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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the period ended June 30, 2004

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 0-25508

RTW, INC.

(Exact name of registrant as specified in its charter)

Minnesota

41-1440870

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

8500 Normandale Lake Boulevard, Suite 1400
Bloomington, MN 55437

(Address of principal executive offices and zip code)

(952) 893-0403

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2)

Yes No

At August 1, 2004, approximately 5,263,000 shares of Common Stock were outstanding.

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PART I — FINANCIAL INFORMATION

Item 1: CONSOLIDATED FINANCIAL STATEMENTS AND NOTES (UNAUDITED)

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RTW, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
JUNE 30, 2004 AND DECEMBER 31, 2003
(In thousands, except share data)

	June 30, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Investments at fair value, amortized cost of \$86,773 and \$77,674	\$ 85,499	\$ 79,171
Cash and cash equivalents	32,030	39,650
Accrued investment income	794	769
Premiums receivable, less allowance of \$125 and \$225	4,092	3,482
Reinsurance recoverables:		
On unpaid claim and claim settlement expenses	69,093	71,466
On paid claim and claim settlement expenses	1,007	854
Deferred policy acquisition costs	1,189	926
Furniture and equipment, net	1,076	1,242
Other assets	7,263	4,608
	<u> </u>	<u> </u>
Total assets	\$202,043	\$202,168
	<u> </u>	<u> </u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unpaid claim and claim settlement expenses	\$148,835	\$150,044
Unearned premiums	11,001	9,180
Accrued expenses and other liabilities	6,256	7,357
	<u> </u>	<u> </u>
Total liabilities	166,092	166,581
Shareholders' equity:		
Undesignated stock, no par value; authorized 4,750,000 shares; none issued or outstanding	—	—
Series A Junior Participating Preferred Stock, no par value; authorized 250,000 shares; none issued or outstanding	—	—
Common Stock, no par value; authorized 12,500,000 shares; issued and outstanding 5,260,000 shares at June 30, 2004 and 5,125,000 at December 31, 2003	20,949	20,644
Retained earnings	15,843	13,970
Accumulated other comprehensive (loss) income	(841)	973
	<u> </u>	<u> </u>
Total shareholders' equity	35,951	35,587
	<u> </u>	<u> </u>
Total liabilities and shareholders' equity	\$202,043	\$202,168
	<u> </u>	<u> </u>

See notes to consolidated financial statements.

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RTW, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2004 AND 2003
(Unaudited; in thousands, except share and per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2004	2003	2004	2003
Revenues:				
Gross premiums earned	\$ 15,376	\$ 12,566	\$ 30,338	\$ 25,588
Premiums ceded	(2,208)	(1,721)	(4,528)	(3,621)
Premiums earned	13,168	10,845	25,810	21,967
Investment income	968	1,167	1,850	2,409
Net realized investment gains	58	—	707	—
Service fee income	73	28	140	56
Total revenues	14,267	12,040	28,507	24,432
Expenses:				
Claim and claim settlement expenses	9,005	5,704	18,235	13,898
Policy acquisition costs	1,959	2,765	3,369	3,800
General and administrative expenses	1,932	2,656	4,124	4,942
Total expenses	12,896	11,125	25,728	22,640
Income from operations	1,371	915	2,779	1,792
Interest expense	—	13	—	30
Income before income taxes	1,371	902	2,779	1,762
Income tax expense	428	263	906	559
Net income	\$ 943	\$ 639	\$ 1,873	\$ 1,203
Net income per share:				
Basic income per share	\$ 0.18	\$ 0.12	\$ 0.36	\$ 0.23
Diluted income per share	\$ 0.17	\$ 0.12	\$ 0.34	\$ 0.23
Weighted average shares outstanding:				
Basic shares outstanding	5,236,000	5,128,000	5,182,000	5,121,000
Diluted shares outstanding	5,472,000	5,310,000	5,441,000	5,221,000

See notes to consolidated financial statements.

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RTW, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED JUNE 30, 2004 AND 2003
(Unaudited, in thousands)

	For the Six Months Ended June 30,	
	2004	2003
Cash flows from operating activities:		
Net income	\$ 1,873	\$ 1,203
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized investment gains	(707)	—
Depreciation and amortization	495	624
Changes in assets and liabilities:		
Reinsurance recoverables	2,220	13,345
Unpaid claim and claim settlement expenses	(1,209)	(17,777)
Unearned premiums, net of premiums receivable	1,211	883
Other, net	(3,087)	1,479
Net cash provided by (used in) operating activities	796	(243)
Cash flows from investing activities:		
Proceeds from sales of securities	18,651	10,994
Purchases of securities	(36,485)	(32,902)
Maturities of available for sale investments	9,174	—
Purchases of furniture and equipment	(61)	(94)
Net cash used in investing activities	(8,721)	(22,002)
Cash flows from financing activities:		
Payments on note payable	—	(750)
Stock option exercises	305	51
Retirement of common stock	—	(37)
Net cash provided by (used in) financing activities	305	(736)
Net decrease in cash and cash equivalents	(7,620)	(22,981)
Cash and cash equivalents at beginning of year	39,650	36,288
Cash and cash equivalents at end of period	\$ 32,030	\$ 13,307
Supplemental disclosure of cash flow information:		
Cash paid (received) during the period for:		
Interest	\$ —	\$ 23
Income taxes	\$ 1,175	\$ (1)

See notes to consolidated financial statements.

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RTW, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
THREE AND SIX MONTHS ENDED JUNE 30, 2004 AND 2003
(Unaudited)

NOTE A – BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles applied on a basis consistent with the financial statements included in the RTW, Inc. 2003 Annual Report on Form 10-K filed with the Securities and Exchange Commission, except that the consolidated financial statements included herein were prepared in conformity with the instructions to Form 10-Q for interim financial information and, accordingly, do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. We have prepared the consolidated financial information included herein, other than the consolidated balance sheet at December 31, 2003, without audit by an independent registered public accounting firm. We derived the consolidated balance sheet at December 31, 2003 from the audited consolidated financial statements for the year ended December 31, 2003; however, this report does not include all the disclosures contained therein.

The information furnished includes all adjustments and accruals, consisting only of normal, recurring accrual adjustments, which are, in our opinion, necessary for a fair statement of results for the interim period. The results of operations for any interim period are not necessarily indicative of results for the full year. The unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the 2003 Annual Report on Form 10-K.

NOTE B – STOCK OPTIONS AND STOCK-BASED BENEFIT PLANS

We measure compensation expense for our stock-based employee compensation plans using the intrinsic value method in accordance with the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and comply with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure — an amendment of FAS 123". The fair value of the options granted has been estimated at the date of grant using the Black-Scholes option-pricing model.

Had we calculated compensation expense for our option grants under the 1994 Stock Plan and stock issuances under our Employee Stock Purchase Plan based on the fair value method described in SFAS No. 123, our net income and basic and dilutive net income per share would approximate the following pro forma amounts (in 000's, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net income:				
As reported	\$ 943	\$ 639	\$1,873	\$1,203
Pro forma	866	583	1,616	1,036
Basic net income per share:				
As reported	0.18	0.12	0.36	0.23
Pro forma	0.17	0.11	0.31	0.20
Diluted net income per share:				
As reported	0.17	0.12	0.34	0.23
Pro forma	0.16	0.11	0.30	0.20

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NOTE C – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive loss totaled \$2.1 million in the second quarter of 2004 compared to accumulated other comprehensive income of \$734,000 for the same period in 2003. Accumulated other comprehensive loss totaled \$1.8 million for the six months ended June 30, 2004 compared to accumulated other comprehensive income of \$1.0 million for the same period in 2003. Accumulated other comprehensive income was \$973 at December 31, 2003. The difference between net income and accumulated other comprehensive (loss) income is the result of unrealized gains (losses) that arise during the period on our investments. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Investments”.

NOTE D – LETTER OF CREDIT

On July 30, 2004 the Company entered into a Letter of Credit Reimbursement Agreement (“Agreement”) for \$2.0 million with its primary bank to collateralize a performance bond required as part of RTW’s 25% service contract with the Minnesota Assigned Risk Plan. The Agreement is collateralized by the stock of ACIC and contains a restrictive covenant that requires that ACIC maintain at least a B+ rating from A. M. Best Company.

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Item 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company: RTW, Inc. (RTW) and its wholly owned insurance subsidiary, American Compensation Insurance Company (ACIC), provide disability management services to employers. Collectively, "we," "our" and "us" refer to these entities in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We have developed two proprietary management systems: (i) ID15[®], designed to identify those injured employees who are likely to become inappropriately dependent on the workers' compensation system; and (ii) the RTW SOLUTION[®], designed to lower employers' workers' compensation costs and return injured employees to work as soon as possible. We provide workers' compensation management services: (i) to employers insured through our insurance subsidiary; (ii) to self-insured employers on a fee-for-service basis; (iii) to the Minnesota Assigned Risk Plan on a percent of premium basis; and (iv) on a consulting basis, charging hourly fees. During the first six months of 2004, we operated primarily in Minnesota, Michigan and Colorado.

On March 9, 2004, our A.M. Best financial rating was upgraded from B (Fair, Vulnerable) to B+ (Very Good, Secure) as a result of: (i) our continued profitable operating performance in 2003; and (ii) improved capitalization in ACIC as statutory surplus increased to \$33.0 million at December 31, 2003 from \$26.8 million at December 31, 2002 due to our earnings in 2003. Although we believe that our B+ rating from A.M. Best may increase the number of employers to which we provide our products, there are some employers that will only do business with insurers rated A- or better.

Additional information about RTW is available on our website, www.rtwi.com.

Challenges, risks, uncertainties and trends:

We derive our revenue almost entirely from workers' compensation insurance premiums and investment income including gains and losses from sales of securities. A small portion of our revenue is derived from non-insurance workers' compensation services. We are subject to the challenges, risks, uncertainties and trends that affect the workers' compensation property and casualty insurance sector of our economy including the following:

- Workers' compensation is a state regulated industry. Workers' compensation is governed and regulated by state governmental agencies. We are and will be subject to state regulation in any state in which we provide workers' compensation products and services, now and in the future. State regulatory agencies have broad administrative power with respect to all aspects of our business, including premium rates, benefit levels, policy forms, dividend payments, capital adequacy and the amount and type of investments. Legislation covering insurance companies and the regulations adopted by state agencies are subject to change and any change may adversely affect our operations;
- Workers' compensation claims and related expenses can be volatile. Worker's compensation is a long-tailed property and casualty insurance line. Claims for a given year are open on average for twelve to thirteen years and it is not unusual for workers' compensation insurers to have some claims open for thirty or more years. We have operated our insurance company since 1992 and therefore have relatively limited experience (twelve years), and accordingly, are subject to volatility. See further discussion under "Claim and Claim Settlement Expenses";
- Workers' compensation is subject to inflationary pressures. Worker's compensation is subject to both medical and wage inflation. The cost of medical care has increased in excess of 10% per annum in recent years. This has resulted in reduced profitability in the workers' compensation insurance line. New medical procedures could evolve and new legal theories develop that could cause older claims to re-open and increase expense. See further discussion under "Claim and Claim Settlement Expenses";
- Workers' compensation pricing is cyclical. For the first six months of 2004, we were able to increase premium rates on renewing policies 1.3%. This compares to rate increases of 1.4%, 8.7%, 18.5% and 11.7% in 2003, 2002, 2001 and 2000, respectively. These increases came after many years of pricing decreases that unfavorably affected the industry in the late 1990's. If we are unable to maintain rate increases or decrease our costs, our profit margin will be adversely affected. See further discussion under "Premiums in Force and Gross Premiums Earned";

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- Reinsurance costs for workers' compensation have increased. Reinsurance costs increased over the prior year continuing a pattern of cost increases beginning in 2001. These higher costs, if not recovered through increased pricing from our customers, will adversely affect our profit margin. See further discussion under "Premiums Ceded"; and
- Low interest rates reduce our investment income. Interest rates for investment-grade instruments have increased in recent months moving only slightly from historic lows. Our investment income is directly affected by the interest rate at which we invest our free cash flow. The historical low interest rate environment contributed to a significant mortgage refinancing boom, resulting in prepayment of our mortgage-backed investments and an increase in our cash on hand in ACIC. We have and continue to invest these funds in short-term instruments. A continuation of the lower interest rate environment will continue to adversely affect our investment income. See further discussion under "Investment Income and Net Realized Investment Gains".

Significant Accounting Policies

Our significant accounting policies are summarized in Note 1 – "Summary of Significant Accounting Policies" included in our Consolidated Financial Statements and notes thereto in our 2003 Annual Report on Form 10-K. Our significant accounting policies include those policies related to our accounting for: (i) premiums earned; (ii) unpaid claim and claim settlement expenses, including reserves for incurred but not reported claims and the related reinsurance recoverables; (iii) policy acquisition costs; (iv) income taxes and deferred income taxes; and (v) investments. These accounting policies are discussed in detail within each section of this "Management's Discussion and Analysis of Financial Condition and Results of Operations".

Off-Balance Sheet Arrangements

We do not have any Off-Balance Sheet Arrangements

Financial Summary

This financial summary presents our discussion and analysis of the consolidated financial condition and results of operations of RTW, Inc. This review should be read in conjunction with our consolidated financial statements and notes thereto at June 30, 2004 and December 31, 2003 and the three and six-month periods ended June 30, 2004 and 2003.

The following table provides an overview of our key operating results (amounts in 000's except per share data):

	Three Months Ended March 31,		Six Months Ended June 30,	
	2004	2003	2004	2003
Gross premiums earned	\$15,376	\$12,566	\$30,338	\$25,588
Premiums earned	13,168	10,845	25,810	21,967
Total revenues	14,267	12,040	28,507	24,432
Claim and claim settlement expenses	9,005	5,704	18,235	13,898
Net income	943	639	1,873	1,203
Diluted income per share	\$ 0.17	\$ 0.12	\$ 0.34	\$ 0.23

We reported net income of \$943,000 in the second quarter of 2004 compared to net income of \$639,000 in the second quarter of 2003 and reported a net income of \$1.9 million for the six months ended June 30, 2004 compared to \$1.2 million for the same period in 2003. Diluted net income per share was \$0.17 in the second quarter of 2004 compared to \$0.12 for the second quarter of 2003 and was \$0.34 for the six months ended June 30, 2004 compared to \$0.23 for the same period in 2003. The primary factors affecting our 2004 operating results included the following:

- Our gross premiums earned increased to \$15.4 million in the second quarter of 2004 from \$12.6 million in the second quarter of 2003 and increased to \$30.3 million for the six months ended June 30, 2004 from \$25.6 million for the same period in 2003 due primarily to an increase in premiums in force from comparable periods in 2003. See further discussion under "Premiums In Force and Gross Premiums Earned";
- Premiums earned increased to \$13.2 million in the second quarter of 2004 from \$10.8 million in the second

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quarter of 2003 and increased to \$25.8 million for the six months ended June 30, 2004 from \$22.0 million for the same period in 2003 reflecting the increase in premiums in force from the comparable 2003 period as a result of the premium growth experienced in the second half of 2003 offset by an increase in premiums ceded as our cost of excess of loss reinsurance increased in 2004;

- In addition to the factors affecting premiums earned, total revenues increased as we recorded \$58,000 and \$707,000 of net realized investment gains for the three and six month periods ended June 30, 2004, respectively. There were no net realized investment gains recorded in the first six months of 2003; and
- Claim and claim settlement expenses increased to \$9.0 million in the second quarter of 2004 from \$5.7 million in the second quarter of 2003 and increased to \$18.2 million for the six months ended June 30, 2004 compared to \$13.9 million for the same period in 2003 resulting from the increase in gross premiums earned. Favorable development for prior accident years reduced claim and claim settlement expenses by \$850,000 in the second quarter of 2004 compared to \$2.4 million for the second quarter of 2003 and by \$1.1 million for the six months ended June 30, 2004 compared to \$2.7 million for the same period in 2003. See further discussion under "Claim and Claim Settlement Expenses."

We expect premiums in force to increase moderately from levels reported at June 30, 2004 for the remainder of the year as we focus on writing profitable business at the right price. We will focus on increasing profitability in our markets by: (i) aggressively managing and closing claims; (ii) reviewing policy profitability at renewal and removing unprofitable accounts; and (iii) aggressively managing policy acquisition costs and general and administrative expenses.

We expect that service fee income will increase significantly in the third and fourth quarters of 2004 when we begin providing services to employers insured through the Minnesota Assigned Risk Plan.

In the following pages, we take a look at the operating results for the three and six-month periods ended June 30, 2004 and 2003 for items in our Consolidated Statements of Income and also explain key balance sheet accounts in greater detail.

Results of Operations

Total revenues: Our total revenues include premiums earned, investment income, net realized investment gains, and service fee income. The following tables summarize the components of our revenues and premiums in force (000's):

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Gross premiums earned	\$15,376	\$12,566	\$30,338	\$25,588
Premiums ceded	(2,208)	(1,721)	(4,528)	(3,621)
Premiums earned	13,168	10,845	25,810	21,967
Investment income	968	1,167	1,850	2,409
Net realized investment gains	58	—	707	—
Service fee income	73	28	140	56
Total revenues	\$14,267	\$12,040	\$28,507	\$24,432

	June 30,		December 31,
	2004	2003	2003
Premiums in force, by regional office location:			
Minnesota	\$36,600	\$26,800	\$32,000
Michigan	13,700	12,400	13,100
Colorado	12,100	11,100	13,000
Total premiums in force	\$62,400	\$50,300	\$58,100

Premiums In Force and Gross Premiums Earned: Premiums on workers' compensation insurance policies are our largest source of revenue. Premiums earned are the gross premiums earned by us on in force workers' compensation policies, net of the effects of ceded premiums under reinsurance agreements.

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The premium we charge a policyholder is a function of the policyholders' payroll, industry and prior workers' compensation claims experience. In underwriting a policy, we receive policyholder payroll estimates for the ensuing year. We record premiums written on an installment basis matching billing to the policyholder and earn premiums on a daily basis over the life of each insurance policy based on the payroll estimate. We record the excess of premiums billed over premiums earned for each policy as unearned premiums on our balance sheet. When a policy expires, we audit policyholder payrolls for the policy period and adjust the estimated payroll to its actual value. The result is a "final audit" adjustment recorded to premiums earned when the adjustment becomes known. Final audit premiums recognized during the period include billed final audit premiums plus (or minus) the change in estimate for premiums on unexpired and expired unaudited policies.

Our premiums in force increased \$12.1 million or 24.0% to \$62.4 million at June 30, 2004 from \$50.3 million at June 30, 2003 and increased \$4.3 million or 7.4% from \$58.1 million at December 31, 2003. A significant portion of the increase in premiums in force since June 30, 2003 occurred in our Minnesota region with a modest increase in our Colorado and Michigan regions. In order to continue to improve profitability, we aggressively targeted policies that did not meet our underwriting profit margin standards for non-renewal or re-underwriting at increased rates at policy expiration in 2004 and 2003.

