

Enstar Group LTD
Form 10-K
March 07, 2011

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K
FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

- þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2010**
- or**
- o 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 001-33289
ENSTAR GROUP LIMITED**
(Exact name of registrant as specified in its charter)

BERMUDA
*(State or other jurisdiction of
incorporation or organization)*

N/A
*(I.R.S. Employer
Identification No.)*

**P.O. Box HM 2267
Windsor Place, 3rd Floor, 18 Queen Street
Hamilton HM JX
Bermuda**
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (441) 292-3645

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

Title of Each Class	Name of Each Exchange on Which Registered
Ordinary shares, par value \$1.00 per share	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the closing price as of the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2010, was approximately \$455,419,690.

As of March 1, 2011, the registrant had outstanding 13,073,210 ordinary shares, \$1.00 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A relating to its 2011 annual general meeting of shareholders are incorporated by reference in Part III of this Form 10-K.

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PART I

ITEM 1. BUSINESS

Company Overview

Enstar Group Limited, or Enstar, was formed in August 2001 under the laws of Bermuda to acquire and manage insurance and reinsurance companies in run-off and portfolios of insurance and reinsurance business in run-off, and to provide management, consulting and other services to the insurance and reinsurance industry. Since our formation, we have acquired 30 insurance and reinsurance companies and 15 portfolios of insurance and reinsurance business and are now administering those businesses in run-off. Insurance and reinsurance companies and portfolios of insurance and reinsurance business we acquire that are in run-off no longer underwrite new policies. We derive our net earnings from the ownership and management of these companies and portfolios of business in run-off primarily by settling insurance and reinsurance claims below the acquired value of loss reserves and from returns on the portfolio of investments retained to pay future claims. In addition, we provide management and consultancy services, claims inspection services and reinsurance collection services to our affiliates and third-party clients for both fixed and success-based fees.

Our primary corporate objective is to grow our net book value per share. We believe growth in our net book value is driven primarily by growth in our net earnings, which is in turn partially driven by successfully completing new acquisitions.

We evaluate each acquisition opportunity presented by carefully reviewing the portfolio's risk exposures, claim practices, reserve requirements and outstanding claims, and may seek an appropriate discount and/or seller indemnification to reflect the uncertainty contained in the portfolio's reserves. Based on this initial analysis, we can determine if a company or portfolio of business would add value to our current portfolio of run-off business. If we determine to pursue the purchase of a company in run-off, we then proceed to price the acquisition in a manner we believe will result in positive operating results based on certain assumptions including, without limitation, our ability to favorably resolve claims, negotiate with direct insureds and reinsurers, and otherwise manage the nature of the risks posed by the business.

Initially, at the time we acquire a company in run-off, we estimate the fair value of liabilities acquired based on external actuarial advice, as well as our own views of the exposures assumed. While we earn a larger share of our total return on an acquisition from commuting the liabilities that we have assumed, we also try to maximize reinsurance recoveries on the assumed portfolio.

In the primary (or direct) insurance business, the insurer assumes risk of loss from persons or organizations that are directly subject to the given risks. Such risks may relate to property, casualty, life, accident, health, financial or other perils that may arise from an insurable event. In the reinsurance business, the reinsurer agrees to indemnify an insurance or reinsurance company, referred to as the ceding company, against all or a portion of the insurance risks arising under the policies the ceding company has written or reinsured. When an insurer or reinsurer stops writing new insurance business, either entirely or with respect to a particular line of business, the insurer, reinsurer, or the line of discontinued business is in run-off.

In recent years, the insurance industry has experienced significant consolidation. As a result of this consolidation and other factors, the remaining participants in the industry often have portfolios of business that are either inconsistent with their core competency or provide excessive exposure to a particular risk or segment of the market (i.e.

property/casualty, asbestos, environmental, director and officer liability, etc.). These non-core and/or discontinued portfolios are often associated with potentially large exposures and lengthy time periods before resolution of the last remaining insured claims resulting in significant uncertainty to the insurer or reinsurer covering those risks. These factors can distract management, drive up the cost of capital and surplus for the insurer or reinsurer, and negatively impact the insurer's or reinsurer's credit rating, which makes the disposal of the unwanted company or portfolio an attractive option. Alternatively, the insurer may wish to maintain the business on its balance sheet, yet not divert significant management attention to the run-off of the portfolio. The insurer or reinsurer, in either case, is likely to engage a third party, such as us, that specializes in run-off management to purchase the company or portfolio, or to manage the company or portfolio in run-off.

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In the sale of a run-off company, a purchaser, such as us, may pay a discount to the book value of the company based on the risks assumed and the relative value to the seller of no longer having to manage the company in run-off. Such a transaction can be beneficial to the seller because it receives an up-front payment for the company, eliminates the need for its management to devote any attention to the disposed company and removes the risk that the established reserves related to the run-off business may prove to be inadequate. The seller is also able to redeploy its management and financial resources to its core businesses.

In some situations an insurer or reinsurer may wish to divest itself of a portfolio of non-core legacy business that may have been underwritten alongside other ongoing core business that the insurer or reinsurer does not want to dispose of and so cannot sell the non-core business. In such instances we are able to provide economic finality for the insurer or reinsurer by providing a retroactive loss portfolio reinsurance contract to protect the insurer or reinsurer against deterioration of the subject portfolio of loss reserves. During 2010, we entered into eight loss portfolio reinsurance contracts.

We have entered into ten Reinsurance to Close, or RITC transactions, with Lloyd's of London insurance and reinsurance syndicates in run-off, whereby the portfolio of run-off liabilities is transferred from one Lloyd's syndicate to another.

Alternatively, if the insurer or reinsurer hires a third party, such as us, to manage its run-off business, the insurer or reinsurer will, unlike in a sale of the business, receive little or no cash up front. Instead, the management arrangement may provide that the insurer or reinsurer will retain the profits, if any, derived from the run-off with certain incentive payments allocated to the run-off manager. By hiring a run-off manager, the insurer or reinsurer can outsource the management of the run-off business to experienced and capable individuals, while allowing its own management team to focus on the insurer's or reinsurer's core businesses. Our desired approach to managing run-off business is to align our interests with the interests of the owners through both fixed management fees and certain incentive payments. Under certain management arrangements to which we are a party, however, we receive only a fixed management fee and do not receive any incentive payments.

Following the purchase of a run-off company, or acquisition of a portfolio of business in run-off, or the engagement to manage a run-off company or portfolio of business, it is incumbent on the new owner or manager to conduct the run-off in a disciplined and professional manner in order to efficiently discharge the liabilities associated with the business while preserving and maximizing its assets. Our approach to managing our acquired companies in run-off, as well as run-off companies or portfolios of businesses on behalf of third-party clients, includes negotiating with third-party insureds and reinsureds to commute their insurance or reinsurance agreement (sometimes called policy buy-backs) for an agreed upon up-front payment by us, or the third-party client, and to more efficiently manage payment of insurance and reinsurance claims. We attempt to commute policies with direct insureds or reinsureds in order to eliminate uncertainty over the amount of future claims. Commutations and policy buy-backs provide an opportunity for the company to exit exposures to certain policies and insureds generally at a discount to the ultimate liability and provide the ability to eliminate exposure to further losses. Such a strategy also contributes to the reduction in the length of time and future cost of the run-off.

Following the acquisition of a company in run-off, or acquisition of a portfolio of business in run-off, or new consulting engagement, we will spend time analyzing the acquired exposures and reinsurance receivables on a policyholder-by-policyholder basis. This analysis enables us to identify those policyholders and reinsurers we wish to approach to discuss commutation or policy buy-back. Furthermore, following the acquisition of a company or portfolio of business in run-off, or new consulting engagement, we will often be approached by policyholders or reinsurers requesting commutation or policy buy-back. In these instances we will also carry out a full analysis of the underlying exposures in order to determine the viability of a proposed commutation or policy buy-back. From the initial analysis of the underlying exposures it may take several months, or even years, before a commutation or policy

buy-back is completed. In a number of cases, if we and the policyholder or reinsurer are unable to reach a commercially acceptable settlement, the commutation or policy buy-back may not be achievable, in which case we will continue to settle valid claims from the policyholder, or collect reinsurance receivables from the reinsurer, as they become due.

Insureds and reinsureds are often willing to commute with us, subject to receiving an acceptable settlement, as this provides certainty of recovery of what otherwise may be claims that are disputed in the future, and often

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provides a meaningful up-front cash receipt that, with the associated investment income, can provide funds to meet future claim payments or even commutation of their underlying exposure. Therefore, subject to negotiating an acceptable settlement, all of our insurance and reinsurance liabilities and reinsurance receivables are able to be either commuted or settled by way of policy buy-back over time. Many sellers of companies that we acquire have secure claims paying ratings and ongoing underwriting relationships with insureds and reinsureds, which often hinders their ability to commute the underlying insurance or reinsurance policies. Our lack of claims paying rating and our lack of potential conflicts with insureds and reinsureds of companies we acquire provides a greater ability to commute the newly acquired policies than that of the sellers.

We also attempt, where appropriate, to negotiate favorable commutations with reinsurers by securing the receipt of a lump-sum settlement from the reinsurer in complete satisfaction of the reinsurer's liability in respect of any future claims. We, or the third-party client, are then fully responsible for any claims in the future. We typically invest proceeds from reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

Strategy

We aim to maximize our growth in net book value per share by using the following strategies:

Solidify Our Leadership Position in the Run-Off Market by Leveraging Management's Experience and Relationships. We continue to utilize the extensive experience and significant relationships of our senior management team to solidify our position as a leader in the run-off segment of the insurance and reinsurance market. The experience and reputation of our management team is expected to generate opportunities for us to acquire or manage companies and portfolios in run-off, and to price effectively the acquisition or management of such businesses. Most importantly, we believe the experience of our management team will continue to allow us to manage the run-off of such businesses efficiently and profitably.

Professionally Manage Claims. We are professional and disciplined in managing claims against companies and portfolios we own or manage. Our management understands the need to dispose of certain risks expeditiously and cost-effectively by constantly analyzing changes in the market and efficiently settling claims with the assistance of our experienced claims adjusters and in-house and external legal counsel. When we acquire or begin managing a company or portfolio, we initially determine which claims are valid through the use of experienced in-house adjusters and claims experts. We pay valid claims on a timely basis, while relying on well-documented policy terms and exclusions where applicable and litigation when necessary to defend against paying invalid claims under existing policies and reinsurance agreements.

Commute Assumed Liabilities and Ceded Reinsurance Assets. Using detailed analysis and actuarial projections, we negotiate with the policyholders of the insurance and reinsurance companies or portfolios we own or manage with a goal of commuting insurance and reinsurance liabilities for one or more agreed upon payments at a discount to the ultimate liability. Such commutations can take the form of policy buy-backs and structured settlements over fixed periods of time. By acquiring companies that are direct insurers, reinsurers or both, we are able to negotiate favorable entity-wide commutations with reinsurers that would not be possible if our subsidiaries had remained independent entities. We also negotiate with reinsurers to commute their reinsurance agreements providing coverage to our subsidiaries on terms that we believe to be favorable based on then-current market knowledge. We invest the proceeds from reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

Continue to Commit to Highly Disciplined Acquisition, Management and Reinsurance Practices. We utilize a disciplined approach to minimize risk and increase the probability of positive operating results from companies and portfolios we acquire or manage. We carefully review acquisition candidates and management engagements for consistency with accomplishing our long-term objective of producing positive operating results. We focus our investigation on risk exposures, claims practices and reserve requirements. In particular, we carefully review all outstanding claims and case reserves, and follow a highly disciplined

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approach to managing allocated loss adjustment expenses, such as the cost of defense counsel, expert witnesses and related fees and expenses.

Prudent Management of Investments and Capital. We strive to structure our investments in a manner that recognizes our liquidity needs for future liabilities. In that regard, we attempt to correlate the maturity and duration of our investment portfolio to our general liability profile. If our liquidity needs or general liability profile unexpectedly change, we may not continue to structure our investment portfolio in its current manner and would adjust as necessary to meet new business needs. We pursue prudent capital management relative to our risk exposure and liquidity requirements to maximize profitability and long-term growth in shareholder value. Our capital management strategy is to deploy capital efficiently to acquisitions and to establish, and re-establish when necessary, adequate loss reserves to protect against future adverse developments.

Recent Transactions

Claremont

On December 31, 2010, we, through our wholly-owned subsidiary, CLIC Holdings, Inc., completed the acquisition of Claremont Liability Insurance Company, or Claremont, for an aggregate purchase price of \$13.9 million. Claremont is a California-domiciled insurer that is in run-off. The acquisition was funded from available cash on hand.

CIGNA Reinsurance

On December 31, 2010, we, through our wholly-owned subsidiary, Fitzwilliam Insurance Limited, or Fitzwilliam, entered into a 100% reinsurance agreement, administrative services agreement, and related transaction documents with three affiliates of CIGNA Corporation, or CIGNA affiliates, pursuant to which Fitzwilliam reinsured all of the run-off workers compensation and personal accident reinsurance business of those CIGNA affiliates. Pursuant to the transaction documents, the CIGNA affiliates have transferred assets into three reinsurance collateral trusts securing the obligations of Fitzwilliam under the reinsurance agreement and administrative services agreement. Fitzwilliam received total assets and assumed total net reinsurance reserves of approximately \$190.5 million. Fitzwilliam transferred approximately \$50 million of additional funds to the trusts to further support these obligations. We funded the contribution to the trusts through a draw on a new \$115 million credit facility entered into with Barclays Bank PLC on December 29, 2010.

In addition to the trusts, we have provided a limited parental guarantee supporting certain obligations of Fitzwilliam in the amount of \$79.7 million. The amount of the guarantee will increase or decrease over time under certain circumstances, but will always be subject to an overall maximum cap with respect to reinsurance liabilities.

Clarendon

On December 22, 2010, we, through our wholly-owned subsidiary, Clarendon Holdings, Inc., entered into a definitive agreement for the purchase of Clarendon National Insurance Company, or Clarendon, from Clarendon Insurance Group, Inc., an affiliate of Hannover Re. Clarendon is a New Jersey-domiciled insurer that is in run-off. The purchase price is approximately \$200 million and will be financed in part by a bank loan facility provided by a London-based bank entered into on March 4, 2011 and in part from available cash on hand. Completion of the transaction is conditioned on, among other things, regulatory approval and satisfaction of various customary closing conditions. The transaction is expected to close in the second quarter of 2011.

Inter-Hannover Reinsurance

On December 3, 2010, we, through our wholly-owned subsidiary, Fitzwilliam, entered into a 100% quota share reinsurance agreement with International Insurance Company of Hannover, or IICH, with respect to a specific portfolio of run-off business. Fitzwilliam received total assets and assumed total net reinsurance reserves of approximately \$137.1 million. In addition, we provided a parental guarantee supporting the IICH obligations of Fitzwilliam in the amount of approximately £76.0 million (approximately \$118.7 million). The amount of the guarantee will decrease over time in line with relevant independent actuarial assessments.

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New Castle

On December 3, 2010, we, through our wholly-owned subsidiary, Kenmare Holdings Ltd., or Kenmare, completed the acquisition of New Castle Reinsurance Company Ltd., or New Castle, for an aggregate purchase price of \$22.0 million. New Castle is a Bermuda-domiciled insurer that is in run-off. The acquisition was funded from available cash on hand.

CitiLife

On November 8, 2010, we, through our wholly-owned subsidiary, Kenmare, entered into a definitive agreement for the purchase of CitiLife Financial Limited from Citigroup Insurance Holding Corporation, an affiliate of Citigroup Inc. CitiLife Financial Limited is a Dublin, Ireland-based life insurer that is in run-off. The purchase price is 30 million (approximately \$40.2 million) and is expected to be financed from available cash on hand. Completion of the transaction is conditioned on, among other things, regulatory approval and satisfaction of various customary closing conditions. The transaction is expected to close in the first quarter of 2011.

Brampton (formerly Aioi Europe)

In March 2006, we and Shinsei Bank, Ltd., or Shinsei, through Hillcot Holdings Ltd., or Hillcot, completed the acquisition of Brampton Insurance Company of Europe Limited, or Brampton, a London-based subsidiary of Aioi Insurance Company Limited. Brampton underwrote general insurance and reinsurance business in Europe for its own account from 1982 until 2002 when it generally ceased underwriting and placed its general insurance and reinsurance business into run-off. The aggregate purchase price paid for Brampton was £62.0 million (approximately \$108.9 million), with £50.0 million in cash paid upon the closing of the transaction and £12.0 million in the form of a promissory note, payable twelve months from the date of the closing. In April 2006, Hillcot borrowed approximately \$44.0 million from a London-based bank to partially assist with the financing of the Brampton acquisition. Following a repurchase by Brampton of its shares valued at £40.0 million in May 2006, Hillcot repaid the promissory note and reduced the bank borrowing to \$19.2 million, which was repaid in May 2008.

