

New Castle Reinsurance Company Ltd.

(Incorporated in Bermuda)

Financial Statements

December 31, 2008 and 2007

(expressed in U.S. dollars)

March 17, 2009

Report of Independent Auditors

To the shareholder of New Castle Reinsurance Company Ltd.

In our opinion, the accompanying balance sheets and the related statements of operations, shareholder's equity and cash flows present fairly, in all material respects, the financial position of New Castle Reinsurance Company Ltd. at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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.



Chartered Accountants

New Castle Reinsurance Company Ltd.

Balance Sheet

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

	<u>2008</u>	<u>2007</u>
Assets		
Cash and cash equivalents (note 3, 4, 10)	\$ 680,306,336	\$ 746,021,343
Investments in fixed maturity securities - held to maturity (note 5)	17,000,000	-
Prepaid reinsurance premiums	13,021,924	8,429,278
Premiums receivable	49,802,629	38,595,324
Deferred acquisition costs	4,111,288	3,876,812
Other assets	634,040	1,628,130
	<u>\$ 764,876,217</u>	<u>\$ 798,550,887</u>
Liabilities		
Loss and loss adjustment expense reserves (note 6)	\$ 95,462,180	\$ 39,133,734
Unearned premiums	42,280,364	35,637,354
Reinsurance balances payable (note 3)	4,153,333	3,332,126
Due to related parties (note 3)	1,936,947	9,797,309
Accounts payable and accrued expenses	215,000	170,000
	144,047,824	88,070,523
Shareholder's equity		
Capital stock (note 8)	1,000,000	1,000,000
Contributed surplus	499,000,000	499,000,000
Retained earnings	120,828,393	210,480,364
	<u>620,828,393</u>	<u>710,480,364</u>
	<u>\$ 764,876,217</u>	<u>\$ 798,550,887</u>

The accompanying notes are an integral part of these financial statements

New Castle Reinsurance Company Ltd.

Statement of Operations

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

	<u>2008</u>	<u>2007</u>
Underwriting income		
Gross premiums written	\$ 204,656,023	\$ 189,271,942
Reinsurance premiums ceded (note 7)	<u>(38,705,528)</u>	<u>(25,178,799)</u>
Net premiums written	165,950,495	164,093,143
Change in unearned premiums	<u>(3,118,183)</u>	<u>(17,564,944)</u>
Net premiums earned	<u>162,832,312</u>	<u>146,528,199</u>
Underwriting expenses		
Loss and loss adjustment expenses (note 6)	143,375,254	39,470,155
Acquisition costs	17,865,672	14,119,120
Other underwriting expenses	<u>1,639,143</u>	<u>1,256,797</u>
	<u>162,880,069</u>	<u>54,846,072</u>
Underwriting (loss) income	(47,757)	91,682,127
Investment income (note 5)	17,758,649	34,392,132
Realized gains (losses)	-	631,300
General and administrative expenses (note 3)	(5,504,132)	(13,611,488)
Net foreign exchange gains (losses)	<u>(1,858,731)</u>	<u>(79,854)</u>
Net income for the year	<u>\$ 10,348,029</u>	<u>\$ 113,014,217</u>

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

New Castle Reinsurance Company Ltd.

Statement of Shareholder's Equity As of December 31, 2008 and 2007

(expressed in U.S. dollars)

	<u>2008</u>	<u>2007</u>
Capital stock		
Balance – beginning and end of year	\$ 1,000,000	\$ 1,000,000
Contributed surplus		
Balance – beginning and end of year	499,000,000	499,000,000
Retained earnings		
Balance – beginning of year	210,480,364	97,466,147
Dividend paid (note 8)	(100,000,000)	-
Net income	10,348,029	113,014,217
Balance – end of year	120,828,393	210,480,364
Total shareholder's equity	<u>\$ 620,828,393</u>	<u>\$ 710,480,364</u>

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

New Castle Reinsurance Company Ltd.