Our gross premiums earned increased 22.4% to \$15.4 million in the second quarter of 2004 from \$12.6 million in the second quarter of 2003 and increased 18.6% to \$30.3 million for the six months ended June 30, 2004 from \$25.6 million for the same period in 2003 due primarily to the increase in premiums in force. Final audit premiums had negligible effect on gross premiums earned for the three and six-month periods ending June 30, 2004, respectively. In contrast, final audit premiums increased gross premiums earned by \$119,000 and \$247,000 for the three and six-month periods ending June 30, 2003, respectively.

Renewal premium rates increased 1.5% in the second quarter of 2004 and 1.3% for the six months ended June 30, 2004 while renewal premium rates decreased 3.4% in the second quarter of 2003 and increased 1.4% for the six months ended June 30, 2003. We file our rates at the high end of the market in each region in which we operate, usually at or near the rates charged by the residual markets in these regions.

Premiums Ceded: Reinsurance agreements enable us to share certain risks with other insurance companies. We purchase reinsurance to protect us from potential losses in excess of the level we are willing to accept. We expect the companies to which we have ceded reinsurance to honor their obligations. In the event that these companies are unable to honor their obligations to us, we will be required to pay the underlying obligations ourselves. We are not aware of any developments with respect to any of our reinsurers that would result in our current reinsurance balances becoming uncollectible.

Under our excess of loss reinsurance policies, we pay reinsurers to limit our per-incident exposure and record this cost to premiums ceded as a reduction of gross premiums earned. In Minnesota, we are required to purchase excess of loss coverage for our Minnesota policies from the Minnesota Workers' Compensation Reinsurance Association (WCRA). We purchased reinsurance for 2004 in our non-Minnesota regions from three reinsurers. The following table summarizes our reinsurance coverage (all losses ceded on a per occurrence basis):

		Covers losses per occurrence:	
		In excess of:	Limited to:
Minnesota:			
2004	WCRA	\$360,000	Statutory limit
	Various reinsurers	\$200,000	\$360,000
2003	WCRA	\$360,000	Statutory limit
	Various reinsurers	\$200,000	\$360,000
2002	WCRA	\$350,000	Statutory limit
Non-Minnesota:			
2004	Various reinsurers	\$200,000	\$20.0 million excluding acts of terrorism
2003	Various reinsurers	\$200,000	\$20.0 million excluding acts of terrorism
2002	Various reinsurers	\$300,000	\$20.0 million

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Premiums ceded to reinsurers were \$2.2 million in the second quarter of 2004 compared to \$1.7 million in the second quarter of 2003 and were \$4.5 million for the six months ended June 30, 2004 compared to \$3.6 million for the same period in 2003. As a percent of gross premiums earned, premiums ceded increased to 14.4% for the three months ended June 30, 2004 compared to 13.7% for the same period in 2003 and to 14.9% for the six months ended June 30, 2004 compared to 14.2% for the same period in 2003. The rates we are charged for excess of loss reinsurance coverage increased in all regions in 2004 while the rates we are charged are lower for Minnesota risks compared to non-Minnesota risks.

Premiums Earned Outlook: The outlook for premiums in force, gross premiums earned and premiums ceded for the remainder of 2004 include the following factors:

- We expect premium rates on renewing policies to increase slightly for the remainder of 2004. Premium rate increases realized in 2003 will continue to favorably affect profitability in 2004 as we earn more premiums on those policies. We expect premiums in force to increase moderately for the remainder of 2004;
- Our 2004 gross premiums earned will move in the same direction as our premiums in force, lagging slightly as premiums are earned over the term of the insurance policy; and
- We expect that premiums ceded under excess of loss policies will increase when compared to 2003, but remain consistent with the first six months of 2004 as a percentage of gross premiums earned.

Investment Income and Net Realized Investment Gains: Investment income includes earnings from our investment portfolio and our net realized investment gains, which include gains from sales of securities, and are displayed separately on our accompanying Consolidated Statements of Income.

We currently invest entirely in U.S. domiciled investment-grade taxable and tax-exempt fixed maturity investments and classify our investments as available-for-sale. We intend to hold our available-for-sale investments to maturity, but may sell them before maturity in response to tax planning considerations, changes in interest rates, changes in prepayment risk, changes in funding sources or terms, or to address liquidity needs. Our primary investment objective is to maintain a diversified, high-quality, fixed-investment portfolio structured to maximize our after-tax investment income without taking inappropriate credit risk. For further discussion of investments, see the "Investments" section of this Management's Discussion and Analysis.

Investment income decreased to \$968,000 in the second quarter of 2004 from \$1.2 million in the second quarter of 2003 and decreased to \$1.9 million for the six months ended June 30, 2004 from \$2.4 million for the same period in 2003 as our investment portfolio decreased to \$85.5 million at June 30, 2004 from \$104.5 million at June 30, 2003. Investment income also declined as a result of the decrease in our investment yield to 4.0% at June 30, 2004 from 4.6% at June 30, 2003. Interest rates declined early in 2003, reaching a low point in June 2003 before returning to beginning of the year levels by December 2003. Approximately \$20.3 million of mortgage-backed securities in our investment portfolio were repaid earlier than expected in 2003 due to the significant consumer mortgage refinancing that occurred in 2003. The funds that came available could not be reinvested at comparable rates, causing the book investment yield to decline. In order to reduce the near-term interest rate risk on the portfolio, we built our cash position throughout 2003 by holding cash received on mortgage-backed security prepayments and through sales of securities in 2003 with the expectation that interest rates would rise in 2004. Subsequent to December 31, 2003, we began to diversify our portfolio by investing in tax-exempt municipal securities to take advantage of the tax benefits of those securities and existing interest rate spreads. Additionally in the first six months of 2004, we reinvested proceeds from maturing securities, prepayments of mortgage-backed securities and a portion of our cash and cash equivalents into taxable and tax-exempt securities. The investment income realized in future periods will be affected by yields attained on new investments.

In 2004, we sold certain securities within the portfolio to take advantage of favorable interest rates. We realized net investment gains of \$58,000 and \$707,000 for the three and six months ended June 30, 2004, respectively. No realized investment gains were realized in similar periods in 2003. Further recognition of realized investment gains and losses would depend on sales of our investments, if any, to meet our short-term cash requirements, to take advantage of market conditions or as we replace securities to manage our portfolio returns.

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Investment Income and Net Realized Investment Gains Outlook: Barring significant changes in interest rates or operational cash flows, we expect that income from our investment portfolio for the remainder of 2004 will be affected by the following:

- Our investment in tax-exempt municipal bonds will result in reduced investment yields and will favorably affect net income as the rates will be lower on a pre-tax basis but will be higher on a tax-adjusted basis;
- We expect interest rates to increase during the remainder of 2004; however, the timing of any such rate increases is unknown at this time. We intend to invest our excess cash into higher yielding investments as rates increase;
- Funds from our operating cash flows and investment cash flows provide growth in our investment portfolio. Cash flows for the remainder of 2004 will be affected by: (i) premiums ceded net of reinsurance reimbursements under our excess of loss treaties; and (ii) net cash flows resulting from claim payments on claims from 2004 and prior years offset by cash flows from current in-force policies;
- Future recognition of realized investment gains and losses will depend on sales of our investments, if any, to meet our short-term cash requirements or as we replace securities to manage our portfolio risks and returns; and
- New and renegotiated reinsurance treaties may affect our future cash flow and future investment income.

Service Fee Income: We receive service fee income from providing third party administration to self-insured employers on a fee-for-service basis and from consulting services provided to employers and agents, charging hourly fees. Service fee income grew to \$73,000 in the second quarter of 2004 from \$28,000 in the same quarter in 2003 and increased to \$140,000 for the six months ended June 30, 2004 from \$56,000 for the six months ended June 30, 2003.

Service Fee Income Outlook: Service fee income realized for the balance of 2004 will be affected by the following:

- In March, 2004, we announced that we were awarded a three-year contract to service 25% of the Minnesota Assigned Risk Plan (ARP). We will be paid a fee based on a percent of premium serviced and begin servicing 25% of new ARP business on July 1, 2004 and 25% of ARP renewal business on September 1, 2004. The estimated annual premium for the entire ARP is in excess of \$100 million. This contract is currently expected to produce service fee billings in excess of \$4.0 million during the first 14 months of the contract, approximately \$250,000 of earned service fee income during 2004 and approximately \$3.0 million of earned service fee income during 2005. Service fee income is recognized over the life of the underlying ARP policy and the related claims in a manner consistent with RTW's Premiums Earned revenue recognition policy; and
- We currently have 15 additional customers in Minnesota, California and Michigan that will generate an additional \$500,000 of annualized service fee revenue during the duration of their contracts. We continue to market our alternative products aggressively inside and outside the regions in which we currently operate. We expect service fee revenue will increase as new customers become aware of and purchase these services. The ultimate effect of this on service fee income is not known at this time.

Total expenses: Our expenses include claim and claim settlement expenses, policy acquisition costs, general and administrative expenses, interest expense and income taxes.

Claim and Claim Settlement Expenses: Claim expenses refer to medical and indemnity benefits that we paid or expect to pay to claimants for events that have occurred. The costs of investigating, resolving and processing these claims are referred to as claim settlement expenses. We record these expenses, net of amounts recoverable under reinsurance contracts, to claim and claim settlement expenses in the accompanying Consolidated Statements of Income.

Claim and claim settlement expenses are our largest expense and result in our largest liability. We establish reserves that reflect our estimates of the total claim and claim settlement expenses we will ultimately have to pay under our workers' compensation insurance policies. These include claims that have been reported but not yet settled and claims that have been incurred but not yet reported to us. For further discussion of reserve determination, see the "Unpaid Claim and Claim Settlement Expenses" section of this Management's Discussion and Analysis.

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Claim and claim settlement expenses increased to \$9.0 million in the second quarter of 2004 from \$5.7 million in the second quarter of 2003 and to \$18.2 million for the six months ended June 30, 2004 from \$13.9 million for the same period in 2003. As a percent of gross premiums earned, claim and claim settlement expenses increased to 58.6% for the second quarter of 2004 from 45.4% for the second quarter of 2003 and to 60.1% for the six months ended June 30, 2004 from 54.3% for the same period in 2003. These changes are due to the following:

- Claim and claim settlement expenses increased in total due to the overall increase in premiums in force and the related increase in gross premiums earned;
- We recorded an \$850,000 reduction in claim and claim settlement expenses in the second quarter of 2004 as well as a \$200,000 reduction in the first quarter of 2004 to reflect favorable claim development for 2003 and prior accident years. The 2003 results included a \$2.4 million reduction in the second quarter of 2003 and a \$300,000 reduction recorded in the first quarter of 2003;
- Continued improvements in our ability to manage claims; and
- Offsetting these decreases, claim costs continued to reflect increasing medical and indemnity costs in accident year 2004 as compared to accident year 2003 resulting from inflationary pressures.

Claim and Claim Settlement Expense Outlook: We expect that claim and claim settlement expenses will be affected by the following factors:

- Claim costs will continue to be affected by: (i) increases in medical and indemnity costs resulting from inflationary changes; (ii) severity experienced in current and future periods in our policyholder base; (iii) changes resulting from increases in operating efficiency and effectiveness realized through enhancements to our internal processes and procedures, including changes to our proprietary computer systems; and (iv) legislative changes that affect benefits payable under workers' compensation laws;
- Increases in premium rates, if any, will result in increasing gross premiums earned without a corresponding increase in claim and claim settlement expenses, ultimately decreasing claim and claim settlement expense as a percent of premiums earned. Changes in premium rates due to legislative changes in estimated loss costs, increased competition and improving customer loss experience may offset rate improvements; and
- Continued application of our claims management technology and methods to all open claims.

The ultimate effect of the above factors on claim and claim settlement expenses as a percent of premiums earned for the remainder of 2004 is unknown at this time.

Policy Acquisition Costs: Policy acquisition costs are costs directly related to writing an insurance policy and consist of commissions, state premium taxes, underwriting personnel costs and expenses, sales and marketing costs and other underwriting expenses, less ceding commissions received from our reinsurers. Ceding commissions are amounts that reinsurers pay to us for placing reinsurance with them.

The following table summarizes policy acquisition costs (000's):

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
Commission expense	\$1,116	\$ 901	\$ 2,222	\$1,846
Premium tax expense	236	264	459	394
Other policy acquisition costs	1,178	1,944	1,835	2,279
Direct policy acquisition costs	2,530	3,109	4,516	4,519
Ceding commissions on excess of loss reinsurance	(571)	(344)	(1,147)	(719)
Total policy acquisition costs	\$1,959	\$2,765	\$ 3,369	\$3,800

Under certain of our excess of loss reinsurance policies, the reinsurer returns a portion of the premiums we cede as ceding commissions to reimburse us for our cost of placing and managing these policies. Ceding commissions received under these excess of loss reinsurance policies totaled \$571,000 for the second quarter of 2004 compared to \$344,000 for the second quarter of 2003 and \$1.1 million for the six months ended June 30, 2004 compared to \$719,000 for the six months ended June 30, 2003. These ceding commissions reduced our policy acquisition costs. Excluding the effect of ceding commissions, policy acquisition costs decreased to \$2.5 million in the second quarter of 2004 from \$3.1 million in the second quarter of 2003, and remained unchanged for the first six months of 2004

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compared to the same period in 2003. As a percent of gross premiums earned, direct policy acquisition costs decreased to 16.5% in the second quarter of 2004 from 24.7% in the second quarter of 2003 and to 14.9% for the six months ended June 30, 2004 from 17.7% for the same period in 2003. The first six months of 2004 reflects the following:

- Gross premiums earned increased in the six months ended June 30, 2004 compared to the same period in 2003 resulting in a corresponding increase in policy acquisition costs;
- Commission expense increased to 7.3% of gross premiums earned for the three and six months ended June 30, 2004 from 7.2% for the same periods in 2003, respectively. The increased commission rates are the result of our new business growth in the second half of 2003 and first half of 2004 on which we pay higher commission rates. In all of our markets, we believe the commission rates we pay are marketplace competitive;
- Premium tax expense decreased to 1.5% of gross premiums earned for the second quarter of 2004 from 2.1% in the second quarter of 2003 and remained at 1.5% for the six months ended June 30, 2004 and June 30, 2003;
- We recorded a \$478,000 increase in other policy acquisition costs in the second quarter of 2004 reflecting a reapportionment of 2003 mandatory reinsurance pools expenses. We recorded a \$1.3 million increase in other policy acquisition costs in the second quarter of 2003 reflecting a reapportionment of 2002 mandatory reinsurance pools expenses; and
- Other policy acquisition costs consist of payroll audit vendor costs, various state assessments related to second injury funds and the net effect of assigned risk plan activity in the states in which we have operated. Other policy acquisition costs, excluding the mandatory pool reallocation discussed above, decreased to 4.6% of gross premiums earned in the second quarter of 2004 compared to 5.4% in the second quarter of 2003 but increased to 4.5% for the six months ended June 30, 2004 from 4.0% for the same period in 2003.

Policy Acquisition Cost Outlook: We expect that policy acquisition costs in 2004 will be affected by the following:

- Our commission expense will continue to be affected by how much new business we write relative to renewal business as we pay higher commissions on new policies. We had significant new business growth in the latter half of 2003 and the first half of 2004 and we expect new business to grow moderately for the remainder of 2004;
- Premium tax accrual rates will return to their normal level of 2% for the balance of 2004;
- Other underwriting expenses will continue to be affected by pool reimbursements offset by pool disbursements, the effect of which is not known at this time.

General and Administrative Expenses: Our general and administrative expenses include personnel costs, office rent, certain state administrative assessments based on premiums and other costs and expenses not specific to claim and claim settlement expenses or policy acquisition costs.

General and administrative expenses decreased to \$1.9 million in the second quarter of 2004 from \$2.7 million in the second quarter of 2003 and to \$4.1 million for the six months ended June 30, 2004 from \$4.9 million for the same period in 2003. As a percent of gross premiums earned, general and administrative expenses decreased to 12.6% in the second quarter of 2004 from 21.1% in the second quarter of 2003 and to 13.6% for the six months ended June 30, 2004 from 19.3% for the same period in 2003. General and administrative expenses, as a percentage of gross premiums earned, are expected to decrease since we will earn more premium in 2004 and will have more premium to cover our relatively fixed costs. General and administrative expenses continue to be managed aggressively and reduced where appropriate.

General and Administrative Expenses Outlook: We expect that general and administrative expenses will be affected by the following:

- Our contract to manage 25% of the Minnesota Assigned Risk Plan business will require staff additions and increase our general and administrative expense;
- We will make appropriate investments in infrastructure to position us for the future;

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- We have no plans to open additional offices in 2004. We will continually monitor reported claim counts for 2004 and re-examine staffing needs as necessary; and
- All expenses will continue to be aggressively managed and reduced where appropriate.

Interest Expense: We incurred interest charges on our note payable in the first six months of 2003. The note payable was paid in full in September 2003. We expect to incur no interest charges in 2004.

Income Taxes: We incur federal income taxes on our combined service organization (RTW) operations and insurance (ACIC) operations. We incur state income taxes on the results of our service organization's operations and incur premium taxes in lieu of state income taxes for substantially all of our insurance operations. In certain instances, we may incur state income taxes on our insurance operations. Additionally, certain provisions of the Internal Revenue Code adversely affect our taxable income by accelerating recognition and payment of income taxes. Adjustments to book income generating current tax liabilities include limitations on the deductibility of unpaid claim and claim settlement expenses, limitations on the deductibility of unearned premium reserves and limitations on deductions for bad debt reserves.

In assessing our ability to realize deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. We consider recent operating results, the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At December 31, 2001, we established a \$14.5 million valuation allowance (allowance) against deferred tax assets resulting in a corresponding increase in income tax expense. This allowance decreased by \$7.9 million to \$6.6 million at December 31, 2002 as a result of the income we earned in 2002 and federal tax refunds totaling \$3.8 million resulting from a change in Federal tax law. This allowance was further decreased by \$3.0 million in 2003 to \$3.6 million as a result of the income we earned in 2003 and analysis of our projected taxable income and available tax planning strategies. We expect any remaining deferred tax assets, net of the allowance, at June 30, 2004, to be realized as a result of the future income and the reversal of existing taxable temporary differences.

Income tax expense for the second quarter of 2004 was \$428,000, or 31.2% of income before income taxes, compared to \$263,000, or 29.2% of income before income taxes, for the same period in 2003. Income tax expense for the six months ended June 30, 2004 was \$906,000, or 32.6% of income before income taxes, compared to \$559,000, or 31.7% of income before income taxes for the same period in 2003. The income tax expense percentages in the three and six-months ended June 30, 2004 and 2003 have been affected by: (i) our income from operations; (ii) changes in taxable net income from our insurance subsidiary (ACIC) which is subject to only federal income taxes; and (iii) the amount of municipal bond income that we have earned.

Income Tax Outlook: Income tax expense will vary based on: (i) our results from operations for the remainder of 2004; (ii) the amount of tax exempt income we earn in 2004; and (iii) changes in our analysis of the income tax valuation allowance recorded during the remainder of 2004. The ultimate change is unknown at this time.

