Montpelier Reinsurance Ltd.

Consolidated Financial Statements
December 31, 2010 and 2009
(expressed in millions of U.S. dollars)

Report of Independent Auditors

To: The Board of Directors and Shareholder of Montpelier Reinsurance Ltd.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and comprehensive income, of changes in shareholder's equity and of cash flows present fairly, in all material respects, the financial position of Montpelier Reinsurance Ltd. and its subsidiary at December 31, 2010 and December 31, 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers

Hamilton, Bermuda
April 29, 2011

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Montpelier Reinsurance Ltd.

Consolidated Balance Sheets

As at December 31, 2010 and 2009

(expressed in millions of U.S. dollars, except share and per share amounts)

	2010 $	2009 $ (See Note 10)
Assets		
Fixed maturity investments, at fair value (amortized cost: $2,067.8 and $2,036.7)	2,084.7	2,065.3
Equity securities, at fair value (cost: $116.9 and $150.3)	152.9	167.2
Other investments (cost $77.9 and $81.2)	84.0	80.2
Total investments	2,321.6	2,312.7
Cash and cash equivalents	146.2	132.3
Restricted cash	24.1	39.5
Reinsurance recoverable on unpaid losses	54.0	63.1
Reinsurance recoverable on paid losses	12.6	44.5
Premiums receivable	124.2	115.8
Unearned premium ceded	20.2	10.7
Deferred acquisition costs	24.5	22.9
Accrued investment income	15.3	14.2
Unsettled sales of investments	32.5	1.5
Amounts due from affiliates	156.7	128.4
Other assets	16.4	26.7
Total assets	2,948.3	2,912.3
Liabilities		
Loss and loss adjustment expense reserves	720.6	643.1
Unearned premium	157.4	141.7
Insurance and reinsurance balances payable	21.2	30.0
Unsettled purchases of investments	108.9	8.6
Amounts due to affiliates	1.7	5.9
Accounts payable, accrued expenses and other liabilities	35.8	63.6
Total liabilities	1,045.6	892.9
Common shareholder's equity		
Common shares at $1.00 par value per share – authorized and Issued 1,000,000 shares	1.0	1.0
Additional paid-in capital	1,558.6	1,558.6
Retained earnings	343.1	457.2
Accumulated other comprehensive income	-	2.6
Total common shareholder's equity	1,902.7	2,019.4
Total liabilities and common shareholder's equity	2,948.3	2,912.3

Approved by the Board of Directors

____________________ Director   ____________________ Director

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

Montpelier Reinsurance Ltd.

Consolidated Statements of Operations and Comprehensive Income

For the years ended December 31, 2010 and 2009

(expressed in millions of U.S. dollars)

	2010 $	2009 $
Revenues		
Gross premiums written	611.5	563.3
Reinsurance premiums ceded	(41.7)	(24.8)
Net premiums written	569.8	538.5
Changes in net unearned premiums	(6.1)	(8.8)
Net premiums earned	563.7	529.7
Net investment income	72.1	78.8
Net realized and unrealized investment gains	53.2	181.4
Net foreign exchange gains (losses)	1.0	(0.7)
Net income (expense) from derivative instruments	(4.8)	7.3
Other revenues	0.2	0.1
Total revenues	685.4	796.6
Expenses		
Underwriting expenses:		
Loss and loss adjustment expenses	258.3	116.5
Acquisition costs	93.6	76.5
General and administrative expenses	56.2	77.8
Non-underwriting expenses:		
Interest and other financing expenses	1.4	1.5
Total expenses	409.5	272.3
Net income	275.9	524.3
Change in fair value of Symetra	-	(0.6)
Reclassification of inception-to-date net unrealized gain from Symetra	(2.6)	-
Comprehensive income	273.3	523.7

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

Montpelier Reinsurance Ltd.

Consolidated Statements of Shareholder's Equity

For the years ended December 31, 2010 and 2009

(expressed in millions of U.S. dollars)

	Total common shareholder's equity $	Common shares $	Additional paid-in capital $ (See Note 10)	Retained earnings $ (See Note 10)	Accumulated other comprehensive income (loss) $
Balances at January 1, 2009	1,616.2	1.0	1,573.6	38.4	3.2
Net income	524.3	-	-	524.3	-
Other comprehensive loss	(0.6)	-	-	-	(0.6)
Distributions to common shareholder	(120.5)	-	(15.0)	(105.5)	-
Balances at December 31, 2009	2,019.4	1.0	1,558.6	457.2	2.6
Net income	275.9	-	-	275.9	-
Other comprehensive loss	(2.6)	-	-	-	(2.6)
Distributions to common shareholder	(390.0)	-	-	(390.0)	-
Balances at December 31, 2010	1,902.7	1.0	1,558.6	343.1	-

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

Montpelier Reinsurance Ltd.

Consolidated Statements of Cash Flows

For the years ended December 31, 2010 and 2009

(expressed in millions of U.S. dollars)

	2010 $	2009 $
Cash flows from operations		
Net income	275.9	524.3
Charges (credit) to reconcile net income (loss) to net cash from operations:		
Net realized and unrealized investment gains	(53.2)	(181.4)
Net realized and unrealized investment losses (gains) on investment-related derivative instruments	5.6	(8.1)
Net amortization and depreciation of assets and liabilities	12.9	5.0
Net change in:		
Loss and loss adjustment expense reserves	77.5	(141.7)
Reinsurance recoverable on paid and unpaid losses	41.0	42.9
Unearned premium	15.7	(1.7)
Deferred acquisition costs	(1.6)	(3.2)
Premiums receivable	(8.4)	18.4
Amounts due to/from affiliates, net	(32.5)	(97.1)
Other	(22.2)	(4.2)
Net cash provided from operations	310.7	153.2
Cash flows from investing activities		
Purchases of fixed maturity investments	(2,410.8)	(2,234.7)
Purchases of equity securities	(291.2)	(311.8)
Purchases of other investments	(100.9)	(92.9)
Sales, maturities, calls and pay downs of fixed maturity	2,453.3	1,930.5
Sales and redemptions of equity securities	352.5	485.8
Sales and redemptions of other investments	92.4	166.2
Settlements of investment-related derivative instruments	(7.7)	9.5
Payment of accrued investment performance fees	(9.8)	-
Net change in restricted cash	15.4	(32.7)
Net acquisitions of capitalized assets	-	0.2
Net cash provided from (used for) investing activities	93.2	(79.9)
Cash flows from financing activities		
Distributions paid to the Company's shareholder	(390.0)	(120.5)
Net cash used for financing activities	(390.0)	(120.5)
Net increase (decrease) in cash and cash equivalents during the year	13.9	(47.2)
Cash and cash equivalents – beginning of year	132.3	179.5
Cash and cash equivalents – end of year	146.2	132.3

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

(expressed in millions of U.S. dollars)

1. General

Montpelier Reinsurance Ltd. (the “Company”) was incorporated under the laws of Bermuda on November 14, 2001 and is a wholly-owned subsidiary of Montpelier Re Holdings Ltd. (“MRH”), a Bermuda-based holding company listed on the New York Stock Exchange and the Bermuda Stock Exchange.

The Company is registered as a Bermuda Class 4 insurer and seeks to identify and underwrite attractive insurance and reinsurance opportunities by combining underwriting experience with proprietary risk pricing and capital allocation models and catastrophe modeling tools.

2. Summary of Significant Accounting Policies

(a) **Basis of Presentation**
These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Montpelier Investments Holdings Ltd. (“MIHL”). MIHL is a Bermuda company in which certain of the Company's investments are held. All significant inter-company balances have been eliminated.

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

(b) **Insurance and Reinsurance Premiums and Related Costs**
Reinsurance contracts can be written on a risks-attaching or losses-occurring basis. Under risks-attaching reinsurance contracts, all claims from cedants’ underlying policies incepting during the contract period are covered, even if they occur after the expiration date of the reinsurance contract. In contrast, losses-occurring reinsurance contracts cover all claims occurring during the period of the contract, regardless of the inception dates of the underlying policies. Any claims occurring after the expiration of the losses-occurring contract are not covered.

Premiums written are recognized as revenues, net of any applicable underlying reinsurance coverage, and are earned over the term of the related policy or contract. For direct insurance, and facultative and losses-occurring contracts, the earnings period is the same as the reinsurance contract. For risks-attaching contracts, the earnings period is based on the terms of the underlying insurance policies.

For contracts that have a risk period of three years or less, the premiums are earned ratably over the term. For the relatively few contracts with risk periods greater than three years, premiums are earned in accordance with predetermined schedules that reflect the level of risk associated with each period in the contract term. These schedules are reviewed periodically and are adjusted as deemed necessary.

For the majority of the Company’s excess-of-loss contracts, written premium is based on the deposit or minimum premium as defined in the contract. Subsequent adjustments, based on reports of actual premium or revisions in estimates by ceding companies, are recorded in the period in which they are determined. For the Company’s pro-rata contracts and excess-of-loss contracts where no deposit or minimum premium is specified in the contract, written premium is recognized based on estimates of ultimate premiums provided by ceding companies and the Company’s underwriters. Initial estimates of written premium are recognized in the period in which the underlying risks incept. Subsequent adjustments, based on reports of actual premium by the ceding companies, or revisions in estimates, are recorded in the period in which they are determined. Unearned premiums represent the portion of

(expressed in millions of U.S. dollars)

premiums written that are applicable to future insurance or reinsurance coverage provided by policies or contracts in force.

Premiums receivable are recorded at amounts due less any provision for doubtful accounts. As of December 31, 2010 and 2009, the Company's provision for doubtful accounts was $3.0 million and $2.3 million, respectively.

When a reinsurance contract provides for a reinstatement of coverage following a covered loss, the associated reinstatement premium is recorded as both written and earned premium when the Company determines that the loss event has occurred.

Deferred acquisition costs are comprised of ceding commissions, brokerage, premium taxes and excise taxes, each of which relates directly to the writing of insurance and reinsurance contracts. These deferred acquisition costs are generally amortized over the underlying risk period of the related contracts. However, if the sum of a contracts' expected losses and LAE, and deferred acquisition costs exceeds related unearned premiums and projected investment income, a premium deficiency is determined to exist. In this event, deferred acquisition costs are immediately expensed to the extent necessary to eliminate the premium deficiency. If the premium deficiency exceeds deferred acquisition costs then a liability is accrued for the excess deficiency. During the year the Company did not record a premium deficiency.

