68
<b>Fully Diluted earnings per share:</b>			
Per share numerator (in millions):			
After tax earnings	\$ 18.5	\$ 21.1	\$ 70.4
Less dividends on preferred stock	-	(9.9)	(12.2)
After tax earnings applicable to common stock	18.5	11.2	58.2
Tax benefit from sale of discontinued operations	66.0	-	-
Loss on early extinguishment of debt, after tax	(.4)	-	-
Cumulative effect of accounting change - purchased mortgage servicing, after tax	-	(44.3)	-
Net income (loss) for per share computation	\$ 84.1	\$ (33.1)	\$ 58.2
<b>Per share denominator (in thousands):</b>			
Average common shares outstanding	7,794	8,874	9,593
Dilutive options, warrants and performance shares	788	534	655
Dilutive preferred stock	607	-	-
Shares for per share computation	9,189	9,408	10,248
<b>Per share earnings (in dollars):</b>			
After tax earnings	\$ 2.02	\$ 1.20	\$ 5.68
Tax benefit from sale of discontinued operations	7.18	-	-
Loss on early extinguishment of debt, after tax	(.04)	-	-
Cumulative effect of accounting change - purchased mortgage servicing, after tax	-	(4.71)	-
Net income (loss)	\$ 9.16	\$ (3.51)	\$ 5.68





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caption: "On the cover" It took a bit of a search, but we found the "WM" of our White Mountains logo in the hills surrounding Mount Washington, New Hampshire. (c) William H. Johnson.

CHAIRMAN'S LETTER

Dear Shareholder,

1995 financial results for your enterprise were satisfactory. We ended the year with a GAAP book value per share of \$83.28, up 21%.

1995 was a year we applied a box of Crayolas to the pencil outline of Fund American. We are pleased with the emerging portrait. As planned, we liquidated over \$200 million of our passive investments this year and redeployed them into operating businesses. Our insurance operations, headed by Tom Kemp and Morgan Davis, are taking shape nicely. White Mountains Holdings, a start-up only a year ago, has become the parent to a nice cluster of successful insurance companies: Financial Security Assurance, Main Street America, White Mountains Insurance, and new acquisitions Valley and Charter. In 1996 we will add one more significant holding, Folksamerica Reinsurance, to this family.

Financial Security Assurance (FSA), which joined us in 1994, exceeded its challenging new business goal for 1995 while achieving a growth in adjusted book value per share of 20%. Bob Cochran and his team capped a fine year by completing the acquisition of municipal bond insurer Capital Guaranty, creating a \$1.5 billion combined enterprise. This places FSA solidly in the top rank of AAA rated financial-guaranty insurers.

Main Street America turned in a GAAP aftertax ROE of 34% for 1995. CEO Phil Koerner modestly allows that, "1995 was a good year." \$131 million in written premiums and a 1995 combined ratio of 100.2% increased Main Street America's value to us in our first year of affiliation.

Morgan Davis has our home state White Mountains Insurance off to a solid start. The company was licensed in March 1995, appointed 24 independent agents in September, wrote its first policy in October, and finished the year with \$250,000 in written premiums. The enthusiasm of the agents and the gratifying response from the New Hampshire marketplace have delighted us.

The fourth quarter acquisition of the Valley Group, which writes \$73 million in property and casualty premiums annually in Washington, Oregon and California, adds Dan Post to

[PHOTO OF CHAIRMAN APPEARS HERE]

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caption: John J. Byrne, Chairman

our family of experienced insurance managers. As part of the purchase we also acquired Charter, which writes \$64 million of non-standard automobile premiums in Texas annually, which Dan Post also manages.

White Mountains Holdings now has total assets of \$360 million, with a group of affiliated insurers focused on careful underwriting in good regional or niche markets, writing over \$300 million in annual premiums. I see a long steady future for our insurance operations under this team of seasoned insurance professionals - three yards and a cloud of dust.

While Source One achieved above-plan net income of \$26 million, they fell short on originations in a brutally competitive mortgage market, and seriously lagged on our touchstone measure -- growth in intrinsic business value. For the second time in two years, we have not completed a sale of Source One after an expression of interest from a competitor. We believe the time will come when values return to this industry.

Finally, this is the year Fund American completed a lengthy transformation. In July we paid off the last portion of preferred stock held by our former parent, American Express. We had a little ceremony up here in rural New England to celebrate. We've completed a ten-year journey from initial public offering, through the fine operations of Fireman's Fund, to the Allianz sale, to a liquidation period where we returned almost \$4 billion to our stakeholders, to re-emerge as a smaller, more sharply focused regional insurance company and mortgage company. We appreciate those of you who have made the entire journey with us, and welcome those who joined along the way.

Thank you for your patience.

Respectfully submitted,

/s/ John J. Byrne

John J. Byrne  
Chairman  
March 17, 1996

White Mountains Holdings  
Tom Kemp, CEO

Dear Shareholder,

We applied a variety of colors to our portrait in the last year in White Mountains. A new idea fifteen months ago, White Mountains has blossomed into a \$360 million company, a major planning and operating unit of Fund American. Jack reviewed the companies making up White Mountains Holdings in his letter. In 1996, we plan to add a 50% interest in Folksamerica Reinsurance, acquired for \$79 million.

White Mountains' mission is to become a premier group of regional or niche property and casualty underwriters which, with prudent operating and financial leverage, produces for their owners a long-term return equal to 700 basis points over ten year treasuries (currently 13%, for ease of conversation) after corporate tax. We wish each member of our group to be well managed in its own right, and each underwriting-driven using its own strategy. We will function as intelligent owner and capital provider/allocator.

My years of association with Jack Byrne have inculcated a set of insurance business traditions and operating principles which you will recognize if you follow our companies. These principles guide our acquisitions and unify our affiliates. For White Mountains I state them as follows:

1. Underwriting comes first. An insurance enterprise must respect the

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fundamentals of insurance. There must be a realistic expectation of underwriting profit on all business written, and demonstrated fulfillment of that expectation over time, with focused attention to loss ratios and to all of the professional insurance disciplines.

2. Invest for total return. Historical insurance accounting has tended to hide

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unrealized gains and losses in the investment portfolio and to over-reward reported investment income (interest and dividends). Regardless of the accounting, we must invest for the best growth in value over time. In addition to investing our bond portfolios for total after tax return, that will mean prudent investment in equities consistent with leverage and insurance risk considerations. (Over the long-term equities are not necessarily any more risky than the true risks in bonds or other fixed income investments.)

3. Maintain a disciplined balance sheet. The first concern here is that

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insurance liabilities must always be fully recognized. Loss reserves and, increasingly, expense reserves must be solid before any other aspect of the business can be solid. Pricing, marketing, and underwriting all depend on informed judgement of ultimate loss costs.

4. Be the low cost operator. This principle seems to wax and wane in management

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attention, and in the quality of its management. Spending more money to provide a better product or service may confuse or seem to rebut the "low cost" argument. Investments in better systems can be expensive (and worse, ineffective). However, the business that can produce its product/service at a lower cost than competitors has an embedded advantage (a moat around its franchise).

5. Think like owners. Each of the first four principles are "thinking like

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owners", so, to some degree, this is a catchall, but it has a value all its own. Yes, there are other "stakeholders" in a business enterprise, and yes, doing good work (as a business or an individual) requires more than this quarter's profit. But thinking like an owner embraces all that without losing the touchstone of a capitalist economic enterprise. We should be students of capital and business (and much else, but business is what this organization is about). The short version, in my view, is that the original Adam Smith had it right...capital will flow according to its own nature; the "invisible hand." If we do not earn and deserve our owners' capital, we will not long have it.

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[PHOTO OF TOM KEMP APPEARS HERE]

caption: Tom Kemp, CEO

In the coming year, many of us at White Mountains will be playing new or expanded roles, and all of us will be working with new colleagues. For Dan Post, Stu Olson, Phil Koerner, Bob Cochran, Roger Taylor, Morgan Davis and Carey Benson some of the associations are new but the current role is clear: be the hands-on general manager of Valley, NGM/MSA, FSA, White Mountains Insurance and Charter. In the pages which follow, our managers will briefly explore some unique features of our affiliated companies. I am proud to have assembled them; I think you will be proud to own them. We look forward to sharing our futures with you.

Respectfully submitted,

/s/ K.T. Kemp

K.T. Kemp

In the next few pages, each of our general managers talk about their companies. Some have been part of the Fund American family for years (Source One), some were introduced to you last year (FSA, White Mountains Insurance and Main Street America), and some are new to you this year (Valley and Charter). While Valley and Charter are both part of the "Valley Group", we present them separately here because the businesses are distinct. Independent as our companies are, you will discover in their comments a common commitment to service, value and financial discipline.

Financial Security Assurance (FSA)  
Bob Cochran, President & CEO  
Roger Taylor, Managing Director & COO

Founded in 1985, FSA is one of the four major bond insurers that provide guarantees of principal and interest in the municipal bond and asset-backed securities markets. In 1995 we became a bigger, better, stronger company.

Through strong origination activity, growth in the value of our investment portfolio and our merger with Capital Guaranty Corporation, we increased our assets to almost \$1.5 billion, shareholders' equity to \$778 million and total claims-paying resources to more than \$1 billion.

Financial guaranty insurance bridges differences between the needs of investors and issuers in the municipal bond and asset-backed securities markets. Investors in FSA-guaranteed securities rely on the guaranty not only for default protection but also to enhance liquidity, to mitigate the risk of issuer downgrade and to simplify the investment decision concerning complex securities.

For issuers, FSA's Aaa/AAA guaranty lowers interest costs and broadens the distribution of securities. We add additional value through the knowledge and skill of our underwriters. Our job is not to only raise a bond issue's rating to Triple-A. We also work with issuers and their advisors to find the structure and execution that best meets the issuer's needs.

#### INCREASED MUNICIPAL PRESENCE THROUGH THE CAPITAL GUARANTY MERGER

The merger with Capital Guaranty was greeted enthusiastically in the municipal bond market. It brings important benefits to FSA, including increased capital and claims-paying resources, expanded service capabilities, and improved liquidity for FSA-insured municipal bonds.

FSA began providing municipal bond insurance in 1990, and our municipal business has grown substantially since then. The merger accelerates this growth. FSA and Capital Guaranty together captured about 9% of the insured municipal new-issue market in 1995, and we will build on this base over time. We are committed to being a major participant in this market, providing high-quality, responsive service to all our customers, including issuers, their advisors and purchasers of FSA-insured municipal bonds.

Conditions in the municipal bond market were mixed in 1995. The U.S. municipal new-issue volume of \$156 billion was essentially flat with the previous year, although volume did improve over the course of the year. The insured portion of the market actually grew 11% in dollar volume, and insurance penetration rose to 44%, partly as a result of price competition that reduced the cost of insurance. Industry pricing firmed somewhat toward the end of 1995, a development we applaud. Higher prices, even with lower penetration, would improve insurers' overall returns. And lower penetration would be healthy for the market as a whole, creating a wider choice of ratings and yields for institutional investors.

We are pleased with our results given this environment. FSA insured more than twice as many primary-market municipal transactions than in the previous year. We increased the municipal par amount we originated by 22% to \$5.4 billion, wrote \$65.3 million of present value premiums and maintained average returns on equity in our target range.

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[PHOTO OF BOB COCHRAN APPEARS HERE]  
caption 1: Bob Cochran, President & CEO

[PHOTO OF ROGER TAYLOR APPEARS HERE]  
caption 2: Roger Taylor, Managing Director & COO

## A RECORD YEAR IN THE ASSET-BACKED MARKET

To a greater extent than any other bond insurer, FSA balances its involvement in the municipal and asset-backed businesses. In 1995 the value of this approach was obvious, as our asset-backed business led FSA's overall performance. In this market, we turned in our finest performance ever, guaranteeing \$9.8 billion of asset-backed obligations to produce \$73.9 million of present value premiums, an 88% increase.

While the U.S. municipal bond market is mature, the asset-backed market still has significant growth potential. New U.S. public issues on non-mortgage asset-backed securities soared to \$108 billion in 1995 from only \$51 billion as recently as 1992. There are also other substantial market sectors, including residential mortgage-backed securities, asset-backed private placements and commercial paper, as well as international markets. With insured penetration of this market currently at less than 15%, we are optimistic about our asset-backed business.

## GLOBAL PERSPECTIVE

We continue to position FSA to benefit from the expansion of international financial markets. To support this effort, we opened representative offices in Madrid and Paris in 1995. During the year, we guaranteed a number of international transactions, including financings in Australia, France and the United Kingdom.

## LOOKING AHEAD

We enter 1996 in a very strong position. We are the most experienced and broadly based guarantor in the expanding asset-backed market. We have a greatly enhanced profile in the municipal bond market and are positioned for growth there. Because of our balanced strategy across these two markets, we have the most diversified insured portfolio and the broadest opportunities in the industry.

Just as important, we have the capital resources to take advantage of these opportunities. Of the major bond insurers, FSA has the lowest ratio of risk to capital and, according to Standard & Poor's Ratings Services, the highest margin of safety for capital adequacy. As a result, we provide exceptional value for policyholders and have capital to support further growth.

The guiding principles at FSA are financial strength, stringent underwriting and customer service. We will stay focused on these principles as we continue to build value for all our stakeholders.



White Mountains Insurance Company  
Tom Kemp, Chairman  
Morgan Davis, President & CEO

It has been a whirlwind first year for White Mountains Insurance. Conceptualized, organized, capitalized, licensed, and writing new business all in a matter of months.

We began by letting our customers teach us how to meet their needs. As a newly emerging insurance company we knew it would be important to offer the agents and their commercial customers a market that could respond to the business that is indigenous to the territory. To do this we had to listen intently to what was needed and rely on our past experiences with the New Hampshire marketplace.

We met with more than 75 agents in the state to determine their needs as well as the needs of their commercial clients. We were told that to be successful we must be a generalist, have local knowledge of the territory, operate as a regional company, avoid class underwriting and make it easy for the agent to do business. The agents also stressed the importance of developing a good working relationship between the company and the agency. While these strategies might seem obvious, it quickly became clear that in New Hampshire our competitors often overlooked these concerns. Fortunately, it presents us with opportunities we can capitalize upon.

Using the information we gained from our personal visits, we were able to start building our company "brick by brick". We are acutely aware that every "brick" is a small business, somebody else's dream. Protecting those dreams is our mission. Our initial accounts consisted of manufacturers and contractors, historical societies, restaurants, repair garages and other valuable services based here in New Hampshire.

Having established a foothold in New Hampshire, plans are to expand our operation into the adjoining states to reach our goal of being recognized as a premier commercial middle market property and casualty insurance company in New England. We believe that the same market opportunities that were discovered in New Hampshire exist in the surrounding states and we are poised to take advantage of them. By the year 2000 we expect to be an important and significant competitor with a profitable book of business. White Mountains Insurance prides itself in living up to its slogan, "Go to the White Mountains, the 'go-to' company."

AN AGENTS PERSPECTIVE:

"To sum up White Mountains: fresh approach, modern ideas, strong capitalization."

[TWO PHOTOS APPEAR HERE]

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caption 1: New Hampshire Governor Steve Merrill (center) joined Tom Kemp and Morgan Davis at the opening of the White Mountains' principal field office in Manchester.

caption 2: Sharon G. Bush, Vice President, Tender Corporation describes a product's packaging to Jim Keck and Jim Wickman, White Mountains Insurance Company, and Terrence Abbott, President & CEO, A.D. Davis, Inc. Insurance Agency. Tender Corporation worked with White Mountains Insurance representatives to configure its warehouse inventory to maximize the effectiveness of their sprinkler system.

AN AGENTS PERSPECTIVE:

"White Mountains combines big company experience with small company enthusiasm."

Main Street America  
Phil Koerner, President & CEO

It is always a pleasure to talk about strong results, so I'm happy to share that we experienced a good year in 1995. Our written premiums increased by 6%, our policyholders' surplus grew by more than 18% and our combined ratio beat estimated industry averages by over six percentage points.

We also created opportunities to fortify our foundation for future growth. We appointed over 100 new agency partners throughout our operating territories. At the beginning of the year we began to do business in the state of North Carolina, and by December we had 13 agency partners and nearly \$600,000 in written premiums. Throughout 1995 we prepared for a merger with The Mutual Assurance Company (MACO) of Philadelphia, finalized in January of 1996. Through MACO subsidiaries, we are preparing to enter new territories, particularly in the Southeast, an area of targeted growth for our organization. As the second-oldest property insurer in the nation, MACO adds a rich insurance tradition to our group of companies.

Clearly, we are pleased with what we have achieved this year. Yet, we prefer to view our growth in a broader perspective: To take stock of what we have become over time, and what we accomplished along the way.

