

Ironshore Insurance Ltd.
Consolidated Financial Statements
December 31, 2008



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REPORT OF INDEPENDENT AUDITORS

TO THE BOARD OF DIRECTORS AND SHAREHOLDER OF
IRONSHORE INSURANCE LTD.

We have audited the accompanying consolidated balance sheets of Ironshore Insurance Ltd. as of December 31, 2008 and 2007, and the related consolidated statements of operations and comprehensive (loss) income, changes in shareholder's equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ironshore Insurance Ltd. at December 31, 2008 and 2007, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, with effect from January 1, 2008, the Company prospectively reclassified as trading, investments previously designated as available-for-sale and changed the manner in which movements in unrealized gains and losses on these investments are recognized.

Ernst & Young Ltd.

Hamilton, Bermuda
April 30, 2009

IRONSHORE INSURANCE LTD.
CONSOLIDATED BALANCE SHEETS
As at December 31
(Expressed in U.S. dollars, except share data)

ASSETS	<u>2008</u>	<u>2007</u>
Investments securities, at fair value:		
Fixed maturity investments (amortized cost: 2008 - \$1,241,898,022; 2007 - \$919,742,133)	\$1,158,233,695	\$908,902,609
Equity securities (cost: 2008 - \$nil; 2007 - \$32,730,025)	-	33,344,596
Derivative investments	-	146,886,390
Short term investments, at cost	-	89,109,729
Total Investments	<u>1,158,233,695</u>	<u>1,178,243,324</u>
Cash and cash equivalents	55,282,281	36,105,498
Accrued investment income	9,837,547	7,304,526
Premium balances receivable	75,827,026	63,027,831
Reinsurance recoverable	253,231,390	80,098,947
Deferred acquisition costs	30,074,440	21,574,855
Prepaid reinsurance premiums	41,269,428	19,786,534
Receivable for investments sold	-	1,010,343
Amounts receivable from related parties	11,780,085	-
Intangible assets	23,168,406	11,316,066
Other assets	6,145,065	2,473,924
Total Assets	<u>\$1,664,849,363</u>	<u>\$1,420,941,848</u>
LIABILITIES		
Reserve for losses and loss adjustment expenses	\$433,954,553	\$121,984,185
Unearned premiums	210,582,638	169,731,044
Insurance and reinsurance balances payable	58,758,466	16,251,897
Deferred acquisition costs ceded	5,239,491	721,122
Deferred tax liabilities	425,585	-
Payable for investments purchased	-	150,960,182
Amounts payables to related parties	-	1,624,136
Other liabilities	17,152,038	8,143,581
Total Liabilities	<u>726,112,771</u>	<u>469,416,147</u>
SHAREHOLDER'S EQUITY		
Common stock, 2,000,000 authorized, \$1.00 par value, 1,000,000 issued and outstanding (2007 - 1,000,000)	1,000,000	1,000,000
Additional paid-in capital	973,869,346	896,179,901
Accumulated other comprehensive loss	-	(10,224,953)
Retained (deficit) earnings	(36,132,754)	64,570,753
Total Shareholder's Equity	<u>938,736,592</u>	<u>951,525,701</u>
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	<u>\$1,664,849,363</u>	<u>\$1,420,941,848</u>

See accompanying notes to the consolidated financial statements.

IRONSHORE INSURANCE LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE (LOSS) INCOME
For the year ended December 31
(Expressed in U.S. dollars)

	2008	2007
REVENUES		
Gross premiums written	\$383,066,568	\$317,140,986
Reinsurance premiums ceded	(89,221,130)	(39,752,251)
Net premiums written	293,845,438	277,388,735
Change in unearned premiums	(19,368,700)	(149,944,510)
Net premiums earned	274,476,738	127,444,225
Net investment income	54,864,134	49,288,081
Net realized and unrealized losses on investments	(103,940,367)	(15,096,623)
Net foreign exchange (losses) gains	(2,393,373)	186,947
Other income	235,350	35,000
Total revenues	223,242,482	161,857,630
EXPENSES		
Losses and loss adjustment expenses	218,457,566	43,097,971
Acquisition expenses	43,933,561	18,578,280
General and administrative expenses	50,899,056	35,904,140
Total expenses	313,290,183	97,580,391
NET (LOSS) INCOME BEFORE TAXES	\$(90,047,701)	\$64,277,239
Income tax expense	430,853	-
NET (LOSS) INCOME	\$(90,478,554)	\$64,277,239
Net unrealized holding losses arising during period	-	(25,321,576)
Net realized losses on investments, included in net income	-	15,096,623
Other Comprehensive Loss	-	(10,224,953)
COMPREHENSIVE (LOSS) INCOME	\$(90,478,554)	\$54,052,286

See accompanying notes to the consolidated financial statements.

IRONSHORE INSURANCE LTD.
CONSOLIDATED STATEMENTS OF CHANGES
IN SHAREHOLDER'S EQUITY
For the year ended December 31
(Expressed in U.S. dollars)

	2008	2007
Share Capital		
Common voting shares	\$1,000,000	\$1,000,000
Additional paid-in capital		
Balance at beginning of year	896,179,901	928,523,737
Stock compensation expense	1,424,555	2,492,022
Capital contribution	76,264,890	8,291,436
Return of capital	-	(43,127,294)
Balance at end of year	973,869,346	896,179,901
Accumulated other comprehensive loss		
Balance at beginning of year	(10,224,953)	-
Change in net unrealized losses on investments	-	(10,224,953)
Cumulative effect adjustment from adoption of FAS 159	10,224,953	-
Balance at end of year	-	(10,224,953)
Retained (deficit) earnings		
Balance at beginning of year	64,570,753	293,514
Cumulative effect adjustment from adoption of FAS 159	(10,224,953)	-
Net (loss) income for year	(90,478,554)	64,277,239
Balance at end of year	(36,132,754)	64,570,753
TOTAL SHAREHOLDER'S EQUITY	\$938,736,592	\$951,525,701

See accompanying notes to the consolidated financial statements.

