

**ACE Tempest Reinsurance Ltd. and
its subsidiaries**

(Incorporated in Bermuda)

Consolidated Financial Statements

December 31, 2010 and 2009

(in thousands of U.S. dollars)



April 29, 2011

Report of Independent Auditors

To the Board of Directors and Shareholder of ACE Tempest Reinsurance Ltd.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and other comprehensive income, shareholder's equity and cash flows present fairly, in all material respects, the financial position of **ACE Tempest Reinsurance Ltd. and its subsidiaries** at December 31, 2010 and 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 consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.


Chartered Accountants

ACE Tempest Reinsurance Ltd. and its subsidiaries

Consolidated Balance Sheets

As at December 31, 2010 and 2009

(in thousands of U.S. dollars, except par value)

	2010 \$	2009 \$
Assets		
Fixed maturities available for sale, at fair value (amortized cost \$11,380,383 and \$10,614,146)	11,833,387	10,849,547
Fixed maturities held to maturity, at amortized cost (fair value \$313,124 and \$302,327)	302,294	293,976
Equity securities, at fair value (cost \$343,808 and \$108,025)	352,025	110,151
Short-term investments, at cost and fair value	272,111	170,188
Other investments (cost \$1,254,514 and \$1,091,460)	1,356,301	1,155,312
Cash	238,039	52,622
Total investments and cash	14,354,157	12,631,796
Securities lending collateral	559,256	490,828
Accrued investment income	140,975	133,308
Reinsurance balances receivable	946,991	618,219
Prepaid reinsurance premiums	186,511	188,396
Reinsurance recoverable	1,031,327	894,982
Value of reinsurance business assumed	282,761	297,857
Deferred policy acquisition costs	124,467	127,556
Goodwill	364,959	364,959
Loan to affiliate	133,204	129,014
Amounts due from affiliates	130,435	146,085
Funds withheld	37,379	6,526
Other assets	36,760	20,409
Total assets	18,329,182	16,049,935
Liabilities		
Unpaid losses and loss expenses	7,152,724	6,956,521
Future policy benefits	695,962	390,967
Unearned premiums	1,140,311	1,090,020
Reinsurance balances payable	302,417	297,206
Securities lending payable	566,507	503,260
Amounts due to affiliates	54,597	51,394
Payable for securities purchased	39,035	25,948
Dividend payable	0	300,000
Accounts payable, accrued expenses and other liabilities	37,983	817
Total liabilities	9,989,536	9,616,133
Shareholder's equity		
ACE Tempest Reinsurance Ltd. shareholder's equity		
Common shares (\$10 par value, 10,000,000 authorized 280,000 issued and outstanding)	2,800	2,800
Additional paid-in capital	2,472,332	2,182,335
Retained earnings	4,926,860	3,606,958
Accumulated other comprehensive income	524,333	274,359
Total ACE Tempest Reinsurance Ltd. shareholder's equity	7,926,325	6,066,452
Noncontrolling interest	413,321	367,350
Total equity	8,339,646	6,433,802
Total liabilities and shareholder's equity	18,329,182	16,049,935

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

ACE Tempest Reinsurance Ltd. and its subsidiaries

Consolidated Statements of Operations and Other Comprehensive Income

For the years ended December 31, 2010 and 2009

(in thousands of U.S. dollars)

	2010 \$	2009 \$
Revenues		
Gross premiums written		
Property and casualty premiums	3,630,622	3,476,527
Life and annuity premiums	432,647	346,095
	4,063,269	3,822,622
Reinsurance premiums ceded	(626,795)	(568,234)
Net premiums written	3,436,474	3,254,388
Change in unearned premiums	(44,689)	150,581
Net premiums earned	3,391,785	3,404,969
Net investment income	570,609	559,388
Other income (expenses), net	16,433	(2,202)
Net realized gains (losses):		
Other-than-temporary impairment (OTTI) losses gross	(47,767)	(256,548)
Portion of OTTI losses recognized in other comprehensive income	21,999	91,339
Net OTTI losses recognized in income	(25,768)	(165,209)
Net realized gains (losses) excluding OTTI losses	186,969	(6,120)
Total net realized gains (losses)	161,201	(171,329)
Total revenues	4,140,028	3,790,826
Expenses		
Losses and loss expenses	1,699,633	1,555,085
Future policy benefits	10,609	13,052
Policy acquisition costs	1,062,923	1,081,219
Administrative expenses	20,566	21,120
Interest expense	154	70
Total expenses	2,793,885	2,670,546
Net Income	1,346,143	1,120,280
Less: Net income (loss) attributable to the noncontrolling interest	26,241	(21,281)
Net Income attributable to ACE Tempest Reinsurance Ltd.	1,319,902	1,141,561
Other comprehensive income		
Unrealized appreciation on investments	426,831	923,091
Reclassification adjustments for net realized losses (gains) included in net income	(160,151)	220,850
	266,680	1,143,941
Change in:		
Cumulative Translation Adjustments	(16,706)	5,895
Other comprehensive income	249,974	1,149,836
Comprehensive income	1,596,117	2,270,116
Less: Comprehensive income attributable to the noncontrolling interest	19,730	64,150
Comprehensive income attributable to ACE Tempest Reinsurance Ltd.	1,576,387	2,205,966

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

ACE Tempest Reinsurance Ltd. and its subsidiaries

Consolidated Statements of Shareholder's Equity For the years ended December 31, 2010 and 2009

(in thousands of U.S. dollars)

	2010 \$	2009 \$
Common shares		
Balance – beginning and end of year	2,800	2,800
Additional paid-in capital		
Balance – beginning of year	2,182,335	2,182,335
Change in year	289,997	-
Balance – end of year	2,472,332	2,182,335
Retained earnings		
Balance – beginning of year	3,606,958	3,089,094
Effect of adoption of OTTI standard	-	76,303
Net income	1,319,902	1,141,561
Dividends declared	-	(700,000)
Balance - end of year	4,926,860	3,606,958
Accumulated other comprehensive income (loss)		
Net unrealized appreciation (depreciation) on investments		
Balance – beginning of year	268,464	(799,174)
Effect of adoption of OTTI standard	-	(76,303)
Change in year	266,680	1,143,941
Balance - end of year	535,144	268,464
Cumulative Translation Adjustments		
Balance – beginning of year	5,895	-
Change in year	(16,706)	5,895
Balance - end of year	(10,811)	5,895
Accumulated other comprehensive income (loss)	524,333	274,359
Total shareholder's equity	7,926,325	6,066,452
Noncontrolling interest		
Balance - beginning of year	367,350	325,448
Contributions by holder of non-controlling interest	-	(967)
Net income (loss)	26,241	(21,281)
Change in year - unrealized appreciation	19,730	64,150
Total noncontrolling equity	413,321	367,350