On November 2, 2010, we acquired the 49.9% of the shares of Hillcot from Shinsei that we did not previously own for a purchase price of \$38.0 million, resulting in us owning 100% of Hillcot. At the time of acquisition, Hillcot owned 100% of the shares of Brampton. The fair value of the assets acquired that we did not previously own was \$34.9 million. The excess of the purchase price over the fair value of assets acquired in the amount of \$3.1 million was recorded as a charge to additional paid-in capital in accordance with the applicable guidance of accounting principles generally accepted in the United States of America, or U.S. GAAP. J. Christopher Flowers, a member of our board of directors and one of our largest shareholders, is a director and the largest shareholder of Shinsei.

Sale of Interest in Stonewall and Acquisition of Seaton

On June 13, 2008, our indirect subsidiary, Virginia Holdings Ltd., or Virginia, completed the acquisition from Dukes Place Holdings, L.P. (a portfolio company of GSC European Mezzanine Fund II, L.P.) of 44.4% of the outstanding capital stock of Stonewall Acquisition Corporation, or SAC, which at that time was the parent of two Rhode Island-domiciled insurers in run-off, Stonewall Insurance Company and Seaton Insurance Company, or Seaton. The total purchase price, including acquisition costs, was \$21.4 million and was funded from available cash on hand. SAC entered into a definitive agreement on December 3, 2009 for the sale of its shares in Stonewall Insurance Company to Columbia Insurance Company, an affiliate of National Indemnity Company (an indirect subsidiary of Berkshire Hathaway, Inc.), for a sale price of \$56.0 million, subject to certain post-closing purchase price adjustments that brought the total consideration received to \$60.4 million. The transaction received the required regulatory approval on March 31, 2010 and subsequently closed on April 7, 2010. The proceeds received by SAC and certain other assets

were distributed between Dukes Place Holdings, L.P. and Virginia. The proceeds received by Virginia included the shares of Seaton distributed on August 3, 2010, resulting in Virginia owning 100% of Seaton following the distribution (prior to the distribution, Virginia had indirectly owned 44.4% of Seaton through its holdings in SAC).

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Providence Washington

On July 20, 2010, we, through our wholly-owned subsidiary PWAC Holdings, Inc., completed the acquisition of PW Acquisition Company, or PWAC, for a purchase price of \$25.0 million. PWAC owns the entire share capital of Providence Washington Insurance Company. Providence Washington Insurance Company and its two subsidiaries are Rhode Island-domiciled insurers that are in run-off. The purchase price was financed by a term facility provided by a London-based bank, or the EGL Facility, which was fully repaid in September 2010.

Torus Reinsurance

In July 2010, following the acquisition of the entire issued share capital of Glacier Insurance AG by Torus Insurance (Bermuda) Limited, or Torus, Fitzwilliam entered into two quota share reinsurance agreements with Torus protecting the prior year reserve development of two portfolios of business reinsured by them: a 79% quota share of Torus 95% quota share reinsurance of Glacier Insurance AG, and a 75% quota share of Torus 100% quota share reinsurance of Glacier Reinsurance AG. Fitzwilliam received total assets and assumed total gross reinsurance reserves of approximately \$105.0 million.

Bosworth

In May 2010, a specific portfolio of business in run-off underwritten by Mitsui Sumitomo Insurance Co., Ltd. of Japan, or Mitsui, was transferred to our 50.1% owned subsidiary, Bosworth Run-off Limited, or Bosworth. This transfer, which occurred under Part VII of the U.K. Financial Services and Markets Act 2000, was approved by the U.K. Court and took effect on May 31, 2010. As a result of the transfer, Bosworth received total assets and assumed net reinsurance reserves of approximately \$117.5 million. Shinsei owns the remaining 49.9% of Bosworth.

Assuransinvest

On March 30, 2010, we, through our wholly-owned subsidiary, Nordic Run-Off Limited, completed the acquisition of Forsakringsaktiebolaget Assuransinvest MF, or Assuransinvest, for a purchase price of SEK 78.8 million (approximately \$11.0 million). Assuransinvest is a Swedish-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

Knapton Insurance (formerly British Engine)

On March 2, 2010, we, through our wholly-owned subsidiary, Knapton Holdings Limited, or Knapton Holdings, completed the acquisition of Knapton Insurance Limited, formerly British Engine Insurance Limited, or Knapton, from RSA Insurance Group plc for a total purchase price of £28.8 million (approximately \$44.0 million). Knapton is a U.K.-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

In April 2010, Knapton Holdings entered into a term facility agreement with a London-based bank, or the Knapton Facility. On April 20, 2010, Knapton Holdings drew down \$21.4 million from the Knapton Facility.

Allianz Reinsurance

In February 2010, we, through our wholly-owned subsidiary, Fitzwilliam, entered into a 100% quota share reinsurance agreement with Allianz Global Corporate & Specialty AG (UK) Branch, or Allianz, with respect to a specific portfolio of run-off business of Allianz. Fitzwilliam received total assets and assumed total gross reinsurance reserves of approximately \$112.6 million.

Shelbourne RITC Transactions

In December 2007, we, in conjunction with JCF FPK I L.P., or JCF FPK, and a newly-hired executive management team, formed U.K.-based Shelbourne Group Limited, or Shelbourne, to invest in RITC transactions (the transferring of liabilities from one Lloyd's syndicate to another) with Lloyd's of London insurance and reinsurance syndicates in run-off. We own approximately 56.8% of Shelbourne, which in turn owns 100% of Shelbourne Syndicate Services Limited, the Managing Agency for Lloyd's Syndicate 2008, a syndicate approved by Lloyd's of London on December 16, 2007 to undertake RITC transactions with Lloyd's syndicates in run-off.

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JCF FPK is a joint investment program between J.C. Flowers II L.P., or the Flowers Fund, and Fox-Pitt Kelton Cochran Caronia & Waller (USA) LLC, or FPK. The Flowers Fund is a private investment fund advised by J.C. Flowers & Co. LLC. J. Christopher Flowers, a member of our board of directors and one of our largest shareholders, is the Chairman and Chief Executive Officer of J.C. Flowers & Co. LLC. John J. Oros, who served as our Executive Chairman and a member of our board of directors until his resignation on August 20, 2010, is a Managing Director of J.C. Flowers & Co. LLC. In addition, an affiliate of the Flowers Fund controlled approximately 41% of FPK until its sale of FPK in December 2009.

Lloyd's Syndicate 2008 has, to date, entered into ten RITC agreements with Lloyd's syndicates, inclusive of two agreements entered into in February 2011. In February 2008, Lloyd's Syndicate 2008 entered into RITC agreements with four Lloyd's syndicates with total gross insurance reserves of approximately \$471.2 million. In February 2009, Lloyd's Syndicate 2008 entered into a RITC agreement with a Lloyd's syndicate with total gross insurance reserves of approximately \$67.0 million. During 2010, Lloyd's Syndicate 2008 entered into RITC agreements with three Lloyd's syndicates with total gross insurance reserves of approximately \$192.6 million. In February 2011, Lloyd's Syndicate 2008 entered into RITC agreements with two Lloyd's syndicates with total gross insurance reserves of approximately \$129.6 million.

The capital commitment to Lloyd's Syndicate 2008, at February 28, 2011, amounted to £80.1 million (approximately \$125.1 million) and was financed by approximately £47.4 million (approximately \$74.0 million) from available cash on hand; £19.0 million (approximately \$29.7 million) from a letter of credit issued by a London-based bank that has been secured by a parental guarantee from us; approximately £5.2 million (approximately \$8.1 million) from the Flowers Fund (acting in its own capacity and not through JCF FPK) by way of non-voting equity participation; and approximately £8.5 million (approximately \$13.3 million) from JCF FPK.

Copenhagen Re

On October 15, 2009, we, through our wholly-owned subsidiary, Marlon Insurance Company Limited, completed the acquisition of Copenhagen Reinsurance Company Ltd., or Copenhagen Re, from Alm. Brand Forsikring A/S for a total purchase price, including acquisition costs, of DKK149.2 million (approximately \$29.9 million). Copenhagen Re is a Danish-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

Constellation

On January 31, 2009, we, through our indirect subsidiary, Sun Gulf Holdings Inc., completed the acquisition of all of the outstanding capital stock of Constellation Reinsurance Company Limited, or Constellation, for a total purchase price of approximately \$2.5 million. Constellation is a New York-domiciled reinsurer that is in run-off. The acquisition was funded from available cash on hand.

Unionamerica

On December 30, 2008, our indirect subsidiary Royston Run-Off Limited, or Royston, completed the acquisition of all of the outstanding capital stock of Unionamerica Holdings Limited, or Unionamerica, from St. Paul Fire and Marine Insurance Company, an affiliate of The Travelers Companies, Inc., or Travelers. Unionamerica is comprised of the discontinued operations of Travelers' U.K.-based London Market business, which were placed into run-off between 1992 and 2003. The total purchase price, including acquisition costs, of \$343.4 million was financed by approximately \$184.6 million from a credit facility provided by a London-based bank; approximately \$49.8 million from the Flowers Fund by way of its non-voting equity interest in Royston Holdings Ltd., the direct parent company of Royston; and the remainder from available cash on hand. In December 2010, approximately \$114.0 million of the credit facility was repaid and, on March 3, 2011, another \$40.5 million of the credit facility was repaid.

Hillcot Re

On October 27, 2008, our wholly-owned subsidiary Kenmare, purchased the entire issued share capital of Hillcot Re Ltd., or Hillcot Re, the wholly-owned subsidiary of Hillcot for a total purchase price, including acquisition costs, of \$54.7 million. Prior to the completion of the transaction, we owned 50.1% of the outstanding share capital of Hillcot

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and Shinsei owned the remaining 49.9%. Upon completion of the transaction, Hillcot paid a distribution to Shinsei of approximately \$27.1 million representing its 49.9% share of the consideration. The total purchase price of \$54.7 million was funded from available cash on hand. Hillcot Re is a U.K.-based reinsurer that is in run-off.

Capital Assurance

On August 18, 2008, we completed the acquisition of all of the outstanding capital stock of Capital Assurance Company Inc. and Capital Assurance Services, Inc. for a total purchase price, including acquisition costs, of approximately \$5.6 million. Capital Assurance Company, Inc. is a Florida-domiciled insurer that is in run-off. The acquisition was funded from available cash on hand.

EPIC

On August 14, 2008, we completed the acquisition of all of the outstanding capital stock of Electricity Producers Insurance Company (Bermuda) Limited, or EPIC, from its parent British Nuclear Fuels plc. The total purchase price, including acquisition costs, of £36.8 million (approximately \$69.0 million) was financed by approximately \$32.8 million from a credit facility provided by a London-based bank; approximately \$10.2 million from the Flowers Fund by way of non-voting equity participation; and the remainder from available cash on hand. In October 2008, we fully repaid the outstanding principal and accrued interest on the credit facility.

Goshawk

On June 20, 2008 we, through our wholly-owned subsidiary Enstar Acquisitions Limited, or EAL, announced a cash offer to all of the shareholders of Goshawk Insurance Holdings Plc, or Goshawk, at 5.2 pence (approximately \$0.103) for each share, or the Offer, conditioned on, among other things, receiving acceptance from shareholders owning 90% of the shares of Goshawk. Goshawk owns Rosemont Reinsurance Limited, a Bermuda-based reinsurer that wrote primarily property and marine business, which was placed into run-off in October 2005. The Offer valued Goshawk at approximately £45.7 million in the aggregate.

On July 17, 2008, after acquiring more than 30% of the shares of Goshawk through market purchases, EAL was obligated to remove all of the conditions of the Offer except for the receipt of acceptances from shareholders owning 50% of the shares of Goshawk. On July 25, 2008, the acceptance condition was met and the Offer became unconditional. On August 19, 2008, the Offer closed with shareholders representing approximately 89.44% of Goshawk accepting the Offer for total consideration of £40.9 million (approximately \$80.9 million).

The total purchase price, including acquisition costs, of approximately \$82.0 million was financed by a drawdown of \$36.1 million from a credit facility provided by a London-based bank, a contribution of \$11.7 million of the acquisition price from the Flowers Fund, by way of non-voting equity participation, and the remainder from available cash on hand.

In connection with the acquisition, Goshawk's existing bank loan of \$16.3 million was refinanced by the drawdown of \$12.2 million (net of fees) from a credit facility provided by a London-based bank and \$4.1 million from the Flowers Fund. In December 2009, we fully repaid the outstanding principal and interest on the credit facility.

On November 26, 2009, we acquired an additional 10.01% of the outstanding shares that we did not previously own for a purchase price of approximately \$4.7 million. We now own 99.45% of the outstanding shares of Goshawk.

Gordian

On March 5, 2008, we completed the acquisition of AMP Limited s, or AMP s, Australian-based closed reinsurance and insurance operations, or Gordian. The purchase price, including acquisition expenses, of approximately AU\$436.9 million (approximately \$405.4 million) was financed by approximately AU\$301.0 million (approximately \$276.5 million), including an arrangement fee of AU\$4.5 million (approximately \$4.2 million), from bank financing provided jointly by a London-based bank and a German bank (the Flowers Fund is a significant shareholder of the German bank); approximately AU\$41.6 million (approximately \$39.5 million) from the Flowers Fund, by way of non-voting equity participation; and approximately AU\$98.7 million (approximately \$93.6 million) from available cash on hand. In September 2010, the remaining balance of the outstanding facility was repaid in full.

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Guildhall

On February 29, 2008, we completed the acquisition of Guildhall Insurance Company Limited, or Guildhall, a U.K.-based reinsurance company that has been in run-off since 1986. The purchase price, including acquisition expenses, of approximately £33.4 million (approximately \$65.9 million) was financed by the drawdown of approximately £16.5 million (approximately \$32.5 million) from a U.S. dollar facility loan agreement with a London-based bank; approximately £5.0 million (approximately \$10.0 million) from the Flowers Fund, by way of non-voting equity participation; and approximately £11.9 million (approximately \$23.5 million) from available cash on hand. In September 2008, the facility loan was repaid in full.

Marlon

On August 28, 2007, we completed the acquisition of Marlon Insurance Company Limited, a reinsurance company in run-off, and Marlon Management Services Limited for a total purchase price, including acquisition costs, of approximately \$31.2 million, which was funded by \$15.3 million borrowed under a facility loan agreement with a London-based bank and available cash on hand. Marlon Insurance Company Limited and Marlon Management Services Limited are both U.K.-based companies. In February 2008, the facility loan was repaid in full.

Tate & Lyle

On June 12, 2007, we completed the acquisition of Tate & Lyle Reinsurance Ltd., or Tate & Lyle, for a total purchase price, including acquisition costs, of approximately \$5.9 million funded from available cash on hand. Tate & Lyle is a Bermuda-based reinsurance company in run-off.

Inter-Ocean

On February 23, 2007, we, through our wholly-owned subsidiary Oceania Holdings Ltd, or Oceania, completed the acquisition of Inter-Ocean Holdings Ltd., or Inter-Ocean. The total purchase price, including acquisition costs, was approximately \$57.5 million, which was funded by \$26.8 million borrowed under a facility loan agreement with a London-based bank and available cash on hand. Inter-Ocean owns two reinsurers, one based in Bermuda and one based in Ireland. Both of these companies wrote international reinsurance and had in place retrocessional policies providing for the full reinsurance of all of the risks they assumed. In October 2007, Oceania repaid its bank debt in full.

The Enstar Group, Inc.

On January 31, 2007, we completed the merger, or the Merger, of CWMS Subsidiary Corp. with and into The Enstar Group, Inc., or EGI, and, as a result, EGI, renamed Enstar USA, Inc., is now our wholly-owned subsidiary. Prior to the Merger, EGI owned approximately 32% economic and 50% voting interests in us. As a result of the completion of the Merger, B.H. Acquisition Ltd. is now our wholly-owned subsidiary.

Unione

In November 2006, we, through our wholly-owned subsidiary Virginia, purchased Unione Italiana (U.K.) Reinsurance Company Limited, or Unione, a U.K. company, for approximately \$17.4 million. Unione underwrote business from the 1940 s though to 1995. Prior to acquisition, Unione closed the majority of its portfolio by way of a solvent scheme of arrangement in the U.K. Unione s remaining business is a portfolio of international insurance and reinsurance which has been in run-off since 1971.

Cavell

In October 2006, we, through our wholly-owned subsidiary Virginia, purchased Cavell Holdings Limited (U.K.), or Cavell, for approximately £31.8 million (approximately \$60.9 million). Cavell owns a U.K. reinsurance company and a Norwegian reinsurer, both of which wrote portfolios of international reinsurance business and went into run-off in 1993 and 1992, respectively. The purchase price was funded by \$24.5 million borrowed under a

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facility loan agreement with a London-based bank and available cash on hand. In February 2008, Virginia repaid its bank debt in full.

