

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010 AND 2009



April 29, 2011

Report of Independent Auditors

To the Board of Directors and Shareholder of ACE Bermuda Insurance Ltd.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive income, of shareholder's equity and of cash flows present fairly, in all material respects, the financial position of **ACE Bermuda Insurance Ltd. and its subsidiaries** at December 31, 2010 and December 31, 2009 and the results of their operations and their 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.

A handwritten signature in black ink that reads "PricewaterhouseCoopers" in a cursive script.

Chartered Accountants

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ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
	(in thousands of U.S. dollars, except share and per share data)	
Assets		
Investments		
Fixed maturities available for sale, at fair value (amortized cost - \$3,874,092 and \$3,377,857)	\$ 4,049,319	\$ 3,469,844
Fixed maturities held to maturity, at amortized cost (fair value - \$117,136 and \$141,438)	112,273	138,054
Equity securities, at fair value (cost - \$946 and \$228,472)	1,088	284,543
Short-term investments	101,985	130,431
Other investments (cost - \$360,831 and \$334,848)	419,078	373,366
Total investments	<u>4,683,743</u>	<u>4,396,238</u>
Cash	34,943	91,432
Securities lending collateral	161,647	167,375
Accrued investment income	51,383	46,055
Insurance and reinsurance balances receivable	66,295	70,488
Reinsurance recoverable on losses and loss expenses	522,710	517,103
Deferred policy acquisition costs	3,775	23,586
Value of reinsurance business assumed	33,646	30,873
Prepaid reinsurance premiums	69,490	79,612
Amount due from parent and affiliates	-	362
Investments in partially-owned insurance companies	12,327	13,024
Other assets	166,523	143,776
Total assets	<u>\$ 5,806,482</u>	<u>\$ 5,579,924</u>
Liabilities		
Unpaid losses and loss expenses	\$ 2,130,563	\$ 2,541,139
Unearned premiums	239,138	304,375
Insurance and reinsurance balances payable	75,573	81,230
Deposit liabilities	242,332	243,664
Securities lending payable	162,103	168,334
Payable for securities purchased	86,423	2,656
Accounts payable, accrued expenses, and other liabilities	134,934	51,048
Amount due to parent and affiliates	64,134	27,952
Total liabilities	<u>3,135,200</u>	<u>3,420,398</u>
Shareholder's equity		
Common shares (\$1.00 par value, 1,250,000 shares authorized, issued and outstanding)	1,250	1,250
Additional paid-in capital	1,881,217	1,881,217
Retained earnings	573,909	94,917
Accumulated other comprehensive income	214,906	182,142
Total shareholder's equity	<u>2,671,282</u>	<u>2,159,526</u>
Total liabilities and shareholder's equity	<u>\$ 5,806,482</u>	<u>\$ 5,579,924</u>

See accompanying notes to consolidated financial statements

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
For the years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
	(in thousands of U.S. dollars)	
Revenues		
Gross premiums written	\$ 478,624	\$ 603,811
Reinsurance premiums ceded	(152,103)	(197,568)
Net premiums written	<u>326,521</u>	<u>406,243</u>
Change in unearned premiums	9,976	17,343
Net premiums earned	336,497	423,586
Net investment income	209,372	184,263
Net realized gains (losses)	139,348	(78,569)
Other income (expenses)	<u>22,871</u>	<u>(9,959)</u>
Total revenues	<u>708,088</u>	<u>519,321</u>
Expenses		
Losses and loss expenses	168,830	237,611
Policy acquisition costs	7,344	41,438
Administrative expenses	<u>48,955</u>	<u>46,667</u>
Total expenses	<u>225,129</u>	<u>325,716</u>
Income before income tax	482,959	193,605
Income tax expense	<u>(3,967)</u>	<u>(3,048)</u>
Net income	<u>\$ 478,992</u>	<u>\$ 190,557</u>
Other comprehensive income		
Unrealized appreciation (depreciation) arising during the year	\$ 163,132	\$ 447,340
Reclassification adjustment for net realized (gains) losses included in net income	(130,228)	26,395
Amortization of net realized appreciation related to securities transferred to held to maturity	<u>(526)</u>	<u>(407)</u>
Other comprehensive income, before income tax	32,378	473,328
Income tax benefit (expense) related to other comprehensive income items	<u>386</u>	<u>(501)</u>
Other comprehensive income	<u>32,764</u>	<u>472,827</u>
Comprehensive income	<u>\$ 511,756</u>	<u>\$ 663,384</u>

See accompanying notes to consolidated financial statements

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY
For the years ended December 31, 2010 and 2009

	2010	2009
	(in thousands of U.S. dollars)	
Common shares		
Balance – beginning of year and end of year	\$ <u>1,250</u>	\$ <u>1,250</u>
Additional paid-in capital		
Balance – beginning of year and end of year	<u>1,881,217</u>	<u>1,881,217</u>
Retained earnings (accumulated deficit)		
Balance – beginning of year	94,917	(139,483)
Net income	478,992	190,557
Effect of adoption of OTTI standard	-	39,754
Effect of adoption of ASC 944-20	-	4,089
Balance – end of year	<u>573,909</u>	<u>94,917</u>
Accumulated other comprehensive income		
Net unrealized appreciation (depreciation) on investments		
Balance – beginning of year	182,142	(290,685)
Effect of adoption of OTTI standard	-	(39,754)
Other comprehensive income	<u>32,764</u>	<u>512,581</u>
Balance – end of year	<u>214,906</u>	<u>182,142</u>
Total shareholder's equity	<u>\$ <u>2,671,282</u></u>	<u>\$ <u>2,159,526</u></u>

See accompanying notes to consolidated financial statements

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2010 and 2009

	2010	2009
	(in thousands of U.S. dollars)	
Cash flows from operating activities		
Net income	\$ 478,992	\$ 190,557
Adjustments to reconcile net income to net cash flows from operating activities:		
Net realized (gains) losses	(139,348)	78,569
Amortization of premium/discount on fixed maturities	(2,703)	(8,202)
Equity earnings	(27,692)	6,536
Accrued investment income	(5,328)	(392)
Insurance and reinsurance balances receivable	1,837	1,286
Deferred policy acquisition costs	1,468	505
Value of reinsurance business assumed	(2,773)	2,497
Unpaid losses and loss expenses	(404,060)	(9,200)
Unearned premiums	(15,219)	(16,755)
Funds withheld	-	(906)
Insurance and reinsurance balances payable	(5,138)	(27,978)
Accounts payable, accrued expenses, and other liabilities	104,665	(42,334)
Deferred income taxes	(131)	(257)
Other	11,976	2,666
Net cash flows (used for) from operating activities	\$ (3,454)	\$ 176,592
Cash flows (used for) from investing activities		
Purchases of fixed maturities available for sale	(2,362,466)	(1,878,418)
Purchases of to be announced mortgage-backed securities	(279,141)	(1,329,400)
Purchases of fixed maturities held to maturity	-	(34)
Purchases of equity securities	(2,972)	(16,648)
Sales of fixed maturities available for sale	1,783,126	871,726
Sales of to be announced mortgage-backed securities	211,569	1,520,305
Sales of fixed maturities held to maturity	-	405
Sales of equity securities	305,411	369,875
Maturities and redemptions of fixed maturities available for sale	266,593	194,803
Maturities and redemptions of fixed maturities held to maturity	25,532	31,152
Net proceeds from the settlement of investment derivatives	13,123	(1,843)
Other	2,660	89,937
Net cash flows (used for) investing activities	\$ (36,565)	\$ (148,140)
Cash flows from (used for) financing activities		
Amount (paid to) received from parent company and affiliates, net	(5,699)	(3,537)
Net cash flows used for financing activities	\$ (5,699)	\$ (3,537)
Effect of foreign currency rate changes on cash and cash equivalents	(336)	(2,229)
Net (decrease) increase in cash	\$ (46,054)	\$ 22,686
Cash – beginning of year	91,432	68,746
Effect on cash of adoption of ASU 2009-17	(10,435)	-
Cash – end of year	\$ 34,943	\$ 91,432

See accompanying notes to consolidated financial statements

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. General

ACE Bermuda Insurance Ltd. (“the Company”) is an indirect wholly owned subsidiary of ACE Limited (“ACE”). ACE was incorporated with limited liability under the Cayman Islands Companies Law until July 18, 2008 at which time ACE moved its jurisdiction of incorporation from Cayman Islands to Zurich, Switzerland.

The Company wholly owns the following insurance subsidiaries: Corporate Officers & Directors Assurance Limited (“CODA”), ACE Bermuda International Reinsurance (Ireland) Limited (“ABIR”), ACE Bermuda International Insurance (Ireland) Limited (“ABII”), ACE Capital Title Reinsurance Company, Paget Reinsurance International Limited and Paget Reinsurance Limited. In addition, the company wholly owns Sovereign Risk Insurance Limited, a general managing agency who wholly owns Sovereign Risk Insurance (Dubai) Limited, an insurance intermediary. The Company is also investor in certain partially-owned insurance companies with insurance operations as described in footnote 4(d).

2. Principal Business

The Company and its subsidiaries provide property and casualty insurance and reinsurance coverage for a diverse group of international clients across a broad range of businesses including: excess liability, professional lines, excess property, political risk and financial lines. The nature of the coverage provided is generally expected to result in low frequency but high severity individual losses. The reinsurance market is an integral part of the risk management strategy of the Company and coverage has been secured on most major lines of business.

Paget Reinsurance International Limited is a rent-a-captive facility and Paget Reinsurance Limited is a segregated accounts company. Refer to note 3(n) for accounting for variable interest entities. Both primarily reinsure affiliate companies in respect of certain clients throughout the world.

During the years ended December 31, 2010 and 2009, the Company entered into certain related party transactions as described in note 10.

3. Significant accounting policies

In June 2009, the Financial Accounting Standards Board (FASB) issued The FASB Accounting Standards Codification™ embodied in Accounting Standards Codification (ASC) Topic 105, *Generally Accepted Accounting Principles* (the Codification). The Codification, which was launched on July 1, 2009, became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force, and related literature. The Codification establishes one level of authoritative guidance. All other literature is considered non-authoritative. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009.

a) Basis of presentation

The accompanying consolidated financial statements, which include the accounts of the Company and its subsidiaries, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and, in the opinion of management, reflect all adjustments (consisting of normally recurring accruals) necessary for a fair statement of the results and financial position. All significant intercompany accounts and transactions have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company’s principal estimates include:

- unpaid losses and loss expense reserves;
- reinsurance recoverable, including a provision for uncollectible reinsurance;
- the valuation of the investment portfolio and assessment of OTTI; and
- the valuation of derivative instruments.

