

AUDITED FINANCIAL STATEMENTS

DaVinci Reinsurance Ltd.

December 31, 2010 and 2009

Audited Financial Statements

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December 31, 2010 and 2009

REPORT OF INDEPENDENT AUDITORS

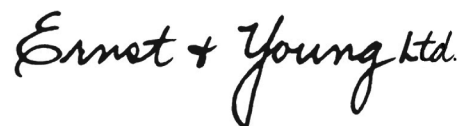
TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF
DAVINCI REINSURANCE LTD.

We have audited the accompanying balance sheets of DaVinci Reinsurance Ltd. as of December 31, 2010 and 2009, and the related statements of operations, changes in shareholders' equity and comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of DaVinci Reinsurance Ltd. at December 31, 2010 and 2009, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As described in Note 3, on April 1, 2009 the Company adopted FSP FAS 115-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (Codified in FASB ASC Topic 320, *Investments - Debt and Equity Securities*).

A handwritten signature in cursive script that reads 'Ernst & Young Ltd.'.

Hamilton, Bermuda
April 1, 2011

DAVINCI REINSURANCE LTD.

BALANCE SHEETS

AT DECEMBER 31, 2010 AND 2009
(in thousands of United States dollars)

Assets	<u>2010</u>	<u>2009</u>
Fixed maturity investments trading, at fair value (Amortized cost \$1,573,445 and \$Nil at December 31, 2010 and 2009, respectively) (Note 3)	\$ 1,582,333	\$ -
Fixed maturity investments available for sale, at fair value (Amortized cost \$1,012 and \$1,340,792 at December 31, 2010 and 2009, respectively) (Note 3)	1,022	1,346,345
Short term investments, at fair value (Note 3)	98,293	259,453
Other investments, at fair value (Note 3)	<u>56,791</u>	<u>66,418</u>
Total investments	1,738,439	1,672,216
Cash and cash equivalents	15,060	19,547
Accrued investment income	9,775	7,310
Premiums receivable (Note 8)	97,767	93,323
Prepaid reinsurance (Notes 5 and 8)	7,075	9,875
Losses recoverable (Notes 5 and 7)	-	138
Deferred acquisition costs	16,135	17,705
Receivable for investments sold	-	28
Other secured assets (Note 6)	7,125	15,616
Other assets (Notes 4 and 12)	<u>3,050</u>	<u>558</u>
Total assets	\$ <u>1,894,426</u>	\$ <u>1,836,316</u>
Liabilities and Shareholders' Equity		
Liabilities		
Reserve for claims and claim expenses (Notes 7 and 8)	\$ 232,547	\$ 194,061
Unearned premiums (Note 8)	82,571	90,593
Reinsurance balances payable (Note 8)	10,678	4,101
Amounts due to affiliates, net (Note 8)	50,021	57,495
Accounts payable and accrued liabilities	21,894	662
Other secured liabilities (Note 6)	7,000	15,500
Other liabilities (Notes 4 and 12)	<u>825</u>	<u>227</u>
Total liabilities	<u>405,536</u>	<u>362,639</u>
Shareholders' Equity (Note 9)		
Common shares: \$1.00 par value - 4,480,000 shares authorized; 3,560,615 issued and outstanding at December 31, 2010 (2009 - 3,658,525)	3,561	3,659
Additional paid-in capital	731,107	907,518
Accumulated other comprehensive income	10	5,553
Retained earnings	<u>754,212</u>	<u>556,947</u>
Total shareholders' equity	<u>1,488,890</u>	<u>1,473,677</u>
Total liabilities and shareholders' equity	\$ <u>1,894,426</u>	\$ <u>1,836,316</u>

See accompanying notes to the financial statements

DAVINCI REINSURANCE LTD.

STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in thousands of United States dollars)

	<u>2010</u>	<u>2009</u>
Revenues		
Gross premiums written (Notes 5 and 8)	\$ <u>366,691</u>	\$ <u>391,959</u>
Net premiums written (Note 5)	\$ 326,103	\$ 332,104
Increase (decrease) in net unearned premiums	<u>5,222</u>	<u>(5,345)</u>
Net premiums earned (Notes 5 and 8)	331,325	326,759
Net investment income (Note 3)	31,186	44,347
Net foreign exchange losses	(3,531)	(3,324)
Equity in earnings of RIHL (Note 3)	-	9,168
Other income (loss) (Notes 6, 8 and 12)	7	(13,004)
Net realized and unrealized gains on fixed maturity investments (Note 3)	34,886	10,911
Total other-than-temporary impairments (Note 3)	(648)	(1,089)
Portion recognized in other comprehensive income (Note 3)	<u>-</u>	<u>-</u>
Net other-than-temporary impairments (Note 3)	<u>(648)</u>	<u>(1,089)</u>
Total revenues	<u>393,225</u>	<u>373,768</u>
Expenses		
Net claims and claim expenses incurred (Notes 5, 7 and 8)	92,230	(36,529)
Acquisition expenses	38,017	40,477
Operational expenses (Note 8)	61,545	88,955
Corporate expenses	<u>1,048</u>	<u>183</u>
Total expenses	<u>192,840</u>	<u>93,086</u>
Net income	\$ <u>200,385</u>	\$ <u>280,682</u>

See accompanying notes to the financial statements

DAVINCI REINSURANCE LTD.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in thousands of United States dollars)

	<u>2010</u>	<u>2009</u>
Common shares		
Balance - January 1	\$ 3,659	\$ 3,706
Issuance of common shares (Note 9)	17	91
Redemption of common shares (Note 9)	<u>(115)</u>	<u>(138)</u>
Balance - December 31	<u>3,561</u>	<u>3,659</u>
Additional paid-in capital		
Balance - January 1	907,518	907,471
Adjustment to common shares outstanding	-	47
Return of capital (Note 9)	<u>(176,411)</u>	<u>-</u>
Balance - December 31	<u>731,107</u>	<u>907,518</u>
Accumulated other comprehensive income		
Balance - January 1	5,553	5,349
Cumulative effect of change in accounting principle (1)	-	(70)
Change in net unrealized gains on investments	<u>(5,543)</u>	<u>274</u>
Balance - December 31	<u>10</u>	<u>5,553</u>
Retained earnings		
Balance - January 1	556,947	280,326
Cumulative effect of change in accounting principle (1)	-	70
Net income	200,385	280,682
Dividends declared	<u>(3,120)</u>	<u>(4,131)</u>
Balance - December 31	<u>754,212</u>	<u>556,947</u>
Total shareholders' equity	\$ <u>1,488,890</u>	\$ <u>1,473,677</u>
Comprehensive income		
Net income	\$ 200,385	\$ 280,682
Change in net unrealized gains on fixed maturity investments available for sale	<u>(5,543)</u>	<u>274</u>
Comprehensive income	\$ <u>194,842</u>	\$ <u>280,956</u>
Disclosure regarding net unrealized gains (Note 3)		
Total realized and net unrealized holding gains on fixed maturity investments available for sale and net-other-than temporary impairments	\$ 16,262	\$ 10,096
Net realized gains on fixed maturity investments available for sale	(22,453)	(10,911)
Net other-than-temporary impairments recognized in earnings	<u>648</u>	<u>1,089</u>
Change in net unrealized gains on fixed maturity investments available for sale	\$ <u>(5,543)</u>	\$ <u>274</u>

(1) Cumulative effect adjustment to opening retained earnings as of April 1, 2009, related to the recognition and presentation of other-than-temporary impairments, as required by Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic *Investments - Debt and Equity Securities*.

See accompanying notes to the financial statements

DAVINCI REINSURANCE LTD.

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

(in thousands of United States dollars)

	<u>2010</u>	<u>2009</u>
Cash flows provided by operating activities:		
Net income	\$ 200,385	\$ 280,682
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and accretion	8,863	2,125
Equity in earnings of RIHL	-	(9,168)
Net realized and unrealized gains on fixed maturity investments	(34,886)	(10,911)
Net unrealized gains included in net investment income	(2,872)	(16,791)
Net other-than-temporary impairments	648	1,089
Change in:		
Accrued investment income	(2,465)	(5,611)
Premiums receivable	(4,444)	(467)
Prepaid reinsurance	2,800	(2,310)
Deferred acquisition costs	1,570	(1,790)
Reserve for claims and claim expenses, net	38,624	(98,828)
Unearned premiums	(8,022)	7,655
Reinsurance balances payable	6,577	1,214
Amounts due to affiliates, net	(7,474)	32,319
Other, net	<u>19,318</u>	<u>(5,287)</u>
Net cash provided by operating activities	<u>218,622</u>	<u>173,921</u>
Cash flows used in investing activities:		
Purchases of investments available for sale	-	(3,305,044)
Proceeds from sales and maturities of investments available for sale	1,360,682	1,991,143
Purchases of investments trading	(2,526,866)	-
Proceeds from sale of investments trading	949,045	-
Proceeds from redemptions of investment in RIHL	-	407,597
Purchases of investment in RIHL	-	-
Net sales of short term investments	161,160	702,753
Net sales of other investments	<u>12,499</u>	<u>17,998</u>
Net cash used in investing activities	<u>(43,480)</u>	<u>(185,553)</u>
Cash flows used in financing activities:		
Issuance of common shares	17	-
Redemption of common shares	(115)	-
Return of capital	(176,411)	-
Dividends paid	<u>(3,120)</u>	<u>(4,131)</u>
Net cash used in financing activities	<u>(179,629)</u>	<u>(4,131)</u>
Net decrease in cash and cash equivalents	(4,487)	(15,763)
Cash and cash equivalents, beginning of year	<u>19,547</u>	<u>35,310</u>
Cash and cash equivalents, end of year	<u>\$ 15,060</u>	<u>\$ 19,547</u>

See accompanying notes to the financial statements

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 1. ORGANIZATION

DaVinci Reinsurance Ltd. (the "Company") was incorporated under the laws of Bermuda in October 2001 and provides property catastrophe and specialty reinsurance coverages to insurers and reinsurers on a worldwide basis. The Company is a majority-owned subsidiary of DaVinciRe Holdings Ltd. ("DaVinci"), a Bermuda company. DaVinci is a minority-owned subsidiary of Renaissance Other Investments Holdings Ltd. ("ROIHL"), a Bermuda company, which is a wholly-owned subsidiary of RenaissanceRe Holdings Ltd. ("RenaissanceRe"), also a Bermuda company.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). Certain prior year comparatives have been reclassified to conform to the current year presentation.