At the Main Street America group, we develop five-year Scenarios. These Scenarios are checkpoints for us, as we travel on our journey into the future. Along the route, we make opportunities to pause and reflect upon our journey thus far; to re-examine our chosen route; and to always seek more efficient means of travel. For us, this year brought the culmination of our 1995 Scenario, and allowed us to take a look at where we are in our progress toward the new millennium.

We have realized many goals in the past five years, becoming the kind of organization we wanted to be when we were spinning our dreams in the 1980's. Our premium writings increased by over 60%, while our policyholders' surplus doubled. Our average premium per agency rose \$150,000. Information System & Services Corporation, our policy processing subsidiary, now provides services to 35 insurance companies.

We purchased Guilderland Reinsurance Company and are establishing an assumed reinsurance operation as well. One of the most meaningful events of the past five years was the mutually-profitable relationship we entered into with Fund American. Altogether we met, and in many cases exceeded, our expectations.

This was possible because we preserved those characteristics most important to us. For example, we develop relationships carefully and then look for ways to enrich them. Recognizing that business will always be personal, we emphasize relationships as a means to accomplish our goals. We continue to focus on those customers around whom we've built our organization - Main Street Americans - and the independent agents who serve them.

While acquiring more customers, we have retained our emphasis on personal service. "We take you personally", developed ten years ago as a service slogan, has evolved into a description of the way we behave toward co-workers and customers alike. And through significant production growth, we continued to focus on the quality of our underwriting - which is one of the best ways to ensure that today's production translates into tomorrow's prosperity. Together, these attributes brought us success by any set of standards.

[PHOTO OF PHIL KOERNER APPEARS HERE]

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caption 1: Phil Koerner, President & CEO

As Irving Berlin once said, "The toughest thing about success is that you've got to keep on being a success." We are proud we have had cumulatively successful results throughout the decade, yet we must avoid wrapping ourselves in a cloak of false security based upon our past success. This is particularly important as we look down the road toward a very challenging remainder of the century.

The next few years will test our mettle as other companies enter our market, technology evens the playing field among insurers and regulators continue to exert their influence over the parameters within which we can operate. Yet, our 2000 Scenario - our next checkpoint - calls for us to have doubled our premium volume while keeping our manpower steady. That is a very ambitious plan. Ambitious plans require a talent for envisioning the future, the ability to evaluate the shifting sands of the environment, and the clarity to describe where you want to go to all of the people who will take you there. Most importantly, ambitious plans require execution.

We have a consistent record of executing our plans - which has been the key to our success thus far. We are well aware that the next several years will challenge us. Throughout those years, we will focus on our market and the needs of our customers, value our relationships, and provide outstanding service. Furthermore, we are committed to doing our work more intelligently, and engaging all of the people, resources and tools at our disposal in our quest to become more productive. As we do these things well, we will continue to execute our plans, and move into the next century as a strong, focused and prosperous insurer.

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caption: Main Street America headquarters in Keene, NH

Valley Insurance Group  
Dan Post, President & CEO  
Stu Olson, Executive Vice President & COO

We are pleased to introduce you to the Valley Group which also includes Charter, described separately. In 1985 the Valley Insurance Company opened its first office in Albany, Oregon, with a clear vision in mind: to provide quality insurance products and services to families and family owned businesses through independent agencies. The customers receive the best attributes of size - financial strength and security - and the best elements of service - speed and innovation - allowing us to underwrite uniformly and operate efficiently.

We feel we do a great job here, because of our belief in our employees. We have many Valley employees who have moved and grown throughout our history. The experience of Sherri Vandecoevering, an underwriter at Valley, typifies this: "Valley gave me the support and training to move from a data entry position to a professional underwriter." In return, the company has benefited from her many "million-dollar-months." In all, seventy Valley employees participated in accredited accounting and insurance classes this past fall. Fulfilled employees lead to satisfied customers.

Excellence in customer service is the cornerstone of Valley's foundation for success. One area where Valley's reputation is particularly strong is claims. Our claims philosophy is to pay all claims promptly and fairly. Every attempt is made to contact claimants and insureds immediately and to make them aware of our concern and intention to handle their claims properly. We tell our claims staff, "People buy insurance to protect themselves in case of a loss, and its our job to prove to insureds that their agents placed them with the best company." The value of a caring attitude can never be overstated.

Unfortunately 1995 was a year in which we were to be tested in our claims area. With three unprecedented catastrophes ("cats" to insurance folks) our people worked around the clock to make our insureds whole. Our strong relationships and "pre-cat" agreements with independent adjusters and contractors enabled us to quickly and effectively serve the needs of our customers.

Here is what one agent wrote us about our performance:

"During the second and third weeks of January we followed up with all of our clients that had claims as a result of the December windstorm. Our intent was to make sure that our clients were properly taken care of and that nothing had fallen through the cracks. We were extremely pleased that there were no negative comments and, in many cases, clients expressed appreciation for the speedy response and understanding exhibited by Valley. The claims department, and the entire company, deserve a heartfelt 'Well Done' for their efforts."

[TWO PHOTOS APPEAR HERE]

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caption 1: Dan Post, President & CEO  
caption 2: Valley employees strengthen their community by supporting local charities such as the United Way and the YMCA. Forty-five Valley employees from our Albany, Oregon headquarters participated in December's blood drive for the American Red Cross.

Good service works; actually, its the key to our success. Valley is rewarded for its efforts with high customer retention rates. Over the past two years Valley has retained 88% of its personal lines customers on a yearly basis. High retentions over the long-term lead to lower than average policy acquisition expense rates and better underwriting results. Our customers are pleased, and we are pleased.

In 1995 we found the right partner in White Mountains and Fund American, consolidated certain functions with Charter, became a service provider to White Mountains Insurance, and wrote \$66.8 million in net premiums. Unfortunately, we had painful loss experience. Rather than make excuses for catastrophes which are an integral cost of our product, we look forward to 1996 with renewed effort on underwriting and pricing. We know that over time our patient, disciplined strategy is working.

For 1996 we have many things to do. Although we plan to write 15% more premiums, losses and expense control will remain our priorities; we will not sacrifice profit for growth. In January 1996, we completed the acquisition of Valley National Insurance Company which is licensed in forty-nine states, effectively bringing us a national franchise. Valley National Insurance Company expands our canvas in this and future years (Fund American, keep those crayons handy!).

We are proud to join the White Mountains and Fund American family. The financial strength and insurance expertise of our new parent is a tremendous resource. We are pleased that our focus on personal service and careful underwriting matches so well with our parent's philosophy.

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caption: Julie Hansen, Processing Center Manager, gives the "gift of life" at a quarterly, Valley-sponsored blood drive.

The Charter Group  
Dan Post, President & CEO  
Carey Benson, Senior VP & COO

Charter joined the Valley Group in 1995. Charter was founded in Dallas, Texas, in 1971, to provide a brokerage and servicing outlet for non-standard automobile business written by the Allstate Insurance Company. Over the years, Charter broadened its market to include independent agents who also needed access to a non-standard automobile program. Today the company writes policies through 750 independent agents across Texas. As a regional specialist company, Charter has built its reputation distributing competitive, quality insurance products and exceptional service to its customers.

At Charter we focus on the automobile insurance needs of drivers with poor driving records or other characteristics which may lead to higher losses. Although many insurance companies focus on the standard and preferred risk markets, there are opportunities available in the non-standard market as well.

One of our operating tenets is to maintain low expenses relative to our competitors. The keys for achieving low expenses are: (1) concentration in the personal automobile line itself, specifically non-standard automobile, thereby enjoying the unique service capabilities, efficiencies and operating advantages that such specialization creates; (2) maintaining a low cost operating structure; and (3) encouraging our employees to work efficiently, through emphasis on automated systems and technology. Although our expense ratio improved dramatically from 54.7% for 1994, to 25.5% for 1995, we will continue to focus on improvement (the low in the industry is 22%). Achieving a low expense ratio puts us in a favorable competitive position in a price sensitive market.

An equally important component is our underwriting philosophy and execution. Charter's underwriting philosophy involves disciplined risk selection and sophisticated pricing structures. Classes of risks are defined with clear underwriting guidelines and pricing methodologies. Spread of risk is achieved by a mix of agents, geographic and economic diversity, and concentration avoidance. Low loss ratios help us compete profitably on price.

We strive to deliver on the Insurance Promise by providing service beyond our customers' expectations. Charter's service standards and service response times are monitored continuously. With the implementation of underwriting service units (self-directed work groups) which began in January 1996, we will more effectively target agreed-upon goals for customer service, premium production and underwriting results by individual agencies.

After a difficult 1994, we accomplished a great deal of change and progress this past year. We began consolidating functions with Valley where it will be beneficial, yet strengthened the internal capabilities of our company. We reduced our expense ratio to a level that is close to the lowest in the industry. We studied and implemented a new rating system and more effective pricing and commission structures. We completed significant systems enhancements. As a result of these changes our written premium grew by 38% in 1995. We believe that the long-term opportunities for our non-standard program are exceptional.

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caption: Carey Benson, Senior Vice President & COO

In 1996 we will focus on our business fundamentals. If we can continue lowering the cost of our product, and if we price it properly, we will deliver above average service and generate above average returns on the capital our shareholder has entrusted to us.

[TWO PHOTOS APPEAR HERE]

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Caption 1: Charter Group Facility in Dallas, Texas

Caption 2: Reginald Bibb, Casualty Claims Supervisor and Elsa Kemp, Claims Adjuster use new technology, implemented in August 1995, to print "on-the-scene" damage appraisals for customers."



Source One Mortgage Services Corporation  
Jim Conrad, President & CEO  
Bob Richards, Chairman

We ended the year with \$26 million in net income, but our intrinsic value dropped with the 200 plus basis point decline in long-term interest rates. 1995 proved to be a volatile operating environment for Source One and the mortgage banking industry. It was the second consecutive year we originated fewer loans. Originations fell from \$4.6 billion to \$2.9 billion, a decline of 37%.

With significant industry overcapacity and extended irrational pricing, many of our competitors have elected to exit the mortgage banking business, while others have opted for scale. Consolidation is occurring in the industry on the servicing side very quickly. As evidence, two years ago there were no \$100 billion servicers. Today there are five.

Production seems to be a mixed bag with consolidation and fragmentation occurring simultaneously. This is because the big servicers are building large production networks to replenish run-off in their portfolios. The availability of a large number of wholesalers offering attractively priced products led to the growth of the independent broker segment of the business. Brokers tend to be small and operate in local markets.

To be competitive and profitable in this type environment, Source One is:

1. Centralizing as many of the production operation functions as possible.
2. Utilizing technology to improve the quality, competitiveness, and speed of delivery of our product offerings.
3. Committing to continue to lower the per unit cost associated with producing and servicing loans.
4. Developing a hedging strategy to protect the value of our capitalized servicing asset.

[TWO PHOTOS APPEAR HERE]

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caption 1: Bob Richards, Chairman and Jim Conrad, President & CEO  
caption 2: Source One maintains a commitment not only to customer service, but also to community service. Here, two Source One employees, John Heflin (left) and John Clancey (right) participate in "Paint the Town," a charitable event where people from local companies volunteer to fix up homes in need of repair around the Detroit area.

While interest rates continue to take us on a roller-coaster ride, originations have started the new year on an up-beat.

Source One will be celebrating its 50th Anniversary in 1996. During this time, Source One has fulfilled its mission of "Financing the Future of America's Homeowners" for millions of people around the country. Dalbar Inc., a Boston based research company, recently conducted a nationwide survey which found Source One to be the mortgage industry's top company in the area of customer service. We earned this recognition because of our commitment to customer satisfaction. The company is proud of its commitment to equal opportunity lending, ensuring that every person who has the desire and means to own a home can qualify for a mortgage. In 1996 and beyond, Source One will continue to make the dream of home ownership a reality.

[PHOTO APPEARS HERE]

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caption: Source One's home office in Farmington Hills, Michigan

Fund American  
SELECTED CONSOLIDATED FINANCIAL DATA

Millions, except per share amounts	Year Ended December 31,				
	1995	1994	1993	1992	1991
<b>Income Statement Data:</b>					
Revenues	\$ 222	\$ 229	\$ 251	\$ 214	\$ 234
Expenses	226	226	234	191	162
Pretax operating earnings (loss)	(4)	3	17	23	72
Net investment gains	39	39	124	65	112
Pretax earnings	35	42	141	88	184
Income tax provision	17	21	71	34	64
After tax earnings	18	21	70	54	120
Gain from sale of discontinued operations, after tax	66 (a)	--	--	1 (c)	1,306 (c)
Loss on early extinguishment of debt, after tax	--	--	--	--	(29) (f)
Cumulative effect of accounting changes:					
Purchased mortgage servicing, after tax	--	(44) (b)	--	--	--
Postretirement benefits, after tax	--	--	--	(2) (d)	--
Income taxes	--	--	--	(24) (e)	--
Cumulative effect of transition adjustment for prior period net unrealized investment losses, after tax	--	--	--	--	(84) (g)
<b>Net income (loss)</b>	<b>\$ 84</b>	<b>\$ (23)</b>	<b>\$ 70</b>	<b>\$ 29</b>	<b>\$1,313</b>
<b>Primary earnings per share:</b>					
After tax earnings	\$ 1.71	\$ 1.20	\$ 5.68	\$ 2.71	\$ 4.87
Net income (loss)	9.36	(3.51)	5.68	.74	67.14
<b>Fully diluted earnings per share:</b>					
After tax earnings	2.02	1.20	5.68	2.70	4.85
Net income (loss)	9.16	(3.51)	5.68	.73	53.14
Cash dividends paid per share of common stock	.20	--	--	--	.68
<b>Ending Balance Sheet Data:</b>					
Total assets	\$1,872	\$1,807	\$3,305	\$3,129	\$2,964
Short-term debt	445	254	1,537	1,513	1,013
Long-term debt	407	547	601	423	324
Minority interest-- preferred stock of subsidiary	44	100	--	--	--
Shareholders' equity	700 (h)	661 (h)	905 (h)(i)	988 (h)	1,496
Book value per common and equivalent share	83.28	68.95	77.27 (i)	80.65	75.49

- (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. See Note 3 of the Notes to Consolidated Financial Statements.
- (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. See Note 6 of the Notes to Consolidated Financial Statements.
- (c) Reflects the sale of Fireman's Fund. See Note 3 of the Notes to Consolidated Financial Statements.
- (d) Reflects the prior years' cumulative effect of the adoption of Statement of Financial Accounting Standards ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions."
- (e) Reflects the prior years' cumulative effect of the adoption of SFAS No. 109, "Accounting for Income Taxes."
- (f) Reflects the repayment during the first quarter of 1991 of all the parent company's debt outstanding at December 31, 1990.
- (g) Prior to 1991 such unrealized investment losses were recorded as a direct adjustment to shareholders' equity, with no corresponding charge to earnings.
- (h) Reflects redemptions of the Company's Voting Preferred Stock Series D, par value \$1.00 per share (the "Series D Preferred Stock") and repurchases of shares of the Company's Common Stock, par value \$1.00 per share ("Shares"). See Note 13 of the Notes to Consolidated Financial Statements.
- (i) Reflects the distribution of approximately 74% of the outstanding shares of Common Stock of White River Corporation ("White River") to shareholders on December 22, 1993.

Fund American  
MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Years Ended  
December 31,  
1995, 1994 and  
1993

Consolidated Results

Fund American reported net income of \$84.1 million for the year ended December 31, 1995, which compares to a net loss of \$23.2 million for 1994 and net income of \$70.4 million for 1993. 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 a former subsidiary; and (iv) the receipt of a \$9.7 million pretax breakup fee, plus related expenses, from Home Holdings, Inc. The 1994 net loss includes a \$44.3 million after tax charge related to a change in accounting methodology adopted by Source One.

Book value per common and common equivalent share was \$83.28 at December 31, 1995, which compares to \$68.95 at December 31, 1994. The 1995 favorable tax development and strong investment portfolio results combined to produce most of the increase in book value per share from 1994 to 1995.

After tax earnings for 1995 were \$18.5 million versus \$21.1 million and \$70.4 million for 1994 and 1993, respectively. The decrease from 1993 to 1994 is primarily due to \$73.4 million of pretax unrealized gains recorded in earnings for 1993. Under a new accounting standard adopted as of December 31, 1993, Fund American now records changes in unrealized gains and losses related to its investment portfolio as a direct adjustment to shareholders' equity with no credit or charge to net income.

Insurance Operations

As is further described under "Liquidity and Capital Resources," White Mountains is acquiring and developing various insurance operating interests. WMIC began operations in the third quarter of 1995, and White Mountains completed the acquisitions of Valley and Charter on December 1, 1995.

Insurance operating results for the year ended December 31, 1995 included \$5.8 million of net earned premiums and \$8.2 million of losses and loss adjustment expenses. Losses and loss adjustment expenses included \$3.0 million of reserve strengthening at Valley for losses incurred prior to the date of acquisition.