Investments

Our portfolio of fixed maturity securities at June 30, 2004 included U.S. government securities (44.6%), mortgage-backed securities (31.1%), municipal securities (22.0%) and asset-backed securities (2.3%). Our portfolio is managed by an independent investment manager to maximize our after-tax investment income without taking inappropriate credit risk. In 2004, we sold securities within the portfolio to take advantage of favorable interest rates and realized net investment gains of \$58,000 and \$707,000 for the three and six months ended June 30, 2004, respectively. We conservatively manage our fixed maturity portfolio, investing only in investment grade (BBB or better rating from Standard and Poor's) securities of U.S. domiciled issuers. All securities in our portfolio were rated AAA at June 30, 2004 and December 31, 2003. We do not invest in derivative securities.

Operating cash flows consist of the deficit or excess of premiums collected over claim and claim settlement expenses paid reduced by payments for reinsurance premiums as well as other operating expenses paid. Investment cash flows consist of income on existing investments and proceeds from sales and maturities of investments. Additionally, as we lowered our reinsurance retention levels to \$25,000 in mid-1998, we decreased our current period cash flows as a result of "pre-funding" quarterly reinsurance premiums under that agreement. Reinsurance reimbursements from our \$25,000 to \$300,000 excess of loss reinsurance agreement offset similar payments to claimants for those years in 2004. Our investment portfolio decreased \$19.1 million to \$85.5 million at June 30, 2004 from \$104.6 million at June 30, 2003. Our investment portfolio was \$79.2 million at December 31, 2003. During 2003, interest rates declined, leading to a significant mortgage refinancing by consumers, resulting in

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significant prepayment or early redemption of our mortgage-backed securities. Cash and cash equivalents were \$32.0 million, \$39.7 million and \$13.3 million at June 30, 2004, December 31, 2003 and June 30, 2003, respectively. We expect that cash will decrease for the remainder of 2004 as we pay claims for 2003 and prior years, years in which we earned higher premiums and incurred a higher number of claims reported and as we reinvest into tax-exempt municipal bonds and other fix-income securities.

We record investments on our balance sheet at fair value, with the corresponding appreciation or depreciation from amortized cost recorded in shareholders' equity as accumulated other comprehensive income, net of taxes. Because value is based on the relationship between the portfolio's stated yields and prevailing market yields at any given time, interest rate fluctuations can have a swift and significant impact on the carrying value of these securities. As a result of classifying our securities as available-for-sale, and thus carrying them at fair value, we expect to encounter adjustments in shareholders' equity as market interest rates and other factors change. Prevailing market interest rates increased from levels at June 30, 2003 through the first six months of 2004, resulting in a \$1.3 million net unrealized loss on investments at June 30, 2004 compared to a \$5.0 million net unrealized gain at June 30, 2003 and a \$1.5 million net unrealized gain at December 31, 2003.

Unpaid Claim and Claim Settlement Expenses

At June 30, 2004, the liability for unpaid claim and claim settlement expenses totaled \$148.8 million, and our reinsurance recoverables on unpaid claim and claim settlement expenses totaled \$69.0 million, resulting in net reserves totaling \$79.8 million. Net reserves at June 30, 2003 totaled \$92.1 million and included the liability for unpaid claim and claim settlement expenses totaling \$172.1 million, net of reinsurance recoverables on unpaid claim and claim settlement expenses of \$80.0 million.

Accounting for workers' compensation insurance operations requires us to estimate the liability for unpaid claim and claim settlement expenses ("reserves") and the related reinsurance recoverables, (together, the "net reserves") at each balance sheet date. Our reserves represent the estimated total unpaid cost of claim and claim settlement expenses, which cover events that occurred to date in 2004 and prior years. These reserves reflect our estimates of the total costs of claims that were reported, but not yet paid, and the cost of claims incurred but not yet reported (IBNR). For reported claims, we establish reserves on a "case" basis. For IBNR claims, we calculate the difference between: (i) projected ultimate claim and claim settlement expenses as determined using generally accepted actuarial standards; and (ii) case reserves and carry the difference as an IBNR reserve. By using both estimates of reported claims and IBNR claims, we estimate the ultimate net reserves for unpaid claim and claim settlement expenses.

The amount by which estimated net reserves, measured subsequently by reference to payments and additional estimates, differ from those originally reported for a period is known as "development." Development is unfavorable (deficient) when losses ultimately settle for more than the levels at which they were reserved or subsequent estimates indicate a basis for reserve increases on open claims. Development is favorable (redundant) when losses ultimately settle for less than the amount reserved or subsequent estimates indicate a basis for reducing loss reserves on open claims. Favorable or unfavorable development of loss reserves is reflected in earnings in the year recognized.

Both internal and independent external actuaries review net reserves for adequacy on a periodic basis. These reviews assume that past experience, adjusted for the effects of current events and anticipated trends, is an appropriate basis for predicting future events. When reviewing net reserves, actuaries analyze historical data and estimate the effect of various factors on estimated ultimate reserves including: (i) trends in general economic conditions, including the effects of inflation; (ii) estimates of trends in claims frequency and severity; (iii) our industry historical loss experience; and (iv) legislative enactments, legal developments and changes in social and political attitudes. Variables in the reserve estimation process can be affected by both internal and external events, including changes in claims handling procedures, economic inflation, legal trends and legislative changes. Many of these items are not directly quantifiable, particularly on a prospective basis. There is no precise method for subsequently evaluating the effect of any specific factor on the adequacy of reserves because the eventual redundancy or deficiency is affected by many factors. Additionally, there may be significant reporting lags between the occurrence of the loss and the time it is actually reported to the insurer. Due to our commencing operations in 1992, we have limited historical data to estimate our reserves for unpaid claim and claim settlement expenses and reinsurance recoverables on unpaid claim and claim settlement expenses and, accordingly, we supplement our experience with external industry data, as adjusted, to reflect anticipated differences between our results and the industry.

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Estimating the effect that inflation will have on the ultimate cost of claims is a major risk factor in our workers' compensation reserve estimates. Future earnings will be affected by reserve development associated with any changes in our inflation assumptions. Estimates for the 2003 and 2002 accident years represent the majority of the uncertainty because these claims have the lowest proportionate amount of paid loss as of June 30, 2004. Our reserve estimates are most sensitive to changes in the assumption about inflation for the 2003 and 2002 accident years. Each one percent (1%) increase or decrease in the inflation rate for each of these accident years would increase or decrease our net loss reserve estimates at December 31, 2003 by approximately \$390,000. Information about the 2004 accident year is still very immature and any estimate of a one percent (1%) change would be premature.

Our independent actuary provides management with an opinion annually regarding the acceptable range for adequate statutory reserves based on generally accepted actuarial guidelines. We record our net reserves by considering a range of estimates bounded by the high and low point of the range. Within that range, we record our best estimate. We focus our decision process on improving our financial strength ratings and expect to remain a market for workers' compensation insurance in all market conditions. At December 31, 2003, we established recorded reserves in the upper end of the actuary's range and we continue to believe that recorded reserves remain in that range at June 30, 2004. The ultimate actual liability may be higher or lower than reserves established.

Our reserves are primarily undiscounted; however, we discounted reserves for selected claims that have fixed and determinable future payments at rates ranging from 3.5% to 8.0% in 2003 and 2002. The discount rates in 2004 are subject to change as market interest rates change. We use the same rates for Generally Accepted Accounting Principles as we do for Statutory Accounting Practices in determining our liability. We also reduce the unpaid claim and claim settlement expenses for estimated amounts of subrogation.

We continually monitor loss development trends and data to establish adequate premium rates and to determine reasonable reserve estimates. Reserves that are based on estimates are inherently uncertain and represent a significant risk to the business. We attempt to mitigate this risk by continually improving and refining our workers' compensation claims processing practices and by continual monitoring through actuarial estimation methods.

After taking into account all relevant factors, we believe our reserves for unpaid claim and claim settlement expenses and reinsurance recoverables on unpaid claim and claim settlement expenses at June 30, 2004 are adequate to cover the ultimate net costs of claim and claim settlement expenses at that date. The ultimate cost of claim and claim settlement expenses may differ materially from the established reserves, particularly when claims may not be settled for many years. Establishing appropriate reserves is an inherently uncertain process and there can be no certainty that currently established reserves will prove adequate in light of subsequent actual experience.

Income for the three and six months ended June 30, 2004 included an \$850,000 and \$1.1 million, respectively, reduction of projected claim and claim settlement expenses resulting from favorable development of claims for 2003 and prior accident years. Income for the three and six months ended June 30, 2003 included a \$2.4 million and \$2.7 million, respectively, reduction of projected claim and claim settlement expenses resulting from favorable development of claims for 2002 and prior accident years.

Liquidity and Capital Resources

Liquidity refers to our ability to generate sufficient cash flows to meet the short- and long-term cash requirements of our operations. Capital resources represent those funds deployed or available to be deployed to support our business operations.

Our primary sources of cash from operations are premiums collected, reimbursements under reinsurance contracts and investment income. Our investment portfolio is also a source of liquidity, through the sale of readily marketable fixed maturity investments. Our primary cash requirements consist of payments for: (i) claim and claim settlement expenses; (ii) reinsurance; (iii) policy acquisition costs; (iv) general and administrative expenses; (v) capital expenditures; and (vi) income taxes. We generate cash from or use cash in operations based on timing differences between the receipt of premiums and the payment of claim and claim settlement expenses. Selected reinsurance retention levels also use cash as a result of "pre-funding" premiums under the policies or provide cash upon reimbursement of claim payments. In 2003 and the first half of 2004, reinsurance reimbursements from our \$25,000 to \$300,000 excess of loss reinsurance agreement, which began in mid 1998 and ran-off in 2001, offset similar payments to claimants for those years. This trend will continue through the remainder of 2004. We further expect that cash and cash equivalents will decrease from levels reported at December 31, 2003 and June 30, 2004 during the remainder of 2004 as we take advantage of the anticipated increase in interest rates. Available cash is invested in either short-term cash and cash equivalents or longer-term available-for-sale securities pending future

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payments for such expenses as medical and indemnity benefits and other operating expenses. Cash and cash equivalents consist of cash and a money market fund that invest primarily in short-term government securities.

Cash provided by operating activities for the six months ended June 30, 2004 was \$796,000. This is primarily a result of net income of \$1.9 million, a decrease of \$2.2 million in reinsurance recoverables, an increase of \$1.2 million in unearned premiums, net of premiums receivable, an increase in other assets totaling \$2.6 million, a decrease of \$1.1 million in accrued expenses and other liabilities, depreciation and amortization expense of \$495,000 offset by a decrease of \$1.2 million in unpaid claim and claim settlement expenses which are non-cash accruals for future claims and net realized investment gains totaling \$707,000. Net cash used in investing activities was \$8.7 million due to \$36.5 million in purchases of securities and \$61,000 in purchases of furniture and equipment offset by \$18.7 million in proceeds from sales of and prepayments on securities and \$9.2 million from the maturity of securities. Net cash from financing activities was \$305,000 due to the exercise of stock options.

Our need for additional capital is primarily the result of regulations that require certain ratios of regulatory or statutory capital to premiums written in our insurance subsidiary as defined by state regulatory bodies and insurance rating agencies. Raising additional permanent capital, while difficult in the current environment in which we operate, would further reduce our ratio of premium to capital and provide a more solid base for the future growth of our insurance subsidiary. As an alternative to raising additional permanent capital, certain reinsurance contracts could be used on an interim basis that would have the effect of reducing the ratio of premiums to capital and surplus in ACIC to satisfy state regulatory requirements.

Minnesota state insurance regulations limit distributions, including dividends, from our insurance subsidiary to us. Under Minnesota insurance law regulating the payment of dividends, in any twelve month period, ACIC can pay a dividend to us from its earned surplus (unassigned surplus) not to exceed the greater of 10% of ACIC's total surplus or ACIC's prior years net income reduced for realized capital gains net of income taxes. At June 30, 2004, ACIC could pay a dividend to RTW of \$3.2 million without the approval of the Minnesota Department of Commerce. ACIC has never paid a dividend to RTW, and we intend to retain capital in the insurance subsidiary.

Investments held as statutory deposits and pledged as collateral do not have an adverse effect on our liquidity. We believe that cash flow generated by our operations and our cash and investment balances will be sufficient to fund continuing operations and capital expenditures for the next twelve months.

Interest Rate Risk

Our fixed maturity investments are subject to interest rate risk. Increases and decreases in prevailing interest rates generally translate into decreases and increases in the fair value of these instruments. Also, fair values of interest rate sensitive instruments may be affected by the credit worthiness of the issuer, prepayment options, relative values of alternative instruments, the liquidity of the instrument and other general market conditions. We regularly evaluate interest rate risk in order to evaluate the appropriateness of our investments.

An increase of 100 basis points in prevailing interest rates would reduce the fair value of our interest rate sensitive instruments by approximately \$4.2 million at June 30, 2004.

The effect of interest rate risk on potential near-term fair value was determined based on commonly used models. The models project the impact of interest rate changes on factors such as duration, prepayments, put options and call options. Fair value was determined based on the net present value of cash flows or duration estimates, using a representative set of likely future interest rate scenarios.

NAIC Risk-based Capital Standards

The National Association of Insurance Commissioners (NAIC) has risk-based capital standards to determine the capital requirements of a property and casualty insurance carrier based upon the risks inherent in its operations. These standards require computing a risk-based capital amount that is compared to a carrier's actual total adjusted capital. The computation involves applying factors to various financial data to address four primary risks: asset risk, insurance underwriting risk, credit risk and off-balance sheet risk. These standards provide for regulatory intervention when the percent of total adjusted capital to authorized control level risk-based capital is below certain levels. Based upon the risk-based capital standards, our percent of total adjusted capital is substantially in excess of authorized control level risk-based capital.

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Regulation

Our insurance subsidiary is subject to substantial regulation by governmental agencies in the states in which we operate, and will be subject to such regulation in any state in which we provide workers' compensation products and services in the future. State regulatory agencies have broad administrative power with respect to all aspects of our business, including premium rates, benefit levels, policy forms, dividend payments, capital adequacy and the amount and type of investments we may hold. These regulations are primarily intended to protect covered employees and policyholders rather than the insurance company. Both the legislation covering insurance companies and the regulations adopted by state agencies are subject to change. At June 30, 2004, our insurance subsidiary was licensed to do business in Minnesota, South Dakota, Wisconsin, Colorado, Missouri, Illinois, Kansas, Michigan, Indiana, Massachusetts, Connecticut, Rhode Island, Pennsylvania, Tennessee, Maryland, Arkansas, Iowa, Florida, Georgia, New Jersey, North Carolina, Texas and Oklahoma.

In March 1998, the NAIC adopted the Codification of Statutory Accounting Principles (Codification). Codification is intended to standardize regulatory accounting and reporting to state insurance departments and became effective January 1, 2001. Statutory accounting principles, however, will continue to be established by individual state laws and permitted practices. The State of Minnesota required adoption of the Codification for preparing statutory financial statements for financial periods occurring on or after January 1, 2001.

Effect of Recent Accounting Pronouncements

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure — an amendment of FAS 123." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for stock-based employee compensation. It also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income of an entity's accounting policy decisions with respect to stock-based employee compensation. This Statement also amends APB Opinion No. 28, "Interim Financial Reporting," to require disclosure about those effects in interim financial information. SFAS No. 148 is effective for annual and interim periods beginning after December 15, 2002. The adoption of the interim disclosure provisions of SFAS No. 148 in the first quarter of 2003 did not have any impact on our financial position, results of operations or cash flows. We are currently evaluating whether to adopt the fair-value based method of accounting for stock-based employee compensation in accordance with SFAS No. 148 and its resulting affect on our financial position, results of operations and cash flows.

Forward Looking Statements

Information included in this Report on Form 10-Q which can be identified by the use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," or "continue" or the negative thereof or other variations thereon or comparable terminology constitutes "forward-looking information" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. The following important factors, among others, in some cases have affected and in the future could affect our actual results and could cause our actual financial performance to differ materially from that expressed in any forward-looking statement: (i) our ability to retain renewing policies and write new business with a B+ (Very Good, Secure) rating from A.M. Best; (ii) our ability to extend our workers' compensation services to self-insured employers and other alternative markets and to operate profitably in providing these services; (iii) our ability to continue to increase pricing on insured products in the markets in which we remain or alternatively non-renew or turn away improperly priced business; (iv) the ability of our reinsurers to honor their obligations to us; (v) our ability to accurately predict claim development; (vi) our ability to provide our proprietary products and services to customers successfully; (vii) our ability to manage both our existing claims and new claims in an effective manner; (viii) our experience with claims frequency and severity; (ix) medical inflation; (x) competition and the regulatory environment in which we operate; (xi) general economic and business conditions; (xii) our ability to obtain and retain reinsurance at a reasonable cost; (xiii) changes in workers' compensation regulation by states, including changes in mandated benefits or insurance company regulation; (xiv) interest rate changes; and (xv) other factors as noted in our other filings with the SEC. This discussion of uncertainties is by no means exhaustive but is designed to highlight important factors that may affect our future performance.

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Item 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information with respect to Disclosures about Market Risk is contained in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Interest Rate Risk” under Item 2 of this Report on Form 10-Q and is incorporated herein by reference.

Item 4: CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

The Company’s President and Chief Executive Officer, Jeffrey B. Murphy, and Chief Financial Officer, Alfred L. LaTendresse, have evaluated the Company’s disclosure controls and procedures as of the end of the period covered by this report. Based upon that review, they have concluded that these controls and procedures are effective in ensuring that material information related to the Company is made known to them by others within the Company.

(b) Changes in Internal Control Over Financial Reporting

There have been no significant changes in internal control over financial reporting that occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the registrant’s internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

None

Item 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

None

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Company held its Annual Meeting of Shareholders on June 16, 2004.

(b) The Company solicited proxies from its shareholders to vote on the following items:

- To elect three directors to serve until the 2007 Annual Meeting of Shareholders;
- To ratify the appointment of Ernst & Young, LLP as independent auditors for the Company for the fiscal year ending December 31, 2004; and
- To amend the RTW, Inc. 1995 Employee Stock Purchase Plan.

(c) A total of 4,487,337 votes were cast in person or by proxy at the annual meeting and the vote counts were as follows:

Proposal	Director until	For	Against	Withhold	Abstain	Broker Non-votes
Election of Directors						
Jeffrey B. Murphy	2007	4,423,640		63,697		
Gregory D. Koschinska	2007	4,469,659		17,678		
Vina L. Marquart	2007	4,419,748		67,589		
John O. Goodwyne	2006					
David C. Prosser	2006					
William J. Deters	2005					
John W. Prosser	2005					
Ratification of Auditors		4,464,909	12,898		9,530	0
Amend Employee Stock Purchase Plan		2,748,657	62,249		12,699	1,663,732

Accordingly, Jeffrey B. Murphy, Gregory D. Koschinska and Vina L. Marquart were elected directors of the Company with terms expiring in 2007, Ernst & Young, LLP was ratified as independent auditors for the Company and the RTW, Inc. 1995 Employee Stock Purchase Plan amendment was approved. John O. Goodwyne and David C. Prosser continue as directors of the Company until 2006 and William J. Deters and John W. Prosser continue as directors of the Company until 2005.