Use of estimates in financial statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported and disclosed amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. The major estimates reflected in the Company's financial statements include, but are not limited to, the reserve for claims and claim expenses, reinsurance recoverables, estimates of written and earned premiums, fair value, including the fair value of investments, financial instruments and derivatives, and impairment charges.

Premiums and related expenses

Premiums are recognized as income, net of any applicable retrocessional coverage purchased, over the terms of the related contracts and policies. Premiums written are based on contract and policy terms and include estimates based on information received from both insureds and ceding companies. Subsequent differences arising on such estimates are recorded in the period in which they are determined. Unearned premiums represent the portion of premiums written that relate to the unexpired terms of contracts and policies in force. Amounts are computed by pro-rata methods based on statistical data or reports received from ceding companies. Reinstatement premiums are estimated after the occurrence of a significant loss and are recorded in accordance with the contract terms based upon paid losses and case reserves. Reinstatement premiums are earned when written.

Acquisition costs, consisting principally of commissions, brokerage and premium tax expenses incurred at the time a contract or policy is issued, are deferred and amortized over the period in which the related premiums are earned. Deferred policy acquisition costs are limited to their estimated realizable value based on the related unearned premiums. Anticipated claims and claim expenses, based on historical and current experience, and anticipated investment income related to those premiums are considered in determining the recoverability of deferred acquisition costs.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

Claims and claim expenses

The reserve for claims and claim expenses includes estimates for unpaid claims and claim expenses on reported losses as well as an estimate of losses incurred but not reported ("IBNR"). The reserve is based on individual claims, case reserves and other reserve estimates reported by insureds and ceding companies as well as management estimates of ultimate losses. Inherent in the estimates of ultimate losses are expected trends in claim severity and frequency and other factors which could vary significantly as claims are settled. The Company does not have the benefit of a significant amount of its own historical experience with its specialty reinsurance line. Accordingly, the setting and reserving for incurred losses in this line of business could be subject to greater variability.

Ultimate losses may vary materially from the amounts provided in the financial statements. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in the statements of operations in the period in which they become known and are accounted for as changes in estimates.

Reinsurance

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. If the Company determines that adjustments to earlier estimates are appropriate, such adjustments are recorded in the period in which they are determined. Reinsurance recoverables on dual trigger reinsurance contracts require the Company to estimate its ultimate losses applicable to these contracts as well as estimate the ultimate amount of insured industry losses that will be reported by the applicable statistical reporting agency, as per the contract terms. Amounts recoverable from reinsurers are recorded net of a valuation for estimated uncollectible recoveries.

Assumed and ceded reinsurance contracts that lack a significant transfer of risk are treated as deposits.

Investments, cash and cash equivalents

Fixed Maturity Investments

Investments in fixed maturities are classified as available for sale or trading and are reported at fair value. Investment transactions are recorded on the trade date with balances pending settlement reflected in the balance sheet as a receivable for investments sold or a payable for investments purchased. Net investment income includes interest and dividend income together with amortization of market premiums and discounts and is net of investment management and custody fees. The amortization of premium and accretion of discount for fixed maturity securities is computed using the effective yield method. For mortgage-backed securities and other holdings for which there is prepayment risk, prepayment assumptions are evaluated quarterly and revised as necessary. Any adjustments required due to the change in effective yields and maturities are recognized on a prospective basis through yield adjustments. Fair values of fixed maturity investments are based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications and/or internal pricing valuation techniques. The net unrealized appreciation or depreciation on fixed maturity investments available for sale is included in accumulated other comprehensive income.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

The net unrealized appreciation or depreciation on fixed maturity investments trading is included in net realized and unrealized gains on fixed maturity investments in the statements of operations. Realized gains or losses on the sale of fixed maturity investments are determined on the basis of the first in first out cost method and include adjustments to the cost basis of fixed maturity investments for declines in value that are considered to be other than temporary.

Other-Than-Temporary Impairment Effective April 1, 2009

The Company recognizes other-than-temporary impairments in earnings for its impaired fixed maturity securities available for sale (i) for which the Company has the intent to sell the security or (ii) it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery and (iii) for those securities which have a credit loss. In assessing whether a credit loss exists, the Company compares the present value of the cash flows expected to be collected from the security with the amortized cost basis of the security. In instances in which a determination is made that an impairment exists but the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before the anticipated recovery of its remaining amortized cost basis, the impairment is separated into (i) the amount of the total impairment related to the credit loss and (ii) the amount of the total impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to all other factors is recognized in other comprehensive income. In periods after the recognition of other-than-temporary impairments on the Company's fixed maturity securities available for sale, the Company accounts for such securities as if they had been purchased on the measurement date of the other-than-temporary impairment at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized in earnings. For debt securities in which other-than-temporary impairments were recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be amortized into net investment income.

Other-Than-Temporary Impairment Process Prior to April 1, 2009

Under the pre-existing guidance, which was in effect for the three months ended March 31, 2009, the Company assessed, on a quarterly basis, whether declines in the fair value of its fixed maturity investments available for sale represented impairments that were other-than-temporary based on several factors. The factors the Company considered in the assessment of a security included: (i) the time period during which there had been a significant decline below cost; (ii) the extent of the decline below cost; (iii) the Company's intent and ability to hold the security; (iv) the potential for the security to recover in value; (v) an analysis of the financial condition of the issuer; and (vi) an analysis of the collateral structure and credit support of the security, if applicable. Where the Company determined that there was an other-than-temporary decline in the fair value of the security, the cost of the security was written down to its fair value and the unrealized loss at the time of determination was reflected in the Company's statements of operations. The majority of the Company's fixed maturity investments available for sale are managed by external investment managers in accordance with specific investment mandates and guidelines. The investment managers are directed to manage the Company's investments to maximize total investment return in accordance with these investment mandates and guidelines.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

While the Company has adequate capital and liquidity to support its operations and to hold its fixed maturity investments available for sale which were in an unrealized loss position until they recover in value, the Company has not prohibited or restricted its investment managers from selling these investments and its investment managers actively trade the Company's investments. The Company was therefore unable to represent or certify that it had the intent or ability to hold these investments until they recovered in value. As a consequence, under the pre-existing guidance which was in effect for the three months ended March 31, 2009, the Company impaired essentially all of its fixed maturity investments available for sale that were in an unrealized loss position at each quarterly reporting date.

Short Term Investments and Cash and Cash Equivalents

Short term investments, which are managed as part of the Company's investment portfolio and have a maturity of one year or less when purchased, are carried at fair value. Cash equivalents include money market instruments with a maturity of ninety days or less when purchased.

Renaissance Investment Holdings Ltd. ("RIHL")

The Company redeemed its interest in RIHL during 2009 at the then current net asset value (see Note 3). RIHL was formed to enhance administrative efficiency and take advantage of the increased benefits and reduced costs ordinarily associated with the management of large investment portfolios of different subsidiaries in the same group. In addition, the administrative efficiency afforded by the use of RIHL facilitated the establishment of the Company's collateralized letter of credit facility on advantageous terms that the Company believed would otherwise not have been available. Through RIHL, the Company invested in a diversified portfolio of highly liquid debt securities which were recorded at fair value. RIHL was assigned a rating of AAAf/S2 by Standard & Poor's Rating Agency ("S&P") and 100% of the securities held through RIHL had been assigned a rating of A or higher by nationally recognized rating agencies. Third party service providers performed custodial functions in respect of RIHL, including valuation of the investment assets held through RIHL. External investment managers managed the assets held through RIHL, pursuant to written investment guidelines.

The Company's ownership in RIHL was recorded using the equity method. The Company's share of RIHL's net income is included in equity in earnings of RIHL in the statements of operations. Any decline in the value of the Company's share of RIHL considered by management to be other-than-temporary was charged to earnings in the period in which it was determined.