Statement of Cash Flows

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities		
Net income for the year	\$ 10,348,029	\$ 113,014,217
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized foreign exchange loss (gain) on cash and cash equivalents	2,914,236	(322,715)
Prepaid reinsurance premiums	(4,592,646)	(7,484,840)
Premiums receivable	(11,207,305)	(21,055,994)
Deferred acquisition costs	(234,476)	(2,892,939)
Other assets	994,090	(1,458,721)
Loss and loss adjustment expense reserves	56,328,446	31,547,042
Unearned premiums	6,643,010	25,049,784
Reinsurance balances payable	821,207	3,332,126
Due to affiliate	(7,860,362)	2,500,705
Accounts payable and accrued expenses	45,000	(38,683)
	<u>54,199,229</u>	<u>142,189,982</u>
Cash flow from investing activity		
Purchase of investments in fixed maturity securities	(17,000,000)	-
	<u>(17,000,000)</u>	<u>-</u>
Cash flow from financing activity		
Dividend paid	(100,000,000)	-
	<u>(100,000,000)</u>	<u>-</u>
Increase (decrease) in cash and cash equivalents	(62,800,771)	142,189,982
Effect of foreign currency on cash and cash equivalents	(2,914,236)	322,715
Cash and cash equivalents - Beginning of year	<u>746,021,343</u>	<u>603,508,646</u>
Cash and cash equivalents - End of year	<u>\$ 680,306,336</u>	<u>\$ 746,021,343</u>

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

New Castle Reinsurance Company Ltd.

Notes to Financial Statements

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

1. *Nature of the business*

New Castle Reinsurance Company Ltd. (the “Company” or “New Castle Re”) was incorporated under the laws of Bermuda on November 1, 2005 and commenced operations on November 8, 2005. The Company is registered as a Class 4 insurer under The Insurance Act 1978, amendments thereto and related regulations (“the Act”).

The Company’s principal activity is to actively underwrite a portfolio of property and other short-tail classes of reinsurance. New Castle Re is a wholly owned subsidiary of New Castle Reinsurance Holdings Ltd. (“New Castle Re Holdings”), a Bermuda exempted company. New Castle Re is under common ownership with CIG Reinsurance Ltd. (“CIG Re”), a class 4 reinsurer under the Act incorporated under the laws of Bermuda in 2004. The Company concentrates on lines of business where it has underwriting expertise and where extensive probabilistic modeling provides prospective exposure-based pricing.

On December 16, 2008, CIG Re entered into a series of agreements with an unrelated entity i) for the sale of all of its fixed assets and the assignment of its contractual obligations and rights under the lease to its principal place of business and other key licenses, ii) to provide underwriting, risk management, claims and finance and accounting services to the unrelated entity and iii) for the transfer of employees to the unrelated entity at a future date subject to regulatory approval. The Company and CIG Re further entered into an agreement with the unrelated entity for the provision of claims, risk management, finance and accounting services subsequent to the transfer of employees as described above, to facilitate the orderly run-off of business.

The Company’s board of directors decided in January 2009 that the Company would not continue to write new or renewal business and that all existing policy risks and liabilities would be run-off in the ordinary course of business. Existing assets of the Company will be used to settle contractual liabilities as they fall due with surplus assets being used to finance capital distributions to shareholders subject to appropriate regulatory approval.

2. *Significant accounting policies*

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities as at the balance sheet date. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. Certain prior year comparatives have been reclassified to conform to the current year presentation.

The following is a summary of the significant accounting policies adopted by the Company:

(a) **Premiums and unearned premiums**

Premiums are recognized as written for the full period of the contract as of the date that the contract is bound. The Company writes both excess of loss and pro-rata contracts.

For excess of loss contracts, written premium is based on the estimated premium at the inception of the contract. Subsequent adjustments to the estimated premium are recognized in the period in which they are determined.

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

2. *Significant accounting policies - continued*

(a) **Premiums and unearned premiums - continued**

For pro-rata contracts, initial estimates of written premium are based on information received from ceding companies and are recognized in the period in which the underlying risks incept. Subsequent adjustments, based on reports of actual premium by the ceding companies, or revisions in earlier estimates, are recorded in the period they are determined.