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Item 5. OTHER INFORMATION

None.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Listing of Exhibits

- Exhibit 10.1 – LETTER OF CREDIT REIMBURSEMENT AGREEMENT DATED AS OF JULY 30, 2004 BETWEEN RTW, INC. AND U.S. BANK NATIONAL ASSOCIATION
- Exhibit 10.2 – PLEDGE AGREEMENT DATED JULY 30, 2004 BY RTW, INC. IN FAVOR OF U.S. BANK NATIONAL ASSOCIATION
- Exhibit 10.3 – CHANGE IN AMOUNT OF U.S. BANK LETTER OF CREDIT DATED JULY 30, 2004
- Exhibit 10.4 – FIRST AMENDMENT TO PLEDGE AGREEMENT DATED JULY 30, 2004 BY RTW, INC. IN FAVOR OF U.S. BANK NATIONAL ASSOCIATION
- Exhibit 11 - STATEMENT REGARDING COMPUTATION OF BASIC AND DILUTED NET INCOME PER SHARE
- Exhibit 31.1 - CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
- Exhibit 31.2 - CERTIFICATION PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
- Exhibit 32 - CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

(b) Listing of Reports on Form 8-K

The Company filed a Current Report on Form 8-K dated April 28, 2004, pursuant to Item 12 of Form 8-K, Disclosure of Results of Operations and Financial Condition, under which RTW, Inc. furnished a press release, issued on April 28, 2004, disclosing material non-public information regarding its results of operations for the quarter ended March 31, 2004.

The Company filed a Current Report on Form 8-K dated June 16, 2004, pursuant to Item 7 and 9 of Form 8-K, Other Events, under which RTW, Inc. furnished the slide presentation that was used in conjunction with the comments made to the shareholders at the Annual Meeting.

The Company filed a Current Report on Form 8-K dated July 29, 2004, pursuant to Item 12 of Form 8-K, Disclosure of Results of Operations and Financial Condition, under which RTW, Inc. furnished a press release, issued on July 28, 2004, disclosing material non-public information regarding its results of operations for the quarter ended June 30, 2004.

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SIGNATURES

Pursuant to the requirements 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.

RTW, Inc.

Dated: August 13, 2004

By /s/ Jeffrey B. Murphy

Jeffrey B. Murphy
President and Chief Executive Officer
(Principal Executive Officer)

Dated: August 13, 2004

By /s/ Alfred L. LaTendresse

Alfred L. LaTendresse
Secretary, Treasurer and Chief Financial Officer
(Principal Financial and Accounting Officer)

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LETTER OF CREDIT
REIMBURSEMENT AGREEMENT
BETWEEN
RTW, INC.
AND
U.S. BANK NATIONAL ASSOCIATION
DATED AS OF JULY 30, 2004

LETTER OF CREDIT
REIMBURSEMENT AGREEMENT

THIS LETTER OF CREDIT REIMBURSEMENT AGREEMENT, dated as of July 30, 2004, between RTW, INC., a corporation organized under the laws of Minnesota (the "Company") in favor of U.S. BANK NATIONAL ASSOCIATION, a national banking association (the "Bank").

RECITALS

1. The Company has requested that the Bank issue certain irrevocable standby letters of credit not exceeding \$4,050,000 in the aggregate.
2. The Company has agreed to reimburse the Bank for the Bank's liability, if any, under said letters of credit.

NOW, THEREFORE, in consideration of the premises and in order to induce the Bank to issue the aforesaid letters of credit, and intending to be legally bound hereby, the Company and the Bank hereby agree as follows:

ARTICLE I
Definitions and Accounting Terms

Section 1. Defined Terms. As used in this Agreement, the following terms shall have the following respective meanings (and such meanings shall be equally applicable to both the singular and the plural forms of the terms defined, as the context may require).

"ACIC": American Compensation Insurance Company, a Minnesota corporation.

"Affiliate": When used with reference to any Person, (a) each Person that, directly or indirectly, controls, is controlled by or is under common control with, the Person referred to, (b) each Person which beneficially owns or holds, directly or indirectly, five percent or more of any class of voting stock of the Person referred to (or if the Person referred to is not a corporation, five percent or more of the equity interest), (c) each Person, five percent or more of the voting stock (or if such Person is not a corporation, five percent or more of the equity interest) of which is beneficially owned or held, directly or indirectly, by the Person referred to, and (d) each of such Person's officers, directors, joint venturers and partners. The term control (including the terms "controlled by" and "under common control with") means the possession, directly, of the power to direct or cause the direction of the management and policies of the Person in question.

"Bank": as defined in the opening paragraph hereof.

"Beneficiary": as to any Letter of Credit, the beneficiary of such letter of credit.

"Business Day": any day which is not a Saturday or Sunday and is not a day on which banking institutions in Minnesota, or the city in which the principal office of the Bank is located, are authorized or required by law to close, or on which the New York Stock Exchange is closed.

"Code": the Internal Revenue Code of 1986, as amended.

"Company": as defined in the opening paragraph hereof.

"Contingent Obligation": With respect to any Person at the time of any determination, without duplication, any obligation, contingent or otherwise, of such Person guaranteeing or having the economic effect of guaranteeing any Indebtedness of any other Person (the "primary obligor") in any manner, whether directly or otherwise: (a) to purchase or pay (or advance or supply funds for the purchase or payment of) such Indebtedness or to purchase (or to advance or supply funds for the purchase of) any direct or indirect security therefor, (b) to purchase property, securities, equity interests or services for the purpose of assuring the owner of such Indebtedness of the payment of such Indebtedness, (c) to maintain working capital, equity capital or other financial statement condition of the primary obligor so as to enable the primary obligor to pay such Indebtedness or otherwise to protect the owner thereof against loss in respect thereof, or (d) entered into for the purpose of assuring in any manner the owner of such Indebtedness of the payment of such Indebtedness or to protect the owner against loss in respect thereof; provided, that the term "Contingent Obligation" shall not include endorsements for collection or deposit, in each case in the ordinary course of business.

"Date of Issuance": for a Letter of Credit, the date on which such Letter of Credit is issued by the Bank.

"Default": any event which, with the giving of notice (whether such notice is required under Article IX, or under some other provision of this Agreement, or otherwise) or lapse of time, or both, would constitute an Event of Default.

"ERISA": the Employee Retirement Income Security Act of 1974, as amended.

"ERISA Affiliate": any trade or business (whether or not incorporated) that is a member of a group of which the Company is a member and which is treated as a single employer under Section 414 of the Code.

"Event of Default": any Event of Default described in Article IX hereof.

"Expiration Date": for a Letter of Credit, the date on which such Letter of Credit expires.

"GAAP": generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other entity as may be

approved by a significant segment of the accounting profession, which are applicable to the circumstances as of the date of determination.

"Immediately Available Funds": funds with good value on the day and in the city in which payment is received.

"Indebtedness": with respect to any Person at the time of any determination, without duplication, (a) all obligations of such Person for borrowed money, (b) all obligations of such Person evidenced by bonds, debentures, notes or other similar instruments, (c) all obligations of such Person upon which interest charges are customarily paid or accrued, (d) all obligations of such Person under conditional sale or other title retention agreements relating to property purchased by such Person, (e) all obligations of such Person issued or assumed as the deferred purchase price of property or services, (f) all obligations of others secured by any Lien on property owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (g) all capitalized lease obligations of such Person, (h) all obligations of such Person in respect of interest rate protection agreements or other hedging arrangements, (i) all obligations of such Person, actual or contingent, as an account party in respect of letters of credit or bankers' acceptances, (j) all obligations of any partnership or joint venture as to which such Person is or may become personally liable, and (k) all Contingent Obligations of such Person.

"Investment": The acquisition, purchase, making or holding of any stock or other security, any loan, advance, contribution to capital, extension of credit (except for trade and customer accounts receivable for inventory sold or services rendered in the ordinary course of business and payable in accordance with customary trade terms), any acquisitions of real or personal property (other than real and personal property acquired in the ordinary course of business) and any purchase or commitment or option to purchase stock or other debt or equity securities of or any interest in another Person or any integral part of any business or the assets comprising such business or part thereof. The amount of any Investment shall be the original cost of such Investment plus the cost of all additions thereto, without any adjustments for increases or decreases in value, or write-ups, write-downs or write-offs with respect to such Investment.

"Letter of Credit": an irrevocable direct-pay letter of credit of the Bank in the form of Exhibit A attached hereto or such other form prescribed by the Bank, as such letter of credit may be amended, supplemented, extended or restated from time to time.

"Lien": any security interest, mortgage, pledge, lien, charge, encumbrance, title retention agreement or analogous instrument or device (including but not limited to the interest of the lessors under capitalized leases), in, of or on any assets or properties of the Person referred to, now owned or hereafter acquired.

"PBGC": the Pension Benefit Guaranty Corporation, established pursuant to Subtitle A of Title IV of ERISA, and any successor thereto or to the functions thereof.

"Person": any natural person, corporation, partnership, joint venture, firm, association, trust, unincorporated organization, government or governmental agency or political subdivision or any other entity, whether acting in an individual, fiduciary or other capacity.

"Plan": each employee benefit plan (whether in existence on the date of this Agreement or thereafter instituted), as such term is defined in Section 3 of ERISA, maintained for the benefit of employees, officers or directors of the Company or of any ERISA Affiliate.

"Pledge Agreement": the Pledge Agreement dated concurrently herewith given by the Company in favor of the Bank whereunder the Company has pledged to the Bank all of its common stock in ACIC as security for the Company's obligations under this Agreement and the Related Documents.

"Prime Rate": the rate of interest from time to time publicly announced by the Bank as its "prime rate"; the Bank may lend to its customers at rates that are at, above or below the Prime Rate. For purposes of determining any interest rate hereunder which is based on the Prime Rate, such interest rate shall change as and when the Prime Rate shall change.

"Prohibited Transaction": the respective meanings assigned to such term in Section 4975 of the Code and Section 406 of ERISA.

"Related Documents": a Letter of Credit, this Agreement, the Pledge Agreement or any other agreement or instrument relating hereto or thereto.

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

"Restricted Payments": With respect to the Company, collectively, all dividends or other distributions of any nature (cash, securities other than common stock of the Company, assets or otherwise), and all payments on any class of equity securities (including warrants, options or rights therefor) issued by the Company, whether such securities are authorized or outstanding on the date hereof or at any time thereafter and any redemption or purchase of, or distribution in respect of, any of the foregoing, whether directly or indirectly.

"Stated Amount": the amount of any Letter of Credit as stated in such Letter of Credit.

"Subsidiary": any corporation 50% or more of whose securities or other ownership interests having ordinary voting power for the election of a majority of the

board of directors or other Persons performing similar functions are owned by the Company either directly or through one or more Subsidiaries.

Section 2. Accounting Terms and Calculations. Except as may be expressly provided to the contrary herein, all accounting terms used herein shall be interpreted and all accounting determinations hereunder shall be made in accordance with GAAP. To the extent any change in GAAP affects any computation or determination required to be made pursuant to this Agreement, such computation or determination shall be made as if such change in GAAP had not occurred unless the Company and the Bank agree in writing on an adjustment to such computation or determination to account for such change in GAAP.

Section 3. Other Definitional Terms. The words "hereof," "herein" and "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. References to Sections, Exhibits, schedules and like references are to this Agreement unless otherwise expressly provided.

ARTICLE II
Issuance of Letters of Credit.

Section 1. Issuance of Letters of Credit. At any time and from time to time from the date hereof to June 30, 2005, upon written request of the Company to the Bank, the Bank may, in its sole discretion, issue Letters of Credit in the aggregate amount of not more than \$4,050,000, substantially in the form attached hereto as Exhibit A or such other form as may be prescribed by the Bank, subject to and upon the terms and conditions set forth in this Agreement; provided, that no Letter of Credit shall have an initial expiration date more than one year from its Date of Issuance, but such expiration date may be extended without amendment for one year from the initial expiration date or any future expiration date so long as such Letter of Credit provides that the Bank may notify a Beneficiary by registered mail not less than thirty (30) days prior to such expiration date that any such Letter of Credit will not be renewed for any such additional period.

ARTICLE III
Reimbursement and Other Payments

Section 1. Payments to the Bank. The Company hereby agree to pay to the Bank:

(a) on each of (a) the Date of Issuance, and (b) on each anniversary of the Date of Issuance thereafter occurring so long as a Letter of Credit is outstanding, a letter of credit fee in an amount equal to the product of the Stated Amount of such Letter of Credit as of each such date times 1.5%;

(b) on the Date of Issuance and on each anniversary of the Date of Issuance so long as a Letter of Credit is outstanding, the Bank's customary letter of credit administration fee for such Letter of Credit (currently \$300 per year);

(c) upon each transfer of any Letter of Credit in accordance with its terms, the sum of \$1,000 per transfer plus the Bank's actual costs and expenses associated with such transfer;

(d) on the day that any amount is drawn under a Letter of Credit, and after such drawing has been honored by the Bank, a sum equal to the amount so drawn under such Letter of Credit;

(e) upon each draw under a Letter of Credit, the Bank's drawing fee (currently an amount equal to the greater of (A) \$75 or (B) one-eighth of one percent of the amount of the draw);

(f) upon each draw paid by wire transfer, a wire transfer fee of \$ 15;

(g) upon each billing made by the Bank hereunder, a billing fee of \$25;

(h) upon the making of any amendment to a Letter of Credit, the Bank's customary amendment fee (currently \$75 per amendment);

(i) on demand, any and all reasonable charges and expenses, including the reasonable fees and expenses of outside counsel (determined on the basis of such counsel's generally applicable rates, which may be higher than the rates such counsel charges the Bank in certain matters) and/or the allocated costs of in-house counsel incurred from time to time, incurred by the Bank in enforcing any rights under this Agreement;

(j) on demand, interest on all amounts remaining unpaid by the Company to the Bank at any time under this Agreement from the date such amounts become payable (in the case of an amount payable on demand, from the date the Bank is first entitled to demand payment, regardless of whether a demand for payment is actually made) until payment in full at a fluctuating interest rate per annum (computed on the basis of the actual number of days elapsed and a year of 360 days) equal to two percent (2%) per annum above the Prime Rate; provided that such fluctuating interest rate shall in no event be higher than the maximum rate permitted by law.

Section 2. Change in Law, Etc. If any change in any law or regulation or in the interpretation thereof by any court or administrative or governmental authority charged with the administration thereof, or the enactment of any new law or regulation, shall either (i) impose, modify or deem applicable any reserve, special deposit, capital adequacy or similar requirement against loans made by or letters of credit issued by, the Bank or (ii) impose on the Bank any other condition regarding this Agreement or a Letter of Credit, and the result of any event referred to in the preceding clause (i) or (ii) shall be to increase the cost to the Bank of issuing or maintaining a Letter of Credit (which increase in cost shall be the result of the Bank's reasonable allocation of the aggregate of such cost increases resulting from such event), or to reduce the amount of principal, interest or any fee or compensation receivable by the Bank in respect of this Agreement or a Letter of Credit, or in the case of capital adequacy requirements, the result is to increase the amount of capital required to be maintained by the Bank with respect to a Letter of Credit above the amount of capital that otherwise would be required to be maintained by it with respect thereto (taking into account the Bank's internal policies with respect to capital maintenance as of the date hereof and laws in effect on the date of this Agreement requiring future increases in capital maintenance) then, upon demand by the Bank, the Company shall pay

to the Bank, on the date or dates or at the intervals specified by the Bank, such additional amounts as the Bank shall determine to be necessary to compensate the Bank for such increased cost or capital or reduced receipt, together with interest on each such amount from the date demanded until payment in full thereof at the fluctuating rate as provided in Section 1(j) above; provided, however, that such increased compensation shall not become effective, and shall not begin to accrue, until 30 days after the date on which the Bank gives the Company written notice thereof. A certificate setting forth in reasonable detail such increased cost or capital or reduced receipt incurred by the Bank as a result of any event mentioned in clause (i) or (ii) of this Section 2 and the amount determined by the Bank to be necessary to compensate the Bank therefor, submitted by the Bank to the Company, shall be conclusive, absent manifest error, as to the amounts thereof.

Section 3. Form of Payment. All payments by the Company to the Bank hereunder shall be non-refundable and made in lawful currency of the United States and in Immediately Available Funds at the Bank's principal office at the address indicated in Article XI Section 2, no later than 2:00 p.m. local time at such office on the day payment is due. Payments received by the Bank after 2:00 p.m., local time at such office, shall be deemed to be received on the following Business Day.

ARTICLE IV
Conditions Precedent to Issuance of a Letter of Credit

Section 1. Items to be Received. It shall be a condition precedent to the issuance by the Bank of a Letter of Credit that the Bank shall have received, on or before the Date of Issuance, the following items, each, unless otherwise indicated, dated the Date of Issuance and in form and substance satisfactory to the Bank and its counsel:

- (a) this Agreement, duly executed by the Company;
- (b) the Pledge Agreement, dated as of even date herewith, executed by the Company in favor of the Bank, together with the original stock certificates in ACIC pledged thereby duly endorsed to the Bank in blank.
- (c) a copy of the Company's organizational documents and all amendments thereto (certified by the Company's Secretary or Assistant Secretary as being true, correct and complete), a copy of the Company's resolution and such other evidence as the Bank may reasonably require that the execution, delivery and performance of this Agreement and each other Related Document to which the Company is a party has been duly authorized by all necessary organizational action;
- (d) payment, in Immediately Available Funds, of the initial letter of credit fee payable under Article III, Sections 1(a) and 1(b) of this Agreement;
- (e) payment of the fees, service charges and disbursements of legal counsel to the Bank;
- (f) such financial statements of the Company as may be requested by the Bank; and

(g) an opinion of Lindquist & Vennum covering the matters described by the Bank and otherwise in form and substance acceptable to the Bank.

(h) such other documents, instruments, approvals and, if requested by the Bank, certified duplicates of executed copies thereof, as the Bank may reasonably request.

Section 2. Representations. The following statements shall be true and correct on the Date of Issuance:

(a) the representations and warranties contained in Article VI of this Agreement are correct on and as of the Date of Issuance as though made on and as of such date;

(b) no petition by or against the Company has at any time been filed under the United States Bankruptcy Code or under any similar act; and

(c) no Event of Default has occurred and is continuing, or would result from the issuance of a Letter of Credit and execution, delivery or performance of this Agreement or any other Related Document.