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

ACE Tempest Reinsurance Ltd. and its subsidiaries

Consolidated Statements of Cash Flows

For the years ended December 31, 2010 and 2009

(in thousands of U.S. dollars)

	2010 \$	2009 \$
Cash flows from (used for) operating activities		
Net income	1,346,143	1,120,280
Adjustments to reconcile net income to net cash flows from operating activities:		
Net realized losses (gains)	(161,201)	171,329
Amortization of premiums/discounts on fixed maturities	10,588	(8,235)
Unpaid losses and loss expenses, net of reinsurance recoverable	111,202	21,929
Future policy benefits, net of reinsurance recoverable	293,215	13,052
Unearned premiums	45,992	(151,910)
Reinsurance balances payable	5,287	123,716
Amounts due to affiliates	15,651	(50,773)
Accounts payable, accrued expenses, other liabilities and funds withheld	6,313	(21,950)
Reinsurance balances receivable	(349,044)	(79,011)
Prepaid reinsurance premiums	(1,289)	3,682
Accrued investment income	(8,979)	(24,282)
Deferred policy acquisition costs	4,802	55,094
Value of reinsurance business assumed	15,096	19,733
Amounts due from affiliates	3,202	44,885
Other	(60,991)	45,916
Net cash flows from operating activities	1,275,987	1,283,455
Cash flows from (used for) investing activities		
Purchases of fixed maturities (available for sale and held to maturity)	(9,123,011)	(10,887,922)
Purchase of equity securities	(678,139)	(45,791)
Sales of fixed maturities available for sale	7,400,098	9,137,139
Sales of equity securities	451,574	86,118
Maturities and redemptions of fixed maturities available for sale	848,331	812,780
Maturities and redemptions of fixed maturities held to maturity	77,595	32,836
Net proceeds (disbursements) from the settlement of derivatives and other investments	21,844	(19,524)
Purchases of other investments, net	(79,413)	(37,152)
Net cash flows (used for) investing activities	(1,081,121)	(921,516)
Cash flows from (used for) financing activities		
Noncontrolling interest financing	-	(967)
Dividends paid	(300,000)	(400,000)
Contributed capital	289,997	-
Net cash flows (used for) financing activities	(10,003)	(400,967)
Effect of foreign currency rate change on cash and cash equivalents	554	2,189
Net increase (decrease) in cash	185,417	(36,839)
Cash - beginning of year	52,622	89,461
Cash - end of year	238,039	52,622
Supplemental cash flow information		
Interest paid	154	67

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

ACE Tempest Reinsurance Ltd. and its subsidiaries

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

1. *General*

ACE Tempest Reinsurance Ltd. (“the Company” or “ATR”) was incorporated under the laws of Bermuda on February 22, 1996 and is a wholly-owned subsidiary of ACE Tempest Life Reinsurance Ltd. (“ATLR”). The Company’s ultimate parent company is ACE Limited (“ACE”).

2. *Principal Business*

The Company provides property catastrophe, property, casualty and accident and health reinsurance for a diverse group of customers worldwide. For these classes of business during the year ended December 31, 2010, approximately 41 percent (2009 - 45 percent) of the Company’s gross premiums written came from North America, 32 percent (2009 - 31 percent) from Europe, 20 percent (2009 - 19 percent) from Asia and 7 percent (2009 - 5 percent) from Latin America. During 2010, the company also wrote \$432.6 million (2009 - \$346.1 million) of long duration personal accident and health and life reinsurance premiums.

3. *Significant accounting policies:*

(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 for such periods. 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 loss and loss expense reserves and future policy benefits reserves;
- value of reinsurance business assumed;
- reinsurance recoverable, including a provision for uncollectible reinsurance;
- the assessment of risk transfer for certain reinsurance contracts;
- the valuation of the investment portfolio and assessment of OTTI;
- the valuation of certain derivatives; and
- the valuation of goodwill.

Amounts included in the consolidated financial statements reflect the Company’s best estimates and assumptions; actual amounts could differ materially from these estimates.

(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 current 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.

ACE Tempest Reinsurance Ltd. and its subsidiaries

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

For property and casualty (P&C) reinsurance products, premiums written are primarily earned on a pro-rata basis over the terms of the policies to which they relate. Unearned premiums represent the portion of premiums written applicable to the unexpired portion of the policies in force.

Mandatory reinstatement premiums assessed on reinsurance policies are earned in the period of the loss event that gave rise to the reinstatement premiums. All remaining unearned premiums are recognized over the remaining coverage period.

Premiums from long duration contracts such as certain long duration personal accident and health (A&H) policies are generally recognized as revenue when due from policyholders. Benefits and expenses are matched with such income to result in the recognition of profit over the life of the contracts.

Retroactive loss portfolio transfer (LPT) contracts in which the insured loss events occurred prior to the inception of the contract are evaluated to determine whether they meet the established criteria for reinsurance accounting. If reinsurance accounting is appropriate, written premiums are fully earned and corresponding losses and loss expenses recognized at the inception of the contract. The contracts can cause significant variances in gross premiums written, net premiums written, net premiums earned, and net incurred losses in the years in which they are written.

(c) **Policy acquisition costs**

Policy acquisition costs consist of commissions, premium taxes, and underwriting and other costs that vary with, and are primarily related to, the production of premium. Policy acquisition costs are deferred and amortized. Policy acquisition costs on P&C contracts are generally amortized ratably over the period in which premiums are earned. Policy acquisition costs on long duration contracts are amortized over the estimated life of the contracts in proportion to premium revenue recognized. Policy acquisition costs are reviewed to determine if they are recoverable from future income, including investment income. Unrecoverable costs are expensed in the period identified.

(d) **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, 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.

Reinsurance recoverable 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 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

ACE Tempest Reinsurance Ltd. and its subsidiaries

Notes to Consolidated Financial Statements

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assets held in trust, letters of credit, and liabilities held by the Company with the same legal entity for which it believes there is a contractual 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. The more significant considerations include, but are not necessarily limited to, the following:

- For reinsurers that maintain a financial strength rating from a major rating agency, and for which recoverable balances are considered representative of the larger population (i.e., default probabilities are consistent with similarly rated reinsurers and payment durations conform to averages), the financial rating is based on a published source and the default factor is based on published default statistics of a major rating agency applicable to the reinsurer's particular rating class. When a recoverable is expected to be paid in a brief period of time by a highly rated reinsurer, such as certain property catastrophe claims, a default factor may not be applied;
- For balances recoverable from reinsurers that are both unrated by a major rating agency and for which management is unable to determine a credible rating equivalent based on a parent, affiliate, or peer company, the Company determines a rating equivalent based on an analysis of the reinsurer that considers an assessment of the creditworthiness of the particular entity, industry benchmarks, or other factors as considered appropriate. The Company then applies the applicable default factor for that rating class. For balances recoverable from unrated reinsurers for which the ceded reserve is below a certain threshold, the Company generally applies a default factor of 25 percent, consistent with published statistics of a major rating agency;
- For balances recoverable from reinsurers that are either insolvent or under regulatory supervision, the Company establishes a default factor and resulting provision for uncollectible reinsurance based on reinsurer-specific facts and circumstances. Upon initial notification of an insolvency, the Company generally recognizes expense for a substantial portion of all balances outstanding, net of collateral, through a combination of write-offs of recoverable balances and increases to the provision for uncollectible reinsurance. When regulatory action is taken on a reinsurer, the Company generally recognizes a default factor by estimating an expected recovery on all balances outstanding, net of collateral. When sufficient credible information becomes available, the Company adjusts the provision for uncollectible reinsurance by establishing a default factor pursuant to information received; and
- For other recoverables, management determines the provision for uncollectible reinsurance based on the specific facts and circumstances of that dispute.