Premiums are earned over the terms of the underlying insurance policies. The portion of the premium related to the unexpired portion of the policy at the end of the fiscal year is reflected in unearned premiums. Ceded reinsurance premiums are similarly earned over the terms of the contracts with the unexpired portion deferred on the balance sheet.

Where contract terms require the reinstatement of coverage after a ceding company's loss, the reinstatement premiums are recorded as written premium and estimated consistently with the underlying loss estimates based on information provided by the ceding company and are fully earned when the loss event occurs.

(b) **Deferred acquisition costs**

Policy acquisition costs are comprised of ceding commissions, brokerage, premium taxes and other expenses that relate directly to the acquisition of premiums. These costs are deferred and amortized over the terms of the related policies. Deferred policy acquisition costs are reviewed to determine if they are recoverable from future underwriting profits, including investment income. If such costs are estimated to be unrecoverable, they are expensed.

(c) **Loss and loss adjustment expense reserves**

Loss and loss adjustment expense reserves are established and maintained by the Company to cover the estimated liability for both reported and unreported claims. A significant portion of the Company's business is in the property catastrophe market and consists of programs with higher layers of risks. Reserving for losses in such programs is inherently complicated in that losses in excess of the attachment level of the underlying policies are characterized by high severity and low frequency. This limits the volume of industry claims experience available from which to reliably predict ultimate losses following a loss event. In addition, the Company has limited past loss experience due to its short operating history which increases the inherent uncertainty in estimating ultimate loss levels.

Loss and loss adjustment expense reserves include a component for outstanding case reserves for which claims have been reported and a component for losses incurred but not reported ("IBNR"). Case reserve estimates are initially set on the basis of loss reports received from third parties. Estimated IBNR reserves consist of a provision for additional development in excess of the case reserves reported by ceding companies as well as a provision for claims which have occurred but which have not yet been reported by ceding companies. IBNR reserves are estimated by management using various actuarial methods as well as a combination of historical insurance industry loss experience, underwriters' experience, estimates of pricing adequacy trends and managements' professional judgment. The Company's loss estimates are subject to an annual corroborative review by independent actuaries.

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

2. *Significant accounting policies - continued*

(c) **Loss and loss adjustment expense reserves - continued**

Delays in ceding companies reporting losses to the Company, together with the potential for unforeseen adverse developments, may result in loss and loss adjustment expenses ultimately being significantly greater or less than the reserve provided at the time of the loss event. Loss and loss adjustment expense reserve estimates and the methodology of estimating such reserves are regularly reviewed and updated as new information becomes known. Any resulting adjustments are reflected in income in the period in which they are known.

(d) **Reinsurance**

In the normal course of business, the Company seeks to reduce the loss that may arise from events that could cause unfavourable underwriting results by reinsuring certain levels of risk in various areas of exposure with other insurers or reinsurers. The Company remains liable in the event that it is unable to collect amounts due from its own reinsurers, and with respect to certain contracts that carry underlying reinsurance protection, the Company would be liable in the event that the ceding companies are unable to collect amounts due from the underlying third party reinsurers. The Company records provisions for uncollectible underlying reinsurance recoverable when collection becomes unlikely. The Company is selective in regard to its reinsurers, placing reinsurance only with reinsurers with a strong financial condition, industry ratings and underwriting ability. The Company monitors the financial condition and ratings of its reinsurers on an ongoing basis.

(e) **Cash and cash equivalents**

Cash and cash equivalents include repurchase agreement receivables and time deposits with an original maturity of three months or less from the date of purchase.

(f) **Repurchase Agreements**

A repurchase agreement involves acquiring securities for cash and obtaining a simultaneous commitment from the seller to repurchase the securities at an agreed upon price and date. The Company takes possession of the securities collateralizing the repurchase agreement. The collateral is marked to market daily to ensure that the market value of the underlying assets remains sufficient to protect the Company in the event of default by the seller. The Company records the repurchase agreements receivable in cash and cash equivalents in the balance sheet.