RIHL, at its sole discretion, may require any shareholder to surrender some, or all of such shareholder's shares for redemption upon 30 days prior written notice. In addition, RIHL shall redeem all outstanding shares by a date, no later than December 31, 2038.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

Other Investments

Other investments are carried at fair value with interest, dividend income, income distributions and realized and unrealized gains and losses included in net investment income. The fair value of other investments is generally established on the basis of the net asset valuations provided by the investment manager, third party administrator, recent financial information or available market data to estimate fair value. In certain cases, management's judgment may also be required to estimate fair value. Actual final valuations may differ, perhaps materially so, from the Company's estimates and these differences are recorded in the period they become known as a change in estimate. The Company's estimate of the fair value of catastrophe bonds are based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications.

Derivatives

The Company enters into derivative instruments such as futures, options, swaps, forward contracts and other derivative contracts in order to manage its foreign currency exposure, obtain exposure to a particular financial market, for yield enhancement, or for trading and speculation. The Company accounts for its derivatives in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic *Derivatives and Hedging*, which requires all derivatives to be recorded at fair value on the Company's balance sheet as either assets or liabilities, depending on their rights or obligations, with changes in fair value reflected in current earnings. The Company does not currently apply hedge accounting. The fair value of the Company's derivatives are estimated by reference to quoted prices or broker quotes, where available, or in the absence of quoted prices or broker quotes, the use of industry or internal valuation models.

Fair value

The Company accounts for certain of its assets and liabilities at fair value in accordance with FASB ASC Topic *Fair Value Measurements and Disclosures*. The Company recognizes the change in unrealized gains and losses arising from changes in fair value in its statements of operations, with the exception of changes in unrealized gains and losses on its fixed maturity investments available for sale, which are recognized as a component of accumulated other comprehensive income in shareholders' equity.

Foreign exchange

The Company's functional currency is the United States ("U.S.") dollar. Revenues and expenses denominated in foreign currencies are translated at the prevailing exchange rate at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date, which may result in the recognition of exchange gains or losses which are included in the determination of net income.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 3. INVESTMENTS

Fixed maturity investments trading

During 2010, the Company started designating, upon acquisition, certain fixed maturity investments as trading, rather than as available for sale. The following table summarizes the fair value of fixed maturity investments trading at December 31, 2010:

	<u>2010</u>
U.S. treasuries	\$ 349,336
Agencies	201,117
Non-U.S. government (Sovereign debt)	12,227
FDIC guaranteed corporate	373,164
Non-U.S. government-backed corporate	193,943
Corporate	<u>452,546</u>
	<u>\$ 1,582,333</u>

Fixed maturity investments available for sale

The following table summarizes the amortized cost, fair value and related unrealized gains and losses and non-credit other-than-temporary impairments of fixed maturity investments available for sale at December 31, 2010:

	Included in Accumulated Other Comprehensive Income			Fair Value	Non-Credit Other-Than- Temporary Impairments (1)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
Corporate	\$ 1,012	\$ 10	\$ -	\$ 1,022	\$ -

- (1) Represents the non-credit component of other-than-temporary impairments recognized in accumulated other comprehensive income since the adoption of guidance related to the recognition and presentation of other-than-temporary impairments under FASB ASC Topic *Investments – Debt and Equity Securities*, during the second quarter of 2009, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 3. INVESTMENTS, cont'd.

The following table summarizes the amortized cost, fair value and related unrealized gains and losses and non-credit other-than-temporary impairments of fixed maturity investments available for sale at December 31, 2009:

	Amortized Cost	Included in Accumulated Other Comprehensive Income		Fair Value	Non-Credit Other-Than- Temporary Impairments (1)
		Gross Unrealized Gains	Gross Unrealized Losses		
U.S. treasuries	\$ 247,234	\$ -	\$ (327)	\$ 246,907	\$ -
Agencies	120,739	287	(64)	120,962	-
Non-U.S. government (Sovereign debt)	14,626	8	(5)	14,629	-
FDIC guaranteed corporate	523,371	3,271	(276)	526,366	-
Non-U.S. government-backed corporate Corporate	129,462 305,360	880 4,896	(713) (2,404)	129,629 307,852	- -
	<u>\$1,340,792</u>	<u>\$ 9,342</u>	<u>\$ (3,789)</u>	<u>\$ 1,346,345</u>	<u>\$ -</u>

(1) Represents the non-credit component of other-than-temporary impairments recognized in accumulated other comprehensive income since the adoption of guidance related to the recognition and presentation of other-than-temporary impairments under FASB ASC Topic *Investments – Debt and Equity Securities*, during the second quarter of 2009, adjusted for subsequent sales of securities. It does not include the change in fair value subsequent to the impairment measurement date.

Contractual maturities of fixed maturity investments at December 31, 2010 are as follows. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Trading		Available for sale		Total Fixed Maturity Investments	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in less than one year	\$ 78,692	\$ 78,976	\$ 1,012	\$ 1,022	\$ 79,704	\$ 79,998
Due after one through five years	1,324,440	1,329,790	-	-	1,324,440	1,329,790
Due after five through ten years	167,712	170,993	-	-	167,712	170,993
Due after ten years	2,601	2,574	-	-	2,601	2,574
	<u>\$ 1,573,445</u>	<u>\$1,582,333</u>	<u>\$ 1,012</u>	<u>\$ 1,022</u>	<u>\$ 1,574,457</u>	<u>\$ 1,583,355</u>

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009
(amounts in tables expressed in thousands of United States dollars)

NOTE 3. INVESTMENTS, cont'd.

Net investment income

The components of net investment income for the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
Fixed maturity investments	\$ 29,125	\$ 24,603
Short term investments	410	975
Other investments	4,094	20,636
Cash and cash equivalents	44	186
	<u>33,673</u>	<u>46,400</u>
Investment expenses	(2,487)	(2,053)
Net investment income	<u>\$ 31,186</u>	<u>\$ 44,347</u>

Net realized gains on the sale of fixed maturity investments are determined on the basis of the first in, first out cost method and for fixed maturity investments available for sale include adjustments to the cost basis of investments for declines in value that are considered to be other-than-temporary. During 2010, the Company started designating upon acquisition certain fixed maturity investments as trading. As a result, unrealized gains (losses) on fixed maturity investments designated as trading are recorded in net realized and unrealized gains (losses) on the Company's statements of operations. Unrealized gains (losses) on the Company's fixed maturity investments available for sale, are recorded in accumulated other comprehensive income on the Company's balance sheets. The Company's net realized and unrealized gains on fixed maturity investments and net other-than-temporary impairments for the years ended December 31, 2010 and 2009 are as follows:

	2010	2009
Gross realized gains	\$ 27,545	\$ 15,212
Gross realized losses	(1,546)	(4,301)
Net realized gains on fixed maturity investments	<u>25,999</u>	<u>10,911</u>
Net unrealized gains on fixed maturity investments trading	<u>8,887</u>	<u>-</u>
Net realized and unrealized gains on fixed maturity investments	34,886	10,911
Net other-than-temporary impairments	(648)	(1,089)
Change in net unrealized gains on fixed maturity investments available for sale included in accumulated other comprehensive income (1)	<u>(5,543)</u>	<u>5,361</u>
Total net realized and unrealized gains, net other-than-temporary impairments and change in net unrealized gains on fixed maturity investments	<u>\$ 28,695</u>	<u>\$ 15,183</u>

- (1) Excludes cumulative effect adjustment of \$0.1 million to opening retained earnings as of April 1, 2009, related to the recognition and presentation of other-than-temporary impairments, as required by FASB ASC Topic *Investments - Debt and Equity Securities*.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 3. INVESTMENTS, cont'd.

The Company performed reviews of its investments for the year ended December 31, 2010 and 2009, respectively, in order to determine whether declines in the fair value below the amortized cost basis of its fixed maturity investments available for sale were considered other-than-temporary in accordance with the applicable guidance, as discussed below.

At December 31, 2010, \$330.3 million (2009 - \$164.5 million) of cash and investments at fair value were on deposit with, or in trust accounts for the benefit of various counterparties, including with respect to the Company's principal letter of credit facility. Of this amount, \$22.4 million is on deposit with, or in trust accounts for the benefit of, U.S. state regulatory authorities.

Other-Than-Temporary Impairment Process Prior to April 1, 2009

Under the pre-existing guidance, which was in effect for the three months ended March 31, 2009, the Company assessed, on a quarterly basis, whether declines in the fair value of its fixed maturity investments available for sale represented impairments that were other-than-temporary based on several factors. The factors the Company considered in the assessment of a security included: (i) the time period during which there had been a significant decline below cost; (ii) the extent of the decline below cost; (iii) the Company's intent and ability to hold the security; (iv) the potential for the security to recover in value; (v) an analysis of the financial condition of the issuer; and (vi) an analysis of the collateral structure and credit support of the security, if applicable. Where the Company determined that there was an other-than-temporary decline in the fair value of the security, the cost of the security was written down to its fair value and the unrealized loss at the time of determination was reflected in the Company's statements of operations.

The majority of the Company's fixed maturity investments available for sale are managed by external investment managers in accordance with specific investment mandates and guidelines. The investment managers are directed to manage the Company's investments to maximize total investment return in accordance with these investment mandates and guidelines. While the Company has adequate capital and liquidity to support its operations and to hold its fixed maturity investments available for sale which were in an unrealized loss position until they recover in value, the Company has not prohibited or restricted its investment managers from selling these investments and its investment managers actively traded the Company's investments. The Company was therefore unable to represent or certify that it had the intent or ability to hold these investments until they recovered in value. As a consequence, under the pre-existing guidance, the Company impaired essentially all of its fixed maturity investments available for sale that were in an unrealized loss position at each quarterly reporting date. For the three months ended March 31, 2009, the Company recorded other-than-temporary impairments of \$0.1 million. As of March 31, 2009, the Company had essentially no fixed maturity investments available for sale in an unrealized loss position.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 3. INVESTMENTS, cont'd.