The methods used to determine the reinsurance recoverable balance and related provision for uncollectible reinsurance are regularly reviewed and updated and any resulting adjustments are reflected in earnings in the period identified.

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

The value of reinsurance business assumed represents the excess of estimated ultimate value of the liabilities assumed under retroactive reinsurance contracts over consideration received. The value of reinsurance business assumed is amortized and recorded to losses and loss expenses based on the payment pattern of the losses assumed and ranges between 5 and 40 years. The unamortized value is reviewed regularly to determine if it is recoverable based upon the terms of the contract, estimated losses and loss expenses, and anticipated investment income. Unrecoverable amounts are expensed in the period identified.

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December 31, 2010 and 2009

(e) **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 represent investments in hedge funds and private equity investments, made through the investment vehicles Oasis Investments Limited and Oasis Investments 2 Ltd (collectively "Oasis Investments"). The Company is the majority shareholder in Oasis Investments and has the ability to exercise control, and as such, the results of operations and related assets and liabilities of Oasis Investments are consolidated. The non-majority ownership in Oasis Investments is reported as noncontrolling interest in the Consolidated Balance Sheets and Statements of Operations and Other Comprehensive Income. Other investments also include a partially-owned insurance company. Investments in the partially-owned insurance company primarily represent a direct investment in which the Company has significant influence and, as such, meet the requirements for equity accounting. The Company reports its share of the net income or loss of the partially-owned insurance company in Other income (expense). Other investments for which the Company cannot exercise 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 in shareholders' equity. The Company regularly reviews its investments for OTTI. Refer to Note 4.

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 (e.g., 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 uses derivative instruments including futures, options, swaps, and foreign currency forward contracts for the purpose of managing certain investment portfolio risks 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 together with amortization of fixed maturity market premiums and discounts and is net of investment management and custody fees. For mortgage-backed securities, and any 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 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

ACE Tempest Reinsurance Ltd. and its subsidiaries

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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 related liability reflecting the Company's obligation to return the collateral plus interest. The fair value of the total assets fell below the corresponding liability as at December 31, 2010 and 2009. This is considered a temporary decline and is recognized in other comprehensive income.

Refer to Note 10 for a discussion on the determination of fair value for the Company's various investment securities.

(f) **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.

(g) **Goodwill**

Goodwill represents the excess of the cost of acquisitions over the fair value of net assets acquired and is not amortized. Goodwill is assigned at acquisition to the applicable reporting unit of the acquired entities giving rise to the goodwill. Goodwill impairment tests are performed annually, or more frequently if circumstances indicate a possible impairment. The Company estimates a reporting unit's fair value using a consistently applied combination of the following models: an earnings multiple, a book value multiple or a discounted cash flow. The Company's earnings and book value models apply multiples of comparable publicly traded companies to forecasted earnings or book value of each reporting unit and consider current market transactions. The discounted cash flow model applies a discount to estimated cash flows including a terminal value calculation. Where appropriate, the Company considers the impact of a control premium. No impairment in goodwill was determined in 2010 or 2009.

(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 incurred but not reported (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 the recorded amounts. The Company does not discount its property and casualty loss reserves.

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

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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.

(i) **Future policy benefits**

The development of long duration contract reserves requires management to make estimates and assumptions regarding expenses, mortality, persistency, and investment yields. Such estimates are primarily based on historical experience and information provided by ceding companies and include a margin for adverse deviation. Interest rates used in calculating reserves range from one percent to seven percent at December 31, 2010 and 2009. Actual results could differ materially from these estimates. Management monitors actual experience, and where circumstances warrant, will revise its assumptions and the related reserve estimates. Revisions are recorded in the period they are determined.

(j) **Foreign currency remeasurement and translation**

The Company determines the functional currency for each of its operations, which is generally the currency of the operating environment. Transactions in currencies other than the operation's functional currency are remeasured into the functional currency and the resulting foreign exchange gains and losses are reflected in Net realized gains (losses) in the consolidated statements of operations. Functional currency assets and liabilities are translated into the reporting currency, U.S. dollars, using period end rates of exchange and the related translation adjustments are recorded as a separate component of AOCI. Functional statement of operations amounts expressed in functional currencies are translated using average exchange rates. Gains and losses resulting from foreign currency transactions are recorded in Net realized gains (losses).

(k) **Administrative expenses**

Administrative expenses generally include all operating costs other than policy acquisition costs.

(l) **Cash flow information**

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 statement of cash flows. Purchases, sales, and maturities of short-term investments are recorded net for purposes of the consolidated statements of cash flows and are classified with cash flows related to fixed maturities.

(m) **Derivatives**

The Company recognizes all derivatives at fair value in the consolidated balance sheets. The Company participates in derivative instruments in one principal way as follows:

- (i) To mitigate our own financial risks, principally arising from our 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 statement of operations.

During 2010 and 2009, the Company did not designate any derivatives as hedges.

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(n) **Share-based compensation**

The Company receives an allocation of share based compensation costs from its ultimate parent, ACE Limited. ACE Limited measures and records compensation cost for all share-based payment awards at grant-date fair value. Compensation costs are recognized for share-based payment awards with only service conditions that have graded vesting schedules on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

(o) **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 Accounting Standards Codification (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.

To be adopted after 2010

Accounting for costs associated with acquiring or renewing insurance contracts

In October 2010, the Financial Accounting Standards Board (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 interim and annual reporting periods beginning on January 1, 2012, and may be applied prospectively or retrospectively. The Company is in the process of assessing the impact that the implementation of ASU 2010-26 will have on its financial condition and results of operations.

4. **Investments:**

(a) **Transfers of securities**

As part of the Company's fixed income diversification strategy, ACE has decided to hold certain additional securities to maturity. Because the Company has the intent to hold these securities to maturity, transfers of such securities with a total fair value of \$87.5 million were made during the third and fourth quarters of 2010 from Fixed maturities available for sale to Fixed maturities held to maturity. The net unrealized appreciation at the date of the transfer continues to be reported as a component of AOCI and is being amortized over the remaining life of the securities as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

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(b) **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 OTTI recognized in Accumulated other comprehensive income.

