

**EVEREST INTERNATIONAL REINSURANCE, LTD.**

(a wholly owned subsidiary of Everest Re Group, Ltd.)

**GAAP Financial Statements**

**For the Years Ended December 31, 2008 and 2007**

EVEREST INTERNATIONAL REINSURANCE, LTD.  
BALANCE SHEETS

(Dollars in thousands)	December 31,	
	2008	2007
<b>ASSETS:</b>		
Fixed maturities - available for sale, at market value (amortized cost: 2008, \$480,271; 2007, \$384,884)	\$ 441,641	\$ 380,277
Equity securities - available for sale, at fair value	-	107,220
Other invested assets (cost: 2008, \$3,347; 2007, \$2,478)	3,347	2,478
Short-term investments	194,090	138,225
Cash	6,180	11,658
Total investments and cash	<u>645,258</u>	<u>639,858</u>
Accrued investment income	5,986	5,216
Premiums receivable	66,895	76,931
Funds held - reinsureds	52,029	56,026
Deferred acquisition costs	16,573	15,694
Other assets	12	4,033
<b>TOTAL ASSETS</b>	<u>\$ 786,753</u>	<u>\$ 797,758</u>
<b>LIABILITIES:</b>		
Reserve for losses and loss adjustment expenses	\$ 329,579	\$ 320,215
Unearned premium reserve	60,107	54,475
Losses in course of payment	6,651	8,945
Other liabilities	1,956	1,293
Total liabilities	<u>398,293</u>	<u>384,928</u>
Commitments and Contingencies (Note 10)		
<b>SHAREHOLDER'S EQUITY:</b>		
Common shares, par value: \$1.00; 1,064,000 issued and outstanding (2008 and 2007)	1,064	1,064
Additional paid-in capital	280,509	280,509
Accumulated other comprehensive (loss) income	(38,631)	7,665
Retained earnings	145,518	123,592
Total shareholder's equity	<u>388,460</u>	<u>412,830</u>
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>	<u>\$ 786,753</u>	<u>\$ 797,758</u>

The accompanying notes are an integral part of the financial statements.

EVEREST INTERNATIONAL REINSURANCE, LTD.  
 STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME

(Dollars in thousands)	December 31,	
	2008	2007
<b>REVENUES:</b>		
Premiums earned	\$ 248,456	\$ 266,287
Net investment income	24,249	24,927
Net realized capital (losses) gains	(55,963)	3,676
Other income (expense)	15,150	(6,908)
Total revenues	<u>231,892</u>	<u>287,982</u>
<b>CLAIMS AND EXPENSES:</b>		
Incurred losses and loss adjustment expenses	134,616	152,894
Commission, brokerage, taxes and fees	74,156	79,490
Other underwriting expenses	489	486
Total claims and expenses	<u>209,261</u>	<u>232,870</u>
NET INCOME BEFORE TAXES	22,631	55,112
Income tax expense	<u>705</u>	<u>311</u>
NET INCOME	<u>\$ 21,926</u>	<u>\$ 54,801</u>
Other comprehensive (loss) income	<u>(46,296)</u>	<u>8,287</u>
COMPREHENSIVE (LOSS) INCOME	<u>\$ (24,370)</u>	<u>\$ 63,088</u>

The accompanying notes are an integral part of the financial statements.

EVEREST INTERNATIONAL REINSURANCE, LTD.  
STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

(Dollars in thousands, except share amounts)	December 31,	
	2008	2007
<b>COMMON SHARES (shares outstanding):</b>		
Balance, beginning of period	1,064,000	1,064,000
Balance, end of period	<u>1,064,000</u>	<u>1,064,000</u>
<b>COMMON SHARES (par value):</b>		
Balance, beginning of period	\$ 1,064	\$ 1,064
Balance, end of period	<u>1,064</u>	<u>1,064</u>
<b>ADDITIONAL PAID-IN CAPITAL:</b>		
Balance, beginning of period	280,509	280,509
Balance, end of period	<u>280,509</u>	<u>280,509</u>
<b>ACCUMULATED OTHER COMPREHENSIVE LOSS:</b>		
Balance, beginning of period	7,665	(622)
Net (decrease) increase during the period	(46,296)	8,287
Balance, end of period	<u>(38,631)</u>	<u>7,665</u>
<b>RETAINED EARNINGS:</b>		
Balance, beginning of period	123,592	68,791
Net income	21,926	54,801
Balance, end of period	<u>145,518</u>	<u>123,592</u>
<b>TOTAL SHAREHOLDER'S EQUITY, END OF PERIOD</b>	<u>\$ 388,460</u>	<u>\$ 412,830</u>

The accompanying notes are an integral part of the financial statements.

