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October 7, 2008

Subject: IFIC and the Credit Crunch

To our Valued Agents:

This letter is to let you know how your surety market, IFIC, is doing during this credit crunch. The most currently available interim results (August 31, 2008) report another record year, even after some significant losses in our investments. Outstanding underwriting profits are driving these interim bottom line record results. This is due to our continued growth in written premium, low loss ratios and most importantly long-term consistent favorable loss development. The credit (pardon the pun) for this is you and your working relationship with IFIC regional underwriters. Thank you!

These are serious times for the economy in which we do business together. As a result, this letter will outline some of how we are managing these issues and what you should expect. If you would like to inquire about these issues in greater detail you are welcome to give our CFO, Arnie Spier or myself a call. We will be happy to disclose and explain any details you would like.

Collateral & Cash Deposits

Aside from almost \$40 million in cash collateral, IFIC has about \$250 million in irrevocable letters of credit (ILOCs). In addition to the cash collateral the company maintains operating cash balances in excess of \$20 million.

We have been making decisions to move monies deposited in some banks to other banks based on recent assessments of the banks' creditworthiness. We also are increasing the amount of our cash balances in a combination of treasuries with a positive yield, other government backed securities and money market funds.

In recent weeks, circumstances have forced us to draw on ILOCs issued by three different banks in order to maintain our collateral position. When a bank's credit worthiness becomes questionable we have to strike the right balance of not over reacting, while making sure we are proactive so we don't miss the window of opportunity to protect our collateral position. When we make such decisions, we consider the collateralized surety obligations. Based on our current underwriting of a principal we may consider whether or not we still need the ILOC at its current level or at all. We also consider a principal's ability to replace the ILOC.

Thus, on a case by case basis, we have and may make exceptions to not draw on an ILOC based on the specifics of the collateralized surety bond liability. Any time we draw on an ILOC due to a bank's creditworthiness, we will give the bonded principal the choice of placing the funds in either treasuries or a money market fund. All interest earned on the monies will be returned when the cash collateral is returned. In any event, we will consult with our regional underwriters who will do the same with you in this regard.

Going forward, we will be assessing from which banks we are most comfortable taking ILOCs and which ones we are not. This will make it easier for us to ask for a prompt and orderly replacement of an ILOC when necessary, rather than drawing on them. Moreover, it will provide some basis to determine from what bank we are able to take ILOCs.

Our policy has been to accept both ILOCs and cash as collateral. We remain unchanged in this approach.

Invested Assets

At December 31, 2007 IFIC's \$86 million in capital & surplus is supported by about \$160 million in invested assets that breaks down as follows: \$40 million in cash, \$20 million in equities and \$100 million in fixed income securities.

About two years ago, we moved from having an allocation of less than 5% of our invested assets directly in equity securities to up to 15% in a group of diversified mutual funds in equities. We felt and still feel it makes sense that a modest allocation in equities like this will augment our return on invested assets over the long-term while limiting our exposure in down markets (like this one) to a manageable level.

Our fixed income investments are made up of corporate, municipal and government backed bonds managed by a professional fixed income money manager with a specialty in doing so for insurance companies. Naturally, our investment policy, approved by our board of directors, requires that we invest in only the highest rated bonds. As a result, we have had only one investment default so far in this credit crunch and this was a \$1 million bond in Lehman. Ultimately, we expect this will reduce our before tax earnings this year in a range less than 1% to 4%. While that is a lot of dollars for a single event, it is not a very material impact on our results.

None the less, as a result of the credit crunch we have been reevaluating our approach in fixed income securities. We feel the historical spread on yields in corporate and municipal fixed incomes as compared to treasuries of a like duration is not compensatory for the risk to capital. As a result, we have developed a plan to transition our fixed income investments entirely to treasuries over the next year. It will take that long in order to do so while also avoiding any material capital losses on the liquidation of those securities. At the end of the day, this will only enhance IFIC's stable capital structure.

Underwriting in this credit crunch

Our approach to underwriting in this credit crunch is guided by the same underlying philosophy outlined to you in our 2007 annual letter to agents. We will continue to underwrite each account, one at a time, on its own merits. We are guided by our underwriting guidelines and rely on the working relationships of you and our regional offices underwriters to develop the needed judgment to make the right decisions and recommendations.

Of course, we will evolve with changing market conditions. In these current market conditions we need to make sure we are underwriting the bank facilities and banking relationships of your accounts when it is warranted based on the specifics of your customers surety account. We are counting not just on your support in this regard but also your valuable advice. This is important to us because we continue to believe we should not rely on a risk based credit scoring/modeling to aid us in times like this. We all know there have been certain large financial institutions that have had great credit ratings shortly before they failed. We think it is best for an organization like IFIC to just stick with underwriting the facts of each case rather than underwriting a book of business as a whole.

Closing

Thank you for your support. We appreciate it because without it we would not be having another great year. Whether or not 2008 closes out to be another record year remains to be seen. Nonetheless, we are confident it will be another great year. We are counting on your continued support so that we can continue to be a stable, predictable and responsive market for you in these difficult economic times.

Once again, if there are any explanations or information you would like in greater detail that is touched upon earlier in this letter please feel free to give our CFO Arnie Spier or myself a call. We will be happy to answer all of your questions.

Sincerely,

A handwritten signature in black ink that reads "Bob Minster". The signature is written in a cursive, slightly stylized font.

Robert W. Minster
Executive Vice President
Chief Operating Officer