

IPCRE LIMITED AND SUBSIDIARY

Consolidated Financial Statements
(With Independent Auditors' Report Thereon)

Years Ended December 31, 2008 and 2007

IPCRE LIMITED AND SUBSIDIARY

Consolidated Balance Sheets

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars except for per share amounts)

| | <u>2008</u> | <u>2007</u> |
|--|---------------|---------------|
| Assets | | |
| Fixed maturity investments, at fair value (amortized cost 2008: \$1,777,936; 2007: \$1,756,532) | \$ 1,793,020 | \$ 1,803,275 |
| Equity investments, at fair value (cost 2008: \$405,708; 2007: \$485,205) | 365,147 | 630,483 |
| Cash and cash equivalents | 76,921 | 39,332 |
| Reinsurance premiums receivable | 108,033 | 91,393 |
| Deferred premiums ceded | 2,165 | 2,578 |
| Loss and loss adjustment expenses recoverable | 2,771 | 17,497 |
| Accrued investment income | 27,717 | 30,369 |
| Deferred acquisition costs | 9,341 | 8,893 |
| Prepaid expenses and other assets | <u>3,074</u> | <u>3,054</u> |
| Total assets | \$ 2,388,189 | \$ 2,626,874 |
| Liabilities | | |
| Reserve for losses and loss adjustment expenses | \$ 355,893 | \$ 395,245 |
| Unearned premiums | 85,473 | 75,980 |
| Reinsurance premiums payable | 628 | 4,677 |
| Deferred fees and commissions | 290 | 407 |
| Loan from parent | 75,000 | - |
| Payable to parent | 659 | - |
| Accounts payable and accrued liabilities | <u>19,661</u> | <u>22,999</u> |
| Total liabilities | 537,604 | 499,308 |
| Shareholder's equity | | |
| Share capital: 1,250,000 shares outstanding, par value \$200 | 250,000 | 250,000 |
| Contributed surplus | 1,211,609 | 1,211,609 |
| Retained earnings | 389,852 | 666,838 |
| Accumulated other comprehensive loss | <u>(876)</u> | <u>(881)</u> |
| Total shareholder's equity | 1,850,585 | 2,127,566 |
| Total liabilities and shareholder's equity | \$ 2,388,189 | \$ 2,626,874 |

See accompanying notes to consolidated financial statements

Signed on behalf of the Board

Director

Director

IPCRE LIMITED AND SUBSIDIARY

Consolidated Statements of Income

For each of the years in the three-year period ended December 31, 2008

(Expressed in thousands of U.S. dollars)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|------------------|---------------|-----------------|
| Revenues | | | |
| Gross premiums written | \$ 403,395 | \$ 404,096 | \$ 429,851 |
| Change in unearned premiums | <u>(9,493)</u> | <u>4,063</u> | <u>(13,732)</u> |
| Premiums earned | 393,902 | 408,159 | 416,119 |
| Reinsurance premiums ceded | 6,122 | 16,529 | 17,690 |
| Change in deferred premiums ceded | <u>413</u> | <u>245</u> | <u>1,297</u> |
| Premiums ceded | 6,535 | 16,774 | 18,987 |
| Net premiums earned | 387,367 | 391,385 | 397,132 |
| Net investment income | 94,105 | 121,841 | 109,659 |
| Net (losses) gains on investments | <u>(168,208)</u> | <u>67,555</u> | <u>12,085</u> |
| Total income | 313,264 | 580,781 | 518,876 |
| Expenses | | | |
| Net losses and loss adjustment expenses | 155,632 | 124,923 | 58,505 |
| Net acquisition costs | 36,429 | 39,856 | 37,542 |
| General and administrative expenses | 22,148 | 27,398 | 31,481 |
| Interest expense | 2,659 | - | - |
| Net foreign exchange loss (gain) | <u>1,848</u> | <u>1,167</u> | <u>(2,635)</u> |
| Total expenses | 218,716 | 193,344 | 124,893 |
| Net income | \$ 94,548 | \$ 387,437 | \$ 393,983 |

See accompanying notes to consolidated financial statements

IPCRE LIMITED AND SUBSIDIARY

Consolidated Statements of Comprehensive Income

For each of the years in the three-year period ended December 31, 2008

(Expressed in thousands of U.S. dollars)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|------------------|-------------------|-------------------|
| Net income | \$ 94,548 | \$ 387,437 | \$ 393,983 |
| Other comprehensive income (loss) | | | |
| Movement in accumulated benefit pension obligation | 5 | (195) | (380) |
| Net holding gains on investments during year | — | — | 46,993 |
| Reclassification adjustment for gains included in net income | <u>—</u> | <u>—</u> | <u>(12,085)</u> |
| | <u>5</u> | <u>(195)</u> | <u>34,528</u> |
| Comprehensive income | <u>\$ 94,553</u> | <u>\$ 387,242</u> | <u>\$ 428,511</u> |

See accompanying notes to consolidated financial statements

IPCRE LIMITED AND SUBSIDIARY

Consolidated Statements of Shareholder's Equity

For each of the years in the three-year period ended December 31, 2008
(Expressed in thousands of U.S. dollars, except for per share amounts)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|------------------|------------------|-----------------|
| Common shares, par value \$200 | | | |
| Balance, at beginning and end of year | \$ 250,000 | \$ 250,000 | \$ 250,000 |
| | ===== | ===== | ===== |
| Additional paid-in capital | | | |
| Balance, at beginning and end of year | \$ 1,211,609 | \$ 1,211,609 | \$ 1,211,609 |
| | ===== | ===== | ===== |
| Retained earnings | | | |
| Balance, beginning of year | \$ 666,838 | \$ 402,685 | \$ 67,202 |
| Cumulative-effect adjustment of adopting SFAS 159 | - | 127,996 | - |
| Net income | 94,548 | 387,437 | 393,983 |
| Dividends paid and advanced distribution | <u>(371,534)</u> | <u>(251,280)</u> | <u>(58,500)</u> |
| Balance, end of year | \$ 389,852 | \$ 666,838 | \$ 402,685 |
| | ===== | ===== | ===== |
| Accumulated other comprehensive (loss) income | | | |
| Balance, beginning of year | \$ (881) | \$ 127,310 | \$ 92,782 |
| Cumulative-effect adjustment of adopting SFAS 159 | - | (127,996) | - |
| Other comprehensive income (loss) | <u>5</u> | <u>(195)</u> | <u>34,528</u> |
| Balance, end of year | \$ (876) | \$ (881) | \$ 127,310 |
| | ===== | ===== | ===== |
| Total shareholder's equity | \$ 1,850,585 | \$ 2,127,566 | \$ 1,991,604 |
| | ===== | ===== | ===== |

See accompanying notes to consolidated financial statements

IPCRE LIMITED AND SUBSIDIARY

Consolidated Statements of Cash Flows

For each of the years in the three-year period ended December 31, 2008

(Expressed in thousands of U.S. dollars)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|------------------|------------------|------------------|
| Cash flows from operating activities | | | |
| Net income | \$ 94,548 | \$ 387,437 | \$ 393,983 |
| Adjustments to reconcile net income to cash provided by (used in) operating activities: | | | |
| Amortization of fixed maturity premiums (discounts), net | 695 | (3,733) | (9,512) |
| Net losses (gains) on investments | 168,208 | (67,555) | (12,085) |
| Changes in: | | | |
| Reinsurance premiums receivable | (16,640) | 22,418 | 66,987 |
| Deferred premiums ceded | 413 | 245 | 1,297 |
| Loss and loss adjustment expenses recoverable | 14,726 | (15,508) | (935) |
| Accrued investment income | 2,652 | (1,900) | (8,584) |
| Deferred acquisition costs | (448) | 658 | (1,708) |
| Prepaid expenses and other assets | (20) | (600) | 3,823 |
| Reserve for losses and loss adjustment expenses | (39,352) | (153,382) | (523,429) |
| Unearned premiums | 9,493 | (4,063) | 13,732 |
| Reinsurance premiums payable | (4,049) | (3) | (311) |
| Deferred fees and commissions | (117) | (27) | (190) |
| Payable to parent | 659 | - | - |
| Accounts payable and accrued liabilities | <u>(3,334)</u> | <u>3,756</u> | <u>4,532</u> |
| Cash provided by (used in) operating activities | <u>227,434</u> | <u>167,743</u> | <u>(72,400)</u> |
| Cash flows from investing activities | | | |
| Purchases of fixed maturity investments | (1,635,775) | (1,048,754) | (1,767,146) |
| Proceeds from sales of fixed maturity investments | 1,413,754 | 990,876 | 1,413,748 |
| Proceeds from maturities of fixed maturity investments | 210,500 | 117,525 | 535,450 |
| Purchases of equity investments | (65,538) | (25,009) | (128,607) |
| Proceeds from sales of equity investments | <u>183,748</u> | <u>-</u> | <u>134,683</u> |
| Cash provided by investing activities | <u>106,689</u> | <u>34,638</u> | <u>188,128</u> |
| Cash flows from financing activities | | | |
| Proceeds from loan from parent | 150,000 | - | - |
| Repayment of loan from parent | (75,000) | - | - |
| Cash dividends paid to shareholder and distributions pending | <u>(371,534)</u> | <u>(251,280)</u> | <u>(58,500)</u> |
| Cash used in financing activities | <u>(296,534)</u> | <u>(251,280)</u> | <u>(58,500)</u> |
| Net increase (decrease) in cash and cash equivalents | 37,589 | (48,899) | 57,228 |
| Cash and cash equivalents, beginning of year | <u>39,332</u> | <u>88,231</u> | <u>31,003</u> |
| Cash and cash equivalents, end of year | <u>\$ 76,921</u> | <u>\$ 39,332</u> | <u>\$ 88,231</u> |

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Interest paid totalled \$2,549, \$nil and \$nil for the years ended December 31, 2008, 2007 and 2006, respectively.