EVEREST INTERNATIONAL REINSURANCE, LTD.  
STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Years Ended December 31,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 21,926	\$ 54,801
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease in premiums receivable	10,036	11,790
Decrease (increase) in funds held by reinsureds, net	3,997	(17,533)
Increase in reserve for losses and loss adjustment expenses	9,364	76,606
Increase in unearned premiums	5,632	42
Change in equity adjustments in limited partnerships	1,008	288
Change in other assets and liabilities, net	737	(36,359)
Amortization of bond premium	100	(824)
Non-cash change in foreign exchange on investments	(12,272)	5,508
Net realized capital losses (gains)	55,963	(3,676)
Net cash provided by operating activities	<u>96,491</u>	<u>90,643</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from fixed maturities matured/called - available for sale, at market value	24,379	21,712
Proceeds from fixed maturities sold - available for sale, at market value	18,345	5,825
Proceeds from equity securities sold - available for sale, at fair value	90,454	231,914
Cost of fixed maturities acquired - available for sale, at market value	(146,418)	(69,404)
Cost of equity securities acquired - available for sale, at fair value	(32,025)	(335,205)
Cost of other invested assets acquired	(1,876)	(2,766)
Net (purchases) sales of short-term securities	(54,831)	43,639
Net decrease in unsettled securities transactions	3	47
Net cash used in investing activities	<u>(101,969)</u>	<u>(104,238)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net cash used in financing activities	<u>-</u>	<u>-</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>		
	<u>-</u>	<u>-</u>
Net decrease in cash	(5,478)	(13,595)
Cash, beginning of period	11,658	25,253
Cash, end of period	<u>\$ 6,180</u>	<u>\$ 11,658</u>

The accompanying notes are an integral part of the financial statements.

**EVEREST INTERNATIONAL REINSURANCE, LTD.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Years Ended December 31, 2008 and 2007**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Business and Basis of Presentation.**

Everest International Reinsurance, Ltd. (the "Company" or "Everest International"), a Bermuda insurance company and direct wholly owned subsidiary of Everest Re Group, Ltd. ("Group") is registered as a Class 4 general insurer and long-term insurer (effective December 16, 2008). The Company's operations include the reinsuring of property and casualty products. Currently, this business is the result of two quota share reinsurance agreements with affiliates: (1) Everest Reinsurance Company ("Everest Re") and (2) Everest Reinsurance (Bermuda), Ltd. ("Bermuda Re").

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). All amounts are reported in U.S. dollars.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities (and disclosure of contingent assets and liabilities) at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ultimate actual results could differ, possibly materially, from those estimates.

**B. Investments.**

Fixed maturity security investments are all classified as available for sale. Unrealized appreciation and depreciation, as a result of temporary changes in market value during the period, are reflected in shareholder's equity in "accumulated other comprehensive income" in the balance sheets. Equity securities are carried at fair value with fair value re-measurements reflected as net realized capital gains and losses in the statements of operations and comprehensive income. Unrealized losses on fixed maturities, which are deemed other-than-temporary, are charged to net income as net realized capital losses. Short-term investments are stated at cost, which approximates market value. Realized gains or losses on the sales of investments are determined on the basis of identified cost. For non-publicly traded securities, market prices are determined through the use of pricing models that evaluate securities relative to the U.S. Treasury yield curve, taking into account the issue type, credit quality and cash flow characteristics of each security. For publicly traded securities, market value is based on quoted market prices or valuation models that use observable market inputs. When a sector of the financial markets is inactive or illiquid, the Company may use its own assumptions about future cash flows and risk-adjusted discount rates to determine fair value. Retrospective adjustments are employed to recalculate the values of asset-backed securities. Each acquisition lot is reviewed to recalculate the effective yield. The recalculated effective yield is used to derive a book value as if the new yield were applied at the time of acquisition. Outstanding principal factors from the time of acquisition to the adjustment date are used to calculate the prepayment history for all applicable securities. Conditional prepayment rates, computed with life to date factor histories and weighted average maturities, are used to effect the calculation of projected and prepayments for pass-through security types. Other invested assets include limited partnerships. Limited partnerships are accounted for under the equity method of accounting, which may be recorded on a monthly or quarterly lag.

**C. Deferred Acquisition Costs.**

Acquisition costs, consisting principally of commissions and brokerage expenses and other fees incurred at the time a contract or policy is issued and that vary with and are directly related to the Company's reinsurance and insurance business, are deferred and amortized over the period in which the related premiums are earned, generally one year. Deferred acquisition costs are limited to their estimated realizable value by line of business based on the related unearned premiums, anticipated claims and claim expenses and anticipated investment income. Deferred acquisition costs amortized to income were \$74.2 million and \$79.5 million in 2008 and 2007, respectively.

**D. Reserve for Losses and Loss Adjustment Expenses.**

The reserve for losses and loss adjustment expenses (“LAE”) is based on individual case estimates and reports received from ceding companies. A provision is included for losses and LAE incurred but not reported (“IBNR”) based on past experience. See also Note 3. The reserves are reviewed periodically and any changes in estimates are reflected in earnings in the period the adjustment is made. The Company’s loss and LAE reserves represents management’s best estimate of the ultimate liability.