Other-Than-Temporary Impairment Process Effective April 1, 2009

Pursuant to the guidance effective April 1, 2009, the Company revised its quarterly process for assessing whether declines in the fair value of its fixed maturity investments available for sale represent impairments that are other-than-temporary. The process now includes reviewing each fixed maturity investment available for sale that is impaired and determining: (i) if the Company has the intent to sell the debt security or (ii) if it is more likely than not that the Company will be required to sell the debt security before its anticipated recovery; and (iii) whether a credit loss exists, that is, where the Company expects that the present value of the cash flows expected to be collected from the security are less than the amortized cost basis of the security.

In assessing the Company's intent to sell securities, the Company's procedures may include actions such as discussing planned sales with its third party investment managers, reviewing sales that have occurred shortly after the balance sheet date, and consideration of other qualitative factors that may be indicative of the Company's intent to sell or hold the relevant securities. For the year ended December 31, 2010, the Company recognized \$Nil (2009 - \$1.1 million), of other-than-temporary impairments due to the Company's intent to sell these securities as of December 31, 2010.

In assessing whether it is more likely than not that the Company will be required to sell a security before its anticipated recovery, the Company considers various factors including its future cash flow forecasts and requirements, legal and regulatory requirements, the level of its cash, cash equivalents, short term investments and fixed maturity investments available for sale in an unrealized gain position, and other relevant factors. For the year ended December 31, 2010, the Company recognized \$Nil (2009 - \$Nil) of other-than-temporary impairments due to required sales.

In evaluating credit losses, the Company considers a variety of factors in the assessment of a security including: (i) the time period during which there has been a significant decline below cost; (ii) the extent of the decline below cost and par; (iii) the potential for the security to recover in value; (iv) an analysis of the financial condition of the issuer; (v) the rating of the issuer; (vi) the implied rating of the issuer based on an analysis of option adjusted spreads; (vii) the absolute level of the option adjusted spread for the issuer; and (viii) an analysis of the collateral structure and credit support of the security, if applicable.

Once the Company determines that it is possible that a credit loss may exist for a security, the Company performs a detailed review of the cash flows expected to be collected from the issuer. The Company estimates expected cash flows by applying estimated default probabilities and recovery rates to the contractual cash flows of the issuer, with such default and recovery rates reflecting long-term historical averages adjusted to reflect current credit, economic and market conditions, giving due consideration to collateral and credit support, if applicable, and discounting the expected cash flows at the purchase yield on the security. In instances in which a determination is made that an impairment exists but the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before the anticipated recovery of its remaining amortized cost basis, the impairment is separated into: (i) the amount of the total other-than-temporary impairment related to the credit loss; and (ii) the amount of the total other-than-temporary impairment related to all other factors. The amount of the other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the other-than-temporary impairment related to all other factors is recognized in other comprehensive income. For the year ended December 31, 2010, the Company recognized \$0.6 million (2009 - \$Nil) of credit related other-than-temporary impairments which were recognized in earnings and \$Nil (2009 - \$Nil) related to other factors which were recognized in other comprehensive income.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 3. INVESTMENTS, cont'd.

At December 31, 2010 and 2009, the Company did not hold any fixed maturity investments whereby an other-than-temporary impairment was related to credit losses recognized in earnings for which a portion of an other-than-temporary impairment was recognized in accumulated other comprehensive income for the year ended December 31, 2010.

Other investments

The table below shows the Company's portfolio of other investments at December 31, 2010 and 2009:

	2010	2009
Senior secured bank loan fund	\$ 56,791	\$ 54,089
Catastrophe bonds	-	12,329
	<u>\$ 56,791</u>	<u>\$ 66,418</u>

Interest income, income distributions and realized and unrealized gains and losses on other investments are included in net investment income and totaled \$4.1 million (2009 - \$20.6 million) of which \$1.8 million was related to net unrealized gains (2009 - \$16.8 million).

RIHL

The Company elected to redeem its interest in RIHL at the net asset value during 2009. The aggregate redemption proceeds totaled \$407.6 million. The proceeds from the redemption in RIHL were invested in a diversified portfolio of highly liquid debt securities, with essentially 100% of the securities having been assigned a rating of A or higher by nationally recognized rating agencies. RIHL had been assigned a rating of AAAf/S2 by S&P and 100% of the securities held by RIHL had been assigned a rating of A or higher by nationally recognized rating agencies.

The Company's equity in earnings of RIHL and change in net unrealized gains on its investment in RIHL for the year ended December 31, 2009, are as follows:

	2009
Net investment income	\$ 3,332
Net realized gains	6,257
Net other-than-temporary impairments	<u>(421)</u>
Equity in earnings of RIHL	\$ 9,168
Change in net unrealized gains on investment in RIHL included in accumulated other comprehensive income	<u>(5,087)</u>
Total equity in earnings of RIHL and change in unrealized gains on investment in RIHL	<u>\$ 4,081</u>

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS

The use of fair value to measure certain assets and liabilities with resulting unrealized gains or losses is pervasive within the Company's financial statements, and is a significant accounting policy and estimate for the Company. Fair value is defined under accounting guidance currently applicable to the Company to be the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between open market participants at the measurement date. The Company recognizes the change in unrealized gains and losses arising from changes in fair value in its statements of operations, with the exception of changes in unrealized gains and losses on its fixed maturity investments available for sale, which are recognized as a component of accumulated other comprehensive income in shareholders' equity.

FASB ASC Topic *Fair Value Measurements and Disclosures* prescribes a fair value hierarchy that prioritizes the inputs to the respective valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

The three levels of the fair value hierarchy are described below:

- Fair values determined by Level 1 inputs utilize unadjusted quoted prices obtained from active markets for identical assets or liabilities for which the Company has access. The fair value is determined by multiplying the quoted price by the quantity held by the Company;
- Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals, broker quotes and certain pricing indices; and
- Level 3 inputs are based on unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In these cases, significant management assumptions can be used to establish management's best estimate of the assumptions used by other market participants in determining the fair value of the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement of the asset or liability. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the asset or liability.

In order to determine if a market is active or inactive for a security, the Company considers a number of factors, including, but not limited to, the spread between what a seller is asking for a security and what a buyer is bidding for the same security, the volume of trading activity for the security in question, the price of the security compared to its par value (for fixed maturity investments), and other factors that may be indicative of market activity.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

There have been no material changes in the Company's valuation techniques, nor have there been any transfers between Level 1 and Level 2, and Level 2 and Level 3, respectively, during the period represented by these financial statements.

Below is a summary of the assets and liabilities that are measured at fair value on a recurring basis and also represents the carrying amount on the Company's balance sheet at December 31, 2010:

	Total	Level 1	Level 2	Level 3
Fixed maturity investments				
U.S. treasuries	\$ 349,336	\$ 349,336	\$ -	\$ -
Agencies	201,117	-	201,117	-
Non-U.S. government (Sovereign debt)	12,227	-	12,227	-
FDIC guaranteed corporate	373,164	-	373,164	-
Non-U.S. government-backed corporate	193,943	-	193,943	-
Corporate	453,568	-	453,568	-
Total fixed maturity investments	1,583,355	349,336	1,234,019	-
Short term investments	98,293	-	98,293	-
Other investments				
Senior secured bank loan fund	56,791	-	56,791	-
Other secured assets	7,125	-	7,125	-
Other assets	3,106	-	2,663	443
	<u>\$ 1,748,670</u>	<u>\$ 349,336</u>	<u>\$ 1,398,891</u>	<u>\$ 443</u>

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Below is a summary of the assets and liabilities that are measured at fair value on a recurring basis and also represents the carrying amount on the Company's balance sheet at December 31, 2009:

	Total	Level 1	Level 2	Level 3
Fixed maturity investments				
U.S. treasuries	\$ 246,907	\$ 246,907	\$ -	\$ -
Agencies	120,962	-	120,962	-
Non-U.S. government (Sovereign debt)	14,629	-	14,629	-
FDIC guaranteed corporate	526,366	-	526,366	-
Non-U.S. government-backed corporate	129,629	-	129,629	-
Corporate	307,852	-	307,852	-
Total fixed maturity investments	1,346,345	246,907	1,099,438	-
Short term investments	259,453	-	259,453	-
Other investments				
Senior secured bank loan fund	54,089	-	54,089	-
Catastrophe bonds	12,329	-	12,329	-
Total other investments	66,418	-	66,418	-
Other secured assets	15,616	-	15,616	-
Other assets and (liabilities)	323	-	(227)	550
	<u>\$ 1,688,155</u>	<u>\$ 246,907</u>	<u>\$ 1,440,698</u>	<u>\$ 550</u>

Fixed Maturity Investments

Fixed maturity investments included in Level 1 consist of the Company's investments in U.S. treasuries. Fixed maturity investments included in Level 2 are agencies, non-U.S. government, FDIC guaranteed corporate, non-U.S. government-backed corporate and corporate fixed maturity investments.