See accompanying notes to consolidated financial statements

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

1. **General**

IPCRE Limited, (the “Company”) was incorporated in Bermuda on June 4, 1993 and is a wholly-owned subsidiary of IPC Holdings, Ltd. (the “Parent”). The Parent was incorporated through the sponsorship of American International Group (“AIG”). As of December 31, 2005, AIG owned 24.2% of the common shares of the Parent. On August 15, 2006 AIG sold its entire shareholding in the Parent in an underwritten public offering.

The Company provides reinsurance of property catastrophe risks worldwide, substantially on an excess of loss basis. Property catastrophe reinsurance covers unpredictable events such as hurricanes, windstorms, hailstorms, earthquakes, volcanic eruptions, fires, freezes, industrial explosions and other man-made or natural disasters. The Company’s loss experience will generally include infrequent events of great severity. Catastrophes are an inherent risk of the Company’s business and a major event, or series of events, can be expected to occur from time to time, which adversely affects the Company’s results of operations and financial condition. The Company’s clients include many of the leading insurance companies in the world. The Company also writes, to a limited extent, aviation, property-per risk excess and other short-tail reinsurance in various parts of the world. Approximately 53% of underlying exposure premiums written (being total premiums written excluding reinstatement premiums) in 2008 related to U.S. risks (2007: 57%; 2006: 49%). The balance of the Company’s covered risks is located principally in Europe, Japan, Australia and New Zealand.

On September 10, 1998, the Company incorporated a subsidiary in Ireland, named IPCRE Europe Limited. This company underwrites selected reinsurance business.

2. **Significant accounting policies**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America 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. Actual results could differ from those estimates. The significant accounting policies are as follows:

a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, IPCRE Europe Limited, (together “IPCRE”). All significant intercompany transactions have been eliminated in consolidation. Except in relation to the loan from parent as detailed in Note 11, intercompany payables and receivables are interest-free and have no fixed repayment terms.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

2. Significant accounting policies (continued)

b) Premiums and acquisition costs

Premiums are recorded as written at the inception of each policy, based upon information received from ceding companies and their brokers, and are earned over the policy period. For excess of loss contracts, the amount of deposit premium is contractually documented at inception, and management uses this as its best estimate for accounting for these premiums. Premiums are earned on a pro rata basis over the policy period. Premiums may be adjusted upwards or downwards as a result of changes in the cedants' actual exposure base and the original estimates thereof, although most contracts do provide for a minimum premium in the contract terms. We refer to such changes in premiums as adjustment premiums. Reinstatement premiums are recognized and accrued at the time losses are incurred and where coverage of the original contract is reinstated under pre-defined contract terms and are earned pro rata over the reinstated coverage period. Such accruals are based upon actual contractual terms applied to the amount of loss reserves expected to be paid, and the only element of management judgement involved is with respect to the amount of loss reserves as described below, and associated rates on line (i.e. price). For proportional treaties, the amount of premium is normally estimated by management at inception based on information from the ceding company. The Company accounts for such premium using initial estimates, which are reviewed regularly with respect to the actual premium reported by the ceding company. Premiums are earned on a pro rata basis over the coverage period and unearned premiums represent the portion of premiums written which is applicable to the unexpired terms of the policies in force. Ceded reinsurance premiums are similarly pro-rated over the terms of the contracts with the unexpired portion deferred in the balance sheet.

Acquisition costs, consisting primarily of commissions and brokerage expenses incurred at policy issuance, are deferred and amortized to income over the period in which the related premiums are earned. Deferred acquisition costs are limited to estimated realizable value based on related unearned premium, anticipated claims and expenses and investment income.

c) Reserve for losses and loss adjustment expenses

The reserve for losses and loss adjustment expenses, which includes a provision for losses and loss adjustment expenses incurred but not reported and development on reported claims (reported but not enough), is based on reports from industry sources, including an analysis and review of our share of initial estimated total industry losses, in-force contracts, individual loss advices received from ceding companies and brokers, output from commercially available catastrophe loss models and management's estimates. Our reserve estimates are not mathematically or formulaically derived from factors such as numbers of claims. For certain catastrophic events there is considerable uncertainty underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Reserves are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. It is reasonably possible that changes in the near term could require a material change in the amount estimated. Such adjustments, if any, are reflected in results of operations in the period in which they become known. Reserves are retained in original currencies with the effect of foreign exchange movements recorded as net foreign exchange loss (gain) in the consolidated statements of income. For proportional treaties, an estimated loss and loss adjustment expense ratio (the ratio of losses and loss adjustment expenses incurred to premiums earned) is initially used, based upon information provided by the ceding company and/or their broker and the Company's historical experience of that treaty, if any. The estimate is reviewed regularly and is adjusted as actual experience becomes known.

Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

2. **Significant Accounting Policies** (continued)

d) Fair value measurements

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements”. SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. SFAS 157 requires that a fair value measurement reflect the assumptions market participants would use in pricing an asset or liability based on the best information available.

In February 2007, the FASB issued SFAS No. 159 “The Fair Value Option for Financial Assets and Financial Liabilities”. In accordance with our adoption of SFAS 159 on January 1, 2007 the investments are now reported as “Trading” under SFAS No. 115 “Accounting for Certain Investments in Debt and Equity Securities”. Due to adoption of SFAS 159 we record changes to the fair value of our investment portfolio as net (losses) gains on investments in our consolidated statements of income. SFAS 159 required all unrealized gains and losses in our investment portfolio to be reclassified from accumulated other comprehensive (loss) income within shareholder’s equity on our consolidated balance sheets to retained earnings as of January 1, 2007. This cumulative-effect adjustment reclassifying unrealized gains and losses was \$128.0 million, which represented the difference between the cost or amortized cost of our investments and the fair value of those investments at December 31, 2006. Simultaneous to the adoption of SFAS 159 we also adopted SFAS 157 which did not amend the carrying value of our fixed maturity and equity investments as they were previously carried at fair value.

In February 2008, the FASB issued FSP FAS 157-2, “Effective Date of FASB Statement No. 157”, which permits a one-year deferral of the application of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 is effective in conjunction with SFAS 157 for interim and annual financial statements issued after January 1, 2008. The Company does not expect that the adoption of FSP FAS 157-2 will have an effect on its financial statements because as at December 31, 2008 it does not have goodwill or other intangible assets.

In October 2008, the FASB issued FSP FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active”. This FSP clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in the determination of the fair value of a financial asset when the market for that asset is not active. The key considerations illustrated in the FSP FAS 157-3 example include the use of an entity’s own assumptions about future cash flows and appropriately risk-adjusted discount rates, appropriate risk adjustments for nonperformance and liquidity risks, and the reliance that an entity should place on quotes that do not reflect the result of market transactions. FSP FAS 157-3 was preceded by a press release that was jointly issued by the Office of the Chief Accountant of the Securities and Exchange Commission (“SEC”) and the FASB staff on September 30, 2008 which provided immediate clarification on fair value accounting based on the measurement guidance of SFAS 157. FSP FAS 157-3 was effective upon issuance. FSP FAS 157-3 was considered in management’s process for determination of fair value.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

2. **Significant Accounting Policies** (continued)

SFAS 157 established a hierarchy for inputs in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs are used when available. Observable inputs are inputs that market participants would use in pricing the asset based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions that market participants would use in pricing the asset based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these instruments does not entail a significant degree of judgement.

Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.

Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

Details on assets and liabilities that have been included under the requirements of SFAS 157 to illustrate the bases for determining the fair values of the assets and liabilities held by the Company are detailed in Note 3.

The fair value of other assets and liabilities, consisting of reinsurance premiums receivable, accrued investment income, other assets, reinsurance premiums payable and accounts payable approximates their carrying value due to their relative short-term nature. The estimates of fair value of assets and liabilities are subjective in nature and are not necessarily indicative of the amounts that the Company would actually realize in a current market exchange.

Certain instruments such as deferred premiums ceded, losses and loss adjustment expenses recoverable, deferred acquisition costs, prepaid expenses, reserve for loss and loss adjustment expenses, unearned premiums and deferred fees and commissions are excluded from fair value disclosure. Thus, the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

e) Cash and cash equivalents

Cash and cash equivalents include amounts held in banks, and time deposits with maturities of less than three months from the date of purchase. The carrying amount of cash and cash equivalents approximates fair value because of the short maturity of those instruments.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

2. Significant accounting policies (continued)

f) Investments

In accordance with our investment guidelines, our investments consist of high-grade marketable fixed maturity investments, including U.S. Government treasuries and mortgage-backed securities issued by U.S. Government sponsored entities, certain equity investments in mutual funds and an investment in a fund of hedge funds. Investments are carried at fair value.