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
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While the amounts included in the consolidated financial statements reflect the Company's best estimates and assumptions, these amounts could ultimately be materially different from the amounts currently recorded in the consolidated financial statements.

b) Premiums

Premiums are generally recognized as written upon inception of the policy. For multi-year policies for which premiums written are payable in annual installments, only the annual premium is included as written at policy inception, due to the ability of the insured/reinsured to commute or cancel coverage within the term of the policy. The remaining annual premiums are included as written at each successive anniversary date within the multi-year term.

Premiums written are primarily earned on a daily pro rata basis over the terms of the policies to which they relate. Accordingly, unearned premiums represent the portion of premiums written which is applicable to the unexpired portion of the policies in force. For retrospectively rated multi year policies, the amount of premiums recognized in the current period is computed, using a with and without method, as the difference between the ceding enterprise's total contract costs before and after the experience under the contract as of the reporting date.

c) Policy acquisition costs

Policy acquisition costs consist of commissions, premium taxes, and other costs that vary with, and are primarily related to, the production of premium. Acquisition costs are deferred and amortized over the period in which the related premiums are earned. Policy acquisition costs are reviewed to determine if they are recoverable from future income, including investment income. If such costs are unrecoverable, they are expensed in the period this determination is made.

d) Value of reinsurance business assumed

The value of reinsurance business assumed represents the difference between the estimated ultimate value of the liabilities assumed under retroactive reinsurance contracts and the consideration received under the contract. The value of the reinsurance business assumed is amortized and recorded to loss and loss expenses based on the payment pattern of the loss assumed and ranges between 5 and 40 years. The unamortized value is reviewed regularly to determine if it is recoverable under the terms of the contract. If such amounts are estimated to be unrecoverable, they are expensed.

e) Reinsurance

The Company assumes and cedes reinsurance with other insurance companies to provide greater diversification of business and minimize the net loss potential arising from large risks. Ceded reinsurance contracts do not relieve the Company of its primary obligation to its policyholders.

For both ceded and assumed reinsurance, risk transfer requirements must be met in order to obtain reinsurance status for accounting purposes, principally resulting in the recognition of cash flows under the contract as premiums and losses. To meet risk transfer requirements, a reinsurance contract must include insurance risk, consisting of both underwriting and timing risk, and a reasonable possibility of a significant loss for the assuming entity. To assess risk transfer for certain contracts, the Company generally develops expected discounted cash flow analyses at contract inception. If risk transfer requirements are not met, a contract is accounted for using the deposit method. Deposit accounting requires that consideration received or paid be recorded in the balance sheet as opposed to premiums written or losses incurred in the statement of operations and any non-refundable fees earned based on the terms of the contract. Refer to Note 3 (i).

Reinsurance recoverable includes the balances due from reinsurance companies for paid and unpaid losses and loss expenses and that will be recovered from reinsurers, based on contracts in force, and is presented net of a provision for uncollectible reinsurance determined based upon a review of the financial condition of the reinsurers and other factors. The method for determining the reinsurance recoverable on unpaid losses and loss expenses incurred but not reported (IBNR) involves actuarial estimates consistent with those used to establish the associated liability for unpaid loss and loss expenses as well as a determination of the Company's ability to cede unpaid losses and loss

ACE BERMUDA INSURANCE LTD. AND SUBSIDIARIES
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expenses under its existing reinsurance contracts. The provision for uncollectible reinsurance is based on an estimate of the amount of the reinsurance recoverable balance that the Company will ultimately be unable to recover due to reinsurer insolvency, a contractual dispute, or any other reason. The valuation of this provision includes several judgments including certain aspects of the allocation of reinsurance recoverable on IBNR claims by reinsurer and a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer, net of collateral, and default factors used to determine the portion of a reinsurer's balance deemed uncollectible. The definition of collateral for this purpose requires some judgment and is generally limited to assets held in a Company-only beneficiary trust with the same legal entity for which it believes there is a right of offset. The determination of the default factor is principally based on the financial strength rating of the reinsurer. Default factors require considerable judgment and are determined using the current financial strength rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions.

Prepaid reinsurance premiums represent the portion of premiums ceded to reinsurers applicable to the unexpired coverage terms of the reinsurance contracts in force.

f) Investments

Fixed maturity investments are classified as either available for sale or held to maturity. The available for sale portfolio is reported at fair value. The held to maturity portfolio includes securities for which the Company has the ability and intent to hold to maturity or redemption and is reported at amortized cost. Equity securities are classified as available for sale and are recorded at fair value. Short-term investments comprise securities due to mature within one year of the date of purchase and are recorded at fair value which typically approximates cost. Short-term investments include certain cash and cash equivalents, which are part of investment portfolios under the management of external investment managers.

Other investments principally comprise partially owned investment companies and limited partnerships. Other investments, over which the Company cannot exercise significant influence, are carried at fair value with changes in fair value recognized through other comprehensive income (OCI). For these investments, investment income and realized gains are recognized as related distributions are received in other (expense) income.

These investments primarily represent direct investments in which the Company has significant influence and its ownership is in excess of three percent; as such, meet the requirements for equity method of accounting. The Company reports its share of the net income or loss of the partially-owned insurance companies in other income (expense). Investments in partially-owned insurance companies over which the Company does not exert significant influence are carried at fair value.

Realized gains or losses on sales of investments are determined on a first-in, first-out basis. Unrealized appreciation (depreciation) on investments is included as a separate component of accumulated other comprehensive income (AOCI) in shareholder's equity. The Company regularly reviews its investments for other than temporary impairments (OTTI). Refer to Note 4(f).

With respect to securities where the decline in value is determined to be temporary and the security's value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are the result of changing or unforeseen facts and circumstances (i.e., arising from a large insured loss such as a catastrophe), deterioration of the credit-worthiness of the issuer or its industry, or changes in regulatory requirements. The Company believes that subsequent decisions to sell such securities are consistent with the classification of the majority of the portfolio as available for sale.

The Company utilizes derivative instruments including futures, options, and foreign currency forward contracts for the purpose of managing certain investment portfolio risk and exposures. Refer to Note 8. Derivatives are reported at fair value and recorded in the accompanying consolidated balance sheets in Accounts payable, accrued expenses and other liabilities with changes in fair value included in net realized gains (losses) in the consolidated statements of operations. Collateral held by brokers equal to a percentage of the total value of open futures contracts is included in the investment portfolio.

Net investment income includes interest and dividend income and amortization of fixed maturity market premiums and discounts and is net of investment management and custody fees. For mortgage-backed securities, and any

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other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the resultant change in effective yields and maturities are recognized prospectively. Prepayment fees or call premiums that are only payable when a security is called prior to its maturity are earned when received and reflected in Net investment income.

The Company participates in a securities lending program operated by a third party banking institution whereby certain assets are loaned out to qualified borrowers and from which the Company earns an incremental return. Borrowers provide collateral, in the form of either cash or approved securities, of 102 percent of the fair value of the loaned securities. Each security loan is deemed to be an overnight transaction. Cash collateral is invested in a collateral pool which is managed by the banking institution. The collateral pool is subject to written investment guidelines with key objectives which include the safeguard of principal and adequate liquidity to meet anticipated redemptions. The fair value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the fair value of the loaned securities changes. The collateral is held by the third party banking institution, and the collateral can only be accessed in the event that the institution borrowing the securities is in default under the lending agreement. As a result of these restrictions, the Company considers its securities lending activities to be non-cash investing and financing activities. An indemnification agreement with the lending agent protects the Company in the event a borrower becomes insolvent or fails to return any of the securities on loan. The fair value of the securities on loan is included in fixed maturities and equity securities. The securities lending collateral is reported as a separate line in total assets with a corresponding liability related to the Company's obligation to return the collateral plus interest.

Refer to Note 9 for a discussion on the determination of fair value for the Company's various investment securities.

g) Cash

Cash includes cash on hand and deposits with an original maturity of three months or less at time of purchase. Cash held by external money managers is included in short-term investments.

h) Unpaid losses and loss expenses

A liability is established for the estimated unpaid losses and loss expenses under the terms of, and with respect to, the Company's policies and agreements. These amounts include provision for both reported claims (case reserves) and IBNR claims. The methods of determining such estimates and establishing the resulting liability are reviewed regularly and any adjustments are reflected in operations in the period in which they become known. Future developments may result in losses and loss expenses materially greater or less than recorded amounts.

Included in unpaid losses and loss expenses are liabilities for asbestos and environmental claims and expenses (A&E). These unpaid losses and loss expenses are principally related to claims arising from remediation costs associated with hazardous waste sites and bodily-injury claims related to asbestos products and environmental hazards. The estimation of these liabilities is particularly sensitive to changes in the legal environment, including specific settlements that may be used as precedents to settle future claims. However, the Company does not anticipate future changes in laws and regulations in setting its A&E reserve levels.

Prior period development arises from changes to loss estimates recognized in the current year that relate to loss reserves first reported in previous calendar years and excludes the effect of losses from the development of earned premiums from previous accident years. For purposes of analysis and disclosure, management views prior period development to be changes in the nominal value of loss estimates from period to period and excludes changes in loss estimates that do not arise from the emergence of claims, such as those related to uncollectible reinsurance, interest, unallocated loss adjustment expenses, or foreign currency. Accordingly, specific items excluded from prior period development include the following: gains/losses related to foreign currency remeasurement; losses recognized from the early termination or commutation of reinsurance agreements that principally relate to the time value of money; changes in the value of reinsurance business assumed reflected in losses incurred but principally related to the time value of money; and losses that arise from changes in estimates of earned premiums from prior accident years. Except for foreign currency revaluation, which is disclosed separately, these items are included in current year losses.