Included in acquisition costs are profit commissions incurred. Accrued profit commissions are included in insurance and reinsurance balances payable.

(c) **Loss and LAE Reserves**

Loss and LAE reserves are comprised of case reserves (which are based on claims that have been reported) and IBNR reserves (which are based on losses that are believed to have occurred but for which claims have not yet been reported and may include a provision for expected future development on case reserves). Case reserve estimates are initially set on the basis of loss reports received from third parties. Estimated IBNR reserves consist of a provision for additional development in excess of the case reserves reported by ceding companies as well as a provision for claims which have occurred but which have not yet been reported to us by ceding companies. IBNR reserves are estimated by management using various actuarial methods as well as a combination of the Company's own loss experience, historical insurance industry loss experience and management's professional judgment. The Company's internal actuaries review the reserving assumptions and methodologies on a quarterly basis and its loss estimates are subject to an annual corroborative review by independent actuaries using generally accepted actuarial principles.

The uncertainties inherent in the reserving process, reliance and delays in ceding companies reporting losses, together with the potential for unforeseen adverse developments, may result in loss and LAE reserves ultimately being significantly greater or less than the reserve provided at the end of any given reporting period. The degree of uncertainty is further increased when a significant loss event takes place near the end of a reporting period. Loss and loss adjustment expense reserve estimates are regularly reviewed and updated as new information becomes known. Any resulting adjustments are reflected in income in the period in which they become known.

A significant portion of the Company's current business is in the Property Catastrophe class of business and other classes with high attachment points of coverage. As a result, reserving for losses relating to such programs can be imprecise. Montpelier's exposures are also highly leveraged, meaning that the proportional impact of any change in the estimate of total loss incurred by the cedent is magnified in the layers at which the Company's coverage attaches. Additionally, the high-severity, low-frequency nature of

(expressed in millions of U.S. dollars)

the exposures limits the volume of claims experience available from which to reliably predict ultimate losses following a loss event, and renders certain traditional loss estimation techniques inapplicable.

(d) **Ceded Reinsurance**
In the normal course of business, the Company purchases reinsurance from third-parties in order to manage its exposures. The amount of ceded reinsurance that the Company buys varies from year-to-year depending on its risk appetite, and the availability and cost of ceded reinsurance. Reinsurance premiums ceded are accounted for on a basis consistent with those used in accounting for the underlying premiums assumed, and are reported as a reduction of net premiums written. Certain of the Company's assumed pro-rata contracts incorporate reinsurance protection provided by third-party reinsurers that inures to the Company's benefit. These reinsurance premiums are reported as a reduction in gross premiums written.

The cost of reinsurance purchased varies based on a number of factors. The initial premium associated with excess-of-loss reinsurance is normally based on the underlying premiums assumed by the Company. As these reinsurance contracts are usually purchased prior to the time the assumed risks are written, ceded premium recorded in the period of inception reflects an estimate of the amount that the Company will ultimately pay. In the majority of cases, the premium initially recorded is subsequently adjusted to reflect premium actually assumed by the Company during the contract period. These adjustments are recorded in the period they are determined, and to date have not been significant. In addition, losses which pierce excess-of-loss reinsurance cover may generate reinstatement premium ceded, depending on the terms of the contract. This reinstatement premium ceded is recognized as written and expensed at the time the reinsurance recovery is estimated and recorded.

The cost of quota share reinsurance is initially based on the Company's estimated gross premium written related to the specific lines of business covered by the reinsurance contract. As gross premiums are written during the period of coverage, reinsurance premiums ceded are adjusted in accordance with the terms of the quota share agreement.

Reinsurance recoverable on paid losses represents amounts currently due from reinsurers. Reinsurance recoverable on unpaid losses represent amounts collectible from reinsurers once the losses are paid. The recognition of reinsurance recoverable requires two key judgments. The first judgment involves the estimation of the amount of gross IBNR to be ceded to reinsurers. Ceded IBNR is generally developed as part of the Company's loss reserving process and consequently, its estimation is subject to similar risks and uncertainties as the estimation of gross IBNR. The second judgment relates to the amount of the reinsurance recoverable balance that ultimately will not be collected from reinsurers due to insolvency, contractual dispute, or other reasons.

(e) **Investments and Cash**
The Company's fixed maturity investments and equity securities are carried at fair value, with the net unrealized appreciation or depreciation on such securities reported within net realized and unrealized gains (losses) in the Company's statement of operations.

The Company's other investments are carried at either fair value or on the equity method of accounting (which is based on underlying net asset values) and consist primarily of investments in limited partnership interests and private investment funds, event-linked securities ("CAT Bonds"), private placements and certain derivative instruments. See Notes 7 and 9.

Investments are recorded on a trade date basis. The fair value of the investment portfolio is determined based on bid prices (as opposed to ask prices) which are not adjusted for transaction costs. Gains and losses on sales of investments are determined on the first-in, first-out basis and are included in income when realized. Realized gains and losses generally result from the sale of securities. Unrealized gains and

(expressed in millions of U.S. dollars)

losses represent the gain or loss that would result from a hypothetical sale of securities on the reporting date. In instances where the Company becomes aware of a significant unrealized loss with little or no likelihood of recovery, it writes down the cost basis of the investment and recognizes the loss as being realized.

Some of the Company's investment managers are entitled to performance fees determined as a percentage of the portfolio's net total return achieved over specified periods. The Company's net realized and unrealized investment gains and net income (expenses) from derivative instruments are presented net of any associated performance fees. The Company incurred performance fees related to investments and investment-related derivative instruments of $1.5 million and $0.4 million, respectively, during 2010 and $8.3 million and $1.4 million, respectively, during 2009.

Cash and cash equivalents include cash and fixed income investments with maturities of less than three months, as measured from the date of purchase. Restricted cash of $24.1 million and $39.5 million at December 31, 2010 and 2009, respectively, consisted of collateral supporting open short sale investment and derivative positions. .

Net investment income is stated net of investment management, custody and other investment-related expenses. Investment income is recognized when earned and includes interest and dividend income together with the amortization of premiums and the accretion of discounts on fixed maturities purchased at amounts different from their par value.

(f) **Funds Withheld**

Funds withheld by reinsured companies represent insurance balances retained by ceding companies in accordance with contractual terms. The Company typically earns investment income on these balances during the period the funds are held. At December 31, 2010 and 2009, funds withheld balances of $5.9 million and $4.0 million, respectively, were recorded within other assets on the consolidated balance sheets.

(g) **Changes in Accounting Principles and Recent Accounting Pronouncements**

In April 2009 the FASB issued new accounting guidance that outlines factors to be considered by a reporting entity in determining whether a market for an asset or liability is active. Factors indicating inactivity in a market include: few recent transactions; price quotations that are not based on current information or which vary substantially over time or among market makers; a significant increase in implied liquidity risk premiums, yields or performance indicators; a wide bid-ask spread; and a significant decline or absence of a market for new issuances or limited information released publicly. In circumstances where the reporting entity concludes that there has been a significant decrease in the volume of market activity for an asset or liability as compared to normal market activity, transactions or quoted prices may not reflect fair value. In such circumstances, the new guidance requires analysis of the transactions or quoted prices and, where appropriate, adjustment to estimate fair value. In addition, the new guidance expands interim disclosures to require a description of the inputs and valuation techniques used to estimate fair value and a discussion of changes during the period. The Company adopted this new guidance during the second quarter of 2009. This adoption did not have a material impact on the Company's operations or financial position or on its financial statement disclosure.

In May 2009 the FASB issued new accounting guidance requiring companies to evaluate events or transactions that occur after the balance sheet date through the date that the financial statements are issued or available to be issued. This guidance did not materially change the manner in which the Company reports subsequent events, either through recognition or disclosure. The Company adopted this guidance during the second quarter of 2009.

(expressed in millions of U.S. dollars)

In June 2009 the FASB approved the *FASB Accounting Standards Codification* (the "Codification") as the single source of authoritative nongovernmental GAAP. The Codification was effective for financial statements that cover interim and annual periods ending after September 15, 2009. The Codification was not designed to change GAAP other than by resolving certain minor inconsistencies that previously existed. Rather it is intended to make it easier to find and research GAAP applicable to a particular transaction or specific accounting issue.

In June 2009 the FASB issued new accounting guidance which will change the way entities account for securitizations and special-purpose entities. The new guidance will require more information about transfers of financial assets, including securitization transactions, and where companies have continuing exposure to the risks related to transferred financial assets. It eliminates the concept of a qualifying special-purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosures. The new guidance will also change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The new guidance did not have a material impact on the presentation of the Company's operations or financial condition.

In September 2009 the FASB issued new accounting guidance on using net asset values per share provided by investees to estimate the fair value of alternative investments. The guidance permits an entity to use net asset value as a practical expedient on an investment-by-investment basis and also requires disclosure about the attributes of such investments. This guidance, which the Company adopted during the fourth quarter of 2009, did not have a material impact on the presentation of the Company's operations or financial position. The Company's enhanced disclosure resulting from this new accounting guidance is incorporated in Note 7.

In January 2010 the FASB issued new accounting guidance intended to improve disclosures about fair value measurements. As discussed in Note 7, GAAP establishes a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The newly issued accounting guidance adds requirements for disclosures about transfers into and out of these levels, as well as for separate disclosures about purchases, sales, issuances and settlements relating to one of these levels. The adoption of this guidance did not have a material impact on the presentation of the Company's operations or financial condition.

In July 2010 the FASB issued new accounting guidance intended to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. The objective of the guidance is to facilitate financial statement users' evaluation of (i) the nature of credit risk inherent in a company's portfolio of financing receivables, (ii) how that risk is assessed in calculating an allowance for credit losses, if any, and (iii) the changes and reasons for those changes in any such allowance. The Company's adoption of this guidance did not impact the Company's disclosures regarding financing receivables.

In October 2010 the FASB issued new accounting guidance intended to address diversity in practice regarding the interpretation of which costs relating to the acquisition of insurance business qualify for deferral. The new guidance modifies the definition of the types of costs that can be capitalized. For example, the guidance specifies that insurance companies can no longer capitalize costs relating to unsuccessful business acquisition efforts. Similarly, costs associated with soliciting potential customers, market research, training and product development should be charged to expense as incurred. The new guidance, which is effective for fiscal years beginning after December 15, 2011, is not expected to have a material impact on the presentation of the Company's operations or financial position.