ARTICLE V Obligations Absolute

Section 1. Obligations Absolute. The obligations of the Company under this Agreement shall be absolute, unconditional and irrevocable, and shall not be subject to any right of set-off or counterclaim and shall be paid or performed strictly in accordance with the terms of this Agreement, under all circumstances whatsoever, including, without limitation, the following circumstances:

(a) any lack of validity or enforceability of a Letter of Credit or any Related Document;

(b) any amendment or waiver of any provision of all or any of the Related Documents;

(c) the existence of any claim, setoff, defense or other rights which the Company may have at any time against a Beneficiary, the Bank (other than the defense of payment to the Bank in accordance with the terms of this Agreement) or any other person or entity, whether in connection with this Agreement, the Related Documents or any transaction contemplated thereby or any unrelated transaction;

(d) any statement or any other document presented under a Letter of Credit proving to be forged, fraudulent, invalid or insufficient in any respect or any statement therein being untrue or inaccurate in any respect whatsoever;

(e) payment by the Bank under a Letter of Credit against presentation of a sight draft or certificate which does not comply with the terms of such Letter of Credit; and

(f) any other circumstance or happening whatsoever, whether or not similar to any of the foregoing.

Notwithstanding the foregoing, the Company shall have a claim against the Bank, and the Bank shall be liable to the Company, to the extent, but only to the extent, of any direct, as opposed to consequential, damages suffered by the Company which the Company proves were caused by the Company's willful misconduct or gross negligence in determining whether documents presented under any Letter of Credit comply with the terms thereof.

ARTICLE VI
Representations and Warranties

The Company represents and warrants as follows:

Section 1. Organization, Standing, Etc. The Company is a corporation duly organized and validly existing and in good standing under the laws of the State of Minnesota and has all requisite power and authority to carry on its business as now conducted, to enter into this Agreement and the Related Documents to which it is a party and to perform its obligations under this Agreement and such Related Documents. The Company and each Subsidiary has the power and authority and the legal right to own and operate its properties and to conduct the business in which it is currently engaged.

Section 2. Authorization and Validity. The execution, delivery and performance by the Company of this Agreement and the Related Documents to which it is a party have been duly authorized by all necessary organizational action by the Company, and this Agreement and such Related Documents constitute the legal, valid and binding obligations of the Company, enforceable against the Company in accordance with their respective terms, subject to limitations as to enforceability which might result from bankruptcy, insolvency, moratorium and other similar laws affecting creditors' rights generally and subject to limitations on the availability of equitable remedies.

Section 3. No Conflict; No Default. The execution, delivery and performance by the Company of this Agreement and the Related Documents to which it is a party will not (a) violate any provision of any law, statute, rule or regulation or any order, writ, judgment, injunction, decree, determination or award of any court, governmental agency or arbitrator presently in effect having applicability to the Company or any Subsidiary, (b) violate or contravene any provision of the organizational documents of the Company, or (c) result in a breach of or constitute a default under any indenture, loan or credit agreement or any other agreement, lease or instrument to which the Company or any Subsidiary is a party or by which it or any of its properties may be bound or result in the creation of any Lien thereunder. To the best knowledge of the Company, neither the Company nor any Subsidiary is in default under or in violation of any such law, statute, rule or regulation, order, writ, judgment, injunction, decree, determination

or award or any such indenture, loan or credit agreement or other agreement, lease or instrument in any case in which the consequences of such default or violation could have a material adverse effect on the business, operations, properties, assets or condition (financial or otherwise) of the Company or such Subsidiary.

Section 4. Government Consent. No order, consent, approval, license, authorization or validation of, or filing, recording or registration with, or exemption by, any governmental or public body or authority is required on the part of the Company or any Subsidiary to authorize, or is required in connection with the execution, delivery and performance of, or the legality, validity, binding effect or enforceability of, this Agreement or any of the Related Documents.

Section 5. Financial Statements and Condition. The Company's audited and unaudited financial statements heretofore furnished to the Bank have been prepared in accordance with GAAP on a consistent basis (except for year-end audit adjustments as to the interim statements) and fairly present the consolidated or consolidating financial condition of the Company and the Subsidiaries as of such dates and the results of their operations and changes in financial position for the respective periods then ended. As of the dates of such financial statements, neither the Company nor any Subsidiary had any material obligation, contingent liability, liability for taxes, or long-term lease obligation which is not reflected in such financial statements or in the notes thereto. Since the date of delivery of any such audited or unaudited financial statements, there has been no material adverse change in the business, operations, property, assets or condition, financial or otherwise, of the Company or any Subsidiary.

Section 6. Litigation. There are no actions, suits or proceedings pending or, to the knowledge of the Company, threatened against or affecting the Company or any Subsidiary or any of its properties before any court or arbitrator, or any governmental department, board, agency or other instrumentality which, if determined adversely to the Company or any Subsidiary, would have a material adverse effect on the business, operations, property or condition (financial or otherwise) of the Company or on the ability of the Company to perform its obligations under this Agreement or any of the Related Documents to which it is a party.

Section 7. ERISA. Each Plan complies with all material applicable requirements of ERISA and the Code and with all material applicable rulings and regulations issued under the provisions of ERISA and the Code setting forth those requirements. No Reportable Event, other than a Reportable Event for which the reporting requirements have been waived by regulations of the PBGC, has occurred and is continuing with respect to any Plan. All of the minimum funding standards applicable to such Plans have been satisfied and there exists no event or condition which would permit the institution of proceedings to terminate any Plan under Section 4042 of ERISA. There is no action, suit, proceeding or investigation pending or threatened (or any basis therefor known to the Company or any ERISA Affiliate) by the PBGC or any other governmental or administrative agency or body involving any violation or alleged violation of ERISA or the Code with respect to any Plan. The current value of the Plans' benefits, if any, guaranteed under Title IV of ERISA does not exceed the current value of the Plans' assets allocable to such benefits.

Section 8. Regulation U. The Company is not engaged in the business of extending credit for the purpose of purchasing or carrying margin stock (as defined in Regulation U of the

Board of Governors of the Federal Reserve System). The value of all margin stock owned by the Company does not constitute more than 25% of the value of the assets of the Company.

Section 9. Taxes. The Company and each Subsidiary has filed all federal, state and local tax returns required to be filed (except for extensions requested in accordance with law) and has paid or made provision for the payment of all taxes due and payable pursuant to such returns and pursuant to any assessments made against it or any of its property and all other taxes, fees and other charges imposed on it or any of its property by any governmental authority (other than taxes, fees or charges the amount or validity of which is currently being contested in good faith by appropriate proceedings and with respect to which reserves in accordance with GAAP have been provided on the books of the Company or such Subsidiary). No tax Liens have been filed and no material claims are being asserted with respect to any such taxes, fees or charges. The charges, accruals and reserves on the books of the Company or the relevant Subsidiary in respect of taxes and other governmental charges are adequate.

Section 10. Burdensome Restrictions. Neither the Company nor any Subsidiary is a party to or otherwise bound by any indenture, loan or credit agreement or any lease or other agreement or instrument or subject to any charter or corporate restriction which would foreseeably have a material adverse effect on the business, properties, assets, operations or condition (financial or otherwise) of the Company or such Subsidiary or on the ability of the Company or such Subsidiary to carry out its obligations under this Agreement or any of the Related Documents to which it is a party.

Section 11. Force Majeure. Since the date of the most recent financial statement referred to in Article VI, Section 5, the business, properties and other assets of the Company or such Subsidiary have not been materially and adversely affected in any way as the result of any fire or other casualty, strike, lockout, or other labor trouble, embargo, sabotage, confiscation, condemnation, riot, civil disturbance, activity of armed forces or act of God.

Section 12. Investment Company Act. The Company is not an "investment company" or a company "controlled" by an investment company within the meaning of the Investment Company Act of 1940, as amended.

Section 13. Full Disclosure. Subject to the following sentence, neither the financial statements referred to in Article VI, Section 5, nor any other certificate, written statement, exhibit or report furnished by or on behalf of the Company in connection with or pursuant to this Agreement or any Related Document contains any untrue statement of a material fact or omits to state any material fact necessary in order to make the statements contained therein not misleading. Certificates or statements furnished by or on behalf of the Company to the Bank consisting of projections or forecasts of future results or events have been prepared in good faith and based on good faith estimates and assumptions of the management of the Company, and the Company has no reason to believe that such projections or forecasts are not reasonable.

Section 14. Subsidiaries. The Company has no Subsidiaries, except as described in Schedule 1 hereto.

Section 15. Survival of Representations. All representations and warranties contained in this Article VI shall survive the delivery of any Letter of Credit and any investigation at any time made by or on behalf of the Bank shall not diminish its rights to rely thereon.

ARTICLE VII
Affirmative Covenants of the Companies

So long as either (i) any Letter of Credit is outstanding, or (ii) any amount is due or owing to the Bank hereunder, the Company agrees, unless the Bank shall otherwise consent in writing, that:

Section 1. Financial Statements and Reports. The Company will furnish to the Bank:

(a) As soon as available and in any event within 120 days after the end of each fiscal year of the Company, the consolidated and consolidating financial statements of the Company and the Subsidiaries consisting of at least statements of income, cash flow and changes in shareholder's equity, and a balance sheet as at the end of such year, setting forth in each case in comparative form corresponding figures from the previous annual audit, certified without qualification by independent certified public accountants of recognized standing selected by the Company and acceptable to the Bank.

(b) As soon as available, and in any event within 60 days after the end of each fiscal quarter, consolidated and consolidating statements of income, cash flow, changes in shareholder's equity for the Company and its Subsidiaries for such quarter and for the period from the beginning of such fiscal year to the end of such quarter, and a balance sheet of the Company and its Subsidiaries as at the end of such quarter, setting forth in comparative form figures for the corresponding period for the preceding fiscal year, accompanied by a certificate signed by Person having principal financial accounting responsibility for the Company and its Subsidiaries stating that such financial statements present fairly the financial condition of the Company and its Subsidiaries and that the same have been prepared in accordance with GAAP.

(c) As soon as practicable and in any event within 60 days after the end of each fiscal quarter, a statement signed by Person having principal financial accounting responsibility for the Company stating that as at the end of such quarter there did not exist any Default or Event of Default or, if such Default or Event of Default existed, specifying the nature and period of existence thereof and what action the Company proposes to take with respect thereto.

(d) Immediately upon any Person having substantial management responsibilities for the Company (which includes the Company's Chief Executive Officer or Chief Financial Officer) becoming aware of any Default or Event of Default, a notice describing the nature thereof and what action the Company proposes to take with respect thereto.

(e) Immediately upon any Person having management responsibilities for, the Company (which includes the Company's Chief Executive Officer or Chief Financial Officer) becoming aware of the occurrence, with respect to any Plan, of any Reportable

Event (other than a Reportable Event for which the reporting requirements have been waived by PBGC regulations) or any "prohibited transaction" (as defined in Section 4975 of the Code), a notice specifying the nature thereof and what action the Company proposes to take with respect thereto, and, when received, copies of any notice from PBGC of intention to terminate or have a trustee appointed for any Plan.

Section 2. Existence. The Company will, and will cause each Subsidiary to, maintain its (i) existence in its present legal form in good standing under the laws of its jurisdiction of organization and (ii) its qualification to transact business in each jurisdiction where failure so to qualify would permanently preclude the Company or such Subsidiary from enforcing its rights with respect to any material asset or would expose the Company or such Subsidiary to any material liability.

Section 3. Payment of Taxes and Claims. The Company will, and will cause each Subsidiary to, file all tax returns and reports which are required by law to be filed by it and will pay before they become delinquent all taxes, assessments and governmental charges and levies imposed upon it or its property and all claims or demands of any kind (including but not limited to those of suppliers, mechanics, carriers, warehouses, landlords and other like Persons) which, if unpaid, might result in the creation of a Lien upon its property; provided that the foregoing items need not be paid if they are being contested in good faith by appropriate proceedings, and as long as the Company's or such Subsidiary's title to its property is not materially adversely affected, its use of such property in the ordinary course of its business is not materially interfered with and adequate reserves with respect thereto have been set aside on the Company's or such Subsidiary's books in accordance with GAAP.

Section 4. Books and Records. The Company will, and will cause each Subsidiary to, keep adequate and proper records and books of account in which full and correct entries will be made of its dealings, business and affairs.

Section 5. Compliance. The Company will, and will cause each Subsidiary to, comply in all material respects with all laws, rules, regulations, orders, writs, judgments, injunctions, decrees or awards to which it may be subject; provided, however, that failure so to comply shall not be a breach of this covenant if such failure does not have, or is not reasonably expected to have, a materially adverse effect on the properties, business, prospects or condition (financial or otherwise) of the Company and such Subsidiary and the Company and such Subsidiary is acting in good faith and with reasonable dispatch to cure such noncompliance.

Section 6. Compliance with Other Documents. The Company will comply in all material respects with the Related Documents.

Section 7. Notice of Litigation. The Company will give prompt written notice to the Bank of the commencement of any action, suit or proceeding before any court or arbitrator or any governmental department, board, agency or other instrumentality affecting the Company or any property of the Company or any Subsidiary or to which the Company or any Subsidiary is a party in which an adverse determination or result could have a material adverse effect on the business, operations, property or condition (financial or otherwise) of the Company or any Subsidiary or on the ability of the Company or any Subsidiary to perform its obligations under

this Agreement and the other Related Documents, stating the nature and status of such action, suit or proceeding.

ARTICLE VIII
Negative Covenants of the Company

So long as either (i) any Letter of Credit is outstanding, or (ii) any amount is due or owing to the Bank hereunder, the Company agrees, unless the Bank shall otherwise consent in writing, that:

Section 1. Merger. The Company will not, and will not permit any Subsidiary to, merge or consolidate or enter into any analogous reorganization or transaction with any Person unless the Company or such Subsidiary is the surviving entity and no Default or Event of Default would result from such merger or consolidation.

Section 2. Amendments or Modifications of Related Documents. The Company will not amend, modify or supplement, nor agree or consent to any amendment or modification of, or supplement to, any of the Related Documents.

Section 3. Disposition of Assets. The Company will not, and will not permit any Subsidiary to, directly or indirectly, sell, assign, lease, convey, transfer or otherwise dispose of (whether in one transaction or a series of transactions) any property (including accounts and notes receivable, with or without recourse) or enter into any agreement to do any of the foregoing, except:

(a) dispositions of assets in the ordinary course of business, including, without limitation, dispositions of Investments held by ACIC in the ordinary course of its business (but only to the extent that such disposition does not violate any agreement between the Bank and ACIC);

(b) dispositions of used, worn-out or surplus equipment, all in the ordinary course of business;

(c) the sale of equipment to the extent that such equipment is exchanged for credit against the purchase price of similar replacement equipment, or the proceeds of such sale are applied with reasonable promptness to the purchase price of such replacement equipment; and

(d) other dispositions of property during the term of this Agreement whose net book value in the aggregate does not exceed \$100,000.

Section 4. Plans. The Company will not permit, and will not allow any Subsidiary to permit, any event to occur or condition to exist which would permit any Plan to terminate under any circumstances which would cause the Lien provided for in Section 4068 of ERISA to attach to any assets of the Company or any Subsidiary; and the Company will not permit, as of the most recent valuation date for any Plan subject to Title IV of ERISA, the present value (determined on the basis of reasonable assumptions employed by the independent actuary for such Plan and

previously furnished in writing to the Bank) of such Plan's projected benefit obligations to exceed the fair market value of such Plan's assets.

Section 5. Change in Nature of Business. The Company will not, and will not permit any Subsidiary to, make any material change in the nature of the business of the Company or such Subsidiary, as carried on at the date hereof. For purposes of this Section, the provision of claims management, disability management, the provision and sale of software related to such activities and similar insurance-related activities will not be deemed to be a material change in the nature of the business of the Company or any Subsidiary of the Company, as carried on at the date hereof.

Section 6. Subsidiaries. After the date of this Agreement, the Company will not, and will not permit any Subsidiary to, form or acquire any corporation which would thereby become a Subsidiary, unless the Company gives notice of the establishment of the new Subsidiary to the Bank.

Section 7. Negative Pledges; Subsidiary Restrictions. The Company will not, and will not permit any Subsidiary to, enter into any agreement, bond, note or other instrument with or for the benefit of any Person other than the Bank which would (i) prohibit the Company or such Subsidiary from granting, or otherwise limit the ability of the Company or such Subsidiary to grant, to the Bank any Lien on any assets or properties of the Company or such Subsidiary, or (ii) require the Company or such Subsidiary to grant a Lien to any other Person if the Company or such Subsidiary grants any Lien to the Bank. The Company will not permit any Subsidiary to place or allow any restriction, directly or indirectly, on the ability of such Subsidiary to (a) pay dividends or any distributions on or with respect to such Subsidiary's capital stock or (b) make loans or other cash payments to the Company.

Section 8. Restricted Payments. The Company will not make any Restricted Payments, except that the Company may redeem stock purchased by employees pursuant to incentive plans, provided that the aggregate redemption price paid for such stock shall not exceed \$250,000 in any single fiscal year.

Section 9. Transactions with Affiliates. The Company will not, and will not permit any Subsidiary to, enter into any transaction with any Affiliate of the Company, except upon fair and reasonable terms no less favorable to the Company or such Subsidiary than would obtain in a comparable arm's-length transaction with a Person not an Affiliate.

Section 10. Accounting Changes. The Company will not, and will not permit any Subsidiary to, make any significant change in accounting treatment or reporting practices, except as required by GAAP, or change its fiscal year or the fiscal year of any Subsidiary.

Section 11. Indebtedness. The Company will not, and will not permit any Subsidiary to, incur, create, issue, assume or suffer to exist any Indebtedness, except:

- (a) obligations of the Company under this Agreement and the Related Documents;

(b) liabilities, other than for borrowed money, incurred in the ordinary course of business.

(c) Indebtedness existing on the date of this Agreement and disclosed on Schedule 2 hereto, but not including any extension or refinancing thereof.

(d) Indebtedness secured by Liens permitted under Article VIII, Section 12(h) hereof provided that the aggregate principal amount of such Indebtedness at any time outstanding shall not exceed \$100,000.

(e) Other unsecured Indebtedness, in an amount which, when combined with the amount of the existing Indebtedness permitted under clause (c) of this Section, does not exceed \$20,000,000.

(f) Liabilities from the continued adjudication of claims resulting from workplace injuries in the ordinary course of the Company's workplace compensation insurance policies.

Section 12. Liens. The Company will not, and will not permit any Subsidiary to, create, incur, assume or suffer to exist any Lien, or enter into, or make any commitment to enter into, any arrangement for the acquisition of any property through conditional sale, lease-purchase or other title retention agreements, with respect to any property now owned or hereafter acquired by the Company or a Subsidiary, except:

(a) Liens in favor of the Bank.

(b) Liens existing on the date of this Agreement and disclosed on Schedule 3 hereto.

(c) Deposits or pledges to secure payment of workers' compensation, unemployment insurance, old age pensions or other social security obligations, in the ordinary course of business of the Company or a Subsidiary.

(d) Liens for taxes, fees, assessments and governmental charges not delinquent or to the extent that payment therefor shall not at the time be required to be made in accordance with the provisions of Article VII, Section 3 hereof.