The Company's fixed maturity investments are priced using broker quotations and pricing services, such as index providers and pricing vendors. The pricing vendors provide pricing for a high volume of liquid securities that are actively traded. For securities that do not trade on an exchange, the pricing services generally utilize market data and other observable inputs in matrix pricing models to determine prices. Prices are generally verified using third party data.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Prices obtained from broker quotations are considered non-binding, however they are based on observable inputs and by observing secondary trading of similar securities obtained from active, non-distressed markets. The Company considers these Level 2 inputs as they are corroborated with other externally obtained information. The techniques generally used to determine the fair value of our fixed maturity investments are detailed below by asset class.

U.S. treasuries

At December 31, 2010, the Company's U.S. treasuries fixed maturity investments had a weighted average yield to maturity of 1.2%, a weighted average credit quality of AAA, and are primarily priced by pricing vendors. When pricing these securities, the vendor may utilize daily data from many real time market sources, including active broker dealers, as such, the Company considers its U.S. treasuries fixed maturity investments Level 1. All data sources are regularly reviewed for accuracy to ensure the most reliable price source is used for each issue and maturity date.

Agencies

At December 31, 2010, the Company's agencies fixed maturity investments had a weighted average yield to maturity of 0.8% and a weighted average credit quality of AAA. The issuers of the Company's agencies fixed maturity investments primarily consist of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other agencies. Fixed maturity investments included in agencies, are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The dollar value for each security is individually computed using analytical models which incorporate option adjusted spreads and other daily interest rate data. The Company considers its agencies fixed maturity investments Level 2.

Non-U.S. government (Sovereign debt)

Non-U.S. government fixed maturity investments held by the Company at December 31, 2010, had a weighted average yield to maturity of 3.1% and a weighted average credit quality of AA. The issuers for securities in this sector are generally non-U.S. governments and agencies as well as supranational organizations. Securities held in these sectors, are primarily priced by pricing vendors who employ proprietary discounted cash flow models to value the securities. Key quantitative inputs for these models are daily observed benchmark curves for treasury, swap and high issuance credits. The pricing vendor may then apply a credit spread for each security which is developed by in-depth and real time market analysis. For securities in which trade volume is low, the pricing vendor may also utilize data from more frequently traded securities with similar attributes. These models may also be supplemented by daily market and credit research for international markets. The Company considers its non-U.S. government fixed maturity investments Level 2.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

FDIC guaranteed corporate

The Company's FDIC guaranteed corporate fixed maturity investments had a weighted average yield to maturity of 0.6% and a weighted average credit quality of AAA at December 31, 2010. The issuers consist of well known corporate issuers who participate in the FDIC program. The Company's FDIC guaranteed corporate fixed maturity investments, are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources regarding the issuer of the security, obtain credit data, as well as other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available.

The pricing vendor may also consider the specific terms and conditions of the securities, including any specific features which may influence risk. Each security is individually evaluated using a spread model which is added to the U.S. treasury curve or LIBOR. The Company considers its FDIC guaranteed corporate fixed maturity investments Level 2.

Non-U.S. government-backed corporate

Non-U.S. government-backed corporate fixed maturity investments are considered Level 2 by the Company and had a weighted average yield to maturity of 1.3% and a weighted average credit quality of AAA at December 31, 2010. Non-U.S. government-backed fixed maturity investments are primarily priced by pricing vendors who employ proprietary discounted cash flow models to value the securities. Key quantitative inputs for these models are daily observed benchmark curves for treasury, swap and high issuance credits. The pricing vendor may then apply a credit spread for each security which is developed by in-depth and real time market analysis. For securities in which trade volume is low, the pricing vendor may also utilize data from more frequently traded securities with similar attributes. These models may also be supplemented by daily market and credit research for international markets.

Corporate

At December 31, 2010, the Company's corporate fixed maturity investments had a weighted average yield to maturity of 3.0% and a weighted average credit quality of AA, and principally consist of U.S. and international corporations. The Company's corporate fixed maturity investments are primarily priced by pricing vendors, and are considered Level 2 by the Company. When evaluating these securities, the vendor may gather information from market sources regarding the issuer of the security, obtain credit data, as well as other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing vendor may also consider the specific terms and conditions of the securities, including any specific features which may influence risk. Each security is individually evaluated using a spread model which is added to the U.S. treasury curve or LIBOR.

Short Term Investments

Short term investments are considered Level 2 and fair values are generally determined using amortized cost which approximates fair value and, in certain cases, in a manner similar to the Company's fixed maturity investments noted above.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Other Investments

Senior secured bank loan fund

At December 31, 2010, the Company's investment in a senior secured bank loan fund includes funds that invest primarily in bank loans and other senior debt instruments. The fair value of the Company's investment in a senior secured bank loan fund is estimated using the net asset value per share of the funds and are redeemable, in whole or in part, on a monthly basis, and are considered Level 2.

Other Secured Assets

Other secured assets represent contractual rights under a purchase agreement, contingent purchase agreement and credit derivatives agreement with a major bank to sell certain securities within the Company's catastrophe-linked securities portfolio. The Company's other secured assets are accounted for at fair value based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications. As such, the Company considers its catastrophe bonds Level 2.

Other Assets and Liabilities

Included in other assets and liabilities measured at fair value at December 31, 2010 is the Company's assumed and ceded (re)insurance contracts accounted for as Level 3, as the fair value of these contracts is obtained through the use of internal valuation models with the inputs to the internal valuation model based on proprietary data as observable market inputs are not available. In addition, other assets and liabilities include certain other derivatives entered into by the Company; the fair value of these transactions include the fair value of certain foreign currency forward contracts and the fair value of certain interest rate futures, determined using industry valuation models and considered Level 2, as the inputs to the valuation model are based on observable market inputs.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Below is a reconciliation of the beginning and ending balances, for the periods shown, of assets and liabilities measured at fair value on a recurring basis using Level 3 inputs. Interest and dividend income are included in net investment income and are excluded from the reconciliation.

	2010	2009
Balance - January 1	\$ 550	\$ 640
Total unrealized gains		
Included in net investment income	-	-
Included in other loss	-	-
Total realized losses		
Included in net investment income	-	-
Included in other income (loss)	(631)	(14,817)
Total foreign exchange gains	-	-
Net purchases, issuances and settlements	524	14,727
Net transfers in and/or out of Level 3	-	-
Balance - December 31	<u>\$ 443</u>	<u>\$ 550</u>

Reinsurance Contracts Accounted for at Fair Value

The Company assumes and cedes certain reinsurance contracts that are accounted for at fair value under the fair value election option. The fair value of these contracts is obtained through the use of internal valuation models. These contracts are recorded on the Company's balance sheet in other assets and other liabilities and totaled \$0.4 million and \$Nil, respectively (2009 - \$0.6 million and \$Nil, respectively). During 2010, the Company recorded losses of \$0.6 million (2009 - \$14.8 million) which are included in other income (loss) and represents changes in the fair value of these contracts.

The Fair Value Option for Financial Assets and Financial Liabilities

The Company has elected to account for certain assets and liabilities at fair value under FASB ASC Topic *Financial Instruments*. The Company has elected to use the guidance under FASB ASC Topic *Financial Instruments*, as it represents the most current authoritative GAAP. Below is a summary of the balances the Company has elected to account for at fair value:

	2010	2009
Other investments	\$ 56,791	\$ 66,418
Other secured assets	7,125	15,616
Other assets and liabilities	443	550

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Included in net investment income for the year ended December 31, 2010 is \$1.8 million (2009 - \$16.8 million) of net unrealized gains related to the changes in fair value of other investments. Net unrealized gains related to the changes in the fair value of other secured assets and other assets and liabilities recorded in other income (loss) was \$22 thousand and \$Nil, respectively, for the year ended December 31, 2010 (2009 - \$0.7 million and \$Nil, respectively).

Measuring the Fair Value of Other Investments Using Net Asset Valuations

The table below shows the Company's portfolio of other investments measured using net asset valuations:

	Fair Value	Unfunded Commitment	Redemption Frequency	Redemption Notice Period
Senior secured bank loan fund	\$ 56,791	\$ -	Monthly	Monthly

Senior secured bank loan fund – The Company's investment in a senior secured bank loan fund primarily invests in bank loans and other senior debt instruments. The investment is redeemable in whole, or in part, on a monthly basis.

NOTE 5. CEDED REINSURANCE

The Company purchases reinsurance and other protection to manage its risk portfolio and reduce its exposure to large losses. The Company currently has in place contracts that provide for recovery of a portion of certain claims and claim expenses, generally in excess of various retentions or on a proportional basis. In addition to loss recoveries, certain of the Company's ceded reinsurance contracts also provide for recoveries of additional premiums, reinstatement premiums and for lost no-claims bonuses, which are incurred when losses are ceded to other reinsurance contracts. The Company remains liable to the extent that any reinsurance company fails to meet its obligations. A portion of the Company's ceded reinsurance was ceded to Renaissance Reinsurance Ltd. ("Renaissance Reinsurance"), a wholly-owned subsidiary of RenaissanceRe (see Note 8).

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 5. CEDED REINSURANCE, cont'd.