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 reduce the loss 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.

Management expects that White Mountains' insurance operations will have a significantly larger impact on Fund American's reported financial results in 1996 and future years. See "Liquidity and Capital Resources - White Mountains."

#### Mortgage Origination and Servicing Operations

Source One adopted SFAS No. 122, "Accounting for Mortgage Servicing Rights," an amendment to SFAS No. 65, as of January 1, 1995. SFAS No. 122 requires the total cost of acquiring mortgage loans, either through loan origination activities or purchase transactions, to be allocated to the mortgage servicing rights and the loans based on their relative fair values. The statement requires entities to measure impairment on a disaggregated basis by stratifying the capitalized servicing asset based on one or more predominant risk characteristics of the underlying loans. Impairment is recognized through a valuation allowance for each individual stratum. The adoption of SFAS No. 122 as it relates to the capitalization of originated mortgage servicing rights resulted in the recognition of an additional pretax gain on sales of mortgages of \$27.2 million for the year ended December 31, 1995. The impairment provisions of SFAS No. 122 resulted in a pretax charge of \$28.0 million for the year.

In 1994 Source One changed the methodology used to measure impairment of its purchased mortgage servicing rights asset. The new accounting methodology measured the asset's impairment on a disaggregated basis and discounted the asset's estimated future cash flows using a current market rate. Prior to 1994 Source One measured the asset's impairment on a disaggregated basis including a cost of capital charge for estimating the asset's future cash flows. The adoption of the new accounting methodology, recorded as a cumulative adjustment as of January 1, 1994, resulted in a \$68.1 million pretax, \$44.3 million after tax, charge to income for 1994.

Net mortgage servicing revenue was \$60.5 million for the year ended December 31, 1995 which compares to \$82.4 million in 1994 and \$53.5 million in 1993. The decrease in net servicing revenue for 1995 compared to 1994 reflects the sale of \$11.0 billion of servicing rights to third parties during 1995, partially offset by slower amortization of the capitalized mortgage servicing asset due to lower actual and anticipated mortgage loan prepayments in 1995 compared to 1994. The increase in net servicing revenue in 1994 compared to 1993 reflects slower amortization of the capitalized servicing asset due to the reduced pace of mortgage loan payoffs in the servicing portfolio during 1994 compared to 1993, partially offset by lower weighted average net servicing fee rates on newly originated loans. A summary of the mortgage loan servicing portfolio activity follows:

Billions	Year Ended December 31,		
	1995	1994	1993
Beginning balance	\$ 39.6	\$ 38.4	\$ 37.3
Mortgage loan production	2.9	4.6	11.5
Servicing acquisitions	4.7	3.7	6.4
Servicing sales	(11.0)	--	--
Mortgage loan payoffs	(2.3)	(4.7)	(13.6)
Servicing released, principal amortization and foreclosures	(2.1)	(2.4)	(3.2)
Ending balance	\$ 31.8	\$ 39.6	\$ 38.4

During 1995 Source One sold the rights to service a total of \$11.0 billion of mortgage loans for net cash proceeds of \$181.1 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 for cash proceeds of \$70.2 million and continues to service these loans pursuant to a subservicing agreement. A gain of \$19.9 million was deferred in 1994 and is being recognized in income over the five-year life of the subservicing agreement. For the years ended December 31, 1995 and 1994, the Company recognized \$4.2 million and \$2.7 million, respectively, of the deferred gain which is included in net mortgage servicing revenue. The mortgage servicing portfolio as of December 31, 1995 and 1994 includes loans subserviced for others having a principal balance totalling \$4.0 billion and \$4.3 billion, respectively.

Management's intent regarding the 1995 servicing sale was to take advantage of the substantial increase in the value of servicing rights that was created by the rise in interest rates during 1994 and to bring servicing and origination activities into better balance. Additional sales transactions may occur in the future when management deems it to be economically advantageous. However, a strategy of Source One is to continue to increase the size of the servicing portfolio in order to take advantage of its low cost servicing operation. Consistent with that strategy, Source One purchased the rights to service \$4.7 billion of mortgage loans in the fourth quarter of 1995.

Source One estimates the fair values of its mortgage servicing rights by calculating the present value of the expected future 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 and discounts those cash flows using current estimated market rates. As of December 31, 1995 such discount rates were 10.5% for conventional loans and 12.0% for insured loans.

To measure impairment of the mortgage servicing rights, Source One stratifies its mortgage loan servicing portfolio based on the portfolio's predominant risk characteristics which have been determined to be prepayment, default and operational risks. This results in stratification by interest rate, loan type (investor) and original term to maturity. The prepayment assumptions used in the estimation of fair values are based on market prepayment predictions. The fair value of each stratum is computed and compared to its recorded book value to determine if a valuation allowance, or recovery of a previously established valuation allowance, is required.

The discount rate and prepayment assumptions are significant factors used in estimating the fair value of Source One's mortgage servicing rights and could be significantly impacted by changes in interest rates. Accordingly, it is likely that management's estimate of the fair value of the capitalized servicing asset will change from time to time due to changes in interest rates.

Total mortgage loan production decreased to \$2.9 billion for the year ended December 31, 1995 from \$4.6 billion and \$11.5 billion in 1994 and 1993, respectively. Production related to refinance activity represented approximately 23%, 50% and 67% of total mortgage loan production for the years ended December 31, 1995, 1994 and 1993, respectively. Mortgage loan payoffs decreased to \$2.3 billion and \$4.7 billion for the years ended December 31, 1995 and 1994 from \$13.6 billion in 1993. The decreases in mortgage loan production and payoffs in 1995 and 1994 reflect increases in market interest rates during 1994 and into the first quarter of 1995, and a corresponding reduction in industry-wide mortgage loan refinancing activity from 1993 levels. However, declining market interest rates for mortgage loans during 1995, particularly during the third and fourth quarters, and a flattening of the yield curve resulted in increased fixed rate loan production volumes during the second half of 1995 as compared to the first half of the year.

The net gain on sales of mortgages decreased to \$24.0 million for the year ended December 31, 1995 from \$29.5 million in 1994 and \$34.8 million in 1993. The 1995 net gain amount includes \$27.2 million of gains related to the adoption of SFAS No. 122. Intensive price competition during 1995 led to increased pricing subsidies on originated loans which suppressed gains on sales of mortgages into the secondary market. The decrease in 1994 compared to 1993 reflects lower mortgage loan sales volumes due to the reduction in mortgage loan production and increased pricing subsidies on newly originated loans during the second half of 1994.

#### Investment Operations

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

Millions	Year Ended December 31,		
	1995	1994	1993
Net investment income:			
Source One	\$ 37.7	\$ 71.5	\$ 117.0
Other	17.7	18.7	16.5
Total net investment income	55.4	90.2	133.5
Net realized investment gains	38.8	38.8	50.6
Change in net unrealized investment gains and losses:			
Included in net income	--	--	73.4
Recorded directly to shareholders' equity	28.0	(84.3)	69.9
Total net investment gains (losses), before tax	66.8	(45.5)	193.9
Total net investment return, before tax	\$ 122.2	\$ 44.7	\$ 327.4

Fund American's net investment income is comprised primarily of interest income earned on mortgage loans originated by Source One. The decrease in Source One's net investment income from 1994 to 1995 is mainly attributable to decreased interest income from mortgage loans held for sale related to lower mortgage loan production combined with lower mortgage interest rates experienced during 1995. The decrease in Source One's net investment income from 1993 to 1994 is due primarily to decreased interest income from mortgage loans held for sale related to lower mortgage production experienced during 1994. The decrease in other net investment income from 1994 to 1995 resulted from net sales of investment securities during 1995. The increase in other net investment income from 1993 to 1994 resulted from a second quarter 1994 transfer of \$112.0 million of common equity securities from Source One to its parent, Fund American Enterprises, Inc. ("FAE", a subsidiary of the Company), in exchange for shares of Source One's common stock held by FAE. Prior to such transfer, the net investment income relating to the securities transferred was included in net investment income of Source One. The effects of the securities transfer on other investment income were partially offset by the Company's 1994 investment sales. Cash basis sales and maturities of investments, net of purchases and excluding short-term investments, totalled \$154.1 million, \$151.9 million and \$115.0 million for the years ended December 31, 1995, 1994 and 1993, respectively.

Net realized investment gains during 1995, before tax, included \$23.9 million of gains from the sale of American Express Company common stock. Net realized investment gains during 1994, before tax, included \$22.6 million of gains from the sale of The Louisiana Land and Exploration Company common stock and \$21.7 million of gains from the sale of American Express Company common stock. Net realized gains during 1993, before tax, included \$14.0 million of gains from the sale of A. H. Belo common stock and \$13.2 million of gains from the sale of San Juan Basin Royalty Trust units.

Total investment gains and losses during the three years ended December 31, 1995 have been substantially affected by changes in market prices for crude oil and natural gas. At December 31, 1995, 77% of Fund American's portfolio of common equity securities was invested in the energy, natural resources and related industries sector. Fund American believes that the oil and natural gas industries are highly cyclical and, therefore, anticipates continued volatility in the value of its investment portfolio in the future.

Prior to December 31, 1993 unrealized gains and losses from investments held by Fund American, other than securities held by Source One, were included in net income. As of December 31, 1993 Fund American adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Under the provisions of SFAS No. 115, substantially all of Fund American's portfolio of common equity securities, fixed maturity investments and other investments are classified as securities available for sale and are reported at fair value as of the balance sheet date, with related unrealized gains and losses excluded from earnings and reported as a net amount in a separate component of shareholders' equity. Therefore, for periods beginning after December 31, 1993, all of Fund American's net unrealized gains and losses are reported as a direct adjustment to shareholders' equity with no credit or charge to net income.

A review of certain significant holdings in Fund American's portfolio of common equity securities at December 31, 1995 follows. Share or unit and dollar amounts refer to the aggregate number of shares or units and the aggregate fair value at December 31, 1995 of Fund American's holdings of each security discussed.



Energy, Natural Resources and Related Industries. The energy and natural

resources industries, particularly the crude oil and natural gas industries, are highly competitive, require significant capital expenditures and are subject to extensive regulation at both the national and local levels. Fund American believes that the market prices of securities of companies engaged in those businesses are relatively volatile due to fluctuations in the prices of crude oil, natural gas and other natural resources. Fund American's holdings within the energy, natural resources and related industries sector consist in great part of large blocks of securities of a small number of issuers. This concentration may make the value of Fund American's portfolio more volatile than the value of a more diversified portfolio.

The Louisiana Land & Exploration Company ("LLX"; 2,928,100 shares; \$125.5 million). LLX is one of the largest independent exploration and production companies in the nation. LLX explores for, produces and markets crude oil and natural gas in the United States and certain foreign countries. Fund American believes that LLX's operations are affected by, among other things, changes in the prices of crude oil and natural gas, general economic conditions and LLX's ability to successfully produce and replace crude oil and natural gas reserves. Between January 31, 1996 and March 21, 1996 Fund American sold all 2,928,100 shares of LLX for net cash proceeds of \$125.1 million.

San Juan Basin Royalty Trust ("SJT"; 10,994,876 units; \$68.7 million). SJT 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 SJT may affect the distributions to unitholders of SJT and, therefore, the market prices of the units of SJT. In addition, Fund American believes that the tax and accounting issues involved in owning units in SJT may make such units unappealing to many investors

Other Significant Holdings.

Zurich Reinsurance Centre Holdings, Inc. ("ZRC"; 2,042,572 shares; \$62.0 million). ZRC is one of the largest writers of broker-market property and casualty reinsurance products in North America. On January 10, 1996 Fund American sold all 2,042,572 shares of ZRC for net cash proceeds of \$61.8 million.

Expenses

Compensation and benefits expense increased to \$111.6 million in 1995 from \$69.2 million in 1994 and \$63.5 million in 1993. 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, less certain direct costs, against compensation and benefits expense. The high amount of originations experienced by Source One during 1993 resulted in significantly more origination fees offsetting compensation and benefits expense for those years than in 1994 and 1995. Excluding the effects of the 1995 warrant extension and mortgage loan origination fees, compensation and benefits expense was \$82.9 million, \$98.8 million and \$137.8 million for each of the years ended December 31, 1995, 1994 and 1993, respectively. The declines in compensation and benefits expense reflect significant reductions in production-related personnel at Source One since 1993.

General expenses of \$60.3 million for 1995 compare to 1994 and 1993 amounts of \$77.7 million and \$67.5 million, respectively. The increase in general expenses from 1993 to 1994 is due to the expansion of Source One's mortgage loan production network throughout 1993 and early 1994. Efforts to reduce Source One's operating expenses in response to the contraction in mortgage originations began to take effect in late 1994 and continued through 1995.

Interest expense decreased to \$45.8 million in 1995 which compares to \$78.8 million for 1994 and \$103.1 million for 1993. The decreases are primarily the result of a decrease in total average indebtedness outstanding at Source One. Source One's average inventory of mortgage loans held for sale, which decreased from 1993 through 1995 as a result of lower mortgage loan production, is funded mainly with debt.

Source One's provision for mortgage loan losses, included in general expenses, was \$7.0 million in 1995 which compares to \$8.2 million for 1994 and \$3.7 million for 1993. The increase from 1993 to 1994 is primarily due to charge-offs of certain commercial real estate owned properties and higher average loss volumes relating to certain California residential mortgage loans.

#### Income Taxes

The income tax provision related to pretax earnings for 1995, 1994 and 1993 represents an effective tax rate of 47.3%, 49.3% and 50.1%, respectively. The tax provision for 1993 includes \$13.0 million of current income tax relating to taxable capital gains triggered by the distribution of approximately 74% of the shares of common stock of White River ("White River Shares") to shareholders on December 22, 1993. Such gains were not recognized for financial reporting purposes pursuant to generally accepted accounting principles ("GAAP"). The 1993 provision also includes \$4.7 million of deferred income tax reflecting a tax reserve established on White River's books of record as of December 22, 1993, the date of the distribution. Such reserve offset White River's deferred tax asset calculated on a stand-alone basis as of that date.

Fund American has recorded a net deferred Federal income tax asset of \$24.8 million as of December 31, 1995. The deferred tax asset includes a \$38.2 million net asset related to various operating items partially offset by a \$13.4 million net liability related to net unrealized gains on investment securities.

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 taxable periods ending on or prior to October 23, 1985 (the date of Fund American's initial public offering of Shares) 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 has, 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 1990 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 enhance shareholder value. As is further described below, the formation and capitalization White Mountains embodies this strategy.

### 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 June 1994 the Company entered into a revolving credit agreement with a syndicate of banks. Under the agreement, through August 9, 1996 the Company and certain of its subsidiaries may borrow up to \$75.0 million at short-term market interest rates. The credit agreement contains certain customary covenants, including a \$475.0 million minimum tangible net worth requirement and a minimum financial asset coverage requirement. At December 31, 1995 and 1994 the Company 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. Proceeds from the issuance of the notes were used to repay an existing revolving credit facility and for general corporate purposes. During 1995 and 1994 the Company repurchased \$8.8 million and \$25.0 million, respectively, in principal amount of the notes due February 2003. At December 31, 1995 the remaining outstanding notes had an average maturity of 7.41 years and an average yield to maturity of 7.82%.

In August 1994 the Company redeemed 22,778 shares of the Series D Preferred Stock for \$82.0 million. 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 was 7.75% through July 1994 and 8.75% from August 1994 through July 1995.

During 1995, 1994 and 1993 the Company repurchased 877,868 Shares, 1,128,057 Shares and 536,247 Shares, respectively, for \$65.5 million, \$78.8 million and \$41.8 million, respectively. All such repurchased Shares have been retired. The repurchases of Shares represent a return of excess capital to the Company's shareholders.

During 1993 and 1994 the Company did not pay regular cash dividends to holders of Shares. In the fourth quarter 1995 the Board reinstated regular periodic dividends on Shares of \$.20 per quarter. 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. There can be no assurance, therefore, as to whether or when the Board will declare additional dividends on Shares.

On December 22, 1993 the Company distributed approximately 74% of the outstanding shares of Common Stock of White River to its shareholders. White River commenced operations on September 24, 1993, concurrent with the purchase and transfer of selected assets and the assumption of certain liabilities from Fund American. The assets sold or otherwise transferred by Fund American to White River included primarily \$84.0 million of common equity securities, \$147.1 million of securities classified as other investments and \$25.8 million of short-term investments. White River's initial capitalization consisted of a \$50.0 million demand note payable to Fund American, \$7.0 million of redeemable preferred stock and \$200.0 million of common shareholder's equity. Of the 1,014,750 White River Shares retained by Fund American, 295,932 have been reserved by Fund American for delivery upon exercise of existing employee stock options and warrants.

Pursuant to the terms of a December 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 its borrowings under the Term Note and the Revolver.