(e) Liens of carriers, warehousemen, mechanics and materialmen, and other like Liens arising in the ordinary course of business, for sums not due or to the extent that payment therefor shall not at the time be required to be made in accordance with the provisions of Article VII, Section 3 hereof.

(f) Liens incurred or deposits or pledges made or given in connection with, or to secure payment of, indemnity, performance or other similar bonds.

(g) Encumbrances in the nature of zoning restrictions, easements and rights or restrictions of record on the use of real property and landlord's Liens under leases on the

premises rented, which do not materially detract from the value of such property or impair the use thereof in the business of the Company or a Subsidiary.

(h) The interest of any lessor under any capitalized lease entered into after the date hereof or purchase money Liens on property acquired after the date hereof; provided, that, (i) the Indebtedness secured thereby is otherwise permitted by this Agreement and (ii) such Liens are limited to the property acquired and do not secure Indebtedness other than the related capitalized lease obligations or the purchase price of such property.

Section 13. A.M. Best Rating of ACIC. The Company will not permit the rating of ACIC by A.M. Best & Company at any time to be less than B+.

ARTICLE IX
Events of Default

Section 1. Events of Default. The occurrence of any of the following events (including the expiration of any specified time) shall constitute an "Event of Default":

(a) any amount required to be paid by the Company under this Agreement or any other Indebtedness of the Company to the Bank, whether now existing or hereafter arising is not paid when due (whether by acceleration or otherwise);

(b) the Company shall fail to comply with any agreement, covenant, condition, provision or term contained in Article VII, Sections 2, 3 or 5 or in Article VIII; or

(c) the Company shall fail to comply with any other agreement, covenant, condition, provision or term contained in this Agreement (other than those hereinabove set forth in this Article IX) and such failure to comply is not remedied within 30 calendar days after written notice of such failure is given by the Bank to the Company (unless the Bank shall agree in writing to an extension of such time prior to its expiration), or for such longer period of time (not to exceed 90 days) as may be reasonably necessary to remedy such default (other than defaults which can be cured by a money payment), provided that such default is capable of being remedied and the Company is proceeding with reasonable diligence to remedy the same; or

(d) any representation or warranty made by or on behalf of the Company, any Subsidiary in this Agreement or any other Related Document or by or on behalf of the Company or any Subsidiary in any certificate, statement, report or document herewith or hereafter furnished to the Bank pursuant to this Agreement or any Related Document shall prove to have been false or misleading in any material respect on the date as of which the facts set forth are stated or certified; or

(e) the Company shall become insolvent or shall generally not pay its debts as they mature or shall apply for, shall consent to, or shall acquiesce in the appointment of a custodian, trustee or receiver of the Company or for a substantial part of the property thereof or, in the absence of such application, consent or acquiescence, a custodian,

trustee or receiver shall be appointed for the Company or for a substantial part of the property thereof and shall not be discharged within 30 days; or

(f) any bankruptcy, reorganization, debt arrangement or other proceedings under any bankruptcy or insolvency law shall be instituted by or against the Company, and, if instituted against the Company, shall have been consented to or acquiesced in by the Company, or shall remain undismissed for 30 days, or an order for relief shall have been entered against the Company; or

(g) any dissolution or liquidation proceeding shall be instituted by or against the Company and, if instituted against the Company, shall be consented to or acquiesced in by the Company or shall remain for 30 days undismissed; or

(h) a judgment or judgments for the payment of money in excess of the sum of \$100,000 in the aggregate shall be rendered against the Company and the Company shall not discharge the same or provide for its discharge in accordance with its terms, or procure a stay of execution thereof, prior to any execution on such judgment by such judgment creditor, within 30 days from the date of entry thereof, and within said period of 30 days, or such longer period during which execution of such judgment shall be stayed, appeal therefrom and cause the execution thereof to be stayed during such appeal; or

(i) the maturity of any material Indebtedness of the Company (other than Indebtedness under this Agreement) shall be accelerated, or the Company shall fail to pay any such material Indebtedness when due (after the lapse of any applicable grace period) or, in the case of such Indebtedness payable on demand, when demanded (after the lapse of any applicable grace period), or any event shall occur or condition shall exist and shall continue for more than the period of grace, if any, applicable thereto and shall have the effect of causing, or permitting the holder of any such Indebtedness or any trustee or other Person acting on behalf of such holder to cause, such material Indebtedness to become due prior to its stated maturity or to realize upon any collateral given as security therefor. For purposes of this clause (i), Indebtedness of the Company shall be deemed "material" if it exceeds \$100,000 as to any item of Indebtedness or in the aggregate for all items of Indebtedness with respect to which any of the events described in this Article has occurred; or

(j) the occurrence of any event of whatsoever nature (including any adverse determination in any litigation, arbitration, or governmental investigation or proceeding) which could reasonably be expected to materially and adversely affect (a) the financial condition or operations of the Company and the Subsidiaries taken as a whole, (b) impair the ability of the Company to perform its obligations under this Agreement or any Related Document, (c) the rights and remedies of the Bank against the Company, or (d) the timely payment of amounts payable by the Company hereunder.

ARTICLE X
Remedies

Section 1. Remedies. Upon the occurrence and during the continuance of an Event of Default, the Bank may, in addition to any other remedies available to it at law or in equity, exercise any one or more of the following remedies:

(a) The Bank may, by written notice to the Company, declare all obligations of the Company under this Agreement to be immediately due and payable, whereupon such obligations shall become immediately due and payable.

(b) The Bank may make demand upon the Company and forthwith upon such demand the Company shall pay to the Bank in Immediately Available Funds for deposit in a special cash collateral account maintained with the Bank (the "Cash Collateral Account") an amount equal to the maximum amount then available to be drawn under the Letters of Credit (assuming compliance with all conditions for drawing thereunder). The Bank shall have sole discretion in administering such funds, including the right to return such funds to the Company if the Bank so elects. Until each Letter of Credit has expired and all obligations of the Company under this Agreement shall have been paid in full:

(i) If requested by the Company and subject to the right of the Bank to withdraw funds from the Cash Collateral Account as provided below, the Bank will in its name or the name of the Company from time to time, invest funds on deposit in the Cash Collateral Account, reinvest proceeds and invest interest or other income received from any such investments, in such Eligible Securities (as hereinafter defined) as the Company may select and give notice thereof to the Bank. Such proceeds, interest or income which are not so invested or reinvested in Eligible Securities shall, except as otherwise provided in this Section 1(b), be deposited and held by the Bank in the Cash Collateral Account. "Eligible Securities" means (A) United States Treasury bills with a remaining maturity of 90 days or less, (B) negotiable certificates of deposit of the Bank or of any other bank having combined capital and surplus of at least \$100,000,000 with a remaining maturity of 90 days or less, and (C) such other instruments as the Company may request and the Bank may approve in writing. Eligible Securities from time to time purchased and held pursuant to this Section 1(b) shall be referred to as "Collateral Securities" and shall, for purposes of this Agreement, constitute part of the funds held in the Cash Collateral Account in amounts equal to their respective outstanding principal amounts.

(ii) If at any time the Bank determines that any funds held in the Cash Collateral Account are subject to any right or claim of any person or entity other than the Bank or that the total amount of such funds is less than the maximum amount at such time available to be drawn under the Letters of Credit, the Company will, forthwith upon demand by the Bank, pay to the Bank, as additional funds to be deposited and held in the Cash Collateral Account, an amount equal to the excess of (A) such maximum amount at such time available to be drawn under the Letters of Credit over (B) the total amount of funds, if any,

then held in the Cash Collateral Account which the Bank determines to be free and clear of any such right and claim.

(iii) The Company hereby pledges, and grants to the Bank a security interest in, all funds held in the Cash Collateral Account (including Collateral Securities) from time to time and all proceeds thereof, as security for the payment of all amounts due and to become due from the Company to the Bank under this Agreement.

(iv) The Bank may, at any time or from time to time after funds are either deposited in the Cash Collateral Account or invested in Collateral Securities, after selling (upon five days' notice to the Company), if necessary, any Collateral Securities, apply funds then held in the Cash Collateral Account to the payment of any amounts, in such order as the Bank may elect, as shall have become or shall become due and payable by the Company to the Bank under this Agreement. The Company agrees that, to the extent notice of sale of any Collateral Securities shall be required by law, five days' notice to the Company of the time and place of any public sale or the time after which any private sale is to be made shall constitute reasonable notification. The Bank may adjourn any public or private sale from time to time by announcement at the time and place fixed therefor, and such sale may, without further notice, be made at the time and place to which it was so adjourned.

(v) Neither the Company nor any person or entity claiming on behalf of or through the Company shall have any right to withdraw any of the funds held in the Cash Collateral Account, except as otherwise provided in clause (vi) below, except that after the termination of the Letters of Credit in accordance with its terms and the payment of all amounts payable by the Company to the Bank under this Agreement, any funds remaining in the Cash Collateral Account shall be returned by the Bank to the Company or paid to whomever may be legally entitled thereto.

(vi) So long as no Default or Event of Default shall have occurred and be continuing, the Bank will release to the Company (A) the interest or other income received on Collateral Securities and (B) at the written request of the Company, funds held in the Cash Collateral Account in an amount up to but not exceeding the excess, if any (immediately prior to the release of any such funds), of the total amount of funds held in the Cash Collateral Account over the maximum amount available to be drawn under the Letters of Credit.

(vii) The Company agrees that it will not (A) sell or otherwise dispose of any interest in the Cash Collateral Account or any funds held therein, or (B) create or permit to exist any Lien upon or with respect to the Cash Collateral Account or any funds held therein, except as provided in or contemplated by this Agreement.

(viii) The Bank shall exercise reasonable care in the custody and preservation of any funds held in the Cash Collateral Account and shall be deemed to have exercised such care if such funds are accorded treatment substantially equivalent to that which the Bank accords its own property, it being understood that the Bank shall not have any responsibility for taking any necessary steps to preserve rights against any parties with respect to any such funds.

(c) The Bank may offset any deposits of the Company held by the Bank (including those held by the Bank in the Cash Collateral Account and any unmatured time deposits) against sums due or to become due hereunder, whether or not then due.

(d) The Bank may exercise any remedy available to it under any other Related Document.

(e) The Bank may take whatever action at law or in equity that may appear necessary or appropriate to collect any amount due or thereafter to become due, or to enforce performance and observance of any obligation, agreement or covenant of the Company hereunder or under any other Related Document.

(f) Notwithstanding any of the foregoing, the Bank will not apply (whether pursuant to Article X, Section 1(b)(iv), Article X, Section 1(c) or otherwise) any funds on deposit in the Cash Collateral Account (or any other deposits of the Company held by the Bank) to the payment or reimbursement of any drawing under any Letter of Credit unless and until such drawing has been honored by the Bank from its own funds.

ARTICLE XI
Miscellaneous

Section 1. Amendments, Etc. No amendment or waiver of any provision of this Agreement nor any consent to any departure by the Company therefrom shall in any event be effective unless the same shall be in writing and signed by the Bank, and then such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given.

Section 2. Notices. Except as otherwise specifically provided for herein, all notices and other communications provided for herein shall be in writing and telecopied, mailed or delivered to the intended recipient at the following addresses:

If to the Company: 8500 Normandale Lake Blvd., Suite 1450
Bloomington, MN 55437
Attn: Jeffrey B. Murphy

If to the Bank: U.S. Bank National Association
U.S. Bancorp Center
800 Nicollet Mall
Minneapolis, MN 55402
Attention: Christine Geer

or as to each party at such other address as shall be designated by such party in a written notice to the other parties. All notices and other communications hereunder shall be deemed to have been duly given when transmitted by telecopier, or personally delivered or, in the case of a mailed notice, three Business Days after the date deposited in the mails, airmail postage prepaid, in each case given or addressed as aforesaid.

Section 3. No Waiver; Remedies. No failure on the part of the Bank to exercise, and no delay in exercising, any right hereunder shall operate as a waiver thereof; nor shall any single or partial exercise of any right hereunder preclude any other or further exercise thereof or the exercise of any other right. The remedies herein provided are cumulative and not exclusive of any remedies provided by law.

Section 4. Indemnification. The Company hereby indemnifies and holds harmless the Bank from and against any and all claims, damages, losses, liabilities, reasonable costs or expenses whatsoever (including attorneys' fees) which the Bank may incur (or which may be claimed against the Bank by any person or entity whatsoever) by reason of or in connection with the execution and delivery or transfer of, or payment or failure to pay under, any Letter of Credit; provided that the Company shall not be required to indemnify the Bank for any claims, damages, losses, liabilities, costs or expenses to the extent, but only to the extent, caused by (i) the willful misconduct or gross negligence of the Bank or (ii) the Bank's willful failure to pay under any Letter of Credit after the presentation to it by the Trustee of a sight draft and certificate strictly complying with the terms and conditions of such Letter of Credit. Nothing in this Section 4 is intended to limit the reimbursement obligation of the Company contained in Article III, Section 1 hereof.

Section 5. Continuing Obligation. This Agreement is a continuing obligation, shall survive the termination of any Letter of Credit and shall (a) be binding upon the Company, its successors and assigns, and (b) inure to the benefit of and be enforceable by the Bank and its successors, transferees and assigns; provided that the Company may not assign all or any part of this Agreement without the prior written consent of the Bank.

Section 6. Liability of the Bank. As between the Bank and the Company, the Company assumes all risks of the acts or omissions of any Beneficiary with respect to its use of any Letter of Credit. Neither the Bank nor any of its officers or directors shall be liable or responsible for: (a) the use which may be made of any Letter of Credit or for any acts or omissions of the Beneficiary in connection therewith; (b) the validity, sufficiency or genuineness of documents, or of any endorsement(s) thereon, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged; or (c) any other circumstances whatsoever in making or failing to make payment under any Letter of Credit, except only that the Company shall have a claim against the Bank, and the Bank shall be liable to the Company, to the extent, but only to the extent, of any direct, as opposed to consequential, damages suffered by the Company which the Company proves, by clear and convincing evidence, were caused by (i) the Bank's willful misconduct or gross negligence in determining whether documents presented under any Letter of Credit comply with the terms of any Letter of Credit or (ii) the Bank's willful failure to pay under any Letter of Credit after the presentation to it by the Beneficiary of a sight draft and certificate strictly complying with the terms and conditions of such Letter of Credit. In

furtherance and not in limitation of the foregoing, the Bank may accept documents that appear on their face to be in order, without responsibility for further investigation.

Section 7. Costs, Expenses and Taxes. The Company agrees to pay on demand all costs and expenses in connection with the preparation, execution, delivery and enforcement of this Agreement and any other documents which may be delivered in connection with this Agreement, including, without limitation, the fees, service charges and out-of-pocket expenses of outside counsel to the Bank (determined on the basis or at such counsel's generally applicable rates, which may be higher than the rates such counsel charges to the Bank in certain matters) and the allocated costs of the in-house counsel incurred from time to time.

Section 8. Severability. Any provision of this Agreement which is prohibited, unenforceable or not authorized in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition, unenforceability or nonauthorization without invalidating the remaining provisions hereof or affecting the validity, enforceability or legality of such provision in any other jurisdiction.

Section 9. Governing Law and Construction. THE VALIDITY, CONSTRUCTION AND ENFORCEABILITY OF THIS AGREEMENT SHALL BE GOVERNED BY THE LAWS OF THE STATE OF MINNESOTA, WITHOUT GIVING EFFECT TO CONFLICT OF LAWS PRINCIPLES THEREOF, BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS. Whenever possible, each provision of this Agreement and any other statement, instrument or transaction contemplated hereby or relating hereto shall be interpreted in such manner as to be effective and valid under such applicable law, but, if any provision of this Agreement or any other statement, instrument or transaction contemplated hereby or relating hereto shall be held to be prohibited or invalid under such applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement or any other statement, instrument or transaction contemplated hereby or relating hereto.

Section 10. Consent to Jurisdiction. AT THE OPTION OF THE BANK, THIS AGREEMENT MAY BE ENFORCED IN ANY FEDERAL COURT OR MINNESOTA STATE COURT SITTING IN HENNEPIN COUNTY; AND THE COMPANY CONSENTS TO THE JURISDICTION AND VENUE OF ANY SUCH COURT AND WAIVES ANY ARGUMENT THAT VENUE IN SUCH FORUMS IS NOT CONVENIENT.

Section 11. Waiver of Jury Trial. THE COMPANY AND THE BANK IRREVOCABLY WAIVES ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 12. Counterparts. This Agreement may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed an original, but all such counterparts together shall constitute but one and the same instrument.

Section 13. Headings. The Table of Contents and Section headings in this Agreement are included herein for convenience of reference only and shall not constitute a part of this Agreement for any other purpose.

Section 14. Accounting. All financial statements furnished to the Bank under this Agreement and all computations and determinations required to be made pursuant to this Agreement shall be made in accordance with GAAP, applied on a basis consistent with the audited financial statements referred to in Article VI, Section 5.

Section 15. Term of Agreement. This Agreement shall remain in full force and effect from the date hereof until such time as no Letters of Credit remain outstanding and all amounts owing hereunder to the Bank have been fully paid.

Section 16. Entire Agreement. This Agreement and the other Related Documents to which the Company is a party embody the entire agreement and understanding between the Company and the Bank with respect to the subject matter hereof and thereof and supersede all prior agreements and understandings relating to such subject matter.

Section 17. Company Acknowledgements. The Company acknowledges that (a) it has been advised by its own legal counsel in the negotiation, execution and delivery of this Agreement and the Related Documents and has not received or relied on any advice from the Bank or the Bank's legal counsel, Dorsey & Whitney LLP, (b) the Bank has no fiduciary relationship to the Company, the relationship being solely that of debtor and creditor, and (c) no joint venture exists between the Company and the Bank.

Section 18. Waivers and Recovery of Payments.

(a) Waivers of Defenses. The obligations of the Company hereunder shall not be released, in whole or in part, by any action or thing which might, but for this provision of this Agreement, be deemed a legal or equitable discharge of a surety or guarantor, other than irrevocable payment and performance in full of the obligations hereunder (except for contingent indemnity and other contingent obligations not yet due and payable) at a time after any obligation of the Bank hereunder to issue Letters of Credit shall have expired or been terminated and all outstanding Letters of Credit shall have expired or the liability of the Bank thereon shall have otherwise been discharged. The purpose and intent of this Agreement is that the obligations hereunder constitute the direct and primary obligations of the Company and that the covenants, agreements and all obligations of the Company hereunder be absolute, unconditional and irrevocable.

(b) Recovery of Payment. If any payment received by the Bank and applied to the obligations hereunder is subsequently set aside, recovered, rescinded or required to be returned for any reason (including, without limitation, the bankruptcy, insolvency or reorganization of the Company or any other obligor), the obligations hereunder to which such payment was applied shall, to the extent permitted by applicable law, be deemed to have continued in existence, notwithstanding such application, and the Company shall be liable for such obligations as fully as if such application had never been made. References in this Agreement to amounts "irrevocably paid" or to "irrevocable payment"

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refer to payments that cannot be set aside, recovered, rescinded or required to be returned for any reason.