The following table sets forth the effect of reinsurance and retrocessional activity on premiums written and earned and on net claims and claim expenses incurred for the years ended December 31, 2010 and 2009:

	2010	2009
<u>Premiums written</u>		
Assumed	\$ 366,691	\$ 391,959
Ceded	(40,588)	(59,855)
Net premiums written	<u>\$ 326,103</u>	<u>\$ 332,104</u>
<u>Premiums earned</u>		
Assumed	\$ 374,713	\$ 384,303
Ceded	(43,388)	(57,544)
Net premiums earned	<u>\$ 331,325</u>	<u>\$ 326,759</u>
<u>Claims and claim expenses</u>		
Gross claims and claim expenses incurred	\$ 92,092	\$ (36,529)
Claims and claim expenses recovered	138	-
Net claims and claim expenses incurred	<u>\$ 92,230</u>	<u>\$ (36,529)</u>

NOTE 6. OTHER SECURED ASSETS AND OTHER SECURED LIABILITIES

Other secured assets and other secured liabilities represent contractual rights and obligations under a purchase agreement, contingent purchase agreement and credit derivatives agreement (collectively, the "Agreements") with a major bank to sell certain securities within the Company's catastrophe-linked securities portfolio ("Cat-Linked Securities"). Under the terms of the Agreements, the Company sells its ownership interest in Cat-Linked Securities to the bank at par. During 2010, Cat-Link Securities with a par amount of \$8.5 million matured (2009 - \$15.0 million). The Agreements allow the Company to repurchase these securities at par and obligate the Company to repurchase the securities under certain circumstances including catastrophe triggering events and events of default. As a result of these transactions, the Company is receiving the spread over LIBOR on the remaining \$7.0 million of Cat-Linked Securities, less a financing fee.

The Company accounted for the sale of the Cat-Linked Securities under the Agreements as a secured borrowing with a pledge of collateral under the provisions of FASB ASC Topic *Transfers and Servicing*, and accordingly recognized no gain or loss upon the transaction date. The credit derivatives agreement is accounted for at fair value with changes in fair value recognized in other income (loss). As a result of the Agreements, the Company recognized its Cat-Linked Securities, as other secured assets which totaled \$7.1 million at December 31, 2010 (2009 - \$15.6 million), representing the fair value of the pledged collateral and credit derivatives agreement, and recognized a \$7.0 million liability (2009 - \$15.5 million), representing its obligation to repurchase the Cat-Linked Securities at par.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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(amounts in tables expressed in thousands of United States dollars)

NOTE 6. OTHER SECURED ASSETS AND OTHER SECURED LIABILITIES, cont'd.

The Company recognized \$0.6 million of other income in its statements of operations in 2010 (2009 - \$1.8 million) from this transaction, representing the spread over LIBOR less the financing fee on the Cat-Linked Securities, inclusive of the change in the fair value of the credit derivatives agreement.

Under the terms of the Agreements, the Company may sell other catastrophe-linked securities.

NOTE 7. RESERVE FOR CLAIMS AND CLAIM EXPENSES

The Company uses statistical and actuarial methods to estimate ultimate expected claims and claim expenses. The period of time from the reporting of a loss to the Company and the settlement of the Company's liability may be many years. During this period, additional facts and trends will be revealed. As these factors become apparent, case reserves will be adjusted, sometimes requiring an increase or decrease in the overall reserves of the Company, and at other times requiring a reallocation of IBNR reserves to specific case reserves or additional case reserves. These estimates are reviewed regularly, and such adjustments, if any, are reflected in the results of operations in the period in which they become known and are accounted for as changes in estimates. Adjustments to the Company's claims and claim expense reserves can impact current year net income by increasing net income if the estimates of prior year claims and claim expense reserves prove to be overstated or by decreasing net income if the estimates of prior year claims and claim expense reserves prove to be insufficient.

The Company's estimates of claims and claim expenses are also based in part upon the estimation of claims resulting from natural and man-made disasters such as hurricanes, earthquakes, tsunamis, winter storms, terrorist attacks and other catastrophic events. Estimation by the Company of claims resulting from catastrophic events is inherently difficult because of the potential severity of property catastrophe claims. Additionally, the Company does not have the benefit of a significant amount of its own historical experience with its specialty reinsurance line. Therefore, the Company uses both proprietary and commercially available models, as well as historical reinsurance industry claims experience, for purposes of evaluating future trends and providing an estimate of ultimate claims costs.

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NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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NOTE 7. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

Activity in the liability for unpaid claims and claim expenses for the years ended December 31, 2010 and 2009 are summarized as follows:

	2010	2009
Net reserves as of January 1	\$ 193,923	\$ 292,751
Net incurred related to:		
Current year	142,073	31,948
Prior years	(49,843)	(68,477)
Total net incurred	92,230	(36,529)
Net paid related to:		
Current year	17,022	6,013
Prior years	36,584	56,286
Total net paid	53,606	62,299
Total net reserves as of December 31	232,547	193,923
Losses recoverable as of December 31	-	138
Total gross reserves as of December 31	\$ 232,547	\$ 194,061

During 2010, favorable development on prior year reserves of \$49.8 million was principally attributable to the reduction in net ultimate losses associated with the 2005 Buncefield Oil Depot loss (\$8.8 million); the 2005 hurricanes, Katrina, Rita and Wilma (\$7.2 million); European windstorm Klaus (\$3.0 million); and the 2004 hurricanes, Charley, Frances, Ivan and Jeanne (\$2.6 million); the 2008 hurricanes, Gustav and Ike (\$0.3 million), with the remainder due to a reduction in ultimate losses on a large number of relatively small catastrophes, all principally due to better than expected reported claims activity, and with respect of the 2004 and 2005 hurricanes, the adoption of a new actuarial technique using reported loss development factors to estimate the ultimate losses for these events.

During 2009, the Company's prior years favorable development of \$68.5 million was principally attributable to a reduction in ultimate net losses associated with certain events, including the 2008 hurricanes, Gustav and Ike (\$18.5 million); the 2007 European windstorm Kyrill (\$7.7 million); the 2007 California wildfires (\$5.5 million); the 2005 hurricanes, Katrina, Rita and Wilma (\$5.1 million); the 2007 flooding in the U.K. (\$4.3 million); and the 2004 hurricanes, Charley, Frances, Ivan and Jeanne (\$3.2 million), due to better than expected reported claims activity, and with respect of the 2004 and 2005 hurricanes, the adoption of a new actuarial technique using reported loss development factors to estimate the ultimate losses for these events.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

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NOTE 8. RELATED PARTY TRANSACTIONS AND MAJOR CUSTOMERS

The Company entered into reinsurance agreements with Renaissance Reinsurance in each year from 2002 to 2010 and also entered into reinsurance agreements with Glencoe Insurance Ltd. ("Glencoe"), a wholly-owned subsidiary of RenaissanceRe, to assume a portion of Glencoe's property business in each year from 2002 to 2007. During 2010, net premiums earned assumed from Renaissance Reinsurance were \$1.7 million (2009 - \$4.1 million). In addition, during 2010, net claims and claim expenses incurred under these agreements with Renaissance Reinsurance and Glencoe were negative \$3.4 million (2009 - negative \$1.4 million). At December 31, 2010, outstanding reserves for claims and claim expenses assumed under these agreements with Renaissance Reinsurance and Glencoe were \$2.9 million (2009 - \$6.5 million), unearned premium reserves for these agreements were \$45 thousand (2009 - \$Nil) and premiums receivable were \$0.8 million (2009 - \$Nil).

The Company also entered into reinsurance agreements to cede a portion of its property catastrophe business to Renaissance Reinsurance in various years from 2002 to 2010. During 2010, net earned premiums ceded under these agreements were \$7.3 million (2009 - \$13.2 million) and net claims and claim expenses recovered were negative \$0.1 million (2009 - \$Nil). At December 31, 2010, reinsurance recoverables under these agreements were \$Nil (2009 - \$0.1 million), prepaid reinsurance for these agreements were \$2.6 million (2009 - \$3.4 million) and reinsurance balances payable were \$0.1 million (2009 - \$Nil).

A subsidiary of the Company's ultimate parent has entered into the following non-insurance transactions with Tower Hill Holdings Inc. ("Tower Hill") and certain of its subsidiaries: a \$10.0 million equity investment in Tower Hill, which is accounted for under the equity method of accounting; a \$5.0 million promissory note to Tower Hill Insurance Group, LLC, under common ultimate ownership with Tower Hill; and a \$50.0 million equity investment in Tower Hill Insurance Group, LLC, Tower Hill Claims Services, LLC and Tower Hill Claims Management, LLC (collectively, the "Tower Hill Companies").

The Company has entered into reinsurance agreements with certain subsidiaries and affiliates of Tower Hill and has also entered into reinsurance agreements with respect to business produced by Tower Hill Insurance. These reinsurance agreements include excess of loss reinsurance and four net retained personal property quota share agreements for 2010 and 2009. For the year ended December 31, 2010, the Company recorded \$12.6 million (2009 - \$16.3 million) of gross premium written assumed from Tower Hill and its subsidiaries and affiliates related to the above mentioned contracts. Gross premiums earned totaled \$14.9 million (2009 - \$13.5 million) and expenses incurred were \$1.6 million (2009 - \$1.4 million) for the year ended December 31, 2010 related to these contracts. The Company had a net related outstanding receivable balance of \$6.5 million as of December 31, 2010 (2009 - \$9.0 million).