IRONSHORE INSURANCE LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the year ended December 31
(Expressed in U.S. dollars)

	2008	2007
Cash flows provided by operating activities:		
Net (loss) income	\$(90,478,554)	\$64,277,239
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	246,420	119,870
Stock compensation expense	1,424,555	2,492,022
Amortization of debt securities	(3,074,241)	(2,397,453)
Net realized and unrealized losses on investments	103,940,367	15,096,623
Changes in operational assets and liabilities:		
Net sales and purchases of derivative investments	139,335,144	(8,172,321)
Accrued investment income	(2,269,368)	(6,569,853)
Premium balances receivable	(12,799,195)	(63,027,831)
Reinsurance recoverable	(92,640,363)	(1,008,016)
Deferred acquisition costs	(8,499,585)	(21,574,855)
Prepaid reinsurance premiums	(21,482,894)	(19,786,534)
Amounts receivable from related parties	(11,780,085)	-
Other assets	(1,528,712)	(1,856,961)
Reserve for losses and loss adjustment expenses	231,478,288	42,893,254
Unearned premiums	40,851,594	169,731,044
Insurance and reinsurance balances payable	42,506,569	15,481,435
Deferred acquisition costs ceded	4,518,369	721,122
Amounts payable to related parties	(1,624,136)	826,210
Deferred tax liabilities	425,585	-
Other liabilities	7,758,463	8,079,189
Net cash provided by operating activities	326,308,221	195,324,184
Cash flows used in investing activities:		
Purchase of subsidiary, net of cash acquired	(41,892,061)	(24,462,816)
Purchases of fixed maturity investments	(1,189,775,533)	(1,458,832,032)
Purchases of short term investments	(106,219,699)	(4,870,181,559)
Purchases of equity securities	-	(44,231,000)
Proceeds on sales of fixed maturity investments	709,057,712	536,311,781
Proceeds on maturities of fixed maturity investments	5,468,626	6,950,000
Proceeds on maturities and sales of short term investments	210,216,751	4,789,809,846
Proceeds on sales of equity securities	32,124,110	10,929,294
Purchases of fixed assets	(376,234)	(574,219)
Notes receivable (Note 3)	(2,000,000)	-
Net cash used in investing activities	(383,396,328)	(1,054,280,705)
Cash flows provided by financing activities:		
Proceeds from issuance of common stock	-	35,000,000
Additional paid-in capital received from shareholder	76,264,890	8,291,436
Additional paid-in capital returned to shareholder	-	(43,127,294)
Net cash provided by financing activities	76,264,890	164,142
Net increase (decrease) in cash and cash equivalents	19,176,783	(858,792,379)
Cash and cash equivalents at beginning of year	36,105,498	894,897,877
Cash and cash equivalents at end of year	\$55,282,281	\$36,105,498

See accompanying notes to the consolidated financial statements.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

1. Nature of the business

Ironshore Insurance Ltd. (“Ironshore Insurance”) was incorporated under the laws of Bermuda on October 19, 2006. The Company, together with its subsidiaries (collectively referred to as the “Company”), began underwriting activities in 2007 and provides specialty commercial property and casualty coverages for risks located throughout the world. Ironshore Insurance is registered as a Class 4 insurer under The Insurance Act 1978 in Bermuda, related regulations and amendments thereto (“The Act”). The Company is a wholly owned subsidiary of Ironshore Inc. a company that was incorporated under the laws of the Cayman Islands on September 26, 2006.

Ironshore Services Inc., a subsidiary of Ironshore Inc., was incorporated in Delaware and provides group-wide services and support.

The Company’s U.S. platform consists of Ironshore Holdings (U.S.) Inc. (“Ironshore Holdings US”) which was incorporated in Delaware on April 10, 2007 and its principal subsidiaries Ironshore Reinsurance Ltd. (“Ironshore Reinsurance”) which is domiciled in Bermuda and is registered as a Class 3 insurer under The Act, Ironshore Indemnity Inc., (“Ironshore Indemnity”), a Minnesota domiciled insurer and Ironshore Specialty Insurance Limited (“Ironshore Specialty”), an Arizona domiciled insurer. The U.S. companies serve the professional liability, construction and healthcare liability specialty market sectors.

Ironshore Insurance Services LLC, a New York corporation and a subsidiary of Ironshore Holdings US, was created to act as a general agent on behalf of Ironshore Reinsurance and performs all functions necessary for the production, service and management of policies issued by Ironshore Reinsurance.

2. Significant accounting policies

Basis of presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and include the financial statements of Ironshore Insurance Ltd., and its wholly owned subsidiaries, (collectively the “Company”). All inter-company balances and transactions have been eliminated on consolidation.

Use of Estimates in Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported and disclosed amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of reserves and expenses during the reporting period. Actual results could differ materially from those estimates. The major estimates reflected in the Company’s consolidated financial statements include, but are not limited to, the reserves for losses and loss adjustment expenses, losses recoverable, estimates of written and earned premiums, the fair value of investments and financial instruments, and the Company’s deferred tax asset valuation allowance.

Premiums and related expenses

Premiums written and ceded are earned on a pro rata basis over the terms of the risk period. For all contracts and policies written, the risk period is the same as the contract or policy terms. Premiums written include estimates based on information received from brokers, ceding companies and insureds, and any subsequent differences arising on such estimates are recorded in the periods in which they are determined. The portion of the premiums written and ceded applicable to the unexpired terms of the underlying contracts and policies are recorded as unearned premiums and prepaid reinsurance premiums, respectively. For contracts written on a losses occurring basis, the risk period is generally the same as the contract or policy term. For contracts written on a risks attaching basis, the risk period is based on the terms of the underlying contracts and policies. Reinstatement premiums are estimated after the occurrence of a loss and are recorded in accordance with the contract terms based upon the ultimate loss estimates associated with each contract. Reinstatement premiums are earned when written.

Acquisition expenses are costs that vary with, and are directly related to, the production of new and renewal business, and consist principally of commissions and brokerage expenses. These costs are deferred and amortized over the periods in which the related premiums are earned. Deferred acquisition costs are limited to their estimated realizable value based on the related unearned premiums. Anticipated loss and loss adjustment expenses based on historical and current experience and anticipated investment income related to those premiums are considered in determining the recoverability of deferred acquisition costs.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

Certain assumed reinsurance contracts are deemed not to transfer insurance risk in accordance with Financial Accounting Standard No. 113 "Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts" ("FAS 113") and are accounted for using the deposit method of accounting as prescribed in Statement of Position 98-7 "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk" ("SOP 98-7"). Management exercises significant judgment in determining whether assumed contracts should be accounted for as reinsurance contracts under FAS 113 or deposit insurance contracts under SOP 98-7. It is possible that the Company could incur losses on such contracts. Under SOP 98-7, for those contracts that contain an element of underwriting risk, the estimated profit margin is deferred and amortized over the contract term and is included in the Company's underwriting results. When the estimated profit margin is explicit, the margin is reflected as fee income and adverse results on such contracts are reflected as incurred losses. When the estimated profit margin is implicit, the margin is reflected as an offset to paid losses and any adverse results are reflected as incurred losses. For those contracts that do not transfer an element of underwriting risk, the projected profit is reflected in earnings over the estimated settlement period using the interest method and is included in investment income. Deposit accounting liabilities are included in "Other liabilities" on the Company's balance sheet.

Reinsurance

In the normal course of business, the Company may seek to mitigate underwriting risk that could cause unfavorable results by reinsuring certain amounts of risk with reinsurers. Reinsurance premiums ceded are expensed pro rata over the period the reinsurance coverage is provided. Prepaid reinsurance premiums represent the portion of premiums ceded on the unexpired terms of the policies purchased. Reinsurance ceding commissions are recognized in earnings on a pro rata basis over the period the reinsurance coverage is provided. The portions of such commissions that will be earned in the future is deferred and recorded as deferred acquisition costs ceded on the balance sheet.