Investment transactions are recorded on a trade date basis.

With the investments being classified as "Trading" all subsequent changes to the fair value of our investment portfolio are recorded as net (losses) gains on investments in our consolidated statements of income.

Realized gains and losses on sales of investments continue to be determined on a first-in, first-out basis. Net investment income includes interest income on fixed maturity investments, recorded when earned, dividend income on equity investments, recorded when declared, and the amortization of premiums and discounts on investments.

g) Translation of foreign currencies

Transactions in foreign currencies are translated into U.S. dollars at the rate of exchange prevailing in the accounting period of each transaction. Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the exchange rates in effect on the balance sheet date. Realized and unrealized exchange gains and losses are included in the determination of net income.

h) Pension plan

As of December 31, 2006, the Company adopted all provision of FASB SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements 87, 88, 106 and 132(R)". This Statement requires an employer to recognize the over funded or under funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in the funded status in the year in which the changes occur through comprehensive income.

i) Accounting pronouncements

In December 2007, the FASB issued SFAS No. 141 (revised 2007) "Business Combinations", ("SFAS 141R"). SFAS 141R replaced SFAS 141, "Business Combinations", and supersedes or amends other related authoritative literature although it retains the fundamental requirements in SFAS 141 that the acquisition method of accounting (which SFAS 141 called the purchase method) be used for all business combinations and for an acquirer to be identified for each business combination. SFAS 141R also established principles and requirements for how the acquirer: (a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141R will apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R also requires the acquirer to expense costs relating to any acquisitions that close after December 31, 2008. The Company does not expect that the adoption of SFAS 141R will have a material impact on its financial statements.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

2. **Significant accounting policies** (continued)

i) Accounting pronouncements (continued)

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51". SFAS 160 amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to establish accounting and reporting standards for the noncontrolling (minority) interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. In addition, it also changes the way the consolidated income statement is presented by requiring consolidated net income to include amounts attributable to both the parent and the noncontrolling interest with separate disclosure of each component on the face of the consolidated income statement. It does not, however, impact the calculation of net income per share as such calculation will continue to be based on amounts attributable to the parent. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, and shall be applied prospectively as of the beginning of the fiscal year in which it is initially applied except that the presentation and disclosure requirements shall be applied retrospectively for all periods presented. The Company does not expect that the adoption of SFAS 160 will have a material impact on its financial statements unless the Company purchases less than a 100% interest in a business.

In March 2008, the FASB issued SFAS No. 161 "Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement 133". This Statement changes required disclosures for derivatives and hedging activities, including enhanced disclosures regarding (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Specifically, SFAS 161 requires: disclosure of the objectives for using derivative instruments be disclosed in terms of underlying risk and accounting designation; disclosure of the fair values of derivative instruments and their gains and losses in a tabular format; disclosure of information about credit-risk-related contingent features; and a cross-reference from the derivative footnote to other footnotes in which derivative-related information is disclosed. The statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company does not expect that the adoption of SFAS 161 will have a material impact on the Company's consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position ("FSP") No. FAS 142-3, "Determination of the Useful Life of Intangible Assets". FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, "Goodwill and Other Intangible Assets" (FAS 142). The intent of the position is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS 141R, and other U.S. generally accepted accounting principles. The provisions of FSP FAS 142-3 are effective for fiscal years beginning after December 15, 2008. The Company does not expect that the adoption of FSP FAS 142-3 will have an effect on its financial statements because as at December 31, 2008 it does not have goodwill or other intangible assets.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

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(Expressed in thousands of U.S. dollars, except for per share amounts)

2. **Significant accounting policies** (continued)

i) Accounting pronouncements (continued)

In May 2008, the FASB issued SFAS No. 162 “The Hierarchy of Generally Accepted Accounting Principles”. SFAS 162 identifies the sources of generally accepted accounting principles and provides a framework, or hierarchy, for selecting the principles to be used in preparing U.S. GAAP financial statements for nongovernmental entities. This Statement makes the GAAP hierarchy explicitly and directly applicable to preparers of financial statements, a step that recognizes preparers' responsibilities for selecting the accounting principles for their financial statements. The hierarchy of authoritative accounting guidance is not expected to change current practice but is expected to facilitate the FASB's plan to designate as authoritative its forthcoming codification of accounting standards. This Statement is effective 60 days following the SEC's approval of the PCAOB's related amendments to AU Section 411, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles”, to remove the GAAP hierarchy from its auditing standards.

In May 2008, the FASB also issued SFAS No. 163 “Accounting for Financial Guarantee Insurance Contracts – an Interpretation of FASB Statement No. 60”. SFAS 163 prescribes the accounting for premium revenue and claims liabilities by insurers of financial obligations, and requires expanded disclosures about financial guarantee insurance contracts. SFAS 163 applies to financial guarantee insurance and reinsurance contracts issued by insurers subject to SFAS 60, “Accounting and Reporting by Insurance Enterprises”. The Statement does not apply to insurance contracts that are similar to financial guarantee insurance contracts such as mortgage guaranty or trade-receivable insurance, financial guarantee contracts issued by noninsurance entities, or financial guarantee contracts that are derivative instruments within the scope of SFAS 133. SFAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years, except for certain disclosure requirements about the risk-management activities of the insurance enterprise that are effective for the first quarter beginning after the Statement was issued. Except for those disclosures, early application is prohibited. SFAS 163 is not expected to have an effect on the Company as it does not enter into financial guarantee contracts.

In May 2008, the FASB also issued FSP APB 14-1, “Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)”. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon either mandatory or optional conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, Accounting for Convertible Debt and Debt issued with Stock Purchase Warrants. Additionally, FSP APB 14-1 specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. FSP APB 14-1 is not expected to have an effect on the Company as at December 31, 2008, it does not have any convertible debt instruments.

The Company has considered all new pronouncements. There are no new pronouncements that we did not adopt that would have had a material impact on these consolidated financial statements.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

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(Expressed in thousands of U.S. dollars, except for per share amounts)

3. Fair value of financial instruments

Investments are carried at fair value.

The carrying amount of cash and cash equivalents approximates to their fair value because of the short period until maturity of those instruments.

Prices reported to us by our investment managers, as provided by independent pricing services (“pricing services”) form the basis of the fair value of fixed maturity investments. The market makers are the primary pricing source used by our investment managers although the ultimate valuations also rely on other data inputs and models. Both market-makers and the alternative pricing services’ valuation models rely on a variety of observable inputs to calculate a fixed maturity investment’s fair value. Observable inputs that may be used include the following: benchmark yields (Treasury and swaps curves), transactional data for new issuance, broker quotes, cash flows, recent issuance, supply, sector and issuer level spreads, credit ratings, maturity, weighted average life, capital structure, corporate actions, underlying collateral, loan performance, comparative bond analysis and third-party pricing sources. In order to monitor the quality of the prices, the pricing services and the investment managers perform data integrity checks and quality management processes.

It is ultimately management’s responsibility to determine whether the values received and recorded in the financial statements are representative of appropriate fair value measurements. In respect of our fixed maturity investments, we periodically assess valuation relative to current financial market conditions. We also consider any valuation disparities between the custodian and investment managers and supplement this with our own independent verification to external pricing sources. In addition to this the Company’s custodian, on behalf of the Company, performs validation checks on the prices used to ensure no missing or stale pricing and to ensure that the price derived from the pricing source compares reasonably with its peer pricing services. Any material differences are investigated and resolved. As of December 31, 2008 100% of our fixed maturity investments were valued using pricing services. There have been no adjustments to the prices obtained from the pricing services. Our valuation procedures also consider the credit quality composition of the portfolio and any significant migrations in the credit quality of our holdings from period to period.