During 2010, Renaissance Reinsurance loaned \$3.7 million in the form of secured promissory notes to HomeWise Holdings, Inc. ("HomeWise") which reflected the total premiums receivable to Renaissance Reinsurance and the Company. At the same time, Renaissance Reinsurance entered into a back to back loan with the Company under the same terms and conditions as the original loan, with a principal amount of \$1.2 million, which reflected the Company's portion of the premiums receivable. Subsequent to the initial loan, HomeWise made one principal and interest payment and then requested modifications to the loan agreement. After further deterioration in HomeWise's financial position both the loan and notes were written down to \$Nil. Included in investment income and other income (loss) for the year ended December 31, 2010 is interest income of \$48 thousand and a loss of \$1.1 million related to the write down of the secured promissory notes, respectively.

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NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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(amounts in tables expressed in thousands of United States dollars)

NOTE 8. RELATED PARTY TRANSACTIONS AND MAJOR CUSTOMERS, cont'd.

Under the terms of a management agreement, Renaissance Underwriting Managers Ltd. ("Renaissance Underwriting Managers"), a wholly-owned subsidiary of RenaissanceRe, has contracted to provide all of the Company's management, underwriting, investment management and administrative functions, for which it is paid a fee that is a percentage of premium and a profit commission. Included in operational expenses for the year ended December 31, 2010, is a related expense of \$59.8 million (2009 - \$87.3 million). Of this amount, \$48.9 million is recorded in amounts due to affiliates at December 31, 2010 (2009 - \$57.5 million). Amounts due to affiliates are non-interest-bearing and payable in accordance with the terms of the management agreement. As per the management agreement, \$40.0 million (2009 - \$42.6 million) of the amounts due to affiliates represents deferred profit commission which is not currently due but will be accrued to offset future underwriting year deficits, should they occur, subject to a maximum dollar amount. Additionally, the Company is required to reimburse Renaissance Underwriting Managers for other directly identifiable costs. For the years ended December 31, 2010 and 2009, no such directly identifiable costs were allocated to the Company.

During the year ended December 31, 2010, the Company received 89.1% (2009 - 90.9%) of its gross premiums written from three reinsurance brokers (2009 - three). Subsidiaries and affiliates of AON Benfield, Marsh Inc. and the Willis Group accounted for approximately 58.8%, 23.2%, and 7.1% respectively (2009 - 60.8%, 21.8% and 8.3%), of the Company's gross premiums written in 2010.

NOTE 9. SHAREHOLDERS' EQUITY

The aggregate authorized capital of the Company is 4,480,000 common shares. The Company's authorized \$1.00 par value common shares at December 31, 2010 and 2009 are segregated into share classes as follows:

	Number of Shares				Outstanding 2010	Par Value 2010
	Authorized	Outstanding 2009	Issued	Redeemed		
Class A	230,000	251,389	-	(20,484)	230,905	\$ 231
Class AA	3,000,000	3,000,000	-	-	3,000,000	3,000
Class B	230,000	190,441	-	-	190,441	190
Class C	100,000	-	-	-	-	-
Class D	230,000	67,434	17,095	(17,107)	67,422	68
Class E	230,000	5,219	-	(2,625)	2,594	3
Class F	460,000	144,042	-	(74,789)	69,253	69
	4,480,000	3,658,525	17,095	(115,005)	3,560,615	\$ 3,561

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

DECEMBER 31, 2010 AND 2009

(amounts in tables expressed in thousands of United States dollars)

NOTE 9. SHAREHOLDERS' EQUITY, cont'd.

	Number of Shares				Outstanding 2009	Par Value 2009
	Authorized	Outstanding 2008	Issued	Redeemed		
Class A	230,000	160,624	90,765	-	251,389	\$ 252
Class AA	3,000,000	3,000,000	-	-	3,000,000	3,000
Class B	230,000	190,441	-	-	190,441	190
Class C	100,000	-	-	-	-	-
Class D	230,000	67,505	-	(71)	67,434	68
Class E	230,000	6,180	-	(961)	5,219	5
Class F	460,000	280,755	-	(136,713)	144,042	144
	4,480,000	3,705,505	90,765	(137,745)	3,658,525	\$ 3,659

Class A shares have full voting rights. All Class AA shares are owned by DaVinci and are entitled to 99.8% of the economic interest of the Company and 0.1% of the voting rights of the Company. Class B and D shares have voting rights that are limited to 9.9% for each class. Class E and F shares are non-voting. Other than the Class AA shares, all shares have equal dividend and participation rights. However, special dividends have been and may be awarded to the Class AA shareholders, to cover the debt servicing cost of DaVinci, upon approval from the Board of Directors. In the event of a mandatory redemption instituted by the Company, Class D, E and F shares are redeemable first, followed by Class B shares. Additionally, Class B shares have certain rights requiring them to be redeemed only in proportion to Class A shares. In the event of a share issuance involving a new shareholder, either a joiner agreement must be executed by the new shareholder, or a new shareholder agreement would be required and must be signed by all shareholders. Additionally, the existing shareholders have the right of first refusal for any new share issuances.

Shareholders are party to a shareholders agreement (the "Shareholders Agreement") which provides the shareholders, excluding ROIHL, with certain redemption rights that enable each shareholder to notify DaVinci of such shareholder's desire for DaVinci to repurchase up to half of such shareholder's aggregate number of shares held, subject to certain limitations, such as limiting the aggregate of all share repurchase requests to 25% of DaVinci's capital in any given year and satisfying all applicable regulatory requirements. If total shareholder requests exceed 25% of DaVinci's capital, the number of shares repurchased will be reduced among the requesting shareholders pro-rata, based on the amounts desired to be repurchased. Shareholders desiring to have the DaVinci repurchase their shares must notify DaVinci before March 1 of each year. The repurchase price will be based on GAAP book value as of the end of the year in which the shareholder notice is given, and the repurchase will be effective as of such date. Payment will be made by April 1 of the following year, following delivery of the audited financial statements for the year in which the repurchase was effective. The repurchase price is subject to a true-up for development on outstanding loss reserves after settlement of all claims relating to the applicable years.

Certain third party shareholders of DaVinci submitted repurchase notices on or before the required annual redemption notice date of March 1, 2010, in accordance with the Shareholders Agreement. The repurchase notices submitted on or before March 1, 2010 were for shares of DaVinci with a GAAP book value of \$88.4 million at December 31, 2010. Effective January 1, 2011, DaVinci redeemed the shares and returned additional capital for an aggregate of \$175.0 million, less a \$17.5 million reserve holdback.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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NOTE 9. SHAREHOLDERS' EQUITY, cont'd.

Certain third party shareholders of DaVinci submitted repurchase notices on or before the required annual redemption notice date of March 1, 2009, in accordance with the Shareholders Agreement. The repurchase notices submitted on or before March 1, 2009 were for shares of DaVinci with a GAAP book value of \$173.6 million at December 31, 2009. Effective January 1, 2010, DaVinci redeemed the shares for \$173.6 million, less a \$17.6 million reserve holdback. During the year ended December 31, 2010, the Company recorded a net adjustment of \$2.8 million related to the development of outstanding losses with respect to the shares of DaVinci previously redeemed, as described above.

Refer to Note 14 for additional common share transactions occurring subsequent to December 31, 2010.

NOTE 10. TAXATION

Under current Bermuda law, the Company is not subject to any income or capital gains taxes. In the event that such taxes are imposed, the Company would be exempted from any such tax until March 2016 pursuant to the Bermuda Exempted Undertakings Tax Protection Act of 1966, and Amended Act of 1987.

NOTE 11. STATUTORY REQUIREMENTS

Under the Insurance Act 1978, amendments thereto and Related Regulations of Bermuda (the "Insurance Act"), the Company is required to prepare statutory financial statements and to file in Bermuda a statutory financial return. The Insurance Act also requires the Company to maintain certain measures of solvency and liquidity. At December 31, 2010, the statutory capital and surplus of the Company was \$1,472.8 million (2009 - \$1,455.9 million) and the minimum amount required to be maintained under Bermuda law, the Minimum Solvency Margin, was \$163.1 million (2009 - \$166.1 million). In addition, a minimum liquidity ratio must be maintained whereby relevant assets, as defined by the Act, must exceed 75% of relevant liabilities. At December 31, 2010 and 2009, the liquidity ratio was met.

Under the Insurance Act, the Company is classified as a Class 4 insurer, and is therefore restricted as to the payment of dividends in the amount of 25% of the prior year's statutory capital and surplus, unless at least two members of the Board of Directors attest that a dividend in excess of this amount would not cause the Company to fail to meet its relevant margins. During 2010, the Company declared and paid cash dividends of \$3.1 million (2009 - \$4.1 million) to DaVinci.

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NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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NOTE 11. STATUTORY REQUIREMENTS, cont'd.