Accruals for commissions are established for reinsurance contracts that provide for the stated commission percentage to increase or decrease based on the loss experience of the contract. Changes in estimates for such arrangements are recorded as commission expense. Commission accruals for contracts with adjustable features are estimated based on expected loss and LAE.

**E. Premium Revenues.**

Written premiums are earned ratably over the periods of the related reinsurance contracts. Unearned premium reserves are established relative to the unexpired contract period. Such reserves are established based upon reports received from ceding companies or estimated using pro rata methods based on statistical data. Reinstatement premiums represent additional premium received on reinsurance coverages, most prevalently catastrophe related, when limits have been depleted under the original reinsurance contract and additional coverage is granted. Written and earned premiums and the related costs, which have not yet been reported to the Company, are estimated and accrued.

**F. Income Taxes.**

Under the current Bermuda law, no income or capital gains taxes are imposed on the Company. The Minister of Finance of Bermuda has also assured the Company that, pursuant to the Exempted Undertakings Tax Protection Act of 1966, they will be exempt until 2016 from any such taxes imposed in the future.

**G. Foreign Currency.**

Gains and losses resulting from foreign currency transactions, other than debt securities available for sale, are recorded through the statements of operations and comprehensive income (loss) in other income (expense). Gains and losses resulting from changes in the foreign currency exchange rates on debt securities, available for sale at market value, are recorded in the balance sheets in accumulated other comprehensive income (loss) as unrealized appreciation (depreciation).

**H. Application of New Accounting Standards.**

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“FAS”) No. 157 “Fair Value Measurements” (“FAS 157”). FAS 157 defines fair value, establishes a framework for measuring fair value consistently in GAAP and expands disclosures about fair value measurements. The Company adopted FAS 157 as of January 1, 2007.

In February 2007, the FASB issued FAS No. 159 “The Fair Value Option for Financial Assets and Financial Liabilities - including an amendment to FASB Statement No. 115” (“FAS 159”). FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Company adopted FAS 159 as of January 1, 2007.

In October 2008, the FASB issued FASB Staff Position FAS 157-3 “Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active” (“FAS 157-3”). FAS 157-3 clarifies the application of FAS No. 157 “Fair Value Measurements” (“FAS 157”), in a market that is not active. This FASB Staff Position is effective upon issuance.

## 2. INVESTMENTS

The amortized cost, market value, and gross unrealized appreciation and depreciation of available for sale, market value fixed maturity security investments are as follows for the periods indicated:

(Dollars in thousands)	At December 31, 2008			
	Amortized	Unrealized	Unrealized	Market
	Cost	Appreciation	Depreciation	Value
Fixed maturities - available for sale				
U.S. Treasury securities and obligations of				
U.S. government agencies and corporations	\$ 1,124	\$ 228	\$ -	\$ 1,352
Corporate securities	150,790	2,268	(13,062)	139,996
Mortgage-backed securities	122,921	1,811	(5,923)	118,809
Foreign government securities	121,632	2,983	(15,424)	109,191
Foreign corporate securities	83,804	872	(12,383)	72,293
Total fixed maturities	<u>\$ 480,271</u>	<u>\$ 8,162</u>	<u>\$ (46,792)</u>	<u>\$ 441,641</u>

(Dollars in thousands)	At December 31, 2007			
	Amortized	Unrealized	Unrealized	Market
	Cost	Appreciation	Depreciation	Value
Fixed maturities - available for sale				
U.S. Treasury securities and obligations of				
U.S. government agencies and corporations	\$ 1,127	\$ 5	\$ -	\$ 1,132
Corporate securities	135,439	352	(3,384)	132,407
Mortgage-backed securities	95,489	382	(874)	94,997
Foreign government securities	79,511	178	(920)	78,769
Foreign corporate securities	73,318	334	(680)	72,972
Total fixed maturities	<u>\$ 384,884</u>	<u>\$ 1,251</u>	<u>\$ (5,858)</u>	<u>\$ 380,277</u>

The amortized cost and market value of fixed maturities are shown in the following table by contractual maturity. Mortgage-backed securities generally are more likely to be prepaid than other fixed maturities. As the stated maturity of such securities may not be indicative of actual maturities, the total for mortgage-backed securities is shown separately.

