UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

þ Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2008

OR

o Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the transition period from ________________to ________________________

Commission file number 001-33364

Flagstone Reinsurance Holdings Limited
(Exact Name of Registrant as Specified in Its Charter)

Bermuda	98-0481623
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

Crawford House
23 Church Street
Hamilton HM 11
Bermuda
(Address of Principal Executive Offices)

(441) 278-4300
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Securities registered pursuant to Section 12(b) of the Act:
Common Shares, par value 1 cent per share
Name of exchange on which registered:
New York Stock Exchange
Bermuda Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of most recently completed second fiscal quarter (June 30, 2009), was $319,613,429 based on the closing sales price of the Registrant's common shares of $10.30 on June 30, 2009.

As of February 22, 2010, the Registrant had 82,985,219 common voting shares outstanding, net of treasury shares, with a par value $.01 per share.

Documents Incorporated by Reference:

Document	Part(s) Into Which Incorporated
Portions of the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, relating to the Registrant's Annual General Meeting of Shareholders scheduled to be held May 15, 2010 are incorporated by reference into Part III of this report. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this report.	Part III

FLAGSTONE REINSURANCE HOLDINGS LIMITED
INDEX TO FORM 10-K

Index

PART I

References in this Annual Report on Form 10-K to the "Company", "Flagstone", "we", "us", and "our" refer to Flagstone Reinsurance Holdings Limited and/or its subsidiaries, including Flagstone Réassurance Suisse SA, its wholly-owned Switzerland reinsurance company, Marlborough Underwriting Agency Limited, its United Kingdom Lloyd's managing agency, Island Heritage Holdings Ltd., its Cayman-based insurance holding company, Flagstone Alliance Insurance & Reinsurance PLC, its wholly-owned Cyprus insurance and reinsurance company, Flagstone Reinsurance Africa Limited, its South African reinsurance company, Mont Fort Re Ltd., its wholly-owned Bermuda reinsurance company, and any other direct or indirect wholly-owned subsidiary, unless the context suggests otherwise. References to "Flagstone Suisse" refer to Flagstone Réassurance Suisse SA, its wholly-owned subsidiaries and its Bermuda branch. References to "Marlborough" refer to Marlborough Underwriting Agency Limited, its wholly-owned subsidiaries and Syndicate 1861. References to "Island Heritage" refer to Island Heritage Holdings Ltd. and its subsidiaries. References to "Flagstone Alliance" refer to Flagstone Alliance Insurance & Reinsurance PLC and its subsidiaries. References to "Flagstone Africa" refer to Flagstone Reinsurance Africa Limited. References to "Mont Fort" refer to Mont Fort Re Ltd. References in this Annual Report on Form 10-K to "dollars" or "$" are to the lawful currency of the United States of America, unless the context otherwise requires.

Cautionary Statement Regarding Forward-Looking Statements.

This Annual Report on Form 10-K contains, and the Company may from time to time make, written or oral " forward-looking statements " within the meaning of the U.S. federal securities laws, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. All forward-looking statements rely on a number of assumptions concerning future events and are subject to a number of uncertainties and other factors, many of which are outside the Company's control that could cause actual results to differ materially from such statements. In particular, statements using words such as " may ", " should ", "estimate ", " expect ", " anticipate ", " intend ", " believe ", " predict ", " potential ", or words of similar import generally involve forward-looking statements.

Important events and uncertainties that could cause the actual results to differ include, but are not necessarily limited to: market conditions affecting the Company's common share price; the impact of volatility in the financial markets, including the duration of the economic crisis and the effectiveness of governmental solutions; the weakening economy, including the impact on our consumers' businesses; fluctuations in interest rates; the effects of corporate bankruptcies on capital markets; the possibility of severe or unanticipated losses from natural or man-made catastrophes; the effectiveness of our loss limitation methods; our dependence on principal employees; the cyclical nature of the insurance and reinsurance business; the levels of new and renewal business achieved; opportunities to increase writings in our core property and specialty reinsurance and insurance lines of business and in specific areas of the casualty reinsurance market; the sensitivity of our business to financial strength ratings established by independent rating agencies; the estimates reported by cedents and brokers on pro-rata contracts and certain excess of loss contracts where the deposit premium is not specified in the contract; the inherent uncertainties of establishing reserves for loss and loss adjustment expenses, our reliance on industry loss estimates and those generated by modeling techniques; unanticipated adjustments to premium estimates; changes in the availability, cost or quality of reinsurance or retrocessional coverage; changes in general economic conditions; changes in governmental regulation or tax laws in the jurisdictions where we conduct business; the amount and timing of reinsurance recoverables and reimbursements we actually receive from our reinsurers; the overall level of competition, and the related demand and supply dynamics in our markets relating to growing capital levels in the insurance and reinsurance industries; declining demand due to increased retentions by cedents and other factors; the impact of terrorist activities on the economy; and rating agency policies and practices.