(expressed in millions of U.S. dollars)

(h) **Foreign Currency Exchange**
The U.S. dollar is the Company's reporting currency. Transactions involving certain monetary assets and liabilities denominated in foreign currencies have been remeasured into U.S. dollars at exchange rates in effect at the balance sheet date, and the related revenues and expenses are converted using either specific or average exchange rates for the period, as appropriate. Net foreign exchange gains and losses arising from these activities are reported as a component of net income in the period in which they arise.

3. *Unpaid Loss and LAE Reserves*

The following table summarizes the Company's unpaid loss and LAE reserve activities for the years ended December 31, 2010 and 2009:

	2010 $	2009 $
Gross loss and LAE reserves - beginning	643.1	784.8
Reinsurance recoverable on unpaid losses - beginning	(63.1)	(114.1)
Net loss and LAE reserves - beginning	580.0	670.7
Losses and LAE incurred relating to:		
Current year losses	362.2	190.4
Prior year losses	(103.9)	(73.9)
Total incurred losses and LAE	258.3	116.5
Losses and LAE paid and approved for payment:		
Current year losses	(62.5)	(27.1)
Prior year losses	(109.2)	(180.1)
Total losses and LAE paid and approved for payment	(171.7)	(207.2)
Net loss and LAE reserves - ending	666.6	580.0
Reinsurance recoverable on unpaid losses - ending	54.0	63.1
Gross loss and LAE reserves - ending	720.6	643.1

Losses and LAE incurred – 2010
Current year loss and LAE incurred included:

- $76.8 million associated with the February 2010 earthquake in Chile,
- $27.9 million associated with the September 2010 earthquake in New Zealand,
- $20.0 million from the Deepwater Horizon oil rig explosion and fire.

Prior year favorable loss and LAE reserve development of $103.9 million related primarily to the following loss events:

- Casualty classes of business, excluding medical malpractice and individual risk contracts, relating to several prior accident years ($11.5 million decrease),
- 2008 individual risk property loss ($10.7 million decrease),

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- Medical malpractice class of business, relating to several prior accident years ($8.0 million decrease),
- Other individual risk losses relating to several prior accident years ($7.4 million decrease),
- 2007 and 2008 non-U.S. catastrophes ($6.2 million decrease),
- 2009 European windstorm Klaus ($5.5 million decrease),
- 2005 Hurricanes Katrina, Rita and Wilma ($5.2 million decrease)
- The favorable commutation of reinsurance contracts, relating to multiple prior accident years ($4.9 million decrease).

The remaining prior year loss and LAE reserve development related to smaller adjustments made across multiple lines of business.

Losses and LAE incurred – 2009

Current year loss and LAE incurred included $52.8 million from relatively small catastrophe losses, including European windstorm Klaus and hail storms in Europe and Canada.

Prior year favorable loss and LAE reserve development of $73.9 million related primarily to the following loss events:

- 2005 Hurricanes Katrina, Rita and Wilma ($10.9 million decrease),
- 2008 Hurricane Ike ($3.8 million decrease),
- 2005 explosion ($4.5 million subrogation recovery),
- 2007 California wildfires ($4.0 million decrease),
- 2007 mining accident (claim settlement resulting in a $3.8 million decrease),
- 2007 European windstorm Kyrill and U.K. floods (decreases of $2.4 million each).

The remaining prior year loss and LAE reserve development related to smaller adjustments made across multiple lines of business.

4. Reinsurance with Third Parties

In the normal course of business, the Company purchases reinsurance from third parties in order to manage its exposures. The amount of reinsurance that the Company buys varies from year-to-year depending on its risk appetite, availability and cost. All of the Company's reinsurance purchases to date have represented prospective cover, meaning that the coverage has been purchased to protect us against the risk of future losses as opposed to covering losses that have already occurred but have not yet been paid. The majority of the Company's reinsurance contracts are excess-of-loss contracts covering one or more lines of business. To a lesser extent, the Company has also purchased quota share reinsurance with respect to specific lines of its business. The Company also purchases industry loss warranty ("ILW") policies which provide coverage for certain losses incurred, provided they are triggered by events exceeding a specified industry loss size as well

(expressed in millions of U.S. dollars)

as the Company's own incurred loss. For non-ILW excess-of-loss reinsurance contracts, the attachment point and exhaustion of these contracts are based solely on the amount of the Company's actual losses incurred from an event or events.

In addition, for certain pro-rata contracts that the Company enters into, the associated direct insurance contracts carry underlying reinsurance protection from third-party reinsurers, known as inuring reinsurance, which the Company nets against its gross premiums written.

The Company remains liable for losses it incurs to the extent that any third party reinsurer is unable or unwilling to make timely payments under reinsurance agreements. The Company would be liable in the event that the ceding companies are unable to collect amounts due from underlying third-party reinsurers.

Under the Company's reinsurance security policy, reinsurers are generally required to be rated "A-" (Excellent) or better by A.M. Best (or an equivalent rating with another recognized rating agency) at the time the policy is written. The Company also considers reinsurers that are not rated or do not fall within this threshold on a case-by-case basis when collateralized up to policy limits, net of any premiums owed. The Company monitors the financial condition and ratings of its reinsurers on an ongoing basis.

The Company records provisions for uncollectible reinsurance recoverable when collection becomes unlikely due to the reinsurer's inability to pay. The Company does not believe that there are any amounts uncollectible from its reinsurers as of the balance sheet dates presented.

Earned reinsurance premiums ceded were $32.1 million and $35.2 million for the years ended December 31, 2010 and 2009, respectively. Reinsurance recoveries of $19.2 million and $27.4 million were netted against the Company's loss and LAE for 2010 and 2009, respectively. In addition to loss recoveries, certain of the Company's ceded reinsurance contracts provide for recoveries of additional premiums, reinstatement premiums and for lost no-claims bonuses, which are incurred when losses are ceded to these reinsurance contracts.

5. Reinsurance Recoverable on Paid and Unpaid Losses

The A.M. Best ratings of the Company's reinsurers related to reinsurance recoverable on paid losses at December 31, 2010 and 2009, are as follows:

	December 31, 2010		December 31, 2009	
Rating	**Amount**	**% of Total**	Amount	% of Total
A+	**$ 5.6**	**44 %**	$ 42.7	96 %
A	**6.9**	**55**	1.7	4
A-	**0.1**	**1**	0.1	-
Total reinsurance recoverable on paid losses	**$ 12.6**	**100 %**	$ 44.5	100 %

(expressed in millions of U.S. dollars)

The A.M. Best ratings of the Company's reinsurers related to reinsurance recoverable on unpaid losses at December 31, 2010 and 2009, are as follows:

	December 31, 2010		December 31, 2009	
Rating	**Amount**	**% of Total**	Amount	% of Total
A++	**$ —**	**— %**	$ 0.4	1 %
A+	**16.0**	**30**	27.5	44
A	**20.5**	**38**	30.0	47
A-	**1.2**	**2**	2.2	3
Unrated by A.M. Best	**16.3**	**30**	3.0	5
Total reinsurance recoverable on unpaid losses	**$ 54.0**	**100%**	$ 63.1	100%

The Company's unrated reinsurance recoverables as of December 31, 2010 and 2009 relate to reinsurers that have either: (i) fully collateralized the reinsurance obligation; (ii) a Standard & Poor's financial strength rating equivalent to an A.M. Best rating of A- or better; or (iii) entered run-off but are considered by management to be financially sound.

6. *Reinsurance Disputes*

The Company is subject to litigation and arbitration proceedings in the normal course of its business. These proceedings often involve reinsurance contract disputes which are typical for the reinsurance industry. Expected or actual reductions in reinsurance recoveries due to contract disputes, as opposed to a reinsurer's inability to pay, are not recorded as an uncollectible reinsurance recoverable. Rather, they are factored into the determination of the Company's net loss and LAE reserves.

As of December 31, 2010, we had no ongoing material pending legal proceedings.

In June 2010 the Company resolved, through arbitration, a dispute involving two reinsurance contracts (the "Disputed Contracts") with Manufacturers Property and Casualty Limited ("MPCL") that originated in 2007. The Company subsequently received an award (the "Award") equal to the sum of all outstanding paid reinsurance recoverables owed to us as under the Disputed Contracts of March 31, 2010, a portion of our defense costs associated with the proceedings and accrued interest on overdue amounts owed through the date of payment.

In October 2010 the Company and MPCL further agreed to an early settlement (the "Settlement") of all remaining paid and unpaid reinsurance recoverables outstanding under the Disputed Contracts. The financial impact of the Settlement was not material to the Company.

The Company received a total of $51.6 million from MPCL during 2010 in satisfaction of both the Award and the Settlement of which $46.4 million represented paid and unpaid reinsurance recoverables outstanding under the Disputed Contracts and $5.2 million represented reimbursable defense costs and accrued interest.

The reinsurance payments received from MPCL during 2010 have been recorded as a reduction to reinsurance recoverable on paid and unpaid losses on the Company's consolidated balance sheets. The defense costs and accrued interest recovered from MPCL have been recorded as a reduction to general and administrative expenses on the Company's consolidated statements of operations.

(expressed in millions of U.S. dollars)

7. *Investments*

Fixed maturity Investments and Equity Securities
The table below shows the aggregate cost (or amortized cost) and fair value of the Company's fixed maturity investments and equity securities, by investment type, as of December 31, 2010 and 2009:

	December 31, 2010		December 31, 2009	
Fixed Maturity Investments:	**Cost or Amortized $**	**Fair Value $**	**Cost or Amortized $**	**Fair Value $**
Residential mortgage-backed securities	519.8	522.7	623.5	625.4
Corporate debt securities	651.9	665.6	507.5	541.3
Debt securities issued by the U.S. Treasury and its agencies	390.1	389.7	401.9	401.2
U.S. government-sponsored enterprise securities	210.7	212.2	319.8	318.8
Commercial mortgage-backed securities	133.9	133.3	64.1	60.3
Debt securities issued by states of the U.S. and political subdivisions	57.3	57.7	23.9	24.6
Other debt obligations	104.1	103.5	96.0	93.7
Total fixed maturity investments	2,067.8	2,084.7	2,036.7	2,065.3
Equity securities:				
Exchange-listed funds	44.6	44.6	2.9	3.1
Energy	22.5	41.6	35.2	44.3
Financial	19.2	23.0	33.9	38.1
Technology	16.1	21.5	23.2	26.9
Consumer goods	6.5	9.1	15.9	18.0
Materials	4.4	1.6	15.9	16.1
Other	3.6	11.5	23.3	20.7
Total equity securities	116.9	152.9	150.3	167.2

As of December 31, 2010, 85% of the Company's fixed maturity investments were either rated “A” (Strong) or better by Standard & Poor's or represented U.S. government or U.S. government-sponsored enterprise securities and 8% were rated “BBB” (Good) or below by Standard & Poor's.