It may be possible that the use of different pricing methodologies and assumptions may have a material effect on the estimated fair value amounts. During periods of market disruption including periods of significantly rising or falling interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain of the Company’s fixed maturity investments if trading becomes infrequent, or market data becomes less available or there is a decrease in observable inputs. In such cases, more fixed maturity investment valuations would require the use of management judgement. As such, valuations may include inputs and assumptions that are unobservable or require greater estimation as well as valuation methods which are more sophisticated or require greater estimation thereby resulting in values which may be less than the value at which the investments may be ultimately sold. Further, rapidly changing and unprecedented credit and equity market conditions could materially impact the valuation of securities as reported within the Company’s consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on the Company’s results of operations and financial condition. As at December 31, 2008, we did not have any significant fixed maturity investments that were not rated and all of our fixed maturity investments were classified as Level 1 or Level 2.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

3. Fair value of financial instruments (continued)

The following table shows how our investments are categorised under SFAS 157 at December 31, 2008:

| <u>Description</u> | <u>Fair Value Measurement December 31, 2008</u> | <u>Quoted Prices In Active Market (Level 1)</u> | <u>Significant Other Observable Inputs (Level 2)</u> | <u>Significant Unobservable Inputs (Level 3)</u> |
|----------------------------------|---|---|--|--|
| Fixed maturity investments | | | | |
| U.S. Government Treasuries | \$ 17,653 | \$ 17,653 | \$ - | \$ - |
| Other fixed maturity investments | <u>1,775,367</u> | <u>-</u> | <u>1,775,367</u> | <u>-</u> |
| Total fixed maturity investments | <u>1,793,020</u> | <u>17,653</u> | <u>1,775,367</u> | <u>-</u> |
| Equity investments | | | | |
| Mutual funds | 196,602 | - | 196,602 | - |
| AIG Select Hedge fund | 159,709 | - | - | 159,709 |
| Other Equity investments | <u>8,836</u> | <u>-</u> | <u>8,836</u> | <u>-</u> |
| Total equity investments | <u>365,147</u> | <u>-</u> | <u>205,438</u> | <u>159,709</u> |
| Total investments | <u>\$ 2,158,167</u> | <u>\$ 17,653</u> | <u>\$ 1,980,805</u> | <u>\$ 159,709</u> |

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets and liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are reported as transfers in or out of the Level 3 category as of the beginning of the quarter in which the reclassifications occur.

Included within the category fixed maturity investments are bonds issued by the U.S. Treasury. We believe that the market for U.S. Government Treasury securities is an actively traded market given the high level of trading volume and the auction process and therefore we are classifying them as Level 1. For our remaining fixed maturity investments, which trade in less active markets, but continue to be valued using observable inputs, we are classifying them as Level 2. Also included within the category fixed maturity investments is our mortgage-backed securities portfolio.

Our investment in mutual funds is stated at fair value as determined by the most recently reported net asset value as advised by the funds. These funds have daily reported net asset values ("NAV") – with the funds' holdings predominantly in publicly quoted securities, with daily redemptions allowed and with no associated liquidity restrictions. Due to the funds' values being current NAVs, with no significant lock ups, no delays in withdrawal and not publicly quoted prices, we are classifying the other equity investments as Level 2.

Other equity investments represents equity securities and fixed maturities held in rabbi trusts maintained by the Company for deferred compensation plans and are classified within the valuation hierarchy as Level 2, on the same basis as the Company's other equity securities and fixed maturities.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

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(Expressed in thousands of U.S. dollars, except for per share amounts)

3. Fair value of financial instruments (continued)

Included in our equity investments is a fund of hedge funds. It has a monthly reported net asset value with a one-month delay in its valuation. As a result, the most recently advised NAV included in our financial statements at the end of each quarter has historically been based upon the NAVs of the underlying funds at the end of the preceding month. However, due to the significant market volatility during the year ended December 31, 2008 and the guidance set out in FSP FAS 157-3 as at December 31, 2008 we have used the most recently available NAV (November 30, 2008) plus an estimate of the NAV performance of the fund of hedge funds for December 2008 to allow us to incorporate all readily-available information into the valuation as reported within the Company's consolidated financial statements.

The estimated NAV is obtained from the fund's investment manager who derives an estimate of the performance of the fund based on the month-end positions from the underlying third-party funds. In order to obtain comfort over the reasonableness of this estimated NAV, we assessed the difference between the estimated NAV and final month-end NAVs to ensure that there have been no significant variances in the past. Any movement in the estimated NAV relative to the final NAV of the fund would be recorded in the following reporting period. Such adjustments may be material. The use of the estimated NAV in respect of the fund of hedge funds increased the level of unobservable inputs. Hence, we have classified the fund of funds as Level 3.

The following table presents the fair market value of the Company's Level 3 financial assets (and liabilities) as at December 31, 2008.

| | |
|--|-------------|
| Fair value measurements using significant unobservable inputs (Level 3) | |
| Beginning balance as at January 1, 2008 | \$ - |
| Transfers in and/or out of Level 3 | \$ 192,254 |
| Total realized and unrealized (losses) gains included in earnings | \$ (32,545) |
| Purchases, issuance and settlements | \$ - |
| Ending balance at December 31, 2008 | \$ 159,709 |
| <hr/> | |
| The amount of total (losses) gains for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2008 | \$ (32,545) |
| <hr/> | |

The company uses beginning fair values for the accounting for transfers in and out of Level 3.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

4. Investments

In accordance with our investment guidelines, our investments consist of high-grade marketable fixed maturity investments, including U.S. Government treasuries and mortgage-backed securities issued by U.S. Government sponsored entities, certain equity investments in mutual funds and an investment in a fund of hedge funds.

- a) The cost or amortized cost, gross gains, gross losses and fair value of investments classified by category as of December 31, 2008 and 2007 are as follows:

| <u>December 31, 2008</u> | Cost or amortized <u>cost</u> | Gross unrealized <u>gains</u> | Gross unrealized <u>losses</u> | Fair <u>value</u> |
|-----------------------------|-------------------------------------|-------------------------------------|--------------------------------------|-----------------------------|
| Fixed maturity investments: | | | | |
| U.S. Government treasuries | \$ 16,925 | \$ 728 | \$ - | \$ 17,653 |
| U.S. Government agencies | 166,054 | 13,051 | - | 179,105 |
| Non-U.S. governments | 60,011 | 2,720 | - | 62,731 |
| Banking and financial | 845,434 | 15,628 | (35,445) | 825,617 |
| Other corporate | 367,267 | 9,596 | (8,170) | 368,693 |
| Supranational entities | 223,900 | 13,085 | (182) | 236,803 |
| Mortgage-backed securities | <u>98,345</u> | <u>4,073</u> | <u>-</u> | <u>102,418</u> |
| | \$ 1,777,936 | \$ 58,881 | \$ (43,797) | \$ 1,793,020 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Equity investments | \$ 405,708 | \$ 2,202 | \$ (42,763) | \$ 365,147 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| <u>December 31, 2007</u> | Cost or amortized <u>cost</u> | Gross unrealized <u>gains</u> | Gross unrealized <u>losses</u> | Fair <u>value</u> |
| Fixed maturity investments: | | | | |
| U.S. Government agencies | 214,506 | 9,647 | (18) | 224,135 |
| Non-U.S. governments | 82,714 | 2,301 | (6) | 85,009 |
| Banking and financial | 756,451 | 17,022 | (1,759) | 771,714 |
| Other corporate | 395,120 | 9,850 | (156) | 404,814 |
| Supranational entities | <u>307,741</u> | <u>9,885</u> | <u>(23)</u> | <u>317,603</u> |
| | \$ 1,756,532 | \$ 48,705 | \$ (1,962) | \$ 1,803,275 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Equity investments | \$ 485,205 | \$ 145,278 | \$ - | \$ 630,483 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

As part of the mortgage-backed securities portfolio, our investment guidelines permit participating in to-be-announced securities ("TBAs"). During the year ended December 31, 2008 we participated in TBAs. Mortgage-backed securities are typically traded on a to-be-announced basis. By acquiring a TBA, the Company makes a commitment to purchase a future issuance of mortgage-backed securities. As part of the mortgage-backed securities portfolio, the investment guidelines allow the Company to enter into long and short TBA positions, which are deliverable within a month. As at December 31, 2008, the Company held no TBA positions. securities portfolio, the investment guidelines allow the Company to enter into long and short TBA positions, which are deliverable within a month. As at December 31, 2008, the Company held no TBA positions.

IPCRE LIMITED AND SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

4. **Investments** (continued)

b) *Pledged assets*

In the normal course of business the Company provides security to reinsureds if requested. Such security takes the form of a letter of credit or a cash advance. Letters of credit are issued by the Company's bankers, in favour of the ceding company, at the request of the Company. At December 31, 2008, the Company had two letter of credit facilities. At December 31, 2007, the Company had three letter of credit facilities. Under two separate agreements effective September 20, 1994 (as subsequently amended) and April 13, 2006, the Company provides the banks security by giving them a lien over certain of the Company's investments in an amount not to exceed 118% of the aggregate amount of letters of credit outstanding. The total amount of security required by the banks under the three facilities at December 31, 2008 was approximately \$194,234 (2007: \$214,834). Effective December 31, 2008 outstanding letters of credit were \$166,280 (2007: \$183,333).

c) *Net investment income*

Net investment income is made up as follows:

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---|-----------------------------|-----------------------------|-----------------------------|
| Interest on fixed maturity investments | \$ 89,731 | \$ 92,901 | \$ 86,345 |
| Interest on cash and cash equivalents | 6,027 | 3,627 | 2,106 |
| Net amortization of (premiums) discounts on investments | <u>(695)</u> | <u>3,734</u> | <u>9,512</u> |
| | 95,063 | 100,262 | 97,963 |
| | | | |
| Dividend income from equity investments | 17 | 22,382 | 12,713 |
| Refund of equity funds fees | 2,226 | 3,010 | 2,843 |
| Less: investment expenses | <u>(3,201)</u> | <u>(3,812)</u> | <u>(3,860)</u> |
| Net investment income | \$ 94,105 | \$ 121,842 | \$ 109,659 |
| | <u> </u> | <u> </u> | <u> </u> |