	2010				
	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value	OTTI Recognized in Accumulated Other Comprehensive Income
	(in thousands of U.S. dollars)				
<u>Available for sale</u>					
U.S. Treasury and agency	\$ 703,415	\$ 17,499	\$ (5,850)	\$ 715,064	\$ -
Foreign	3,051,926	127,224	(25,001)	3,154,149	(10,410)
Corporate securities	4,964,168	353,233	(15,255)	5,302,146	(1,923)
Mortgage-backed securities	2,521,255	68,177	(66,706)	2,522,726	(69,417)
States, municipalities, and political subdivisions	139,619	1,706	(2,023)	139,302	-
	<u>\$ 11,380,383</u>	<u>\$ 567,839</u>	<u>\$ (114,835)</u>	<u>\$ 11,833,387</u>	<u>\$ (81,750)</u>
<u>Held to maturity</u>					
U.S. Treasury and agency	24,408	1,863	-	26,271	-
Foreign	7,268	250	-	7,518	-
Corporate securities	76,085	3,935	(35)	79,985	-
Mortgage-backed securities	190,368	5,344	(705)	195,007	-
States, municipalities, and political subdivisions	4,165	178	-	4,343	-
	<u>\$ 302,294</u>	<u>11,570</u>	<u>(740)</u>	<u>313,124</u>	<u>\$ -</u>

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	2009				
	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value	OTTI Recognized in Accumulated Other Comprehensive Income
	(in thousands of U.S. dollars)				
<u>Available for sale</u>					
U.S. Treasury and agency	\$ 1,157,404	\$ 10,257	\$ (7,961)	\$ 1,159,700	\$ -
Foreign	2,607,716	106,663	(52,695)	2,661,684	(13,249)
Corporate securities	4,322,684	271,058	(33,487)	4,560,255	(9,812)
Mortgage-backed securities	2,468,805	63,599	(121,711)	2,410,693	(74,055)
States, municipalities, and political subdivisions	57,537	926	(1,248)	57,215	-
	<u>\$ 10,614,146</u>	<u>\$ 452,503</u>	<u>\$ (217,102)</u>	<u>\$ 10,849,547</u>	<u>\$ (97,116)</u>
<u>Held to maturity</u>					
U.S. Treasury and agency	53,356	2,465	-	55,821	-
Foreign	9,497	372	-	9,869	-
Corporate securities	93,481	3,414	(575)	96,320	-
Mortgage-backed securities	132,591	3,192	(694)	135,089	-
States, municipalities, and political subdivisions	5,051	177	-	5,228	-
	<u>\$ 293,976</u>	<u>\$ 9,620</u>	<u>\$ (1,269)</u>	<u>\$ 302,327</u>	<u>\$ -</u>

As discussed in Note 4 (e), if a credit loss is indicated on an impaired fixed maturity investment, an OTTI is considered to have occurred and the portion of the impairment not related to credit losses (non-credit OTTI) is recognized in Other comprehensive income. Included in "OTTI Recognized in Accumulated Other Comprehensive Income" is the cumulative amount of non-credit OTTI recognized in comprehensive income adjusted for subsequent sales, maturities, and redemptions. "OTTI Recognized in Accumulated Other Comprehensive Income" does not include the impact of subsequent changes in fair value of the related securities. In periods subsequent to a recognition of OTTI in Other comprehensive income, changes in the fair value of the related fixed maturity investments are reflected in Unrealized appreciation (depreciation) in the consolidated statement of shareholders' equity. For the year ended December 31, 2010 and 2009, \$46 million and \$80 million, respectively, of net unrealized appreciation related to such securities is included in Other comprehensive income. At December 31, 2010 and 2009, Accumulated other comprehensive income includes net unrealized depreciation of \$19 million and \$32 million, respectively, 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 81 percent and 74 percent of the total mortgage-backed securities at December 31, 2010 and 2009, 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.

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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		2009	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(in thousands of U.S. dollars)			
<u>Available for sale; maturity period</u>				
Due in 1 year or less	\$ 397,763	\$ 392,202	\$ 189,615	\$ 185,282
Due after 1 year through 5 years	3,964,177	3,794,430	4,468,194	4,334,242
Due after 5 years through 10 years	4,279,300	4,026,357	3,138,250	2,966,184
Due after 10 years	669,421	646,139	642,795	659,633
	<u>9,310,661</u>	<u>8,859,128</u>	<u>8,438,854</u>	<u>8,145,341</u>
Mortgage-backed securities	2,522,726	2,521,255	2,410,693	2,468,805
	<u>\$ 11,833,387</u>	<u>\$ 11,380,383</u>	<u>\$ 10,849,547</u>	<u>\$ 10,614,146</u>
<u>Held to maturity; maturity period</u>				
Due in 1 year or less	\$ 31,123	\$ 30,401	\$ 48,663	\$ 47,990
Due after 1 year through 5 years	83,125	77,701	110,141	104,786
Due after 5 years through 10 years	457	449	6,302	6,335
Due after 10 years	3,412	3,375	2,132	2,274
	<u>118,117</u>	<u>111,926</u>	<u>167,238</u>	<u>161,385</u>
Mortgage-backed securities	195,007	190,368	135,089	132,591
	<u>\$ 313,124</u>	<u>\$ 302,294</u>	<u>\$ 302,327</u>	<u>\$ 293,976</u>

(c) 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	343,808	108,025
Gross unrealized appreciation	8,232	2,698
Gross unrealized depreciation	(15)	(572)
Equity securities – fair value	<u>352,025</u>	<u>110,151</u>

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(d) Other investments

The following table presents Other investments at December 31, 2010 and 2009.

(in thousands of U.S. dollars)	Ownership Percentage	2010		2009	
		Fair Value	Cost	Fair Value	Cost
Oasis Investments Limited and Oasis Investments 2 Ltd	66.6%	1,252,007	1,151,968	1,055,524	994,946
Huatai Insurance Company	9.6%	104,294	102,546	99,788	96,514
		1,356,301	1,254,514	1,155,312	1,091,460

Oasis Investments Limited and Oasis Investments 2 Ltd are consolidated in these financial statements as the Company owns 66.6%. The hedge funds and private equity investments are made through the investment vehicles Oasis Investments Limited and Oasis Investments 2 Ltd. There has been no change in the ownership percentages held during 2010.