Reinsurance recoverable is presented on the balance sheet net of any reserves for uncollectible reinsurance. The method of determining the reinsurance recoverable on unpaid losses and loss adjustment expenses involves actuarial estimates in a manner consistent with the determination of unpaid losses and loss adjustment expenses.

Reserve for losses and loss adjustment expenses

The reserve for losses and loss adjustment expenses includes reserves for unpaid reported losses and for losses incurred but not reported. The reserve for unpaid reported losses and loss expenses is established by management based on reports from loss adjusters, ceding companies and insureds and represents the estimated ultimate cost of events or conditions that have been reported to, or specifically identified, by the Company. The reserve for incurred but not reported losses and loss adjustment expenses is established by management based on actuarially determined estimates of ultimate losses and loss expenses. Inherent in the estimate of ultimate losses and loss expenses are expected trends in claim severity and frequency and other factors which vary significantly as claims are settled. Accordingly, ultimate losses and loss expenses may differ materially from the amounts recorded in the consolidated financial statements. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are recorded in earnings in the periods in which they become known.

Investment

Effective January 1, 2008, the Company adopted FAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115" ("FAS 159"). Following the adoption of FAS 159, all of the Company's fixed maturity investments and equity securities which were previously classified as available-for-sale securities are reported as trading. Prior to the adoption of FAS 159, these assets were accounted for at fair value under FAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" ("FAS 115") and were classified as available-for-sale. In accordance with FAS 115, these securities were carried at fair value and the related unrealized gains and losses were reported as a separate component of shareholder's equity, with changes therein reported as a component of other comprehensive income. The adoption of FAS 159 on January 1, 2008 resulted in \$10,224,953 of net unrealized losses being charged to retained earnings as a cumulative effect adjustment which is offset by an increase in accumulated other comprehensive income as described in the statement of shareholders' equity. The Company believes that accounting for its investments as trading with all changes in fair value included in net income reduces an element of management judgment as the Company is no longer required to perform an analysis of its investments for other-than-temporary impairment.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

Fair values of the Company's fixed maturity and equity investments are based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications and/or internal pricing valuation techniques. Investment transactions are recorded on a trade date basis with balances pending settlement recorded separately in the balance sheet as receivable for investments sold or payable for investments purchased. Net investment income includes interest and dividend income together with amortization of market premiums and accretion of discounts and is recorded net of investment expenses.

Short term investments, which are managed as part of the Company's investment portfolio, have an original maturity of one year or less when purchased, and are carried at cost which approximates fair value.

Realized gains and losses on sales of investments are determined on the average cost by specific security 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. The amortization of premium and accretion of discount is computed using the effective interest rate method.

For mortgage-backed and other asset-backed debt securities, fair value includes estimates regarding prepayment assumptions, which are based on current market conditions. Amortized cost in relation to these securities is calculated using a constant effective yield based on anticipated prepayments and estimated economic lives of the securities. When actual prepayments differ significantly from anticipated prepayments, the effective yield is recalculated to reflect actual payments to date. Changes in estimated yield are recorded on a retrospective basis, which results in future cash flows being used to determine current book value. Realized investment gains and losses are recognized in earnings using the specific identification method. Interest on fixed maturity investments is recorded in net investment income when earned and adjusted for any amortization of premium or discount.

Fair value measurement

Effective January 1, 2008, the Company adopted FAS No. 157, "Fair Value Measurements" ("FAS 157"). FAS 157 defines fair value as the price received to transfer an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date reflecting the highest and best use valuation concepts. FAS 157 establishes a framework for measuring fair value using a hierarchy of fair value measurements that distinguishes market data between observable independent market inputs and unobservable market assumptions and requires additional disclosures about such fair value measurements.

FAS 157 requires that financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under FAS 157 are described further below:

- Level 1: Quoted prices in active markets for identical assets/liabilities (unadjusted);
- Level 2: Indirect observable inputs including quoted prices for similar assets/liabilities (adjusted) and market corroborated inputs;
- Level 3: Unobservable inputs which reflect the underlying entity's interpretation of risk assumptions used by market participants.

On October 10, 2008, the FASB also issued a FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP 157-3") to clarify the application of FAS 157 in a market that is not active. FSP 157-3 confirms that the fair value measurement objective remains the same in an inactive market, that is the price that would be received in an orderly transaction that is not a forced liquidation or distressed sale at the measurement date. The determination of fair value in a dislocated market depends on facts and circumstances and may require the use of significant judgment about whether individual transactions are forced liquidations or distressed sales. FSP 157-3 also provides that in determining the fair value for a financial asset, the use of a reporting entity's own assumptions about future cash flows and appropriately risk-adjusted discount rates is acceptable when relevant observable inputs are not available. It further indicates that regardless of the valuation technique used, an entity must include appropriate risk adjustments that market participants would make for nonperformance and liquidity risks. Finally, FSP 157-3 provides that broker quotes may be an appropriate input when measuring fair value but the nature of the quote should be considered when weighing the evidence available. The Company has considered the provisions of FSP 157-3 and has determined that its fair value measurement policies are consistent with the guidance in FSP 157-3.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

Derivatives

Under FAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“FAS No. 133”), and related interpretations, all derivative financial instruments including embedded derivative instruments are required to be recognized as either assets or liabilities in the consolidated balance sheets and measured at fair value. The accounting for gains and losses associated with changes in the fair value of a derivative and the effect on the consolidated financial statements depends on whether it has been designated and qualifies as part of a hedging relationship and whether the hedge is highly effective in achieving offsetting changes in the fair value of the asset or liability hedged.

The Company’s investment strategy allows for the use of derivative instruments. The Company utilizes various derivative instruments such as options and futures contracts as part of the management of its interest rate risk. Derivative instruments may be used to enhance investment performance, replicate investment positions or manage market exposures and duration risk that would be allowed under the Company’s investment guidelines if implemented in other ways. The Company does not currently apply hedge accounting.

Derivative investments are recorded at fair value and changes in fair value are recorded in net realized losses on investments in the Company’s results of operations. The fair value of the Company’s derivatives are estimated by reference to quoted prices or broker quotes, where available and in the absence of quoted prices or broker quotes, the use of industry or internal valuation models.

Cash and cash equivalents

The Company considers all investments with an original maturity of ninety days or less as cash equivalents.

Intangible assets

The Company accounts for intangible assets that arise from business combinations in accordance with FAS No. 141, “Business Combinations” (“FAS No. 141”) and FAS No. 142 “Goodwill and Other Intangibles Assets” (“FAS No. 142”). Intangible assets are valued at fair value at the date of acquisition. The Company’s intangible assets relate to the purchase of admitted and non admitted licenses and the purchase of a customer listing.

Purchased licenses are considered to have indefinite lives and are not amortized but are tested for impairment at least annually. The impairment test has two steps. The first step identifies potential impairments by comparing the fair value of the reporting unit to its book value, including intangibles. If the fair value of the reporting unit exceeds the carrying amount, the intangible is not impaired and the second step is not required. If the carrying value is in excess of the fair value, the second step computes the possible impairment loss by comparing the implied fair value of the intangible with the carrying amount. If the implied fair value of the intangible is less than the carrying amount, a write-down is recorded.