[Signature Page follows.]

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and delivered by their respective officers thereunto duly authorized as of the date first above written.

RTW, INC.

By /s/ Alfred L. LaTendresse

Its Executive Vice President and
Chief Financial Officer

U.S. BANK NATIONAL ASSOCIATION

By /s/ Christine J. Geer

Its Corporate Banking Officer

[Signature Page to Letter of Credit Reimbursement Agreement]

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EXHIBIT A
to
LETTER OF CREDIT REIMBURSEMENT AGREEMENT
Form of Letter of Credit

Beneficiary:

[NAME AND ADDRESS]

Applicant: [CALTIVUS]

We have established this clean, irrevocable and unconditional Letter of Credit in favor of Beneficiary for drawing up to \$_____,000.00 (_____,and no/100 dollars) effective immediately. This letter of credit is issued, presentable and payable at our office at U.S. Bank National Association, [800 NICOLLET MALL, MINNEAPOLIS, MINNESOTA 55402 ATTN: STANDBY LETTERS OF CREDIT] and expires one year from the date hereof (the "Expiration Date"). Except when the amount of this Letter of Credit is increased, this Credit cannot be modified or revoked without your consent.

The term "Beneficiary" includes any successor by operation of law of the named Beneficiary including without limitation, any liquidator, rehabilitator, receiver or conservator. Drawings by any liquidator, rehabilitator, receiver or conservator shall be for the benefit of all of the Beneficiary's policyholders.

We hereby undertake to promptly honor your sight draft(s) drawn on us, indicating our Credit number_____, any part of this Credit upon presentation of your draft drawn on us at our office specified in paragraph one, on or before the expiration date hereof, or any automatically extended expiration date; provided, however, the maximum aggregate amount that may be drawn under this Credit shall not exceed US\$_____,000.00.

Except as expressly stated herein, this undertaking is not subject to any agreement, requirement or qualification. The obligation of U.S. Bank National Association under this Credit is the individual obligation of U.S. Bank National Association, and is in no way contingent upon reimbursement with respect thereto, or upon our ability to perfect any lien, security interest or any other reimbursement.

This Letter of Credit is deemed to be automatically extended without amendment for one year from the expiration date or any future expiration date, unless thirty (30) days prior to such expiration date, we notify you by registered mail that the Letter of Credit will not be renewed for any such additional period.

This Letter of Credit is subject to and governed by the Laws of the State of [New York] and the 1993 Revision of the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 500) and, in the event of any conflict, the Laws of the State of [New York] will control. If this Credit expires during an interruption of business as described in Article 17 of said Publication 500, the Bank hereby specifically agrees to effect payment if this credit is drawn against within thirty (30) days after the resumption of our business.

U.S. Bank National Association

Authorized Signature

Subsidiaries

Rtw, Inc has one subsidiary, American Compensation Insurance Company ("ACIC"), a Minnesota corporation.

Indebtedness

The Company's ACIC subsidiary is obligated with respect to a \$1.5 million letter of credit issued by U.S. Bank National Association in favor of General Reinsurance.

Liens

The Company's ACIC subsidiary has pledged securities to U.S. Bank National Association in connection with a \$1.5 million letter of credit issued by U.S. Bank National Association to General Reinsurance.
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PLEDGE AGREEMENT

THIS PLEDGE AGREEMENT, dated as of July 30, 2004, is made and given by RTW, INC., a corporation organized under the laws of the State of Minnesota (the "Pledgor") to U.S. BANK NATIONAL ASSOCIATION, a national banking association (the "Secured Party").

RECITALS

A. The Pledgor and the Bank entered into a Letter of Credit Reimbursement Agreement (the "Reimbursement Agreement") dated concurrently herewith under which the Secured Party has issued a standby letter of credit in the amount of \$4,050,000 in favor of Hartford Fire Insurance Company for the account of the Pledgor.

B. The Pledgor is the owner of the shares (the "Pledged Shares") of stock described in Schedule I hereto issued by the corporation named therein.

C. It is a condition precedent to the obligation of the Secured Party to extend credit accommodations pursuant to the terms of the Reimbursement Agreement that this Agreement be executed and delivered by the Pledgor.

D. The Pledgor finds it advantageous, desirable and in the best interests of the Pledgor to comply with the requirement that this Agreement be executed and delivered to the Secured Party.

NOW, THEREFORE, in consideration of the premises and in order to induce the Secured Party to enter into the Reimbursement Agreement and to extend credit accommodations to the Pledgor thereunder, the Pledgor hereby agrees with the Secured Party as follows:

Section 1. Defined Terms.

1.1 As used in this Agreement, the following terms shall have the meanings indicated:

"Collateral" shall have the meaning given to such term in Section 2.

"Event of Default" shall have the meaning given to such term in Section 11.

"Lien" shall mean any security interest, mortgage, pledge, lien, charge, encumbrance, title retention agreement or analogous instrument or device (including the interest of the lessors under capitalized leases), in, of or on any assets or properties of the Person referred to.

"Obligations" shall mean (a) all indebtedness, liabilities and obligations of the Pledgor to the Secured Party of every kind, nature or description under the Reimbursement Agreement or under any Related Document (as defined in the Reimbursement Agreement) and any letter of credit issued under the Reimbursement

Agreement, (b) all liabilities of the Pledgor under this Agreement, (c) any and all other liabilities and obligations of the Pledgor to the Secured Party of every kind, nature and description, whether direct or indirect or hereafter acquired by the Secured Party from any Person, absolute or contingent, regardless of how such liabilities arise or by what agreement or instrument they may be evidenced, and in all of the foregoing cases whether due or to become due, and whether now existing or hereafter arising or incurred.

"Person" shall mean any individual, corporation, partnership, limited partnership, limited liability company, joint venture, firm, association, trust, unincorporated organization, government or governmental agency or political subdivision or any other entity, whether acting in an individual, fiduciary or other capacity.

"Pledged Shares" shall have the meaning given to such term in Recital B above.

"Security Interest" shall have the meaning given to such term in Section 2.

1.2 Terms Defined in Uniform Commercial Code. All other terms used in this Agreement that are not specifically defined herein or the definitions of which are not incorporated herein by reference shall have the meaning assigned to such terms in the Article 9 of the Uniform Commercial Code in effect in the State of Minnesota as of the date first above written to the extent such other terms are defined therein.

1.3 Singular/Plural, etc. Unless the context of this Agreement otherwise clearly requires, references to the plural include the singular, the singular, the plural and "or" has the inclusive meaning represented by the phrase "and/or." The words "include," "includes" and "including" shall be deemed to be followed by the phrase "without limitation." The words "hereof," "herein," "hereunder," and similar terms in this Agreement refer to this Agreement as a whole and not to any particular provision of this Agreement. References to Sections are references to Sections in this Pledge Agreement unless otherwise provided.

Section 2. Pledge. As security for the payment and performance of all of the Obligations, the Pledgor hereby pledges to the Secured Party and grants to the Secured Party, a security interest (the "Security Interest") in the following (the "Collateral"):

2.1 The Pledged Shares and the certificates representing the Pledged Shares, and all dividends, cash, instruments and other property from time to time received, receivable or otherwise distributed in respect of or in exchange for any or all of the Pledged Shares.

2.2 All additional shares of stock of any issuer of the Pledged Shares from time to time acquired by the Pledgor in any manner and the certificates representing such additional shares, and all dividends, cash, instruments and other property from time to time received, receivable or otherwise distributed in respect of or in exchange for any or all of such shares.

2.3 All proceeds of any and all of the foregoing (including proceeds that constitute property of types described above).

Section 3. Delivery of Collateral. All certificates and instruments representing or evidencing the Pledged Shares shall be delivered to the Secured Party contemporaneously with the execution of this Agreement. All certificates and instruments representing or evidencing Collateral received by the Pledgor after the execution of this Agreement shall be delivered to the Secured Party promptly upon the Pledgor's receipt thereof. All such certificates and instruments shall be held by or on behalf of the Secured Party pursuant hereto and shall be in suitable form for transfer by delivery, or shall be accompanied by duly executed instruments of transfer or assignment in blank, all in form and substance satisfactory to the Secured Party. The Secured Party shall have the right at any time after an Event of Default, to cause any or all of the Collateral to be transferred of record into the name of the Secured Party (but subject to the rights of the Pledgor under Section 6) and to exchange certificates representing or evidencing Collateral for certificates of smaller or larger denominations.

Section 4. Certain Warranties and Covenants. The Pledgor makes the following warranties and covenants:

4.1 The Pledgor has title to the Pledged Shares and will have title to each other item of Collateral hereafter acquired, free of all Liens except the Security Interest.

4.2 The Pledgor has full power and authority to execute this Pledge Agreement, to perform the Pledgor's obligations hereunder and to subject the Collateral to the Security Interest created hereby.

4.3 No financing statement covering all or any part of the Collateral is on file in any public office (except for any financing statements filed by the Secured Party).

4.4 The Pledged Shares have been duly authorized and validly issued by the issuer thereof and are fully paid and non-assessable. The certificates representing the Pledged Shares are not subject to any offset or similar right or claim of the issuers thereof.

4.5 The Pledged Shares constitute the percentage of the issued and outstanding shares of stock of the respective issuers thereof indicated on Schedule I (if any such percentage is so indicated).

Section 5. Further Assurances. The Pledgor agrees that at any time and from time to time, at the expense of the Pledgor, the Pledgor will promptly execute and deliver all further instruments and documents, and take all further action that may be necessary or that the Secured Party may reasonably request, in order to perfect and protect the Security Interest or to enable the Secured Party to exercise and enforce its rights and remedies hereunder with respect to any Collateral (but any failure to request or assure that the Pledgor execute and deliver such instruments or documents or to take such action shall not affect or impair the validity, sufficiency or enforceability of this Agreement and the Security Interest, regardless of whether any such item was or was not executed and delivered or action taken in a similar context or on a prior occasion).

Section 6. Voting Rights; Dividends; etc.

6.1 Subject to Section 6.4, the Pledgor shall be entitled to exercise or refrain from exercising any and all voting and other consensual rights pertaining to the Pledged Shares or any other stock that becomes part of the Collateral or any part thereof for any purpose not inconsistent with the terms of this Agreement or the Reimbursement Agreement; provided, however, that the Pledgor shall not exercise or refrain from exercising any such right if such action could reasonably be expected to have a material adverse effect on the value of the Collateral or any material part thereof.

6.2 Subject to Section 6.5, the Pledgor shall be entitled to receive, retain, and use in any manner not prohibited by the Reimbursement Agreement any and all dividends paid in respect of the Collateral; provided, however, that any and all

(a) dividends paid or payable other than in cash in respect of, and instruments and other property received, receivable or otherwise distributed in respect of, or in exchange for, any Collateral,

(b) dividends and other distributions paid or payable in cash in respect of any Collateral in connection with a partial or total liquidation or dissolution or in connection with a reduction of capital, capital surplus or paid-in-surplus, and

(c) cash paid, payable or otherwise distributed in redemption of, or in exchange for, any Collateral,

shall be, and shall be forthwith delivered to the Secured Party to hold as Collateral and shall, if received by the Pledgor, be received in trust for the benefit of the Secured Party, be segregated from the other property or funds of the Pledgor, and be forthwith delivered to the Secured Party as Collateral in the same form as so received (with any necessary indorsement or assignment). The Pledgor shall, upon request by the Secured Party, promptly execute all such documents and do all such acts as may be necessary or desirable to give effect to the provisions of this Section 6.2.

6.3 The Secured Party shall execute and deliver (or cause to be executed and delivered) to the Pledgor all such proxies and other instruments as the Pledgor may reasonably request for the purpose of enabling the Pledgor to exercise the voting and other rights that it is entitled to exercise pursuant to Section 6.1 hereof and to receive the dividends that it is authorized to receive and retain pursuant to Section 6.2 hereof.

6.4 Upon the occurrence and during the continuance of any Event of Default, the Secured Party shall have the right in its sole discretion, and the Pledgor shall execute and deliver all such proxies and other instruments as may be necessary or appropriate to give effect to such right, to terminate all rights of the Pledgor to exercise or refrain from exercising the voting and other consensual rights that it would otherwise be entitled to exercise pursuant to Section 6.1 hereof, and all such rights shall thereupon become vested in the Secured Party who shall thereupon have the sole right to exercise or refrain from exercising such voting and other consensual rights; provided, however, that the Secured Party shall not be deemed to possess or have control over any voting rights with respect

to any Collateral unless and until the Secured Party has given written notice to the Pledgor that any further exercise of such voting rights by the Pledgor is prohibited and that the Secured Party and/or its assigns will henceforth exercise such voting rights; and provided, further, that neither the registration of any item of Collateral in the Secured Party's name nor the exercise of any voting rights with respect thereto shall be deemed to constitute a retention by the Secured Party of any such Collateral in satisfaction of the Obligations or any part thereof.

6.5 Upon the occurrence and during the continuance of any Event of Default:

(a) all rights of the Pledgor to receive the dividends that it would otherwise be authorized to receive and retain pursuant to Section 6.2 hereof shall cease, and all such rights shall thereupon become vested in the Secured Party, who shall thereupon have the sole right to receive and hold such dividends as Collateral, and

(b) all payments of dividends that are received by the Pledgor contrary to the provisions of paragraph (a) of this Section 6.5 shall be received in trust for the benefit of the Secured Party, shall be segregated from other funds of the Pledgor and shall be forthwith paid over to the Secured Party as Collateral in the same form as so received (with any necessary indorsement).

Section 7. Transfers and Other Liens; Additional Shares.

7.1 Except as may be permitted by the Reimbursement Agreement, the Pledgor agrees that it will not (i) sell, assign (by operation of law or otherwise) or otherwise dispose of, or grant any option with respect to, any of the Collateral, or (ii) create or permit to exist any Lien, upon or with respect to any of the Collateral.

7.2 The Pledgor agrees that it will (i) cause each issuer of the Pledged Shares that it controls not to issue any stock or other securities in addition to or in substitution for the Pledged Shares issued by such issuer, except to the Pledgor, and (ii) pledge hereunder, immediately upon its acquisition (directly or indirectly) thereof, any and all additional shares of stock or other securities of each issuer of the Pledged Shares.

Section 8. Secured Party Appointed Attorney-in-Fact. As additional security for the Obligations, the Pledgor hereby appoints the Secured Party the Pledgor's attorney-in-fact, with full authority in the place and stead of such Pledgor and in the name of such Pledgor or otherwise, from time to time in the Secured Party's good-faith discretion, to take any action and to execute any instrument that the Secured Party may reasonably believe necessary or advisable to accomplish the purposes of this Agreement (subject to the rights of the Pledgor under Section 6 hereof), in a manner consistent with the terms hereof, including, without limitation, to receive, indorse and collect all instruments made payable to the Pledgor representing any dividend or other distribution in respect of the Collateral or any part thereof and to give full discharge for the same.

Section 9. Secured Party May Perform. The Pledgor hereby authorizes the Secured Party to file financing statements with respect to the Collateral. The Borrower irrevocably

waives any right to notice of any such filing. If the Pledgor fails to perform any agreement contained herein, the Secured Party may itself perform, or cause performance of, such agreement, and the reasonable expenses of the Secured Party incurred in connection therewith shall be payable by the Pledgor under Section 14 hereof.

Section 10. The Secured Party's Duties. The powers conferred on the Secured Party hereunder are solely to protect its interest in the Collateral and shall not impose any duty upon it to exercise any such powers. The Secured Party shall be deemed to have exercised reasonable care in the safekeeping of any Collateral in its possession if such Collateral is accorded treatment substantially equal to the safekeeping which the Secured Party accords its own property of like kind. Except for the safekeeping of any Collateral in its possession and the accounting for monies and for other properties actually received by it hereunder, the Secured Party shall have no duty, as to any Collateral, as to ascertaining or taking action with respect to calls, conversions, exchanges, maturities, tenders or other matters relative to any Collateral, whether or not the Secured Party has or is deemed to have knowledge of such matters, or as to the taking of any necessary steps to preserve rights against any Persons or any other rights pertaining to any Collateral. The Secured Party will take action in the nature of exchanges, conversions, redemption, tenders and the like requested in writing by the Pledgor with respect to any of the Collateral in the Secured Party's possession if the Secured Party in its reasonable judgment determines that such action will not impair the Security Interest or the value of the Collateral, but a failure of the Secured Party to comply with any such request shall not of itself be deemed a failure to exercise reasonable care.

Section 11. Default. Each of the following occurrences shall constitute an Event of Default under this Agreement: (a) the Pledgor shall fail to observe or perform any covenant or agreement applicable to the Pledgor under this Agreement; or (b) any representation or warranty made by the Pledgor in this Agreement or in any financial statements, reports or certificates heretofore or at any time hereafter submitted by or on behalf of the Pledgor to the Secured Party shall prove to have been false or materially misleading when made; or (c) any default or event of default (however denominated or described) shall occur under the Reimbursement Agreement.

Section 12. Remedies upon Default. If any Event of Default shall have occurred and be continuing:

12.1 The Secured Party may exercise in respect of the Collateral, in addition to other rights and remedies provided for herein or otherwise available to it, all the rights and remedies of a secured party on default under Article 9 the Uniform Commercial Code as adopted in the State of Minnesota (the "Code") in effect at that time, and may, without notice except as specified below, sell the Collateral or any part thereof in one or more parcels at public or private sale, at any exchange, broker's board or at any of the Secured Party's offices or elsewhere, for cash, on credit or for future delivery, and upon such other terms as the Secured Party may reasonably believe are commercially reasonable. The Pledgor agrees that, to the extent notice of sale shall be required by law, at least ten days' prior notice to the Pledgor of the time and place of any public sale or the time after which any private sale is to be made shall constitute reasonable notification. The Secured Party shall not be obligated to make any sale of Collateral regardless of notice of sale having been given. The Secured Party may adjourn any public or private sale from time

to time by announcement at the time and place fixed therefor, and such sale may, without further notice, be made at the time and place to which it was so adjourned. The Pledgor hereby waives all requirements of law, if any, relating to the marshalling of assets which would be applicable in connection with the enforcement by the Secured Party of its remedies hereunder, absent this waiver. The Secured Party may disclaim warranties of title and possession and the like.

12.2 The Secured Party may notify any Person obligated on any of the Collateral that the same has been assigned or transferred to the Secured Party and that the same should be performed as requested by, or paid directly to, the Secured Party, as the case may be. The Pledgor shall join in giving such notice, if the Secured Party so requests. The Secured Party may, in the Secured Party's name or in the Pledgor's name, demand, sue for, collect or receive any money or property at any time payable or receivable on account of, or securing, any such Collateral or grant any extension to, make any compromise or settlement with or otherwise agree to waive, modify, amend or change the obligation of any such Person.

12.3 Any cash held by the Secured Party as Collateral and all cash proceeds received by the Secured Party in respect of any sale of, collection from, or other realization upon all or any part of the Collateral may, in the discretion of the Secured Party, be held by the Secured Party as collateral for, or then or at any time thereafter be applied in whole or in part by the Secured Party against, all or any part of the Obligations (including any expenses of the Secured Party payable pursuant to Section 14 hereof).