(g) **Derivative instruments**

The Company recognizes all derivatives as either assets or liabilities in the balance sheet and measures those instruments at fair value. The changes in the fair value of derivatives are shown in the statement of income as realized gains and losses. Changes in fair value of derivatives may create volatility in the Company's results of operations from period to period.

(h) **Foreign currency**

Monetary assets and liabilities denominated in foreign currencies have been translated to U.S. dollars at the rates of exchange prevailing at the balance sheet date. Income and expense transactions originating in foreign currencies are translated at the rates of exchange prevailing on the date of the transaction. Gains and losses on foreign currency translation are included in income.

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

2. *Significant accounting policies - continued*

(i) **Investments**

Investments in fixed maturity debt securities which the Company has the positive intent and ability to hold to maturity are classified as hold-to-maturity securities and are reported at amortized cost.

The Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, Fair Value Measurements (“SFAS 157”) as of January 1, 2008. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. 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). A Financial Instrument’s level within the fair value hierarchy is based on the lowest level of any input, individually or in the aggregate, that is significant to the fair value measurement.

3. *Related party transactions*

The Company has entered into a triparty global master repurchase agreement with Citadel Equity Fund, Ltd. (“CEFL”), an entity under common management with the investors in the Company. Under the terms of this agreement, the Company advances cash to CEFL on a daily basis. Such advances are fully secured by a portfolio of eligible securities held in trust by The Bank of New York.

As at December 31, 2008, \$573,000,000 (December 31, 2007 – \$698,000,000) was advanced under this agreement which was secured by a portfolio of US Treasuries, mortgage backed securities and corporate bonds and is included in cash and cash equivalents on the balance sheet.

The Company is party to an Administrative Services Agreement under which it receives underwriting, risk management and administrative services from CIG Re. During the period ended December 31, 2008, total fees of \$4,869,679 were charged under this agreement, of which \$84,924 was payable at the year end date (December 31, 2007 – \$12,855,735 and \$9,495,158, respectively).

During 2008, the Company entered into a quota share retrocession contract with CIG Re. Under this contract, the Company ceded \$7,000,000 of premium and \$770,000 of acquisition costs to CIG Re. As at December 31, 2008 the Company had a net payable under this contract of \$4,153,333, which was included in reinsurance balances payable (December 31, 2007 - \$2,966,667).

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

4. Cash and cash equivalents

The components of cash and cash equivalents are as follows:

	<u>2008</u>	<u>2007</u>
Unpledged cash and cash equivalents:		
Cash	\$ -	\$ 1,382,307
Money market funds	45,951,383	40,953,407
Amounts advanced under global master repurchase agreement with a related party	573,000,000	698,000,000
Cash and cash equivalents pledged as collateral:		
Cash (note 10)	61,354,953	5,685,629
	<u>\$ 680,306,336</u>	<u>\$ 746,021,343</u>

Money market funds are rated “AAA” by Standard and Poor’s Rating Agency. The Company’s holdings in money market funds are all considered to be level 1 for the purposes of determining fair value under SFAS 157.

5. Investments and investment income

Investments in fixed maturity securities consist of two catastrophe bonds purchased during the year at a cost of \$17,000,000. These pay a floating rate of interest and mature in 2011.

The components of investment income are as follows:

	<u>2008</u>	<u>2007</u>
Interest on cash and cash equivalents	\$ 2,294,327	\$ 1,286,366
Interest on global master repurchase agreement with a related party	13,633,911	33,105,766
Interest on fixed maturity securities	1,830,411	-
	<u>\$ 17,758,649</u>	<u>\$ 34,392,132</u>

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

6. *Loss and loss adjustment expense reserves*

Loss and loss adjustment expense reserves are estimates subject to variability, and the variability could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts or significant changes in the severity or frequency of claims from original estimates based on historical trends. Loss and loss adjustment expense estimates are based on all relevant information available to the Company. Methods of estimation are used which the Company believes produce reasonable results given current information.