On June 29, 1995 White River repaid \$35.1 million in principal amount on the Revolver with (i) 930,000 shares of common stock of Mid Ocean Limited ("Mid Ocean Shares") and (ii) options to acquire an additional 388,140 Mid Ocean Shares through November 2002. On July 3, 1995, White River repaid the remaining \$4.9 million principal balance on the Revolver and \$5.0 million in principal amount on the Term Note in exchange for certain common equity securities. On August 31, 1995, White River repaid the remaining \$45.0 million principal balance on the Term Note with 1,525,424 shares of common stock of Zurich Reinsurance Centre Holdings, Inc.

On March 11, 1996 Fund American entered into a definitive agreement to purchase for \$50.0 million 3,144,827 shares of Common Stock of Travelers-Aetna Property Casualty Corp ("TAPCC"). Fund American's investment will initially represent a .87% interest in TAPCC. Fund American expects the transaction to close near the end of the first quarter of 1996. Upon the closing John J. Byrne, Fund American's Chairman and Chief Executive Officer, will become a director of TAPCC. Fund American intends to fund the investment in TAPCC using proceeds from sales of short-term investments.

#### White Mountains

In 1995 the Company capitalized White Mountains with \$250.0 million of assets. White Mountains was formed to be the holding company for all of Fund American's insurance operating interests. As of December 31, 1995 White Mountains' principal holdings included: 100% ownership of Valley, Charter and WMIC; a 21.0% interest in FSA; and a 33.1% interest in MSA.

Under the insurance laws of the various states under which White Mountains' insurance subsidiaries 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 White Mountains' insurance operating subsidiaries in the future.

FSA. In May 1994 the Company purchased 2,000,000 shares of 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's Common Stock at the initial offering price of \$20.00 per share. At that time the Company's Chairman, John J. Byrne, also became Chairman of FSA. FSA conducts operations principally through Financial Security Assurance Inc., a wholly-owned monoline financial guarantee insurance subsidiary with Aaa/AAA claims-paying ratings. FSA is principally engaged in guaranteeing municipal bonds and residential mortgage and other asset-backed securities.

Following receipt of regulatory approvals, in September 1994 the Company acquired various fixed price options and shares of convertible 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. All shares of and rights to FSA Common Stock owned or acquired by the Company as described above 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. In 1995 the Company purchased an additional 460,200 shares of FSA Common Stock on the open market for \$8.8 million. As of December 31, 1995 Fund American's economic and voting interests in FSA were 21.0% and 19.0%, respectively. In December 1995 and January 1996 the Company transferred all of its interests in FSA to White Mountains.

MSA. In December 1994 the Company purchased a 33.2% interest in MSA for \$25.0 million in cash. MSA shares in 40% of National Grange Mutual Insurance Company's business through a reinsurance agreement. In December 1995 the Company transferred all of its interest in MSA to White Mountains.

Valley and Charter. On December 1, 1995 White Mountains acquired Valley and Charter for \$41.7 million in cash less \$3.0 million of purchase price adjustments. Valley's wholly owned subsidiary, Valley Insurance Company, is an "A" rated, Northwest-based property and casualty company which writes personal and commercial lines through independent agents. In 1995 Valley Insurance Company wrote \$73.1 million of gross premiums in Oregon, Washington and California. Charter's wholly owned subsidiary, Charter Indemnity Company, wrote \$64.4 million of gross non-standard automobile insurance premiums in Texas during 1995.

In November 1995 Charter issued two notes totalling \$20.2 million with interest rates of 6.5%. The notes are due in 1996 and are collateralized by certain assets of Charter.

WMIC. WMIC is a New Hampshire licensed commercial property and casualty insurance company which commenced its operations in September 1995 and wrote \$250,000 in premiums during the year. WMIC is expected to expand its operations to other states as additional state approvals are obtained.

Folksamerica. On March 11, 1996 Fund American announced that it had reached definitive agreement to purchase for \$79.4 million a 50% interest in Folksamerica Holding Company, Inc. ("Folksamerica"), parent company of Folksamerica Reinsurance Company. The proceeds from Fund American's investment will be used by Folksamerica to complete its previously announced acquisition of Christiania General Insurance Corporation of New York ("Christiania") for \$88.0 million. Consummation of both transactions is subject to state insurance regulatory and Federal antitrust approvals. Fund American believes that it will receive the requisite approvals to proceed with the Folksamerica transaction, however, there is no assurance that such approvals will be ultimately be obtained.

Folksamerica is a multi-line broker-market reinsurance company which in 1995 had net written premiums of \$159.7 million. At December 31, 1995, Folksamerica had \$75.5 million of shareholders' equity and total capitalization of \$151.0 million. Christiania had net written premiums in 1995 of \$123.2 million and shareholders' equity of \$128.0 million at December 31, 1995. On a pro forma basis giving effect to the investment by Fund American and the acquisition of Christiania, Folksamerica will have approximately \$220.0 million of statutory policyholders' surplus, making it the nation's 16th largest broker-market reinsurer.

Fund American's investment in Folksamerica will include (i) 6,920,000 shares of ten-year 6.5% voting preferred stock having a liquidation preference of \$79.4 million and (ii) ten-year warrants to purchase up to 6,920,000 shares of Folksamerica Common Stock for \$11.47 per share. Folksamerica's book value per share at December 31, 1995 was \$10.91.

Fund American expects to assign the purchase of the Folksamerica investment to White Mountains. White Mountains intends to fund the Folksamerica investment using proceeds from sales of investment securities and an additional \$25.0 million capital contribution from the Company.

Upon consummation of the investment, Fund American expects to include Folksamerica's financial results in Fund American's consolidated financial statements. This will have a material effect on Fund American's financial statements. Folksamerica's consolidated financial statements, pro forma for the completion of Fund American's investment and the acquisition of Christiania, include total assets of \$1,024.4 million as of December 31, 1995 and total revenues of \$324.9 million for the year then ended.

#### Source One

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

In 1995 Source One sold the rights to service \$11.0 billion of mortgage loans to third parties for net cash proceeds of \$181.1 million. The proceeds were used by Source One to retire debt and to repurchase shares of its common stock from FAE.

In March 1995 Source One consolidated its three then existing credit facilities into a single credit facility in the amount of \$500.0 million. The new facility can be increased at Source One's option with bank concurrence up to \$1.0 billion. Borrowings under the new facility, which matures in March 1998, are secured primarily by Source One's mortgage loans receivable and mortgage loan servicing portfolio. As of December 31, 1995 no borrowings were outstanding under the new facility. As of December 31, 1994 there was \$195.0 million outstanding under the previous three credit facilities.

Source One's secured credit agreements contain covenants which limit its ability to pay dividends or make distributions on its capital in excess of existing preferred stock dividend requirements. These covenants also require Source One to maintain a certain level of total tangible net worth and a certain ratio of debt to total tangible net worth. Source One is currently in compliance with all such covenants.

In August 1995 Source One entered into a \$60.0 million unsecured revolving credit facility which expires in July 1996.

Source One also has a revolving credit agreement under which it can borrow up to \$10.0 million. As of December 31, 1995 and 1994 there was \$4.5 million and \$3.8 million outstanding under this agreement, respectively.

Source One has a \$650.0 million domestic and Euro commercial paper program. The weighted average number of days to maturity of commercial paper outstanding at December 31, 1995 was 19 days. As of December 31, 1995 and 1994 Source One had \$256.6 million and \$26.1 million of commercial paper outstanding, respectively.

In 1986 Source One issued \$125.0 million of 8.25% debentures due November 1, 1996. During 1995 Source One repurchased and retired \$50.4 million in principal amount 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%. In 1991 Source One issued \$160.0 million of 8.875% medium-term notes due in 2001. INFLATION During 1995 Source One repurchased and retired in principal amount \$10.3 million medium-term notes that were due in 1996 and \$21.6 million of medium-term notes that were due in 2001.

In 1992 Source One issued \$100.0 million of 9% debentures due in 2012 under terms of a \$250.0 million shelf registration statement. The proceeds from issuance were used for general corporate purposes.

In March 1994 Source One issued 4,000,000 shares of 8.42% perpetual Cumulative Preferred Stock, Series A ("Source One Preferred Stock"), having a liquidation preference of \$25.00 per share, for net cash proceeds of \$96.9 million. The Source One Preferred Stock is not redeemable prior to May 1, 1999.

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 9.375% subordinated interest deferrable debentures (the "Subordinated Debentures"). The Subordinated Debentures are due on December 31, 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.

FAE announced on December 26, 1995 that it had entered into a letter of intent with Mellon Mortgage Company ("Mellon") contemplating the sale of Source One for an aggregate price equal to Source One's adjusted book value as of the closing date plus a premium of \$65.0 million, and the assumption of all Source One's existing debt and preferred stock. On March 6, 1996 FAE announced that its discussions with Mellon were proceeding more slowly than had been anticipated and that Mellon had subsequently revised the scope and other terms of the originally announced Source One transaction. FAE is continuing discussions with Mellon and other parties. There can be no assurance that any transaction will be negotiated or consummated.

## INFLATION

Inflation 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.

Inflation affects Source One most significantly in the area of loan originations. As noted above, interest rates normally increase during periods of high inflation and decrease during periods of low inflation. Historically, Source One's loan originations have increased in response to falling interest rates and have decreased during periods of rising interest rates. However, higher interest rate environments typically enhance the value of Source One's mortgage loan servicing portfolio due to related declines in refinancing activity. Lower interest rates generally result in higher payoffs and, therefore, typically reduce the value of the mortgage loan servicing portfolio.



Fund American  
CONSOLIDATED BALANCE SHEETS

Dollars in millions	December 31,	
	1995	1994
<b>Assets</b>		
Common equity securities, at fair value (cost \$232.1 and \$294.2)	\$ 274.5	\$ 332.4
Fixed maturity investments, at fair value (cost \$109.8 and \$102.2)	110.7	102.2
Other investments (cost \$86.7 and \$61.4)	95.9	55.1
Short-term investments, at amortized cost (which approximated fair value)	103.6	119.2
<b>Total investments</b>	<b>584.7</b>	<b>608.9</b>
Cash	2.7	1.5
Capitalized mortgage servicing, net of accumulated amortization	397.1	530.5
Mortgage loans held for sale	381.0	210.5
Pool loan purchases	119.0	163.9
Mortgage claims receivable and real estate acquired, less allowance for mortgage loan losses of \$13.5 and \$13.4	45.4	49.8
Insurance premiums receivable	45.3	--
Investments in unconsolidated affiliates	96.2	69.7
Goodwill	24.6	28.0
Other assets	175.9	144.5
<b>Total assets</b>	<b>\$ 1,871.9</b>	<b>\$ 1,807.3</b>
<b>Liabilities</b>		
Short-term debt	\$ 445.4	\$ 254.1
Long-term debt	407.3	547.0
Loss and loss adjustment expense reserves	44.1	--
Unearned insurance premiums	35.0	--
Accounts payable and other liabilities	196.4	245.1
<b>Total liabilities</b>	<b>1,128.2</b>	<b>1,046.2</b>
Minority interest -- preferred stock of subsidiary	44.0	100.0
<b>Shareholders' equity</b>		
Preferred stock -- authorized 10,000,000 shares, Series D voting preferred stock, issued 0 and 20,833 shares	--	75.0
Common stock -- authorized 125,000,000 shares, issued 32,719,279 and 33,597,147 shares	32.7	33.6
Common paid-in surplus	375.5	338.1
Retained earnings	1,124.6	1,098.2
Common stock in treasury, at cost: 25,034,939 and 25,187,210 shares	(871.0)	(878.5)
Net unrealized investment gains	37.9	19.7
Loan for common stock issued	--	(25.0)
<b>Total shareholders' equity</b>	<b>699.7</b>	<b>661.1</b>
<b>Total liabilities, minority interest and shareholders' equity</b>	<b>\$ 1,871.9</b>	<b>\$ 1,807.3</b>

See Notes to Consolidated Financial Statements.

Fund American  
CONSOLIDATED INCOME STATEMENTS

Millions, except per share amounts	Year Ended December 31,		
	1995	1994	1993
<b>Revenues:</b>			
Mortgage servicing revenue	\$ 141.9	\$ 169.3	\$ 187.1
Amortization of mortgage servicing	81.4	86.9	133.6
Net mortgage servicing revenue	60.5	82.4	53.5
Gain on sales of mortgage servicing	40.0	--	--
Net gain on sales of mortgages	24.0	29.5	34.8
Other mortgage operations revenue	16.4	23.9	29.2
Insurance premiums earned	5.8	--	--
Net investment income	55.4	90.2	133.5
Equity in earnings of unconsolidated affiliates	9.4	2.5	--
Other revenue	10.8	--	--
<b>Total revenues</b>	<b>222.3</b>	<b>228.5</b>	<b>251.0</b>
<b>Expenses:</b>			
Compensation and benefits	111.6	69.2	63.5
General expenses	60.3	77.7	67.5
Interest expense	45.8	78.8	103.1
Insurance losses and loss adjustment expenses	8.2	--	--
<b>Total expenses</b>	<b>225.9</b>	<b>225.7</b>	<b>234.1</b>
Pretax operating earnings (loss)	(3.6)	2.8	16.9
Net realized investment gains	38.8	38.8	50.6
Change in net unrealized investment gains and losses	--	--	73.4
Net investment gains	38.8	38.8	124.0
Pretax earnings	35.2	41.6	140.9
Income tax provision	16.7	20.5	70.5
After tax earnings	18.5	21.1	70.4
Tax benefit from sale of discontinued operations	66.0	--	--
Loss on early extinguishment of debt, after tax	(.4)	--	--
Cumulative effect of accounting change - purchased mortgage servicing, after tax	--	(44.3)	--
Net income (loss)	84.1	(23.2)	70.4
Less dividends on preferred stock	3.8	9.9	12.2
<b>Net income (loss) applicable to common stock</b>	<b>\$ 80.3</b>	<b>\$ (33.1)</b>	<b>\$ 58.2</b>
<b>Primary earnings per share:</b>			
After tax earnings	\$ 1.71	\$ 1.20	\$ 5.68
Tax benefit from sale of discontinued operations	7.69	--	--
Loss on early extinguishment of debt, after tax	(.04)	--	--
Cumulative effect of accounting change	--	(4.71)	--
<b>Net income (loss)</b>	<b>\$ 9.36</b>	<b>\$ (3.51)</b>	<b>\$ 5.68</b>
<b>Fully diluted earnings per share:</b>			
After tax earnings	\$ 2.02	\$ 1.20	\$ 5.68
Tax benefit from sale of discontinued operations	7.18	--	--
Loss on early extinguishment of debt, after tax	(.04)	--	--
Cumulative effect of accounting change	--	(4.71)	--
<b>Net income (loss)</b>	<b>\$ 9.16</b>	<b>\$ (3.51)</b>	<b>\$ 5.68</b>

See Notes to Consolidated Financial Statements.

Fund American  
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 (losses)	Loan for common stock issued
Balances at January 1, 1993	\$988.3	\$157.0	\$390.1	\$1,375.2	\$(886.2)	\$(24.0)	\$(23.8)
Net income	70.4	--	--	70.4	--	--	--
Dividends to preferred stockholders	(12.2)	--	--	(12.2)	--	--	--
Distribution of subsidiary to common stockholders	(146.9)	--	--	(146.9)	--	--	--
Purchases of common stock retired	(41.8)	--	(5.9)	(35.9)	--	--	--
Stock options exercised and performance shares awarded	2.0	--	--	.7	1.3	--	--
Change in net unrealized investment gains and losses, after tax	23.7	--	--	--	--	23.7	--
Cumulative effect of change in accounting for investment securities, after tax	22.1	--	--	(52.7)	--	74.8	--
Other	(.6)	--	--	--	--	--	(.6)
Balances at December 31, 1993	905.0	157.0	384.2	1,198.6	(884.9)	74.5	(24.4)
Net loss	(23.2)	--	--	(23.2)	--	--	--
Dividends to preferred stockholders	(9.4)	--	--	(9.4)	--	--	--
Redemption of preferred stock	(82.0)	(82.0)	--	--	--	--	--
Purchases of common stock retired	(78.8)	--	(12.5)	(66.3)	--	--	--
Stock warrants exercised	4.9	--	--	(1.5)	6.4	--	--
Change in net unrealized investment gains and losses, after tax	(54.8)	--	--	--	--	(54.8)	--
Other	(.6)	--	--	--	--	--	(.6)
Balances at December 31, 1994	661.1	75.0	371.7	1,098.2	(878.5)	19.7	(25.0)
Net income	84.1	--	--	84.1	--	--	--
Dividends to stockholders	(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	\$ --

See Notes to Consolidated Financial Statements.