In addition to the equity securities presented above, the Company also had open short equity positions recorded within its other liabilities of $25.4 million and $38.6 million at December 31, 2010 and 2009, respectively, with associated net unrealized losses of $1.3 million and $0.5 million, respectively.

(expressed in millions of U.S. dollars)

The contractual maturity of the Company's fixed maturity investments at December 31, 2010 and 2009 is presented below:

	December 31, 2010		December 31, 2009	
	Amortized $	Fair value $	Amortized $	Fair value $
Due in one year or less	124.4	127.6	228.2	231.9
Due after one year through five years	797.0	809.9	742.4	755.6
Due after five years through ten years	303.1	303.3	240.9	250.2
Due after ten years	85.6	84.4	41.5	48.2
Mortgage-backed and asset-backed securities	757.7	759.5	783.7	779.4
Total fixed maturity investments	2,067.8	2,084.7	2,036.7	2,065.3

Other Investments

The Company's investments in limited partnership interests and private investment funds are carried at either their fair value or their underlying net asset value, depending on the Company's ownership share. For those funds carried at fair value, the underlying net asset value is used as a best estimate of fair value. The Company's CAT Bonds, private placement and derivative instruments are carried at fair value.

The table below shows the aggregate cost and carrying value of the Company's other investments, by investment type, as at December 31, 2010 and 2009:

	December 31, 2010		December 31, 2009	
Other investments carried at net asset value:	Cost $	Carrying value $	Cost $	Carrying value $
Limited partnership interests and other	27.1	27.1	20.0	20.0
Other investments carried at fair value:				
CAT Bonds	10.0	10.6	10.0	10.0
Limited partnership interests	38.3	42.6	27.9	26.5
Symetra common shares	-	-	20.0	22.6
Derivative instruments	2.5	3.7	3.3	1.1
Total other investments carried at fair value	50.8	56.9	61.2	60.2
Other investments	77.9	84.0	81.2	80.2

Net appreciation or depreciation on the Company’s investments in limited partnerships, private investment funds and CAT Bonds is reported as net realized and unrealized gains (losses) in the Company's consolidated statements of operations. Net appreciation or depreciation on the Company’s derivative instruments is reported as net income (expense) from derivative instruments.

The Company’s interests in limited partnerships and private investment funds that are carried at fair value relate to vehicles that invest in distressed mortgages. Redemptions from these investments occur at the

(expressed in millions of U.S. dollars)

discretion of the investment manager or, in other cases, subject to a unanimous vote of the partners. The Company does not expect to redeem a significant portion of these investments prior to 2012.

In January 2010 the common stock of Symetra Financial Corporation ("Symetra") began trading on the New York Stock Exchange under symbol "SYA" as a result of the completion of Symetra's initial public offering (the "Symetra IPO"). Prior to the Symetra IPO, Montpelier's investment in Symetra was carried as an other investment on the Company's consolidated balance sheets and its net appreciation or depreciation was reported as a separate component of shareholder's equity, with changes therein reported as a component of other comprehensive income on the Company's consolidated statements of operations.

The Company's investment in Symetra is now presented as an equity security on the Company's consolidated balance sheets and changes in its fair value are recorded as net realized and unrealized gains (losses) on the Company's consolidated statements of operations. The Company's cumulative net appreciation associated with its investment in Symetra, which totaled $2.6 million at December 31, 2009, was reclassified from other comprehensive income during the first quarter of 2010 and is now included in net unrealized investment gains on the Company's consolidated statements of operations.

Montpelier also entered into various investment option and futures contracts during 2010 and 2009. See Note 9.

Fair Value Hierarchy

GAAP establishes a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into the three broad levels described below. The level in the hierarchy within which a given fair value measurement falls is determined based on the lowest level input that is significant to the measurement.

- Level 1 inputs - unadjusted, quoted prices in active markets for identical assets or liabilities.
- Level 2 inputs - information other than quoted prices included within Level 1 that is observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and observable inputs other than quoted prices, such as interest rates and yield curves.
- Level 3 inputs – unobservable inputs.

The Company uses an independent service provider for assistance with its investment accounting function. This service provider, as well as the Company's investment managers, in turn use several pricing services and brokers to assist with the determination of the fair value of the Company's marketable securities. The ultimate pricing source varies based on the security and pricing service, but investments valued on the basis of observable (Levels 1 and 2) inputs are generally assigned values on the basis of actual transactions. Securities valued on the basis of pricing models with significant unobservable inputs or non-binding broker quotes are classified as Level 3.

In accordance with GAAP, the valuation techniques used by the Company and its pricing services maximize the use of observable inputs; unobservable inputs are used to measure fair value only to the extent that observable inputs are unavailable. The Company uses the market approach and income approach valuation techniques. There have been no changes in the Company's use of valuation techniques since its adoption of the relevant accounting guidance.

(expressed in millions of U.S. dollars)

The following tables present the Company's investment securities carried at fair value, categorized by the level within hierarchy in which the fair value measurements fall, at December 31, 2010 and 2009.

	December 31, 2010			
	Level 1 $	**Level 2 $**	**Level 3 $**	**Total Fair Value $**
Fixed maturity investments:				
Residential mortgage-backed securities	-	522.7	-	522.7
Corporate debt securities	-	627.7	37.9	665.6
Debt securities issued by the U.S. Treasury and its agencies	245.9	143.8	-	389.7
U.S. government-sponsored enterprise securities	-	212.2	-	212.2
Commercial mortgage-backed securities	-	133.3	-	133.3
Debt securities issued by U.S. states and political subdivisions	-	57.7	-	57.7
Other debt obligations	-	98.8	4.7	103.5
Total fixed maturity investments	245.9	1,796.2	42.6	2,084.7
Equity securities:				
Exchange-listed funds	19.5	25.1	-	44.6
Energy	41.6	-	-	41.6
Financial	22.1	0.9	-	23.0
Technology	21.5	-	-	21.5
Consumer goods	8.9	0.2	-	9.1
Materials	1.4	0.2	-	1.6
Other	11.1	0.4	-	11.5
Total equity securities	126.1	26.8	-	152.9
Other investments	-	14.3	42.6	56.9
Total investments at fair value	372.0	1,837.3	85.2	2,294.5

(expressed in millions of U.S. dollars)

	December 31, 2009			
	Level 1 **$**	**Level 2** **$**	**Level 3** **$**	**Total Fair Value** **$**
Fixed maturity investments:				
Residential mortgage-backed securities	3.3	569.5	60.5	633.3
Corporate debt securities	-	462.6	78.7	541.3
Debt securities issued by the U.S. Treasury and its agencies	265.1	136.1	-	401.2
U.S. government-sponsored enterprise securities	-	318.8	-	318.8
Commercial mortgage-backed securities	-	60.3	-	60.3
Debt securities issued by U.S. states and political subdivisions	-	24.6	-	24.6
Other debt obligations	-	75.5	10.3	85.8
Total fixed maturity investments	268.4	1,647.4	149.5	2,065.3
Equity securities:				
Energy	44.3	-	-	44.3
Financial	28.9	5.2	4.0	38.1
Technology	26.1	1.5	-	27.6
Consumer goods	17.7	0.3	-	18.0
Materials	16.0	0.1	-	16.1
Other	22.4	0.7	-	23.1
Total equity securities	155.4	7.8	4.0	167.2
Other investments	-	11.1	49.1	60.2
Total investments at fair value	423.8	1,666.3	202.6	2,292.7

The Company's open short equity positions are valued on the basis of Level 1 inputs.

Investments classified as Level 3 as of December 31, 2010 and 2009, primarily consisted of the following: (i) with respect to fixed maturity investments, bank loans, certain corporate bonds, convertible debt and asset-backed securities, many of which are not actively traded; (ii) with respect to equity securities, preferred instruments and non-U.S. equity securities; and (iii) with respect to other investments, certain limited partnerships. As of December 31, 2009, equity securities and other investments classified as Level 3 also included preferred instruments and the Company's investment in Symetra, respectively.

As of December 31, 2010 and 2009, the Company's total Level 3 assets represented 3.7% and 8.8% of its total investments measured at fair value, respectively. During 2010, sales of bank loans within the Company's portfolio of corporate debt securities, as well as increased pricing transparency associated with certain residential mortgage-backed and corporate fixed-maturity securities historically classified as Level 3, resulted in a shift of such investments to Level 2. In addition, during the first quarter of 2010, the Company's investment in

(expressed in millions of U.S. dollars)

Symetra was reclassified from other investments to equity securities and was transferred from Level 3 to Level 1 as a result of the Symetra IPO.

There were no significant transfers between Levels 1 and 2 during 2010 or 2009.