The Customer listing is considered to have a finite life and is amortized over its useful life of 3 years.

The Company considers the recoverability of its intangible assets whenever a change in circumstances arises and in the event that an impairment exists, any excess unamortized balances are charged to earnings.

Foreign exchange

The Company’s functional currency is the United States Dollar (U.S. dollars or \$).

Monetary assets and liabilities denominated in foreign currencies are revalued at the exchange rates in effect at the balance sheet date with the resulting foreign exchange gains and losses included in income. Revenues and expenses denominated in other than U.S. dollars currencies are translated at the average rate for the period.

Stock compensation

The Company accounts for its participation in Ironshore Inc.’s stock compensation plans in accordance with the fair value recognition provisions of SFAS 123(R) “Share-Based Payment.” Accordingly, the Company measures the compensation expense for share based awards based on the estimated fair value of the award on the date of grant, and such amount is charged to earnings over the requisite service period. Ironshore Inc. charges the Company for a portion of the expense associated with the stock-based employee compensation.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

Taxation

Income taxes have been provided in accordance with the provisions of FAS No. 109, "Accounting for Income Taxes" ("FAS 109"), on those operations which are subject to income taxes. Deferred tax assets and liabilities result from temporary differences between the amounts recorded in the consolidated financial statements and the tax basis of the Company's assets and liabilities. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance against deferred tax assets is recorded if it is more likely than not that all, or some portion, of the benefits related to deferred tax assets will not be realized.

Effective January 1, 2008, the Company adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements and applies to all tax positions related to income taxes subject to FAS 109. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods.

New Accounting Pronouncements

In December 2007, the FASB issued FAS No. 141R, a revision to FAS 141 which requires changes to the accounting for transaction costs, certain contingent assets and liabilities and other balances in a business combination. In cases of partial acquisitions, when control is obtained, the controlling company must measure and record all of the target's assets and liabilities including goodwill at fair value as if the entire target company had been acquired. The statement is effective for the Company for acquisitions occurring after December 31, 2008. The adoption of FAS 141R is not expected to have any material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued FAS No. 161 "Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement 133" ("FAS 161"). 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 FAS 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, FAS 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 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 adoption of FAS 161 is not expected to have any material impact on the Company's consolidated financial statements.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

3. Business Combinations

On January 2, 2008, the Company acquired TIG Specialty Insurance Company from Fairfax Financial Holdings Limited for a net purchase price of \$39,892,061 and subsequently renamed it, Ironshore Specialty. Ironshore Specialty is an Excess & Surplus lines admitted licensed carrier. Ironshore Specialty is domiciled in Arizona and is licensed in 48 states and the District of Columbia. This acquisition complements Ironshore's 2007 acquisition of Ironshore Indemnity, a licensed admitted carrier and allows Ironshore to offer a variety of insurance products and solutions to its clients. Ironshore Specialty commenced operations under the Company's management in April, 2008 and its results are included in these audited consolidated financial statements from that date.

At the date of acquisition, the seller assumed all known, unknown and contingent liabilities of Ironshore Specialty relating to events occurring on or before the acquisition date. The related loss reserves amounting to \$80,492,080 and a reinsurance recoverable of the same amount were recorded on the date of acquisition. Ironshore Specialty also received a conditional guarantee from the parent of the seller that will take effect should the seller be unable to fulfill its obligations. To the extent both companies do not meet their obligation under these agreements, Ironshore Specialty remains primarily liable for these liabilities.

The fair value of the net assets acquired and allocation of purchase price is summarized as follows:

Total purchase price		\$40,288,582
Assets acquired		
Cash and cash equivalents	396,521	
Fixed maturity investments	16,478,859	
Short term investments	14,534,594	
Accrued investment income	263,653	
Reinsurance recoverables	80,492,080	
Assets acquired	112,165,707	
Liabilities acquired		
Reserve for losses and loss adjustment expenses	80,492,080	
Liabilities acquired	80,492,080	
Net assets acquired		31,673,627
Excess purchase price		\$8,614,955

The excess purchase price of \$8,614,955 relates to licenses held by Ironshore Specialty and was recorded as an intangible asset with an indefinite life. As the purchase price has been fully allocated against the fair values of the assets and liabilities no goodwill was recorded.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

On December 12, 2008, the Company acquired the assets of Marine Re Inc. (“Marine Re”) for \$3,250,000 of which \$2,000,000 was paid in cash and \$1,250,000 was deferred. On the same date, the Company extended offers of employment to the existing management and staff of that firm. Marine Re underwrites all reinsurance classes but specializes in hull and cargo for commercial and pleasure craft. Ironshore will operate through Marine Re’s existing binding authority with effect from January 1, 2009. The assets acquired consist principally of a customer list with an estimated fair value of \$3.25 million. In addition, the Company provided a loan of \$2.0 million to two former shareholders of Marine Re.

The identifiable intangible assets acquired with Marine Re will be amortized over their useful life of 3 years and the expected amortization is as follows:

2009	\$1,083,333
2010	1,083,333
2011	<u>1,083,334</u>
Total	<u>\$3,250,000</u>

On November 1, 2007, Ironshore Holdings US completed the purchase of Stockbridge Insurance Company for a purchase price of \$24,462,816 and subsequently renamed it Ironshore Indemnity. Ironshore Indemnity is domiciled in Minnesota and is licensed in 46 states and the District of Columbia. The purchase of Ironshore Indemnity was made to expand the ability of Ironshore Holdings US to write insurance on an admitted basis within the U.S.. At the date of acquisition, the seller assumed all known, unknown and contingent liabilities of Ironshore Indemnity relating to events occurring on or before the acquisition date. The related loss reserves amounting to \$79,090,931 and reinsurance recoverable of the same amount were recorded on the date of acquisition. Ironshore Indemnity also received a conditional guarantee from the parent of the seller that will take effect should the seller be unable to fulfill its obligations. To the extent both companies do not meet their obligation under these agreements, Ironshore Indemnity remains primarily liable for these liabilities.