Fund American  
CONSOLIDATED STATEMENTS OF CASH FLOWS

Millions	Year Ended December 31,		
	1995	1994	1993
Net income (loss)	\$ 84.1	\$ (23.2)	\$ 70.4
Charges (credits) to reconcile net income (loss) to cash flows from operations:			
Tax benefit from sale of discontinued operations	(66.0)	--	--
Loss on early extinguishment of debt, after tax	.4	--	--
Cumulative effect of accounting change - purchased mortgage servicing, after tax	--	44.3	--
Equity in earnings of unconsolidated affiliates	(9.4)	(2.5)	--
Compensation expense resulting from warrant extension	46.2	--	--
Net investment gains	(38.8)	(38.8)	(124.0)
(Increase) decrease in mortgage loans held for sale	(170.5)	1,088.0	(182.4)
Gain on sales of mortgage servicing	(40.0)	--	--
Depreciation and amortization	86.4	99.2	142.3
Capitalized excess mortgage servicing income	(7.4)	(16.7)	(58.1)
Change in current income taxes receivable and payable	24.4	22.6	21.2
Deferred income tax (benefit) provision	(9.5)	(1.4)	37.2
Change in other assets	(4.9)	24.8	(26.9)
Change in accounts payable and other liabilities	35.9	(7.3)	(26.1)
Other, net	7.3	4.9	9.7
<b>Net cash (used for) provided from operating activities</b>	<b>(61.8)</b>	<b>1,193.9</b>	<b>(136.7)</b>
Cash flows from investing activities:			
Net decrease (increase) in short-term investments	15.6	133.3	(10.2)
Sales and maturities common stocks and other investments	204.5	338.2	360.4
Sales and maturities of fixed maturity investments	62.1	--	--
Purchases of common stocks and other investments	(63.7)	(137.8)	(241.8)
Purchases of fixed maturity investments	(48.8)	(48.5)	(3.6)
Purchase of Valley and Charter	(42.2)	--	--
Investments in unconsolidated affiliates	(33.0)	(44.0)	--
Collections on mortgage origination and servicing	192.7	232.3	213.3
Additions to purchased mortgage servicing	(82.1)	(90.1)	(72.2)
Originated mortgage servicing	(31.2)	--	--
Proceeds from sales of mortgage servicing	181.1	70.2	--
Additions to other mortgage origination and servicing assets	(150.4)	(242.8)	(255.9)
Sales (purchases) of fixed assets, net	.4	(3.6)	(11.2)
<b>Net cash provided from (used for) investing activities</b>	<b>205.0</b>	<b>207.2</b>	<b>(21.2)</b>
Cash flows from financing activities:			
Net issuances (repayments) of short-term debt	96.5	(1,314.5)	21.5
Repayments of long-term debt	(93.7)	(23.9)	--
Proceeds from issuances of long-term debt	--	--	178.0
Proceeds from issuances of preferred stock by subsidiary	--	96.9	--
Redemptions of preferred stock	(75.0)	(82.0)	--
Purchases of common stock retired	(65.5)	(78.8)	(41.8)
Cash dividends paid to shareholders	(6.4)	(10.8)	(12.7)
Other	2.1	2.8	2.1
<b>Net cash (used for) provided from financing activities</b>	<b>142.0)</b>	<b>(1,410.3)</b>	<b>147.1)</b>
<b>Net increase (decrease) in cash during year</b>	<b>1.2</b>	<b>(9.2)</b>	<b>(10.8)</b>
Cash balance at beginning of year	1.5	10.7	21.5
<b>Cash balance at end of year</b>	<b>\$ 2.7</b>	<b>\$ 1.5</b>	<b>\$ 10.7</b>

See Notes to Consolidated Financial Statements.

Fund American  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. Fund American's principal businesses are conducted through White Mountains and Source One. White Mountains is an insurance holding company principally engaged through its affiliates in the businesses of property and casualty insurance and financial guaranty insurance. Source One is one of the largest mortgage banking companies in the United States.

The financial statements have been prepared in accordance with 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 reclassified to conform with the current year presentation.

Investment securities

As of December 31, 1993 Fund American adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Under the provisions of SFAS No. 115, substantially all of Fund American's portfolio of common equity securities, fixed maturity investments and other investments are classified as securities available for sale and are reported at fair value as of the balance sheet date, with related unrealized gains and losses excluded from earnings and reported as a net amount in a separate component of shareholders' equity. Prior to December 31, 1993 unrealized gains and losses from investments held by Fund American, other than securities held by Source One, were included in net income.

Other investments may 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; mortgage loans held for investment; residual interests in real estate mortgage investment conduits ("REMICs") and interest rate principal contracts. Mortgage loans held for investment are stated at the lower of cost or fair value, determined on an individual loan basis at the time the permanent investment decisions were made. 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 are considered held for purposes other than trading and are carried at fair value with unrealized gains and losses reported in other income.

Short-term investments are carried at amortized cost which approximated fair value as of December 31, 1995 and 1994. Short-term mortgage-backed securities are classified as trading securities and are stated at fair value with unrealized gains and losses, if any, reported in income.

Related discounts, if any, are accreted to income over the anticipated life of the investment.

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.

#### 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. White Mountains' insurance subsidiaries insure property and liability risks in Oregon, California, Washington, Texas and New Hampshire.

Policy acquisition costs include commissions and other costs which 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.

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 reduce the loss 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, (i.e., 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 in excess of the estimated fair value of the net assets acquired was allocated to goodwill and is being amortized over 20 years.

Mortgage loans held for sale are stated at the lower of aggregate cost or fair value.

Conventional mortgage loans are placed on a non-accrual basis when delinquent 90 days or more as to interest or principal. Interest on delinquent Federal Housing Administration ("FHA") insured loans is accrued at the insured rate beginning on the sixty-first day of delinquency. Interest on delinquent Veterans Administration ("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, have been deferred and are 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 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 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.

Capitalized mortgage servicing also includes the present value of future servicing revenue in excess of normal servicing revenue on loans sold with servicing retained. Such "excess servicing" is deferred and amortized using a method that relates the anticipated net servicing revenue to total projected net servicing revenue to be received over the expected life of the loan. Impairment tests for excess servicing are performed on a disaggregated basis. The original discount rate is used to discount excess servicing future cash flows.

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 Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA") or Federal Home Loan Mortgage Corporation ("FHLMC) mortgage-backed security pools which Source One services or, to a lesser degree, from private investors. 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 which are not fully recoverable from the claims filed with the underlying mortgage insuring agencies.

Real estate acquired is stated at the lower of net realizable value or the recorded balance satisfied at the date of acquisition, as determined on an individual property basis. Costs related to holding the properties are charged to expense as incurred.

The allowance for mortgage loan losses is based on an analysis of the mortgage loan servicing portfolio and, in management's judgment, is adequate to provide for estimated losses.

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.

Source One adopted the provisions of SFAS No. 122, "Accounting for Mortgage Servicing Rights," an amendment to SFAS No. 65, as of January 1, 1995. SFAS No. 122 requires the total cost of acquiring mortgage loans, either through loan origination activities or purchase transactions, to be allocated to the mortgage servicing rights and the loans based on their relative fair values. The statement requires entities to measure impairment 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. In accordance with SFAS No. 122, prior year financial statements have not been restated.

#### Earnings per share

For purposes of earnings per share, common stock equivalents include stock options, warrants and non-cash performance shares. The Series D Preferred Stock is not a common stock equivalent.

Primary earnings per share amounts are based on the weighted average number of common shares and dilutive common stock equivalents outstanding. In the calculation, income is adjusted for preferred stock dividends. The weighted average shares used in the primary computation were 8,581,456; 9,405,093 and 10,247,746 for the years ended December 31, 1995, 1994 and 1993, respectively.

Fully diluted earnings per share amounts are based on the weighted average number of common shares outstanding, assuming full dilution. Income is adjusted for preferred stock dividends when the preferred shares are anti-dilutive. The weighted average shares used in the fully diluted computation were 9,189,054; 9,408,785 and 10,247,746 for the years ended December 31, 1995, 1994 and 1993, respectively.

#### Future application of accounting standard

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. The disclosure requirements of the standard are effective for fiscal years beginning after December 15, 1995. Fund American does not expect to adopt the recognition and measurement criteria of SFAS No. 123 and expects to provide the requisite pro forma information and additional disclosures in 1996 as permitted by the new standard.



Fund American accounts for its stock options outstanding in accordance with Accounting Principles Board Opinion ("APB") No. 25 , "Accounting for Stock Issued to Employees, and accordingly, recognizes compensation and benefits expense for stock option grants to the extent that the fair value of the stock exceeds the exercise price of the option at the measurement date.

2. Insurance Operations

Insurance operations acquired and formed in 1995

On December 1, 1995 White Mountains acquired Valley and Charter for \$41.7 million in cash less \$3.0 million of purchase price adjustments. Valley's wholly owned subsidiary, Valley Insurance Company, is an "A" rated, Northwest-based property and casualty company which writes personal and commercial lines through independent agents. In 1995 Valley Insurance Company wrote \$73.1 million of gross premiums in Oregon, Washington and California. Charter's wholly owned subsidiary, Charter Indemnity Company, wrote \$64.4 million of gross non-standard automobile insurance premiums in Texas during 1995. 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, a New Hampshire licensed commercial property and casualty insurance company, commenced its operations in September 1995 and wrote \$250,000 in direct premiums during the year. WMIC is expected to expand its operations to other states as additional state approvals are obtained.

Loss and loss adjustment expense reserve activity

The following table summarizes White Mountains' insurance subsidiaries' loss and loss adjustment expense reserve activity for the year ended December 31, 1995:

Millions	Loss and loss adjustment expense reserves
Balance as of December 31, 1994	\$ --
Reserves acquired through the purchase of Valley and Charter	39.9
Estimated losses and loss adjustment expenses incurred	5.2
Reserve strengthening for periods' losses and loss adjustment expenses	3.0
Losses and loss adjustment expenses paid	(4.0)
Balance as of December 31, 1995	\$44.1

Additional insurance operations information

Under the insurance laws of the various states under which White Mountains' insurance subsidiaries 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 White Mountains' insurance operating subsidiaries in the future.

Total policyholders surplus of White Mountains' insurance operating subsidiaries as of December 31, 1995 was \$58.5 million.

### 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 taxable periods ending on or prior to October 23, 1985 (the date of Fund American's initial public offering of Shares) 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 has, 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 1990 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.

### 4. Investment Securities

Net investment income consisted of the following:

Millions	Year Ended December 31,		
	1995	1994	1993
Interest income:			
Mortgage loans held for sale	\$ 35.9	\$ 66.6	\$ 88.0
Short-term investments	6.6	7.8	6.4
Other	5.7	5.3	24.3
Total interest income	48.2	79.7	118.7
Dividend and royalty trust income	7.5	11.1	15.2
Less investment expenses and other	(.3)	(.6)	(.4)
Net investment income, before tax	\$ 55.4	\$ 90.2	\$ 133.5

Net realized investment gains and changes in net unrealized investment losses were as follows:

Millions	Year Ended December 31,		
	1995	1994	1993
Gross realized investment gains	\$ 46.3	\$ 67.0	\$ 63.0
Gross realized investment losses	(7.5)	(28.2)	(12.4)
Net realized investment gains	38.8	38.8	50.6
Net unrealized investment gains (losses)			
Included in net income	--	--	73.4
Recorded directly to shareholders' equity	28.0	(84.3)	69.9
Total net investment gains (losses), before tax	\$ 66.8	\$ (45.5)	\$ 193.9

Proceeds from sales of investments, excluding short-term investments, totalled \$252.1 million, \$340.3 million and \$356.3 million for the years ended December 31, 1995, 1994 and 1993, respectively.

The components of ending net unrealized investment gains and losses were as follows:

Millions	December 31,	
	1995	1994
Unrealized gains	\$ 60.6	\$ 47.3
Unrealized losses	(2.3)	(17.0)
Total net unrealized investment gains, before tax	\$ 58.3	\$ 30.3

The cost or amortized cost, gross unrealized investment gains and losses, and carrying values of fixed maturity investments as of December 31, 1995 and 1994 were as follows:

Millions	December 31, 1995			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
U S West, Inc. redeemable preferred stock	\$ 48.8	--	--	\$ 48.8
State and municipal obligations	33.3	.1	(.1)	33.3
U. S. Government and agency obligations	23.5	.7	--	24.2
Aggregate of holdings less than \$10 million	4.2	.2	--	4.4
Total fixed maturity investments	\$109.8	1.0	(.1)	\$110.7

Millions	December 31, 1995			
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying value
White River Corporation term note	\$ 50.0	--	--	\$ 50.0
U S West, Inc. redeemable preferred stock	48.6	--	--	48.6
Aggregate of holdings less than \$10 million	3.6	--	--	3.6
Total fixed maturity investments	\$102.2	--	--	\$102.2

The cost or amortized cost and carrying value of fixed maturity investments at December 31, 1995 and 1994 are shown 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,			
	1995		1994	
	Cost or amortized cost	Carrying value	Cost or amortized cost	Carrying value
Due in one year or less	\$ 3.0	\$ 3.0	\$ 50.0	\$ 50.0
Due after one year through five years	16.7	17.2	--	--
Due after five years through ten years	60.0	60.1	52.2	52.2
Due after ten years	30.1	30.4	--	--
<b>Total</b>	<b>\$109.8</b>	<b>\$110.7</b>	<b>\$102.2</b>	<b>\$102.2</b>

Non-cash exchanges of investment securities totalling \$90.4 million and \$0.3 million during 1995 and 1994, respectively, are not reflected in the Consolidated Statements of Cash Flows.

#### 5. Mortgage Origination and Servicing

Source One services loans throughout the United States. Source One's portfolio of mortgage loans serviced, including loans subserviced, interim servicing contracts and those under contract to acquire and excluding loans sold but not transferred, totalled \$31.8 billion and \$39.6 billion as of December 31, 1995 and 1994, respectively. The servicing portfolio included GNMA guaranteed mortgage-backed securities of \$10.7 billion and \$11.9 billion as of December 31, 1995 and 1994, respectively. The following table summarizes the mortgage loan servicing portfolio:

	Outstanding principal balance (millions)	Loan balance (thousands)	Weighted average		
			Interest rate	Net servicing fee rate	Remaining contractual life (months)
Loan Type:					
Residential:					
Conventional	\$16,291	\$ 73	8.37%	.411%	229
FHA	7,606	49	8.67	.433	271
VA	3,814	49	8.43	.432	256
Commercial	81	709	7.51	.155	171
	27,792	61	8.46	.419	245
Subservicing	4,039				
<b>Total servicing portfolio</b>	<b>\$31,831</b>				

The servicing fee rates in the preceding table are shown after deducting applicable guarantee fees. Guarantee fees, when applicable, range from six 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 mortgage loan servicing portfolio by interest rate range and by location of property:

Interest rate range	December 31, 1995			December 31, 1994		
	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	2,674	\$ 114	5.51%	6,597	\$ 318	5.37%
6.00% - 6.49%	8,208	434	6.19	11,887	800	6.21
6.50% - 6.99%	25,192	2,077	6.69	37,415	3,339	6.71
7.00% - 7.49%	64,052	4,573	7.16	89,649	7,316	7.16
7.50% - 7.99%	84,899	6,745	7.63	93,328	7,748	7.61
8.00% - 8.49%	60,843	4,315	8.10	57,323	4,220	8.09
8.50% - 8.99%	80,936	4,217	8.60	78,998	4,465	8.60
9.00% - 9.49%	38,939	2,234	9.08	36,115	2,168	9.08
9.50% - 9.99%	57,131	3,185	9.60	59,174	3,383	9.60
10% and above	71,177	3,937	10.55	72,942	4,160	10.52
<b>Total</b>	<b>494,051</b>	<b>\$31,831</b>	<b>8.33%</b>	<b>543,428</b>	<b>\$37,917</b>	<b>8.14%</b>

Interest rate range	December 31, 1995			December 31, 1994		
	Number of loans	Aggregate principal balance (millions)	Weighted average interest rate	Number of loans	Aggregate principal balance (millions)	Weighted average interest rate
California	73,865	\$ 6,668	20.9%	79,621	\$ 7,195	19.0%
New York	45,830	2,803	8.8	35,214	2,611	6.9
Washington	30,064	2,386	7.5	42,584	3,502	9.2
Texas	28,841	1,705	5.4	26,411	1,863	4.9
Florida	28,123	1,502	4.7	29,955	1,842	4.9
Michigan	30,235	1,308	4.1	33,174	1,865	4.9
Illinois	18,486	1,291	4.1	20,984	1,580	4.2
New Jersey	15,201	1,056	3.3	18,075	1,331	3.5
Arizona	15,751	949	3.0	17,570	1,104	2.9
Massachusetts	12,822	875	2.7	14,416	1,005	2.6
Other	194,833	11,288	35.5	225,424	14,019	37.0
<b>Total</b>	<b>494,051</b>	<b>\$31,831</b>	<b>100.0%</b>	<b>543,428</b>	<b>\$37,917</b>	<b>100.0%</b>

The tables above include \$4,039 million and \$4,294 million outstanding principal balance of loans subserviced for others as of December 31, 1995 and 1994, respectively. The tables exclude \$1,651 million outstanding principal balance of interim servicing as of December 31, 1994.