(e) Net realized gains (losses)

The Company adopted provisions included in ASC 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. 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 other comprehensive income. For fixed maturities held to maturity, OTTI recognized in other comprehensive income is accreted from accumulated other comprehensive income 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 newly adopted 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 Accumulated other comprehensive income and an increase to Retained earnings of \$76.3 million as at April 1, 2009. These adjustments reflect the net amount of 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 provisions of Topic 320 as described above. The factors that the Company considers when determining if a credit loss exists related to a fixed

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maturity are discussed in “Evaluation of potential credit losses related to fixed maturities” below. Prior to the adoption, when 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 approximately \$25.8 million and \$19.5 million of gross unrealized loss at December 31, 2010 and 2009, respectively. 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

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conditions. The following table presents default assumptions by Moody's rating category (historical mean default rate provided for comparison).

Moody's Rating Category	1-in-100 Year Default Rate	Historical Mean Default Rate
<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%

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 of \$6.1 million and \$17.8 million for December 31, 2010 and 2009, respectively.

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

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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.

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%

⁽¹⁾ Prime, ALT-A, and Sub-prime sector bonds are categorized based on creditworthiness of the borrower. Option ARM sector bonds are categorized based on the type of mortgage product, rather than creditworthiness 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 of \$5.9 million and \$31.1 million for December 31, 2010 and 2009, respectively.

The following table presents, for the years ended December 31, 2010 and 2009 the Net realized gains (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.

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	<u>2010</u>	<u>2009</u>
Fixed maturities:		
OTTI on fixed maturities, gross	\$ (34,029)	\$ (175,196)
OTTI on fixed maturities recognized in other comprehensive income (pre-tax)	<u>21,999</u>	<u>91,339</u>
OTTI on fixed maturities, net	(12,030)	(83,857)
Gross realized gains excluding OTTI	222,675	187,592
Gross realized losses excluding OTTI	<u>(47,513)</u>	<u>(283,946)</u>
Total fixed maturities	<u>163,132</u>	<u>(180,211)</u>
<u>Equity securities:</u>		
OTTI on equity securities	(285)	(1,849)
Gross realized gains excluding OTTI	10,255	3,946
Gross realized losses excluding OTTI	<u>(711)</u>	<u>(23,970)</u>
Total equity securities	<u>9,259</u>	<u>(21,873)</u>
OTTI on other investments	(13,453)	(79,503)
Foreign exchange gains (losses)	(22,139)	(18,187)
Derivative instruments	23,189	67,644
Other	<u>1,213</u>	<u>60,801</u>
Net realized gains (losses)	<u>161,201</u>	<u>(171,329)</u>
Change in net unrealized appreciation (depreciation) on investments:		
Fixed maturities available for sale	211,813	960,767
Fixed maturities held to maturity	7,183	(13)
Equity securities	4,520	24,869
Other	<u>43,164</u>	<u>82,015</u>
Change in net unrealized appreciation (depreciation) on investments	<u>266,680</u>	<u>1,067,638</u>
Total net realized gains (losses) and change in net unrealized appreciation (depreciation) on investments	<u>\$ 427,881</u>	<u>\$ 896,309</u>

The following table presents, for the year ended December 31, 2010, and for the nine month period from the date of adoption of the then 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 Other comprehensive income.

	<u>Year Ended December 31, 2010</u>	<u>Nine Months Ended December 31, 2009</u>
	(in thousands of U.S. dollars)	
Balance of credit losses related to securities still held-beginning of period	\$ 77,796	\$ 57,508
Additions where no OTTI was previously recorded	8,053	42,505
Additions where an OTTI was previously recorded	3,972	6,381
Reductions reflecting amounts previously recorded in OCI but subsequently reflected in net income	-	-
Reductions for securities sold during the period	<u>(33,152)</u>	<u>(28,598)</u>
Balance of credit losses related to securities still held-end of period	<u>\$ 56,669</u>	<u>\$ 77,796</u>

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(f) **Gross unrealized loss**

At December 31, 2010, there were 963 fixed maturities out of a total of 5,436 fixed maturities in an unrealized loss position. The largest single unrealized loss in the fixed maturities was \$3.0 million. Fixed maturities in an unrealized loss position at December 31, 2010, were comprised of both investment grade 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.

As at 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	\$ 168,366	(5,850)	-	-	168,366	(5,850)
Foreign bonds	700,595	(12,460)	88,236	(12,541)	788,831	(25,001)
Corporate securities	463,893	(8,687)	40,115	(6,603)	504,008	(15,290)
Mortgage-backed securities	857,164	(17,400)	241,946	(50,011)	1,099,110	(67,411)
States, municipalities, and political subdivisions	49,042	(1,314)	1,662	(709)	50,704	(2,023)
Total fixed maturities	2,239,060	(45,711)	371,959	(69,864)	2,611,019	(115,575)
Equity securities	9	(15)	-	-	9	(15)
Other investments	44,182	(5,800)	-	-	44,182	(5,800)
Total	\$ 2,283,251	(51,526)	371,959	(69,864)	2,655,210	(121,390)

As at 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	\$ 609,895	(7,097)	17,370	(864)	627,265	(7,961)
Foreign bonds	744,789	(44,363)	80,174	(8,332)	824,963	(52,695)
Corporate securities	364,384	(16,022)	205,012	(18,056)	569,396	(34,078)
Mortgage-backed securities	318,363	(11,388)	423,732	(111,017)	742,095	(122,405)
States, municipalities, and political subdivisions	13,645	(620)	4,548	(628)	18,193	(1,248)
Total fixed maturities	2,051,076	(79,490)	730,836	(138,897)	2,781,912	(218,387)
Equity securities	103,656	(572)	0	0	103,656	(572)
Other investments	53,800	(10,900)	0	0	53,800	(10,900)
Total	\$ 2,208,532	(90,962)	730,836	(138,897)	2,939,368	(229,859)

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(g) **Net investment income**

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

(in thousands of U.S. dollars)	<u>2010</u>	<u>2009</u>
Fixed maturities	579,038	\$547,056
Short-term investments	86	4,265
Equity securities	8,614	16,028
Other investments	27,363	24,735
Investment (expense) income from affiliates	971	3,718
Gross investment income	<u>616,072</u>	<u>595,802</u>
Investment expenses	(45,463)	(36,414)
Net investment income	<u>570,609</u>	<u>559,388</u>

(h) **Restricted Assets**

The Company is required to maintain assets on deposit with various regulatory authorities to support its reinsurance operations. These requirements are generally promulgated in the statutory regulations of the individual jurisdictions. The assets on deposit are available to settle reinsurance liabilities. The Company also utilizes trust funds in certain transactions where the trust funds are set up for the benefit of the ceding companies and generally take the place of Letter of Credit (“LOC”) requirements. The Company also has investments in segregated portfolios primarily to provide collateral or guarantees for LOCs and derivative transactions. Included in restricted assets at December 31, 2010, are fixed maturities totaling \$4,763.7 million and cash of \$11.2 million. The following table presents the components of the restricted assets at December 31, 2010 and 2009.