The following tables present a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs during the years ended December 31, 2010 and 2009:

	December 31, 2010					
	Beginning Level 3 $	**Net Payments Purchase $**	**Net Realized Losses $**	**Net Unrealized Gains (Losses) $**	**Net Transfers In (Out) $**	**Ending Level 3 Balance $**
Fixed maturity investments:						
Residential mortgage-backed	60.5	-	-	-	(60.5)	-
Commercial mortgage-backed	-	(14.9)	-	2.9	-	(12.0)
Corporate debt securities	78.7	-	(0.6)	-	(28.2)	49.9
Debt securities issued by the U.S.	-	-	-	-	-	-
Treasury and its agencies						
Debt securities issued by U.S. states and political	-	4.2	-	-	-	4.2
Other debt obligations	10.3		-	-	(9.8)	0.5
Total fixed maturity investments	149.5	(10.7)	(0.6)	2.9	(98.5)	42.6
Equity securities:						
Financial	4.0	(2.2)	-	(1.7)	(0.1)	-
Other	-	0.3	(0.3)	-	-	-
Total equity securities	4.0	(1.9)	(0.3)	(1.7)	(0.1)	-
Other investments	49.1	9.5	-	6.6	(22.6)	42.6
Total investments	202.6	(3.1)	(0.9)	7.8	(121.2)	85.2

(expressed in millions of U.S. dollars)

	December 31, 2009					
	Beginning Level 3 $	Net Payments Purchase $	Net Realized Losses $	Net Unrealized Gains (Losses) $	Net Transfers In (Out) $	Ending Level 3 Balance $
Fixed maturity investments:						
Residential mortgage-backed	14.8	76.9	-	(0.1)	(31.1)	60.5
Corporate debt securities	126.7	11.7	(1.0)	23.6	(82.3)	78.7
Other debt obligations	17.4	(7.0)	-	-	(0.1)	10.3
Total fixed maturity investments	158.9	81.6	(1.0)	23.5	(113.5)	149.5
Equity securities:						
Financial	1.0	3.0	-	-	-	4.0
Other	0.4	(0.4)	-	-	-	-
Total equity securities	1.4	2.6	-	-	-	4.0
Other investments	31.0	3.5	-	2.2	12.4	49.1
Total investments	191.3	87.7	(1.0)	25.7	(101.1)	202.6

Changes in Carrying Value

Changes in the carrying value of the Company's investment portfolio for the years ended December 31, 2010 and 2009 consisted of the following:

	Net realized gains (losses) on investments $	Net unrealized gains (losses) on investments $	Net foreign exchange and derivative income (expense) from investments [(1)] $	Total changes in carrying value reflected in earnings $	Changes in carrying value reflected in other comprehensive income $
Year ended December 31, 2010	30.8	(11.3)	(0.4)	19.1	-
Fixed maturity	8.4	16.7	0.5	25.6	-
Equity securities	(1.8)	10.4	(4.8)	3.8	-
Other investments					
Year ended December 31, 2009					
Fixed maturity	24.9	76.9	0.3	102.1	-
Equity securities	-	74.6	(2.3)	72.3	-
Other investments	(5.5)	10.5	7.5	12.5	(0.6)

Securities lending

(expressed in millions of U.S. dollars)

[(1)]Represents net realized and unrealized foreign exchange gains (losses) from investments and income (expense) derived from investments in the Foreign Exchange Contracts, Credit Derivatives, Interest Rate Contracts and Investment Options and Futures (See Note 9). These derivatives are carried at fair value as other investments in the Company's consolidated balance sheets.

Net Investment Income

The Company's net investment income for the years ended December 31, 2010 and 2009 consisted of the following:

	2010 $	2009 $
Fixed maturity in investments	73.4	80.5
Cash and cash equivalents	-	0.2
Equity securities	1.1	3.0
Other investments	5.0	3.0
Total investment income	79.5	86.7
Investment expenses	(7.4)	(7.9)
Net investment income	72.1	78.8

Sales of investments totaled $2,272.1 million and $1,804.7 million for the years ended December 31, 2010 and 2009, respectively. Maturities, calls and paydowns of investments totaled $626.1 million and $777.8 million for the years ended December 31, 2010 and 2009, respectively. There were no non-cash exchanges or involuntary sales of investment securities during 2010 and 2009.

Assets on Deposit and Held in Trust

Effective September 30, 2010, the Company established a Multi-Beneficiary U.S. Reinsurance Trust (the “Reinsurance Trust”) for the benefit of certain of its U.S. cedants. The Reinsurance Trust was established as an alternative means of providing statutory credit to the Company’s cedants. As of December 31, 2010, the Reinsurance Trust was approved, and the Company was granted authorized or trusteed reinsurer status in 15 states and is currently seeking approval in all remaining states and the District of Columbia. The initial minimum value of the Reinsurance Trust was set at $20.0 million plus the amount of the Company’s reinsurance liabilities to such cedants (which were $54.8 million at December 31, 2010). As of December 31, 2010, the fair value of all assets held in the Reinsurance Trust was $101.4 million. See Note 8

Effective March 31, 2010, the Company and Montpelier Capital Limited (“MCL”), a wholly-owned subsidiary of MRH based in the U.K., entered into a Lloyd's Deposit Trust Deed (the “Lloyd's Capital Trust”) in order to meet MCL's ongoing funds at Lloyd's (“FAL”) requirements. The minimum value of cash and investments held by the Lloyd’s Capital Trust is determined on the basis of MCL's Individual Capital Assessment, which is used to determine the required amount of FAL. The initial minimum value of the Lloyd's Capital Trust was set at $230.0 million. The Company provides the necessary collateral. As of December 31, 2010, the fair value of all assets held in the Lloyd’s Capital Trust was $249.5 million. See Note 8

The Company’s assets on deposit and held in trust appear on the Company’s consolidated balance sheets as cash and cash equivalents, investments and accrued investment income, as appropriate.

(expressed in millions of U.S. dollars)

8. Financing Arrangements

Letter of Credit Facilities

In the normal course of business, the Company and MRH maintain letter of credit facilities and the Company provides letters of credit to third parties as a means of providing collateral and/or statutory credit to certain of its constituents. These letter of credit facilities were secured by collateral accounts containing cash and investments of the Company totaling $376.7 million and $835.8 million at December 31, 2010 and 2009, respectively. The following table outlines these facilities as of December 31, 2010:

Secured Operational Letter of Credit Facilities	Total Capacity	Amount Drawn	Expiry Date
Syndicated Facility: Tranche B	9.3	9.3	Aug. 2010
Syndicated 5-Year Facility (I)	500.0	36.6	June 2011
Syndicated 5-Year Facility (II)	215.0	173.6	June 2012
Bilateral facility A	100.0	8.0	None

The agreements governing these letter of credit facilities contain covenants that limit the Company's ability, among other things, to grant liens on its assets, sell assets, merge or consolidate, incur debt and enter into certain burdensome agreements. In addition, the syndicated secured facilities require the Company to maintain debt leverage of no greater than 30% and to maintain an A.M. Best financial strength rating of no less than B++. If the Company were to fail to comply with these covenants or fail to meet these financial ratios, the lenders could revoke the facilities and exercise remedies against the collateral. As of December 31, 2010 and 2009, the Company was in compliance with all covenants.

Effective August 4, 2010, the Syndicated Facility: Tranche B, which had a capacity of $225.0 million, expired under its terms and was not renewed. As a result: (i) the Company can no longer issue letters of credit under the facility; (ii) all outstanding letters of credit drawn under the facility will continue for up to 360 days; and (iii) all outstanding letters of credit drawn under the facility will have to be renewed into an alternate Montpelier facility upon expiry. This facility is subject to an annual commitment fee of 0.225% on drawn balances and, while active, was subject to an annual commitment fee of 0.075% on undrawn balances.

The Syndicated 5-Year Facility (I) is subject to an annual commitment fee of 0.275% on drawn balances and 0.075% on undrawn balances.

The Syndicated 5-Year Facility (II) is subject to an annual commitment fee of 0.225% on drawn balances and 0.08% on undrawn balances.

The Bilateral Facility is subject to an annual commitment fee of 0.40%, which was increased effective April 1, 2010 from 0.20%. The commitment fee is charged on drawn balances only.

In 2007 the Company, MRH and MCL entered into a letter of credit facility ("the Lloyd's Standby Facility") to support business written by Syndicate 5151. The Lloyd's Standby Facility provided MCL with a secured £74.0 million standby letter of credit facility through December 31, 2012.

In October 2008 the Lloyd's Standby Facility was amended and restated to provide MCL with a secured £110.0 million standby letter of credit facility through December 31, 2013.

(expressed in millions of U.S. dollars)

In March 2009 the Lloyd's Standby Facility was further amended to provide MCL with a secured $230.0 million standby letter of credit facility through December 31, 2013.

The Lloyd's Standby Facility was subject to an annual commitment fee of 0.45% on drawn balances and 0.158% on undrawn balances through March 2009 and an annual commitment fee of 0.60% on drawn balances and 0.21% on undrawn balances thereafter. The Company provided the necessary collateral for the facility.

Effective March 31, 2010, the Company, MRH and MCL voluntarily terminated the Lloyd's Standby Letter of Credit Facility and the Company and MCL entered into the Lloyd's Capital Trust (as described below) in order to meet MCL's ongoing FAL requirements.

Trust Arrangements

Effective September 30, 2010, the Company established the Reinsurance Trust as an alternative means of providing statutory credit to certain of the Company's U.S. cedants. The initial minimum value of the Reinsurance Trust was set at $20.0 million plus the amount of the Company's reinsurance liabilities to such cedants (which were $54.8 million at December 31, 2010). See Note 7.

Effective March 31, 2010, the Company and MCL entered into the Lloyd's Capital Trust in order to meet MCL's ongoing FAL requirements. The initial minimum value of the Lloyd's Capital Trust was set at $230.0 million. See Note 7

9. Derivative Contracts

The Company enters into derivative instruments from time to time in order to manage certain of its business risks and to supplement its investing and underwriting activities.

The primary risks the Company seeks to manage through its use of derivative instruments are underwriting risk and foreign exchange risk. Derivative instruments designed to manage the Company's underwriting risk include: (i) an option on hurricane seasonal futures (the "ILW Contract"), (ii) an ILW swap contract (the "ILW Swap") and (iii) catastrophe bond protection (the "CAT Bond Protection"). These derivative instruments provide reinsurance-like protection to the Company for specific loss events associated with certain lines of its business.

As an extension of its underwriting activities, the Company has sold ILW protection (the "ILW Contracts"). This derivative instrument provides reinsurance-like protection to third parties for specific loss events associated with certain lines of business.

Foreign exchange risk, specifically the Company's risk associated with making claim payments in foreign currencies, is managed through the use of foreign currency exchange agreements ("Foreign Exchange Contracts").

As an extension of the Company's investing activities, certain of its investment managers have entered into investment options and futures ("Investment Options and Futures"), credit derivative arrangements ("Credit Derivatives"), and interest rate contracts ("Interest Rate Contracts"), as well as Foreign Exchange Contracts.

None of the Company's derivatives are designated as hedging instruments.