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i) Deposit liabilities

Deposit liabilities include a deposit liability associated with a variable interest entity (see Note 5), reinsurance deposit liabilities and contract holder deposit funds. Accretion of deposit liabilities is recorded in investment income. The reinsurance deposit liabilities arise from contracts sold by the Company which are deemed to lack either significant underwriting and/or timing risk. At contract inception, the deposit liability is equal to net cash received by the Company. For certain contracts, an accretion rate is established based on actuarial estimates whereby the deposit liability is adjusted to the estimated amount payable over the term of the contract. The deposit accretion/amortization rate is the rate of return required to fund expected future payment obligations. The Company periodically reassesses the estimated ultimate liability and related expected rate of return. Any resulting changes to the amount of the deposit liability is reflected as an adjustment to interest expense to reflect the cumulative effect of the period the contract has been in force, and by an adjustment to the future accretion rate of the liability over the remaining estimated contract term.

j) Translation of foreign currencies

Revenues and expenses and the related unearned premiums and deferred acquisition costs denominated in non U.S. dollar currencies are translated into U.S. dollars at the rates of exchange at the transaction date. Monetary assets and liabilities are translated at the rates of exchange in effect at the end of the period. Transaction gains and losses resulting from foreign currency transactions are recorded in net realized (losses).

k) Income taxes

Income taxes have been recorded related to 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. The valuation allowance assessment considers tax planning strategies, where applicable.

The Company recognizes uncertain tax positions deemed more likely than not of being sustained upon examination. Recognized income tax positions are measured at the largest amount that is greater than 50 percent likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

l) Cash flow information

Purchases, sales, and maturities of short-term investments are recorded net for purposes of the statements of cash flows and are included with fixed maturities. Cash flows, such as settlements and collateral requirements, associated with all other derivative instruments are included on a net basis within cash flows from investing activities in the consolidated statements of cash flows.

m) Derivatives

The Company recognizes all derivatives at fair value in the consolidated balances sheets. The Company participates in derivative instruments to mitigate financial risks, principally arising from investment holdings, products sold, or assets and liabilities held in foreign currencies. For these instruments, changes in assets or liabilities measured at fair value are recorded as realized gains or losses in the consolidated statements of operations.

The Company did not designate any derivatives as accounting hedges during 2010 or 2009.

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n) New accounting pronouncements

Adopted in 2010

Fair value measurements and disclosures

Accounting Standard Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06) includes provisions that amend ASC Topic 820, *Fair Value Measurements and Disclosures*, (Topic 820) to require reporting entities to make new disclosures about recurring and nonrecurring fair value measurements including the amounts of and reasons for significant transfers into and out of Level 1 and Level 2 fair value measurements and separate disclosure of purchases, sales, issuances, and settlements in the reconciliation of Level 3 fair value measurements. ASU 2010-6 was effective for interim and annual reporting periods beginning after December 15, 2009, except for Level 3 reconciliation disclosures which are effective for interim and annual periods beginning after December 15, 2010.

Consolidation of variable interest entities and accounting for transfers of financial assets

ASU No. 2009-17, *Improvements to Financial Reporting by Enterprises Involved With Variable Interest Entities* (ASU 2009-17) include provisions effective for interim and annual reporting periods beginning on January 1, 2010. ASU 2009-17 amends ASC Topic 810, *Consolidation*, to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity and requires ongoing qualitative reassessments of whether an enterprise is the primary beneficiary of a variable interest entity. The adoption of ASU 2009-17 resulted in the deconsolidation of Paget Reinsurance Limited's segregated accounts. The opening value of minority interest of \$28 million and the corresponding values of the segregated accounts assets and liabilities (including, but not limited to, deferred policy acquisition costs, unearned premiums, cash and accounts payable) were deconsolidated as the risks and rewards of its operations are retained by the segregated account owners. There was no impact on opening retained earnings.

Embedded credit derivatives

ASU No. 2010-11, *Scope Exception Related to Embedded Credit Derivatives* (ASU 2010-11) includes provisions effective for interim and annual reporting periods beginning on July 1, 2010. The provisions of ASU 2010-11 amend ASC Topic 815, *Derivatives and Hedging*, to provide clarification on the bifurcation scope exception for embedded credit derivative features. The adoption of these provisions did not have a material impact on the Company's financial condition or results of operations.

To be adopted after 2010

Accounting for costs associated with acquiring or renewing insurance contracts

In October 2010, the FASB issued ASU No. 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* (ASU 2010-26). The provisions of ASU 2010-26 modify the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. This guidance is effective for annual reporting periods beginning on January 1, 2012, and may be applied prospectively or retrospectively. The adoption of these provisions will not have a material impact on the Company's financial condition or results of operations.

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4. Investments

a) Fixed maturities

The following tables present the fair values and amortized costs of and the gross unrealized appreciation (depreciation) related to fixed maturities as well as related OTTI recognized in AOCI.

2010					
	<u>Amortized Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Fair Value</u>	<u>OTTI Recognized in Accumulated Other Comprehensive Income</u>
	(in thousands of U.S. dollars)				
<u>Available for sale</u>					
U.S. Treasury and agency	\$ 498,384	\$ 22,295	\$ (2,869)	\$ 517,810	\$ -
Foreign	341,018	23,392	(594)	363,816	(2,519)
Corporate securities	2,213,930	141,404	(11,711)	2,343,623	(6,204)
Mortgage-backed securities	719,121	21,486	(19,877)	720,730	(17,064)
States, municipalities, and political subdivisions	<u>101,639</u>	<u>2,676</u>	<u>(975)</u>	<u>103,340</u>	<u>(5)</u>
	<u>\$ 3,874,092</u>	<u>\$ 211,253</u>	<u>\$ (36,026)</u>	<u>\$ 4,049,319</u>	<u>\$ (25,792)</u>
<u>Held to maturity</u>					
Foreign	\$ 10,079	\$ 531	\$ (22)	\$ 10,588	-
Corporate securities	46,107	2,494	(2)	48,599	-
Mortgage-backed securities	55,622	2,293	(439)	57,477	-
States, municipalities, and political subdivisions	<u>465</u>	<u>7</u>	<u>-</u>	<u>472</u>	<u>-</u>
	<u>\$ 112,273</u>	<u>\$ 5,325</u>	<u>\$ (463)</u>	<u>\$ 117,136</u>	<u>\$ -</u>
2009					
	<u>Amortized Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Fair Value</u>	<u>OTTI Recognized in Accumulated Other Comprehensive Income</u>
	(in thousands of U.S. dollars)				
<u>Available for sale</u>					
U.S. Treasury and agency	\$ 478,694	\$ 9,570	\$ (2,789)	\$ 485,475	\$ -
Foreign	271,727	20,566	(836)	291,457	(2,658)
Corporate securities	1,971,672	103,492	(27,342)	2,047,822	(4,883)
Mortgage-backed securities	587,179	19,719	(32,577)	574,321	(7,929)
States, municipalities, and political subdivisions	<u>68,585</u>	<u>2,693</u>	<u>(509)</u>	<u>70,769</u>	<u>(5)</u>
	<u>\$ 3,377,857</u>	<u>\$ 156,040</u>	<u>\$ (64,053)</u>	<u>\$ 3,469,844</u>	<u>\$ (15,475)</u>
<u>Held to maturity</u>					
Foreign	\$ 13,259	\$ 552	\$ (100)	\$ 13,711	-
Corporate securities	55,847	2,298	(202)	57,943	-
Mortgage-backed securities	68,484	1,832	(1,016)	69,300	-
States, municipalities, and political subdivisions	<u>464</u>	<u>20</u>	<u>-</u>	<u>484</u>	<u>-</u>
	<u>\$ 138,054</u>	<u>\$ 4,702</u>	<u>\$ (1,318)</u>	<u>\$ 141,438</u>	<u>\$ -</u>

As discussed in Note 4f, if a credit loss is indicated on an impaired fixed maturity, an OTTI is considered to have occurred and the portion of the impairment not related to credit losses (non-credit OTTI) is recognized in OCI.

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Included in the “OTTI Recognized in AOCI” columns above is the cumulative amount of non-credit OTTI recognized in OCI adjusted for subsequent sales, maturities, and redemptions. OTTI Recognized in AOCI does not include the impact of subsequent changes in fair value of the related securities. In periods subsequent to a recognition of OTTI in OCI, changes in the fair value of the related fixed maturities are reflected in unrealized appreciation (depreciation) in the statement of comprehensive income. For the years ended December 31, 2010 and 2009, \$11.2 million and \$7.5 million, respectively, of net unrealized appreciation related to such securities is included in OCI. At December 31, 2010 and 2009, AOCI includes net unrealized depreciation of \$(11.5) million and \$(2.1) million related to securities remaining in the investment portfolio at those dates for which the Company has recognized a non-credit OTTI.

Mortgage-backed securities issued by U.S. government agencies are combined with all other “to be announced” mortgage derivatives held (refer to Note 8 a) (iv)) and are included in the category, “Mortgage-backed securities”. Approximately 83 percent and 72 percent of the total mortgage-backed securities at December 31, 2010 and 2009, respectively, are represented by investments in U.S. government agency bonds. The remainder of the mortgage exposure consists of collateralized mortgage obligations and non-government mortgage-backed securities, the majority of which provide a planned structure for principal and interest payments and carry a rating of AAA by the major credit rating agencies.

The following table presents fixed maturities at December 31, 2010 and 2009, by contractual maturity. Expected maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

	2010	
	Fair Value	Amortized Cost
	(in thousands of U.S. dollars)	
<u>Available for sale; maturity period</u>		
Due in 1 year or less	\$ 59,340	\$ 57,992
Due after 1 year through 5 years	1,102,341	1,037,680
Due after 5 years through 10 years	1,800,890	1,704,937
Due after 10 years	366,018	354,362
	3,328,589	3,154,971
Mortgage-backed securities	720,730	719,121
	\$ 4,049,319	\$ 3,874,092
<u>Held to maturity; maturity period</u>		
Due in 1 year or less	\$ 13,995	\$ 13,590
Due after 1 year through 5 years	43,408	40,988
Due after 5 years through 10 years	2,256	2,073
	59,659	56,651
Mortgage-backed securities	57,477	55,622
	\$ 117,136	\$ 112,273

b) Equity securities

The following table presents the fair value and cost of and gross unrealized appreciation (depreciation) related to equity securities at December 31, 2010 and 2009.

	2010		2009	
	(in thousands of U.S. dollars)			
Equity securities—cost	\$	946	\$	228,472
Gross unrealized appreciation		150		56,100
Gross unrealized depreciation		(8)		(29)
Equity securities—fair value	\$	1,088	\$	284,543

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c) Other investments

Other investments over which the Company cannot exercise significant influence are carried at fair value with changes in fair value reflected in other comprehensive income. Partially-owned investment companies over which the Company has significant influence are carried under the equity method of accounting. The following table presents the fair value and cost of other investments at December 31, 2010 and 2009.