Escrow funds of approximately \$236.0 million and \$277.9 million as of December 31, 1995 and 1994, 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.

Source One has in force an errors and omissions policy in the amount of \$20.0 million. Primary fidelity coverage up to a limit of \$35.0 million is provided under a Fund American master policy for which Source One pays a portion of the premium.

## 6. Capitalized Servicing

Source One estimates the fair values of its mortgage servicing rights by calculating the present value of the expected future 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 and discounts those cash flows using current estimated market rates. As of December 31, 1995 such discount rates were 10.5% for conventional loans and 12.0% for insured loans.

To measure impairment of the mortgage servicing rights, Source One stratifies its mortgage loan servicing portfolio based on the portfolio's predominant risk characteristics which have been determined to be prepayment, default and operational risks. This results in stratification by interest rate, loan type (investor) and original term to maturity. The prepayment assumptions used in the estimation of fair values are based on market prepayment predictions. The fair value of each stratum is computed and compared to its recorded book value to determine if a valuation allowance, or recovery of a previously established valuation allowance, is required.

The discount rate and prepayment assumptions are significant factors used in estimating the fair value of Source One's mortgage servicing rights and could be significantly impacted by changes in interest rates. Accordingly, it is likely that management's estimate of the fair value of the capitalized servicing asset will change from time to time due to changes in interest rates.

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 as of December 31, 1995:

Loan type	Fair value of mortgage servicing rights (millions)	Principal balance serviced (a) (millions)	Weighted average interest rate	Weighted average maturity (months)	Weighted average service fee
Insured	\$172.0	\$ 8,872	8.77%	259	44%
Conventional	193.4	13,354	8.45	231	.34
Adjustable Rate	21.6	1,297	8.06	309	.43
<b>Total</b>	<b>\$387.0</b>	<b>\$23,523</b>	<b>8.55%</b>	<b>246</b>	<b>.38%</b>

(a) Excludes \$4,039 million of related to originations not subservicing and \$4,269 million capitalized prior to the of mortgage servicing rights adoption of SFAS No. 122.

The adoption of SFAS No. 122 as it relates to the capitalization of originated mortgage servicing rights resulted in the recognition of an additional pretax gain on sales of mortgages of \$27.2 million for the year ended December 31, 1995. The impairment provisions of SFAS No. 122 resulted in a pretax charge of \$28.0 million for the year.

In 1994 Source One adopted an accounting methodology that measured impairment of the purchased mortgage servicing rights asset on a disaggregated basis by discounting estimated future cash flows using a current market rate. Prior to 1994 Source One measured impairment of the purchased mortgage servicing rights asset on a disaggregated basis including a cost of capital charge for estimating future cash flows. The adoption of the new accounting methodology, recorded as a cumulative adjustment as of January 1, 1994, resulted in a \$68.1 million pretax, \$44.3 million after tax, charge to income for 1994.

Source One estimates 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 ("I/O") strip interest rates as quoted by market participants to determine the appropriate discount rates and prepayment speed assumption rates that are based on interest rates, loan types and original term to maturity. The discount rate used to capitalize excess servicing for 1995 was 12.0%; ranged from 8.0% to 10.0% for the year ended December 31, 1994; and was 8.0% for the year ended December 31, 1993. For the years ended December 31, 1995, 1994 and 1993, the weighted average discount rates inherent in the carrying amount of the capitalized excess servicing asset were 10.03%, 9.12% and 9.03%, respectively.

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

Millions	Purchased servicing	Originated servicing	Excess servicing	Valuation allowance	Deferred gain on sale of servicing	Total capitalized servicing
-----						
Balances at						
January 1, 1993	\$ 551.3	\$ --	\$ 73.4	\$ --	\$ --	\$ 624.7
Additions	117.5	--	58.1	--	--	175.6
Scheduled amortization	(90.1)	--	(11.5)	--	--	(101.6)
Impairment and unscheduled amortization	(8.5)	--	(23.5)	--	--	(32.0)
-----						
Balances at						
December 31, 1993	570.2	--	96.5	--	--	666.7
Cumulative effect of accounting change	(68.1)	--	--	--	--	(68.1)
Additions	69.7	--	16.7	--	(19.9)	66.5
Scheduled amortization	(61.7)	--	(12.1)	--	2.7	(71.1)
Impairment and unscheduled amortization	(12.8)	--	(.4)	--	--	(13.2)
Sales	(21.7)	--	(28.6)	--	--	(50.3)
-----						
Balances at						
December 31, 1994	475.6	--	72.1	--	(17.2)	530.5
Additions	64.2	31.2	7.4	--	--	102.8
Scheduled amortization	(43.9)	(1.4)	(7.5)	--	4.2	(48.6)
Impairment and unscheduled amortization	--	--	(.5)	(28.0)	--	(28.5)
Sales	(132.4)	--	(26.7)	--	--	(159.1)
-----						
Balances at						
December 31, 1995	\$ 363.5	\$29.8	\$ 44.8	\$(28.0)	\$(13.0)	\$ 397.1
=====						

During 1995 Source One sold the rights to service \$10,973 million 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 \$3,868 million of mortgage loans for net proceeds of \$70.2 million and continues to service these loans pursuant to a subservicing agreement. A gain of \$19.9 million was deferred in 1994 and is being recognized in income over the five-year life of the subservicing agreement.

#### 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,	
	1995	1994
Adjustable rate mortgage loans, weighted average interest rates of 6.55% and 7.66%	\$ 17.6	\$ 46.4
Fixed rate 5 year through 20 year mortgage loans, weighted average interest rates of 7.47% and 8.81%	59.5	34.0
Fixed rate 30 year mortgage loans, weighted average interest rates of 7.89% and 9.27%	303.0	131.3
Total principal amount	380.1	211.7
Net premiums (discounts)	.9	(1.2)
Total mortgage loans held for sale	\$ 381.0	\$ 210.5

December 31,	Principal balance (millions)		Number of loans	
	1995	1994	1995	1994
Loan type: FHA	\$ 77.6	\$102.8	1,433	1,850
VA	32.5	41.9	545	719
Conventional	8.9	19.2	106	224
Total pool loan purchases	\$119.0	\$163.9	2,084	2,793

#### 8. Debt

Short-term debt  
Short-term debt outstanding consisted of the following:

Millions	December 31,	
	1995	1994
Parent Company:		
Loan guarantee	\$ --	\$ 30.0
Charter:		
Notes payable and obligations under capital leases	20.8	--
Source One:		
Commercial paper	256.6	26.1
Credit agreement borrowings	64.5	198.8
Debentures due in 1996	74.6	--



Medium term notes due in 1996	29.7	--
Less net discounts	(.8)	(.8)
Total Source One	424.6	224.1
Total short-term debt	445.4	254.1

The weighted average interest rates of short-term debt outstanding during 1995 and 1994 were as follows:

	Year Ended December 31,	
	1995	1994
-----		
Parent Company:		
Revolving credit facility	6.57%	5.11%
Loan guarantee	5.36%	5.36%
Charter:		
Notes payable	6.50%	--
Source One:		
Commercial paper	6.04%	3.92%
Credit agreements and bid loans	6.91%	5.03%
=====		

In June 1994 the Company entered into a revolving credit agreement with a syndicate of banks. Under the agreement, through August 9, 1996 the Company and certain of its subsidiaries may borrow up to \$75.0 million at short-term market interest rates. The credit agreement contains certain customary covenants, including a \$475.0 million minimum tangible net worth requirement and a minimum financial asset coverage requirement. At December 31, 1995 and 1994 the Company had no borrowings outstanding under the agreement.

In August 1993 the Company sold a \$30.0 million principal amount secured loan receivable from the Company's Chairman to a third party. The Company had guaranteed repayment of the loan and, therefore, in accordance with GAAP, had reflected the guarantee of the loan as indebtedness on the balance sheet. The loan matured and was repaid on October 23, 1995.

In November 1995 Charter issued two notes totalling \$20.2 million. The notes are due in 1996 and are collateralized by certain assets of Charter.

Source One has a \$650.0 million domestic and Euro commercial paper program. The weighted average number of days to maturity of commercial paper outstanding at December 31, 1995 was 19 days.

In March 1995 Source One consolidated its three then existing credit facilities into a single credit facility in the amount of \$500.0 million. The new facility can be increased at Source One's option with bank concurrence up to \$1.0 billion. Borrowings under the new facility, which matures in March 1998, are secured primarily by Source One's mortgage loans receivable and mortgage loan servicing portfolio. As of December 31, 1995 no borrowings were outstanding under the new facility. As of December 31, 1994 there was \$195.0 million outstanding under the previous three credit facilities.

Source One's secured credit agreements contain covenants which limit its ability to pay dividends or make distributions on its capital in excess of existing preferred stock dividend requirements. These covenants also require Source One to maintain a certain level of total tangible net worth and a certain ratio of debt to total tangible net worth. Source One is currently in compliance with all such covenants.

In August 1995 Source One entered into a \$60.0 million unsecured revolving credit facility which expires in July 1996.

Under the credit agreements described above, Source One receives interest expense credits as a result of holding escrow and custodial funds in trust accounts at non-affiliated banks.

Source One also has a revolving credit agreement under which it can borrow up to \$10.0 million. As of December 31, 1995 and 1994 there was \$4.5 million and \$3.8 million outstanding under this agreement, respectively.

#### Long-Term Debt

Long-term debt outstanding consisted of the following:

Millions	December 31,	
	1995	1994
-----		
Parent Company:		
Medium-term notes	\$116.2	\$125.0
Less net discounts	(.9)	(1.2)
Total Parent Company	115.3	123.8
-----		
Source One:		
Debentures, 8.25% due in 1996	--	125.0
Medium-term notes, 9.65% due in 1996	--	40.0
Medium-term notes, 8.875% due in 2001	138.4	160.0
Debentures, 9% due in 2012	100.0	100.0
Subordinate debentures, 9.375% due 2025	56.0	--
Less net discounts	(2.4)	(1.8)
Total Source One	292.0	423.2
-----		
Total long-term debt	\$407.3	\$547.0
=====		

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. Proceeds from the issuance of the notes were used to repay an existing revolving credit facility and for general corporate purposes. During 1995 and 1994 the Company repurchased \$8.8 million and \$25.0 million, respectively, in principal amount of the notes due February 2003. At December 31, 1995 the remaining outstanding notes had an average maturity of 7.41 years and an average yield to maturity of 7.82%.

In 1986 Source One issued \$125.0 million of 8.25% debentures due November 1, 1996. During 1995 Source One repurchased and retired \$50.4 million in principal amount 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%. In 1991 Source One issued \$160.0 million of 8.875% medium-term notes due in 2001. During 1995 Source One repurchased and retired in principal amount \$10.3 million of medium-term notes that were due in 1996 and \$21.6 million of medium-term notes that were due in 2001.

In 1992 Source One issued \$100.0 million of 9% debentures due in 2012 under terms of a \$250.0 million shelf registration statement. The proceeds from issuance were used for general corporate purposes.

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 9.375% Subordinated Debentures. The Subordinated Debentures are due on December 31, 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.

Total interest paid by Fund American for both short-term and long-term debt was \$47.9 million, \$80.1 million and \$98.1 million in 1995, 1994 and 1993, respectively.

#### 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,		
	1995	1994	1993
-----			
Tax on pretax earnings:			
Federal	\$ 16.6	\$ 20.2	\$ 67.8
State and local	.1	.3	2.7
-----			
Income tax provision on pretax earnings	16.7	20.5	70.5
Tax benefit from sale of discontinued operations	(66.0)	--	--
Tax benefit from loss on early extinguishment of debt	(.2)	--	--
Tax on cumulative effect of accounting change - purchased mortgage servicing	--	(23.8)	--
-----			
Total income tax provision (benefit)	\$(49.5)	\$ (3.3)	\$ 70.5
=====			
Net income tax payments (recoveries)	\$ 2.6	\$ (.7)	\$ 12.0
=====			
Tax provision (benefit) recorded directly to shareholders' equity related to:			
Exercises of employee stock options and warrants	\$ .2	\$ (2.0)	\$ (4.7)
Changes in net unrealized investment gains and losses	\$ 9.8	\$(29.5)	\$ 24.1
=====			

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

Millions	Year Ended December 31,		
	1995	1994	1993
-----			
Current provision	\$ 26.4	\$ 21.9	\$ 33.3
Deferred provision (benefit)	(9.7)	(1.4)	37.2
-----			
Total income tax provision on pretax earnings	\$ 16.7	\$ 20.5	\$ 70.5
=====			

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 follow:

Millions	December 31,	
	1995	1994
Deferred tax assets related to:		
Capitalized mortgage servicing	\$ 13.7	\$ 18.7
Employee compensation and benefit accruals	30.3	12.2
Allowance for mortgage loan losses	4.8	4.7
Other items	12.5	6.1
<b>Total deferred tax assets</b>	<b>61.3</b>	<b>41.7</b>
Deferred tax liabilities related to:		
Purchase accounting adjustments	10.2	11.2
Net unrealized investment gains	13.4	2.5
Equity in earnings of affiliates	4.0	.8
Other items	8.9	5.8
<b>Total deferred tax liabilities</b>	<b>36.5</b>	<b>20.3</b>
<b>Net deferred Federal income tax asset</b>	<b>\$ 24.8</b>	<b>\$ 21.4</b>

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,		
	1995	1994	1993
Tax provision at Federal statutory rate	\$ 12.3	\$ 14.6	\$ 49.3
Differences in taxes resulting from:			
Minority interest dividends	2.7	2.3	--
Purchase accounting adjustments	.7	.7	.8
State and local income taxes	--	.2	1.8
White River Distribution	--	--	17.7
Dividends received deduction	(1.9)	(2.2)	(2.7)
Tax reserve adjustments	2.3	4.6	2.4
Other	.6	.3	1.2
<b>Total income tax provision on pretax earnings</b>	<b>\$ 16.7</b>	<b>\$ 20.5</b>	<b>\$ 70.5</b>

In December 1993 the Company distributed to its shareholders approximately 74% of the outstanding shares of Common Stock of White River. The \$17.7 million income tax provision resulting from the distribution includes \$13.0 million of current tax related to taxable capital gains triggered by the distribution which were not recognized for financial reporting purposes pursuant to GAAP. The provision also includes a \$4.7 million tax reserve established on White River's books of record as of December 22, 1993, the date of the distribution. Such reserve offsets White River's deferred tax asset calculated on a stand-alone basis as of that date.

Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (the "IRC"), impose limitations on the use of certain tax benefits by a corporation that undergoes a more than 50% ownership change. The tax benefits which may be limited include loss carryforwards and built-in losses and deductions existing on the date of ownership change. The annual limitation for the utilization of such benefits during a five-year post-change period is generally calculated by multiplying the value of the corporation (as defined by the IRC) at the time of the ownership change by an interest rate (a long-term tax-exempt bond rate defined by the IRC). While regulatory guidance on the subject is not complete, the Company believes that it had an ownership change during 1992 so as to make the Section 382 and 383 limitations applicable to Fund American. Fund American believes that the imposition of such limitations will not have a material adverse effect on its financial position or results of operations.

#### 10. Retirement and Post-Retirement Plans

In 1993 the Company established the Fund American Deferred Benefit Plan (the "Deferred Benefit Plan"), a nonqualified defined contribution plan for a select group of management employees for the purpose of providing retirement and postretirement benefits. The amount of annual contributions to the Deferred Benefit Plan are determined using actuarial assumptions; however, participants in the Deferred Benefit Plan may choose between various investment options for their plan balances. At December 31, 1995 the Company's liability to participants pursuant to the Deferred Benefit Plan was \$1.9 million.

In 1993 the Company also established the Fund American Voluntary Deferred Compensation Plan (the "Deferred Compensation Plan"), a nonqualified plan for a select group of management employees for the purpose of deferring current compensation. Pursuant to the Deferred Compensation Plan, participants may defer all or a portion of qualifying remuneration payable by Fund American. Participants in the Deferred Compensation Plan may choose between various investment options for their plan balances. At December 31, 1995 the Company's liability to participants pursuant to the Deferred Compensation Plan was \$16.5 million.

Source One established its 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, 1995, 1994 and 1993 totalled \$1.7 million, \$1.1 million and \$1.9 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.