(expressed in millions of U.S. dollars)

The following table presents the fair values, notional values and balance sheet location of the Company's derivative instruments recorded at December 31, 2010 and 2009:

		December 31, 2010		December 31, 2009	
Derivative Instrument	**Balance Sheet Location**	**Fair Value $**	**Notional Value $**	**Fair Value $**	**Notional Value $**
Foreign Exchange Contracts:					
U.S. Dollars purchased	Other Investments	(0.4)	77.0	-	-
U.S. Dollars sold	Other Investments	1.8	101.6	(0.7)	30.5
Credit Derivatives	Other Investments	0.3	15.3	-	-
Interest Rate Contracts	Other Investments	(0.2)	46.3	-	-
Investment Options and Futures (long)	Other Investments	2.2	-	1.8	-
Investment Options and Futures (short)	Other Liabilities	0.6	-	0.6	-
ILW Swaps	Other Assets	0.7	-	-	-
ILW Contract	Other Liabilities	0.1	-	-	-

The following table presents the net income (expense) from the Company's derivative instruments during 2010 and 2009:

	2010 $	2009 $
ILW Swaps	(0.2)	-
CAT Bond Protection	-	(0.2)
Foreign Exchange Contracts	1.9	(0.6)
Interest Rate Contracts	(0.1)	-
Investment Options and Futures	(6.7)	8.1
ILW Contract	0.3	-
Net income (expense) from derivative instruments	(4.8)	7.3

A description of each of the Company's derivative instruments follows:

ILW Swap

In April 2008, the Company entered into the ILW Swap I with a third-party in order to provide protection against the Company’s U.S. hurricane exposure. In return for a fixed-rate payment of $0.7 million, the Company receives a floating-rate payment which is triggered on the basis of losses incurred by the insurance industry as a whole. The maximum recovery to the Company under the ILW Swap is $5.0 million. The ILW Swap expired without value in April 2009.

(expressed in millions of U.S. dollars)

In November 2010, Montpelier Re entered into ILW Swap II with a third-party in order to provide protection against Montpelier Re's U.S. earthquake and Europe windstorm exposures through June 30, 2011. In return for a fixed-rate payment of $1.0 million, Montpelier Re receives a floating-rate payment which is triggered on the basis of losses incurred by the insurance industry as a whole. The maximum recovery to Montpelier Re under ILW Swap II is $5.0 million. The fair value of ILW Swap II at December 31, 2010 was $0.7 million.

The fair value of the ILW Swaps are derived based on unobservable (Level 3) inputs.

CAT Bond Protection

In December 2005, the Company purchased fully-collateralized coverage for losses sustained from qualifying hurricane and earthquake loss events from a third-party that financed this coverage through the issuance of $90.0 million in catastrophe bonds to investors under two separate bond tranches, each of which matured in January 2009. Both tranches responded to parametric triggers, whereby payment amounts were determined on the basis of modeled losses incurred by a notional portfolio rather than by actual losses incurred by the Company. For that reason, this transaction is accounted for as a derivative, rather than as a reinsurance transaction, and was carried at fair value.

Contract payments expensed in connection with the CAT Bond Protection were calculated at 12.83% per annum on the first tranche and 13.58% per annum on the second tranche.

Through the date of maturity of the CAT Bond Protection, no industry loss event occurred which would have triggered a recovery by the Company.

Foreign Exchange Contracts

From time to time the Company, either directly or indirectly through its investment managers, enters into foreign currency exchange agreements which constitute obligations to buy or sell specified currencies at future dates at prices set at the inception of each contract. The Company enters into these agreements in connection with its underwriting activities and its investing activities.

Those Foreign Exchange Contracts related to the Company's underwriting activities do not eliminate fluctuations in the value of the Company's assets and liabilities denominated in foreign currencies; rather, they are designed to protect Montpelier against adverse movements in foreign exchange rates. Those Foreign Exchange Contracts related to the Company's investing activities are designed to either protect the Company from adverse movements in foreign exchange rates or to enhance the Company's investment performance.

The Company's open Foreign Exchange Contracts at December 31, 2010 were denominated in British pounds, New Zealand dollars, European Union euros and Canadian dollars.

The Company's open Foreign Exchange Contracts at December 31, 2009 were denominated in European Union euros and Canadian dollars.

The fair value of the Foreign Exchange Contracts is derived based on other observable (Level 2) inputs.

Credit Derivatives

From time to time the Company's investment managers enter into various credit derivative arrangements whose value is derived from the credit risk associated with an underlying bond, loan or other financial asset. In such transactions, the Company is effectively the buyer or seller of credit protection, depending on the specific instrument. When the Company is buying credit protection, the value of its derivative position increases (or

(expressed in millions of U.S. dollars)

decreases) when the associated credit risk increases (or decreases). Conversely, when the Company is selling credit protection, the value of its derivative position decreases (or increases) when the associated credit risk increases (or decreases).

The fair value of the Credit Derivatives is derived based on other observable (Level 2) inputs.

Interest Rate Contracts

From time to time the Company's investment managers enter into various interest rate derivative contracts whose value is based on the right to pay or receive a notional amount of money at a given interest rate. These instruments are either used to limit the Company's exposure to fluctuations in specified interest rates or to address an anticipated change in interest rates.

The fair value of the Interest Rate Contracts is derived based on other observable (Level 2) inputs.

Investment Options and Futures

From time to time the Company enters into various exchange-traded investment options and futures as part of its investing strategy. As of December 31, 2010 and 2009, the Company had open long option positions with a fair value of $2.2 million and $1.8 million, respectively.

The fair value of the Investment Options and Futures was derived based on other observable (Level 2) inputs.

ILW Contract

In April 2010, the Company entered into the ILW Contract with a third-party under which qualifying loss payments are triggered exclusively by reference to the level of losses incurred by the insurance industry as a whole rather than by losses incurred by the insured. The ILW Contract was designed to provide the insured with $15.0 million of protection resulting from industry losses of stated amounts. The ILW Contract expires in March 2011, and covers losses incurred in several U.S. states resulting from earthquake damage. The Company received consideration of $0.5 million for the ILW Contract.

The ILW Contract is carried at fair value in accordance with GAAP. The fair value of the ILW Contract liability at December 31, 2010 was $0.1 million, and was derived based on unobservable (Level 3) inputs.

10. *Common Shareholder's Equity*

Reclassification of prior year amounts

Prior to 2010, the Company recorded all dividend distributions through a combination of retained earnings and additional paid-in capital. In 2010, the Company changed its method of recording dividend distributions to be consistent with the presentation in its statutory return. Under the revised method, dividends are recorded as distributions from additional paid-in capital only in periods in which the Company is in a retained deficit position. In all other periods, dividends are recorded as distributions from retained earnings.

(expressed in millions of U.S. dollars)

The impact on January 1, 2009 balance as previously reported is set out below:

	As Previously Reported $	**Adjustment $**	**As Adjusted $**
Additional Paid in Capital	1,877.6	(304.0)	1,573.6
Retained Earnings	(265.6)	304.0	38.4

The impact on December 31, 2009 balance as previously reported is set out below:

	As Previously Reported $	**Adjustment $**	**As Adjusted $**
Additional Paid in Capital	1,757.1	(198.5)	1,558.6
Retained Earnings	258.7	198.5	457.2

Dividends and Distributions

The Company declared and paid dividends and distributions to MRH during 2010 and 2009 of $390.0 million and $105.5 million, respectively. See Note 14.

11. Share Based Compensation

LTIP

The Montpelier Re Holdings Ltd. Long-Term Incentive Plan (the “LTIP”) is the primary long-term incentive plan for MRH and its subsidiaries, including the Company. At the discretion of Compensation and Nominating Committee of MRH’s Board of Directors (the “Compensation Committee”), incentive awards, the value of which is based on MRH’s common shares (“Common Shares”), may be made to plan participants. For the periods presented, the Company’s share based incentive awards consisted of Restricted Share Units (“RSUs”) and performance shares.

The Company is required to reimburse MRH, in cash, for any MRH common shares issued to the Company’s plan participants.

RSUs

RSUs are phantom restricted shares which, depending on the individual award, vest in equal tranches over three, four or five year periods, subject to the recipient maintaining a continuous relationship with the Company (either as an employee, a director or a consultant) through the applicable vesting date. Holders of RSUs are not entitled to voting rights but are entitled to receive dividends and distributions declared on MRH’s Common Shares.

(expressed in millions of U.S. dollars)

The Emergency Economic Stabilization Act of 2008, enacted on October 3, 2008 (the "EES Act"), added Section 457A to the U.S. Internal Revenue Code. The Company believes that this tax legislation would have caused certain LTIP participants (those who are U.S. taxpayers) to be taxed on the fair value of RSUs upon vesting, rather than upon receipt of the underlying Common Shares. In order to alleviate this potential mismatch between taxation and receipt of the Common Shares, MRH and the Company formally decided in December 2008 to amend certain outstanding RSU awards to accelerate the distribution of the underlying Common Shares to coincide more closely to the vesting date. The amendment to the award agreements did not change the applicable vesting date, but allowed participants to receive their Common Shares during the same period in which they became taxable.

The Company currently uses "Variable RSUs" as the principal component of its ongoing long-term incentive compensation for employees. Variable RSUs are contingent awards in which the actual number of RSUs to be awarded is dependent on MRH's performance during the initial year of the award cycle (the "Initial RSU Period") meaning that the number of RSUs expected to be awarded for that cycle may fluctuate during this period. The actual number of Variable RSUs to be awarded is based on a targeted return on equity ("ROE") assuming a standardized investment return. ROE is computed by dividing the sum of MRH's consolidated actual underwriting result and standard investment result by MRH's actual average shareholders' equity for the period.

From time to time the Company also uses "Fixed RSUs" as a supplemental component of its ongoing long-term incentive compensation for certain of its employees and directors. Unlike Variable RSUs, Fixed RSUs are fixed and determinable on the grant date. Fixed RSUs are typically granted: (i) to induce individuals to join the Company; (ii) to retain certain key employees; (iii) to reward employees exhibiting outstanding individual performance. Additionally, when the actual number of Variable RSUs to be awarded has been formally determined, they are effectively converted to Fixed RSUs.

As of December 31, 2010, the Company's Variable RSUs outstanding consisted of those for the 2010 to 2013 cycle. The number of Variable RSUs to be awarded for this cycle will be determined based on a 2010 target ROE of 9.69%. At an achieved ROE of 9.69% ("Target") the Company would expect to grant approximately 188,000 Variable RSUs to participants, at an ROE of 3.69% ("Threshold") the Company would not expect to grant any Variable RSUs to participants and at an ROE of 19.69% ("Maximum") the Company would expect to grant approximately 376,000 Variable RSUs to participants.