(Dollars in thousands)	At December 31, 2008	
	Amortized	Market
	Cost	Value
Fixed maturities - available for sale		
Due in one year or less	\$ 33,928	\$ 31,116
Due after one year through five years	127,717	117,480
Due after five years through ten years	153,287	136,544
Due after ten years	42,418	37,692
Mortgage-backed securities	122,921	118,809
Total	<u>\$ 480,271</u>	<u>\$ 441,641</u>

The changes in net unrealized (losses) gains for the Company's investments are derived from the following sources for the periods indicated:

(Dollars in thousands)	Years Ended December 31,	
	2008	2007
Increase (decrease) during the period between the market value and cost of investments carried at market value:		
Fixed maturities	\$ (34,024)	\$ 2,779
Change in unrealized appreciation included in shareholder's equity	\$ (34,024)	\$ 2,779

The Company frequently reviews its investment portfolio for declines in market value and focuses its attention on securities whose fair value has fallen below 80% of their amortized value at the time of review. The Company then assesses whether the decline in value is temporary or other-than-temporary. In making its assessment, the Company evaluates the current market and interest rate environment as well as specific issuer information and the Company's ability and intent to hold to recovery. Generally, a change in a security's value caused by a change in the market or interest rate environment does not constitute an other-than-temporary impairment, but rather a temporary decline in market value. Temporary declines in market value are recorded as unrealized losses in accumulated other comprehensive income. If the Company determines that the decline is other-than-temporary, the carrying value of the investment is written down to fair value and a realized loss is recorded in the Company's statements of operations and comprehensive (loss) income. The Company's assessments are based on the issuer's current and expected future financial position, timeliness with respect to interest and/or principal payments, speed of repayments and any applicable credit enhancements or breakeven constant default rates on asset-backed securities, as well as relevant information provided by rating agencies, investment advisors and analysts.

The table below displays the aggregate market value and gross unrealized depreciation of fixed maturity securities, by investment category and maturity category by length of time that individual securities had been in a continuous unrealized loss position for the period indicated:

(Dollars in thousands)	Duration by security type of unrealized loss at December 31, 2008					
	Less than 12 months		Greater than 12 months		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
	Market Value	Depreciation	Market Value	Depreciation	Market Value	Depreciation
Fixed maturity securities						
U.S. government agencies and authorities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Foreign governments	58,883	(10,704)	16,733	(4,720)	75,616	(15,424)
All other corporate	82,891	(12,178)	118,734	(19,190)	201,625	(31,368)
Total fixed maturities	\$ 141,774	\$ (22,882)	\$ 135,467	\$ (23,910)	\$ 277,241	\$ (46,792)

Duration by maturity of unrealized loss at December 31, 2008						
	Less than 12 months		Greater than 12 months		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
(Dollars in thousands)	Market Value	Depreciation	Market Value	Depreciation	Market Value	Depreciation
Fixed maturity securities						
Due in one year or less	\$ 1,674	\$ (461)	\$ 17,793	\$ (3,501)	\$ 19,467	\$ (3,962)
Due in one year through five years	41,814	(5,834)	46,881	(5,932)	88,695	(11,766)
Due in five years through ten years	66,626	(11,132)	37,730	(8,033)	104,356	(19,165)
Due after ten years	17,110	(4,088)	8,476	(1,888)	25,586	(5,976)
Mortgage-backed securities	14,550	(1,367)	24,587	(4,556)	39,137	(5,923)
Total fixed maturities	\$ 141,774	\$ (22,882)	\$ 135,467	\$ (23,910)	\$ 277,241	\$ (46,792)

The aggregate market value and gross unrealized losses related to investments in an unrealized loss position as of December 31, 2008 were \$277.2 million and \$46.8 million, respectively. There were no unrealized losses on a single security that exceeded 0.8% of the market value of the fixed maturities at December 31, 2008. In addition, there was no significant concentration of unrealized losses in any one market sector. The \$22.9 million of unrealized losses related to fixed maturity securities that had been in an unrealized loss position for less than one year were generally comprised of highly rated corporate and mortgage-backed securities with the losses primarily the result of widening credit spreads from the financial markets crisis during the latter part of the year. Of these unrealized losses, \$22.7 million were related to securities that were rated investment grade or better by at least one nationally recognized statistical rating organization. The \$23.9 million of unrealized losses related to fixed maturity securities in an unrealized loss position for more than one year also related primarily to highly rated corporate and mortgage-backed securities with the losses primarily the result of widening credit spreads during the latter part of the year. Of these unrealized losses, \$22.4 million were related to securities that were rated investment grade or better by at least one nationally recognized statistical rating organization.

The Company, given the size of its investment portfolio and capital position, has the ability to hold these securities until recovery of market value. In addition, all securities currently in an unrealized loss position are current with respect to principal and interest payments.