Reserve activity for loss and loss adjustment expenses is summarized below:

	<u>2008</u>	<u>2007</u>
Gross reserves at beginning of year	\$ 39,133,734	\$ 7,586,692
Gross losses incurred related to:		
Current year	151,152,053	41,056,585
Prior years	<u>(7,776,799)</u>	<u>(1,586,430)</u>
Total gross incurred losses	143,375,254	39,470,155
Gross paid losses related to:		
Current year	(70,909,336)	(5,138,970)
Prior years	<u>(13,865,218)</u>	<u>(3,863,691)</u>
Total gross paid losses	(84,774,554)	(9,002,661)
Effect of foreign exchange movements	<u>(2,272,254)</u>	<u>1,079,548</u>
Total gross reserves at end of year	<u>\$ 95,462,180</u>	<u>\$ 39,133,734</u>

The December 31, 2008 year end balance is comprised of provisions for reported claims of \$58,114,724 (December 31, 2007 – \$24,187,605) and provisions for claims incurred but not reported of \$37,347,456 (December 31, 2007 – \$14,946,129). As at December 31, 2008, the prior year favorable development on loss reserves of \$7,776,799 was principally due to a reduction in reserves on Hurricane Kyrill and the UK floods, both of which occurred in 2007. As at December 31, 2007, the prior year favorable development on loss reserves of \$1,586,430 was principally due to a reduction in reserves for European storms occurring in 2006.

The Company's estimates for these losses are based on currently available information from cedants. Actual losses may vary materially from this estimate based on a number of factors including, receipt of additional information from insureds or brokers, the attribution of losses to coverages that had not previously been considered as exposed and inflation in repair costs due to additional demand for labor and materials. In addition, the loss estimate includes a high level of uncertainty related to, amongst other things, complex coverage issues, limited claims data received to date and potential legal developments that may result in ultimate losses not known for a considerable period of time. Therefore, losses may ultimately be materially greater or lesser than the current estimate and accordingly impact future financial results.

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

7. *Reinsurance*

The Company purchases retrocessional excess of loss protection against large losses on the Company's overall property writings. The Company remains liable in the event that it is unable to collect amounts due from its own reinsurers, and with respect to certain contracts that carry underlying reinsurance protection, the Company would be liable in the event that the ceding companies are unable to collect amounts due from the underlying third party reinsurers. The Company records provisions for uncollectible underlying reinsurance recoverable when collection becomes unlikely. There were no such provisions recorded for uncollectible reinsurance recoverable amounts at December 31, 2008 and 2007. Under the company's reinsurance security policy, reinsurers are generally required to be rated A- or better by A.M. Best Co. The company will consider reinsurers that are not rated or do not fall within the above rating category on a case-by-case basis.

In June 2007, the Company, along with CIG Re (together "the Sponsors"), sponsored the formation of Emerson Reinsurance Ltd. ("Emerson Re"). Emerson Re is a Cayman Islands single-purpose reinsurer which provides \$500 million of annual aggregate protection on the combined portfolios of risks of the Sponsors. Emerson Re has a three-year duration, adjusting its coverage on an annual basis, depending on the underlying risk portfolios. Emerson Re protected losses from all classes of business written by the Sponsors with the exception of stand-alone terrorism contracts.

In February 2009, the reinsurance agreement with Emerson Re was terminated and commuted thereby releasing all parties from all past and future obligations. As a result, deferred acquisition costs of \$1,089,370 will be expensed by the Company in 2009.

8. *Capital stock*

(a) **Authorized shares**

The Company's authorized share capital is 1,000,000 common shares of the par value \$1 each.

(b) **Common shares**

At December 31, 2008 and 2007, the total issued and outstanding common shares of the Company were 1,000,000 with a par value of \$1.

(c) **Contributed surplus**

Shareholders contributed no additional cash to the surplus of the Company during the period.

(d) **Dividends**

During the year ended December 31, 2008, the Company declared and paid a dividend of \$100,000,000 to its shareholder (December 31, 2007 – nil).

9. *Taxation*

Bermuda

The Company has received an undertaking from the Bermuda government exempting it from all local income, withholding and capital gains taxes until March 28, 2016. At the present time no such taxes are levied in Bermuda.