Share Repurchase

On October 1, 2010, we entered into share repurchase agreements, or the Repurchase Agreements, with three of our executives and certain trusts and a corporation affiliated with the executives to repurchase an aggregate of 800,000 of our ordinary shares at a price of \$70.00 per share. We repurchased an aggregate of 600,000 ordinary shares from Dominic F. Silvester (our Chief Executive Officer and Chairman of the Board of Directors) and a trust of which he and his immediate family are the sole beneficiaries, 100,000 ordinary shares from a trust of which Paul J. O Shea (our Joint Chief Operating Officer, Executive Vice President and a member of our Board of Directors) and his immediate family are the sole beneficiaries and 100,000 ordinary shares from a corporation owned by a trust of which Nicholas A. Packer (our Joint Chief Operating Officer and Executive Vice President) and his immediate family are the sole beneficiaries. The repurchase transactions closed on October 14, 2010. The aggregate purchase price of \$56.0 million is payable by us through promissory notes to the selling shareholders. The annual interest rate for the notes is fixed at 3.5%, and the notes are repayable in three equal installments on December 31, 2010, December 1, 2011 and December 1, 2012. In connection with the Repurchase Agreements, we entered into lock-up agreements with each of Messrs. Silvester, O Shea and Packer, and their respective family trusts and corporation. The lock-up agreements prohibit future sales and transfers of shares now owned or subsequently acquired for two years from the date of the Repurchase Agreements.

Share Offering

In July 2008, we completed the sale to the public of 1,372,028 newly-issued ordinary shares, inclusive of the underwriters over-allotment, or the Offering. The shares were priced at \$87.50 per share and we received net proceeds of approximately \$116.8 million, after underwriting fees and other expenses of approximately \$3.3 million. FPK served as lead managing underwriter in the Offering. The Flowers Fund and certain of its affiliated investment partnerships purchased 285,714 ordinary shares with a value of approximately \$25.0 million in the Offering at the public offering price. An affiliate of the Flowers Fund controlled approximately 41% of FPK until its sale of FPK in December 2009.

Management of Run-Off Portfolios

We are a party to several management engagements pursuant to which we have agreed to manage the run-off portfolios of third parties with gross loss reserves, as of December 31, 2010, of approximately \$658.4 million. Such arrangements are advantageous for third-party insurers because they allow a third-party insurer to focus their management efforts on their core competency while allowing them to maintain the portfolio of business on their balance sheet. In addition, our expertise in managing portfolios in run-off allows the third-party insurer the opportunity to potentially realize positive operating results if we achieve our objectives in management of the run-off portfolio. We specialize in the collection of reinsurance receivables through our subsidiary Kinsale Brokers Limited. Through our subsidiaries, Enstar (US) Inc. and Cranmore Adjusters Limited, we also specialize in providing claims inspection services whereby we are engaged by third-party insurance and reinsurance providers to review certain of their existing insurance and reinsurance exposures, relationships, policies and/or claims history.

Our primary objective in structuring our management arrangements is to align the third-party insurer's interests with our interests. Consequently, management agreements typically are structured so that we receive fixed fees in connection with the management of the run-off portfolio and also typically receive certain incentive payments based on a portfolio's positive operating results. These agreements do not include the recurring engagements managed by our claims inspection and reinsurance collection subsidiaries, Cranmore Adjusters Limited, Enstar (US), Inc. and Kinsale

Brokers Limited, respectively.

Claims Management and Administration

An integral factor to our success is our ability to analyze, administer, manage and settle claims and related expenses, such as loss adjustment expenses. Our claims teams are located in different offices within our

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organization and provide global claims support. We have implemented effective claims handling guidelines along with claims reporting and control procedures in all of our claims units. To ensure that claims are appropriately handled and reported in accordance with these guidelines, all claims matters are reviewed regularly, with all material claims matters being circulated to and authorized by management prior to any action being taken.

When we receive notice of a claim, regardless of size and regardless of whether it is a paid claim request or a reserve advice, it is reviewed and recorded within the claims system, reserving our rights where appropriate. Claims reserve movements and payments are reviewed daily, with any material movements being reported to management for review. This enables flash reporting of significant events and potential insurance or reinsurance losses to be communicated to senior management worldwide on a timely basis irrespective from which geographical location or business unit location the exposure arises.

We are also able to efficiently manage claims and obtain savings through our extensive relationships with defense counsel (both in-house and external), third-party claims administrators and other professional advisors and experts. We have developed relationships and protocols to reduce the number of outside counsel by consolidating claims of similar types and complexity with experienced law firms specializing in the particular type of claim. This approach has enabled us to more efficiently manage outside counsel and other third parties, thereby reducing expenses, and to establish closer relationships with ceding companies.

When appropriate, we negotiate with direct insureds to buy back policies either on favorable terms or to mitigate against existing and/or potential future indemnity exposures and legal costs in an uncertain and constantly evolving legal environment. We also pursue commutations on favorable terms with ceding companies of reinsurance business in order to realize savings or to mitigate against potential future indemnity exposures and legal costs. Such buy-backs and commutations typically eliminate all past, present and future liability to direct insureds and reinsureds in return for a lump sum payment.

With regard to reinsurance receivables, we manage cash flow by working with reinsurers, brokers and professional advisors to achieve fair and prompt payment of reinsured claims, taking appropriate legal action to secure receivables where necessary. We also attempt where appropriate to negotiate favorable commutations with our reinsurers by securing a lump sum settlement from reinsurers in complete satisfaction of the reinsurer's past, present and future liability in respect of such claims. Properly priced commutations reduce the expense of adjusting direct claims and pursuing collection of reinsurance receivables (both of which may often involve extensive legal expense), realize savings, remove the potential future volatility of claims and reduce required regulatory capital.

Reserves for Unpaid Losses and Loss Adjustment Expense

Applicable insurance laws and generally accepted accounting practices require us to maintain reserves to cover our estimated losses under insurance policies that we have assumed and for loss adjustment expense, or LAE, relating to the investigation, administration and settlement of policy claims. Our LAE reserves consist of both reserves for allocated loss adjustment expenses, or ALAE, and for unallocated loss adjustment expenses, or ULAE. ALAE are linked to the settlement of an individual claim or loss, whereas ULAE reserve is based on our estimates of future costs to administer the claims.

We and our subsidiaries establish losses and LAE reserves for individual claims by evaluating reported claims on the basis of:

our knowledge of the circumstances surrounding the claim;

the severity of the injury or damage;

the jurisdiction of the occurrence;

the potential for ultimate exposure;

the type of loss; and

our experience with the line of business and policy provisions relating to the particular type of claim.

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Because a significant amount of time can lapse between the assumption of risk, the occurrence of a loss event, the reporting of the event to an insurance or reinsurance company and the ultimate payment of the claim on the loss event, the liability for unpaid losses and LAE is based largely upon estimates. Our management must use considerable judgment in the process of developing these estimates. The liability for unpaid losses and LAE for property and casualty business includes amounts determined from loss reports on individual cases and amounts for losses incurred but not reported, or IBNR. Such reserves, including IBNR reserves, are estimated by management based upon loss reports received from ceding companies, supplemented by our own estimates of losses for which no ceding company loss reports have yet been received.

In establishing reserves, management also considers actuarial estimates of ultimate losses. Our independent actuaries employ generally accepted actuarial methodologies and procedures to estimate ultimate losses and loss adjustment expenses. Our loss reserves are largely related to casualty exposures including latent exposures primarily relating to asbestos and environmental, or A&E, as discussed below. In establishing the reserves for unpaid claims, management considers facts currently known and the current state of the law and coverage litigation. Liabilities are recognized for known claims (including the cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific insurance policy, and management can reasonably estimate its liability. In addition, reserves are established to cover loss development related to both known and unasserted claims.

The estimation of unpaid claim liabilities is subject to a high degree of uncertainty for a number of reasons. Unpaid claim liabilities for property and casualty exposures in general are impacted by changes in the legal environment, jury awards, medical cost trends and general inflation. Moreover, for latent exposures in particular, developed case law and adequate claims history do not exist. There is significant coverage litigation involved with these exposures which creates further uncertainty in the estimation of the liabilities. Therefore, for these types of exposures, it is especially unclear whether past claim experience will be representative of future claim experience. Ultimate values for such claims cannot be estimated using reserving techniques that extrapolate losses to an ultimate basis using loss development factors, and the uncertainties surrounding the estimation of unpaid claim liabilities are not likely to be resolved in the near future. There can be no assurance that the reserves established by us will be adequate or will not be adversely affected by the development of other latent exposures. The actuarial methods used to estimate ultimate loss and ALAE for our latent exposures are discussed below.

For the non-latent loss exposures, a range of traditional loss development extrapolation techniques is applied. Incremental paid and incurred loss development methodologies are the most commonly used methods. Traditional cumulative paid and incurred loss development methods are used where inception-to-date, cumulative paid and reported incurred loss development history is available. These methods assume that groups of losses from similar exposures will increase over time in a predictable manner. Historical paid and incurred loss development experience is examined for earlier underwriting years to make inferences about how later underwriting years' losses will develop. Where company-specific loss information is not available or not reliable, industry loss development information published by reliable industry sources such as the Reinsurance Association of America is considered.

The reserving process is intended to reflect the impact of inflation and other factors affecting loss payments by taking into account changes in historical payment patterns and perceived trends. However, there is no precise method for the subsequent evaluation of the adequacy of the consideration given to inflation, or to any other specific factor, or to the way one factor may affect another.

The loss development tables below show changes in our gross and net loss reserves in subsequent years from the prior loss estimates based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for individual years. A redundancy means the original estimate was higher than the current estimate; a deficiency means that the current estimate is higher

than the original estimate. The Reserve redundancy line represents, as of the date indicated, the difference between the latest re-estimated liability and the reserves as originally estimated.

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	Year Ended December 31,								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(in thousands of U.S. dollars)								
	\$ 419,717	\$ 284,409	\$ 381,531	\$ 1,047,313	\$ 806,559	\$ 1,214,419	\$ 1,591,449	\$ 2,798,287	\$ 2,479,1
	348,279	302,986	365,913	900,274	909,984	1,227,427	1,436,051	2,661,011	2,237,1
	360,558	299,281	284,583	1,002,773	916,480	1,084,852	1,358,900	2,422,291	
	359,771	278,020	272,537	1,012,483	853,139	1,020,755	1,284,304		
	332,904	264,040	243,692	953,834	778,216	949,595			
	316,257	242,278	216,875	879,504	733,151				
	294,945	238,315	204,875	835,488					
	290,926	229,784	195,795						
	282,066	216,969							
	269,522								
	\$ 150,195	\$ 67,440	\$ 185,736	\$ 211,825	\$ 73,408	\$ 264,824	\$ 307,145	\$ 375,996	\$ 242,0

	Year Ended December 31,								
Paid Losses	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(in thousands of U.S. dollars)								
ter	\$ 97,036	\$ 43,721	\$ 19,260	\$ 110,193	\$ 117,666	\$ 90,185	\$ 407,692	\$ 364,440	\$ 377,15
ater	123,844	64,900	43,082	226,225	198,407	197,751	575,522	727,205	
ater	142,282	84,895	61,715	305,913	268,541	353,032	688,946		
ater	160,193	101,414	75,609	375,762	402,134	423,731			
ater	174,476	110,155	87,274	509,319	442,624				
ater	181,800	121,000	101,958	549,033					
ater	189,023	135,426	108,901						
ater	200,454	140,492							
ater	204,805								

	Year Ended December 31,								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(in thousands of U.S. dollars)								
	\$ 224,507	\$ 184,518	\$ 230,155	\$ 736,660	\$ 593,160	\$ 872,259	\$ 1,163,485	\$ 2,403,712	\$ 2,131,408
	190,768	176,444	220,712	653,039	590,153	875,636	1,034,588	2,216,928	1,851,268
	176,118	178,088	164,319	652,195	586,059	753,551	950,739	1,940,472	
	180,635	138,251	149,980	649,355	532,804	684,999	874,961		
	135,219	129,923	136,611	600,939	454,933	611,182			
	124,221	119,521	108,666	531,666	408,270				
	114,375	112,100	104,127	485,392					
	106,920	108,447	92,972						
	103,311	93,188							
	88,345								

cy \$ 136,162 \$ 91,330 \$ 137,183 \$ 251,268 \$ 184,890 \$ 261,077 \$ 288,524 \$ 463,240 \$ 280,140

Paid Losses	Year Ended December 31,								
	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(in thousands of U.S. dollars)								
later	\$ 38,634	\$ 10,557	\$ 11,354	\$ 78,488	\$ 79,398	\$ 43,896	\$ 112,321	\$ 247,823	\$ 250,635
s later	32,291	24,978	6,312	161,178	125,272	(70,430)	243,146	480,102	
s later	44,153	17,304	9,161	206,351	(14,150)	58,228	324,735		
s later	34,483	24,287	(1,803)	67,191	102,776	108,109			
s later	39,232	9,686	2,515	184,150	132,405				
s later	23,309	14,141	11,348	212,822					
s later	24,176	22,966	11,808						
s later	30,551	21,400							
s later	28,303								

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The following table provides a reconciliation of the liability for losses and LAE, net of reinsurance ceded:

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(in thousands of U.S. dollars)				
Net reserves for loss and loss adjustment expenses, beginning of period	\$ 2,131,408	\$ 2,403,712	\$ 1,163,485	\$ 872,259	\$ 593,160
Net reduction in ultimate loss and loss adjustment expense liabilities	(311,834)	(259,627)	(242,104)	(24,482)	(31,927)
Net losses paid	(294,996)	(257,414)	(174,013)	(20,422)	(75,293)
Effect of exchange rate movement	(3,836)	73,512	(124,989)	18,625	24,856
Retroactive reinsurance contracts assumed	785,731	56,630	373,287		
Acquired on purchase of subsidiaries	459,362	114,595	1,408,046	317,505	361,463
Net reserves for loss and loss adjustment expenses, end of period	\$ 2,765,835	\$ 2,131,408	\$ 2,403,712	\$ 1,163,485	\$ 872,259

In the table above, net reduction in ultimate loss and loss adjustment expense liabilities represents changes in estimates of prior period net loss and loss adjustment expense liabilities comprising net incurred loss movements during a period and changes in estimates of net IBNR liabilities. Net incurred loss movements during a period comprise increases or reductions in specific case reserves advised during the period to us by our policyholders and attorneys, or by us to our reinsurers, less claims settlements made during the period by us to our policyholders, plus claim receipts made to us by our reinsurers. Prior period estimates of net IBNR liabilities may change as our management considers the combined impact of commutations, policy buy-backs, settlement of losses on carried reserves and the trend of incurred loss development compared to prior forecasts. The trend of incurred loss development in any period comprises the movement in net case reserves less net claims settled during the period. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Loss and Loss Adjustment Expenses on page 72 for an explanation of how the loss reserving methodologies are applied to the movement, or development, of net incurred losses during a period to estimate IBNR liabilities.

Commutations provide an opportunity for us to exit exposures to entire policies with insureds and reinsureds at a discount to the previously estimated ultimate liability. To the extent possible, our internal and external actuaries eliminate all prior historical loss development that relates to commuted exposures and apply their actuarial methodologies to the remaining aggregate exposures and revised historical loss development information to reassess estimates of ultimate liabilities.

Policy buy-backs provide an opportunity for us to settle individual policies and losses usually at a discount to carried advised loss reserves. As part of our routine claims settlement operations, claims will settle at either below or above the carried advised loss reserve. The impact of policy buy-backs and the routine settlement of claims updates historical loss development information to which actuarial methodologies are applied often resulting in revised estimates of ultimate liabilities. Our actuarial methodologies include industry benchmarking which, under certain methodologies (discussed further under Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies on page 72, compares the trend of our loss development to that of the industry. To the extent that the trend of our loss development compared to the industry changes in any period, it is

likely to have an impact on the estimate of ultimate liabilities.

Year Ended December 31, 2010

The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2010 was \$311.8 million, excluding the impact of foreign exchange rate movements of \$3.8 million and including both net reduction in ultimate loss and loss adjustment expense liabilities of \$19.0 million relating to companies and portfolios acquired during the year and premium and commission adjustments triggered by incurred losses of \$16.5 million.

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The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2010 of \$311.8 million was attributable to a reduction in estimates of net ultimate losses of \$278.1 million, a reduction in aggregate provisions for bad debts of \$49.6 million and a reduction in estimates of unallocated loss adjustment expense liabilities of \$39.7 million, relating to 2010 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$55.4 million.