The table below displays the aggregate market value and gross unrealized depreciation of fixed maturity securities, by investment category and maturity category by length of time that individual securities had been in a continuous unrealized loss position for the period indicated:

Duration by security type of unrealized loss at December 31, 2007						
	Less than 12 months		Greater than 12 months		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
(Dollars in thousands)	Market Value	Depreciation	Market Value	Depreciation	Market Value	Depreciation
Fixed maturity securities						
U.S. government agencies and authorities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Foreign governments	7,365	(302)	53,792	(618)	61,157	(920)
All other corporate	28,832	(424)	173,960	(4,514)	202,792	(4,938)
Total fixed maturities	\$ 36,197	\$ (726)	\$ 227,752	\$ (5,132)	\$ 263,949	\$ (5,858)

Duration by maturity of unrealized loss at December 31, 2007

	Less than 12 months		Greater than 12 months		Total	
	Gross Unrealized		Gross Unrealized		Gross Unrealized	
	Market Value	Depreciation	Market Value	Depreciation	Market Value	Depreciation
(Dollars in thousands)						
Fixed maturity securities						
Due in one year or less	\$ -	\$ -	\$ 10,726	\$ (42)	\$ 10,726	\$ (42)
Due in one year through five years	5,134	(76)	100,065	(1,102)	105,199	(1,178)
Due in five years through ten years	22,285	(377)	51,007	(2,266)	73,292	(2,643)
Due after ten years	5,289	(244)	12,835	(877)	18,124	(1,121)
Mortgage-backed securities	3,489	(29)	53,119	(845)	56,608	(874)
Total fixed maturities	<u>\$ 36,197</u>	<u>\$ (726)</u>	<u>\$ 227,752</u>	<u>\$ (5,132)</u>	<u>\$ 263,949</u>	<u>\$ (5,858)</u>

The aggregate market value and gross unrealized losses related to investments in an unrealized loss position as of December 31, 2007 were \$263.9 million and \$5.9 million, respectively. There were no material concentrations of unrelated losses by issuer, security type or industry within the fixed maturity portfolio. The \$0.7 million of unrealized losses related to fixed maturity securities that had been in an unrealized loss position for less than one year were generally comprised of highly rated corporate securities and the losses were primarily the result of interest rates being higher than when the securities were purchased. Of these unrealized losses, \$0.7 million were related to securities that were rated investment grade or better by at least one nationally recognized statistical rating organization. The \$5.1 million of unrealized losses related to fixed maturity securities in an unrealized loss position for more than one year also related primarily to highly rated corporate and mortgage-backed securities and were the result of interest rates being higher than when the securities were purchased. Of these unrealized losses, \$4.7 million related to securities that were rated investment grade or better by at least one nationally recognized statistical rating organization.

The components of net investment income are presented in the table below for the periods indicated:

	Years Ended December 31,	
	2008	2007
(Dollars in thousands)		
Fixed maturities	\$ 20,120	\$ 18,096
Equity securities	2,165	1,325
Short-term investments and cash	3,519	6,191
Other invested assets		
Limited partnerships	(953)	(273)
Total gross investment income	<u>24,851</u>	<u>25,339</u>
Interest credited and other expense	(602)	(412)
Total net investment income	<u>\$ 24,249</u>	<u>\$ 24,927</u>

The Company had a contractual commitment to invest up to an additional \$9.5 million in a limited partnership at December 31, 2008. This commitment will be funded when called in accordance with the partnership agreement, which has an investment period that expires, unless extended, through 2012.

The components of net realized capital (losses) gains are presented in the table below for the periods indicated:

(Dollars in thousands)	Years Ended December 31,	
	2008	2007
Fixed maturities, market value:		
Other-than-temporary impairments	\$ (6,646)	\$ (25)
Losses from sales	(527)	(228)
Equity securities, fair value:		
(Losses) gains from sales	(24,352)	6,768
Losses from fair value adjustments	(24,439)	(2,838)
Short-term investments gains (losses)	1	(1)
Total net realized capital (losses) gains	<u>\$ (55,963)</u>	<u>\$ 3,676</u>

Proceeds from sales of fixed maturity investments during 2008 and 2007 were \$18.3 million and \$5.8 million, respectively. Gross gains of \$0.5 million and \$0.0 million and gross losses of \$1.0 million and \$0.2 million were realized on those fixed maturity sales during 2008 and 2007, respectively. Proceeds from sales of equity security investments during 2008 and 2007 were \$90.5 million and \$231.9 million, respectively. Gross gains of \$1.6 million and \$7.3 million and gross losses of \$26.0 million and \$0.5 million were realized on those equity sales during 2008 and 2007, respectively.

Included in net realized capital (losses) gains for 2008 and 2007 was \$6.6 million and \$.03 million, respectively, for write-downs in the value of securities deemed to be impaired on an other-than-temporary basis.