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Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Expressed in thousands of U.S. dollars, except for per share amounts)

4. Investments (continued)

- d) Proceeds from sales of securities for the years ended December 31, 2008 were \$1,597,502 (2007: \$990,876; 2006: \$1,548,431). Components of net realized gains and losses on sales of securities and the change in net appreciation and depreciation on investments are summarized in the following table:

| <u>Fixed maturity investments</u> | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|--------------|-------------|-------------|
| Gross realized gains on sales | \$ 24,171 | \$ 5,884 | \$ 3,385 |
| Gross realized losses on sales | (13,593) | (2,354) | (8,967) |
| Other than temporary impairment provision | — | — | (27,695) |
| Net realized gains (losses) | 10,578 | 3,530 | (33,277) |
| <u>Equity investments</u> | | | |
| Gross realized gains on sales | 38,712 | — | 45,362 |
| Gross realized losses on sales | — | — | — |
| Net realized gains on sales | 38,712 | — | 45,362 |
| Total net realized gains | 49,290 | 3,530 | 12,085 |
| <u>Changes in fair value of investments recorded in net (losses) gains on investments</u> | | | |
| Fixed maturity investments | (31,659) | 36,099 | — |
| Equity investments | (185,839) | 27,926 | — |
| Net unrealized (losses) gains on investments | (217,498) | 64,025 | — |
| Net (losses) gains on investments | (168,208) | 67,555 | 12,085 |
| <u>Change in fair value of investments recorded in accumulated other comprehensive (loss) income</u> | | | |
| Fixed maturity investments | — | — | 26,773 |
| Equity investments | — | — | 8,135 |
| Change in net fair value of investments | — | — | 34,908 |
| Total net (losses) gains on sales and change in fair value on investments | \$ (168,208) | \$ 67,555 | \$ 46,993 |

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(Expressed in thousands of U.S. dollars, except for per share amounts)

4. Investments (continued)

The difference in accounting arising as a result of the adoption of the SFAS 159 fair value option is in respect of the treatment of unrealized gains and losses. Prior to January 1, 2007, investments were reported as available for sale and unrealized gains and losses were included within accumulated other comprehensive (loss) income as a separate component of shareholder's equity. As investments are now reported as trading, the change in their fair value of \$(217,498) and \$64,025 during the years ended December 31, 2008 and 2007 respectively are included in net (losses) gains on investments within the consolidated statements of income. Had the Company applied the same SFAS 159 accounting in previous years, the Company would have had an increase in net gains on investments of \$34,908 for the year ended December 31, 2006.

- e) The following table summarizes the composition of the fair value of all cash and cash equivalents and fixed maturity investments by rating:

| | <u>2008</u> | <u>2007</u> |
|----------------------------|-------------|-------------|
| Cash and cash equivalents | 4.1% | 2.1% |
| U.S. Government treasuries | 0.9% | 0.0% |
| U.S. Government agencies | 9.6% | 12.2% |
| AAA | 43.9% | 45.9% |
| AA | 22.2% | 23.2% |
| A | 18.8% | 16.6% |
| Other | 0.4% | 0.0% |
| BBB | <u>0.1%</u> | <u>0.0%</u> |
| | 100.0% | 100.0% |

The primary rating source is Moody's Investors Service Inc. ("Moody's"). When no Moody's rating is available, Standard & Poor's Corporation ("S & P") ratings are used and where split-ratings exist, the higher of Moody's and S & P is used.

- f) The Company holds the following equity investments.

| | 2008 | 2007 |
|-----------------------------|-------------------|-------------------|
| | <u>Fair value</u> | <u>Fair value</u> |
| AIG Global Equity Fund | \$ 91,682 | \$ 178,681 |
| AIG American Equity Fund | 62,627 | 135,243 |
| AIG US Large Cap Fund | 42,293 | - |
| Vanguard U.S. Futures Fund | <u>-</u> | <u>112,557</u> |
| Investments in mutual funds | 196,602 | 426,481 |
| AIG Select Hedge Fund | 159,709 | 192,824 |
| Other equity investments | <u>8,836</u> | <u>11,178</u> |
| | <u>\$ 365,147</u> | <u>\$ 630,483</u> |

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Notes to Consolidated Financial Statements

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4. **Investments** (continued)

The AIG Global Equity Fund, AIG American Equity Fund, AIG Select Hedge Fund and AIG US Large Cap Fund are all managed by AIG Global Investment Fund Management Limited. The AIG Global Equity Fund invests predominantly in large capitalized companies operating in various sectors of global equity markets, the AIG American Equity Fund invests predominantly in large capitalized companies operating across diverse sectors of North America, the AIG Select Hedge Fund invests in approximately 30-40 third party hedge funds utilizing a broad range of alternative investment strategies, and the AIG US Large Cap Fund seeks to achieve capital growth by investing at least 90% in companies whose assets, products or operations are based in the United States or included in the Russell 1000 Index. The Company's maximum exposure to loss as a result of these investments is limited to the fair values of the Company's investment in these funds. The Vanguard US Futures Fund invests in S & P futures and fixed income products and aims for returns similar to those of the S & P 500 Index.

Excluding the sub-class shares which are described below, Select Hedge permits monthly withdrawals, although there is a notification period of 3 business days prior to the last business day of a month for the redemption to be effective on the last business day of the next following month. Approximately 90% of the proceeds from a redemption will generally be paid within 20 business days after the redemption date, with the balance paid following the Select Hedge's year-end audit.

During January 2009, we redeemed \$50 million of our position in the Select Hedge. The Company expects to receive 90% of the proceeds 20 business days after the redemption date of January 31, 2009, with the remainder upon completion of the audit of the fund. This redemption is in compliance with the terms described in the paragraph above and did not include any redemption of the sub-class shares as described below.

In response to current market conditions, Select Hedge has introduced "side pockets", which are sub-funds within Select Hedge that have restricted liquidity which may potentially extend over a much longer period than the typical liquidity of Select Hedge. Should the Company seek to liquidate its investment in Select Hedge, the Company would not be able to fully liquidate its investment without some delay, which may be considerable. In such cases, until the Company is permitted to fully liquidate its interest in Select Hedge, the value of its investment could fluctuate based on adjustments to the fair value of the investments contained within the side pocket as determined by Select Hedge. Subsequent to year end, the side pockets were isolated by capitalizing a new share class of Select Hedge as of December 30, 2008 in an amount equal to the value of the side pockets as of November 30, 2008. The capitalization was in the form of fully paid shares of the Fund invested solely in the side pockets. As a result, the Company now holds a sub-class of Select Hedge shares in addition to the class of shares it previously held. The sub-class shares are not currently redeemable. The Company expects that the sub-class shares will continue to be valued monthly at their fair value, which reflects the illiquidity of the underlying positions. The Company will be required to hold its sub-class shares until securities held in the side pockets are liquidated. Management has not made any adjustments to the NAV reported by Select Hedge in estimating fair value. Due to the illiquid nature of the investments in the side pockets, there is significant judgement involved in estimating this fair value. As at December 31, 2008, approximately 23.62% of Select Hedge's net assets were invested in side pockets, which totaled approximately \$38 million.

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5. Ceded reinsurance

The Company utilizes reinsurance to reduce its exposure to large losses, outside the United States. Since January 1, 1999, the Company has utilized a proportional reinsurance facility covering property catastrophe business written by the Company. The facility provides coverage in each of at least 5 named zones, and potentially other zones of the Company's choosing, provided that the risks in those zones do not accumulate with those in the named zones. The United States and the Caribbean are excluded zones. The named zones are the United Kingdom; Europe (excluding the U.K.); Australia / New Zealand; Japan and Other. Effective January 1, 2005, the facility provided coverage of up to \$75,000 in each of the named zones, with the exception of Europe (excluding the U.K.), where the coverage remained limited to \$50,000. Business ceded to the facility is solely at the Company's discretion. Effective January 1, 2006, the facility provided coverage of up to \$75,000 in each of the named zones. Effective January 1, 2007, the facility provided coverage of up to \$75,000 in each of the named zones, with the exception of the U.K., where the facility provided coverage of up to \$100,000. Within these limitations, the Company may designate the treaties to be included in the facility, subject to the Company retaining at least 50% of the risk. The premium ceded is pro rata, less brokerage, taxes and an override commission. Most reinsurers participating in the facility have financial strength ratings issued by S & P and/or A.M. Best of A or above, and the minimum rating at the time of acceptance is A-.

Effective January 1, 2002, the Company arranged a Property Catastrophe Excess of Loss Reinsurance facility in respect of certain property catastrophe business written by the Company. This facility covers first losses only for the business ceded to this facility. All subsequent losses are retained by the Company. Business ceded to this facility includes worldwide business excluding the United States and Canada. Effective January 1, 2008, the facility was not renewed. In each of the years ended December 31, 2007 and December 31, 2006, the Company could cede up to \$30,000 ultimate net loss in the aggregate per contract year to the facility. The Company's retention is \$10 in the aggregate per contract. Business ceded to this facility is solely at the Company's discretion. The sole reinsurer participating in this facility has a rating of AA.