The reduction in estimates of net ultimate losses of \$278.1 million comprised net incurred favorable loss development of \$41.1 million and reductions in IBNR reserves of \$236.9 million. The decrease in the estimate of IBNR loss reserves of \$236.9 million was comprised of \$67.8 million relating to asbestos liabilities, \$4.2 million relating to environmental liabilities and \$164.9 million relating to all other remaining liabilities. The reduction in IBNR was a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to loss data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses. The prior period estimate of net IBNR liabilities was reduced as a result of the combined impact of loss development activity during 2010, including commutations and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. The net incurred favorable loss development of \$41.1 million, resulting from settlement of net advised case and LAE reserves of \$336.1 million for net paid losses of \$295.0 million, related to the settlement of non-commuted losses in the year and approximately 90 commutations of assumed and ceded exposures. Commutations provide an opportunity for us to exit exposures to entire policies with insureds and reinsureds at a discount to the previous estimated ultimate liability. As a result of exiting all exposures to such policies, all advised case reserves and IBNR liabilities relating to that insured or reinsured are eliminated. This often results in a net gain irrespective of whether the settlement exceeds the advised case reserves. We adopt a disciplined approach to the review and settlement of non-commuted claims through claims adjusting and the inspection of underlying policyholder records such that settlements of assumed exposures may often be achieved below the level of the originally advised loss, and settlements of ceded receivables may often be achieved at levels above carried balances. Of the 90 commutations completed during 2010, three related to our top ten insured and/or reinsured exposures, including one commutation completed shortly after December 31, 2009 whereby the related reduction in IBNR reserves was recorded in the reduction in net ultimate losses for the year ended December 31, 2009, and one related to the commutation of one of our largest ceded reinsurance assets. The remaining 86 commutations, of which approximately 43% were completed during the three months ended December 31, 2010, were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships, as well as targeting significant individual cedant and reinsurer relationships. The combination of the claims settlement activity in 2010, including commutations (but excluding the impact of the commutation that was completed subsequent to the year ended December 31, 2009) and the actuarial estimation of IBNR reserves required for the remaining non-commuted exposures (which took into account the favorable trend of loss development in 2010 related to such exposures compared to prior forecasts), resulted in our management concluding that the loss development activity that occurred subsequent to the prior reporting period provided sufficient new information to warrant a reduction in IBNR reserves of \$236.9 million in 2010.

The reduction in aggregate provisions for bad debt of \$49.6 million was a result of the collection, primarily during the three months ended December 31, 2010, of certain reinsurance receivables against which bad debt provisions had been provided in earlier periods.

Year Ended December 31, 2009

The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2009 was \$259.6 million, excluding the impact of adverse foreign exchange rate movements of \$73.5 million and including both net reduction in ultimate loss and loss adjustment expense liabilities of \$4.8 million relating to companies acquired during the year and premium and commission adjustments of \$5.5 million triggered by incurred losses.

The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2009 of \$259.6 million was attributable to a reduction in estimates of net ultimate losses of \$274.8 million, a reduction in aggregate provisions for bad debts of \$11.7 million and a reduction in estimates of loss adjustment expense liabilities of \$50.4 million, relating to 2009 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$77.3 million.

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The reduction in estimates of net ultimate losses of \$274.8 million comprised net incurred loss development of \$43.3 million and reductions in IBNR reserves of \$318.2 million. The decrease in the estimate of IBNR loss reserves of \$318.2 million was comprised of \$158.4 million relating to asbestos liabilities, \$17.0 million relating to environmental liabilities and \$142.8 million relating to all other remaining liabilities. The reduction in IBNR is a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to loss data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses. The prior period estimate of net IBNR liabilities was reduced as a result of the combined impact of loss development activity during 2009, including commutations and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. The net incurred loss development of \$43.3 million resulting from settlement of net advised case and LAE reserves of \$214.1 million for net paid losses of \$257.4 million, related to the settlement of non-commuted losses in the year and approximately 79 commutations of assumed and ceded exposures. Of the 79 commutations completed during 2009, two related to our top ten insured and/or reinsured exposures. The remaining 77 were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships, as well as targeting significant individual cedant and reinsurer relationships. Approximately 76% of commutations completed in 2009 related to commutations completed during the three months ended December 31, 2009. Subsequent to the year end, one of our insurance entities completed a commutation of another of one of our top ten reinsured exposures. The combination of the claims settlement activity in 2009, including commutations, and the actuarial estimation of IBNR reserves required for the remaining non-commuted exposures (which took into account the favorable trend of loss development in 2009 related to such exposures compared to prior forecasts as well as the impact of the commutation that was completed subsequent to the year end), resulted in our management concluding that the loss development activity that occurred subsequent to the prior reporting period provided sufficient new information to warrant a reduction in IBNR reserves of \$318.2 million in 2009.

The reduction in aggregate provisions for bad debt of \$11.7 million was a result of the collection, primarily during the three months ended March 31, 2009, of certain reinsurance receivables against which bad debt provisions had been provided in earlier periods.

Year Ended December 31, 2008

The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2008 was \$242.1 million, excluding the impacts of favorable foreign exchange rate movements of \$36.1 million (relating to companies acquired in 2007 and earlier) and including both net reduction in ultimate loss and loss adjustment expense liabilities of \$149.4 million relating to companies acquired during the year and premium and commission adjustments of \$0.1 million triggered by incurred losses.

The net reduction in ultimate loss and loss adjustment expense liabilities for 2008 of \$242.1 million was attributable to a reduction in estimates of net ultimate losses of \$161.4 million, a reduction in aggregate provisions for bad debt of \$36.1 million (excluding \$3.1 million relating to one of our entities that benefited from substantial stop loss reinsurance protection discussed below) and a reduction in estimates of loss adjustment expense liabilities of \$69.1 million, relating to 2008 run-off activity, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$24.5 million.

The reduction in estimates of net ultimate losses of \$161.4 million comprised the following:

(i) A reduction in estimates of net ultimate losses of \$21.7 million in one of our insurance entities that benefited from substantial stop loss reinsurance protection. Net incurred loss development relating to this entity of \$21.6 million was offset by reductions in IBNR reserves of \$94.8 million and reductions in provisions for bad debt of \$3.1 million, resulting in a net reduction in estimates of ultimate losses of \$76.3 million. The entity in question benefited, until

December 18, 2008, from substantial stop loss reinsurance protection whereby \$54.6 million of the net reduction in ultimate losses of \$76.3 million was ceded to a single AA- rated reinsurer such that we retained a reduction in estimates of net ultimate losses relating to this entity of \$21.7 million. On December 18, 2008, we commuted the stop loss reinsurance protection with the reinsurer for the receipt of \$190.0 million payable by the reinsurer to us over four years together with interest compounded at 3.5% per annum. The commutation resulted in no significant financial impact to us. The decrease in the estimate of IBNR loss reserves of \$94.8 million for this one

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insurance entity was comprised of \$77.7 million relating to asbestos liabilities, \$9.0 million relating to environmental liabilities and \$8.1 million relating to all other remaining liabilities. The reduction in IBNR is a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to loss data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses. The prior period estimate of net IBNR liabilities was reduced as a result of the combined impact of loss development activity during 2008, which was comprised of the settlement of certain advised case reserves below their prior period carried amounts, commutations completed and the trend of loss development relating to non-commuted policies compared to prior forecasts. The net incurred loss development relating to this entity of \$21.6 million, whereby advised net case reserves of \$25.0 million were settled for net paid losses of \$46.6 million, primarily related to six commutations of assumed and ceded liabilities completed during 2008. As a result of exiting all exposures to such policies, all advised case reserves and IBNR liabilities relating to that insured or reinsured were eliminated. This often results in a net gain irrespective of whether the settlement exceeds the advised case reserves. Of the six commutations completed for this entity, of which the three largest were completed during the three months ended December 31, 2008, one was among its top ten assumed exposures. The remaining five commutations were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. The combination of the claims settlement activity in 2008, including commutations, combined with the actuarial estimation of IBNR reserves required for the remaining non-commuted exposures (which took into account the favorable trend of loss development in 2008 related to such exposures compared to prior forecasts), resulted in our management concluding that the loss development activity that occurred subsequent to the prior reporting period provided sufficient new information to warrant a reduction in IBNR reserves of \$94.8 million for this one insurance entity in 2008.

(ii) A reduction in estimates of net ultimate losses of \$139.7 million in our other insurance and reinsurance entities comprised net favorable incurred loss development of \$24.1 million and reductions in IBNR reserves of \$115.6 million. The decrease in the estimate of IBNR loss reserves of \$115.6 million was comprised of \$23.8 million relating to asbestos liabilities, \$1.8 million relating to environmental liabilities and \$90.0 million relating to all other remaining liabilities. The reduction in IBNR is a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to loss data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses. The prior period estimate of net IBNR liabilities was reduced as a result of the combined impact of favorable loss development activity during 2008, which was comprised of the settlement of advised case reserves below their prior period carried amounts, commutations completed and the favorable trend of loss development related to non-commuted policies compared to prior forecasts. The net favorable incurred loss development in our remaining insurance and reinsurance entities of \$24.1 million, whereby net advised case and LAE reserves of \$123.5 million were settled for net paid losses of \$99.4 million, primarily related to the settlement of non-commuted losses in the year below carried reserves and approximately 59 commutations of assumed and ceded exposures at less than case and LAE reserves. Of the 59 commutations completed during 2008 for our other reinsurance and insurance companies, two (both of which were completed during the three months ended December 31, 2008) were among our top ten insured and/or reinsured exposures. The remaining 57 were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships, as well as targeting significant individual cedant and reinsurer relationships.

Approximately 82% of commutations completed in 2008 related to commutations completed during the three months ended December 31, 2008. The combination of the claims settlement activity in 2008, including commutations, with the actuarial estimation of IBNR reserves required for the remaining noncommuted exposures (which took into account the favorable trend of loss development in 2008 related to such exposures compared to prior forecasts), resulted in our management concluding that the loss development activity that occurred subsequent to the prior reporting period provided sufficient new information to warrant a reduction in IBNR reserves of \$115.6 million for our remaining insurance and reinsurance entities in 2008.

One of our reinsurance companies had retrocessional arrangements providing for full reinsurance of all risks assumed. During the year, this entity commuted its largest assumed liability and related retrocessional protection whereby the subsidiary paid net losses of \$222.0 million and reduced net IBNR by the same amount, resulting in no gain or loss to us.

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The reduction in aggregate provisions for bad debt of \$36.1 million (excluding \$3.1 million relating to one of our entities that benefited from substantial stop loss reinsurance protection discussed above) was comprised of:

(1) \$13.7 million as a result of the collection, primarily during the three months ended December 31, 2008, of certain reinsurance receivables against which bad debt provisions had been provided in earlier periods, (2) \$8.5 million as a result of the revision of estimates of bad debt provisions following the receipt of new information during the three months ended December 31, 2008 and (3) \$13.9 million as a result of reduced exposures to reinsurers with bad debt provisions following the commutation of assumed liabilities.

Year Ended December 31, 2007

The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2007 was \$24.5 million, excluding the impacts of adverse foreign exchange rate movements of \$18.6 million and including both net reduction in ultimate loss and loss adjustment expense liabilities of \$9.0 million relating to companies acquired during the year and premium and commission adjustments triggered by incurred losses of \$0.3 million.

The net reduction in ultimate loss and loss adjustment expense liabilities for 2007 of \$24.5 million was attributable to a reduction in estimates of net ultimate losses of \$30.7 million and a reduction in estimates of loss adjustment expense liabilities of \$22.0 million, relating to 2007 run-off activity, partially offset by an increase in aggregate provisions for bad debt of \$1.7 million, primarily relating to companies acquired in 2006, and the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$26.5 million.

The reduction in estimates of net ultimate losses of \$30.7 million comprised the following:

(i) An increase in estimates of net ultimate losses of \$2.1 million in one of our insurance entities that benefited from substantial stop loss reinsurance protection. This entity increased ultimate net losses by \$23.5 million which was largely offset by a recoverable from a single AA- rated reinsurer such that a net ultimate loss of \$2.1 million was retained by us. The increase in ultimate net losses of \$23.5 million, before the recoverable from the stop loss reinsurer, comprised net incurred loss development of \$36.6 million, partially offset by a decrease in the estimate of IBNR loss reserves of \$13.1 million. The decrease in the estimate of IBNR loss reserves of \$13.1 million was comprised of \$2.9 million relating to asbestos liabilities, \$6.2 million relating to environmental liabilities and \$4.0 million relating to all other remaining liabilities. The reduction in IBNR is a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to loss data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses. The prior period estimate of net IBNR liabilities was reduced as a result of the combined impact of favorable loss development activity during 2007, which was comprised of the settlement of certain advised case reserves below their prior period carried amounts, commutations completed and the favorable trend of loss development relating to non-commuted policies compared to prior forecasts. The net incurred loss development relating to this entity of \$36.6 million, whereby advised net case reserves of \$16.9 million were settled for net paid losses of \$53.5 million, resulted from the settlement of case and LAE reserves above carried levels and from new loss advices, partially offset by approximately 12 commutations of assumed and ceded exposures below carried reserve levels. As a result of exiting all exposures to such policies, all advised case reserves and IBNR liabilities relating to that insured or reinsured were eliminated. This often results in a net gain irrespective of whether the settlement exceeds advised case reserves. Of the 12 commutations completed for this entity, three were among our top ten cedant exposures. The remaining nine were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. The combination of the claims settlement activity in 2007, including commutations, with the actuarial estimation of IBNR reserves required for the remaining non-commuted exposures (which took into account the favorable trend of loss development in 2007 related to such exposures compared to prior forecasts), resulted in our management concluding that the favorable loss development activity that occurred subsequent to the prior reporting period provided sufficient new information to warrant a reduction in IBNR reserves

of \$13.1 million for this one insurance entity in 2007.

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(ii) Net favorable incurred loss development of \$29.0 million, comprising net paid loss recoveries, relating to another one of our reinsurance companies, offset by increases in net IBNR loss reserves of \$29.0 million, resulting in no ultimate gain or loss. This reinsurance company has retrocessional arrangements providing for full reinsurance of all risks assumed.

(iii) A reduction in estimates of net ultimate losses of \$32.8 million in our remaining insurance and reinsurance entities, which was comprised of net favorable incurred loss development of \$6.5 million and reductions in IBNR reserves of \$26.3 million. The decrease in the estimate of IBNR loss reserves of \$26.3 million was comprised of \$20.1 million relating to asbestos liabilities and \$7.7 million relating to all other remaining liabilities, partially offset by an increase of \$1.5 million relating to environmental liabilities. The reduction in IBNR is a result of the application, on a basis consistent with the assumptions applied in the prior period, of our actuarial methodologies to loss data to estimate loss reserves required to cover liabilities for unpaid losses and loss adjustment expenses. The prior period estimate of net IBNR liabilities was reduced as a result of the combined impact of favorable loss development activity during 2007, which was comprised of the settlement of certain advised case reserves below their prior period carried amounts, commutations completed and the trend of loss development related to non-commuted policies compared to prior forecasts. The net favorable incurred loss development in our remaining insurance and reinsurance entities of \$6.5 million, whereby net advised case and LAE reserves of \$2.5 million were settled for net paid loss recoveries of \$4.0 million, primarily related to the settlement of non-commuted losses in the year below carried reserves and approximately 57 commutations of assumed and ceded exposures at less than case and LAE reserves. Of the 57 commutations completed during 2007 for our remaining reinsurance and insurance companies, five were among our top ten cedant and/or reinsured exposures. The remaining 52 were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships, as well as targeting significant individual cedant and reinsurer relationships. The combination of the claims settlement activity in 2007, including commutations, with the actuarial estimation of IBNR reserves required for the remaining non-commuted exposures (which took into account the favorable trend of loss development in 2007 related to such exposures compared to prior forecasts), resulted in our management concluding that the loss development activity that occurred subsequent to the prior reporting period provided sufficient new information to warrant a reduction in IBNR reserves of \$26.3 million for our remaining insurance and reinsurance entities in 2007.

Year Ended December 31, 2006

The net reduction in ultimate loss and loss adjustment expense liabilities for the year ended December 31, 2006 was \$31.9 million, excluding the impacts of adverse foreign exchange rate movements of \$24.9 million and including both net reduction in ultimate loss and loss adjustment expense liabilities of \$2.7 million relating to companies acquired during the year and premium and commission adjustments triggered by incurred losses of \$1.3 million.

The net reduction in ultimate loss and loss adjustment expense liabilities for 2006 of \$31.9 million was attributable to a reduction in estimates of net ultimate losses of \$21.4 million, a reduction in estimates of loss adjustment expense liabilities of \$15.1 million relating to 2006 run-off activity, a reduction in aggregate provisions for bad debt of \$6.3 million, resulting from the collection of certain reinsurance receivables against which bad debt provisions had been provided in earlier periods, partially offset by the amortization, over the estimated payout period, of fair value adjustments relating to companies acquired amounting to \$10.9 million.

The reduction in estimates of net ultimate losses of \$21.4 million comprised net incurred loss development of \$37.9 million offset by reductions in estimates of IBNR reserves of \$59.3 million. An increase in estimates of ultimate losses of \$3.4 million relating to one of our insurance entities was offset by reductions in estimates of net ultimate losses of \$24.8 million in our remaining insurance and reinsurance entities.

The incurred loss development of \$37.9 million, whereby advised case and LAE reserves of \$37.4 million were settled for net paid losses of \$75.3 million, comprised incurred loss development of \$59.2 million relating to one of our insurance companies partially offset by favorable incurred loss development of \$21.3 million relating to our remaining insurance and reinsurance companies.