The fair value of the net assets acquired and allocation of purchase price is summarized as follows:

Total purchase price	\$26,552,320
Assets acquired	
Cash and cash equivalents	\$2,089,504
Fixed maturity investments	6,844,030
Short term investments	6,957,587
Accrued investment income	115,595
Reinsurance recoverables	<u>79,090,931</u>
Assets acquired	<u>\$95,097,647</u>
Liabilities acquired	
Reserve for losses and loss adjustment expenses	\$79,090,931
Insurance and Reinsurance balances payable	<u>770,462</u>
Liabilities acquired	<u>\$79,861,393</u>
Net assets acquired	<u>\$15,236,254</u>
Excess purchase price	<u>\$11,316,066</u>

The excess purchase price of \$11,316,066 relates to licenses held by Ironshore Indemnity and was recorded as an intangible asset with an indefinite life. As the purchase price has been fully allocated against the fair values of the assets and liabilities no goodwill was recorded.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

4. Investments

The amortized cost, gross unrealized gains and losses and fair value of fixed maturity investments and equity securities at December 31, 2008 are as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agency securities	\$326,208,187	\$10,389,664	\$(399,042)	\$336,198,809
Municipal securities	112,816,111	2,676,215	-	115,492,326
Corporate securities	275,166,602	671,498	(22,790,132)	253,047,968
U.S. asset-backed securities	164,893,918	114,945	(36,032,445)	128,976,418
U.S mortgage-backed securities	362,813,204	8,310,065	(46,605,095)	324,518,174
Total fixed maturity investments	\$1,241,898,022	\$22,162,387	\$(105,826,714)	\$1,158,233,695

The amortized cost, gross unrealized gains and losses and fair value of fixed maturity investments and equity securities at December 31, 2007 are as follows:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agency securities	\$178,272,356	\$4,802,452	\$(46,040)	\$183,028,768
Corporate securities	210,400,344	998,210	(6,900,430)	204,498,124
U.S. asset-backed securities	159,006,121	45,064	(6,144,065)	152,907,120
U.S mortgage-backed securities	372,063,312	2,162,853	(5,757,568)	368,468,597
Total fixed maturity investments	919,742,133	8,008,579	(18,848,103)	908,902,609
Total equity securities	32,730,025	1,365,100	(750,529)	33,344,596
	\$952,472,158	\$9,373,679	\$(19,598,632)	\$942,247,205

Included in the above are fixed maturity investments with a fair value of \$20,519,665 and \$7,519,878, which are on deposit with U.S. insurance regulators at December 31, 2008 and 2007, respectively, to meet certain statutory requirements. The Company also maintains fixed maturity investments and cash amounting to \$59,008,077 and \$25,670,232 in trust accounts as collateral under the terms of certain insurance and reinsurance transactions for the years ended December 31, 2008 and 2007, respectively.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

The following represents an analysis of net realized gains (losses) on the sale of investments for the years ended:

	December 31, 2008		
	Realized gains	Realized losses	Net Realized gains (losses)
Fixed Maturity investments	\$7,578,120	\$(25,453,417)	\$(17,875,297)
Equity securities	484,749	(1,722,181)	(1,237,432)
Derivative investments	4,931,958	(6,095,269)	(1,163,311)
	<u>\$12,994,827</u>	<u>\$(33,270,867)</u>	<u>\$(20,276,040)</u>

	December 31, 2007		
	Realized gains	Realized losses	Net Realized gains (losses)
Fixed maturity investments	\$1,651,279	\$(11,670,683)	\$(10,019,404)
Equity securities	119,852	(691,916)	(572,064)
Derivative investments	5,544,490	(10,049,645)	(4,505,155)
	<u>\$7,315,621</u>	<u>\$(22,412,244)</u>	<u>\$(15,096,623)</u>

The amortized cost and fair value amounts for fixed maturity investments held at December 31, 2008 and 2007 respectively are shown by contractual maturity below. Actual maturity may differ from contractual maturity because certain borrowers may have the right to call or prepay certain obligations with or without call or prepayment penalties.

	December 31, 2008		December 31, 2007	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
Due in one year or less	\$87,721,508	\$88,680,381	\$65,141	\$64,221
Due after one year through five years	401,088,138	398,902,992	326,864,052	327,138,000
Due after five years through ten years	40,114,236	43,427,959	24,545,006	24,029,069
Due after ten years	95,641,571	105,251,876	36,052,693	37,441,410
U.S. mortgage-backed securities	404,691,824	440,740,896	368,468,597	372,063,312
U.S. asset-backed securities	128,976,418	164,893,918	152,907,120	159,006,121
Total fixed maturity investments	<u>\$1,158,233,695</u>	<u>\$1,241,898,022</u>	<u>\$908,902,609</u>	<u>\$919,742,133</u>

The following table sets forth certain information regarding the investment ratings of the Company's fixed maturity investment portfolio as of December 31, 2008. Investment ratings are as designated by Standard & Poor's Ratings Group or Moody's Investors Service.

	December 31, 2008	
	Fair Value	Amortized Cost
S&P Equivalent Rating (a)		
AAA	\$855,885,700	\$888,186,960
AA	41,250,218	48,911,471
A	161,341,665	168,640,355
BBB	67,012,897	85,353,409
Below BBB	31,499,297	49,530,617
NR	1,243,918	1,275,210
Total fixed maturity investments	<u>\$1,158,233,695</u>	<u>\$1,241,898,022</u>

(a) Carried at the lower of Standard & Poor's or Moody's rating, presented in Standard & Poor's equivalent rating.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

Net investment income is derived from the following sources:

	<u>2008</u>	<u>2007</u>
Fixed maturity investments	\$53,735,366	\$36,121,324
Short term investments	331,402	2,798,268
Equity securities	127,159	-
Cash and cash equivalents	2,051,950	11,779,663
Total gross investment income	56,245,877	50,699,255
Investment expenses	(1,381,743)	(1,411,174)
Net investment income	<u>\$54,864,134</u>	<u>\$49,288,081</u>

Fair value measurement

The following table presents the Company's assets that were accounted for at fair value as of December 31, 2008 by level within the fair value hierarchy:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Value as at December 31, 2008
Assets (at fair value)				
Fixed maturities	<u>\$172,087,554</u>	<u>\$967,622,608</u>	<u>\$18,523,533</u>	<u>\$1,158,233,695</u>

In accordance with FAS 157, the Company and its pricing services maximize the use of observable inputs ensuring that unobservable inputs are used only when observable inputs are not available. As of December 31, 2008, Level 1 includes U.S. government and government agency securities. These securities are actively traded which is defined by the Company's pricing service as a security that has traded in the previous 7 days.

Level 2 securities include other fixed maturity securities, such as municipal securities, corporate securities, U.S. asset-backed securities and U.S. mortgage-backed securities. The fair value of these securities was generally based on quoted prices for similar assets. The Company's investments classified as Level 3 as of December 31, 2008 included mortgage-backed securities, collateralized mortgage obligations and U.S. asset-backed securities. These securities were valued based solely on broker quotes where significant inputs that were utilized in determining the value are difficult to corroborate with observable market data.