United States

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

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

10. Letters of credit

In the normal course of business, the Company provides security to reinsureds as required under contract provisions. Such security takes the form of a letter of credit issued by a bank at the request of the Company. As at December 31, 2008, letters of credit secured by a pledge on cash and cash equivalents amounting to \$61,354,953 had been issued (December 31, 2007 – \$5,685,629).

11. Post Balance Sheet Events

The Company's board of directors decided in January 2009 that the Company would not continue to write new or renewal business and that all existing policy risks and liabilities would be run-off in the ordinary course of business. Existing assets of the Company will be used to settle contractual liabilities as they fall due with surplus assets being used to finance capital distributions to shareholders subject to appropriate regulatory approval. The company declared and paid a distribution of \$300,000,000 out of contributed surplus to its shareholder on January 27, 2009, for which the Company received approval from the Bermuda Monetary Authority ("BMA").

On February 3, 2009, A.M. Best Company ("A.M. Best") downgraded the financial strength rating of the Company to B++ at which time the Company terminated its rating agreement with A.M. Best. Both the distribution of contributed surplus and the ratings downgrade create a termination event under the majority of the reinsurance contracts written by the Company.

The typical terms of such a termination would provide cedants with the option to terminate the reinsurance cover provided by the Company. In the event that cedants exercise their right to terminate, then the Company will not be liable for losses under the reinsurance contract after the termination date and premiums due under the contract would typically be pro-rated to the termination date. Adjustments to written premiums, unearned premiums, acquisition costs and deferred acquisition costs will be recognized on the date of notification of any such termination.

It is anticipated that any such contract terminations by the Company's cedants will not create losses in future financial periods since premiums are earned ratably over the term of reinsurance contracts as set out in the accounting policies note (note 1).

12. Statutory requirements

Under the Act, the Company is required to prepare Statutory Financial Statements and to file a Statutory Financial Return. The Act also requires the Company to meet certain minimum capital and surplus requirements. To satisfy these requirements, the Company was required to maintain a minimum level of statutory capital and surplus of \$100,000,000 at December 31, 2008 (December 31, 2007 – \$100,000,000). The Company's statutory capital and surplus was \$615,484,351 as at December 31, 2008 (December 31, 2007 – \$704,975,422). Statutory capital and surplus as reported under the Act is different from shareholder's equity as determined in conformity with GAAP due to certain items that are capitalized under GAAP but expensed under the Act.

The Company is also required to maintain a minimum liquidity ratio under the Act, which was met for the periods ended December 31, 2008 and 2007.

New Castle Reinsurance Company Ltd.

Notes to Financial Statements – cont'd

As of December 31, 2008 and 2007

(expressed in U.S. dollars)

12. Statutory requirements - continued

The Act limits the maximum amount of annual dividends and distributions that may be paid by the Company.

The Company shall not pay dividends in any year which would exceed 25% of its prior year statutory capital and surplus or reduce its prior year statutory capital by 15% or more, without the prior notification to, and in certain cases the approval of, the BMA. In addition, The Bermuda Companies Act 1981 limits the Company's ability to pay dividends and distributions to shareholders if there are reasonable grounds for believing that the company would be unable to pay its liabilities as they become due or if the realizable value of its assets would be less than the aggregate of its liabilities, issued share capital and share premium accounts.

Effective December 31, 2008, the BMA introduced a risk based capital model, the Bermuda Statutory Capital Requirement ("BSCR") as a tool to measure risk and determine an enhanced capital requirement and target capital level (defined as 120% of the enhanced capital requirement) for Class 4 insurers. While the required statutory capital and surplus has increased under the BSCR, the Company has capital and surplus in excess of the target capital level.

In July 2008, the Bermuda House of Assembly passed the Insurance Amendment Act (the "2008 Act") which created a new supervisory framework for Bermuda insurers. The 2008 Act established new regulatory capital and solvency requirements. As of December 31, 2008, in accordance with the 2008 Act, all Class 4 Bermuda insurers must prepare and file with the BMA audited financial statements, which may be made publically available.