### 3. RESERVE FOR LOSSES AND LAE

#### Reserves for losses and LAE.

Activity in the reserve for losses and LAE is summarized for the periods indicated:

(Dollars in thousands)	At December 31,	
	2008	2007
Gross reserves at January 1	\$ 320,215	\$ 243,610
Less reinsurance recoverables	-	-
Net reserves at January 1	<u>320,215</u>	<u>243,610</u>
Incurred related to:		
Current year	115,450	146,038
Prior years	19,166	6,856
Total incurred losses and LAE	<u>134,616</u>	<u>152,894</u>
Paid related to:		
Current year	26,907	26,094
Prior years	60,420	58,013
Total paid losses and LAE	<u>87,327</u>	<u>84,107</u>
Foreign exchange/translation adjustment	<u>(37,925)</u>	<u>7,818</u>
Net reserves at December 31	329,579	320,215
Plus reinsurance recoverables	-	-
Gross reserves at December 31	<u>\$ 329,579</u>	<u>\$ 320,215</u>

Prior years' reserves increased by \$19.2 million and \$6.9 million for the years ended December 31, 2008 and 2007, respectively. The increase for 2008 and 2007 was due to loss development under both quota share agreements.

#### 4. FAIR VALUE

The Company records fair value re-measurements as net realized capital gains or losses in the statements of operations and comprehensive income (loss) in accordance with FAS 159. The Company recorded \$24.4 million in net realized capital losses due to fair value re-measurement on equity securities at fair value for the year ended December 31, 2008. The Company recorded \$2.8 million in net realized capital losses due to fair value re-measurements on equity securities at fair value for the year ended December 31, 2007.

The Company's fixed maturities and equity securities are managed by a third party investment asset manager and market and fair values for these securities are obtained from third party pricing services retained by the investment asset manager. In limited instances where prices are not provided by the pricing services, price quotes on a non-binding basis are obtained from investment brokers. The investment asset manager has procedures in place to review the reasonableness of the prices from the service providers and may obtain additional price quotes for verification. In addition, the Company tests the prices on a random basis to an independent pricing source. In limited situations, where financial markets are inactive or illiquid, the Company may use its own assumptions about future cash flows and risk-adjusted discount rates to determine fair value.

Fixed maturities are categorized as Level 2, Significant Other Observable Inputs, since a particular security may not have traded but the pricing services are able to use valuation models with observable market inputs such as interest rate yield curves and prices for similar fixed maturities in terms of issuer, maturity and seniority. Valuations that are derived from techniques in which one or more of the significant inputs are unobservable (including assumptions about risk) are categorized as Level 3, Significant Unobservable Inputs. These securities include broker priced securities and valuation of less liquid securities such as commercial mortgage-backed securities.

Equity securities in U.S. denominated currency are categorized as Level 1, Quoted Prices in Active Markets for Identical Assets, since the securities are actively traded on an exchange and prices are based on quoted prices from the exchange. Equity securities traded on foreign exchanges are categorized as Level 2 due to potential foreign exchange adjustments to fair value.

The following tables present the fair value measurement levels for all assets and liabilities, which the Company has recorded at fair value as of the periods indicated:

		Fair Value Measurement Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)	<u>December 31, 2008</u>			
Assets:				
Fixed maturities, market value	\$ 441,641	\$ -	\$ 425,170	\$ 16,471

	December 31, 2007	Fair Value Measurement Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)				
Assets:				
Fixed maturities, market value	\$ 380,277	\$ -	\$ 356,577	\$ 23,700
Equity securities, fair value	107,220	83,418	23,802	-

The following table presents the fixed maturity investments for which fair value was measured under Level 3, fair value measurements using significant unobservable inputs, for the period indicated:

(Dollars in thousands)	Years Ended December 31,	
	2008	2007
Assets:		
Beginning balance at January 1	\$ 23,700	\$ 20,888
Total gains or (losses) (realized/unrealized)		
Included in earnings (or changes in net assets)	-	(135)
Included in other comprehensive income	(473)	188
Purchases, issuances and settlements	2,375	2,759
Transfers in and/or (out) of Level 3	(9,131)	-
Ending balance at December 31	\$ 16,471	\$ 23,700
The amount of total gains or losses for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	\$ -	\$ -

## 5. CREDIT LINES

Effective July 27, 2007, Group, Bermuda Re and Everest International entered into a new five year, \$850.0 million senior credit facility with a syndicate of lenders, replacing the December 8, 2004, senior credit facilities, which would have expired on December 8, 2007. Both the July 27, 2007 and December 8, 2004 senior credit facilities are referred to as the "Group Credit Facility". Wachovia Bank, a subsidiary of Wells Fargo Corporation ("Wachovia Bank") is the administrative agent for the Group Credit Facility, which consists of two tranches. Tranche one provides up to \$350.0 million of unsecured revolving credit for liquidity and general corporate purposes, and for the issuance of unsecured standby letters of credit. The interest on the revolving loans shall, at the Company's option, be either (1) the Base Rate (as defined below) or (2) an adjusted London Interbank Offered Rate ("LIBOR") plus a margin. The Base Rate is the higher of (a) the prime commercial lending rate established by Wachovia Bank or (b) the Federal Funds Rate plus 0.5% per annum. The amount of margin and the fees payable for the Group Credit Facility depends on Group's senior unsecured debt rating. Tranche two exclusively provides up to \$500.0 million for the issuance of standby letters of credit on a collateralized basis.