(expressed in millions of U.S. dollars)

The following table summarizes the Company's RSU activity for the years ended December 31, 2010 and 2009:

	2010		2009	
	RSUs Outstanding $	Unamortized Grant Date Fair Value $	RSUs Outstanding $	Unamortized Grant Date Fair Value $
Beginning of period	419,526	3.2	329,863	1.6
Fixed RSUs Awarded	-	-	7,500	0.1
Variable RSUs at target, 2010 - 2013 cycle	188,310	3.1	-	-
Changes in Variable RSU projections, 2010 - 2013 cycle	47,081	0.8	-	-
Variable RSUs at target, 2009 - 2012 cycle	-	-	192,559	3.1
Changes in Variable RSU projections, 2009 - 2012 cycle	1,928	-	177,155	2.8
Changes in Variable RSU projections, 2008 - 2011 cycle	-	-	(21,057)	(0.2)
Change in other factors, including expected forfeitures and inter-group transfers [(1)]	-	-	(42,345)	(0.4)
Payments	(208,279)	-	(224,149)	-
Forfeitures	(627)	-	-	-
Expense recognized	-	(3.9)	-	(3.8)
End of period	447,939	3.2	419,526	3.2

[(1)] Periodically, employees transfer to/from other group companies

RSU Awards

On the basis of MRH’s preliminary results achieved during 2010, the Company anticipated issuing a total of 235,391 Variable RSUs or approximately 125% of the 188,310 target RSUs outstanding for the 2010-2013 award cycle at December 31, 2010. The actual number of Variable RSUs awarded for the 2010 to 2013 cycle was decreased by 4,329 RSUs to 231,062 during the first quarter of 2011 or approximately 123% of target RSU’s ultimately fixed for that cycle.

On the basis of the Company's preliminary 2009 results, the Company anticipated issuing a total of 369,714 Variable RSUs for the 2009-2012 award cycle at December 31, 2009. Based on actual 2009 results achieved, as approved by the Compensation Committee in March 2010, the actual number of Variable RSUs award for that cycle was increased by 1,928 RSUs to 371,642 during the first quarter of 2010 or approximately 193% of the target RSU’s ultimately fixed for that cycle.

During the years ended December 31, 2010 and 2009, the Company also issued zero and 7,500 Fixed RSUs, respectively, to certain of its employees.

(expressed in millions of U.S. dollars)

RSU Payments

During 2010 the Company paid out 208,279 vested RSUs and withheld, at the recipients' election, 17,385 RSUs to provide for statutory income tax liabilities. As a result, MRH issued 190,894 Common Shares from its treasury. The fair value of the RSUs paid out during 2010 was $3.9 million.

During 2009 the Company paid out 224,149 vested RSUs and withheld, at the recipients' election, 18,308 RSUs to provide for statutory income tax liabilities. As a result, the Company issued 205,841 Common Shares from its treasury. The fair value of the RSUs paid out during 2009 was $3.1 million.

RSU Assumptions

For the years presented, the Company assumed a 3.0% to 8.8% forfeiture rate depending on the nature and term of the individual award and past and recent experience. The Company's forfeiture assumptions serve to reduce the unamortized grant date fair value of outstanding RSUs as well as the associated RSU expense. As RSUs are actually forfeited, the number of RSUs outstanding is reduced and the remaining unamortized grant date fair value is compared to assumed forfeitures levels. True-up adjustments are made as deemed necessary.

The following table summarizes all Fixed and Variable RSUs outstanding and the unamortized grant date fair value of such RSUs at December 31, 2010, for each award cycle:

Award Date and Cycle	**RSUs Outstanding**	**Unamortized Grant Date Fair Value**
Four-year RSU awards granted in 2008	21,154	0.1
Four-year RSU awards granted in 2009	185,394	1.2
Five-year RSU awards granted in 2009	6,000	-
Four-year RSU awards granted in 2010 (including those awards in their Initial RSU Period)	235,391	1.9
Total RSUs outstanding at December 31, 2010	447,939	3.2

The Company expects to incur future RSU expense associated with its currently outstanding RSUs of $2.0 million, $1.0 million and $0.2 million during 2011, 2012 and 2013 & beyond, respectively.

Performance Shares

From 2002 to 2007, performance shares were a significant element of the Company's LTIP awards in terms of prospective value. At target payout, each performance share represented the fair value of a Common Share. At the end of a performance period, which was generally the three-year period following the date of grant, a plan participant received a harvest of between zero and 200% of the performance shares granted depending on the achievement of specific performance criteria relating to the operating and financial performance of the Company over the period. Additionally, at the discretion of the Compensation Committee, the performance of certain members of senior management could be further measured by reference to the ratio of the actual return on equity to ROAC (the "Swing Factor") resulting in an adjustment to the harvest of up to + / - 25%. The Company no longer has any performance shares outstanding.

(expressed in millions of U.S. dollars)

The actual performance share harvest ratio for all participants with respect to 74,000 performance shares outstanding for the 2007-2009 cycle was 106% based on an achieved ROAC of 16.5%. The 2007-2009 performance shares were settled in March 2010 through a cash payment to participants totaling $1.4 million.

The actual performance share harvest ratio for participants with respect to 62,500 performance shares outstanding for the 2006-2008 cycle was: (i) 116% for the 30,000 performance shares not subject to the Swing Factor based on an achieved ROAC of 17.3%; and (ii) 95% for the 32,500 performance shares subject to the Swing Factor. The 2006-2008 performance shares were settled in February 2009 through a cash payment to participants totaling $1.0 million.

During the years ended December 31, 2010 and 2009, the Company incurred $0.1 million and $0.4 million, respectively, of performance share expense.

12. *Income Taxes*

The Company and MIHL are domiciled in Bermuda. The Company and MIHL intend to conduct substantially all of their operations in Bermuda in a manner such that it is improbable that they would be viewed as being engaged in a trade or business in the U.S. However, because there is no definitive authority regarding activities that constitute being engaged in a trade or business in the U.S., there can be no assurance that the U.S. Internal Revenue Service will not contend, perhaps successfully, that Montpelier Re or MIHL is engaged in a trade or business in the U.S. In that event, those entities would be subject to U.S. income tax, as well as a branch profits tax, on income that is treated as effectively connected with the conduct of that trade or business unless the corporation is entitled to relief under a tax treaty.

At the present time, no income taxes are levied in Bermuda and the Company and its Bermuda-domiciled subsidiary has received an assurance from the Bermuda Minister of Finance exempting them from all Bermuda-imposed income, withholding and capital gains taxes until 2035.

13. *Fair Value of Financial Instruments*

GAAP requires disclosure of fair value information for certain financial instruments. For those financial instruments in which quoted market prices are not available, fair values are estimated by discounting future cash flows using current market rates or quoted market prices for similar obligations. Because considerable judgement is used, these estimates are not necessarily indicative of amounts that could be realized in a current market exchange. The Company carries its financial instruments on its consolidated balance sheets at fair value.

14. *Regulatory Requirements*

The Company is registered under The Insurance Act 1978 (Bermuda), Amendments Thereto and Related Regulations (the “Insurance Act”) as a Class 4 insurer. Under the Insurance Act, the Company is required to annually prepare and file statutory and GAAP financial statements and a statutory financial return. The Insurance Act also requires the Company to maintain minimum levels of statutory capital and surplus. At December 31, 2010 and 2009 this amount was $284.9 million and $269.3 million, respectively. Actual statutory capital and surplus was $1,639.8 million and $1,765.7 million respectively.

The Bermuda Statutory Capital Requirement (“BSCR”) is a risk-based capital model used to measure risk and to determine an enhanced capital requirement and target capital level (defined as 120% of the enhanced capital requirement) for Class 4 insurers. For the years ended December 31, 2010 and 2009, the Company had capital and surplus in excess of three times the required BSCR target capital level.

(expressed in millions of U.S. dollars)

The Insurance Act limits the maximum amount of annual dividends and distributions that may be paid by Montpelier Re in any year which would exceed 25% of its prior year statutory capital and surplus or reduce its prior year statutory capital by 15% or more, without the prior approval of the BMA. During 2010, the Company distributed a total of $390.0 million to MRH, an amount that exceeded 15% of the Company's prior year statutory capital by approximately $82.0 million, after receiving formal approval from the BMA.

The Bermuda Companies Act 1981 also limits the Company's ability to pay dividends and distributions to its shareholders. The Company is not permitted to declare or pay a dividend, or make a distribution out of contributed surplus, if the realizable value of its assets would be less than the aggregate of its liabilities, issued share capital and share premium accounts.

The Company is also required under its Class 4 license to maintain a minimum liquidity ratio whereby the value of its relevant assets is not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and time deposits, quoted investments, unquoted investments, bonds and debentures, investment in mortgage loans, first liens, investment income due and accrued, accounts and premiums receivable, reinsurance premiums receivable, and funds held by ceding reinsurers. The relevant liabilities are total general business insurance reserves and other liabilities, excluding deferred income tax liabilities, sundry liabilities and letter of credit, guarantees and other instruments. At December 31, 2010, the Company met the minimum liquidity ratio requirement.

During 2010 the BMA made amendments to the Insurance Act with a view to enhancing Bermuda's insurance and reinsurance regulatory regime. Of particular importance and significance to the Company and Montpelier Re are the following:

- a group-wide supervisory regime was introduced with the principal purpose of enabling the BMA to form a comprehensive view of the overall exposure of an insurance group;
- the scope of the BMA's powers was extended allowing them to make rules in relation to prudential standards to include insurance reserves and eligible capital requirements; and
- new notification provisions were introduced requiring insurers to notify the BMA in respect of a change of controlling shareholder, changes to controllers and officers or any proposed material change in their business.

There is presently no formal indication as to when group supervision may be implemented by the BMA and what companies will be included, although the Company has recently been notified that the BMA, having considered the matters set out in the 2010 amendments to the Insurance Act, intends to be the Company’s group supervisor.

(expressed in millions of U.S. dollars)

A reconciliation of the variance between Bermuda statutory accounting practices and GAAP is as follows:

	December 31, 2010 $	December 31, 2009 $
Statutory capital and surplus	1,639.8	1,765.7
Non-admitted assets charged to expenses:		
Deferred acquisition costs	24.5	22.8
Prepaid expenses	0.3	0.9
Fixed Assets	8.1	-
Other statutory items:		
MCL's Lloyd's standby facility/Lloyd's Capital Trust (1)	230.0	230.0
Shareholder's equity in accordance with GAAP	1,902.7	2,019.4

(1) As this facility will be used specifically as Funds at Lloyd's to support the business underwritten by Syndicate 5151 and in effect encumbering the Company's assets, a liability needs to be recorded in the statutory balance sheets and the statutory capital and surplus decreased by a corresponding amount, whether or not the Company has pledged specific assets or not under the Facility. (See Notes 7 and 8)

15. Related Party Transactions

KVO Capital Management, LLC ("KVO")

On April 1, 2008, MRH entered into a Letter Agreement with Kernan V. Oberting, MRH's and the Company's former Chief Financial Officer, setting forth the terms of his departure as a full-time employee, effective May 1, 2008, in order to establish KVO, an investment advisory company. The Letter Agreement provided, among other things, for MRH to enter into a Consulting Agreement with Mr. Oberting and KVO and an Investment Management Agreement with KVO (the "Consulting Agreement" and "IMA", respectively).