The following table sets forth the pension cost and actuarial assumptions used in determining the funded status of Source One's qualified defined benefit pension plan:

Dollars in millions	Year Ended December 31,		
	1995	1994	1993
-----			
Pension cost for period:			
Service cost for period	\$ 1.4	\$ 1.6	\$ 1.4
Interest cost on projected benefit obligation	1.4	1.3	1.2
Actual return on plan assets	(3.8)	1.0	(1.3)
Net amortization and deferral	2.6	(1.5)	.9
-----			
Total pension cost	\$ 1.6	\$ 2.4	\$ 2.2
=====			
Funded status at end of period:			
Actuarial present value of benefit obligation:			
Accumulated benefit obligation, including vested benefits of \$15.1, \$11.0 and \$11.3	\$17.2	\$12.6	\$13.0
Effect of projected future salary increases	6.8	5.1	5.3
-----			
Total projected benefit obligation	24.0	17.7	18.3
Plan assets at fair value	18.1	13.1	13.3
-----			
Projected benefit obligation in excess of plan assets	5.9	4.6	5.0
Aggregate of items not yet charged to earnings	(4.2)	(2.7)	(4.4)
-----			
Pension cost accrued at end of period	\$ 1.7	\$ 1.9	\$ .6
=====			
Actuarial assumptions:			
Discount rate	7.0%	8.0%	7.0%
Rate of increase in future compensation levels	6.0%	6.0%	6.0%
Expected long-term rate of return on plan assets	8.0%	8.0%	8.0%
=====			

Total accrued postretirement benefit costs included in accounts payable and other liabilities for Source One employees was \$3.3 million and \$3.2 million at December 31, 1995 and 1994, respectively.

Through December 1, 1995 substantially all the employees of Valley and Charter were covered under a defined benefit pension plan sponsored for 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.

#### 11. Employee Stock Plans

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, 1995, 500,000 Shares remained available for grants under the Incentive Plan.

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.

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 Human Resources Committee (the "Committee") of the Company's Board of Directors (the "Board"). The Committee consists solely of non-management directors.

The following table details the transactions applicable to non-qualified stock options to acquire Shares:

	Number	Exercise price
Balance at January 1, 1993	114,125	\$25.75-\$56.41
Exercised during 1993	107,000	\$25.75-\$59.87
Balance at December 31, 1993 and 1994	7,125	\$24.82-\$32.60
Exercised during 1995	4,125	\$24.82
Balance at December 31, 1995	3,000	\$27.13-\$32.60

All Fund American stock options outstanding at December 31, 1995 were fully vested and exercisable.

Pursuant to the Incentive Plan 57,428 and 56,000 performance shares were granted in 1995 and 1993, respectively. No performance shares were granted in 1994. During 1993, 75,375 performance shares were cancelled and 205,375 performance shares were paid, of which 27,672 were paid in the form of Shares and the remainder in cash. No performance shares were cancelled or paid during 1994 and 1995. At December 31, 1995, 181,678 performance shares were outstanding. Of the performance shares outstanding at December 31, 1995, 68,250 are valued as being equivalent to one Fund American Share plus one-half share of Common Stock of White River. The remaining 113,428 performance shares outstanding at December 31, 1995 are valued as being equivalent to one Fund American Share. The financial goal for full payment of the performance shares is the achievement of a 13% to 15% annual return on equity measured over the applicable performance periods.

In 1985 the Company's Chairman purchased 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 outstanding at December 31, 1995 was extended from January 2, 1996 to January 2, 2002. In accordance with APB No. 25, the warrant extension resulted in a \$46.2 million pretax charge to compensation expense which was recorded in the second quarter of 1995.

Pursuant to certain anti-dilution adjustments related to the distribution of White River Shares to the Company's shareholders, the Chairman received in 1993 warrants entitling him to purchase 640,000 White River Shares for \$8.18 per share, and the exercise price for the Chairman's warrants to purchase Shares was reduced to \$21.66 per Share. The Chairman exercised all the White River warrants on November 19, 1993.



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.

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.

#### 12. Minority Interest -Preferred Stock of Subsidiary

In March 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 \$96.9 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 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 interest expense.

#### 13. Shareholders' Equity

##### Series D and E Preferred Stock

Through July 31, 1994 the Series D Preferred Stock had an annual dividend rate of 7.75% and was initially redeemable for cash or, at the Company's option, for Shares (based on the then current market value of Shares) on July 31, 1994. On August 1, 1994, the Company redeemed 22,778 shares of the Series D Preferred Stock for \$82.0 million, an amount equal to the stock's liquidation preference. In accordance with the terms of the Series D Preferred Stock, the annual dividend rate for the remaining 20,833 shares of the Series D Preferred Stock outstanding was increased to 8.75% and the stock's term was extended to July 31, 1995. 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 1995, 1994 and 1993 the Company repurchased 877,868 Shares, 1,128,057 Shares and 536,247 Shares, respectively, for \$65.5 million, \$78.8 million and \$41.8 million, respectively. All such repurchased Shares have been retired. At December 31, 1995 the Company had outstanding authorization to purchase an additional 372,132 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 reported on the December 31, 1994 balance sheet in other assets, (\$4.3million), and shareholders' equity (\$25.0 million). The non-recourse loan was fully repaid on its maturity date, October 23, 1995.

As approved by shareholders at the 1995 Annual Meeting, the Company entered into a five-year employment contract (the "Agreement") with the Company's Chairman, John J. Byrne. The Agreement provided the Chairman 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, upon the maturity of his existing loan with the Company. In accordance with the Agreement, in October 1995 the Company guaranteed a \$15.0 million loan from a third party to the Chairman. The new loan is recourse to the Chairman'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.

#### Common stock dividends

During 1993 and 1994 the Company did not pay regular cash dividends to holders of Shares. In the fourth quarter 1995 the Board reinstated regular periodic dividends on Shares of \$.20 per quarter. 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.

#### 14. Shareholders' Rights Plan

The Board adopted in 1987, and in 1988 and 1993 amended, a Shareholders' Rights Plan under which rights to purchase preferred stock were distributed to shareholders at the rate of one right for each Share (the "Rights"). Each Right entitles the holder to purchase one one-thousandth of a share of the Company's Series A Cumulative Participating Preferred Stock ("Series A Preferred").

The Rights enable the holders to acquire additional equity in either the Company or an "Acquiring Person," and are exercisable if an unrelated person or group (other than American Express or a wholly-owned subsidiary thereof, any subsidiary of the Company, any employee benefit plan of the Company or its subsidiaries or certain affiliates of the Company and certain persons who inadvertently and temporarily cross the 25% threshold) acquires beneficial ownership of 25% or more of the outstanding Shares (such a 25% or more beneficial owner is deemed an "Acquiring Person"). Thereafter, the Rights would trade separately from Shares and separate certificates representing the Rights would be issued. The terms of the Series A Preferred are such that each one one-thousandth of a share would be entitled to participate in dividends and to vote on an equivalent basis with one whole Share, along with other preferential dividend rights and preferential distribution rights in liquidation.

Upon the existence of an Acquiring Person, the Rights would entitle each holder of a Right to purchase, at the exercise price, that number of one one-thousandth of a share of Series A Preferred equivalent to the number of Shares which, at the time of the transaction, would have a market value of twice the exercise price. If certain acquisitions of the Company occur, a similar right to purchase securities of the Company or the entity acquiring the Company at a discount would arise.

Any Rights that are beneficially owned by an Acquiring Person (or any affiliate or associate of an Acquiring Person) are null and void and any holder of any such Right (including any subsequent holder) will be unable to exercise or transfer any such Right. At any time after a person becomes an Acquiring Person, the Board may mandatorily exchange all or some of the Rights for consideration per Right equal to one-half of the

securities issuable upon the exercise of one Right pursuant to the terms of the Rights Agreement (or the common share equivalent) and without payment of the exercise price. The Rights, which do not have the right to vote or receive dividends, expire November 25, 1997 and may be redeemed by the Company at a price of \$.01 per Right at any time prior to the earlier of (i) such time as a person becomes an Acquiring Person or (ii) the expiration date. Under certain circumstances, the Board may redeem the Rights only if a majority of the disinterested directors (as defined in the Shareholders' Rights Plan) agrees that the redemption is in the best interests of the Company and its shareholders.

In 1987 the Company reserved 600,000 of its authorized preferred shares as Series A Preferred for issuance pursuant to the Shareholders' Rights Plan.

#### 15. Industry Segments

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

Millions	Year Ended December 31,		
	1995	1994	1993
<b>Revenues:</b>			
Mortgage operations	\$ 178.6	\$ 207.2	\$ 234.5
Insurance operations	8.6	--	--
Other	35.1	21.3	16.5
<b>Total</b>	<b>\$ 222.3</b>	<b>\$ 228.5</b>	<b>\$ 251.0</b>
<b>Pretax earnings:</b>			
Mortgage operations	\$ 43.3	\$ 5.3	\$ 62.2
Insurance operations	(4.8)	--	--
Other	(3.3)	36.3	78.7
<b>Total</b>	<b>\$ 35.2</b>	<b>\$ 41.6</b>	<b>\$ 140.9</b>
<b>Ending assets:</b>			
Mortgage operations	\$1,135.0	\$1,210.0	\$2,647.2
Insurance operations	363.1	--	--
Other	373.8	597.3	657.8
<b>Total</b>	<b>\$1,871.9</b>	<b>\$1,807.3</b>	<b>\$3,305.0</b>

#### 16. Investments in Unconsolidated Affiliates

##### Investment in FSA

Fund American owned 2,460,200 and 2,000,000 shares of FSA Common Stock at December 31, 1995 and 1994, respectively. This represented approximately 7.8% and 7.7%, respectively, of the total FSA shares outstanding at those times. Fund American had voting rights to an additional 3,893,940 FSA shares at December 31, 1995 and 1994, raising Fund American's voting control of FSA to approximately 19.0% and 21.0%, respectively. At December 31, 1995 and 1994 Fund American also owned various fixed price options and shares of convertible 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, 1995 and 1994, Fund American's economic interest in FSA was 21.0% and 23.4%, respectively.

Fund American's investment in FSA is accounted for using the equity method. The following table summarizes financial information for FSA:

Millions	1995	1994
Balance sheet data:		
Total investments	\$1,110.7	\$ 747.2
Total assets	1,490.3	1,074.3
Unearned premium reserve, net	330.3	212.9
Loss and loss adjustment expense reserve, net	50.2	35.6
Preferred shareholder's equity	0.7	0.7
Common shareholders' equity	777.2	544.7
Income statement data:		
Gross premiums written	\$ 110.7	\$ 106.4
Net premiums written	77.6	77.8
Net premiums earned	69.3	65.8
Net investment income	49.0	46.6
Net income	55.0	60.4
Amounts recorded by Fund American:		
Investment in FSA	\$ 62.5	\$ 44.4
Equity in earnings of FSA (a)	5.4	2.5
Equity in net unrealized investment gains (losses) of FSA, before tax (b)	4.8	(1.9)

(a) Recorded net of related amortization of goodwill  
(b) Recorded directly to shareholders' equity

At December 31, 1995 and 1994 Fund American's consolidated retained earnings included \$4.6 million and \$2.3 million, respectively, of undistributed earnings of FSA.

#### Investment in MSA

At December 31, 1995 and 1994 Fund American owned 90,606 shares of MSA Common Stock. This represented approximately 33.1% and 33.2%, respectively, of the total MSA shares outstanding at those times. Fund American's investment in MSA is accounted for using the equity method. The following table summarizes financial information for MSA:

Millions	1995	1994
Balance sheet data:		
Total investments	\$ 240.8	\$ 189.6
Total assets	309.6	258.1
Unearned premium reserve, net	58.4	55.2
Loss and loss adjustment expense reserves, net	116.2	115.0
Shareholders' equity	92.0	69.8
Income statement data:		
Net premiums written	\$ 130.9	\$ 97.2
Net premiums earned	127.7	73.4
Net investment income	15.0	8.3
Net income	12.4	3.5
Amounts recorded by Fund American:		
Investment in MSA	\$ 33.7	\$ 25.3
Equity in earnings of MSA (a)	4.0	--
Equity in net unrealized investment gains of MSA, before tax (b)	3.2	--

(a) Recorded net of related amortization of goodwill  
(b) Recorded directly to shareholders' equity

At December 31, 1995 Fund American's consolidated retained earnings included \$4.6 million of undistributed earnings of MSA.

#### 17. Financial Instruments With Off-Balance Sheet Risk

Fund American has only limited involvement with derivative financial instruments and does not use derivative financial instruments for trading purposes. Fund American's use of derivative financial instruments is primarily limited to (i) commitments to extend credit, (ii) mandatory forward commitments, (iii) interest rate floors and (iv) to achieve a fixed interest rate on existing variable rate obligations.

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 (mortgage loan pipeline) is represented by the contractual notional amount of those commitments. Source One's mortgage loan pipeline for locked commitments totalled \$221.9 million and \$147.5 million at December 31, 1995 and 1994, respectively. Fixed rate commitments result in Source One having market interest rate risk as well as credit risk. Variable rate commitments result in only 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 the portion of the mortgage loan pipeline that is expected to close and all mortgage loans receivable. At December 31, 1995 and 1994 Source One had \$561.0 million and \$351.2 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 mortgage loan pipeline and mortgage loans receivable balance 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 currently transacts business with seven approved dealers.

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 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. 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 note rate from the date of loan payoff through the end of the calendar month without reimbursement.

As of December 31, 1995 and 1994 Source One serviced approximately \$10.7 billion and \$11.9 billion of GNMA loans (without substantial recourse), respectively, and \$3.5 billion and \$3.7 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 \$13.5 million and \$13.4 million on the consolidated balance sheets at December 31, 1995 and 1994, respectively. Source One's management believes the allowance for loan losses is adequate to cover unreimbursed foreclosure advances and principal losses. During 1995 Source One modified the methodology used to estimate the allowance for loan losses to more accurately reflect Source One's loss experience. This change reduced the amount that would have been computed under the prior methodology.

Source One enters into interest rate floor contracts to reduce the sensitivity of its earnings to changes in market interest rates. The interest rate floor contracts derive their value from the ten-year constant maturity treasury yield index. The floor yields range from 5.47% to 5.85%. 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 other mortgage operations revenue on the consolidated income statements. As of December 31, 1995 the carrying value of Source One's open interest rate floor contracts totaled \$3.5 million with a total notional principal amount of \$500.0 million. The floors have terms ranging from one to five 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.

#### 18. Fair Value of Financial Instruments

The estimated fair values for 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. Carrying value approximates fair value for common equity securities, fixed maturity investments, 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.** The fair values of mortgage loans held for investment are estimated using quoted market prices for securities backed by similar loans, adjusting for differences in loan characteristics. Fair values of REMICs are estimated using discounted cash flow analyses reflecting I/O strip and LIBOR interest rates, and Prepayment Speed Assumption ("PSA") rates, taking into consideration the characteristics of the related collateral. For interest rate floor contracts, 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.** Fair value is estimated by discounting the annual anticipated net revenue to be received over the life of the related loans, discounted using quoted I/O strip interest rates and PSA rates.

**Mortgage Loans Held for Sale.** Fair values are estimated using quoted market prices for securities backed by similar loans and adjusting for differences in loan characteristics.

**Pool Loan Purchases.** Fair values are estimated using (i) discounted cash flow analyses reflecting Source One's short-term incremental borrowing rate or (ii) quoted market prices for securities backed by similar loans.

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

**Loan For Common Stock Issued.** Fair value is estimated by discounting future cash flows using market interest rates for similar types of borrowing arrangements.

**Debt.** Fair value is estimated by discounting future cash flows using incremental borrowing rates for similar types of borrowing arrangements. For subordinated debentures, fair value is based on 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. Fair value for commitments to extend credit is based on current quoted market prices for securities backed by similar loans, adjusting for loan characteristics.

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

Millions	December 31, 1995		December 31, 1994	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Financial assets:</b>				
Common equity securities	\$274.5	\$274.5	\$332.4	\$332.4
Fixed maturity investments	110.7	110.7	102.2	102.2
Other investments	95.9	96.5	55.1	54.1
Short-term investments	103.6	103.6	119.2	119.2
Cash	2.7	2.7	1.5	1.5
Capitalized excess mortgage servicing	44.7	46.0	72.1	98.3
Mortgage loans held for sale	381.0	391.5	210.5	211.4
Pool loan purchases	119.0	122.3	163.9	164.9
Loans in foreclosure and mortgage claims receivable, net (a)	29.6	29.0	33.3	32.4
Employee loan receivable	--	--	29.3	28.9
Other	25.7	25.7	27.5	27.5
<b>Financial liabilities:</b>				
Short-term debt	445.4	449.0	254.1	254.1
Long-term debt	407.3	450.8	547.0	528.8
Other	12.4	12.4	38.4	38.4
<b>Off-balance-sheet financial instruments:</b>				
Mandatory forward commitments	--	562.4	--	349.0
Commitments to extend credit expected to close	--	226.6	--	147.8

(a) Excludes \$15.8 million and \$16.5 million of real estate owned in 1995 and 1994, respectively.