Under the Insurance Act, the Company, because it is a Class 4 insurer, must maintain capital at a level equal to its enhanced capital requirement ("ECR") which is established by reference to the Bermuda Solvency Capital Requirement ("BSCR") model. The BSCR is a standard mathematical model designed to give the Bermuda Monetary Authority ("BMA") more advanced methods for determining an insurer's capital adequacy. Underlying the BSCR is the belief that all insurers should operate on an ongoing basis with a view to maintaining their capital at a prudent level in excess of the minimum solvency margin otherwise prescribed under the Insurance Act. Alternatively, under the Insurance Act, insurers may, subject to the terms of the Insurance Act and to the BMA's oversight, elect to utilize an approved internal capital model to determine regulatory capital. In either case, the ECR shall at all times equal or exceed the Class 4 insurer's Minimum Solvency Margin and may be adjusted in circumstances where the BMA concludes that the insurer's risk profile deviates significantly from the assumptions underlying its ECR or the insurer's assessment of its risk management policies and practices used to calculate the ECR applicable to it. While not specifically referred to in the Insurance Act, the BMA has also established a target capital level ("TCL") for each Class 4 insurer equal to 120% of its ECR.

While a Class 4 insurer is not currently required to maintain its statutory capital and surplus at this level, the TCL serves as an early warning tool for the BMA and failure to maintain statutory capital at least equal to the TCL will likely result in increased BMA regulatory oversight. The Company is currently completing its 2010 BSCR which must be filed with the BMA on or before April 30, 2011, and at this time believes it will exceed the target level of required capital.

NOTE 12. DERIVATIVE INSTRUMENTS

The Company enters into derivative instruments such as futures, options, swaps, forward contracts and other derivative contracts primarily in order to manage its foreign currency exposure, obtain exposure to a particular financial market or for yield enhancement. The Company accounts for its derivatives in accordance with FASB ASC Topic *Derivatives and Hedging*, which requires all derivatives to be recorded at fair value on the Company's balance sheet as either assets or liabilities, depending on the rights or obligations of the derivatives, with changes in fair value reflected in current earnings. The Company does not currently apply hedge accounting in respect of any positions reflected in its financial statements. The fair value of the Company's derivatives are estimated by reference to quoted prices or broker quotes, where available, or in the absence of quoted prices or broker quotes, the use of industry or internal valuation models. Where the Company has entered into master netting agreements with counterparties, or the Company has the legal and contractual right to offset positions, the derivative positions are generally netted by counterparty and are reported accordingly in other assets and other liabilities.

Interest Rate Futures

The Company uses interest rate futures within its portfolio of fixed maturity investments to manage its exposure to interest rate risk, which can include increasing or decreasing its exposure to this risk. At December 31, 2010, the Company had \$148.7 million of notional long positions of primarily Eurodollar futures contracts. The fair value of these derivatives as recognized in other assets in the Company's balance sheet at December 31, 2010, was \$26 thousand. During the year ended December 31, 2010, the Company recorded gains of \$1.6 million in its statements of operations related to these derivatives. The fair value of these derivatives is determined using exchange traded prices.

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NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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NOTE 12. DERIVATIVE INSTRUMENTS, cont'd.

Underwriting Operations Related Foreign Currency Contracts

The Company's functional currency is the U.S. dollar. The Company writes a portion of its business in currencies other than U.S. dollars and may, from time to time, experience foreign exchange gains and losses, in the Company's financial statements. All changes in exchange rates, with the exception of non-U.S. dollar denominated investments classified as available for sale and non-monetary assets and liabilities, are recognized currently in the Company's statements of operations.

The Company's foreign currency policy with regard to its underwriting operations is generally to hold foreign currency assets, including cash, investments and receivables that approximate the foreign currency liabilities, including claims and claim expense reserves and reinsurance balances payable. When necessary, the Company may use foreign currency forward and option contracts to minimize the effect of fluctuating foreign currencies on the value of non-U.S. dollar denominated assets and liabilities associated with its underwriting operations.

At December 31, 2010, the Company had outstanding underwriting operations related foreign currency contracts of \$4.0 million in long positions and \$86.8 million in short positions, denominated in U.S. dollars (2009 - \$17.0 million and \$17.0 million, respectively). For the year ended December 31, 2010, the Company recorded gains of \$3.2 million (2009 - loss of \$0.9 million) on its foreign currency forward and option contracts related to its underwriting operations. The fair value of these contracts as of December 31, 2010 was a net asset of \$2.6 million (2009 - liability of \$0.2 million) and was included in other assets. Changes in the fair value of the Company's foreign currency derivatives are recognized in the Company's statements of operations.

Reinsurance Derivatives

Refer to Note 4 for "Reinsurance Contracts Accounted for at Fair Value".

The Company has also entered into Agreements with a major bank to sell certain securities within the Company's Cat-Linked Securities, while retaining the underlying risk through a credit derivatives agreement. Please refer to Note 6 for additional information.

NOTE 13. COMMITMENTS AND CONTINGENCIES

Concentration of credit risk

Instruments which potentially subject the Company to concentration of credit risk consist principally of investments, cash, premiums receivable and reinsurance balances. The Company limits the amount of credit exposure to any one financial institution and except for U.S. treasuries, none of the Company's investments exceeded 10% of shareholders' equity at December 31, 2010. See Notes 5 and 7 for information with respect to reinsurance recoverables.

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NOTE 13. COMMITMENTS AND CONTINGENCIES, cont'd.

Letters of credit

RenaissanceRe, the Company's ultimate parent, maintains a letter of credit facility (the "Facility") which, as of December 31, 2010, makes available to its operating subsidiaries and joint ventures letters of credit having an aggregate face amount not to exceed \$1.0 billion. Effective February 15, 2011, RenaissanceRe further reduced the commitments under the Facility from \$1.0 billion to \$700.0 million. Effective March 7, 2011, RenaissanceRe further reduced the commitments under the Facility from \$700.0 million to \$600.0 million. The reduction in the Facility was implemented in connection with a reassessment of the future collateral needs of RenaissanceRe's operating subsidiaries and joint ventures, taking into account, among other things, their access to alternative sources of credit. The commitments may be increased up to an amount not to exceed \$1.1 billion, subject to the satisfaction of certain conditions. The Facility expires on April 22, 2013. The operating subsidiaries or joint ventures may draw down from the Facility as required, so long as they provide eligible collateral and there are no specific allocations of the facility to certain operating subsidiaries or joint ventures. At December 31, 2010, RenaissanceRe's bankers have issued letters of credit of approximately \$591.5 million in favor of certain ceding companies of which approximately \$58.8 million (2009 - \$116.3 million) relates to the Company. The letters of credit are secured by cash and investments of similar amounts.

Indemnifications and warranties

In the ordinary course of its business, the Company may enter into contracts or agreements that contain indemnifications or warranties. Future events could occur that lead to the execution of these provisions against the Company. Based on past experience, management currently believes that the likelihood of such an event is remote.

Litigation

The Company can be subject to claims litigation involving disputed interpretations of policy coverages. Lawsuits, involving claims on policies issued by the Company are typical to the insurance industry in general and in the normal course of business and are considered in its claims and claim expenses reserves. In addition to claims litigation, the Company can be subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on insurance policies. This category of business litigation may involve allegations of underwriting or claims-handling errors or misconduct, employment claims, regulatory activity or disputes arising from our business ventures. Any such litigation or arbitration contains an element of uncertainty, and the inherent uncertainty in such matters may have increased recently and will likely continue to increase. Currently, the Company believes that no individual, normal course litigation or arbitration to which the Company is presently a party is likely to have a material adverse effect on its financial condition, business or operations.

DAVINCI REINSURANCE LTD.

NOTES TO THE FINANCIAL STATEMENTS, Cont'd.

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NOTE 14. SUBSEQUENT EVENTS

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date of December 31, 2010, through April 1, 2011, the date the financial statements were available to be issued.

Certain third party shareholders of DaVinci submitted repurchase notices on or before the required annual redemption notice date of March 1, 2011, in accordance with the Shareholders Agreement. The repurchase notices submitted on or before March 1, 2011 were for shares of DaVinci with a GAAP book value of \$22.8 million at December 31, 2010.

On February 22, 2011, an earthquake struck the South Island of New Zealand near Christchurch (the "February 2011 New Zealand earthquake") causing significant destruction. Given the magnitude and recent occurrence of this event, there is a lack of data available from industry participants and clients, resulting in significant uncertainty with respect to potential insured losses from this event, and also with respect to the Company's potential losses from this event. At this time, the Company has not received meaningful loss or claims reports from brokers or clients. Based upon the publicly available industry preliminary insured loss estimates, market share analysis, the application of the Company's modeling techniques and a review of the Company's in-force contracts, the Company's current preliminary assessment is that the impact of the February 2011 New Zealand earthquake on its financial results is estimated to be \$94.1 million. Losses from this event will be recorded in the Company's 2011 results.

On March 11, 2011, a significant earthquake and tsunami impacted the northeastern coast of Japan (the "Tohoku earthquake") causing significant destruction. Given the magnitude and recent occurrence of this event, there is a lack of data available from industry participants and clients, resulting in significant uncertainty with respect to potential insured losses from this event, and also with respect to the Company's potential losses from this event. At this time, the Company believes it is too early to provide an accurate estimate of the net loss from this tragic event due to the unusual severity and complexity of the event and the preliminary nature of the available information. However, based upon the current publicly available industry insured loss estimates, market share analysis, the application of the Company's modeling techniques and a review of its in-force contracts, the Company's current initial assessment is that the impact of the Tohoku earthquake on the Company's financial results will be significant and is likely to be material.