Effective December 1, 2008 we purchased a common account reinsurance protection in respect of our participation in a specific pro rata treaty written by the Company which was effective on the same date.

Although reinsurance agreements contractually obligate the reinsurers to reimburse the Company for the agreed upon portion of its gross paid losses, they do not discharge the Company's primary liability. Management monitors the financial strength of its reinsurers and believes that the risk of non-payment by the reinsurers is minimal.

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6. Share capital and additional paid-in capital

The authorised share capital of the Company as of December 31, 2008 and 2007 consisted of the following:

| | <u>Shares issued</u> | <u>Share capital</u> | <u>Additional paid-in capital</u> |
|--|----------------------|----------------------|-----------------------------------|
| <u>Authorised, issued and fully paid:</u> | | | |
| 2008: Common shares, par value of \$200 each | 1,250,000 | \$ 250,000 | \$ 1,211,609 |
| 2007: Common shares, par value of \$200 each | 1,250,000 | \$ 250,000 | \$ 1,211,609 |

In 2008, the Company paid dividends of \$106,000, \$126,000 and \$228,813 in March, June and November respectively.

In 2007, the Company paid dividends of \$17,000, \$17,000, \$112,000 and \$16,000 in March, June, September and December respectively. As at December 31, 2007, the Company had also made an advanced distribution to the Parent of \$89,280.

In 2006, the Company paid dividends of \$7,200, \$14,500, \$22,300 and \$14,500 in March, June, September and December respectively.

7. Related party transactions

In 2007 and 2008, the Company did not have any related party transactions. AIG sold all of its shares in the Parent in August 2006 and therefore AIG ceased to be a related party in August 2006. For the purpose of the related party transactions disclosures, AIG were treated as a related party through December 31, 2006 and we are therefore only disclosing information relating to AIG for 2006. In addition to the related party transactions discussed elsewhere in the notes to the financial statements, the Company and its subsidiary had entered into the following transactions and agreements with related parties:

During the year ended December 31, 2006, the following amounts were incurred (received) for services provided by indirect, wholly-owned subsidiaries of AIG:

| | <u>Administrative services</u> | <u>Investment management services</u> | <u>Equity funds fee rebate</u> | <u>Investment custodian services</u> |
|------------------------------|--------------------------------|---------------------------------------|--------------------------------|--------------------------------------|
| Year ended December 31, 2006 | \$ 11,546 | \$ 2,824 | \$ (2,843) | \$ 1,036 |

a) Administrative services

The Parent and the Company are parties to an agreement with American International Company, Limited ("AICL"), an indirect wholly-owned subsidiary of AIG, under which AICL provides administrative services. This agreement provides that AICL make available to the Parent and the Company certain office space, certain information and technology services, payroll and administrative services, human resource personnel and other ancillary services. Up until June 30, 2006, the services were provided for a fee of 2.5% of the first \$500,000 annual gross written premiums (1.5% of the next \$500,000 and 1.0% thereafter). Effective July 1, 2006, a new arrangement was agreed whereby the Company pays an annual fee of \$2,000 in the event the Company's annual gross written premiums equal or are less than \$200,000 and 0.5% of any additional gross written premiums in excess of \$200,000. This administrative services agreement terminates on June 30, 2009 and is automatically renewed thereafter for successive three-year terms unless prior written notice to terminate is delivered by or to AICL at least 180 days prior to the end of such three-year term, or there is a Termination event as defined by the agreement.

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Notes to Consolidated Financial Statements

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(Expressed in thousands of U.S. dollars, except for per share amounts)

7. **Related party transactions** (continued)

In addition, IPCRe Europe Limited is party to an agreement with AIG Insurance Management Services (Europe) Limited ("AIMS"), an indirect wholly-owned subsidiary of AIG, under which AIMS provides administrative services. The services were provided for an annual fee of approximately \$60 per annum for the year ended December 31, 2006. The initial period of this agreement was until June 30, 2007 and thereafter was automatically renewed.

b) Investment management services

During the year ended December 31, 2006, the Company was party to an agreement with AIG Global Investment Corp. (Ireland) Limited ("AIGGIC"), an indirect wholly-owned subsidiary of AIG, under which AIGGIC provides investment advisory and management services. This agreement was subject to termination by either party on 30 days' written notice. The Company paid different levels of fees based on the month-end market values of the individual portfolios (fixed maturity, equity funds and hedge fund).

Rebates were received on the management fees charged by AIG Global Investment Fund Management Limited for two of the equity funds, the AIG Global Equity Fund and the AIG American Equity Fund, as the investment management fee is charged on the whole portfolio. These fees and rebates were included in net investment income in the accompanying consolidated statements of income (included in net investment income in Note 4c).

c) Investment custodian services

The Company was party to an agreement with AIG Trust Services Limited ("AIGTS"), an indirect wholly-owned subsidiary of AIG, under which AIGTS provided investment custodian services. The Company agreed to pay fees of 0.04% per annum based on the month-end market value of investments held under custody, plus reimbursement of fees and out-of-pocket expenses. These fees were included in net investment income in the accompanying consolidated statements of income. This agreement has been terminated effective January 31, 2008.

d) Related party reinsurance business

The Company assumed premiums (including reinstatement premiums) during the year ended December 31, 2006 of \$25,433 from companies who are majority-owned by shareholders of the Parent. The Company did not assume any premiums through brokers related to a shareholder of the Parent during the year ended December 31, 2006 and therefore did not incur any brokerage fees and commissions in respect of this business during the year. The Company ceded premiums (Note 5) during the year ended December 31, 2006 of \$1,437 to a company which is wholly-owned by AIG. All such transactions were undertaken on normal commercial terms. Reinsurance premiums receivable due from related parties as of December 31, 2006 were \$6,956. Reinsurance premiums payable to related parties as of December 31, 2006 were \$399.

e) During the year ended December 31, 2006, a director was also a director and executive officer of various AIG subsidiaries, having been appointed effective January 1, 2006. In addition, the managing director of AIMS served as a director of IPCRe Europe Limited.

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8. Reserve for losses and loss adjustment expenses

Movements in the reserve for losses and loss adjustment expenses are summarized as follows:

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|------------------|------------------|------------------|
| Gross loss reserves, beginning of the year | \$ 395,245 | \$ 548,627 | \$ 1,072,056 |
| Loss reserves recoverable, beginning of the year | <u>(17,497)</u> | <u>(1,989)</u> | <u>(1,054)</u> |
| Total net reserves, beginning of year | 377,748 | 546,638 | 1,071,002 |
| | <hr/> | <hr/> | <hr/> |
| Net losses incurred related to: | | | |
| Current year | 206,578 | 154,657 | 24,697 |
| Prior years | <u>(50,946)</u> | <u>(29,734)</u> | <u>33,808</u> |
| Total incurred | 155,632 | 124,923 | 58,505 |
| | <hr/> | <hr/> | <hr/> |
| Net paid losses related to: | | | |
| Current year | (45,087) | (25,572) | (3,248) |
| Prior years | <u>(126,471)</u> | <u>(271,299)</u> | <u>(582,248)</u> |
| Total paid | (171,558) | (296,871) | (585,496) |
| | <hr/> | <hr/> | <hr/> |
| Effect of foreign exchange movements | (8,700) | 3,058 | 2,627 |
| | <hr/> | <hr/> | <hr/> |
| Total net reserves, end of year | 353,122 | 377,748 | 546,638 |
| Loss reserves recoverable, end of year | <u>2,771</u> | <u>17,497</u> | <u>1,989</u> |
| Gross loss reserves, end of year | \$ 355,893 | \$ 395,245 | \$ 548,627 |
| | <hr/> <hr/> | <hr/> <hr/> | <hr/> <hr/> |

For certain catastrophic events there is considerable uncertainty underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Reserves are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments could require a material change in the amount estimated. The uncertainty associated with estimating reserves for losses and loss adjustment expense is increased as a result of (i) the delays experienced by the ceding company in receiving underlying claim information, and, in turn, the ceding company reporting such information to the Company, (ii) potential policy coverage disputes, including the ability to allocate damages to each specific event when multiple events affect one geographic area, and (iii) the effect of demand surge on the ultimate claim costs associated with building materials and labour. As a result, the initial estimate for hurricane Ike was based on industry insured loss estimates, output from industry and proprietary models, a review of contracts potentially affected by the events, information received from both clients and brokers and management judgement. It has been assumed that underlying policy terms and conditions are upheld during the loss adjustment process. The ultimate net impact of losses from this event on the Company's net income could differ substantially from the initial estimate. Such adjustments, if necessary, are reflected in results of operations in the period in which they become known.

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8. **Reserve for losses and loss adjustment expenses** (continued)

Losses incurred in the year ended December 31, 2008 are predominantly due to hurricane Ike that struck the Gulf Coast of the United States in September, the storm that impacted Queensland, Australia, the flooding in Iowa, the Alon Refinery explosion in Texas and hurricane Gustav. The net amount recorded for hurricane Ike was \$160,000. Net losses incurred in the year ended December 31, 2008 in respect of prior years' favourable development relating to a number of prior year events, predominantly from 2005 and 2007 with the impact mainly due to the 2007 Australian storm and subsequent flooding, the 2007 U.K. floods and hurricane Katrina, as a result of further information received from the market during 2008.