Other financial assets includes investment income receivable, accounts receivable from securities sales 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.

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.

It is not practicable without incurring excessive costs to estimate the fair value of conventional loans sold with recourse, which is an off-balance-sheet financial instrument representing Source One's obligation to repurchase loans sold that subsequently default.



## 19. Related Party Transactions

In December 1993 BYRNE & sons, l.p. ("BYRNE & sons"), a partnership in which the Company's Chairman, John J. Byrne, is the sole general partner, made its initial investment in the Merastar Partners Limited Partnership and the Southern Heritage Limited Partnership (the "Partnerships"). The Partnerships are involved in various property and casualty insurance ventures. Shortly after making its initial investment, BYRNE & sons offered one-third of its interest in the Partnerships to Fund American on equal terms and conditions. In May 1994 Fund American accepted the offer and paid BYRNE & sons an amount equal to one-third of BYRNE & sons' cost for the Partnerships plus interest at a 6.0% annual rate.

For corporate travel purposes Fund American leases aircraft owned by Haverford Transportation Inc. ("HTI"). Mr. Byrne and K. Thomas Kemp, Executive Vice President of the Company, are the sole shareholders of HTI. Fund American believes that its arrangement with HTI is on terms that are more favorable to Fund American than would generally be available if secured through an arrangement with an unaffiliated third party.

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 20.7% 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 and warrants. White River had outstanding a \$50 million term note and a \$40 million revolving loan payable to the Company which were repaid on various dates during 1995. Gordon S. Macklin, a director of the Company, is the non-executive Chairman of White River.

American Express and its former affiliate Lehman Brothers Inc. have 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. In addition, Source One has from time to time sold certain mortgage loans to subsidiaries of American Express. American Express formerly owned all outstanding shares of the Series D Preferred Stock. Howard L. Clark, a director of the Company, was formerly Chairman of American Express and Howard L. Clark, Jr., a director of the Company, is Vice Chairman of Lehman Brothers Inc.

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

Arthur Zankel, a director of the Company, is a General Partner of First Manhattan Co., which has been retained by Fund American from time to time to perform discretionary investment management services, non-discretionary investment advisory services and brokerage services.

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.

Fund American  
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.

Ernst & Young LLP provides an objective, independent review and evaluation of the structure of internal controls to the extent they consider necessary in their audit of Fund American's consolidated financial statements. Ernst & Young also evaluates and reports on the adequacy of and adherence to these internal controls, policies and procedures. In addition, 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 is comprised of all non-management directors and 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.

John J. Byrne  
Chairman of the Board, President  
and Chief Executive Officer

Allan L. Waters  
Senior Vice President  
and Chief Financial Officer

Michael S. Paquette  
Vice President and  
Controller

Fund American  
REPORT OF INDEPENDENT AUDITORS

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, 1995 and 1994, and the related consolidated income statements and statements of shareholders' equity and cash flows for each of the three years in the period ended December 31, 1995. 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 Fund American Enterprises Holdings, Inc. at December 31, 1995 and 1994, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

As discussed in the Notes to Consolidated Financial Statements, in 1995 the Company changed its method of accounting for originated mortgage servicing rights, in 1994 the Company changed its methodology used to measure impairment of purchased mortgage servicing rights and in 1993 the Company changed its method of accounting for certain investment securities.

New York, New York  
February 13, 1996

Fund American  
SELECTED QUARTERLY FINANCIAL DATA  
(Unaudited)

Selected quarterly financial data for 1995 and 1994 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	1995 Three Months Ended (a)				1994 Three Months Ended			
	Dec. 31	Sept. 30	June 30	Mar. 31	Dec. 31	Sept. 30	June 30	Mar. 31
Revenues	\$ 53.6	\$ 48.6	\$ 43.3	\$ 76.8	\$ 41.4	\$ 44.4	\$ 71.7	\$ 71.0
Expenses	52.8	42.9	86.8	43.4	52.0	56.4	59.7	57.6
Pretax operating earnings (loss)	.8	5.7	(43.5)	33.4	(10.6)	(12.0)	12.0	13.4
Net investment gains (losses)	7.0	4.4	10.4	17.0	(4.2)	20.6	20.9	1.5
Pretax earnings (loss)	7.8	10.1	(33.1)	50.4	(14.8)	8.6	32.9	14.9
Income tax provision (benefit)	5.4	3.5	(10.6)	18.4	(2.7)	4.3	13.0	5.9
After tax earnings (loss)	2.4	6.6	(22.5)	32.0	(12.1)	4.3	19.9	9.0
Tax benefit from sale of discontinued operations	-	-	66.0	-	-	-	-	-
Loss on early extinguishment of debt, after tax	-	-	(.2)	(.2)	-	-	-	-
Cumulative effect of accounting change-purchased mortgage servicing, after tax	-	-	-	-	-	-	-	(44.3)
Net income (loss)	\$ 2.4	\$ 6.6	\$ 43.3	\$ 31.8	\$(12.1)	\$ 4.3	\$ 19.9	\$(35.3)
Primary earnings per share:								
After tax earnings (loss)	\$ .29	\$ .75	\$(2.95)	\$ 3.43	\$(1.64)	\$ .24	\$ 1.72	\$ .60
Net income (loss)	.29	.75	5.08	3.41	(1.64)	.24	1.72	(3.86)
Fully diluted earnings per share:								
After tax earnings (loss)	.29	.75	(2.44)	3.23	(1.64)	.24	1.62	.60
Net income (loss)	.29	.75	4.68	3.22	(1.64)	.24	1.62	(3.86)

(a) The quarterly amounts for the three month periods ended June 30 and March 31, 1995, have been restated to reflect the adoption as of January 1, 1995, of SFAS No. 122. Prior to restatement, net income for the three month periods ended June 30 and March 31, 1995, was \$48.2 million and \$26.9 million, respectively.

The quarterly trading range for Shares of common stock during 1995 and 1994 is presented below:

Quarter ended:	1995		1994	
	High	Low	High	Low
December 31	\$ 75	\$ 66 1/4	\$ 79 1/4	\$ 70 1/2
September 30	76	68 1/4	78 3/8	69 3/4
June 30	72 5/8	68 3/8	70 3/8	60 1/2
March 31	76	71 3/4	77	64 3/4

Fund American  
INVESTMENTS  
(Unaudited)

Common Equity Securities

Shares and units in thousands, dollars in millions	December 31, 1995			Percent of total fair value
	Shares or units	Cost	Fair value	
Energy, natural resources and related industries:				
The Louisiana Land and Exploration Company	2,928	\$ 97.9	\$125.5	45.7%
San Juan Basin Royalty Trust	10,995	56.7	68.7	25.0
Aggregate of holdings less than \$10.0 million		14.1	16.1	5.9
Total energy, natural resources and related industries		168.7	210.3	76.6
All other:				
Zurich Reinsurance Centre Holdings, Inc.	2,043	60.4	62.0	22.6
Aggregate of holdings less than \$10.0 million		3.0	2.2	.8
Total common equity securities		\$232.1	\$274.5	100.0%

Fixed Maturity Investments

Millions	December 31, 1995	
	Cost or amortized cost	Fair value
U S West, Inc. redeemable preferred stock	\$ 48.8	\$ 48.8
State and municipal obligations	33.3	33.3
U. S. Government and agency obligations	23.5	24.2
Aggregate of holdings less than \$10.0 million	4.2	4.4
Total fixed maturity investments	\$ 109.8	\$ 110.7

Other Investments

Millions	December 31, 1995	
	Cost or amortized cost	Carrying value
Mid Ocean Limited restricted common shares and options	\$ 24.7	\$ 30.5
White River Corporation restricted common shares	21.1	25.6
Mortgage loans held for investment	24.3	24.3
Aggregate of holdings less than \$10.0 million	16.6	15.5
Total other investments	\$ 86.7	\$ 95.9

Fund American  
BOARD OF DIRECTORS

Class I (terms ending in 1998):

Howard L. Clark	Former Chairman - American Express Company
K. Thomas Kemp	Executive Vice President
Gordon S. Macklin	Chairman - White River Corporation

Class II (terms ending in 1996):

George J. Gillespie, III	Partner - Cravath, Swaine & Moore
John J. Byrne	Chairman, President and CEO

Class III (terms ending in 1997):

Howard L. Clark, Jr.	Vice Chairman - Lehman Brothers Inc.
Robert P. Cochran	President and CEO - Financial Security Assurance Holdings Ltd.
Arthur Zankel	Co-Managing Partner - First Manhattan Co.

Fund American

COMMITTEES OF THE BOARD

Audit Committee of the Board of Directors

The Audit Committee, consisting of all 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 annually reviews the qualifications of the independent auditors, makes recommendations to the Board as to their selection, and reviews the plan, fees and results of their audit.

Howard L. Clark, Jr., Chairman

Human Resources Committee of the Board of Directors

The Human Resources Committee, consisting of all non-management directors, oversees Fund American's compensation and benefit policies and programs, including administration of the Incentive Plan, the Deferred Compensation Plan and the Deferred Benefit Plan. The Human Resources Committee also sets the annual salaries and bonuses for elected officers and certain other key employees.

Gordon S. Macklin, Chairman

Fund American  
CHAIRMEN AND OFFICERS

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CORPORATE

Fund American Enterprises Holdings, Inc. (Hanover, New Hampshire)

John J. Byrne	Chairman, President and CEO	K. Thomas Kemp	Executive VP
Dennis P. Beaulieu	VP and Secretary	Michael S. Paquette	VP and Controller
Reid T. Campbell	Assistant Controller	Allan L. Waters	Senior VP and CFO

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MORTGAGE ORIGINATION AND SERVICING OPERATIONS

Fund American Enterprises, Inc. (Norwich, Vermont)

John J. Byrne	Chairman	Terry L. Baxter	President and Secretary
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Source One Mortgage Services Corporation (Farmington Hills, Michigan)

Robert W. Richards	Chairman	James A. Conrad	President and CEO
Michael C. Allemang	Executive VP and CFO	Robert R. Densmore	Executive VP and Secretary



Fund American  
CHAIRMEN AND OFFICERS

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INSURANCE OPERATIONS

White Mountains Holdings, Inc. (Hanover, New Hampshire)

John J. Byrne	Chairman	K. Thomas Kemp	President and CEO
Dennis P. Beaulieu	VP and Secretary	Michael S. Paquette	VP and Controller
Reid T. Campbell	Assistant Controller	Allan L. Waters	Senior VP and CFO
Morgan W. Davis	Senior VP and COO		

Valley Group, Inc. (Albany, Oregon)

K. Thomas Kemp	Chairman	Daniel A. Post	President and CEO
Kenneth R. Hisel	Senior VP	Stuart E. Olson	Executive VP, COO and CFO
Phillip L. Kloek	Senior VP		

Charter Group, Inc. (Dallas, Texas)

K. Thomas Kemp	Chairman	Daniel A. Post	President and CEO
Carey D. Benson	Senior VP and COO		

White Mountains Insurance Company (Hanover, New Hampshire)

K. Thomas Kemp	Chairman	Morgan W. Davis	President and CEO
Dennis P. Beaulieu	Senior VP, CFO and Treasurer	Michael S. Paquette	VP and Controller

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Fund American  
CORPORATE INFORMATION

Principal Offices

Fund American Enterprises Holdings, Inc.  
White Mountains Holdings, Inc.  
80 South Main Street  
Hanover, New Hampshire 03755-2053  
(603) 643-1567

Fund American Enterprises, Inc.  
The 1820 House, Main Street  
Norwich, Vermont 05055-0850  
(802) 649-3633

Form 10-K

The financial statements contained in this report, in the opinion of management, substantially conform with or exceed the financial statement information required in the "Form 10-K, Annual Report" to be filed with the Securities and Exchange Commission no later than April 1, 1996. Certain supplemental information appears in the Form 10-K which is not disclosed within this document. Copies of the Form 10-K are available without charge upon written request to the Corporate Secretary's office at the Hanover, New Hampshire address.

Transfer Agent and Registrar for Common Stock

First Chicago Trust Company of New York  
P.O. Box 2532  
Mail Suite 4690  
Jersey City, New Jersey 07303-2532

Shareholders may obtain information about transfer requirements, replacement dividend checks, duplicate 1099 forms and changes of address by calling the Transfer Agent's Telephone Response Center at (201) 324-1644. Please be prepared to provide your tax identification or social security number, description of securities and address of record. Other inquiries concerning your shareholder account should be addressed in writing to the Transfer Agent and Registrar.

Stock Exchange Information

The Company's Common Stock (symbol FFC) is listed on the New York Stock Exchange.

Annual Meeting

The 1996 Annual Meeting of shareholders will be held on Thursday, May 16, 1996, at Byrne Hall, Amos Tuck School of Business at Dartmouth College, Hanover, New Hampshire and will commence at 9:00 a.m.

Independent Auditors

Ernst & Young LLP  
787 Seventh Avenue  
New York, New York 10019-6018

Shareholder Inquiries

Written shareholder inquiries should be sent to the Corporate Secretary at the Hanover, New Hampshire address. Written inquiries from the investment community should be directed to the Investor Relations Department, c/o Fund American Enterprises, Inc., at the Norwich, Vermont address.

Matching Gifts Program

Fund American encourages its employees and its Board to support higher education and charitable organizations through the Fund American Matching Gifts Program. Employee gifts to accredited, four-year institutions of higher education located in the United States are matched on the basis of \$2 for every dollar with an annual maximum of \$4,000 per employee. Community or charitable gifts are matched on the basis of \$1 for every dollar with an annual maximum of \$4,000 per individual.

Fund American's Social Responsibility Committee also sponsors employees who contribute their time or expertise to organizations they believe in by supplementing their devotion to the organization with a cash donation. Supplemental endorsement requests are considered on a case by case basis.

[LOGO OR FUND AMERICAN APPEARS HERE]

SUBSIDIARIES OF THE REGISTRANT  
AS OF DECEMBER 31, 1995

FULL NAME OF SUBSIDIARY -----	PLACE OF INCORPORATION -----
CHARTER INDEMNITY COMPANY	TEXAS, USA
FFOG, INC.	DELAWARE, 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
WHITE MOUNTAINS HOLDINGS, INC.	NEW HAMPSHIRE, USA
WHITE MOUNTAINS INSURANCE COMPANY	NEW HAMPSHIRE, USA

## CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Fund American Enterprises Holdings, Inc., of our report dated February 13, 1996, included in the 1995 Annual Report to Shareholders of Fund American Enterprises Holdings, Inc.

Our audits also included the financial statement schedules of Fund American Enterprises Holdings, Inc. listed in Item 14(a). These schedules are the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, the financial statement schedules referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We further consent to the incorporation by reference in the Registration Statements (Form S-8, No. 33-5297, Form S-3, No. 33-54006, and Form S-3, No. 33-54749) pertaining to the Long-Term Incentive Plan, Medium-Term Notes Series A and Common Stock Warrants of Fund American Enterprises Holdings, Inc. of our report dated February 13, 1996, with respect to the consolidated financial statements and financial statement schedules of Fund American Enterprises Holdings, Inc. included or incorporated by reference in the Annual Report (Form 10-K) for the year ended December 31, 1995.

ERNST & YOUNG LLP

New York, New York  
March 25, 1996

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 21st day of February, 1996.

/s/ John J. Byrne

-----  
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 21st day of February, 1996.

/s/ Howard L. Clark

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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 21st day of February, 1996.

/s/ Howard L. Clark, Jr.

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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 21st day of February, 1996.

/s/ Robert P. Cochran

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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 21st day of February, 1996.

/s/ George J. Gillespie III  
- -----  
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 21st day of February, 1996.

/s/ Gordon S. Macklin

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Gordon S. Macklin

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 21st day of February, 1996.

/s/ Michael S. Paquette  
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Michael S. Paquette

FUND AMERICAN ENTERPRISES HOLDINGS, INC.  
POWER OF ATTORNEY

KNOW ALL MEN by these presents, that Allan L. Waters 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 21st day of February, 1996.

/s/ Allan L. Waters

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Allan L. Waters

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 21st day of February, 1996.

/s/ Arthur Zankel

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Arthur Zankel



12-MOS		12-MOS	
DEC-31-1995	JAN-01-1995	DEC-31-1994	JAN-01-1994
DEC-31-1995	DEC-31-1995	DEC-31-1994	DEC-31-1994
	585	3	609
	59		63
	(13)		(13)
	0		0
	0		0
	0		0
445	1,872	254	1,807
	407		547
0	0	0	75
	700		586
	0		0
1,872	1,807		0
	0		0
	222		229
	0		0
	180		147
(39)	0	(39)	0
46	0	79	0
	35		42
	17		21
18	0	0	0
	66		0
	0		0
	0		(44)
	84		(23)
	9.36		(3.51)
	9.16		(3.51)