These and other events that could cause actual results to differ are discussed in more detail in Item 1A, “Risk Factors” and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Annual Report on Form 10-K. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by U.S. federal securities laws. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made.

Index

ITEM 1. BUSINESS

General Development

The Company, a global reinsurance and insurance company, was incorporated under the laws of Bermuda in October 2005 and commenced operations in December 2005. The Company is currently organized into three business segments: Reinsurance, Lloyd's and Insurance. Through our Reinsurance segment, we write primarily property, property catastrophe and short-tail specialty and casualty reinsurance. Through our Lloyd's segment we primarily write property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. Through our Insurance segment, we primarily write property insurance for homes, condominiums and office buildings in the Caribbean region. We diversify our risks across business lines by risk zones, each of which combines a geographic zone with one or more types of peril (for example, Texas Windstorm, Florida Hurricane or California Earthquake). The majority of our reinsurance contracts contain loss limitation provisions such as fixed monetary limits to our exposure and per event caps. We specialize in underwriting where sufficient data exists to analyze effectively the risk/return profile, and where we are subject to legal systems we deem reasonably fair and reliable.

Our largest business is providing property catastrophe reinsurance coverage to a broad range of select insurance companies. These policies provide coverage for claims arising from major natural catastrophes, such as hurricanes and earthquakes, in excess of a specified loss. We also provide coverage for claims arising from other natural and man-made catastrophes such as winter storms, freezes, floods, fires and tornados. Our specialty lines, which represent a growing proportion of our business, cover such risks as aviation, energy, hull and cargo, accident and health, agribusiness, engineering, satellite, space, marine, marine liability and workers' compensation catastrophe.

Because we have a limited operating history and have grown and diversified our lines of business significantly during that time, period to period comparisons of our results of operations are limited and may not be meaningful in the near future. Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and our fiscal year ends on December 31. Since a substantial portion of the insurance and reinsurance we write provides protection from damages relating to natural and man-made catastrophes, our results depend to a large extent on the frequency and severity of such catastrophic events, and the specific coverages we offer to clients affected by these events. This may result in volatility in our results of operations and financial condition. In addition, the amount of premiums written with respect to any particular line of business may vary from quarter to quarter and year to year as a result of changes in market conditions.

We measure our financial success through long-term growth in diluted book value per share plus accumulated dividends measured over intervals of three years, which we believe is the most appropriate measure of the performance of the Company, a measure that focuses on the return provided to the Company's common shareholders. Diluted book value per share is obtained by dividing shareholders' equity by the number of common shares and common share equivalents outstanding including all potentially dilutive securities such as the warrant, performance share units and restricted share units.

We derive our revenues primarily from net premiums earned from the reinsurance and insurance policies we write, net of any retrocessional or reinsurance coverage purchased, net investment income from our investment portfolio, and fees for services provided. Premiums are generally a function of the number and type of contracts we write, as well as prevailing market prices. Premiums are normally due in installments and earned over the contract term.

Our expenses consist primarily of the following types: loss and loss adjustment expenses (“LAE”) incurred on the policies of reinsurance and insurance that we sell; acquisition costs which typically represent a percentage of the premiums that we write; general and administrative expenses which primarily consist of salaries, benefits and related costs, including costs associated with awards under our Performance Share Unit (“PSU”) and Restricted Share Unit (“RSU”) Plans, and other general operating expenses; interest expenses related to our debt obligations; and minority interest, which represents the interest of external parties with respect to the net income of Mont Fort, Island Heritage, and Flagstone Africa.

On September 29, 2009, the Company entered into an agreement to become the sole shareholder of Flagstone Africa, previously known as Imperial Re, by acquiring the remaining 35% share previously held by Imperial Holdings Limited. The transaction was completed on November 10, 2009, upon receipt of regulatory approval.