Losses incurred in the year ended December 31, 2007 are predominantly due to windstorm Kyrill that swept across northern Europe, the storm and subsequent flooding that affected parts of New South Wales, Australia, the flooding that impacted parts of northern England in June and the flooding that impacted various parts of the United Kingdom in July. Net amounts recorded for these events were \$137,867 in the aggregate. Net losses incurred in the year ended December 31, 2007 in respect of prior years are reductions in the ultimate estimated losses, in particular the major windstorms of 2005.

Losses incurred in the year ended December 31, 2006 are predominantly due to cyclone Larry which struck Queensland, Australia and super-typhoon Shanshan, which struck Japan. Amounts recorded for these events were \$13,148 in the aggregate. Losses incurred in the year ended December 31, 2006 in respect of prior years are primarily the result of development in reserves relating to the major windstorms of 2005, primarily hurricane Wilma. In addition there were two losses recorded in 2006 which occurred in 2005: a U.K. explosion and a train wreck and associated chemical spill which took place in South Carolina.

Net losses and loss adjustment expenses in the consolidated statements of income are presented net of reinsurance recoveries during the year ended December 31, 2008 as follows: \$(9,820) (2007: \$17,387; 2006: \$1,555).

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9. Written premium by geographic region

Financial information relating to premiums (excluding reinstatement premiums) written by geographic region is as follows:

| | <u>December 31, 2008</u> | | <u>December 31, 2007</u> | | <u>December 31, 2006</u> | |
|--|--------------------------|-------------|--------------------------|-------------|--------------------------|-------------|
| | Premiums | | Premiums | | Premiums | |
| | <u>written</u> | <u>%</u> | <u>written</u> | <u>%</u> | <u>written</u> | <u>%</u> |
| <u>Geographic Area</u> (1) | | | | | | |
| United States | \$ 196,522 | 53.0% | \$ 221,035 | 56.5% | \$ 205,866 | 48.7% |
| Europe | 102,369 | 27.6% | 103,493 | 26.5% | 107,920 | 25.5% |
| Japan | 20,805 | 5.6% | 20,768 | 5.3% | 22,907 | 5.4% |
| Australia/New Zealand | 12,767 | 3.4% | 19,174 | 4.9% | 15,595 | 3.7% |
| Worldwide (2) | 25,392 | 6.8% | 17,412 | 4.5% | 58,293 | 13.8% |
| Worldwide (excluding the United States) (3) | 3,886 | 1.0% | 4,098 | 1.0% | 9,106 | 2.1% |
| Other | <u>9,117</u> | <u>2.6%</u> | <u>5,134</u> | <u>1.3%</u> | <u>3,451</u> | <u>0.8%</u> |
| | 370,858 | 100.0% | 391,114 | 100.0% | 423,138 | 100.0% |
| Reinstatement premiums | <u>32,537</u> | | <u>12,982</u> | | <u>6,713</u> | |
| | \$ 403,395 | | \$ 404,096 | | \$ 429,851 | |

(1) Except as otherwise noted, each of these categories includes contracts that cover risks located primarily in the designated geographic area.

(2) Includes contracts that cover risks primarily in two or more geographic areas, including the United States.

(3) Includes contracts that cover risks primarily in two or more geographic areas, excluding the United States.

The Company operates in a single segment from a segmental-reporting perspective.

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10. Concentrations and credit risk

Credit risk arises out of the failure of a counterparty to perform according to the terms of the contract. Our cash and cash equivalents is held with multiple institutions. The Company does not require collateral or other security to support financial instruments with credit risk. The Company's fixed income investment portfolio is conservatively managed within a well-controlled risk environment. Our investment guidelines prohibit the purchase of securities with a speculative credit rating (below BBB-/Baa3) and even aggregate BBB/Baa exposure is limited to a maximum of 5%. For the year ended December 31, 2008, a single broker group accounted for approximately 27% (2007: 34%; 2006: 30%) of premiums written, excluding reinstatement premiums. For the year ended December 31, 2008, five broker groups accounted for approximately 85% (2007: 89%; 2006: 89%) of premiums written, excluding reinstatement premiums. In accordance with industry practice, the Company frequently pays amounts owed in respect of claims under our policies to reinsurance brokers, for payment over to the ceding insurers. In the event that a broker failed to make such a payment, depending on the jurisdiction, the Company might remain liable to the client for the deficiency. Conversely, in certain jurisdictions when premiums for such policies are paid to reinsurance brokers for payment over to the Company, such premiums will be deemed to have been paid and the ceding insurer will no longer be liable to the Company for those amounts whether or not actually received by the Company. Consequently, the Company assumes a degree of credit risk associated with brokers around the world during the payment process.

11. Credit facility

Effective March 31, 2006, the Company cancelled its three-year revolving credit facility for \$200,000, which was due to expire on June 30, 2006. Effective April 13, 2006, the Parent and the Company entered into a five-year, \$500,000 credit agreement with a syndicate of lenders, with an expiry date of April 12, 2011. The participants as at December 31, 2008 were Bayerische Hypo-und Vereinsbank AG, New York Branch, Bayerische Landesbank, Citibank, N.A., HSBC Bank USA, N.A., ING Bank N.V., London Branch, JPMorgan Chase Bank, N.A., Mellon Bank, N.A., Mizuho Corporate Bank (USA), Morgan Stanley Bank and Wachovia Bank, National Association. Wachovia Bank, National Association acts as the administrative agent. The credit agreement consists of a \$250,000 senior unsecured credit facility available for revolving borrowings and letters of credit, and a \$250,000 senior secured credit facility available for letters of credit. The revolving line of credit will be available for the working capital, liquidity and general corporate requirements of the Parent and the Company. Under the terms of the \$500,000 credit agreement, the Parent is permitted to declare and pay dividends provided there are no defaults of covenants or unmatured defaults pending. One of the significant covenants of the facility requires the Parent to maintain a minimum consolidated net worth (consolidated shareholders' equity) of \$1,000,000, plus 25% of any positive net income for each fiscal year, beginning with the fiscal year ended December 31, 2006, plus 25% of the net proceeds of any equity issuance or other capital contributions.

As of the date of this report, the outstanding letters of credit issued under the secured facility were \$65,880 (2007: \$49,954) (included in pledged assets in Note 4b), and we are in compliance with all terms and covenants thereof.

On June 12, 2008 the Parent borrowed \$150,000 under its revolving loan facility in order to partially fund its share repurchase program. The loan is unsecured and the interest rate resets at intervals of either 1, 3, or 6 months at the Parent's pre-selection and is based on LIBOR plus a spread based on the Parent's current debt rating. The Parent repaid \$75,000 on December 12, 2008 and the Parent filed a notice of continuation thereby resetting the repayment date to March 12, 2009. As of December 31, 2008, \$75,000 remains outstanding on this loan at a rate of 2.625% (on an annual basis). Interest expense in connection with the loan under the revolving loan facility was \$2,659 for the year ended December 31, 2008 and we are in compliance with all terms and covenants thereof. Simultaneous to the initial borrowing, these funds were loaned by the Parent to the Company essentially under the same terms and conditions as the external loan agreement.

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11. Credit facility (continued)

As of December 31, 2008, the outstanding letters of credit issued under the \$350,000 bilateral secured facility with Citibank Europe Plc. were \$100,400 (2007: \$133,379) (included in pledged assets in Note 4b). The agreement was effective April 14, 1994, it has no fixed termination date and we are in compliance with all terms and covenants thereof.

12. Statutory capital and surplus

The Company is registered as a Class 4 general business insurer under the Bermuda Insurance Act 1978, as amended, and Related Regulations (the "Act"). The Act provides that the statutory assets of an insurer must exceed its statutory liabilities by an amount greater than the prescribed minimum solvency margin. The minimum solvency margin that must be maintained by a Class 4 insurer with respect to its general business is the greater of (i) \$100,000; or (ii) 50% of net premiums written (with a credit for reinsurance ceded not exceeding 25% of gross premiums); or (iii) 15% of net discounted aggregate loss and loss expense provisions and other insurance reserves. These provisions have been met as shown in the following table:

| | <u>2008</u> | <u>2007</u> |
|--|--------------|--------------|
| Actual total statutory capital and surplus | \$ 1,840,295 | \$ 2,207,935 |
| Minimum solvency margin | \$ 198,396 | \$ 193,577 |

The Company's statutory net income for the year ended December 31, 2008 was \$93,983 (2007: \$388,068; 2006: \$393,730).

The Act prohibits a Class 4 insurer from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files at least seven days before payment of such dividends with the Bermuda Monetary Authority (the "Authority") an affidavit signed by at least two directors and the insurer's principal representative stating that the declaration of such dividends has not caused the insurer to fail to meet its relevant margins. As at January 1, 2009, the maximum amount that the Company may declare and pay as dividends without having to file an affidavit with the Authority is approximately \$460,074.