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The incurred loss development of \$59.2 million relating to one of our insurance companies was comprised of net paid loss settlements of \$81.3 million less reductions in case and LAE reserves of \$22.1 million and resulted from the settlement of case and LAE reserves above carried levels and from new loss advices, partially offset by approximately ten commutations of assumed and ceded exposures below carried reserves levels. Actuarial analysis of the remaining unsettled loss liabilities resulted in an increase in the estimate of IBNR loss reserves of \$35.0 million after consideration of the \$59.2 million adverse incurred loss development during the year, and the application of the actuarial methodologies to loss data pertaining to the remaining non-commuted exposures. Factors contributing to the increase include the establishment of a reserve to cover potential exposure to lead paint claims, a significant increase in asbestos reserves related to the entity's single largest cedant (following a detailed review of the underlying exposures), and a change in the assumed A&E loss reporting time-lag as discussed further below. Of the ten commutations completed for this entity, two were among our top ten cedant and/or reinsurance exposures. The remaining eight were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. This entity also benefited from substantial stop loss reinsurance protection whereby the loss development of \$59.2 million was largely offset by a recoverable from a single AA- rated reinsurer. The increase in estimated net ultimate losses of \$3.4 million was retained by us.

The net favorable incurred loss development of \$21.3 million, relating to our remaining insurance and reinsurance companies, whereby net advised case reserves of \$15.3 million were settled for net paid loss recoveries of \$6.0 million, arose from approximately 35 commutations of assumed and ceded exposures at less than case and LAE reserves, where receipts from ceded commutations exceeded settlements of assumed exposures, and the settlement of non-commuted losses in the year below carried reserves.

The net reduction in the estimate of IBNR loss and loss adjustment expense liabilities relating to our remaining insurance and reinsurance companies (i.e., excluding the net \$55.8 million reduction in IBNR reserves relating to the entity referred to above) amounted to \$3.5 million. This net reduction was comprised of an increase of \$19.8 million resulting from (i) a change in assumptions as to the appropriate loss reporting time lag for asbestos related exposures from two to three years and for environmental exposures from two to two and one-half years, which resulted in an increase in net IBNR reserves of \$6.4 million, and (ii) a reduction in ceded IBNR recoverables of \$13.4 million resulting from the commutation of ceded reinsurance protections. The increase in IBNR of \$19.8 million is offset by a reduction of \$23.3 million resulting from the application of our reserving methodologies to (i) the reduced historical incurred loss development information relating to remaining exposures after the 35 commutations, and (ii) reduced case and LAE reserves in the aggregate. Of the 35 commutations completed during 2006 for the remaining of our reinsurance and insurance companies, ten were among our top ten cedant and/or reinsurance exposures. The remaining 25 were of a smaller size, consistent with our approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships.

Asbestos and Environmental (A&E) Exposure***General A&E Exposures***

A number of our subsidiaries wrote general liability policies and reinsurance prior to our acquisition of them under which policyholders continue to present asbestos-related injury claims and claims alleging injury, damage or clean-up costs arising from environmental pollution. These policies, and the associated claims, are referred to as A&E exposures. The vast majority of these claims are presented under policies written many years ago.

There is a great deal of uncertainty surrounding A&E claims. This uncertainty impacts the ability of insurers and reinsurers to estimate the ultimate amount of unpaid claims and related LAE. The majority of these claims differ from any other type of claim because there is inadequate loss development and there is significant uncertainty regarding

what, if any, coverage exists, to which, if any, policy years claims are attributable and which, if any, insurers/reinsurers may be liable. These uncertainties are exacerbated by lack of clear judicial precedent and legislative interpretations of coverage that may be inconsistent with the intent of the parties to the insurance contracts and expand theories of liability. The insurance and reinsurance industry as a whole is engaged in extensive

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litigation over these coverage and liability issues and is, thus, confronted with continuing uncertainty in its efforts to quantify A&E exposures.

Our A&E exposure is administered out of our offices in the United Kingdom and Rhode Island and centrally administered from the United Kingdom. In light of the intensive claim settlement process for these claims, which involves comprehensive fact gathering and subject matter expertise, our management believes that it is prudent to have a centrally administered claim facility to handle A&E claims on behalf of all of our subsidiaries. Our A&E claims staff, working in conjunction with two U.S.-qualified attorneys experienced in A&E liabilities, proactively administers, on a cost-effective basis, the A&E claims submitted to our insurance and reinsurance subsidiaries.

We use industry benchmarking methodologies to estimate appropriate IBNR reserves for our A&E exposures. These methods are based on comparisons of our loss experience on A&E exposures relative to industry loss experience on A&E exposures. Estimates of IBNR are derived separately for each relevant subsidiary of ours and, for some subsidiaries, separately for distinct portfolios of exposure. The discussion that follows describes, in greater detail, the primary actuarial methodologies used by our independent actuaries to estimate IBNR for A&E exposures.

In addition to the specific considerations for each method described below, many general factors are considered in the application of the methods and the interpretation of results for each portfolio of exposures. These factors include the mix of product types (e.g. primary insurance versus reinsurance of primary versus reinsurance of reinsurance), the average attachment point of coverages (e.g. first-dollar primary versus umbrella over primary versus high-excess), payment and reporting lags related to the international domicile of our subsidiaries, payment and reporting pattern acceleration due to large wholesale settlements (e.g. policy buy-backs and commutations) pursued by us, lists of individual risks remaining and general trends within the legal and tort environments.

1. *Paid Survival Ratio Method.* In this method, our expected annual average payment amount is multiplied by an expected future number of payment years to get an indicated reserve. Our historical calendar year payments are examined to determine an expected future annual average payment amount. This amount is multiplied by an expected number of future payment years to estimate a reserve. Trends in calendar year payment activity are considered when selecting an expected future annual average payment amount. Accepted industry benchmarks are used in determining an expected number of future payment years. Each year, annual payments data is updated, trends in payments are re-evaluated and changes to benchmark future payment years are reviewed. This method has advantages of ease of application and simplicity of assumptions. A potential disadvantage of the method is that results could be misleading for portfolios of high excess exposures where significant payment activity has not yet begun.

2. *Paid Market Share Method.* In this method, our estimated market share is applied to the industry estimated unpaid losses. The ratio of our historical calendar year payments to industry historical calendar year payments is examined to estimate our market share. This ratio is then applied to the estimate of industry unpaid losses. Each year, calendar year payment data is updated (for both us and industry), estimates of industry unpaid losses are reviewed and the selection of our estimated market share is revisited. This method has the advantage that trends in calendar-year market share can be incorporated into the selection of company share of remaining market payments. A potential disadvantage of this method is that it is particularly sensitive to assumptions regarding the time-lag between industry payments and our payments.

3. *Reserve-to-Paid Method.* In this method, the ratio of estimated industry reserves to industry paid-to-date losses is multiplied by our paid-to-date losses to estimate our reserves. Specific considerations in the application of this method include the completeness of our paid-to-date loss information, the potential acceleration or deceleration in our payments (relative to the industry) due to our claims handling practices, and the impact of large individual settlements. Each year, paid-to-date loss information is updated (for both us and the industry) and updates to industry estimated reserves are reviewed. This method has the advantage of relying purely on paid loss data and so is not influenced by

subjectivity of case reserve loss estimates. A potential disadvantage is that the application to our portfolios which do not have complete inception-to-date paid loss history could produce misleading results. To address this potential disadvantage, a variation of the method is also considered, which multiplies the ratio of

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estimated industry reserves to industry losses paid during a recent period of time (e.g. 5 years) times our paid losses during that period.

4. *IBNR:Case Ratio Method.* In this method, the ratio of estimated industry IBNR reserves to industry case reserves is multiplied by our case reserves to estimate our IBNR reserves. Specific considerations in the application of this method include the presence of policies reserved at policy limits, changes in overall industry case reserve adequacy and recent loss reporting history for us. Each year, our case reserves are updated, industry reserves are updated and the applicability of the industry IBNR:case ratio is reviewed. This method has the advantage that it incorporates the most recent estimates of amounts needed to settle open cases included in current case reserves. A potential disadvantage is that results could be misleading where our case reserve adequacy differs significantly from overall industry case reserve adequacy.

5. *Ultimate-to-Incurred Method.* In this method, the ratio of estimated industry ultimate losses to industry incurred-to-date losses is applied to our incurred-to-date losses to estimate our IBNR reserves. Specific considerations in the application of this method include the completeness of our incurred-to-date loss information, the potential acceleration or deceleration in our incurred losses (relative to the industry) due to our claims handling practices and the impact of large individual settlements. Each year incurred-to-date loss information is updated (for both us and the industry) and updates to industry estimated ultimate losses are reviewed. This method has the advantage that it incorporates both paid and case reserve information in projecting ultimate losses. A potential disadvantage is that results could be misleading where cumulative paid loss data is incomplete or where our case reserve adequacy differs significantly from overall industry case reserve adequacy.

Under the Paid Survival Ratio Method, the Paid Market Share Method and the Reserve-to-Paid Method, we first determine the estimated total reserve and then deduct the reported outstanding case reserves to arrive at an estimated IBNR reserve. The IBNR:Case Ratio Method first determines an estimated IBNR reserve which is then added to the advised outstanding case reserves to arrive at an estimated total loss reserve. The Ultimate-to-Incurred Method first determines an estimate of the ultimate losses to be paid and then deducts paid-to-date losses to arrive at an estimated total loss reserve and then deducts outstanding case reserves to arrive at the estimated IBNR reserve.

Within the annual loss reserve studies produced by our external actuaries, exposures for each subsidiary are separated into homogeneous reserving categories for the purpose of estimating IBNR. Each reserving category contains either direct insurance or assumed reinsurance reserves and groups relatively similar types of risks and exposures (e.g. asbestos, environmental, casualty and property) and lines of business written (e.g. marine, aviation and non-marine). Based on the exposure characteristics and the nature of available data for each individual reserving category, a number of methodologies are applied. Recorded reserves for each category are selected from the indications produced by the various methodologies after consideration of exposure characteristics, data limitations and strengths and weaknesses of each method applied. This approach to estimating IBNR has been consistently adopted in the annual loss reserve studies for each period presented.

As of December 31, 2010, we had 35 separate insurance and/or reinsurance subsidiaries whose reserves are categorized into approximately 276 reserve categories in total, including 40 distinct asbestos reserving categories and 27 distinct environmental reserving categories.

To the extent data availability allows, the five methodologies described above are applied for each of the 40 asbestos reserving categories and each of the 27 environmental reserving categories. As is common in actuarial practice, no one methodology is exclusively or consistently relied upon when selecting a recorded reserve. Consistent reliance on a single methodology to select a recorded reserve would be inappropriate in light of the dynamic nature of both the A&E liabilities in general, and our actual exposure portfolios in particular.

In selecting a recorded reserve, our management considers the range of results produced by the methods, and the strengths and weaknesses of the methods in relation to the data available and the specific characteristics of the portfolio under consideration. Trends in both our data and industry data are also considered in the reserve selection process. Recent trends or changes in the relevant tort and legal environments are also considered when assessing methodology results and selecting an appropriate recorded reserve amount for each portfolio.

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The liability for unpaid losses and LAE, inclusive of A&E reserves, reflects our best estimate for future amounts needed to pay losses and related LAE as of each of the balance sheet dates reflected in the financial statements herein in accordance with U.S. GAAP. As of December 31, 2010, we had net loss reserves of \$640.1 million for asbestos-related claims and \$96.1 million for environmental pollution-related claims. The following table provides a reconciliation of our gross and net loss and ALAE reserves from A&E exposures and the movement in gross and net reserves:

	2010		Year Ended December 31, 2009		2008	
	Gross	Net	Gross (in thousands of U.S. dollars)	Net	Gross	Net
Provisions for A&E claims and ALAE at January 1	\$ 750,972	\$ 667,632	\$ 943,970	\$ 846,421	\$ 677,610	\$ 419,977
A&E losses and ALAE incurred during the year	(71,302)	(78,801)	(51,612)	(78,756)	(54,337)	(14,448)
A&E losses and ALAE paid during the year	(101,917)	(67,756)	(158,391)	(115,479)	(58,916)	108,583
Provision for A&E claims and ALAE acquired during the year	247,459	215,097	17,005	15,446	379,613	332,309
Provision for A&E claims and ALAE at December 31	\$ 825,212	\$ 736,172	\$ 750,972	\$ 667,632	\$ 943,970	\$ 846,421

During 2010 and 2009, excluding the impact of loss reserves acquired during the year, our reserves for A&E liabilities decreased by \$173.2 million and \$210.0 million on a gross basis and by \$146.6 million and \$194.2 million on a net basis, respectively. The reductions in gross reserves arose from paid claims, successful commutations, policy buy-backs, generally favorable claim settlements during the year and reductions in IBNR resulting from actuarial analysis of remaining liabilities.

During 2008, excluding the impact of loss reserves acquired during the year, our reserves for A&E liabilities decreased by \$113.3 million on a gross basis and increased by \$94.1 million on a net basis. The reduction in gross reserves arose from paid claims, successful commutations, policy buy-backs, generally favorable claim settlements during the year and a reduction in IBNR resulting from actuarial analysis of remaining liabilities. The increase in net reserves arose as a result of (i) the commutation of a substantial stop loss protection in one of our reinsurance entities which had the effect of reducing ceded A&E IBNR recoverable by \$163.4 million; partially offset by (ii) a reduction in net reserves of \$69.3 million which arose from successful commutations, policy buy-backs, generally favorable claims settlements and a reduction in IBNR resulting from actuarial analysis of remaining net liabilities. This commutation, which settled for a total amount receivable of \$190.0 million (including \$163.4 million related to A&E IBNR recoverable), resulted in net A&E losses and ALAE recovered during the year of \$108.6 million.

Asbestos continues to be the most significant and difficult mass tort for the insurance industry in terms of claims volume and expense. We believe that the insurance industry has been adversely affected by judicial interpretations that have had the effect of maximizing insurance recoveries for asbestos claims, from both a coverage and liability

perspective. Generally, only policies underwritten prior to 1986 have potential asbestos exposure, since most policies underwritten after this date contain an absolute asbestos exclusion.

From 2001 through 2003 the industry experienced increasing numbers of asbestos claims, including claims from individuals who did not appear to be impaired by asbestos exposure. Since 2003, however, new claim filings have been fairly stable. It is possible that the increases observed in the early part of the decade were triggered by various state tort reforms (discussed immediately below). At this point, we cannot predict whether claim filings will return to pre-2004 levels, remain stable, or begin to decrease.

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Since 2001, several U.S. states have proposed, and in many cases enacted, tort reform statutes that impact asbestos litigation by, for example, making it more difficult for a diverse group of plaintiffs to jointly file a single case, reducing forum-shopping by requiring that a potential plaintiff must have been exposed to asbestos in the state in which he/she files a lawsuit, or permitting consolidation of discovery. These statutes typically apply to suits filed after a stated date. When a statute is proposed or enacted, asbestos defendants often experience a marked increase in new lawsuits, as plaintiffs' attorneys seek to file suit before the effective date of the legislation. Some of this increased claim volume likely represents an acceleration of valid claims that would have been brought in the future, while some claims will likely prove to have little or no merit. As many of these claims are still pending, we cannot predict what portion of the increased number of claims represent valid claims. Also, the acceleration of claims increases the uncertainty surrounding projections of future claims in the affected jurisdictions.

During the same timeframe as tort reform, the U.S. federal and various U.S. state governments sought comprehensive asbestos reform to manage the growing court docket and costs surrounding asbestos litigation, in addition to the increasing number of corporate bankruptcies resulting from overwhelming asbestos liabilities. Whereas the federal government has failed to establish a national asbestos trust fund to address the asbestos problem, several states, including Texas and Florida, have implemented a medical criteria reform approach that only permits litigation to proceed when a plaintiff can establish and demonstrate actual physical impairment.

Much like tort reform, asbestos litigation reform has also spurred a significant increase in the number of lawsuits filed in advance of the law's enactment. We cannot predict whether the drop off in the number of filed claims is due to the accelerated number of filings or an actual trend decline in alleged asbestos injuries.

Environmental Pollution Exposures

Environmental pollution claims represent another significant exposure for us. However, environmental pollution claims have been developing as expected over the past few years as a result of stable claim trends. Claims against Fortune 500 companies are generally declining, and while insureds with single-site exposures are still active, in many cases claims are being settled for less than initially anticipated due to improved site remediation technology and effective policy buy-backs.