	2010		2009	
	Fair Value	Cost	Fair Value	Cost
	(in thousands of U.S. dollars)			
Other Investments	\$ 5,757	\$ 5,757	\$ 6,016	\$ 6,016
Partially-owned investment companies	413,321	355,074	367,350	328,832
Total	\$ 419,078	\$ 360,831	\$ 373,366	\$ 334,848

Partially-owned investment companies is comprised of one investment in a highly diversified investment company that invests in a variety of investment styles such as long/short equity, global macro, and credit arbitrage partially through a highly diversified portfolio of investment funds. Included in the highly diversified investment company are multiple individual limited partnerships covering a broad range of investment strategies including large cap buyouts, specialist buyouts, growth capital, distressed, mezzanine, real estate, and co-investments. The underlying portfolios consists of various public and private debt and equity securities of publicly traded and privately held companies and real estate assets. These investments are also diversified between geographies, industries, asset types, and investment strategies which provide risk diversification within the investment class and across the overall investment portfolio.

d) Investments in partially-owned insurance companies

The following table presents Investments in partially-owned insurance companies at December 31, 2010 and 2009.

	2010		2009	
	Carrying Value	Ownership Percentage	Carrying Value	Ownership Percentage
	(in thousands of U.S. dollars, except percentage)			
Freisenbruch-Meyer	\$ 8,139	40.0%	\$ 8,663	40.0%
Intrepid Re Holdings Limited	-	0.0%	173	38.5%
Island Heritage	4,188	10.8%	4,188	10.8%
Total	\$ 12,327		\$ 13,024	

e) Gross unrealized loss

At December 31, 2010, there were 403 fixed maturities out of a total of 2,603 fixed maturities in an unrealized loss position. The largest single unrealized loss in the fixed maturities was \$1.4 million. Fixed maturities in an unrealized loss position at December 31, 2010, were comprised of both investment grade securities and below investment grade securities for which fair value declined primarily due to widening credit spreads since the date of purchase and included mortgage-backed securities that suffered a decline in value since their original date of purchase.

The following tables present, for all securities in an unrealized loss position at December 31, 2010, and December 31, 2009 (including securities on loan), the aggregate fair value and gross unrealized loss by length of time the security has continuously been in an unrealized loss position.

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December 31, 2010	0 - 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
		(in thousands of U.S. dollars)				
U.S. Treasury and agency	\$ 69,140	\$ (2,869)	\$ -	\$ -	\$ 69,140	\$ (2,869)
Foreign	35,823	(389)	3,673	(228)	39,496	(617)
Corporate securities	171,867	(3,455)	45,980	(8,259)	217,847	(11,714)
Mortgage-backed securities	155,086	(3,074)	67,516	(17,241)	222,602	(20,315)
States, municipalities, and political subdivisions	31,903	(969)	75	(5)	31,978	(974)
Total fixed maturities	463,819	(10,756)	117,244	(25,733)	581,063	(36,489)
Equity securities	-	(1)	3	(7)	3	(8)
Total	\$ 463,819	\$ (10,757)	\$ 117,247	\$ (25,740)	\$ 581,066	\$ (36,497)

December 31, 2009	0 - 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
		(in thousands of U.S. dollars)				
U.S. Treasury and agency	\$ 272,873	\$ (2,752)	\$ 865	\$ (37)	\$ 273,738	\$ (2,789)
Foreign	16,169	(244)	12,604	(692)	28,773	(936)
Corporate securities	223,754	(5,268)	220,551	(22,276)	444,305	(27,544)
Mortgage-backed securities	71,189	(1,647)	96,982	(31,946)	168,171	(33,593)
States, municipalities, and political subdivisions	13,056	(276)	4,142	(233)	17,198	(509)
Total fixed maturities	597,041	(10,187)	335,144	(55,184)	932,185	(65,371)
Equity securities	281	(27)	11	(2)	292	(29)
Total	\$ 597,322	\$ (10,214)	\$ 335,155	\$ (55,186)	\$ 932,477	\$ (65,400)

f) Net realized gains (losses) and change in net unrealized appreciation (depreciation) on investments

The Company adopted provisions included in Topic 320, *Investments-Debt and Equity Securities*, (Topic 320) related to the recognition and presentation of OTTI on April 1, 2009. Under these provisions, when an OTTI related to a fixed maturity security has occurred, the Company is required to record the OTTI in net income if the Company has the intent to sell the security or it is more likely than not that it will be required to sell the security before the recovery of its amortized cost. Further, in cases where the Company does not intend to sell the security and it is more likely than not that it will not be required to sell the security, the Company must evaluate the security to determine the portion of the impairment, if any, related to credit losses. If a credit loss is indicated, an OTTI is considered to have occurred and any portion of the OTTI related to credit losses must be reflected in net income while the portion of OTTI related to all other factors is recognized in OCI. For fixed maturities held to maturity, OTTI recognized in OCI is accreted from AOCI to the amortized cost of the fixed maturity prospectively over the remaining term of the securities. For fixed maturities, prior to this adoption, the Company was required to record OTTI in net income unless the Company had the intent and ability to hold the impaired security to recovery. These provisions do not have any impact on the accounting for OTTI for any other type of investment.

The cumulative effect of the adoption resulted in a reduction to AOCI and an increase to Retained earnings of \$39.8 million. These adjustments reflect the OTTI recognized in net income prior to the adoption related to fixed maturities held at the adoption date that have not suffered a credit loss, the Company does not intend to sell, and it is more likely than not that the Company will not be required to sell before the recovery of their amortized cost.

Each quarter, the Company reviews its securities in an unrealized loss position (impaired securities), including fixed maturity securities, securities lending collateral, equity securities, and other investments, to identify those impaired securities to be specifically evaluated for a potential OTTI.

For impaired fixed maturities, the Company assesses OTTI based on the provision of Topic 320 as described above. The factors that the Company considers when determining if a credit loss exists related to a fixed maturity are discussed in "Evaluation of potential credit losses related to fixed maturities" below. Prior to the adoption, when

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evaluating fixed maturities for OTTI, the Company principally considered its ability and intent to hold the impaired security to the expected recovery period, the issuer's financial condition, and the Company's assessment (using available market information such as credit ratings) of the issuer's ability to make future scheduled principal and interest payments on a timely basis.

The Company reviews all non-fixed maturity investments for OTTI based on the following:

- the amount of time a security has been in a loss position and the magnitude of the loss position;
- the period in which cost is expected to be recovered, if at all, based on various criteria including economic conditions and other issuer-specific developments; and
- the Company's ability and intent to hold the security to the expected recovery period.

The Company, as a general rule, also considers that equity securities in an unrealized loss position for twelve consecutive months are impaired.

Evaluation of potential credit losses related to fixed maturities

The Company reviews each fixed maturity security in an unrealized loss position to assess whether the security is a candidate for credit loss. Specifically, the Company considers credit rating, market price, and issuer specific financial information, among other factors, to assess the likelihood of collection of all principal and interest as contractually due. Securities for which the Company determines that credit loss is likely are subjected to further analysis to estimate the credit loss recognized in net income, if any. In general, credit loss recognized in net income equals the difference between the security's amortized cost and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security. The specific methodologies and significant assumptions used by asset class are discussed below. All significant assumptions used in determining credit losses are subject to change as market conditions evolve.

U.S. Treasury and agency obligations (including agency mortgage-backed securities), foreign government obligations, and states, municipalities, and political subdivisions obligations

U.S. Treasury and agency obligations (including agency mortgage-backed securities), foreign government obligations, and states, municipalities, and political subdivisions obligations represent less than \$6.7 million of gross unrealized loss at December 31, 2010. These securities were evaluated for credit loss primarily using qualitative assessments of the likelihood of credit loss considering credit rating of the issuers and level of credit enhancement, if any. The Company concluded that the high level of credit worthiness of the issuers coupled with credit enhancement, where applicable, supports recognizing no credit loss in net income.

Corporate securities

Projected cash flows for corporate securities (principally senior unsecured bonds) are driven primarily by assumptions regarding probability of default and also the timing and amount of recoveries associated with defaults. The Company develops these estimates using information based on market observable data, issuer specific information, and credit ratings. The Company developed its default assumption by using historical default data by Moody's Investors Service (Moody's) rating category to calculate a 1-in-100 year probability of default, which results in a default assumption in excess of the historical mean default rate. The Company believes that use of a default assumption in excess of the historical mean is reasonable in light of recent market conditions. Default assumptions by Moody's rating category are as follows (historical mean default rate provided for comparison):

<u>Moody's Rating Category</u>	<u>1-in-100 Year Default Rate</u>	<u>Historical Mean Default Rate</u>
<i>Investment Grade:</i>		
Aaa-Baa	0.0%-1.4%	0.0%-0.3%
<i>Below Investment Grade:</i>		
Ba	4.8%	1.1%
B	12.9%	3.4%
Caa-C	53.6%	13.8%

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Consistent with management's approach to developing default rate assumptions considering recent market conditions, the Company assumed a 25 percent recovery rate (the par value of a defaulted security that will be recovered) across all rating categories rather than using Moody's historical mean recovery rate of 40 percent. The Company believes that use of a recovery rate assumption lower than the historical mean is reasonable in light of recent market conditions. Application of the methodology and assumptions described above resulted in credit losses recognized in net income for corporate securities for the year ended December 31, 2010, of \$3.9 million. Credit losses recognized in net income for corporate securities from the date of adoption to December 31, 2009 amounted to \$11.8 million.

Mortgage-backed securities

For mortgage-backed securities, credit impairment is assessed using a cash flow model that estimates the cash flows on the underlying mortgages, using the security-specific collateral and transaction structure. The model estimates cash flows from the underlying mortgage loans and distributes those cash flows to various tranches of securities, considering the transaction structure and any subordination and credit enhancements that exist in that structure. The cash flow model incorporates actual cash flows on the mortgage-backed securities through the current period and then projects the remaining cash flows using a number of assumptions, including default rates, prepayment rates, and loss severity rates (the par value of a defaulted security that will not be recovered) on foreclosed properties.

The Company develops specific assumptions using market data, where available, and includes internal estimates as well as estimates published by rating agencies and other third-party sources. The Company projects default rates by mortgage sector considering current underlying mortgage loan performance, generally assuming:

- lower loss severity for Prime sector bonds versus ALT-A, Sub-prime, and Option ARM sector bonds; and
- lower loss severity for older vintage securities versus more recent vintage securities, which reflects the recent decline in underwriting standards.