(in thousands of U.S. dollars)	<u>2010</u>	<u>2009</u>
Deposits with non-U.S. regulatory authorities	57,470	47,327
Trust funds	4,696,220	5,103,453
Other pledged assets	21,172	274,294
	<u>4,774,862</u>	<u>5,425,074</u>

In addition, the Company also utilizes a floating charge over certain assets for the benefit of a ceding company. Under the agreement, the Company would be required to secure assets in a trust for the benefit of the ceding company upon certain triggering events, including a rating downgrade below “A” by Standard and Poor’s. The maximum amount of the floating charge through December 31, 2011 is \$250 million.

5. *Unpaid losses and loss expenses*

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 P&C 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

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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 following table presents a reconciliation of unpaid losses and loss expenses for the years ended December 31, 2010 and 2009.

(in thousands of U.S. dollars)	<u>2010</u>	<u>2009</u>
Gross unpaid losses and loss expenses at beginning of year	\$6,956,521	\$6,828,632
Reinsurance recoverable	(877,217)	(808,418)
Net unpaid losses and loss expenses at beginning of year	<u>6,079,304</u>	<u>6,020,214</u>
Net losses and loss expenses incurred in respect of losses occurring in:		
Current year	1,889,486	1,746,514
Prior years	(189,853)	(191,429)
Total	<u>1,699,633</u>	<u>1,555,085</u>
Net losses and loss expenses paid in respect of losses occurring in:		
Current year	490,113	373,954
Prior years	1,114,821	1,249,764
Total	<u>1,604,934</u>	<u>1,623,718</u>
Foreign currency revaluation	(23,559)	127,723
Other movements on losses and loss expenses	(1,732)	-
	<u>(25,291)</u>	<u>127,723</u>
Net unpaid losses and loss expenses at end of year	6,148,712	6,079,304
Reinsurance recoverable	1,004,012	877,217
Gross unpaid losses and loss expenses at end of year	<u>7,152,724</u>	<u>6,956,521</u>

Net losses and loss expenses incurred includes \$190 million and \$191 million of net favorable prior period development in the years ended December 31, 2010 and 2009, respectively. These developments followed a detailed review by the actuaries and reflected lower reported claim development than previously anticipated.

Much of the business written or assumed by Tempest is long-tailed in nature (e.g., Workers' Compensation and Professional Lines) and can exhibit a high degree of variability. Furthermore, many of the lines of business written by Tempest have grown significantly over the past several years as compared to the volume of business written in the early- to mid-2000's. The nature of the business written coupled with the relative immaturity of the business can expose the reserves to a higher-than-normal degree of uncertainty and the ultimate losses may be materially different.

In 2010, significant developments generating this result include favorable developments of \$139 million across long-tailed lines of business with favorable development coming from various accident years due to better than expected claims emergence and favorable claim settlements. In addition, there was favorable development of \$50 million in short-tailed lines primarily arising from 2007 to 2009 accident years, also due to lack of emergence of newly reported claims and favorable development on known claims.

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In 2009, the significant developments generating the results were from net favorable developments of \$96 million across long-tailed lines of business with favorable development coming from 2006 and prior accident years due to better than expected claims emergence and claim settlements. In addition, there was favorable development of \$87 million in short-tailed lines arising from various accident years, due to lower than expected development of known claims.

6. Reinsurance

The Company purchases reinsurance to manage various exposures including catastrophic 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. The amounts for net premiums written and net premiums earned in the consolidated statements of operations are net of reinsurance. The following table presents net earned amounts for the years ended December 31, 2010 and 2009.

(in thousands of U.S. dollars)	2010	2009
Premiums earned		
Assumed	\$4,017,292	\$3,976,886
Ceded	(625,507)	(571,917)
Net	<u>\$3,391,785</u>	<u>\$3,404,969</u>

The following table presents the composition of the Company's reinsurance recoverable on losses and loss expenses at December 31, 2010 and 2009.

(in thousands of U.S. dollars)	2010	2009
Reinsurance recoverable on paid losses and loss expenses, net of a provision for uncollectible reinsurance	\$19,120	\$17,765
Reinsurance recoverable on unpaid losses and loss expenses, net of a provision for uncollectible reinsurance	1,004,012	877,217
Reinsurance recoverable on future policy benefits	8,195	-
Net reinsurance recoverable	<u>\$1,031,327</u>	<u>\$894,982</u>

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 provision for uncollectible reinsurance is required principally due to the failure of reinsurers to indemnify the Company, primarily because of disputes under reinsurance contracts and insolvencies. Provisions have been established for amounts estimated to be uncollectible. At December 31, 2010 and 2009, the Company recorded a provision for uncollectible reinsurance of \$15.7 million and \$18.4 million, respectively.

The following tables present 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 shareholders' 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 underlying matter, credit and collateral analysis, and consideration of the Company's collection experience in similar situations.

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(in thousands of U.S. dollars)	2010	2009
Largest reinsurers	\$347,727	\$438,797
Other reinsurers balances rated A- or better	632,069	401,571
Other reinsurers with ratings lower than A-	51,531	54,614
Total	\$1,031,327	\$894,982

Largest Reinsurers

Transatlantic Holdings

Partner Re

Munich Re Group

Hannover Rueckversicherungs AG

7. *Related party business*

The Company reinsures a number of affiliates for property, casualty, marine, accident and health risks. The business has been ceded on an excess of loss and a quota share basis. The related statement of operations and balance sheet account balances for the years ended December 31, 2010 and 2009 have been affected by these intercompany reinsurance agreements as follows:

(in thousands of U.S. dollars)	2010	2009
Gross premiums written	3,685,425	\$3,484,032
Net premiums earned	3,071,468	3,124,578
Losses and loss expenses	1,618,243	1,558,441
Future Policy Benefits	2,414	13,052
Policy acquisition costs	1,036,123	1,056,985
Reinsurance balances receivable	858,366	527,052
Prepaid reinsurance premiums	536	626
Reinsurance recoverable	6,100	1,560
Reinsurance recoverable on future policy benefits	8,195	-
Deferred policy acquisition costs	112,343	120,085
Value of reinsurance business assumed	282,761	297,857
Unpaid losses and loss expenses	6,971,409	6,792,541
Future policy benefits	687,767	390,967
Unearned premiums	1,053,750	999,652
Reinsurance balances payable	265,168	273,391

The loan to affiliate (ATLR) has no fixed terms of repayment and bears interest at a rate of 3.2%, receivable quarterly in arrears on the last day of March, June, September and December. The loan to affiliate balance was \$133.2 million and \$129.0 million as at December 31, 2010 and 2009 respectively and there was net intercompany interest income of \$1 million and \$3.7 million as at December 31, 2010 and 2009, respectively.

In addition, there are amounts due from related parties of \$130.4 million and \$146.1 million and due to related parties of \$54.6 million and \$51.4 million as at December 31, 2010 and 2009, respectively.