Despite the stability of recent trends, there remains significant uncertainty involved in estimating liabilities related to these exposures. Unlike asbestos claims which are generated primarily from allegedly injured private individuals, environmental claims generally result from governmentally initiated activities. First, the number of waste sites subject to cleanup is unknown. Approximately 1,282 sites are included on the National Priorities List (NPL) of the United States Environmental Protection Agency as of the most recent rulemaking dated September 30, 2010, an increase of 12 sites from the prior year. State authorities have separately identified many additional sites and, at times, aggressively implement site cleanups. Second, the liabilities of the insureds themselves are difficult to estimate. At any given site, the allocation of remediation cost among the potentially responsible parties varies greatly depending upon a variety of factors. Third, as with asbestos liability and coverage issues, judicial precedent regarding liability and coverage issues regarding pollution claims does not provide clear guidance. There is also uncertainty as to the U.S. federal Superfund law itself and, at this time, we cannot predict what, if any, reforms to this law might be enacted by the U.S. federal government, or the effect of any such changes on the insurance industry.

Other Latent Exposures

While we do not view health hazard exposures such as silica and tobacco as becoming a material concern, recent developments in lead litigation have caused us to watch these matters closely. Recently, municipal and state governments have had success, using a public nuisance theory, pursuing the former makers of lead pigment for the abatement of lead paint in certain home dwellings. As lead paint was used almost exclusively into the early 1970's,

large numbers of old housing stock contain lead paint that can prove hazardous to people and, particularly, children. Although governmental success has been limited thus far, we continue to monitor developments carefully due to the size of the potential awards sought by plaintiffs. See Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies Latent Claims on page 73 for a further discussion of recent lead paint developments.

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Investments

Investment Strategy and Guidelines

We derive a significant portion of our income from our invested assets. As a result, our operating results depend in part on the performance of our investment portfolio. Because of the unpredictable nature of losses that may arise under our insurance and reinsurance subsidiaries' insurance or reinsurance policies and as a result of our opportunistic commutation strategy, our liquidity needs can be substantial and may arise at any time. Except for that portion of our portfolio that is invested in non-investment grade securities, we generally follow a conservative investment strategy designed to emphasize the preservation of our invested assets and provide sufficient liquidity for the prompt payment of claims and settlement of commutation payments.

As of December 31, 2010, we had cash and cash equivalents of \$1.46 billion. Our cash and cash equivalent portfolio is comprised mainly of high-grade fixed deposits, commercial paper with maturities of less than three months and money market funds.

Our investment portfolio consists primarily of investment grade-rated, liquid, fixed-maturity securities of short-to-medium term duration along with mutual funds. 87.6% of our total investment portfolio as of December 31, 2010 consisted of investment grade securities, as compared to 92.4% as of December 31, 2009. In addition, our non-investment grade securities, excluding bond funds included as part of other investments, comprised 8.2% and 7.6% of our total investment portfolio, as at December 31, 2010 and 2009, respectively, and consisted of exposures to equities, limited partnerships and limited liability companies, collectively private equities, fixed maturity securities and bond and hedge funds. Assuming the commitments to the other investments were fully funded as of December 31, 2010 out of cash balances on hand at that time, the percentage of investments held in other than investment grade securities would increase to 11.0%. As of December 31, 2009, the increase would have been to 13.0%.

We strive to structure our investments in a manner that recognizes our liquidity needs for future liabilities. In that regard, we attempt to correlate the maturity and duration of our investment portfolio to our general liability profile. If our liquidity needs or general liability profile unexpectedly change, we may not continue to structure our investment portfolio in its current manner and would adjust as necessary to meet new business needs.

Our investment performance is subject to a variety of risks, including risks related to general economic conditions, market volatility, interest rate fluctuations, foreign exchange risk, liquidity risk and credit and default risk. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. A significant increase in interest rates could result in significant losses, realized or unrealized, in the value of our investment portfolio. A significant portion of our non-investment grade securities consists of alternative investments that subject us to restrictions on redemption, which may limit our ability to withdraw funds for some period of time after the initial investment. The values of, and returns on, such investments may also be more volatile.

Investment Committee and Investment Manager

The investment committee of our board of directors supervises our investment activity. The investment committee regularly monitors our overall investment results, which it ultimately reports to the board of directors. Our investment committee is comprised of Robert J. Campbell, a member of our board of directors and the chairman of the committee, Richard J. Harris, our Chief Financial Officer, and, as of August 4, 2010, J. Christopher Flowers and Charles T. Akre, Jr., both members of our board of directors. John J. Oros served on the investment committee until his resignation as our Executive Chairman and a member of our board of directors on August 20, 2010. The investment committee met five times during the year ended December 31, 2010 in conjunction with our regularly

scheduled board of directors meetings. The committee made the following major decisions during the year: (i) approved increased allocations to equities and structured credit securities; (ii) approved increased allocation from cash into short duration securities, predominantly corporate and non-U.S. government securities; and (iii) ensured that the investment portfolio of each entity we acquired during the year met our investment criteria in regards to duration and ratings.

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As stated in *Investment Strategy and Guidelines* above, we generally follow a conservative investment strategy designed to emphasize the preservation of our invested assets and provide sufficient liquidity for the prompt payment of claims and settlement of commutation payments. Our investment portfolio consists primarily of investment grade-rated, liquid, fixed-maturity securities of short-to-medium duration and mutual funds. As of December 31, 2010, only 5.7% of our total investment portfolio was classified as Level 3 as defined in the Fair Value Measurements and Disclosure topic of the Financial Accounting Standards Board Accounting Standards Codification, or FASB ASC. Given our investment objectives, the composition of our current investment portfolio, and our business strategy to acquire insurance and reinsurance companies in run-off, our investment committee's efforts tend to be focused on the structural issues surrounding acquired portfolios. While the investment committee does review the ongoing performance of our investment portfolio, we have not experienced significant widespread liquidity or pricing issues with our portfolio that would require meaningful review by the committee.

We utilize various companies to provide investment advisory and/or management services. We have agreed to pay investment management fees to the managers. These fees, which vary depending on the amount of assets under management, are included in net investment income. The total fees we paid to our investment managers for the year ended December 31, 2010 were \$1.7 million, including approximately \$0.4 million to our largest single investment manager. We have investment management agreements with all of our managers, however, none of them are material to us.

Investment Portfolio

Accounting Treatment

Our investments primarily consist of fixed maturity securities. Our fixed maturity investments are comprised of available-for-sale and trading investments as defined in the *Investment Debt and Equity Securities* topic of FASB ASC. Available-for-sale and trading investments are carried at their fair value on the balance sheet date. Unrealized holdings gains and losses on trading investments, which represent the difference between the amortized cost and the fair market value of securities, are included in our net earnings and are reported as net realized and unrealized gains and losses. Unrealized gains and losses on available-for-sale securities are recognized as part of other comprehensive income.

Composition as of December 31, 2010 and 2009

As of December 31, 2010 and 2009, the fair value of our aggregate invested assets totaled approximately \$3.88 billion and \$3.34 billion, respectively. Aggregate invested assets included cash and cash equivalents, restricted cash and cash equivalents, fixed maturity securities, equities, short-term investments and other investments.

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The following table shows the types of securities in our portfolio, including cash equivalents, and their fair market values as of December 31, 2010 and 2009:

	December 31, 2010		December 31, 2009	
	Fair Value	% of Total Fair Value (in thousands of U.S. dollars)	Fair Value	% of Total Fair Value
Cash and cash equivalents (1)	\$ 1,455,354	37.5%	\$ 1,700,105	50.9%
U.S. government and agency	227,803	5.9%	242,395	7.3%
Non-U.S. government	386,866	10.0%	316,630	9.5%
Corporate	1,347,384	34.7%	881,692	26.4%
Municipal	2,297	0.1%	9,654	0.3%
Residential mortgage-backed	102,506	2.6%	17,644	0.5%
Commercial mortgage-backed	38,841	1.0%	30,409	0.9%
Asset backed	28,613	0.7%	33,991	1.0%
Fixed maturities	2,134,310	55.0%	1,532,415	45.9%
Other investments	234,714	6.0%	81,801	2.5%
Equities	60,082	1.5%	24,503	0.7%
Total investments	2,429,106	62.5%	1,638,719	49.1%
Total cash and investments	\$ 3,884,460	100.0%	\$ 3,338,824	100.0%

(1) Includes restricted cash and cash equivalents of \$656.2 million and \$433.7 million as of December 31, 2010 and 2009, respectively.

U.S. Government and Agency Securities

U.S. government and agency securities are comprised primarily of bonds issued by the U.S. Treasury, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

Non-U.S. Government Securities

Non-U.S. government securities represent the fixed maturity obligations of non-U.S. governmental entities. These are comprised primarily of bonds issued by the Australian, United Kingdom, French, Canadian and German governments.

Corporate Securities

Corporate securities are comprised of bonds issued by corporations that are diversified across a wide range of issuers and industries. The largest single issuer of corporate securities in our portfolio as of December 31, 2010 was National Australia Bank, which represented 5.3% of our total cash and investments and had a credit rating of AA.

Other Investments

	Year Ended December 31,	
	2010	2009
	(in thousands of U.S. dollars)	
Private equities	\$ 104,109	\$ 77,359
Bond funds	102,279	
Hedge fund	22,037	
Other	6,289	4,442
Total	\$ 234,714	\$ 81,801

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In December 2005, we invested in New NIB, a Province of Alberta limited partnership, in exchange for an approximately 1.6% limited partnership interest. New NIB was formed for the purpose of purchasing, together with certain affiliated entities, 100% of the outstanding share capital of NIBC. J. Christopher Flowers, a member of our board of directors and one of our largest shareholders, is a director of New NIB. Certain affiliates of J.C. Flowers I L.P., which is a private investment fund formed and managed by J.C. Flowers & Co. LLC, of which Mr. Flowers is its Chairman and Chief Executive Officer, and Mr. Oros, who was our Executive Chairman and a member of our board of directors until his resignation on August 20, 2010, is a managing director, also participated in the acquisition of NIBC. Certain of our officers and directors made personal investments in New NIB.

We own a non-voting 7.0% membership interest in Affirmative Investment LLC, or Affirmative. J.C. Flowers I L.P. owns the remaining 93.0% interest in Affirmative. Affirmative and its affiliates own approximately 51.0% of the outstanding stock of Affirmative Insurance Holdings, a publicly traded company.

We have a capital commitment of up to \$10.0 million in the GSC European Mezzanine Fund II, LP, or GSC. GSC invests in mezzanine securities of middle and large market companies throughout Western Europe. As of December 31, 2010, the capital contributed to GSC was \$9.9 million, with the remaining commitment being \$0.1 million.

In 2006, we committed to invest up to \$100.0 million in the Flowers Fund. As of December 31, 2010, the capital contributed to the Flowers Fund was \$97.1 million, with the remaining commitment being approximately \$2.9 million. During 2010, we received \$0.3 million in advisory service fees from the Flowers Fund. Certain of our officers and directors made personal investments in the Flowers Fund.

During 2008, we committed to invest up to \$100.0 million in J.C. Flowers III L.P., or Fund III. As of December 31, 2010, the capital contributed to Fund III was \$18.3 million, with the remaining commitment being \$81.7 million. Fund III is a private investment fund advised by J.C. Flowers & Co. LLC.

On January 28, 2009, we invested approximately \$8.7 million in JCF III Co-invest I L.P., an entity affiliated with J.C. Flowers & Co. LLC and Messrs. Flowers and Oros, in connection with its investment in certain of the operations, assets and liabilities of OneWest Bank FSB (formerly known as IndyMac Bank, F.S.B).

We had, as of December 31, 2010 and 2009, excluding our investment in Varadero International Ltd., or Varadero, investments in entities affiliated with Messrs. Flowers and Oros with a total value of \$96.1 million and \$76.1 million, respectively, and outstanding commitments to entities managed by Messrs. Flowers and Oros, for the same periods, of \$84.6 million and \$98.1 million, respectively. Our outstanding commitments may be drawn down over approximately the next five years. As at December 31, 2010, our related party investments associated with Messrs. Flowers and Oros accounted for 99.9% of our total unfunded capital commitments and 50.3% of our total amount of investments classified as other investments.

In March 2010, we committed to invest \$20.0 million in Varadero, a hedge fund. The investment manager of Varadero is Varadero Capital, L.P., of which Varadero GP, LLC is the general partner. As at December 31, 2010, we had funded 100% of our capital commitment. Both the investment manager and general partner are partially owned by an entity affiliated with us and Messrs. Flowers and Oros.

During 2010, we made investments of approximately \$85.4 million in various bond funds.

Equities

During 2007, we funded two equity portfolios that invest in both small and large market capitalization publicly traded U.S. companies. In 2009, we increased funding to those portfolios along with adding a third equity portfolio. In 2010, we further increased the funding of these equity portfolios. The equity portfolios are actively managed by two third-party managers.

Table of Contents***Ratings as of December 31, 2010 and 2009***

The investment ratings (provided by major rating agencies) for our fixed maturity securities held as of December 31, 2010 and 2009 were as follows:

	December 31, 2010		December 31, 2009	
	Fair Value	% of Total Fair Value	Fair Value	% of Total Fair Value
	(in thousands of U.S. dollars)			
AAA	\$ 812,407	38.1%	\$ 719,622	47.0%
AA	450,802	21.1%	283,418	18.5%
A	741,761	34.8%	424,841	27.7%
BBB or lower	122,257	5.7%	85,696	5.6%
Not Rated	7,083	0.3%	18,838	1.2%
Total	\$ 2,134,310	100.0%	\$ 1,532,415	100.0%

Maturity Distribution as of December 31, 2010 and 2009

The maturity distribution for our fixed maturity securities held as of December 31, 2010 and 2009 was as follows:

	December 31, 2010		December 31, 2009	
	Fair Value	% of Total Fair Value	Fair Value	% of Total Fair Value
	(in thousands of U.S. dollars)			
Due in one year or less	\$ 966,319	45.3%	\$ 639,191	41.7%
Due after one year through five years	940,017	44.0%	680,630	44.4%
Due after five years through ten years	47,627	2.2%	101,868	6.6%
Due after ten years	10,387	0.5%	28,682	1.9%
	1,964,350	92.0%	1,450,371	94.6%
Residential mortgage-backed	102,506	4.8%	17,644	1.2%
Commercial mortgage-backed	38,841	1.8%	30,409	2.0%
Asset backed	28,613	1.4%	33,991	2.2%
Total	\$ 2,134,310	100.0%	\$ 1,532,415	100.0%

Unrealized Losses as of December 31, 2010 and 2009

The unrealized losses for our fixed maturity available-for-sale securities held as of December 31, 2010 and 2009 were as follows:

	December 31, 2010			December 31, 2009		
	Fair Value	Unrealized Losses	% of Total Fair Value	Fair Value	Unrealized Losses	% of Total Fair Value
U.S. government and agency	\$ 23,777	\$ (92)	10.9%	\$ 782	\$ (13)	4.5%
Non-U.S. government	38,838	(314)	17.8%			0.0%
Corporate	129,774	(1,615)	59.3%	16,242	(867)	93.4%
Residential mortgage-backed	13,642	(234)	6.2%	369	(160)	2.1%
Commercial mortgage-backed	2,046	(11)	0.9%			0.0%
Asset backed	10,641	(346)	4.9%			0.0%
Total available-for-sale investments	\$ 218,718	(2,612)	100.0%	\$ 17,393	\$ (1,040)	100.0%

Table of Contents***Investment Returns for the Years ended December 31, 2010 and 2009***

Our investment returns for the years ended December 31, 2010 and 2009 were as follows:

	Year Ended December 31,	
	2010	2009
	(in thousands of U.S. dollars)	
Net investment income	\$ 99,906	\$ 81,371
Net realized and unrealized gains (losses)	13,137	4,237
Net investment income and net realized and unrealized gains (losses)	\$ 113,043	\$ 85,608
Effective annualized yield (1)	2.38%	2.13%

(1) Effective annualized yield is calculated by dividing net investment income, excluding writedowns and income on other investments, by the average balance of aggregate cash and cash equivalents, equities and fixed maturity securities on a carrying value basis. Trading securities where the investment return is for the benefit of insureds and reinsurers are excluded from the calculation.

Regulation***General***

The business of insurance and reinsurance is regulated in most countries, although the degree and type of regulation varies significantly from one jurisdiction to another. We have a significant presence in Bermuda, the United Kingdom, Australia and the United States and are subject to extensive regulation under the applicable statutes in these countries. A summary of the regulations governing us in these countries is set forth below.

Bermuda

As a holding company, we are not subject to Bermuda insurance regulations. However, the Insurance Act 1978 of Bermuda and related regulations, as amended, or, together, the Insurance Act, regulate the insurance business of our operating subsidiaries in Bermuda and provide that no person may carry on any insurance business in or from within Bermuda unless registered as an insurer by the Bermuda Monetary Authority, or BMA, under the Insurance Act. Insurance as well as reinsurance is regulated under the Insurance Act.

The Insurance Act also imposes on Bermuda insurance companies certain solvency and liquidity standards and auditing and reporting requirements and grants the BMA powers to supervise, investigate, require information and the production of documents and intervene in the affairs of insurance companies. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below.