These estimates are extrapolated along a default timing curve to estimate the total lifetime pool default rate. Other assumptions used contemplate the actual collateral attributes, including geographic concentrations, rating agency loss projections, rating actions, and current market prices. If cash flow projections indicate that losses will exceed the credit enhancement for a given tranche, then the Company does not expect to recover its amortized cost basis and recognizes an estimated credit loss in net income. The following table presents the significant assumptions used to estimate future cash flows for specific mortgage-backed securities evaluated for potential credit loss at December 31, 2010, by sector and vintage are as follows:

Range of Significant Assumptions Used			
<u>Sector⁽¹⁾</u>	<u>Vintage</u>	<u>Default Rate⁽²⁾</u>	<u>Loss Severity Rate⁽²⁾</u>
<u>Prime</u>	2003 and prior	11%	22%
	2004	18-38%	37-59%
	2005	3-42%	48-80%
	2006-2007	11-65%	39-62%
<u>ALT-A</u>	2003 and prior	25%	41%
	2004	35%	48%
	2005	13-47%	49-62%
	2006-2007	32-59%	55-67%
<u>Option ARM</u>	2003 and prior	25%	37%
	2004	52%	45%
	2005	64-75%	57-66%
	2006-2007	69-78%	65-66%
<u>Sub-prime</u>	2003 and prior	48%	73%
	2004	50%	70%
	2005	65%	78%
	2006-2007	58-75%	72-86%

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(1) Prime, ALT-A, and Sub-prime sector bonds are categorized based on credit worthiness of the borrower. Option ARM sector bonds are categorized based on the type of mortgage product, rather than credit worthiness of the borrower.

(2) Default rate and loss severity rate assumptions vary within a given sector and vintage depending upon the geographic concentration of the collateral underlying the bond and the level of serious delinquencies, among other factors.

Application of the methodology and assumptions described above resulted in credit losses recognized in net income for mortgage-backed securities for the year ended December 31, 2010, of \$2.7 million. Credit losses recognized in net income for mortgage-backed securities from the date of adoption to December 31, 2009 were \$1.9 million.

The following table presents, for the years ended December 31, 2010 and 2009, the Net realized gains (losses), the losses included in Net realized gains (losses) and OCI as a result of conditions which caused the Company to conclude the decline in fair value of certain investments was “other-than-temporary”, and the change in net unrealized appreciation (depreciation) on investments.

	<u>2010</u>	<u>2009</u>
	(in thousands of U.S. dollars)	
<u>Fixed maturities:</u>		
OTTI on fixed maturities, gross	\$ (19,250)	\$ (48,977)
OTTI on fixed maturities recognized in other comprehensive income (pre-tax)	<u>12,627</u>	<u>12,694</u>
OTTI on fixed maturities, net	(6,623)	(36,283)
Gross realized gains excluding OTTI	68,933	55,047
Gross realized losses excluding OTTI	<u>(6,995)</u>	<u>(36,756)</u>
Total fixed maturities	<u>\$ 55,315</u>	<u>\$ (17,992)</u>
 <u>Equity securities:</u>		
OTTI on equity securities	\$ (3)	\$ (11,264)
Gross realized gains excluding OTTI	75,020	54,583
Gross realized losses excluding OTTI	<u>(104)</u>	<u>(51,723)</u>
Total equity securities	<u>74,913</u>	<u>(8,404)</u>
Investment and embedded derivative instruments	478	11,379
OTTI on other investments	-	-
Foreign exchange gains (losses)	8,642	(6,169)
Other Investments – realized (losses)	<u>-</u>	<u>(57,383)</u>
Net realized gains (losses)	<u>\$ 139,348</u>	<u>\$ (78,569)</u>
 Change in net unrealized appreciation (depreciation) on investments:		
Fixed maturities available for sale	\$ 68,737	\$ 331,464
Fixed maturities held to maturity	(526)	(407)
Equity securities	(56,065)	87,679
Short-term investments	-	19
Investments in partially-owned insurance companies	-	(8,976)
Other investments	20,232	37,607
Income tax (expense) benefit	<u>386</u>	<u>0</u>
Change in net unrealized appreciation (depreciation) on investments	<u>32,764</u>	<u>447,386</u>
Total net realized gains (losses) and change in net unrealized appreciation (depreciation) on investments	<u>\$ 170,842</u>	<u>\$ 368,817</u>

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The following table presents, for the year ended December 31, 2010, and for the nine month period from the date of adoption of the new OTTI standard to December 31, 2009, a roll-forward of pre-tax credit losses related to fixed maturities for which a portion of OTTI was recognized in OCI.

	Year Ended December 31, 2010	Nine Months Ended December 31, 2009
	(in thousands of U.S. dollars)	
Balance of credit losses related to securities still held-beginning of period	\$ 18,256	\$ 14,931
Additions where no OTTI was previously recorded	5,398	12,870
Additions where an OTTI was previously recorded	1,225	729
Reductions reflecting amounts previously recorded in Other comprehensive income but subsequently reflected in net income	-	-
Reductions for securities sold during the period	(9,929)	(10,274)
Balance of credit losses related to securities still held-end of period	<u>\$ 14,950</u>	<u>\$ 18,256</u>

g) Net investment income

The following table presents the source of net investment income for the years ended December 31, 2010 and 2009.

	2010	2009
	(in thousands of U.S. dollars)	
Fixed maturities and short term investments	\$ 218,887	\$ 185,321
Equity securities	654	6,124
Other investments	2,749	1,863
Gross investment income	<u>222,290</u>	<u>193,308</u>
Intercompany interest	(719)	(1,738)
Investment expenses	(12,199)	(7,307)
Net investment income	<u>\$ 209,372</u>	<u>\$ 184,263</u>

h) Other income (expenses)

Other (expenses) income is mainly comprised of equity in net income (losses) of partially-owned insurance companies and partially-owned investment companies over which the Company exercises significant influence. In 2009 equity in net loss of \$18 million relating to a partially-owned insurance company which is no longer held as of December 31, 2010. Certain federal excise taxes incurred as a result of capital management initiatives are included in other (expenses) income. As these are considered capital transactions, they are excluded from underwriting results.

5. Variable Interest Entity

The Company entered into an excess of loss reinsurance agreement in 2003 on a block of long-term disability reinsurance. In accordance with the terms of the reinsurance agreement a separate trust has been established. Upon the expiration of the reinsured liabilities, the Company is entitled to the remainder of the assets, less a \$2 million margin. Although the Company is not the primary beneficiary of this trust, the Company absorbs the majority of the expected losses and receives a majority of the expected residual returns on investment results of the trust assets. These consolidated financial statements include the trust assets and a corresponding deposit liability with an aggregate value of \$242 million (2009 - \$237 million). The assets are primarily included in fixed maturities available for sale.

The Company's estimate of its direct liability under the excess of loss reinsurance agreement is reflected in unpaid losses and loss expenses and totaled \$7.2 million and \$nil as of December 31, 2010 and 2009, respectively.

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6. Unpaid losses and loss expenses

The reserves for unpaid losses and loss expenses represents estimated ultimate losses and loss expenses less paid losses and loss expenses and is comprised of the following at December 31, 2010 and 2009.

	<u>2010</u>	<u>2009</u>
	<u>(in thousands of U.S. dollars)</u>	
Case and loss expense reserve	\$ 269,306	\$ 533,701
IBNR loss reserve	1,861,257	2,007,438
Total unpaid losses and loss expense	<u>\$ 2,130,563</u>	<u>\$ 2,541,139</u>

The Company establishes reserves for the estimated unpaid ultimate liability for losses and loss expenses under the terms of its policies and agreements. These reserves include estimates for both claims that have been reported and for IBNR, and include estimates of expenses associated with processing and settling these claims. The process of establishing reserves for property and casualty claims can be complex and is subject to considerable variability as it requires the use of informed estimates and judgments. The Company's estimates and judgments may be revised as additional experience and other data become available and are reviewed, as new or improved methodologies are developed, or as current laws change.

The Company continually evaluates its estimates of reserves in light of developing information and in light of discussions and negotiations with its insureds. While the Company believes that its reserves for unpaid losses and loss expenses at December 31, 2010, are adequate, new information or trends may lead to future developments in ultimate losses and loss expenses significantly greater or less than the reserves provided. Any such revisions could result in future changes in estimates of losses or reinsurance recoverable, and would be reflected in the Company's results of operations in the period in which the estimates are changed.

The reconciliation of unpaid losses and loss expenses for the years ended December 31, 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
	<u>(in thousands of U.S. dollars)</u>	
Gross unpaid losses and loss expenses, beginning of year	\$ 2,541,139	\$ 2,444,604
Reinsurance recoverable on unpaid losses	(512,646)	(402,680)
Net unpaid losses and loss expenses, beginning of year	<u>2,028,493</u>	<u>2,041,924</u>
Net losses and loss expenses incurred in respect of losses occurring in:		
Current year	201,652	269,128
Prior year	(32,822)	(31,517)
Total	<u>168,830</u>	<u>237,611</u>
Net losses and loss expenses paid in respect of losses occurring in:		
Current year	(8,504)	(54,599)
Prior year	(559,425)	(199,121)
Total	<u>(567,929)</u>	<u>(253,720)</u>
Other movements:		
Value of reinsurance business assumed	(2,805)	(2,915)
Foreign exchange revaluation	(5,764)	5,875
Other	(6,960)	(282)
Total	<u>(15,529)</u>	<u>2,678</u>
Net unpaid losses and loss expenses, end of year	<u>\$ 1,613,865</u>	<u>\$ 2,028,493</u>
Represented by:		
Gross unpaid losses and loss expenses, end of year	\$ 2,130,563	\$ 2,541,139
Reinsurance recoverable on unpaid losses	(516,698)	(512,646)
	<u>\$ 1,613,865</u>	<u>\$ 2,028,493</u>

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As indicated in the table above, the prior period development for loss and loss expenses was net favorable of \$32.8 million in 2010. Significant developments underlying this result is favorable development of \$35 million in short-tailed lines primarily arising from 2007 to 2009 accident years due to lack of emergence of newly reported claims and favorable development on known claims. There was offsetting favorable and unfavorable developments across long-tailed lines of business with adverse development in report year 2007 driven by a small number of claims with large limits and favorable developments in report years 2006 and prior due to better than expected claims emergence and a favorable claim settlement.