Level 3 Gains and Losses

The table below presents additional information about assets measured at fair value at December 31, 2008 for which significant Level 3 inputs were utilized to determine the fair value:

	<u>Fixed maturities</u>	<u>Equities</u>	<u>Fair value</u>
Balance, beginning of year	\$145,337,189	\$30,151,095	\$175,488,284
Realized losses	(5,872,721)	(33,254)	(5,905,975)
Movement in unrealized losses	(10,382,689)	-	(10,382,689)
Purchases, sales and settlements	(23,252,962)	(30,117,841)	(53,370,803)
Net transfers out	(87,305,284)	-	(87,305,284)
Balance, end of year	<u>\$18,523,533</u>	<u>-</u>	<u>\$18,523,533</u>

The vast majority of Level 3 assets are made up of securities for which the values were obtained from brokers where either significant inputs were utilized in determining the value that were difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not available to support a Level 2 classification.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

5. Reserves for losses and loss adjustment expenses

Reserves for losses and loss adjustment expenses are based in part on the estimation of case losses reported from brokers, insureds and ceding companies. The Company also uses statistical and actuarial methods to estimate ultimate expected losses and loss expenses. The period of time from the occurrence of a loss, the reporting of a loss to the Company and the settlement of the Company's liability may be several months or years. During this period, additional facts and trends may be revealed. As these factors become apparent, case reserves will be adjusted, sometimes requiring an increase or decrease in the overall reserves of the Company, and at other times requiring a reallocation of incurred but not reported reserves to specific case reserves. These estimates are reviewed regularly, and such adjustments, if any, are reflected in earnings in the period in which they become known. While management believes that it has made a reasonable estimate of ultimate losses, there can be no assurances that ultimate losses and loss expenses will not exceed the total reserves.

The following table represents the activity in the reserve for losses and loss adjustment expenses for the years ended December 31, 2008 and 2007 respectively:

	2008	2007
Gross reserves for losses and loss adjustment expenses, beginning of year	\$121,984,185	-
Less reinsurance recoverable balances, beginning of year	80,098,947	-
Net reserves for losses and loss adjustment expenses, beginning of year	41,885,238	-
Increase in net losses and loss adjustment expenses incurred in respect of losses occurring in:		
Current year	230,081,211	43,097,971
Prior years	(11,623,645)	-
Total incurred losses and loss adjustment expenses	218,457,566	43,097,971
Less net losses and loss adjustment expenses paid in respect of losses occurring in:		
Current year	65,603,799	1,212,733
Prior years	14,015,842	-
Total net paid losses	79,619,641	1,212,733
Net reserve for losses and loss adjustment expenses, end of year	180,723,163	41,885,238
Reinsurance recoverable	253,231,390	80,098,947
Gross reserve for losses and loss adjustment expenses, end of year	\$433,954,553	\$121,984,185

The net favorable loss development for the Company of \$11,623,645 arises from the re-estimation of liabilities principally relating to property contracts.

As of December 31, 2008 and 2007, reinsurance recoverable and reserve for losses and loss adjustment expenses include amounts of \$132.5 million and \$77.3 million, respectively, related to the acquisition of Ironshore Indemnity and Ironshore Specialty that are secured by conditional guarantees from the parents of the sellers.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

6. Reinsurance

In certain cases, the risks written by the Company are wholly or partially reinsured with third-party reinsurers. Reinsurance ceded varies by location and line of business based on a number of factors, including market conditions. The benefits of ceding risks to third-party reinsurers include reducing exposure on individual risks, protecting against catastrophic risks, maintaining acceptable capital ratios and enabling the writing of additional business. Reinsurance ceded does not discharge the Company from its liabilities to the original policyholder in respect of the risk being reinsured.

The Company uses reinsurance to support its underwriting and retention guidelines as well as to control the aggregate exposure of the Company to a particular risk or class of risks. Reinsurance may be purchased at several levels ranging from reinsurance of risks assumed on individual contracts to reinsurance covering the aggregate exposure on a portfolio of policies issued by groups of companies.

The effects of reinsurance on premiums written and earned, and on losses and loss adjustment expenses, for the year ended December 31, 2008 is as follows:

	<u>Written</u>	<u>Earned</u>
Direct	\$236,190,218	\$213,943,736
Assumed	146,876,350	128,271,237
Ceded	(89,221,130)	(67,738,235)
Total	<u>\$293,845,438</u>	<u>\$274,476,738</u>
Losses and loss adjustment expenses:		
Gross losses and loss adjustment expenses incurred		\$338,082,583
Losses and loss adjustment expenses recoverable		<u>(119,625,017)</u>
Net losses and loss adjustment expenses incurred		<u>\$218,457,566</u>

The effects of reinsurance on premiums written and earned, and on losses and loss adjustment expenses, for the year ended December 31, 2007 is as follows:

	<u>Written</u>	<u>Earned</u>
Direct	\$216,958,239	\$100,377,343
Assumed	100,182,747	47,032,599
Ceded	(39,752,251)	(19,965,717)
Total	<u>\$277,388,735</u>	<u>\$127,444,225</u>
Losses and loss adjustment expenses:		
Gross losses and loss adjustment expenses incurred		\$47,215,519
Losses and loss adjustment expenses recoverable		<u>(4,117,548)</u>
Net losses and loss adjustment expenses incurred		<u>\$43,097,971</u>

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

The Company uses reinsurance ceded contracts to reduce its exposure to risk of loss on certain reinsurance contracts. Reinsurance ceded contracts do not relieve the Company from its obligations to policyholders. The Company remains primarily liable to its policyholders for the portion reinsured to the extent that any reinsurer does not meet the obligations assumed under the reinsurance agreements.

Reserves for uncollectible reinsurance are based on an estimate of the amount of the reinsurance recoverable balance that will ultimately not be recovered due to reinsurer insolvency, contractual dispute or some other reason. The valuation of this reserve for uncollectible reinsurance includes several processes including a review of the credit ratings of the reinsurance recoverable by reinsurer and an analysis of default probabilities as well as coverage issues. These factors require considerable management judgment and the factors are reviewed in detail on a quarterly basis with any resulting adjustments recorded in earnings in the period that collection issues are identified. At December 31, 2008 and 2007, the Company has not made any allowance for estimated uncollectible premiums receivable or losses recoverable.

7. Derivative Instruments

During 2008, the Company disposed of all derivative securities including interest rate futures, to be announced mortgage backed securities ("TBA's") and options contracts and therefore the notional and fair values as of December 31, 2008 were nil.

The following table presents the fair value and notional value of these financial instruments as of December 31, 2007:

	December 31, 2007	
	Notional Value	Fair Value
Interest rate futures	\$91,314,938	\$104,562
TBA's	147,294,969	147,294,969
Options	(236,990)	(513,141)
	\$238,372,917	\$146,886,390

8. Share capital

(a) Authorized and issued

The Company's authorized share capital is 2,000,000 ordinary shares with par value of \$1 each. Issued and outstanding share capital as at December 31, 2008 and 2007 respectively, is 1,000,000 ordinary shares with a par value of \$1.00 each. During 2008 and 2007, the Company received \$76,264,890 and \$8,291,436 respectively, of contributed surplus from Ironshore Inc. and during 2008 and 2007 the Company returned \$nil and \$43,127,294 respectively, of contributed surplus to Ironshore Inc..

(b) Dividends

The Company did not declare any dividends during the years ended December 31, 2008 and 2007.

9. Retirement Plans

The Company maintains defined contribution retirement plans. Contributions are based on the participants' eligible compensation. During 2008 and 2007, the Company expensed \$1,014,191 and \$690,941, respectively, related to these retirement plans.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

10. Taxation

(a) Bermuda

Ironshore Insurance and Ironshore Reinsurance have received undertakings from the Bermuda government exempting them from all Bermuda income, withholding and capital gains taxes until March 28, 2016. At the present time, no such taxes are levied in Bermuda.