Classification of Insurers. The Insurance Act distinguishes between insurers carrying on long-term business and insurers carrying on general business. There are six classifications of insurers carrying on general business, with Class 4 insurers subject to the strictest regulation. Our regulated Bermuda subsidiaries, which are incorporated to carry on general insurance and reinsurance business, are registered as Class 2 or 3A insurers in Bermuda and are

regulated as such under the Insurance Act. These regulated Bermuda subsidiaries are not licensed to carry on long-term business. Long-term business broadly includes life insurance and disability insurance with terms in excess of five years. General business broadly includes all types of insurance that are not long-term business.

Principal Representative. An insurer is required to maintain a principal office in Bermuda and to appoint and maintain a principal representative in Bermuda. For the purpose of the Insurance Act, each of our regulated Bermuda subsidiaries' principal offices is at Windsor Place, 3rd Floor, 18 Queen Street, in Hamilton, Bermuda, and each of their principal representatives is Enstar Limited. Without a reason acceptable to the BMA, an insurer may not terminate the appointment of its principal representative, and the principal representative may not cease to act in that capacity, unless 30 days' notice in writing is given to the BMA. It is the duty of the principal representative, forthwith on reaching the view that there is a likelihood that the insurer will become insolvent or that a reportable event has, to the principal representative's knowledge, occurred or is believed to have occurred, to notify the BMA and, within 14 days of such notification, to make a report in writing to the BMA setting forth all the particulars

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of the case that are available to the principal representative. For example, any failure by the insurer to comply substantially with a condition imposed upon the insurer by the BMA relating to a solvency margin or a liquidity or other ratio would be a reportable event.

Independent Approved Auditor. Every registered insurer must appoint an independent auditor who will audit and report annually on the statutory financial statements and the statutory financial return of the insurer, both of which, in the case of our regulated Bermuda subsidiaries, are required to be filed annually with the BMA. The independent auditor must be approved by the BMA and may be the same person or firm that audits our consolidated financial statements and reports for presentation to our shareholders. Our regulated Bermuda subsidiaries' independent auditor is Deloitte & Touche, who also audits our consolidated financial statements.

Loss Reserve Specialist. As a registered Class 2 or 3A insurer, each of our regulated Bermuda insurance and reinsurance subsidiaries is required, every year, to submit an opinion of its approved loss reserve specialist with its statutory financial return in respect of its losses and loss expenses provisions. The loss reserve specialist, who will normally be a qualified casualty actuary, must be approved by the BMA.

Statutory Financial Statements. Each of our regulated Bermuda subsidiaries must prepare annual statutory financial statements. The Insurance Act prescribes rules for the preparation and substance of the statutory financial statements, which include, in statutory form, a balance sheet, an income statement, a statement of capital and surplus and notes thereto. Each of our regulated Bermuda subsidiaries is required to give detailed information and analyses regarding premiums, claims, reinsurance and investments. The statutory financial statements are not prepared in accordance with U.S. GAAP and are distinct from the financial statements prepared for presentation to an insurer's shareholders under the Companies Act. As a general business insurer, each of our regulated Bermuda subsidiaries is required to submit to the BMA the annual statutory financial statements as part of the annual statutory financial return. The statutory financial statements and the statutory financial return do not form part of the public records maintained by the BMA.

Annual Statutory Financial Return. Each of our regulated insurance and reinsurance subsidiaries is required to file with the BMA a statutory financial return no later than six months, in the case of a Class 2, or four months in the case of a Class 3A, after its fiscal year end unless specifically extended upon application to the BMA. The statutory financial return for an insurer includes, among other matters, a report of the approved independent auditor on the statutory financial statements of the insurer, solvency certificates, declaration of statutory ratios, the statutory financial statements, and the opinion of the loss reserve specialist. The solvency certificates must be signed by the principal representative and at least two directors of the insurer certifying that the minimum solvency margin has been met and whether the insurer has complied with the conditions attached to its certificate of registration. The independent approved auditor is required to state whether, in its opinion, it was reasonable for the directors to make these certifications. If an insurer's accounts have been audited for any purpose other than compliance with the Insurance Act, a statement to that effect must be filed with the statutory financial return. Further, every Class 2 insurer must submit a Loss Reserve Specialist Opinion on a triennial basis, while Class 3A insurers must submit annually. Additionally, all Class 3A insurers are required to submit a Schedule of Ceded Reinsurance pursuant to the Insurance Act.

Minimum Liquidity Ratio. The Insurance Act provides a minimum liquidity ratio for general business insurers, like our regulated Bermuda insurance and reinsurance subsidiaries. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities. Relevant assets include, but are not limited to, cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable and reinsurance balances receivable. There are some categories of assets that unless specifically permitted by the BMA, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans. Relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (i.e., liabilities that are not otherwise specifically defined).

Minimum Solvency Margin, Enhanced Capital Requirement and Restrictions on Dividends and Distributions. Under the Insurance Act, the value of the general business assets of a Class 2 or 3A insurer, such as our regulated Bermuda subsidiaries, must exceed the amount of its general business liabilities by an amount greater than the

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prescribed minimum solvency margin. Each of our regulated Bermuda subsidiaries is required, with respect to its general business, to maintain a minimum solvency margin equal to the greatest of:

For Class 2 insurers:

\$250,000;

20% of net premiums written (being gross premiums written less any premiums ceded by the insurer) if net premiums do not exceed \$6,000,000 or \$1,200,000 plus 10% of net premiums written in excess of \$6,000,000; and

10% of net losses and loss expense reserves.

For Class 3A insurers:

\$1,000,000;

20% of net premiums written (being gross premiums written less any premiums ceded by the insurer) if net premiums do not exceed \$6,000,000 or \$1,200,000 plus 15% of net premiums written in excess of \$6,000,000; and

15% of net losses and loss expense reserves.

After the year ended December 31, 2011, Class 3A insurers will be required to maintain available statutory capital and surplus in an amount that is equal to or exceeds the target capital levels based on Enhanced Capital Requirements, or ECR, calculated using the Bermuda Solvency Capital Requirement, or BSCR, model. The BSCR model is a risk based capital model introduced by the BMA that measures risk and determines enhanced capital requirements and a target capital level (defined as 120% of the enhanced capital requirement) based on the subsidiary's statutory financial statements. Each of our regulated Bermuda insurance and reinsurance subsidiaries is prohibited from declaring or paying any dividends during any fiscal year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio. If the subsidiary has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any fiscal year, each of our regulated Bermuda subsidiaries will be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next fiscal year. In addition, once a Class 3A insurer is required to meet the ECR, if it is in breach of its ECR, it will be prohibited from declaring or paying dividends until it rectifies that breach.

Each of our regulated Bermuda insurance and reinsurance subsidiaries is prohibited, without the approval of the BMA, from reducing by 15% or more its total statutory capital as set out in its previous year's financial statements.

Additionally, under the Companies Act, we and each of our regulated Bermuda subsidiaries may declare or pay a dividend, or make a distribution from contributed surplus, only if we have no reasonable grounds for believing that the subsidiary is, or will be after the payment, unable to pay its liabilities as they become due, or that the realizable value of its assets will thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

Supervision, Investigation and Intervention. The BMA may appoint an inspector with extensive powers to investigate the affairs of our regulated Bermuda insurance and reinsurance subsidiaries if the BMA believes that such an investigation is in the best interests of its policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to the BMA, the BMA may direct our regulated Bermuda insurance

and reinsurance subsidiaries to produce documents or information relating to matters connected with its business. In addition, the BMA has the power to require the production of documents from any person who appears to be in possession of those documents. Further, the BMA has the power, in respect of a person registered under the Insurance Act, to appoint a professional person to prepare a report on any aspect of any matter about which the BMA has required or could require information. If it appears to the BMA to be desirable in the interests of the clients of a person registered under the Insurance Act, the BMA may also exercise the foregoing powers in relation to any company that is, or has at any relevant time been, (1) a parent company, subsidiary company or related company of that registered person, (2) a subsidiary company of a parent company of that registered person, (3) a parent company

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of a subsidiary company of that registered person or (4) a controlling shareholder of that registered person, which is a person who either alone or with any associate or associates, holds 50% or more of the shares of that registered person or is entitled to exercise, or control the exercise of, more than 50% of the voting power at a general meeting of shareholders of that registered person. If it appears to the BMA that there is a risk of a regulated Bermuda insurance and reinsurance subsidiary becoming insolvent, or that a regulated Bermuda insurance and reinsurance subsidiary is in breach of the Insurance Act or any conditions imposed upon its registration, the BMA may, among other things, direct such subsidiary (1) not to take on any new insurance business, (2) not to vary any insurance contract if the effect would be to increase its liabilities, (3) not to make certain investments, (4) to liquidate certain investments, (5) to maintain in, or transfer to the custody of a specified bank, certain assets, (6) not to declare or pay any dividends or other distributions or to restrict the making of such payments and/or (7) to limit such subsidiary's premium income.

Disclosure of Information. In addition to powers under the Insurance Act to investigate the affairs of an insurer, the BMA may require insurers and other persons to furnish information to the BMA. Further, the BMA has been given powers to assist other regulatory authorities, including foreign insurance regulatory authorities, with their investigations involving insurance and reinsurance companies in Bermuda. Such powers are subject to restrictions. For example, the BMA must be satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities of the foreign regulatory authority. Further, the BMA must consider whether cooperation is in the public interest. The grounds for disclosure are limited and the Insurance Act provides sanctions for breach of the statutory duty of confidentiality. Under the Companies Act, the Minister of Finance has been given powers to assist a foreign regulatory authority that has requested assistance in connection with inquiries being carried out by it in the performance of its regulatory functions. The Minister's powers include requiring a person to furnish him or her with information, to produce documents to him or her, to attend and answer questions and to give assistance in connection with inquiries. The Minister must be satisfied that the assistance requested by the foreign regulatory authority is for the purpose of its regulatory functions and that the request is in relation to information in Bermuda that a person has in his possession or under his control. The Minister must consider, among other things, whether it is in the public interest to give the information sought.

Notification by Shareholder Controller of New or Increased Control. Any person who, directly or indirectly, becomes a holder of at least 10%, 20%, 33% or 50% of our ordinary shares must notify the BMA in writing within 45 days of becoming such a holder. The BMA may, by written notice, object to such a person if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce their holding of ordinary shares and direct, among other things, that voting rights attaching to the ordinary shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offense.

Objection to Existing Shareholder Controller. For so long as we have as a subsidiary an insurer registered under the Insurance Act, the BMA may at any time, by written notice, object to a person holding 10% or more of the ordinary shares if it appears to the BMA that the person is not, or is no longer fit and proper to be, such a holder. In such a case, the BMA may require the shareholder to reduce its holding of ordinary shares and direct, among other things, that such shareholder's voting rights attaching to ordinary shares shall not be exercisable. A person who does not comply with such a notice or direction from the BMA will be guilty of an offense.

Certain Other Bermuda Law Considerations. Although we are incorporated in Bermuda, we are classified as a non-resident of Bermuda for exchange control purposes by the BMA. Pursuant to our non-resident status, we may engage in transactions in currencies other than Bermuda dollars and there are no restrictions on our ability to transfer funds (other than funds denominated in Bermuda dollars) in and out of Bermuda or to pay dividends to U.S. residents who are holders of our ordinary shares.

Under Bermuda law, exempted companies are companies formed for the purpose of conducting business outside Bermuda from a principal place of business in Bermuda. As exempted companies, neither we nor any of our regulated

Bermuda subsidiaries may, without the express authorization of the Bermuda legislature or under a license or consent granted by the Minister of Finance, participate in certain business transactions, including: (1) the acquisition or holding of land in Bermuda (except that held by way of lease or tenancy agreement that is required for our business and held for a term not exceeding 50 years, or that is used to provide accommodation or recreational

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facilities for our officers and employees and held with the consent of the Bermuda Minister of Finance, for a term not exceeding 21 years), (2) the taking of mortgages on land in Bermuda to secure an amount in excess of \$50,000, or (3) the carrying on of business of any kind for which we are not licensed in Bermuda, except in limited circumstances such as doing business with another exempted undertaking in furtherance of our business carried on outside Bermuda. Each of our regulated Bermuda subsidiaries is a licensed insurer in Bermuda, and, as such, may carry on activities from Bermuda that are related to and in support of its insurance business.

Ordinary shares may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act 2003 of Bermuda, which regulates the sale of securities in Bermuda. In addition, the BMA must approve all issues and transfers of securities of a Bermuda exempted company. Where any equity securities (meaning shares that entitle the holder to vote for or appoint one or more directors or securities that by their terms are convertible into shares that entitle the holder to vote for or appoint one or more directors) of a Bermuda company are listed on an appointed stock exchange (which includes Nasdaq), the BMA has given general permission for the issue and subsequent transfer of any securities of the company from and/or to a non-resident for so long as any such equity securities of the company remain so listed.

The Bermuda government actively encourages foreign investment in exempted entities like us and our regulated Bermuda subsidiaries that are based in Bermuda, but which do not operate in competition with local businesses. We and our regulated Bermuda subsidiaries are not currently subject to taxes computed on profits or income or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax or to any foreign exchange controls in Bermuda.

Under Bermuda law, non-Bermudians (other than spouses of Bermudians, holders of a permanent resident's certificate or holders of a working resident's certificate) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian, holder of a permanent resident's certificate or holder of a working resident's certificate) is available who meets the minimum standard requirements for the advertised position. In 2004, the Bermuda government announced a new immigration policy limiting the duration of work permits to six years, with specified exemptions for key employees. The categories of key employees include senior executives (chief executive officers, presidents through vice presidents), managers with global responsibility, senior financial posts (treasurers, chief financial officers through controllers, specialized qualified accountants, quantitative modeling analysts), certain legal professionals (general counsels, specialist attorneys, qualified legal librarians and knowledge managers), senior insurance professionals (senior underwriters, senior claims adjusters), experienced/specialized brokers, actuaries, specialist investment traders/analysts and senior information technology engineers/managers. All of our executive officers who work in our Bermuda office have obtained work permits.

United Kingdom

General. On December 1, 2001, the U.K. Financial Services Authority, or the FSA, assumed its full powers and responsibilities as the single statutory regulator responsible for regulating the financial services industry in respect of the carrying on of regulated activities (including deposit taking, insurance, investment management and most other financial services business by way of business in the U.K.), with the purpose of maintaining confidence in the U.K. financial system, providing public understanding of the system, securing the proper degree of protection for consumers and helping to reduce financial crime. It is a criminal offense for any person to carry on a regulated activity in the U.K. unless that person is authorized by the FSA and has been granted permission to carry on that regulated activity or falls under an exemption.

Insurance business (which includes reinsurance business) is authorized and supervised by the FSA. Insurance business in the United Kingdom is divided between two main categories: long-term insurance (which is primarily investment-related) and general insurance. Aside from certain insurers with historical exemptions, it is not possible for an insurance company to be authorized in both long-term and general insurance business. These two categories are both divided into classes (for example: permanent health and pension fund management are two classes of long-term insurance; damage to property and motor vehicle liability are two classes of general insurance). Under the Financial Services and Markets Act 2000, or the FSMA, effecting or carrying out contracts of insurance, within

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a class of general or long-term insurance, by way of business in the United Kingdom, constitutes a regulated activity requiring individual authorization. An authorized insurance company must have permission for each class of insurance business it intends to write.

Certain of our regulated U.K. subsidiaries, as authorized insurers, would be able to operate throughout the European Union, subject to certain regulatory requirements of the FSA and in some cases, certain local regulatory requirements. An insurance company with FSA authorization to write insurance business in the United Kingdom can seek consent from the FSA to allow it to provide cross-border services in other member states of the E.U. As an alternative, FSA consent may be obtained to establish a branch office within another member state. Although in run-off, our regulated U.K. subsidiaries remain regulated by the FSA, but may not underwrite new business.

As FSA authorized insurers, the insurance and reinsurance businesses of our regulated U.K. subsidiaries are subject to close supervision by the FSA. The FSA has implemented specific requirements for senior management arrangements, systems and controls of insurance and reinsurance companies under its jurisdiction, which place a strong emphasis on risk identification and management in relation to the prudential regulation of insurance and reinsurance business in the United Kingdom.

Supervision. The FSA carries out the prudential supervision of insurance companies through a variety of methods, including the collection of information from statistical returns, review of accountants' reports, visits to insurance companies and regular formal interviews.

The FSA has adopted a risk-based approach to the supervision of insurance companies. Under this approach the FSA performs a formal risk assessment of insurance companies or groups carrying on business in the U.K. periodically. The periods between U.K. assessments vary in length according to the risk profile of the insurer. The FSA performs the risk assessment by analyzing information which it receives during the normal course of its supervision, such as regular prudential returns on the financial position of the insurance company, or which it acquires through a series of meetings with senior management of the insurance company. After each risk assessment, the FSA will inform the insurer of its views on the insurer's risk profile. This will include details of any remedial action that the FSA requires and the likely consequences if this action is not taken.