In accordance with its Class 4 registration, the Company is required to submit an annual loss reserve opinion on the adequacy of the loss and loss expense provisions reflected in its Statutory Financial Statements and Financial Statutory Return and other matters required to be disclosed to the Authority when filing its Annual Financial Return. This opinion must be provided by its independent loss reserve specialist.

Unaudited

In 2008, the Insurance Act was amended to introduce, among other things, the Bermuda Solvency Capital Requirement model (the "BSCR") which is a standard mathematical model designed to give the Authority more advanced methods for determining an insurer's capital adequacy. Underlying the BSCR is the belief that all insurers should operate on an ongoing basis with a view to maintaining their capital at a prudent level in excess of its minimum solvency margin.

Effective December 31, 2008, every Class 4 insurer, including the Company, must maintain its capital at a target level (the "Enhanced Capital Requirement") which is set at 120% of the minimum amount calculated in accordance with the BSCR (or such other prudential standard as may be established by the Authority). The Company is currently completing the BSCR. Based on our preliminary results, the Company's capital exceeds the ECR as at December 31, 2008.

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13. Pension plan

Effective December 1, 1995, the Company adopted a defined contribution plan for the majority of its officers and employees. Pursuant to the plan, each participant can contribute 5% or more of their base salary and the Company will contribute an amount equal to 5% of each participant's base salary. In 2003, the Company adopted an additional defined contribution plan, a Supplementary Executive Retirement Plan ("SERP"), which is applicable to senior employees. Pursuant to the SERP, the Company contributes an amount equal to 10% of each participant's base salary to a maximum of \$23 per employee (2007: \$23; 2006: \$20). For the year ended December 31, 2008, the Company's contributions in respect of these plans amounted to approximately \$527 (2007: \$463; 2006: \$349).

The Company has also entered into individual pension arrangements with specific employees that are non-contributory defined benefit plans. These defined benefit plans are currently unfunded. Benefits are based upon a percentage of average final compensation multiplied by years of credited service. Independent actuarial reviews of the ongoing benefit obligations were undertaken at December 31, 2008, 2007 and 2006. A summary of the status of the defined benefit plans is provided below:

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|-------------------|-------------------|-------------------|
| Change in benefit obligation | | | |
| Projected benefit obligation, beginning of year | \$ 3,580 | \$ 2,638 | \$ 1,904 |
| Service cost | 301 | 288 | 239 |
| Interest cost | 219 | 185 | 129 |
| Settlement loss | - | - | - |
| Benefits paid | - | - | - |
| Actuarial loss | <u>145</u> | <u>469</u> | <u>366</u> |
| Projected benefit obligation, end of year | \$ 4,245 | \$ 3,580 | \$ 2,638 |
| | <u> </u> | <u> </u> | <u> </u> |
| Reconciliation of funded status, end of year | | | |
| Fair value of assets | \$ <u>-</u> | \$ <u>-</u> | \$ <u>-</u> |
| Funded status, end of year | \$ (4,245) | \$ (3,580) | \$ (2,638) |
| | <u> </u> | <u> </u> | <u> </u> |
| Amounts recognized in the balance sheet, end of year | | | |
| Assets | \$ - | \$ - | \$ - |
| Liabilities | <u>(4,245)</u> | <u>(3,580)</u> | <u>(2,638)</u> |
| Total amounts recognized, end of year | \$ (4,245) | \$ (3,580) | \$ (2,638) |
| | <u> </u> | <u> </u> | <u> </u> |
| Amounts recognized in accumulated other comprehensive (loss) income, end of year | | | |
| Net loss | \$ 876 | \$ 881 | \$ 686 |
| Prior service cost | <u>-</u> | <u>-</u> | <u>-</u> |
| Total amounts recognized, end of year | \$ 876 | \$ 881 | \$ 686 |
| | <u> </u> | <u> </u> | <u> </u> |

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(Expressed in thousands of U.S. dollars, except for per share amounts)

13. Pension plan (continued)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--|-------------|-------------|-------------|
| Components of net periodic benefit cost | | | |
| Service cost | \$ 301 | \$ 288 | \$ 239 |
| Interest cost | 219 | 185 | 129 |
| Actuarial loss | <u>149</u> | <u>273</u> | <u>261</u> |
| Net periodic benefit cost | 669 | 746 | 629 |
| Additional loss due to settlement | <u>—</u> | <u>—</u> | <u>—</u> |
| Net amounts recognized in net periodic benefit cost | 669 | 746 | 629 |
| Total amounts recognized in other comprehensive income | <u>(5)</u> | <u>195</u> | <u>380</u> |
| Total amounts recognized in net periodic benefit cost and other comprehensive income during year | \$ 664 | \$ 941 | \$ 1,009 |
| Projected benefit obligation, end of year | \$ 4,245 | \$ 3,580 | \$ 2,638 |
| Accumulated benefit obligation | \$ 3,911 | \$ 2,970 | \$ 2,154 |
| Fair value of plan assets | \$ — | \$ — | \$ — |

In accordance with SFAS 158 an additional liability of \$876 (2007: \$881; 2006: \$686) is recorded in accumulated other comprehensive (loss) income in shareholder's equity in the accompanying consolidated financial statements as the unfunded accrued benefit liability exceeded the accrued pension cost. Actuarial assumptions used in estimating obligations are a discount rate of 6.25% (2007: 6.25%; 2006: 6.00%) and average compensation increases of 3.75% until age 60 and 2.25% thereafter (2007: 3.75% until age 60 and 2.25% thereafter; 2006: 3.75%). The source data for the discount rate is an analysis of the projected cash flows and the Citigroup pension yield curve. The benefits are forecasted to be paid in 2010 and 2011, at an estimated amount of \$1,882 and \$3,823 respectively.

14. Taxes

At the present time, no income, profit, capital or capital gains taxes are levied in Bermuda. In the event that such taxes are levied, the Company has received an undertaking from the Bermuda Government exempting it from all such taxes until March 28, 2016.

The Company does not consider itself to be engaged in a trade or business in the United States and, accordingly, does not expect to be subject to United States income taxes.

IPCRE Europe Limited is a tax-paying entity subject to the jurisdiction of the Government of Ireland. The amount of taxes incurred for 2008, 2007 and 2006 is not material to the consolidated financial statements.

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15. Subsequent events

The Amalgamation Agreement

On March 1, 2009, the Parent, its wholly-owned subsidiary, IPC Limited, and Max Capital Group Ltd. (“Max”) entered into the Agreement and Plan of Amalgamation, dated as of March 1, 2009 (as amended by the First Amendment to Agreement and Plan of Amalgamation, dated as of March 5, 2009, the “Amalgamation Agreement”), pursuant to which Max will amalgamate with IPC Limited (the “Amalgamation”). The closing of the Amalgamation is subject to customary closing conditions, including certain approvals by the Parent’s and Max’s shareholders and receipt of certain insurance and other regulatory approvals. Immediately following the Amalgamation, the Parent will change its name to “Max Capital Group Ltd.”

After the effective time of the Amalgamation, Max shareholders will have the right to receive 0.6429 common shares of the Parent and cash in lieu of fractional shares in exchange for each Max common share they hold, unless they exercise appraisal rights under Bermuda law. The Parent expects that it will issue approximately 36,440,847 common shares in connection with the Amalgamation. Pursuant to the Amalgamation Agreement the Parent or Max may be required to pay a termination fee of \$50,000 in certain circumstances. In connection with the services of J.P. Morgan Securities Inc. (“JPMorgan”) as financial advisor to the Board of Directors in connection with the Parent’s strategic process and the Amalgamation, the Parent agreed to pay JPMorgan an aggregate fee of \$13,000, \$3,700 of which has been paid as of March 31, 2009 and \$9,300 of which is payable upon the occurrence of a significant business combination transaction.

In connection with the Amalgamation, the Parent filed a preliminary registration statement/joint proxy statement with the SEC on March 27, 2009, and amendments thereto on April 13, 2009, and April 27, 2009. The Parent expects to complete the Amalgamation in June 2009, subject to shareholder approval.

The Validus Offer

On March 31, 2009, the Parent received an unsolicited offer from Validus Holdings, Ltd. (“Validus”) pursuant to which the Parent would amalgamate with a wholly owned subsidiary of Validus and each of the Parent’s common shares would be cancelled and converted into the right to receive 1.2037 Validus common shares. On April 7, 2009, the Parent announced that its Board of Directors, after thorough consideration and consultation with management and its legal and financial advisors and upon consideration of a variety of factors, determined that Validus’s offer did not constitute a superior proposal under the terms of the Amalgamation Agreement, and reaffirmed its recommendation that the Parent’s shareholders approve the Amalgamation with Max. On April 9, 2009 Validus announced that it had filed a preliminary proxy statement with the SEC for the solicitation of proxies in opposition to the Amalgamation with Max. On April 29, 2009 the Parent was served with legal proceedings in the Supreme Court of Bermuda by Validus to challenge the \$50,000 termination fee, payable in certain circumstances under the Amalgamation Agreement, and the “no-talk” provision contained in the Amalgamation Agreement. On April 30, 2009, Validus outlined a three-part plan to acquire the Parent. The Parent is currently evaluating the various legal proceedings being instituted by Validus, with the assistance of the Parent’s legal advisors.