(b) United States

The Company's U.S. subsidiaries are subject to federal, state, and local corporate income taxes and other taxes applicable to U.S. operations. Due to the losses from the U.S. operations, the Company has not incurred any U.S. income tax liabilities. A valuation allowance has been established for the Company's net deferred tax asset related to its U.S. operations, as management believes that the realization of the tax benefits from these deferred tax assets is uncertain. Ironshore Reinsurance has elected to be a 953(d) reporting company, which results in the company being treated as a domestic corporation for U.S. tax purposes.

The components of the provision for income taxes attributable to operations consist of the following:

	2008	2007
Current tax expense:		
US State & local	\$5,268	-
Total	5,268	-
Deferred tax expense:		
US Federal	425,585	-
Total	425,585	-
Provision for income taxes	\$430,853	-

Deferred income taxes reflect the tax impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Significant components of the net deferred tax assets were as follows:

	2008	2007
Deferred tax assets:		
Discounting of loss reserves	\$357,621	\$17,923
Unearned premiums	743,715	129,933
Compensation	3,360,218	1,215,823
Net operating losses	4,499,439	1,196,396
Unrealized losses on investments losses	1,683,905	-
Other deferred tax assets	1,410,232	175,705
Total deferred tax assets	12,055,130	2,735,780
Valuation allowance	(9,163,210)	(2,621,771)
Deferred tax assets net of valuation allowance	\$2,891,920	\$114,009
Deferred tax liabilities:		
Deferred acquisition costs	\$(42,597)	\$(71,259)
Amortization of intangibles	(425,585)	(42,750)
Investments	(2,849,323)	-
Total deferred tax liabilities	(3,317,505)	(114,009)
Net deferred tax liabilities	\$(425,585)	-

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

The provision for income taxes resulted in effective rates that varied from the U.S. statutory federal income tax rate as follows:

	<u>2008</u>	<u>2007</u>
Expected income tax provision (benefit) at 34% rate	\$30,616,218	\$21,854,261
State income taxes (net of federal benefit)	(438,966)	(972,722)
Foreign tax	(36,326,850)	(23,496,522)
Valuation allowance	6,645,930	2,609,552
Other	(65,479)	5,431
Total income tax provision	<u>\$430,853</u>	<u>-</u>

The Company's U.S. subsidiaries have approximately \$12.2 million of U.S. federal net operating loss carryovers and approximately \$3.1 million of U.S. state and local net operating loss carryovers that expire in the years 2028 to 2029.

As of the beginning of fiscal year 2008, the Company adopted FIN 48. The cumulative effect of the adoption resulted in no adjustment to retained earnings. As of the date of adoption, the Company had no unrecognized tax benefits. During 2008, the Company had no additional unrecognized benefits. The Company will recognize interest and penalties related to income tax matters in income tax expense. The Company does not anticipate any significant changes in the amount of unrecognized tax benefits during the next 12 months. The Company's U.S. federal and state income tax returns for 2007 and 2008 remain open to examination.

11. Commitments and contingencies

(a) Concentration of credit risk

The creditworthiness of a counterparty is evaluated by the Company, taking into account credit ratings assigned by independent agencies. The credit approval process involves an assessment of factors, including, among others, the counterparty, country and industry credit exposure limits. The areas where significant concentrations of credit risk may exist includes reinsurance recoverables, investments and cash and cash equivalent balances.

The Company's reinsurance recoverables as of December 31, 2008 and 2007 includes amounts of \$132.5 million and \$77.3 million, respectively, that arose in conjunction with the acquisitions of Ironshore Indemnity and Ironshore Specialty. Under the terms of transfer and assumption agreements, the sellers of both companies agreed to assume from the companies acquired all of their pre-acquisition liabilities. The sellers' parent companies further agreed to conditional guarantees to indemnify the acquired companies from and against any and all such liabilities. In the event that the sellers are unable to meet their obligation under the transfer and assumption and the reinsurance agreements and the sellers' parents are unable to fulfill their obligations under the conditional guarantees, Ironshore Indemnity and Ironshore Specialty remain primarily liable for such claims.

The Company underwrites a significant amount of its business through brokers and credit risk exists should any of these brokers be unable to fulfill their contractual obligations with respect to the payments of insurance and reinsurance balances owed to the Company.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

During the year ended December 31, 2008 and 2007, the following brokers were used to generate greater than 10% of the Company's consolidated gross written premiums:

Broker	% of Gross Premiums Written December 31, 2008	% of Gross Premiums Written December 31, 2007
Willis Limited / Willis (Bermuda) Limited	10.42%	11.75%
Aon Benfield	9.07%	15.28%
Marsh & McLennan Companies	8.82%	11.00%
RK Harrison Insurance Brokers Limited	4.34%	10.74%

The Company's investment portfolio is managed in accordance with guidelines designed to ensure specific investment strategies are met. These guidelines include standards of diversification which limit the allowable holdings of any single issue. There were no investments in any entity in excess of 10% of the Company's shareholders' equity at December 31, 2008 and 2007 other than investments issued or guaranteed by the U.S. government, its agencies or Government-Sponsored Enterprises.

The Company's cash and cash equivalents are on deposit with various financial institutions. Credit risk arises from the failure of the counterparty to perform according to the terms of a contract. The Company's deposits are with large and reputable banks to minimize this risk and they are located in the United States of America and Bermuda.

(b) Employment agreements

The Company has entered into employment agreements with certain individuals that provide for option awards, executive benefits and severance payments under certain circumstances.

(c) Operating leases

The Company has entered into various operating lease agreements to lease office space and fixtures and fittings that expire up to 2022. During 2008 and 2007, total rent expenses of \$1,186,905 and \$670,235 respectively, were recorded in general and administrative expenses. The future minimum lease payments in the aggregate are expected to be \$3,695,404 and annually for the next 5 years are as follows:

	December 31, 2008
2009	\$1,395,443
2010	1,240,029
2011	400,943
2012	407,024
2013	251,965
Later years	-
Total minimum future lease commitments	<u>\$3,695,404</u>

(d) Legal Proceedings

On May 5, 2008, a complaint was filed against the Company relating to the hiring by Ironshore Holdings for its IronHealth division consisting of 20 people who were formerly employees of OneBeacon Insurance Group, Ltd. The complaint also names 4 individuals as defendants. The Company accrued legal fees including defense costs related to these individuals with respect to the litigation and accrued legal fees are included in general and administrative expenses for the year ended December 31, 2008. The complaint asserts claims of breach of fiduciary duty and breach of contract against the individuals and alleges claims of aiding and abetting breach of fiduciary duty against the Company. The Court scheduled the case for trial commencing October 18, 2010. Based on the information available, it is the opinion of management that the resolution of the above mentioned litigation will not have a material adverse effect on the Company.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

12. Related party transactions

Stock compensation expense charged by Ironshore Inc. to the Company is included in general and administrative expenses and additional paid-in capital. For the years ended December 31, 2008 and 2007, the charge amounted to \$1,424,555 and \$2,492,022, respectively.