Pursuant to the Consulting Agreement, KVO was to provide capital management and consulting services to MRH and the Company and, pursuant to the IMA, KVO was to provide the Company with discretionary investment management services, in each case for an initial term beginning May 1, 2008 and ending December 31, 2010 (the "Initial Term"), subject to renewal for additional successive one-year periods.

The Consulting Agreement provided KVO with a monthly consulting fee equal to 0.0025% of MRH's consolidated total invested assets at the end of each month. In addition, if certain performance criteria with respect to MRH's consolidated investment portfolio are satisfied, the Consulting Agreement provided KVO with the opportunity to receive a one-time fee of $250,000 after the end of the Initial Term (the "Performance Criteria Fee").

The IMA provided KVO with a monthly management fee equal to 0.0833% of the net asset value of the Company's investment account, which initially consisted of cash and securities in an aggregate amount equal to $100.0 million (the "Investment Account"). The IMA also provided KVO with the opportunity to receive an annual incentive fee equal to 15% of the Net Profits of the Investment Account (as defined in the Consulting Agreement).

(expressed in millions of U.S. dollars)

On July 28, 2010, MRH and KVO agreed to: (i) amend the IMA (the “IMA Amendment”); (ii) reduce the Investment Account; (iii) permit the Company to make a $25.0 million investment in the KVO Offshore Fund Ltd. (the “KVO Fund”); and (iv) terminate the Consulting Agreement.

Pursuant to the amendment to the IMA the Investment Account, which totaled $165.0 million at December 31, 2009, is being reduced and the fee terms have been amended. During 2010 the Company withdrew $87.0 million in cash and investments from the Investment Account and re-invested $25.0 million of such assets into the KVO Fund. KVO will use its best efforts to permit the Company to make further withdrawals from the Investment Account during early 2011 and it is expected that the Investment Account will total no more than $10.0 million by March 31, 2011. As of December 31, 2010, the Investment Account totaled $81.1 million.

In connection with the IMA Amendment, KVO remains entitled to receive the same monthly management fee as specified in the IMA but earns that fee on the value of the Investment Account through December 31, 2010, as if no withdrawals had been made in 2010 other than the $25.0 million investment in the KVO Fund. KVO is not entitled to a management fee on the value of the Investment Account after December 31, 2010. In addition, KVO remains entitled to an annual incentive fee equal to 15% of the Net Profits of the Investment Account through the date the Investment Account is formally liquidated.

The investment in the KVO Fund is subject to the same management fee and annual incentive fee as the IMA. Half of the KVO Fund investment is subject to a one-year lock-up and the other half is subject to a three-year lock-up. Nonetheless, the Company has the right to withdraw the whole of its investment at an earlier date, subject to a redemption fee equal to 5% of the amount redeemed.

The Consulting Agreement has been terminated as of July 31, 2010. As a result, no consulting fees will be earned by KVO after that date and KVO is no longer eligible to receive the one-time $250,000 Performance Criteria Fee.

During the years ended December 31, 2010 and 2009, the Company paid KVO a total of $1.7 million and $1.3 million, respectively, for managing the Investment Account and the KVO Fund. At December 31, 2010 and 2009, the Company owed KVO an additional $0.1 million and $0.1 million for such services provided, respectively.

With respect to the period from May 1, 2008 to December 31, 2009, KVO earned an incentive fee of $9.8 million based on the accumulated Net Profits within the Investment Account experienced during that period. That fee was fully paid in January 2010. With respect to the period from January 1, 2010 to December 31, 2010, KVO earned an incentive fee of $1.9 million based on the accumulated Net Profits within the Investment Account experienced during that period. One-half of that fee was paid in February 2011 and the other half is expected to be paid prior to June 30, 2011, subject to a claw-back provision to the extent that the accumulated Net Profits of the Investment Account during the first quarter of 2011 is negative. With respect to the period from August 1, 2010 to December 31, 2010, KVO earned an incentive fee of less than $0.1 million based on the accumulated Net Profits within the KVO Fund experienced during that period.

(expressed in millions of U.S. dollars)

Intercompany Quota Share Arrangements

The Company reinsures two affiliates for property and casualty risks on an excess-of-loss and quota share basis. The related statement of operations and balance sheet account balances for the years ended December 31, 2010 and 2009 are as follows:

	2010 **$**	**2009** **$**
Gross premiums written	169.9	119.5
Net premiums earned	160.9	111.0
Losses and LAE	104.9	52.1
Acquisition costs	37.6	22.3
Foreign exchange gains (loss)	3.0	(2.0)
Interest income	2.1	0.6
Premiums receivable	3.1	2.0
Deferred acquisition costs	5.7	3.2
Loss and LAE reserves	137.5	73.7
Unearned premiums	21.5	12.5

The Company receives various services from affiliates. Included in these services are those related to information technology, modelling and marketing, as well as costs incurred by reinsured affiliates that are covered by a quota share agreement. Fees incurred by the Company in connection with these services totaled $26.8 million and $36.1 million in 2010 and 2009 respectively.

In addition to the amounts shown above, the Company was due $156.7 million from affiliates, and owed $1.7 million to affiliates as of December 31, 2010. The receivable related primarily to the intercompany quota share agreements, as well as amounts paid on behalf of affiliates for which the Company has not yet been reimbursed. The payable related primarily to incentive compensation paid by MRH that has not yet been reimbursed by the Company. The amounts due to/from affiliates are unsecured, interest free and are repayable on demand.

16. Commitments and Contingent Liabilities

Commitments

As of December 31, 2010, the Company had unfunded commitments to invest $5.0 million into three separate private investment funds.

The Company's letter of credit facilities and trust arrangements are secured by collateral accounts containing cash, cash and cash equivalents and investments that are required to be maintained at specified levels. See Note 8

The Company leases office space and computer equipment under noncancellable operating leases that expire on various dates. The Company also has various other operating lease obligations that are immaterial in the aggregate.

Future annual minimum commitments under existing noncancellable leases for office space are $3.3 million, $3.4 million, $3.5 million and $3.6 million for 2011, 2012, 2013 and 2014 and thereafter.

(expressed in millions of U.S. dollars)

Future annual minimum commitments under existing noncancellable leases for computer equipment are $1.0 million, $0.9 million, and $0.4 million for 2011, 2012, and 2013. The Company currently has no future annual minimum commitments under existing noncancellable leases for computer equipment beyond 2013.

Litigation

The Company is subject to litigation and arbitration proceedings in the normal course of its business. Such proceedings often involve reinsurance contract disputes which are typical for the insurance and reinsurance industry.

As of December 31, 2010, the Company had no material unresolved legal proceedings.

See Note 6 for detailed information regarding a reinsurance contract dispute that was concluded in June 2010.

Concentrations of Credit and Counterparty Risk

Financial instruments, which potentially subject the Company to significant concentrations of credit risk, consist principally of investment securities, insurance and reinsurance balances receivable and reinsurance recoverables as described below.

The Company believes that there are no significant concentrations of credit risk from a single issue or issuer within its investment portfolio other than concentrations in U.S. government and U.S. government-sponsored enterprises. The Company did not own an aggregate investment in a single entity, other than U.S. government and U.S. government-sponsored enterprises, in excess of 10% of the Company's common shareholders' equity at December 31, 2010.

The Company's portfolio of corporate and structured investments, such as asset and mortgage-backed securities, are subject to individual and aggregate credit risk. The Company monitors the credit quality of its fixed maturity investments with exposure to subprime and Alternative A markets as well as those fixed maturity investments that benefit from credit enhancements provided by third-party financial guarantors. The Company also routinely monitors the credit quality of its commercial mortgage-backed securities and its non-agency collateralized residential mortgage obligations.

Certain of the Company's derivative securities are subject to counterparty risk. The Company routinely monitors this risk.

The Company underwrites the majority of its business through insurance and reinsurance brokers. Credit risk exists should any of these brokers be unable to fulfill their contractual obligations to the Company. For example, the Company is frequently required to pay amounts owed on claims under policies to brokers, and these brokers, in turn, pay these amounts to the ceding companies that have reinsured a portion of their liabilities with the Company. In some jurisdictions, if a broker fails to make such a payment, the Company might remain liable to the ceding company for the deficiency. In addition, in certain jurisdictions, when the ceding company pays premiums for these policies to brokers, these premiums are considered to have been paid and the ceding insurer is no longer liable to the Company for those amounts, whether or not the premiums have actually been received.

The Company remains liable to the extent that any third-party reinsurer or other obligor fails to meet its reinsurance obligations and, with respect to certain contracts that carry underlying reinsurance protection, the Company would be liable in the event that the ceding companies are unable to collect amounts due from underlying third-party reinsurers.

(expressed in millions of U.S. dollars)

Under the Company's reinsurance security policy, reinsurers are generally required to be rated “A-” (Excellent) or better by A.M. Best (or an equivalent rating with another recognized rating agency) at the time the policy is written. The Company considers reinsurers that are not rated or do not fall within the above rating threshold on a case-by-case basis when collateralized up to policy limits, net of any premiums owed. The Company monitors the financial condition and ratings of its reinsurers on an ongoing basis. See Note 5.

17. Subsequent Events

On February 22, 2011, a 6.3-magnitude earthquake occurred in the southern New Zealand city of Christchurch. The Company currently estimates its pretax loss from the February New Zealand earthquake will be approximately $72 million, net of reinstatement premiums, which assumed a US $12 billion industry loss. In view of the uncertainties associated with these initial estimates, actual losses may differ significantly from the estimate.

On March 11, 2011, a major earthquake and tsunami struck Japan’s northeast coast. The Company currently estimates its pretax loss from the Japanese earthquake and tsunami will be approximately $137 million, which is net of retrocessional recoveries and reinstatement premiums and assumes a US $25 billion industry loss. In view of the uncertainties associated with these initial estimates, actual losses may differ significantly from the estimate.