The Group Credit Facility requires Group to maintain a debt to capital ratio of not greater than 0.35 to 1 and to maintain a minimum net worth. Minimum net worth is an amount equal to the sum of \$3,575.4 million plus 25% of consolidated net income for each of Group's fiscal quarters, for which statements are available ending on or after January 1, 2007 and for which consolidated net income is positive, plus 25% of any increase in consolidated net worth during such period attributable to the issuance of ordinary and preferred shares, which at December 31, 2008, was \$3,856.5 million. As of December 31, 2008, Group was in compliance with all Group Credit Facility covenants.

At December 31, 2008 and 2007, there were no outstanding letters of credit under tranche one and tranche two of the Group Credit Facility on behalf of the Company.

## 6. INCOME TAXES

Under Bermuda law, no income or capital gains taxes are imposed on Everest International. The Minister of Finance of Bermuda has also assured Everest International that, pursuant to The Exempted Undertakings Tax Protection Act of 1966, it will be exempt until 2016 from imposition of any such taxes.

The provision for income taxes in the statement of operations and comprehensive income was the result of withholding taxes on dividends from equity securities. The significant components of the provision are as follows for the periods indicated:

	Years Ended December 31,	
	2008	2007
(Dollars in thousands)		
Current foreign tax	\$ 705	\$ 311
Total income tax expense	\$ 705	\$ 311

Reconciliation of the difference between the provision for income taxes and the expected tax provision at the weighted average tax rate for the periods indicated is provided below:

	Years Ended December 31,	
	2008	2007
(Dollars in thousands)		
Withholding taxes	\$ 705	\$ 311
Total income tax provision	\$ 705	\$ 311

## 7. REINSURANCE

Premiums written and earned and incurred losses and LAE are comprised of the following for the periods indicated:

	Years Ended December 31,	
	2008	2007
(Dollars in thousands)		
Written premiums:		
Assumed	\$ 254,087	\$ 266,297
Net written premiums	\$ 254,087	\$ 266,297
Premiums earned:		
Assumed	\$ 248,456	\$ 266,287
Net premiums earned	\$ 248,456	\$ 266,287
Incurred losses and LAE:		
Assumed	\$ 134,616	\$ 152,894
Net incurred losses and LAE	\$ 134,616	\$ 152,894

The Company engages in reinsurance transactions with Everest Re and Bermuda Re, primarily driven by enterprise risk and capital management considerations under which business is assumed at market rates and terms. These transactions include:

- Effective January 1, 2004, Everest Re entered into a whole account quota share reinsurance agreement (“whole account quota share”) with Everest International, whereby Everest Re ceded 2.5% of its business to Everest International of the net retained liability on all new and renewal covered business written during the term of this agreement. This remained in effect through December 31, 2005.
- Effective January 1, 2004, Bermuda Re entered into a whole account quota share with Everest International, whereby Bermuda Re’s UK branch ceded to Everest International 25.0% of its net retained liability on all new and renewal policies underwritten during the term of this agreement. This remained in effect through December 31, 2005.
- Effective January 1, 2006, Everest Re and Everest International amended the whole account quota share so that for all new and renewal business recorded on or after January 1, 2006, Everest Re ceded 3.5% of its casualty business to Everest International and Everest Re ceded 2.5% of its property business to Everest International. However, in no event shall the loss cessions to Everest International relating to any one occurrence on the property business exceed \$12.5 million (2.0% of \$625.0 million). The property portion of this amendment remained in effect through December 31, 2006. The casualty portion remained in effect through December 31, 2007.
- Effective January 1, 2006, Bermuda Re and Everest International amended the whole account quota share, through which Bermuda Re previously ceded 25.0% of its UK branch business to Everest International so that effective January 1, 2006, Bermuda Re ceded 30.0% to Everest International of the net retained liability on all new and renewed policies underwritten by its UK branch during the term of this agreement. However, in no event shall the loss cessions to Everest International relating to any one occurrence on the property business exceed £68.6 million (USD \$120.0 million) (being 30% of £228.5 million (USD \$400.0 million)). This amendment remained in effect through December 31, 2008.
- Effective January 1, 2007, Everest Re and Everest International amended the whole account quota share so that for all new and renewal property business recorded on or after January 1, 2007, Everest Re ceded 2.5% to Everest International. However, in no event shall the loss cessions to Everest International relating to any one occurrence on the property business exceed \$13.0 million (10.0% of \$130.0 million). This amendment remained in effect through December 31, 2007.
- Effective January 1, 2008, Everest Re and Everest International amended the whole account quota share so that for all new and renewal casualty and property business recorded on or after January 1, 2008, Everest Re ceded 4.0% to Everest International. However, in no event shall the loss cessions to Everest International relating to any one catastrophe occurrence on the property business exceed \$13.0 million (10.0% of \$130.0 million) or in the aggregate for each underwriting year for all property catastrophes exceed \$27.5 million (10.0% of \$275.0 million). This amendment remained in effect through December 31, 2008.
- Effective January 1, 2009, Everest Re and Everest International amended the whole account quota share whereby, for all new and renewal casualty and property business recorded on or after January 1, 2009, Everest Re will cede 8.0% to Everest International. However, in no event shall the loss cessions to Everest International relating to any one occurrence exceed \$27.3 million (18.2% of \$150.0 million) or in the aggregate for each underwriting year for all occurrences exceed \$59.1 million (18.2% of \$325.0 million).