During 2008 and 2007, the Company paid expenses of \$13,106,128 and \$3,550,929 and Directors fees of \$1,043,750 and \$822,525, respectively, on behalf of Ironshore Inc..

During 2007, Ironshore Inc. paid an employee of the Company a sign-on bonus of \$250,000. In accordance with the terms of an employment agreement between the Company and the same individual, the Company agreed to pay up to \$1,800,000 if a former employer did not pay certain compensation payable to him. During 2007, the Company recorded \$2,050,000 as a general and administrative expense in respect of this liability. During 2007, the Company paid \$63,207 to the individual, which reduced the maximum amount payable to the individual in respect of the compensation payable to \$1,736,793. This amount is recorded on the balance sheet as of December 31, 2007 as amounts payable to related parties. On October 31, 2008, the individual resigned from the Company. On that date, the balance of \$1,763,793 was recorded as a reduction to general and administrative expenses.

The Company purchases operating services and support from Ironshore Inc., that is an affiliated company. These services are offered to the Company at cost. During 2008, the Company purchased \$4,207,773 related to these services. As at December 31, 2008, the Company was owed \$44,251,968 by Ironshore Inc. which is included in amounts receivable from related parties. As at December 31, 2007, the Company owed \$1,086,949 to Ironshore Inc. which is included in amounts payable to related parties. This amount is unsecured, non-interest bearing and payable upon demand.

The Company purchases operating services and support from Ironshore Services Inc., that is an affiliated company. These services are offered to the Company at cost. During 2008 and 2007, the Company purchased \$8,934,658 and \$2,076,321, respectively, related to these services. As at December 31, 2008, the Company was owed \$737,343 by Ironshore Services Inc. which is included in amounts receivable from related parties. As at December 31, 2007, the Company owed \$537,187 to Ironshore Services Inc. which is included in amounts payable to related parties. This amount is unsecured, non-interest bearing and payable upon demand.

Ironshore Inc.'s founding investors, Tara Partners Fund LLC and Tara Partners Fund II LLC (collectively, "Tara"), are affiliated with two members of Ironshore Inc.'s board of directors. These individuals are also founders and directors of Integro Ltd. ("Integro"), an insurance broker. During 2008 and 2007, the Company wrote \$2,068,254 and \$4,018,547, of premiums that have been brokered by Integro, and paid commissions of \$167,647 and \$304,617, respectively, to Integro. In addition, during 2008 and 2007, the Company paid \$224,750 and \$224,750, respectively, to Integro to purchase directors and officers insurance from a third party insurer which included \$37,700 and \$35,575, respectively, of commission.

13. Statutory financial data

Bermuda

Ironshore Insurance and Ironshore Reinsurance are subject to the requirements of The Insurance Act 1978, Amendments Thereto and Related Regulations ("the Act"). Under the Act, Ironshore Insurance and Ironshore Reinsurance are required to prepare Statutory Financial Statements and to file a Statutory Financial Return. The Insurance Act also requires these subsidiaries to maintain certain measures of solvency and liquidity during the year. Declarations of dividends from retained earnings and distributions from additional paid-in capital are subject to these solvency and liquidity requirements being met. At December 31, 2008 and 2007, these requirements were met.

Under The Act, Ironshore Insurance and Ironshore Reinsurance are restricted with respect to the payment of dividends for amounts greater than 25% of the prior year's statutory capital and surplus. A signed affidavit by at least two members of the Board of Directors attesting that a dividend in excess of this amount would not cause the company to fail to meet its relevant margins is required.

IRONSHORE INSURANCE LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in U.S. dollars, except share amounts)

At December 31, 2008 and 2007, Ironshore Insurance was required to maintain a minimum statutory capital and surplus of \$140.4 million and \$137.5 million, respectively. At December 31, 2008 and 2007, Ironshore Insurance had statutory capital and surplus of approximately \$882.4 million and \$928.8 million, respectively. The declaration of dividends from retained earnings and distributions from additional paid-in capital are limited to the extent that the solvency and liquidity requirements are met.

At December 31, 2008 and 2007, Ironshore Reinsurance was required to maintain a minimum statutory capital and surplus of \$1.2 million and \$1.0 million, respectively. At December 31, 2008 and 2007, this subsidiary had statutory capital and surplus of approximately \$29.5 million and \$21.5 million, respectively. The declaration of dividends from retained earnings and distributions from additional paid-in capital are limited to the extent that the solvency and liquidity requirements are met.

In 2008, new statutory legislation was enacted in Bermuda, which included, among other things, the Bermuda Solvency Capital Requirement (“BSCR”) which is a standard mathematical model designed to give the Bermuda Monetary Authority (“BMA”) 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 the minimum solvency margin otherwise prescribed under the Insurance Act. Effective December 31 2008, the BMA requires all Class 4 insurers to maintain their capital at a target level which is set at 120% of the minimum amount calculated in accordance with the BSCR or an approved in-house model. Ironshore Insurance is in compliance with the BSCR requirements as at December 31, 2008.

United States

Ironshore Indemnity and Ironshore Specialty file financial statements prepared in accordance with statutory accounting practices prescribed or permitted by U.S. insurance regulators. Statutory net income and statutory surplus, as reported to the insurance regulatory authorities, differ in certain respects from the amounts prepared in accordance with GAAP. The main differences between statutory net income and GAAP net income relate to deferred acquisition costs and deferred income taxes. In addition to deferred acquisition costs and deferred income tax assets, other differences between statutory surplus and GAAP shareholder’s equity are unrealized appreciation or decline in value of investments and non-admitted assets.

Ironshore Indemnity is required to maintain a minimum combined statutory surplus of \$1.5 million. As of December 31, 2008 and 2007, the statutory surplus was \$58.7 million and \$31.0 million respectively, and the statutory net income was \$0.7 million and \$2.8 million for the years ended December 31, 2008 and 2007.

The maximum dividend Ironshore Indemnity can pay is restricted by regulatory requirements of the State of Minnesota and is limited to the greater of 10% of the insurer's surplus as regards policyholders on December 31 of the preceding year or the net income, not including realized capital gains, for the 12-month period ending on December 31, of the preceding year. At December 31, 2008 and 2007 the maximum dividend Ironshore Indemnity could pay without regulatory approval is approximately \$3.0 million and \$4.0 million respectively.

Ironshore Specialty is required to maintain a minimum combined statutory surplus of \$1.3 million. As of December 31, 2008, the statutory surplus was \$58.7 million and the statutory net loss was \$9.2 million for the year ended December 31, 2008.

The maximum dividend Ironshore Specialty can pay is restricted by regulatory requirements of the State of Arizona and is limited to the lesser of 10% of statutory surplus as of the end of the preceding year or the statutory net investment income for the preceding year, with larger dividends payable only upon prior regulatory notice and non-disapproval. At December 31, 2008 the maximum dividend payout in year 2009 that can be made without prior regulatory approval is approximately \$1.4 million.