Prior period developments in 2009 were driven by \$46 million of favorable developments in short-tailed lines within accident years 2005 through 2008 due to lack of claims emergence and a favorable settlement impacting the 1997 accident year. Long-tailed lines experienced adverse development of \$13 million impacting report year 2005 due to a court decision made during the 2009 year.

Other reserve movements in 2010 are mainly comprised of the effect on loss reserves of the adoption of ASU 2009-17, relating to the opening reserve balance of Paget Reinsurance Limited.

7. Reinsurance

The Company purchases reinsurance to manage various exposures including catastrophe risks. Although reinsurance agreements contractually obligate the Company's reinsurers to reimburse it for the agreed-upon portion of its gross paid losses, they do not discharge the primary liability of the Company. Direct, assumed, and ceded premiums for the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
	(in thousands of U.S. dollars)	
Premiums written		
Direct	\$ 365,596	\$ 385,156
Assumed	113,028	218,655
Ceded	(152,103)	(197,568)
Net	\$ 326,521	\$ 406,243
 Premiums earned		
Direct	\$ 379,089	\$ 401,623
Assumed	120,121	222,618
Ceded	(162,713)	(200,655)
Net	\$ 336,497	\$ 423,586

The Company evaluates the financial condition of its reinsurers and potential reinsurers on a regular basis and also monitors concentrations of credit risk with reinsurers. The composition of the Company's reinsurance recoverable at December 31, 2010 and 2009 is as follows:

	2010	
	(in thousands of U.S. dollars)	
Reinsurance recoverable on paid losses and loss expenses	\$ 6,012	\$ 4,457
Reinsurance recoverable on unpaid losses and loss expenses	516,698	512,646
Total reinsurance recoverable	\$ 522,710	\$ 517,103

The following table presents a listing, at December 31, 2010, of the categories of the Company's reinsurers. The first category, largest reinsurers, represents all reinsurers where the gross recoverable exceeds one percent of the Company's total shareholder's equity. The provision for uncollectible reinsurance for the largest reinsurers, other reinsurers rated A- or better, and other reinsurers with ratings lower than A- is principally based on an analysis of the credit quality of the reinsurer and collateral balances. The Company establishes its provision for uncollectible reinsurance in this category based on a case by case analysis of individual situations including the merits of the

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underlying matter, credit and collateral analysis, and consideration of the Company's collection experience in similar situations.

Categories	2010	Provision	% of Gross
	(in thousands of U.S. dollars, except percentages)		
Largest reinsurers	\$ 403,463	\$ 6,785	1.7%
Other reinsurers balances rated A- or better	127,608	2,304	1.8%
Other reinsurers balances with ratings lower than A- or not rated	2,765	2,037	73.7%
Total	\$ 533,836	\$ 11,126	2.1%

Largest Reinsurers

Arch Reinsurance Ltd.
Everest Reinsurance (Bermuda) Ltd.
Hannover Rueckversicherungs AG.
Munich Reinsurance Co.
Partner Reinsurance Co. Ltd.
Swiss Reinsurance America Corp.
Transatlantic Reinsurance Co.

8. Commitments, contingencies, and guarantees

a) Derivative instruments

The Company maintains positions in derivative instruments such as futures, options, and foreign currency forward contracts for which the primary purposes are to manage duration and foreign currency exposure, yield enhancement and to obtain an exposure to a particular financial market. Along with convertible bonds and to be announced mortgage-backed securities (TBA), discussed below, these are the most numerous and frequent derivative transactions.

The Company maintains positions in certain convertible bond investments that contain embedded derivatives. In addition, the Company purchases TBAs as part of its investing activities. These securities are included with the Company's fixed maturities available for sale portfolio (FM AFS). The Company carries all derivative instruments at fair value with changes in fair value recorded in net realized (losses) in the consolidated statements of operations. None of the derivatives are used as hedges for accounting purposes.

The following table presents the fair values in an asset or (liability) position and notional values/payment provisions of the Company's derivative instruments at December 31, 2010 and 2009.

	2010		2009	
	Fair Value	Notional Value/ Payment Provision	Fair Value	Notional Value/ Payment Provision
	(in thousands of U.S. dollars)		(in thousands of U.S. dollars)	
<u>Investment and embedded derivative instruments</u>				
Foreign currency forward contracts	\$ -	\$ -	\$ 9	\$ 365
Futures contracts on money market instruments	219	393,000	877	680,000
Futures contracts on notes and bonds	2,001	157,500	(727)	81,900
Options on money market instruments	22	735	(70)	86,030
Convertible bonds	67,310	72,563	56,353	66,168
TBA's	71,229	68,900	2,578	2,440
	\$ 140,781	\$ 692,698	\$ 59,020	\$ 916,903

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The following table presents net realized gains (losses) related to derivative instrument activity in the consolidated statement of operations for the years ended December 31, 2010 and 2009.

	<u>2010</u> <u>(in thousands of</u> <u>U.S. dollars)</u>	<u>2009</u> <u>(in thousands</u> <u>of U.S. dollars)</u>
<u>Investment and embedded derivative instruments</u>		
Foreign currency forward contracts	\$ 7	\$ (637)
All other futures contracts and options	(748)	173
Convertible bonds	(508)	10,806
TBA's	981	(2,093)
Other	747	3,130
	<u>\$ 479</u>	<u>\$ 11,379</u>

Derivatives on money market instruments have durations of approximately 3 months regardless of the maturity date of the derivative.

(i) Foreign currency exposure management

A foreign currency forward contract (forward) is an agreement between participants to exchange specific foreign currencies at a future date. The Company uses forwards to minimize the effect of fluctuating foreign currencies.

(ii) Duration management and market exposure

Futures

Futures contracts give the holder the right and obligation to participate in market movements, determined by the index or underlying security on which the futures contract is based. Settlement is made daily in cash by an amount equal to the change in value of the futures contract times a multiplier that scales the size of the contract. Exchange-traded bond and note futures contracts are used in fixed maturity portfolios as substitutes for ownership of the bonds and notes without significantly increasing the risk in the portfolio. Investments in futures contracts may be made only to the extent that there are assets under management not otherwise committed.

Options

An option contract conveys to the holder the right, but not the obligation, to purchase or sell a specified amount or value of an underlying security at a fixed price. Option contracts are used in the investment portfolio as protection against unexpected shifts in interest rates, which would affect the duration of the fixed maturity portfolio. By using options in the portfolio, the overall interest rate sensitivity of the portfolio can be reduced. Option contracts may also be used as an alternative to futures contracts in the Company's synthetic strategy as described above. The price of an option is influenced by the underlying security, expected volatility, time to expiration, and supply and demand.

The credit risk associated with the above derivative financial instruments relates to the potential for non-performance by counterparties. Although non-performance is not anticipated, in order to minimize the risk of loss, management monitors the creditworthiness of its counterparties and obtains collateral. The performance of exchange-traded instruments is guaranteed by the exchange on which they trade. For non-exchange-traded instruments, the counterparties are principally banks which must meet certain criteria according to the Company's investment guidelines.

(iii) Convertible security investment

A convertible bond is a debt instrument that can be converted into a predetermined amount of the issuer's equity at certain times prior to the bond's maturity. The convertible option is an embedded derivative within the fixed maturity host instruments which are classified in the investment portfolio as available for sale. The Company purchases convertible bonds for their total return and not specifically for the conversion feature.

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(iv) TBA

By acquiring a TBA, the Company makes a commitment to purchase a future issuance of mortgage-backed securities. For the period between purchase of the TBA and issuance of the underlying security, the Company's position is accounted for as a derivative in the consolidated financial statements. The Company purchases TBAs both for their total return and for the flexibility they provide related to the Company's mortgage-backed security strategy.

b) Concentrations of credit risk

The investment portfolio is managed following prudent standards of diversification. Specific provisions limit the allowable holdings of a single issue and issuers. The Company believes that there are no significant concentrations of credit risk associated with its investments.

c) Credit facilities and letters of credit

ACE and participating subsidiaries (including the Company) have in place a \$500 million unsecured revolving credit facility which was renewed for five years in November 2007, replacing the existing \$600 million revolving credit facility. This facility is available for general corporate purposes and the issuance of letters of credit (LOCs). At December 31, 2010 there were \$70 million of LOC's outstanding and \$300 million drawn on this facility.

ACE and participating subsidiaries (including the Company) have in place a \$1 billion five year unsecured operational LOC facility which was renewed for five years in November 2007, replacing both the existing \$1 billion unsecured and \$500 million secured operational LOC facilities. At December 31, 2009 there were \$574 million of LOC's outstanding under this facility.

Both the revolving credit facility and letter of credit facility require that ACE and/or certain of its subsidiaries continue to maintain certain covenants, including a minimum consolidated net worth covenant and a maximum leverage covenant, which have been met at December 31, 2010.

The Company is jointly liable for all drawings made by ACE or any other participating subsidiaries.

ACE's failure to comply with the covenants under any credit facility would, subject to grace periods in the case of certain covenants, result in an event of default. This could require ACE to repay any outstanding borrowings or to cash collateralize letters of credit under such facility. A failure by ACE (or any of its subsidiaries) to pay an obligation due for an amount exceeding \$50 million would result in an event of default under all of the facilities described above.

d) Financial guarantees

The Company has entered into an undertaking, jointly and severally with ACE Tempest Re to support the obligations of the following ACE facility:

A series of four bi-lateral Funds at Lloyd's letter of credit facilities totaling \$400 million, expiring no later than December 31, 2015. This replaced the £300 million syndicated Funds at Lloyd's letter of credit facility expiring in December 2013. At December 31, 2010, \$340 million of these facilities were utilized. The Funds at Lloyd's facilities require that collateral be posted if the financial strength ratings of both of the subsidiary guarantors fall below A- as rated by S&P and A3 as rated by Moody's.

These facilities require that the Company and/or certain of its subsidiaries continue to maintain certain covenants, including a minimum consolidated net worth covenant and a maximum leverage covenant, which have been met at December 31, 2010.

During 2010, the Company had cancelled its guarantees whereby it jointly and severally with ACE Tempest Re supported the obligations of ACE arising under certain bank loans. The bank loans were repaid and as a result the guarantees were released.