- Effective January 1, 2009, Bermuda Re and Everest International amended the whole account quota share, through which Bermuda Re previously ceded 30% of its UK branch business to Everest International so that effective January 1, 2009 Bermuda Re will cede 50% to Everest International of the net retained liability on all new and renewed policies underwritten by its UK branch during the term of this agreement. However, in no event shall the loss cessions to Everest International relating to any one occurrence in the property business exceed €100.0 million, being 50% of €200.0 million.

The following table summarizes the premiums and losses assumed by the Company from its affiliates for the periods indicated:

<b>Everest Re and Bermuda Re</b> (Dollars in thousands)	Years Ended December 31,	
	2008	2007
Assumed written premiums	\$ 254,087	\$ 266,297
Assumed earned premiums	248,456	266,287
Assumed losses and LAE	134,616	152,894

## 8. COMPREHENSIVE (LOSS) INCOME

The following table presents the components of comprehensive (loss) income for the periods indicated:

(Dollars in thousands)	Years Ended December 31,	
	2008	2007
Net income	\$ 21,926	\$ 54,801
Other comprehensive (loss) income:		
Unrealized (losses) gains on securities arising during the period	(53,468)	8,033
Less: reclassification adjustment for realized losses (gains) included in net income	7,172	254
Other comprehensive (loss) income	(46,296)	8,287
Comprehensive (loss) income	\$ (24,370)	\$ 63,088

The following table shows the components of the change in accumulated other comprehensive (loss) income for the periods indicated:

(Dollars in thousands)	Years Ended December 31,	
	2008	2007
Beginning balance of unrealized losses on securities	\$ 7,665	\$ (622)
Current period change in unrealized (losses) gains on securities	(46,296)	8,287
Ending balance of unrealized losses on securities	\$ (38,631)	\$ 7,665

## 9. DIVIDEND RESTRICTIONS AND STATUTORY FINANCIAL INFORMATION

### Dividend Restrictions.

Under Bermuda law, Everest International is prohibited from declaring or making payment of a dividend if it fails to meet its minimum solvency margin or minimum liquidity ratio. As a long term insurer, Everest International is also unable to declare or pay a dividend to anyone who is not a policyholder unless, after payment of the dividend, the value of the assets in its long term business fund, as certified by its approved actuary, exceeds its liabilities for long term business by at least the \$250,000 minimum solvency margin. Prior approval of the Bermuda Monetary Authority is required if Everest International's dividend payments would reduce its prior year-end total statutory capital by 15% or more, or dividends paid would exceed 25% of its prior year end total statutory capital and surplus.

**Statutory Financial Information.**

Everest International prepares its statutory financial statements in conformity with accounting principles set forth in Bermuda in The Insurance Act 1978, amendments thereto and related regulations. The capital and statutory surplus of Everest International was \$371.9 million and \$397.1 million at December 31, 2008 and 2007, respectively. The statutory net income of Everest International was \$8.8 million and \$59.8 million for the years ended December 31, 2008 and 2007, respectively.

**10. CONTINGENCIES**

In the ordinary course of business, the Company is involved in lawsuits, arbitrations and other formal and informal dispute resolution procedures, the outcomes of which will determine the Company's rights and obligations under insurance, reinsurance and other contractual agreements. In some disputes, the Company seeks to enforce its rights under an agreement or to collect funds owing to it. In other matters, the Company is resisting attempts by others to collect funds or enforce alleged rights. These disputes arise from time to time and are ultimately resolved through both informal and formal means, including negotiated resolution, arbitration and litigation. In all such matters, the Company believes that its positions are legally and commercially reasonable. While the final outcome of these matters cannot be predicted with certainty, the Company does not believe that any of these matters, when finally resolved, will have a material adverse effect on the Company's financial position or liquidity. However, an adverse resolution of one or more of these items in any one quarter or fiscal year could have a material adverse effect on the Company's results of operations in that period.

**11. RELATED-PARTY TRANSACTIONS**

During the normal course of business, the Company, through its affiliates, engages in reinsurance and brokerage and commission business transactions with companies controlled by or affiliated with its outside directors. Such transactions, individually and in the aggregate, are not material to the Company's financial condition, results of operations and cash flows.

The Company engages in reinsurance transactions with Everest Re, and Bermuda Re under which business is assumed. See also Note 7.