Section 13. Waiver of Certain Claims. The Pledgor acknowledges that because of present or future circumstances, a question may arise under the Securities Act of 1933, as from time to time amended (the "Securities Act"), with respect to any disposition of the Collateral permitted hereunder. The Pledgor understands that compliance with the Securities Act may very strictly limit the course of conduct of the Secured Party if the Secured Party were to attempt to dispose of all or any portion of the Collateral and may also limit the extent to which or the manner in which any subsequent transferee of the Collateral or any portion thereof may dispose of the same. There may be other legal restrictions or limitations affecting the Secured Party in any attempt to dispose of all or any portion of the Collateral under the applicable Blue Sky or other securities laws or similar laws analogous in purpose or effect. The Secured Party may be compelled to resort to one or more private sales to a restricted group of purchasers who will be obliged to agree, among other things, to acquire such Collateral for their own account for investment only and not to engage in a distribution or resale thereof. The Pledgor agrees that the Secured Party shall not incur any liability, and any liability of the Pledgor for any deficiency shall not be impaired, as a result of the sale of the Collateral or any portion thereof at any such private sale in a manner that the Secured Party reasonably believes is commercially reasonable (within the meaning of Section 9-627 of the Uniform Commercial Code). The Pledgor hereby waives any claims against the Secured Party arising by reason of the fact that the price at which the Collateral may have been sold at such sale was less than the price that might have been obtained at a public sale or was less than the aggregate amount of the Obligations, even if the Secured Party shall accept the first offer received and does not offer any portion of the Collateral to more than one possible purchaser. The Pledgor further agrees that the Secured Party has no obligation to delay sale of any Collateral for the period of time necessary to permit the issuer of

such Collateral to qualify or register such Collateral for public sale under the Securities Act, applicable Blue Sky laws and other applicable state and federal securities laws, even if said issuer would agree to do so. Without limiting the generality of the foregoing, the provisions of this Section would apply if, for example, the Secured Party were to place all or any portion of the Collateral for private placement by an investment banking firm, or if such investment banking firm purchased all or any portion of the Collateral for its own account, or if the Secured Party placed all or any portion of the Collateral privately with a purchaser or purchasers.

Section 14. Costs and Expenses, Indemnity. The Pledgor will pay or reimburse the Secured Party on demand for all out-of-pocket expenses (including in each case all filing and recording fees and taxes and all reasonable fees and expenses of outside counsel to the Secured Party (determined on the basis of such counsel's generally applicable rates, which may be higher than the rates such counsel charges the Secured Party in certain matter), the allocated costs of in-house counsel incurred from time to time and of any experts and agents) incurred by the Secured Party or any Secured Party in connection with the creation, perfection, protection, satisfaction, foreclosure or enforcement of the Security Interest and the preparation, administration, continuance, amendment or enforcement of this Agreement and the Reimbursement Agreement, and all such costs and expenses shall be part of the Obligations secured by the Security Interest. The Pledgor shall indemnify and hold each Secured Party and the Secured Party harmless from and against any and all claims, losses and liabilities (including reasonable attorneys' fees) growing out of or resulting from this Agreement or the Reimbursement Agreement (including enforcement of this Agreement) or the Secured Party's actions pursuant hereto and thereto, except claims, losses or liabilities resulting from the Secured Party's gross negligence or willful misconduct as determined by a final judgment of a court of competent jurisdiction. Any liability of the Pledgor to indemnify and hold any Secured Party and the Secured Party harmless pursuant to the preceding sentence shall be part of the Obligations secured by the Security Interest. The obligations of the Pledgor under this Section shall survive any termination of this Agreement.

Section 15. Waivers and Amendments; Remedies. This Agreement can be waived, modified, amended, terminated or discharged, and the Security Interest can be released, only explicitly in a writing signed by the Secured Party. A waiver so signed shall be effective only in the specific instance and for the specific purpose given. Mere delay or failure to act shall not preclude the exercise or enforcement of any rights and remedies available to the Secured Party. All rights and remedies of the Secured Party shall be cumulative and may be exercised singly in any order or sequence, or concurrently, at the Secured Party's option, and the exercise or enforcement of any such right or remedy shall neither be a condition to nor bar the exercise or enforcement of any other.

Section 16. Notices. Any notice or other communication to any party in connection with this Agreement shall be in writing and shall be sent by manual delivery, telegram, telex, facsimile transmission, overnight courier or United States mail (postage prepaid) addressed to such party at the address specified on the signature page hereof, or at such other address as such party shall have specified to the other party hereto in writing. All periods of notice shall be measured from the date of delivery thereof if manually delivered, from the date of sending thereof if sent by telegram, telex or facsimile transmission, from the first business day after the date of sending if sent by overnight courier, or from four days after the date of mailing if mailed.

Section 17. Pledgor Acknowledgments. The Pledgor hereby acknowledges that (a) the Pledgor has been advised by counsel in the negotiation, execution and delivery of this Agreement, (b) the Secured Party has no fiduciary relationship to the Pledgor, the relationship being solely that of debtor and creditor, and (c) no joint venture exists between the Pledgor and the Secured Party.

Section 18. Continuing Security Interest; Assignments under Reimbursement Agreement. This Agreement shall create a continuing security interest in the Collateral and shall (a) remain in full force and effect until the payment in full of the Obligations and the expiration of the obligation, if any, of the Secured Party to extend credit accommodations to the Pledgor, (b) be binding upon the Pledgor, its successors and assigns, and (c) inure, together with the rights and remedies of the Secured Party hereunder, to the benefit of, and be enforceable by, the Secured Party and its successors, transferees and assigns. Without limiting the generality of the foregoing clause (c), the Secured Party may assign or otherwise transfer all or any portion of its rights and obligations under the Reimbursement Agreement to any other Person to the extent and in the manner provided in the Reimbursement Agreement, and may similarly transfer all or any portion of its rights under this Pledge Agreement to such Persons.

Section 19. Termination of Security Interest. Upon payment in full of the Obligations and the expiration of any obligation of the Secured Party to extend credit accommodations to the Pledgor, the security interest granted hereby shall terminate and all rights to the Collateral shall revert to the Pledgor. Upon any such termination, the Secured Party will return to the Pledgor such of the Collateral as shall not have been sold or otherwise applied pursuant to the terms hereof and execute and deliver to the Pledgor such documents as the Pledgor shall reasonably request to evidence such termination. Any reversion or return of the Collateral upon termination of this Agreement and any instruments of transfer or termination shall be at the expense of the Pledgor and shall be without warranty by, or recourse on, the Secured Party. As used in this Section, "Pledgor" includes any assigns of Pledgor, any Person holding a subordinate security interest in any part of the Collateral or whoever else may be lawfully entitled to any part of the Collateral.

Section 20. GOVERNING LAW AND CONSTRUCTION. THE VALIDITY, CONSTRUCTION AND ENFORCEABILITY OF THIS AGREEMENT SHALL BE GOVERNED BY THE LAWS OF THE STATE OF MINNESOTA; PROVIDED, HOWEVER, THAT NO EFFECT SHALL BE GIVEN TO CONFLICT OF LAWS PRINCIPLES OF THE STATE OF MINNESOTA, EXCEPT TO THE EXTENT THAT THE VALIDITY OR PERFECTION OF THE SECURITY INTEREST HEREUNDER, OR REMEDIES HEREUNDER, IN RESPECT OF ANY PARTICULAR COLLATERAL ARE MANDATORILY GOVERNED BY THE LAWS OF A JURISDICTION OTHER THAN THE STATE OF MINNESOTA. Whenever possible, each provision of this Agreement and any other statement, instrument or transaction contemplated hereby or relating hereto shall be interpreted in such manner as to be effective and valid under such applicable law, but, if any provision of this Agreement or any other statement, instrument or transaction contemplated hereby or relating hereto shall be held to be prohibited or invalid under such applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of

<PAGE>

this Agreement or any other statement, instrument or transaction contemplated hereby or relating hereto.

Section 21. CONSENT TO JURISDICTION. AT THE OPTION OF THE SECURED PARTY, THIS AGREEMENT MAY BE ENFORCED IN ANY FEDERAL COURT OR MINNESOTA STATE COURT SITTING IN HENNEPIN COUNTY OR RAMSEY COUNTY; AND THE PLEDGOR CONSENTS TO THE JURISDICTION AND VENUE OF ANY SUCH COURT AND WAIVES ANY ARGUMENT THAT VENUE IN SUCH FORUMS IS NOT CONVENIENT. IN THE EVENT THE PLEDGOR COMMENCES ANY ACTION IN ANOTHER JURISDICTION OR VENUE UNDER ANY TORT OR CONTRACT THEORY ARISING DIRECTLY OR INDIRECTLY FROM THE RELATIONSHIP CREATED BY THIS AGREEMENT, THE SECURED PARTY AT ITS OPTION SHALL BE ENTITLED TO HAVE THE CASE TRANSFERRED TO ONE OF THE JURISDICTIONS AND VENUES ABOVE-DESCRIBED, OR IF SUCH TRANSFER CANNOT BE ACCOMPLISHED UNDER APPLICABLE LAW, TO HAVE SUCH CASE DISMISSED WITHOUT PREJUDICE.

Section 22. WAIVER OF JURY TRIAL. EACH OF THE PLEDGOR AND THE SECURED PARTY, BY ITS ACCEPTANCE OF THIS AGREEMENT, IRREVOCABLY WAIVES ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 23. Counterparts. This Agreement may be executed in any number of counterparts, each of which when so executed and delivered shall be deemed an original, but all such counterparts together shall constitute but one and the same instrument.

Section 24. General. All representations and warranties contained in this Agreement or in any other agreement between the Pledgor and the Secured Party shall survive the execution, delivery and performance of this Agreement and the creation and payment of the Obligations. The Pledgor waives notice of the acceptance of this Agreement by the Secured Party. Captions in this Agreement are for reference and convenience only and shall not affect the interpretation or meaning of any provision of this Agreement.

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IN WITNESS WHEREOF, the Pledgor has caused this Pledge Agreement to be duly executed and delivered by its officer thereunto duly authorized as of the date first above written.

PLEDGOR:

RTW, INC.

By /s/ Alfred L. LaTendresse

Title Executive Vice President
and Chief Financial Officer

Address for Pledgor:
8500 Normandale Lake Blvd.
Bloomington, MN 55437
Fax Number: (612)893-3700

Address for Secured Party:
U.S. Bank National Association
800 Nicollet Mall
Minneapolis, Minnesota 55402
Attn: Christine Geer

[Signature Page to Pledge Agreement]

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SCHEDULE I

PLEDGED STOCK

Stock Issuer:	American Compensation Insurance Company
Percentage Ownership:	100%
Class of Stock:	Common
Certificate No(s) .:	1 and 3
Number of Shares:	1,000,000

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[US BANK LOGO]
Five Star Service Guaranteed

U.S. Bank National Association
Stand by Letters of Credit
800 Nicollet Mail, BC-MN-H20G
Minneapolis, Minnesota 55402-4302

SWIFT: USBKUS44
TELEX: 192179 USB INTL MPS
Phone: 612-303-7396
612-303-7395
Fax: 812-303-5226

AUGUST 5, 2004

LETTER OF CREDIT NUMBER: SLCMMSP03189

AMENDMENT NUMBER: 1

APPLICANT: RTW, INC.
8500 NORMANDALE LAKE BOULEVARD, SUITE 1400
BLOOMINGTON, MINNESOTA 55437

BENEFICIARY: HARTFORD FIRE INSURANCE COMPANY ("BENEFICIARY")
HARTFORD PLAZA
HARTFORD, CT 06115

THE ABOVE MENTIONED CREDIT IS AMENDED AS FOLLOWS:

PRESENT AVAILABLE BALANCE DECREASED BY \$2,025,000.00 TO A NEW TOTAL OF
\$2,025,000.00.

THIS CREDIT IS SUBJECT TO THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY
CREDITS PUBLISHED BY THE INTERNATIONAL CHAMBER OF COMMERCE, OR ANY SUBSEQUENT
REVISION THERETO.

THIS AMENDMENT IS TO BE CONSIDERED AS PART OF THE ABOVE CREDIT AND MUST BE
ATTACHED THERETO.

ALL OTHER TERMS AND CONDITIONS REMAIN UNCHANGED.

U.S. BANK NATIONAL ASSOCIATION

/s/ Marnie M. Mastrian

AUTHORIZED SIGNATURE

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<FILENAME> c87593exv10w4.txt

<DESCRIPTION> First Amendment to Pledge Agreement dated July 30, 2004 by RTW, Inc. in favor of

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FIRST AMENDMENT TO PLEDGE AGREEMENT

This FIRST AMENDMENT TO PLEDGE AGREEMENT (this "Amendment"), made and entered into as of August 13, 2004, but is effective retroactively to July 30, 2004, is by and between RTW, Inc., a Minnesota corporation (the "Pledgor"), and U.S. Bank National Association, a national banking association (the "Secured Party").

RECITALS

1. The Secured Party and the Pledgor entered into a Pledge Agreement dated as of July 30, 2004 (the "Pledge Agreement"); and

2. The Pledgor desires to amend certain provisions of the Pledge Agreement, and the Secured Party has agreed to make such amendments, subject to the terms and conditions set forth in this Amendment.

AGREEMENT

NOW, THEREFORE, for good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto hereby covenant and agree to be bound as follows:

SECTION 1. CAPITALIZED TERMS. Capitalized terms used herein and not otherwise defined herein shall have the meanings assigned to them in the Pledge Agreement, unless the context shall otherwise require.

SECTION 2. AMENDMENTS. The Pledge Agreement is hereby amended as follows:

2.1 RECITALS. Recital A to the Pledge Agreement is deleted in its entirety and the following is substituted in lieu thereof:

A. The Pledgor and the Secured Party entered into a Letter of Credit Reimbursement Agreement (the "Reimbursement Agreement") dated concurrently herewith under which the Secured Party may from time to time issue letters of credit for the account of the Pledgor.

SECTION 3. EFFECTIVENESS OF AMENDMENTS. The amendments contained in this Amendment shall become effective upon delivery by the Pledgor of, and compliance by the Pledgor with, the following:

SECTION 4. REPRESENTATIONS, WARRANTIES, AUTHORITY, NO ADVERSE CLAIM. The Pledgor hereby represents that on and as of the date hereof and after giving effect to this

Amendment all of the representations and warranties contained in the Pledge Agreement are true, correct and complete in all respects as of the date hereof as though made on and as of such date, except for changes permitted by the terms of the Pledge Agreement.

SECTION 5. AFFIRMATION OF PLEDGE AGREEMENT, FURTHER REFERENCES, AFFIRMATION OF SECURITY INTEREST. The Secured Party and the Pledgor each acknowledge and affirm that the Pledge Agreement, as hereby amended, is hereby ratified and confirmed in all respects and all terms, conditions and provisions of the Pledge Agreement, except as amended by this Amendment, shall remain unmodified and in full force and effect. All references in any document or instrument to the Pledge Agreement are hereby amended and shall refer to the Pledge Agreement as amended by this Amendment.

SECTION 6. COUNTERPARTS. The Amendment Documents may be executed in several counterparts as deemed necessary or convenient, each of which, when so executed, shall be deemed an original, provided that all such counterparts shall be regarded as one and the same document, and either party to the Amendment Documents may execute any such agreement by executing a counterpart of such agreement.

SECTION 7. GOVERNING LAW. THE AMENDMENT DOCUMENTS SHALL BE GOVERNED BY THE INTERNAL LAWS OF THE STATE OF MINNESOTA, WITHOUT GIVING EFFECT TO CONFLICT OF LAW PRINCIPLES THEREOF, BUT GIVING EFFECT TO FEDERAL LAWS APPLICABLE TO NATIONAL BANKS, THEIR HOLDING COMPANIES AND THEIR AFFILIATES.

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IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be executed as of the date and year first above written.

PLEDGOR:

RTW, INC.

By: /s/ Alfred L. LaTendresse

Title: Executive Vice President
and Chief Financial Officer

SECURED PARTY:

U.S. BANK NATIONAL ASSOCIATION

By: /s/ Christine J. Geer

Title: Corporate Banking Officer

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RTW, INC. AND SUBSIDIARY
STATEMENT REGARDING COMPUTATION OF BASIC AND DILUTED NET INCOME PER SHARE

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	FOR THE THREE MONTHS ENDED:		YEAR-TO-DATE
	MARCH 31, 2004	JUNE 30, 2004	JUNE 30, 2004
<S>	<C>	<C>	<C>
BASIC WEIGHTED AVERAGE SHARES OUTSTANDING	5,127,837	5,236,480	5,182,159
STOCK OPTIONS			
Options at \$ 9.50	-	-	-
Options at \$ 8.75	-	-	-
Options at \$ 6.18	26	710	368
Options at \$ 6.00	701	7,507	4,104
Options at \$ 5.33	262	334	298
Options at \$ 4.50	1,234	1,378	1,306
Options at \$ 3.80	9,677	10,355	10,016
Options at \$ 3.13	6,190	6,469	6,330
Options at \$ 2.60	9,581	9,887	9,734
Options at \$ 2.42	36,846	1,448	19,147
Options at \$ 2.20	12,903	13,217	13,060
Options at \$ 2.19	91,036	71,931	81,484
Options at \$ 2.00	1,694	209	952
Options at \$ 1.98	112,602	111,682	112,141
DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	5,410,589	5,471,607	5,441,099
NET INCOME (\$000'S)	\$ 930	\$ 943	\$ 1,873
NET INCOME PER SHARE:			
BASIC INCOME PER SHARE	\$ 0.18	\$ 0.18	\$ 0.36
DILUTED INCOME PER SHARE	\$ 0.17	\$ 0.17	\$ 0.34

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CERTIFICATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER

I, Jeffrey B. Murphy, President and Chief Executive Officer, certify that:

1. I have reviewed this Form 10-Q of RTW, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 13, 2004

By /s/ Jeffrey B. Murphy

Jeffrey B. Murphy
President and Chief Executive Officer
(Principal Executive Officer)

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CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Alfred L. LaTendresse, Chief Financial Officer, certify that:

1. I have reviewed this Form 10-Q of RTW, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 13, 2004

By /s/ Alfred L. LaTendresse

Alfred L. LaTendresse
Chief Financial Officer
(Principal Financial and Accounting Officer)

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<TYPE> EX-32
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CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned certify pursuant to 18 U.S.C. Section 1350, that:

1. The accompanying Quarterly Report on Form 10-Q for the period ended June 30, 2004, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the accompanying Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

RTW, INC.

Dated: August 13, 2004

By /s/ Jeffrey B. Murphy

Jeffrey B. Murphy
President and Chief Executive Officer
(Principal Executive Officer)

Dated: August 13, 2004

By /s/ Alfred L. LaTendresse

Alfred L. LaTendresse
Secretary, Treasurer and Chief Financial Officer
(Principal Financial and Accounting Officer)

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