As at December 31, 2009, there is a dividend payable to the parent company, ATLR, of \$300 million. There is no dividend payable as at December 31, 2010.

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The noncontrolling interest in Oasis Investments is held by a related party.

8. Commitments, contingencies and guarantees

(a) Derivative Instruments

The Company maintains positions in derivative instruments such as futures, options, swaps, and foreign currency forward contracts for which the primary purposes are to manage duration and foreign currency exposure, yield enhancement, or 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 convertible bond investments that contain embedded derivatives. In addition, the Company purchases TBAs as part of its investing activities. These securities are included within the Company's fixed maturities available for sale (FM AFS) portfolio.

The Company carries all derivative instruments at fair value with changes in fair value recorded in Net realized gains (losses) in the consolidated statements of operations. None of the derivative instruments are used as hedges for accounting purposes.

The following table presents the balance sheet locations, 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.

	Consolidated Balance Sheet Location	2010		2009	
		Fair Value	Notional Value	Fair Value	Notional Value
(in thousands of U.S. dollars)					
Total rate of return swaps	AP	\$ -	17,350	\$ -	17,350
Future contracts on money market instruments	AP	2,776	2,803,500	2,125	1,440,500
Future contracts on notes and bonds	AP	(2,060)	223,800	(1,297)	209,500
Options on money market instruments	AP	-	-	(34)	42,030
Options on notes and bond futures	AP	-	-	(123)	223,500
Foreign exchange forward contracts	AP	2,988	348,903	6,680	283,397
Convertible Bonds	FM AFS	349,164	309,204	297,477	659,266
TBAs	FM AFS	-	-	8,090	7,900
Total		\$ 352,868	3,702,757	\$ 312,918	2,883,443

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

Derivative instrument objectives

(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.

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(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.

Interest rate swaps

An interest rate swap is a contract between two counterparties in which interest payments are made based on a notional principal amount, which itself is never paid or received. Under the terms of an interest rate swap, one counterparty makes interest payments based on a fixed interest rate and the other counterparty's payments are based on a floating rate. Interest rate swap contracts are used occasionally in the investment portfolio as protection against unexpected shifts in interest rates, which would affect the fair value of the fixed maturity portfolio. By using interest rate swaps in the portfolio, the overall duration or interest rate sensitivity of the portfolio can be reduced. The Company also employs interest rate swaps related to certain debt issuances for the purpose of either fixing and/or reducing borrowing costs.

(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) To be announced mortgage-backed securities (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.

(v) Total rate of return (TROR) swap

A TROR swap is a contract between two counterparties in which payments are made based on a notional principal amount, which itself is never paid or received. The company has contracted to swap a short-term money market rate in return for the return on a selected group of catastrophe bonds. The interest rate paid and the coupon received are both fixed spreads over LIBOR resulting in no basis risk. In the event that there are any changes in fair market value of the selected group of catastrophe bonds, the increase or decrease is received from or paid to the counterparty. At December 31, 2010 and 2009, the notional principal amounts were \$17 million, respectively. Gains or losses on these transactions are recognized in net realized gains (losses).

The credit risk associated with the above derivative financial instruments relates to the potential for non-performance of counterparty. Non-performance is not anticipated; however, in order to minimize the risk of loss, management monitors the creditworthiness of its counterparty.

(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

ACE and its participating subsidiaries (including the Company) have a \$500 million unsecured revolving credit facility expiring in November 2012, available for general corporate purposes and the issuance of LOCs. At December 31, 2010, ACE had outstanding borrowings against this facility included in Short-term debt totaling \$300 million. Outstanding LOCs issued under this facility were \$70 million at December 31, 2010. This facility requires that ACE and/or certain of its subsidiaries (including the Company) 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.

(d) Letters of Credit

ACE and its participating subsidiaries (including the Company) have a \$1 billion unsecured operational LOC facility expiring in November 2012. At December 31, 2010, \$574 million of this facility was utilized. ACE and its participating subsidiaries (including the Company) also have a \$500 million unsecured operational LOC facility expiring in September 2014. At December 31, 2010, this facility was fully utilized.

The Company is jointly liable for all drawings made by ACE or any other participating subsidiaries. These facilities require that ACE and/or certain of its subsidiaries (including the Company) 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.

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(e) **Guarantee**

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

A series of four bi-lateral Funds at Lloyd's letter of credit facilities 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 falls 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 Bermuda Insurance Ltd supported the obligations of ACE arising under certain bank loans. The bank loans were repaid and as a result the guarantees were released.

During October 2007, the Company placed \$200 million in a trust account for the benefit of an affiliated company, ACE Property and Casualty Insurance Company, to secure the affiliate's reinsurance amounts due from other reinsurance companies.

(f) **Claims and Other Litigation**

The Company may be subject to arbitration proceedings involving disputed interpretations of treaty coverage. These arbitration proceedings, involving disputed interpretations of treaty coverage and/or claims on policies issued by ceding companies, are typical to the reinsurance industry in general and in the normal course of business and are considered in the Company's loss and loss expense reserves. In addition to arbitration proceedings, the Company may be subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on assumed reinsurance treaties. This category of business litigation could involve, amongst other things, allegations of underwriting errors or misconduct, employment claims, regulatory activity or disputes arising from business ventures. In the opinion of the Company's management, the ultimate liability for these matters is not likely to have a material adverse effect on the Company's consolidated financial condition, although it is possible that the effect could be material to the Company's consolidated results of operations for an individual reporting period.

9. *Shareholder's equity*

The Company's authorized share capital is \$100,000,000 consisting of 10,000,000 Common Shares of \$10 par value. On June 19, 2006, the Company increased its share capital by the amount of \$1,550,000 by issuing 155,000 additional common shares at a price of \$10 each. The Company's issued share capital is \$2,800,000 consisting of 280,000 Common Shares of \$10 par value.

During the year ended December 31, 2010, additional paid-in capital of \$290 million was contributed to the Company by their parent company, ATR.

During the years ended December 31, 2010 and 2009, dividends amounting to \$0 million and \$700 million respectively, were declared and \$300 million and \$400 million were paid.

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10. Fair value measurements

Fair value hierarchy

The Company partially adopted the provisions (specific provisions described below) of Topic 820 on January 1, 2008. The Company fully adopted these provisions 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 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 within 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 asset 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 dependant 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. For non-public equity securities, fair values are based on market valuations and are classified within Level 2.

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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 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 the Company 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 are classified within Level 2.

Investments in partially-owned insurance companies

Fair values for investments in partially-owned insurance companies based on the 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.

Other derivative instruments

The Company maintains positions in other derivative instruments including exchange-traded equity futures contracts and option contracts designed to limit exposure to a severe equity market decline. The Company's position in exchange-traded equity futures contracts is classified within Level 1. The fair value of the majority of the Company's remaining positions in other derivative instruments is based on significant observable inputs including equity security and interest rate indices. Accordingly, these are classified within Level 2. The Company's position in credit default swaps is typically included within Level 3.