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e) Restricted assets

Included in available for sale fixed maturity securities are assets which have been used as collateral for certain undertakings of the Company. \$186 million are restricted assets under regulation 114 trusts.

f) Legal proceedings

(i) Claims and other litigation

The Company is subject to claims litigation (more specifically arbitrations) involving disputed interpretations of policy coverages and, in some jurisdictions, direct actions by third parties seeking damages from policyholders. Such contentious matters involving claims on policies issued by the Company, which are typical to the insurance industry in general and in the normal course of business, are considered in the Company's loss and loss-expense reserves. In addition to contentious claims, the Company is subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on insurance policies. This category of business litigation typically involves, among other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity or disputes arising from business ventures. Although the outcomes of any business litigation involving the Company cannot be predicted with certainty, the Company disputes and will continue to dispute allegations against it that are without merit and believes that the ultimate outcomes of any matters in this category of business litigation will not have a material adverse effect on the financial condition, future operating results or liquidity of the Company, although an adverse resolution of a number of these items could have a material adverse effect on the Company's results of operations in a particular fiscal year.

(ii) Business practices litigation

The Company, along with other ACE entities, has been named as a defendant in *New Cingular Wireless Headquarters LLC et al. v. Marsh & McLennan Companies, Inc. et al.* (Case No. 06-5120; United States District Court for the District of New Jersey), a non-class-action lawsuit filed in the Northern District of Georgia but later transferred to the District of New Jersey as a "tag-along" action for coordination with a number of cases that involve similar allegations and were previously consolidated by the Judicial Panel on Multidistrict Litigation ("JPML"). The plaintiffs in *New Cingular* are insurance policyholders who allege that the defendant brokers and insurers conspired to increase premiums and allocate customers through the use of "B" quotes and contingent commissions. The Company believes that the allegations have no merit. The plaintiffs assert the following causes of action against the ACE entities: Federal Racketeer Influenced and Corrupt Organization Act (RICO), federal antitrust law, inducement to breach of fiduciary duty, unjust enrichment, and fraud, and seek compensatory and special damages without specifying an amount. All proceedings in this action and the other "tag-along" actions are currently stayed. In the main action, the Court granted defendants' motions to dismiss and dismissed plaintiffs' antitrust and RICO claims with prejudice on August 31, 2007 and September 28, 2007, respectively. Plaintiffs appealed to the United States Court of Appeals for the Third Circuit. On August 16, 2010, the Third Circuit affirmed, in part, and vacated, in part, the District Court's previous dismissals with instructions for further briefing at the District Court on remand. Defendants have filed their motions and await the District Court's decision.

The Company, along with other ACE entities, has also been named in *Sears, Roebuck & Co. et al. v. Marsh & McLennan Companies, Inc. et al.* (Case No. 07-2535) (filed in the Northern District of Georgia). The allegations in this case are similar to the allegations in the *New Cingular* action identified above. On November 19, 2007, the JPML transferred this lawsuit to the above-referenced multidistrict litigation in the District of New Jersey for coordination. As addressed in the preceding paragraph, all proceedings in this "tag-along" action are currently stayed.

9. Fair value measurements

Fair value hierarchy

The Company fully adopted the provision of Topic 820 on January 1, 2009. The provisions of Topic 820 define fair value as the price to sell an asset or transfer a liability in an orderly transaction between market participants and establish a three-level valuation hierarchy in which inputs into valuation techniques used to measure fair value are

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classified. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. Inputs in Level 1 are unadjusted quoted prices for identical assets or liabilities in active markets. Level 2 includes inputs other than quoted prices included within Level 1 that are observable for assets or liabilities either directly or indirectly. Level 2 inputs include, among other items, quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and inputs other than quoted prices that are observable for the asset or liability such as interest rates and yield curves. Level 3 inputs are unobservable and reflect management's judgments about assumptions that market participants would use in pricing an asset or liability. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Company makes decisions regarding the categorization of assets or liabilities within the valuation hierarchy based on the inputs used to determine respective fair values at the balance sheet date. Accordingly, transfers between levels within the valuation hierarchy are determined on the same basis.

The Company utilizes one or more pricing services to obtain fair value measurements for the majority of the investment securities it holds. Based on management's understanding of the methodologies used by these pricing services, all applicable investments have been valued in accordance with GAAP valuation principles. The following is a description of the valuation techniques and inputs used to determine fair values for the Company's financial instruments carried or disclosed at fair value, as well as the general classification of such financial instruments pursuant to the valuation hierarchy.

Fixed maturities

The Company utilizes pricing services to estimate fair value measurements for the majority of its fixed maturities. The pricing services utilize market quotations for fixed maturities that have quoted prices in active markets; such securities are classified in Level 1. For fixed maturities other than U.S. Treasury securities that generally do not trade on a daily basis, the pricing services prepare estimates of fair value measurements using their pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additional valuation factors that can be taken into account are nominal spreads, dollar basis, and liquidity adjustments. The pricing services evaluate each pricing class based on relevant market and credit information, perceived market movements, and sector news. The market inputs utilized in the pricing evaluation, listed in the approximate order of priority include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each input is dependent on the asset class and the market conditions. Additionally, given the asset class, the priority of the use of inputs may change or some market inputs may not be relevant. The overwhelming majority of fixed maturities are classified within Level 2 because the most significant inputs used in the pricing techniques are observable. Fixed maturities for which pricing is unobservable are classified within Level 3.

Equity securities

Equity securities with active markets are classified within Level 1 as fair values are based on quoted market prices.

Short-term investments

Short-term investments, which comprise securities due to mature within one year of the date of purchase that are traded in active markets, are classified within Level 1 as fair values are based on quoted market prices. Securities such as commercial paper and discount notes are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their cost approximates par value.

Securities lending collateral

The underlying assets included in Securities lending collateral are fixed maturities which are classified in the valuation hierarchy on the same basis as the Company's other fixed maturities. Excluded from the valuation hierarchy is the corresponding liability related to the Company's obligation to return the collateral plus interest.

Other investments

Fair values for the majority of other investments including investments in partially-owned investment companies, investment funds, and limited partnerships, are based on their respective net asset values, or equivalent (NAV). The

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majority of these investments, for which the Company has used NAV as a practical expedient to measure fair value, are classified within Level 3 because either ACE will never have the contractual option to redeem the investment or will not have the contractual option to redeem the investments in the near term. The remainder of such investments is classified within Level 2.

Investments in partially-owned insurance companies

Fair values for investments in partially-owned insurance companies based on financial statements provided by those companies are classified within Level 3.

Investment derivative instruments

For actively traded investment derivative instruments, including futures, options, and exchange-traded forward contracts, the Company obtains quoted market prices to determine fair value. As such, these instruments are included within Level 1. Forward contracts that are not exchange-traded are priced using a pricing matrix model principally employing observable inputs and, as such, are classified within Level 2.

Other derivative instruments

The other derivative instrument held at December 31, 2009 is comprised of a rate of return guarantee contract. The fair value was based on significant unobservable inputs and is classified within level 3. This instrument was sold during the year ended December 31, 2010.

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The following table presents, by valuation hierarchy, the financial instruments carried or disclosed at fair value, and measured on a recurring basis, as of December 31, 2010, and December 31, 2009.

	Quoted Prices in Active Markets for Identical Assets or Liabilities Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
	(in thousands of U.S. dollars)			
December 31, 2010				
Assets:				
<u>Fixed maturities available for sale</u>				
U.S. Treasury and agency	\$ 326,188	\$ 191,622	\$ -	\$ 517,810
Foreign	-	363,816	-	363,816
Corporate securities	298	2,317,262	26,064	2,343,624
Mortgage-backed securities	-	719,578	1,151	720,729
States, municipalities, and political subdivisions	-	103,340	-	103,340
	<u>326,486</u>	<u>3,695,618</u>	<u>27,215</u>	<u>4,049,319</u>
<u>Fixed maturities held to maturity</u>				
Foreign	-	10,588	-	10,588
Corporate securities	-	48,599	-	48,599
Mortgage-backed securities	-	57,477	-	57,477
States, municipalities, and political subdivisions	-	472	-	472
	<u>-</u>	<u>117,136</u>	<u>-</u>	<u>117,136</u>
Equity securities	1,086	-	2	1,088
Short-term investments	66,659	35,326	-	101,985
Other investments	-	-	419,078	419,078
Securities lending collateral	-	161,647	-	161,647
Other derivative instrument	-	-	-	-
Investment derivative instruments	2,242	-	-	2,242
Total assets at fair value	<u>\$ 396,473</u>	<u>\$ 4,009,727</u>	<u>\$ 446,295</u>	<u>\$ 4,852,495</u>

There were no significant transfers between Level 1 and Level 2 during the year ended December 31, 2010.

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	Quoted Prices in Active Markets for Identical Assets or Liabilities Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
	(in thousands of U.S. dollars)			
December 31, 2009				
Assets:				
<u>Fixed maturities available for sale</u>				
U.S. Treasury and agency	\$ 259,947	\$ 225,528	\$ -	\$ 485,475
Foreign	-	291,162	295	291,457
Corporate securities	-	2,021,841	25,981	2,047,822
Mortgage-backed securities	-	573,327	994	574,321
States, municipalities, and political subdivisions	-	70,769	-	70,769
	<u>259,947</u>	<u>3,182,627</u>	<u>27,270</u>	<u>3,469,844</u>
<u>Fixed maturities held to maturity</u>				
Foreign	-	13,711	-	13,711
Corporate securities	-	57,580	363	57,943
Mortgage-backed securities	-	69,300	-	69,300
States, municipalities, and political subdivisions	-	484	-	484
	<u>-</u>	<u>141,075</u>	<u>363</u>	<u>141,438</u>
Equity securities	284,543	-	-	284,543
Short-term investments	123,241	7,190	-	130,431
Other investments	-	-	373,366	373,366
Other derivative instrument	-	-	12,290	12,290
Investment derivative instruments	89	-	-	89
Total assets at fair value	<u>\$ 667,820</u>	<u>\$ 3,330,892</u>	<u>\$ 413,289</u>	<u>\$ 4,412,001</u>

Fair value of alternative investments

Included in Other investments in the fair value hierarchy at December 31, 2010, and December 31, 2009, are investment funds, limited partnerships, and partially-owned investment companies measured at fair value using NAV as a practical expedient. At December 31, 2010, there were no probable or pending sales related to any of the investments measured at fair value using NAV. The following table presents, by investment category, the fair values of and maximum future funding commitments related to these investments at December 31, 2010, and December 31, 2009. The table also shows the expected liquidation period from December 31, 2010.