Solvency Requirements. The Integrated Prudential Sourcebook requires that insurance companies maintain a required solvency margin at all times in respect of any general insurance undertaken by the insurance company. The calculation of the required margin in any particular case depends on the type and amount of insurance business a company writes. The method of calculation of the required solvency margin is set out in the Integrated Prudential Sourcebook, and for these purposes, all insurer's assets and liabilities are subject to specific valuation rules which are set out in the Integrated Prudential Sourcebook. Failure to maintain the required solvency margin is one of the grounds on which wide powers of intervention conferred upon the FSA may be exercised. For fiscal years ending on or after January 1, 2004, the calculation of the required solvency margin has been amended as a result of the implementation of the EU Solvency I Directives. In respect of liability business accepted, 150% of the actual premiums written and claims incurred must be included in the calculation, which has had the effect of increasing the required solvency margin of our regulated U.K. subsidiaries. We continuously monitor the solvency capital position of the U.K. subsidiaries and maintain capital in excess of the required solvency margin.

Insurers are required to calculate an Enhanced Capital Requirement, or ECR, in addition to their required solvency margin. This represents a more risk-sensitive calculation than the previous required solvency margin requirements and is used by the FSA as its benchmark in assessing its Individual Capital Adequacy Standards. Insurers must maintain financial resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they come due. In order to carry out the assessment as to the necessary financial resources that are required, insurers are required to identify the major sources of risk to its ability to meet its liabilities as they

come due, and to carry out stress and scenario tests to identify an appropriate range of realistic adverse scenarios in which the risk crystallizes and to estimate the financial resources needed in each of the circumstances and events identified. In addition, the FSA gives Individual Capital Guidance, or ICG, regularly to insurers and reinsurers following receipt of individual capital assessments, prepared by firms themselves. The FSA's guidance may be that a company should hold more or less than its then current level of regulatory capital, or that the company's regulatory capital should remain unaltered. We calculated the ECR for our regulated U.K. subsidiaries for the period ended December 31, 2009 and submitted those calculations in March

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2010 to the FSA as part of their statutory filings. The ECR calculations for its regulated U.K. subsidiaries for the year ended December 31, 2010 will be submitted by no later than March 31, 2011.

In addition, an insurer (other than a pure reinsurer) that is part of a group is required to perform and submit to the FSA an audited Group Capital Adequacy Return, or GCAR. The GCAR is a solvency margin calculation return in respect of its ultimate parent undertaking, in accordance with the FSA's rules. This return is not part of an insurer's own solvency return and hence will not be publicly available. Although there is no requirement for the parent undertaking solvency calculation to show a positive result, the FSA may take action where it considers that the solvency of the insurance company is or may be jeopardized due to the group solvency position. Further, an insurer is required to report in its annual returns to the FSA all material related party transactions (e.g., intra-group reinsurance, whose value is more than 5% of the insurer's general insurance business amount).

Solvency II. In April 2009, the European Parliament approved the Solvency II framework directive, due to come into force on December 31, 2012. Solvency II will set out new, strengthened EU-wide requirements on capital adequacy and risk management for insurers with the aim of increasing policyholder protection, instilling greater risk awareness and improving the international competitiveness of EU insurers.

Restrictions on Dividend Payments. U.K. company law prohibits our regulated U.K. subsidiaries from declaring a dividend to their shareholders unless they have profits available for distribution. The determination of whether a company has profits available for distribution is based on its accumulated realized profits less its accumulated realized losses. While the United Kingdom insurance regulatory laws impose no statutory restrictions on a general insurer's ability to declare a dividend, the FSA strictly controls the maintenance of each insurance company's required solvency margin within its jurisdiction. The FSA's rules require our regulated U.K. subsidiaries to obtain FSA approval for any proposed or actual payment of a dividend.

Reporting Requirements. U.K. insurance companies must prepare their financial statements under the Companies Act 2006, which requires the filing with Companies House of audited financial statements and related reports. In addition, U.K. insurance companies are required to file with the FSA regulatory returns, which include a revenue account, a profit and loss account and a balance sheet in prescribed forms. Under the Interim Prudential Sourcebook for Insurers, audited regulatory returns must be filed with the FSA within two months and 15 days (or three months where the delivery of the return is made electronically) of the company's year end. Our regulated U.K. insurance subsidiaries are also required to submit abridged quarterly information to the FSA.

Supervision of Management. The FSA closely supervises the management of insurance companies through the approved persons regime, by which any appointment of persons to perform certain specified controlled functions within a regulated entity, must be approved by the FSA.

Change of Control. FSMA regulates the acquisition of control of any U.K. insurance company authorized under FSMA. Any company or individual that (together with its or his associates) directly or indirectly acquires 20% or more of the shares in a U.K. authorized insurance company or its parent company, or is entitled to exercise or control the exercise of 20% or more of the voting power in such authorized insurance company or its parent company, would be considered to have acquired control for the purposes of the relevant legislation, as would a person who had significant influence over the management of such authorized insurance company or its parent company by virtue of his shareholding or voting power in either. A purchaser of 20% or more of our ordinary shares would therefore be considered to have acquired control of our regulated U.K. subsidiaries.

Under FSMA, any person proposing to acquire control over a U.K. authorized insurance company must give prior notification to the FSA of his intention to do so. The FSA would then have up to 60 working days (without taking into account any interruption period) to consider that person's application to acquire control. In considering whether to

approve such application, the FSA must be satisfied that both the acquirer is a fit and proper person to have such control and that the interests of consumers would not be threatened by such acquisition of control. Failure to make the relevant prior application could result in action being taken against us by the FSA.

Intervention and Enforcement. The FSA has extensive powers to intervene in the affairs of an authorized person, culminating in the ultimate sanction of the removal of authorization to carry on a regulated activity. FSMA imposes on the FSA statutory obligations to monitor compliance with the requirements imposed by FSMA, and to enforce the provisions of FSMA-related rules made by the FSA. The FSA has power, among other things, to enforce

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and take disciplinary measures in respect of breaches of both the Interim Prudential Sourcebook for Insurers and breaches of the conduct of business rules generally applicable to authorized persons.

The FSA also has the power to prosecute criminal offenses arising under FSMA, and to prosecute insider dealing under Part V of the Criminal Justice Act of 1993, and breaches of money laundering regulations. The FSA's stated policy is to pursue criminal prosecution in all appropriate cases.

Passporting. European Union directives allow our regulated U.K. subsidiaries to conduct business in European Union states other than the United Kingdom in compliance with the scope of permission granted these companies by the FSA without the necessity of additional licensing or authorization in other European Union jurisdictions. This ability to operate in other jurisdictions of the European Union on the basis of home state authorization and supervision is sometimes referred to as passporting. Insurers may operate outside their home member state either on a services basis or on an establishment basis. Operating on a services basis means that the company conducts permitted businesses in the host state without having a physical presence there, while operating on an establishment basis means the company has a branch or physical presence in the host state. In both cases, a company remains subject to regulation by its home regulator, and not by local regulatory authorities, although the company nonetheless may have to comply with certain local rules. In addition to European Union member states, Norway, Iceland and Liechtenstein (members of the broader European Economic Area) are jurisdictions in which this passporting framework applies.

Australia

In Australia, four of our subsidiaries are companies with Insurance Act 1973 authorizations. Three of these companies are insurance companies authorized to conduct run-off business and one is an authorized non-operating holding company, or NOHC. In addition, we have five Australian registered companies not authorized to conduct insurance business, but which provide services to the authorized entities.

Regulators. The authorized non-operating holding company and the authorized insurers are regulated and are subject to prudential supervision by the Australian Prudential Regulation Authority, or APRA. APRA is the primary regulatory body responsible for regulating compliance with the Insurance Act 1973, or the 1973 Act. In addition, all companies, including the non-authorized entities, must comply with the Corporations Act 2001 and its primary regulator the Australian Securities and Investments Commission, or ASIC.

APRA was established in 1998 as an independent body to supervise banks, credit unions, building societies, general insurance and reinsurance companies, life insurance, friendly societies, and most members of the superannuation industry. APRA's supervisory role over these institutions includes licensing, conducting on-site operational reviews, assessing risk, responding to queries and collecting data. In addition, APRA enforces and administers the 1973 Act and promulgates Prudential Standards to regulate the industries it supervises.

ASIC is Australia's corporate, markets and financial services regulator. In 2001, the Financial Services Reform Act 2001 amended Chapter 7 of the Corporations Act 2001 and the reforms came into force, after a transitional period, in March 2004. These reforms, as they relate to insurance and insurers, are intended to promote: confident and informed decision making by consumers of insurance products and services while facilitating efficiency, flexibility and innovation in the provision of those products and services; fairness, honesty and professionalism by those who provide insurance services; and fair, orderly and transparent markets for insurance products. In 2010, ASIC took on responsibility for regulation of Australia's domestic financial markets and their participants. Through its responsibility for the regulation of financial services, ASIC regulates the giving of advice and making of disclosures in relation to insurance products.

APRA and ASIC entered into a Memorandum of Understanding in June 2004. The objective of the Memorandum was to set out the framework for cooperation between the two agencies in areas of common interest and to set out the responsibilities of each entity. The Memorandum outlined APRA's responsibilities as the prudential supervisor of the financial services industry and ASIC's responsibilities as the body that would be monitoring, regulating and enforcing the Corporations Act and the Financial Services Reform Act and promoting market integrity.

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APRA's Powers. The 1973 Act prescribes APRA's powers in respect of the authorization and prudential supervision of general insurers. The 1973 Act aims to protect the interests of policy holders and prospective policy holders under insurance policies in ways that are consistent with the continued development of a viable, competitive and innovative insurance industry.

APRA's enforcement and disciplinary powers under the 1973 Act include powers to: (a) revoke the authorization of a general insurer or authorized non-operating holding company; (b) remove a director or senior manager of a general insurer, authorized non-operating holding company or corporate agent; (c) determine prudential standards; (d) monitor prudential matters; (e) collect information from auditors and actuaries; (f) remove auditors and actuaries; (g) investigate general insurers and unauthorized insurance matters; (h) apply to have a general insurer wound up; (i) determine insolvent insurer's liabilities in respect of early claims; (j) direct Lloyd's underwriters to not issue or renew policies; and (k) make directions in certain circumstances.

Conducting Insurance Business in Australia. The 1973 Act only permits APRA authorized bodies corporate and Lloyd's underwriters to carry on general insurance business in Australia. Those entities authorized to conduct insurance business in Australia are classified into the following categories:

Category A insurer an insurer incorporated in Australia that does not fall within any of the other categories of insurer;

Category B insurer an insurer incorporated in Australia that is also a subsidiary of a local or foreign insurance group;

Category C insurer a foreign general insurer, which is a foreign insurer operating as a foreign branch in Australia;

Category D insurer an insurer incorporated in Australia that is owned by an industry or a professional association, or by the members of the industry or professional association or a combination of both; and only underwrites business risk of the members of the association or those who are eligible to become members. Medical indemnity insurers are not included in this definition; or

Category E insurer an insurer incorporated in Australia that is a corporate captive or a partnership captive. Category E insurers are often referred to as sole parent captives.

Foreign-owned subsidiaries and foreign general insurers must be authorized by APRA to conduct business in Australia and are subject to similar legislative and prudential requirements as Australian owned and incorporated insurers.

Ownership and Control. The Financial Sector (Shareholdings) Act 1998 governs the ownership of insurers in Australia. The interest of an individual shareholder or a group of associated shareholders in an insurer is generally limited to 15% of the insurer's voting shares. A higher percentage limit may be approved by the Treasurer of the Commonwealth of Australia on national interest grounds.

The Insurance Acquisitions and Takeovers Act 1991 governs the control of and compulsory notification of proposals relating to both the acquisition and lease of Australian-registered insurance companies. All acquisition or lease proposals must be notified to the Minister for Revenue, with authority delegated to APRA, who has the discretion to make a permanent restraining order or go ahead decision regarding the proposal.

Compliance and Governance. Section 32 of the 1973 Act authorizes APRA to determine, vary and revoke prudential standards that impose different requirements to be complied with by different classes of general insurers, authorized non-operating holding companies and their respective subsidiaries. Presently APRA has issued prudential standards that apply to general insurers in relation to capital adequacy, the holding of assets in Australia, risk management, business continuity management, reinsurance management, outsourcing, audit and actuarial reporting and valuation, the transfer and amalgamation of insurance businesses, governance, and the fit and proper assessment of the insurer's responsible persons.

In November 2009, APRA released a new prudential standard entitled GPS 510-Governance with an effective commencement date of April 1, 2010. GPS 510-Governance updated the previous version of GPS 510-Governance by imposing new remuneration obligations on general insurers. GPS 510-Governance mandates that the Board of a

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general insurer (or the group Board if part of a corporate group) must have a remuneration policy that aligns remuneration and risk management. Furthermore, it requires that a Board remuneration committee must be established for each regulated entity (or each group if the regulated entity is part of a corporate group).

Capital Adequacy. APRA's prudential standards require that all insurers maintain and meet prescribed capital adequacy requirements to enable its insurance obligations to be met under a wide range of circumstances. This requires authorized insurers to hold eligible capital in excess of the minimum capital requirement. This amount may be determined using the prescribed method or an internal model based method. APRA has determined that two tiers of capital may be deemed eligible capital and may be used to determine an insurer's capital base. Tier 1 capital comprises the highest quality capital components and Tier 2 capital includes other components that fall short of the quality of Tier 1 capital but still contribute to the overall strength of the insurer. As part of the determination of the proper capital adequacy using the prescribed method, insurers must determine and consider whether or not they must apply prudentially required investment risk charges, insurance risk capital charges and concentration risk capital charges to their capital amount for the purposes of determining the applicable minimum capital requirements.

In addition to the foregoing capital adequacy regulation, APRA has determined that capital adequacy must also be regulated at the group level, see *Group Supervision and Reporting* below.

Group Supervision and Reporting. APRA introduced a new regime for group supervision and reporting in 2009. The Level 2 insurance group supervision and reporting framework applies to a Level 2 insurance group and introduced additional prudential standards, known as Level 2 prudential standards, that are to be read in conjunction with the existing prudential framework, now known as the Level 1 prudential standards. The definition of a Level 2 insurance group includes a NOHC and its controlled insurers and entities, subject to the exemption of certain non-regulated companies from the insurance group.

The foundation of APRA's approach to the supervision of Level 2 insurance groups is that the group as a whole should meet essentially the same minimum capital requirements as apply to individual general insurers. APRA deemed this approach essential to ensure that the acts of an individual insurer in a group do not alter the risk profile of other insurers in the group through financial and operational inter-relationships with other group members or through decisions taken at the group level.

For the purposes of the new group supervision and reporting prudential standards, our Australian authorized NOHC is deemed the parent entity of a Level 2 insurance group. The new prudential standards for insurance group supervision became effective on March 31, 2009 and new reporting standards apply to all Level 2 insurance groups for reporting periods commencing on or after June 30, 2009.

Capital Releases. An insurer must obtain APRA's written consent prior to making any planned reductions in its capital.

A reduction in an insurer's capital includes, but is not limited to:

- a share buyback;

- the redemption, repurchase or early repayment of any qualifying Tier 1 and Tier 2 capital instruments issued by the insurer or a special purpose vehicle;

- trading in the insurer's own shares or capital instruments outside of any arrangement agreed upon with APRA;

payment of dividends on ordinary shares that exceeds an insurer's after-tax earnings, after including payments on more senior capital instruments, in the financial year to which they relate; and

dividend or interest payments (whether whole or partial) on specific types of Tier 2 and Tier 1 capital that exceed an insurer's after-tax earnings, including any payments made on more senior capital instruments, calculated before any such payments are applied in the financial year to which they relate.

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An Australian insurer in run-off must provide APRA a valuation prepared by the appointed actuary that demonstrates that the tangible assets of the insurer, after the proposed capital reduction, are sufficient to cover its insurance liabilities to a 99.5% level of sufficiency of capital before APRA will consent to a capital release.

Assets in Australia. The 1973 Act and APRA require that all insurers are required to maintain assets in Australia at least equal to their liabilities in Australia and foreign insurers are required to maintain assets in Australia that exceed their liabilities in Australia by an amount that is greater than their minimum capital requirements.

Audit and Actuarial Reporting Requirements. APRA requires insurers to submit data in accordance with the reporting standards under the Financial Sector (Collection of Data) Act 1988. Insurers must provide quarterly returns and annual audited returns to APRA. Insurers in run-off must provide a run-off plan annually. Insurance contract transactions are accounted for on a prospective accounting basis, which results in all premium revenue, acquisition costs and reinsurance expenses being recorded directly into profit and loss. Australian Prudential Standard GPS 310 was updated effective July 1, 2010 to simplify prudential reporting obligations for general insurers.

APRA requires all insurers, except for small insurers (those insurers with less than \$20 million of gross insurance liabilities and no material long-tail insurance liabilities) to appoint an actuary. These insurers must obtain an annual insurance liability valuation report, or ILVR, and financial condition report from the appointed actuary. Although an appointed actuary for an insurer in run-off need not provide a financial condition report, he or she must provide a report