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

December 31, 2010	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)			
Assets:				
<u>Fixed maturities available for sale</u>				
U.S. Treasury and agency	\$ 330,113	\$ 384,951	\$ -	\$ 715,064
Foreign	-	3,152,743	1,406	3,154,149
Corporate securities	2,174	5,242,452	57,520	5,302,146
Mortgage-backed securities	-	2,500,942	21,784	2,522,726
States, municipalities, and political subdivisions	-	139,302	-	139,302
	<u>332,287</u>	<u>11,420,390</u>	<u>80,710</u>	<u>11,833,387</u>
<u>Fixed maturities held to maturity</u>				
U.S. Treasury and agency	1,600	24,671	-	26,271
Foreign	-	7,518	-	7,518
Corporate securities	-	79,985	-	79,985
Mortgage-backed securities	-	195,007	-	195,007
States, municipalities, and political subdivisions	-	4,343	-	4,343
	<u>1,600</u>	<u>311,524</u>	<u>-</u>	<u>313,124</u>
Equity securities	347,674	1,766	2,585	352,025
Short-term investments	158,079	114,032	-	272,111
Futures	716	-	-	716
Forwards	2,988	-	-	2,988
Other investments	-	-	1,356,301	1,356,301
Securities lending collateral	-	559,256	-	559,256
Total assets at fair value	<u>\$ 843,344</u>	<u>\$ 12,406,968</u>	<u>\$ 1,439,596</u>	<u>\$ 14,689,907</u>
Liabilities:				
Other derivative instrument	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (192)</u>	<u>\$ (192)</u>

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

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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)			
Assets:				
<u>Fixed maturities available for sale</u>				
U.S. Treasury and agency	\$ 573,975	\$ 585,725	\$ -	\$ 1,159,700
Foreign	2,260	2,647,398	12,026	2,661,684
Corporate securities	3,576	4,488,355	68,324	4,560,255
Mortgage-backed securities	-	2,410,396	297	2,410,693
States, municipalities, and political subdivisions	-	57,215	-	57,215
	<u>579,811</u>	<u>10,189,089</u>	<u>80,647</u>	<u>10,849,547</u>
<u>Fixed maturities held to maturity</u>				
U.S. Treasury and agency	3,833	51,988	-	55,821
Foreign	-	9,869	-	9,869
Corporate securities	-	96,320	-	96,320
Mortgage-backed securities	-	135,089	-	135,089
States, municipalities, and political subdivisions	-	5,228	-	5,228
	<u>3,833</u>	<u>298,494</u>	<u>-</u>	<u>302,327</u>
Equity securities	105,607	526	4,018	110,151
Short-term investments	131,408	38,780	-	170,188
Futures	828	-	-	828
Options	(157)	-	-	(157)
Forwards	6,680	-	-	6,680
Other investments	-	-	1,155,312	1,155,312
Total assets at fair value	<u>\$ 828,010</u>	<u>\$ 10,526,889</u>	<u>\$ 1,239,977</u>	<u>\$ 12,594,876</u>
Liabilities:				
Other derivative instrument	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 222</u>	<u>\$ 222</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.

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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 tables present 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 years ended December 31, 2010 and 2009.

	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
Year ended							
December 31, 2010							
Assets:							
<u>Fixed maturities</u>							
<u>available for sale</u>							
Foreign	\$ 12,026	(314)	(247)	(672)	(9,387)	1,406	-
Corporate securities	68,324	(2,151)	5,410	(415)	(13,648)	57,520	-
Mortgage-backed securities	297	-	(37)	21,524	-	21,784	-
	<u>80,647</u>	<u>(2,465)</u>	<u>5,127</u>	<u>20,437</u>	<u>(23,035)</u>	<u>80,710</u>	<u>-</u>
Equity securities	4,018	225	(437)	(1,371)	150	2,585	-
Other investments	<u>1,155,312</u>	<u>(11,804)</u>	<u>57,661</u>	<u>155,132</u>	<u>-</u>	<u>1,356,301</u>	<u>-</u>
Total assets at fair value	\$ <u>1,239,977</u>	<u>(14,044)</u>	<u>62,350</u>	<u>174,198</u>	<u>(22,885)</u>	<u>1,439,596</u>	<u>-</u>
Liabilities:							
Other derivative instrument	\$ <u>222</u>	<u>(414)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(192)</u>	<u>-</u>

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	<u>Balance- Beginning of Year</u>	<u>Net Realized Gains/ (Losses)</u>	<u>Change in Net Unrealized Gains (Losses) Included in Other Comprehensive Income</u>	<u>Purchases, Sales, and Settlements, Net</u>	<u>Transfers Into (Out of) Level 3</u>	<u>Balance-End of Year</u>	<u>Change in Net Unrealized Gains (Losses) Relating to Financial Instruments Still Held at December 31, 2009, included in Net Income</u>
Year ended							
December 31, 2009							
Assets:							
<u>Fixed maturities available for sale</u>							
Foreign	\$ 14,010	\$ 1,334	\$ 3,066	\$ (1,223)	\$ (5,161)	\$ 12,026	\$ 1,853
Corporate securities	29,461	810	6,597	26,752	4,704	68,324	705
Mortgage-backed securities	6,993	(1,343)	1,374	(150)	(6,577)	297	-
	<u>50,464</u>	<u>801</u>	<u>11,037</u>	<u>25,379</u>	<u>(7,034)</u>	<u>80,647</u>	<u>2,558</u>
Equity securities	-	69	2,043	1,906	-	4,018	-
Other investments	<u>1,057,909</u>	<u>(71,724)</u>	<u>191,471</u>	<u>(22,344)</u>	<u>-</u>	<u>1,155,312</u>	<u>(71,724)</u>
Total assets at fair value	\$ <u>1,108,373</u>	\$ <u>(70,854)</u>	\$ <u>204,551</u>	\$ <u>4,941</u>	\$ <u>(7,034)</u>	\$ <u>1,239,977</u>	\$ <u>(69,166)</u>
Liabilities:							
Other derivative instrument	\$ <u>(621)</u>	\$ <u>222</u>	\$ <u>-</u>	\$ <u>621</u>	\$ <u>-</u>	\$ <u>222</u>	\$ <u>-</u>

11. Taxation

The Company has received an undertaking from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, the Company will be exempt from taxation in Bermuda until March 2016.

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

12. Statutory financial information

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

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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.

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. In March 2011, dividends amounting to \$400 million were declared. During the first quarter of 2011, there were a number of catastrophic events including the New Zealand earthquake and the Japan earthquake and tsunami. Based on current estimates, management does not expect these events to have a significant impact to the Company's financial position.