	Expected Liquidation Period	December 31, 2010		December 31, 2009	
		Fair Value	Maximum Future Funding Commitments	Fair Value	Maximum Future Funding Commitments
(in thousands of U.S. dollars)					
Financial	5 to 9 Years	\$ 68,469	\$ 50,447	\$ 63,825	\$ 36,221
Distressed	6 to 9 Years	73,942	6,651	72,143	11,272
Mezzanine	6 to 9 Years	41,756	57,642	30,710	25,040
Traditional	3 to 8 Years	121,808	91,844	78,773	99,684
Vintage	1 to 3 Years	7,301	1,010	8,876	697
Investment funds	Not Applicable	109,867	-	103,533	-
		<u>\$ 423,143</u>	<u>\$ 207,594</u>	<u>\$ 357,860</u>	<u>\$ 172,914</u>

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Included in all categories in the above table except for Investment funds are investments for which the Company will never have the contractual option to redeem but receives distributions based on the liquidation of the underlying assets. Included in the "Expected Liquidation Period" column above is the range in years over which the Company expects the majority of underlying assets in the respective categories to be liquidated. Further, for all categories except for Investment funds, the Company does not have the ability to sell or transfer the investments without the consent from the general partner of individual funds.

Financial

Financial primarily consists of investments in private equity funds targeting financial services companies such as financial institutions and insurance services around the world.

Distressed

Distressed consists of investments in private equity funds targeting distressed debt/credit and equity opportunities in the U.S.

Mezzanine

Mezzanine consists of investments in private equity funds targeting private mezzanine debt of large-cap and mid-cap companies in the U.S. and worldwide.

Traditional

Traditional consists of investments in private equity funds employing traditional private equity investment strategies such as buyout and venture with different geographical focuses including Brazil, Asia, Europe, and the U.S.

Vintage

Vintage consists of investments in private equity funds made before 2002 and where the funds' commitment periods had already expired.

Investment funds

The Company's investment funds employ various investment strategies such as long/short equity and arbitrage/distressed. Included in this category are investments for which the Company has the option to redeem at agreed upon value as described in each investment fund's subscription agreement. Depending on the terms of the various subscription agreements, the Company may redeem investment fund investments monthly, quarterly, semi-annually, or annually. If the Company wishes to redeem an investment fund investment, the Company must first determine if the investment fund is still in a lock-up period (a time when the Company cannot redeem its investment so that the investment fund manager has time to build the portfolio). If the investment fund is no longer in its lock-up period, the Company must then notify the investment fund manager of its intention to redeem by the notification date prescribed by the subscription agreement. Subsequent to notification, the investment fund can redeem the Company's investment within several months of the notification. Notice periods for redemption of the Company's investment funds range between 5 and 120 days. The Company can redeem its investment funds without consent from the investment fund managers.

Level 3 financial instruments

The following table provides a reconciliation of the beginning and ending balances of financial instruments carried or disclosed at fair value using significant unobservable inputs (Level 3) for the year ended December 31, 2010 and 2009.

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	Balance- Beginning of Year	Net Realized Gains/ Losses	Change in Net Unrealized Gains (Losses) Included in Other Comprehensive Income	Purchases, Sales, Issuances, and Settlements, Net	Transfers Into (Out of) Level 3	Balance- End of Year	Change in Net Unrealized Gains (Losses) Relating to Financial Instruments Still Held at December 31, 2010, included in Net Income
(in thousands of U.S. dollars)							
Year ended							
December 31, 2010							
Assets:							
<u>Fixed maturities</u>							
<u>available for sale</u>							
Foreign	295				(295)	-	-
Corporate securities	25,981	(84)	2,281	(6,003)	3,889	26,064	-
Mortgage-backed securities	994	4	(9)	714	(552)	1,151	-
	<u>27,270</u>	<u>(80)</u>	<u>2,272</u>	<u>(5,289)</u>	<u>3,042</u>	<u>27,215</u>	<u>-</u>
<u>Fixed maturities held to maturity</u>							
Corporate	363	-	-	(363)	-	-	-
	<u>363</u>	<u>-</u>	<u>-</u>	<u>(363)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Equity Securities	-	-	2	-	-	2	-
Other investments	373,366	-	19,729	25,983	-	419,078	-
Other derivative instrument	12,290	390	-	(12,680)	-	-	-
	<u>12,290</u>	<u>390</u>	<u>-</u>	<u>(12,680)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets at fair value	\$ <u>413,289</u>	\$ <u>310</u>	\$ <u>22,003</u>	\$ <u>7,651</u>	\$ <u>3,042</u>	\$ <u>446,295</u>	\$ <u>-</u>

	Balance- Beginning of Year	Net Realized Gains/ Losses	Change in Net Unrealized Gains (Losses) Included in Other Comprehensive Income	Purchases, Sales, Issuances, and Settlements, Net	Transfers Into (Out of) Level 3	Balance- End of Year	Change in Net Unrealized Gains (Losses) Relating to Financial Instruments Still Held at December 31, 2009, included in Net Income
(in thousands of U.S. dollars)							
Year ended							
December 31, 2009							
Assets:							
<u>Fixed maturities</u>							
<u>available for sale</u>							
Foreign	-	2	1	292	-	295	2
Corporate securities	20,861	481	3,707	(547)	1,479	25,981	577
Mortgage-backed securities	11,889	(1,530)	1,943	(4,579)	(6,729)	994	-
	<u>32,750</u>	<u>(1,047)</u>	<u>5,651</u>	<u>(4,834)</u>	<u>(5,250)</u>	<u>27,270</u>	<u>579</u>
<u>Fixed maturities held to maturity</u>							
Corporate	-	-	(15)	(55)	433	363	-
	<u>-</u>	<u>-</u>	<u>(15)</u>	<u>(55)</u>	<u>433</u>	<u>363</u>	<u>-</u>
Other investments	331,270	-	37,697	4,399	-	373,366	-
Other derivative instrument	9,160	3,130	-	-	-	12,290	3,130
	<u>9,160</u>	<u>3,130</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>12,290</u>	<u>3,130</u>
Total assets at fair value	\$ <u>373,180</u>	\$ <u>2,083</u>	\$ <u>43,333</u>	\$ <u>(490)</u>	\$ <u>(4,817)</u>	\$ <u>413,289</u>	\$ <u>3,709</u>

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10. Related party transactions

During the year ended December 31, 2010 the Company (paid) received (\$5.7) million (2009 - \$(3.5) million) from the parent company and affiliates. The net proceeds received were related to the settlement of inter-company loans and payments received for operating purposes and sundry back-office services provided to various affiliate companies. The amounts due (to) from parent and affiliates are repayable on demand. This includes interest bearing loans payable totaling \$64 million (2009 - \$28 million) at rates ranging from 2.87% to 4.21% (2009 - 3.83% to 6.99%). The remaining balances are interest free. The net interest expense incurred during the year ended December 31, 2010 amounted to \$0.7 million (2009 - \$1.7 million).

At December 31, 2010, the Company maintains a receivable of \$28.5 million (2009 - \$31.2 million) from a not-for-profit organization for which the Board of Directors is principally comprised of ACE management. Such receivable is included in "Other Assets" in the accompanying consolidated balance sheets. The borrower has used related proceeds to finance investments in Bermuda real estate properties, some of which have been rented to ACE employees at rates established by independent, professional real estate appraisers, and intends to use income from the investments to both repay the note and fund future charitable activities. Accordingly, the Company reports the note receivable at the lower of its principal value or the fair value of assets held by the borrower, including the real estate properties, to repay the loan.

During the year ended December 31, 2010 the Company entered into reinsurance transactions with various affiliated companies which included net premiums earned of \$14.5 million (2009 - \$114.6 million) and losses and loss expenses, net of recoveries of \$20.2 million (2009 - \$36.9 million). Unpaid losses and loss expenses, net of reinsurance recoverables at December 31, 2010 were \$120.3 million (2009 - \$129.1 million).

11. Taxation

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.

The Company's subsidiaries ABIR and ABII are subject to corporate taxes at a rate of 12.5%, their UK branch at 28% and ACE Capital Title Reinsurance Company is subject to income taxes at a rate of 35%.

12. Statutory financial data

The Company and insurance and reinsurance subsidiaries are subject to insurance laws and regulations in the jurisdictions in which they operate. These regulations include restrictions that limit the amount of dividends or other distributions, such as loans or cash advances, available to shareholders without prior approval of the insurance regulatory authorities.

The Company is registered under The Insurance Act 1978 (Bermuda), amendments thereto and related regulations (the "Act") as a Class 4 insurer. The Act requires the Company to meet a minimum solvency margin and a minimum liquidity ratio. The Company has satisfied these requirements for 2010 and 2009. The Bermuda Statutory Capital Requirement ("BSCR") is a risk-based capital model to measure risk and to determine an enhanced capital requirement and target capital level (defined as 120% of the enhanced capital requirement ("ECR")) for Class 4 insurers. The Company has capital and surplus in excess of the target capital level.

A Class 4 insurer is prohibited from declaring or paying a dividend if in breach of its ECR, solvency margin or minimum liquidity ratio or if the declaration or payment of such dividend would cause such a breach. Where an insurer fails to meet its solvency margin or minimum liquidity ratio on the last day of any financial year, it is prohibited from declaring or paying any dividends during the next financial year without the approval of the Authority. Further, a Class 4 insurer is prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files (at least seven days before payment of such dividends) with the Authority an affidavit signed by at least two directors and the insurer's principal representative stating that the declaration of such dividends has not caused the insurer to fail to meet its solvency margin or minimum liquidity ratio. Class 4 insurers must obtain the Authority's prior approval for a reduction by 15% or more of the total statutory capital as set forth in its previous year's statutory financial statements.

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ACE Capital Title Reinsurance Company is subject to the New York insurance laws and regulations governing title insurers. A stock dividend may not be declared or distributed if such dividend reduces the Company's surplus to less than 50% of its outstanding capital shares. The maximum amount payable by the Company as a dividend during 2010 is \$0.2 million. ABIR and ABII have no restrictions on the distribution of dividends except to the extent that they must not exceed cumulative retained earnings. Capital reductions must be approved by the Irish High Court and would also need to be approved by their Insurance Regulator.

13. Subsequent Events

The Company has performed an evaluation of subsequent events through April 29, 2011, which is the date that the financial statements were issued. No significant subsequent events requiring disclosure or accounting in these consolidated financial statements were identified.