Index

Business Strategy

The Company is in the business of taking two kinds of risk which we refer to as our Franchise Risks: these are insurance risk and investment risk. Our goal with respect to these risks is to be well rewarded for the risks we take, and well diversified so as to produce an acceptable return on equity with moderate volatility. The ultimate responsibility for the levels of Franchise Risk rests with our Executive Chairman and our Chief Executive Officer, reporting to the Board of Directors. We endeavor to minimize other risks such as operational and reputational risks, which we refer to as Enterprise Risks, and the responsibility for managing these lies with our Chief Enterprise Risk Officer, reporting to the Chief Operating Officer and to the Audit Committee.

Our two primary financial goals are to maintain multiple credit ratings in the “A” range, and to produce growth in diluted book value per share with moderate volatility. We believe that prudent management of our underwriting risks, relative to our capital base, together with effective investment of our capital and premium income will achieve our financial goals and deliver attractive risk-adjusted returns for our shareholders. To achieve this objective, our strategy is as follows:

Lead the Industry in the Utilization of Proprietary Analytics. We will continue our extensive use of proprietary analytics to select a diversified portfolio of risks that we believe will generate an attractive return on capital over the long term.

Expand Our Strong Broker and Customer Relationships Through Industry Leading Service. We will continue to strengthen our relationships with brokers and customers and build our franchise. We will seek to enhance our reputation with brokers by responding promptly to submissions, as quickly as within one business day, if necessary, and by providing a reasoned analysis to support our pricing. Members of our senior management team will continue to spend a significant amount of time meeting with brokers and potential new clients and strengthening existing relationships.

Leverage Our Global Operating Platform. We will continue to integrate and grow our global operating platform. We believe that by accessing lower cost, yet highly educated and qualified talent, selected from certain of our locations outside of Switzerland, Bermuda and London, and integrating them into our operations through our technology platform, we will be able to achieve greater capabilities than other global reinsurance companies of comparable capital size.

Employ Our Capital Markets Expertise To Optimize Our Return And Expand Our Opportunities. The capital markets experience of our senior management team is being leveraged to access capital markets in innovative ways. For example, we have participated in catastrophe bond structures, including bond structures involving Montana Re Ltd. (“Montana Re”) and Valais Re Ltd. (“Valais Re”), and each provides protection on our global reinsurance portfolio. Montana Re offers Flagstone protection on its insurance and reinsurance portfolio through two separate tranches, utilizing a Property Claim Service index trigger with state weighted and peril-specific personal and commercial payout factors.

Communicate Proactively and Effectively with the Investor Community. We endeavor to keep our investor base up to date on all recent developments via our website, earnings calls, investor conferences and one on one meetings as requested. This is a top priority for the Flagstone senior management team.

Maintain an Energetic Culture that Continuously Challenges Best Practices. Our team operates in a fast paced dynamic environment and is encouraged to actively challenge best practices in the industry.

Segment Information

The Company is currently organized into three business segments: Reinsurance, Lloyd’s and Insurance. To better align the Company’s operating and reporting structure with its current strategy, as a result of our acquisition of Marlborough, the managing agency for Lloyd’s Syndicate 1861, the Company modified its internal reporting process and the manner in which the business is managed and as a result, the Company revised its segment structure, effective January 1, 2009. As a result of this process, the Company is now reporting its results to the chief operating decision maker based on three reporting segments: Reinsurance, Lloyd’s and Insurance.

Management views the operations and management of the Company as three separate reporting segments. We regularly review our financial results and assess our performance on the basis of our three reporting segments. Financial data relating to our segments is included in Note 21 “Segment Reporting” to our Consolidated Financial Statements (Item 8 below).

Index

Segments, Products and Operations

Reinsurance Segment and Products

We write primarily property, property catastrophe, and short-tail specialty and casualty reinsurance from our offices in Switzerland, Bermuda, Africa, Cyprus, Puerto Rico, and Dubai. For a discussion of our Global Operating Platform, please see "Operations—Global Operating Platform" below.

Substantially all of the reinsurance products we currently seek to write are in the form of treaty reinsurance contracts. When we write treaty reinsurance contracts, we do not evaluate separately each of the individual risks assumed under the contracts and are therefore largely dependent on the individual underwriting decisions made by the cedent. Accordingly, as part of our initial review and renewal process, we carefully review and analyze the cedent's risk management and underwriting practices in deciding whether to provide treaty reinsurance and in appropriately pricing the treaty.

Our contracts can be written on either a pro rata or on an excess of loss basis, generally with a per-event cap. With respect to pro rata reinsurance, we share the premiums as well as the losses and expenses in an agreed proportion with the cedent and typically provide a ceding commission to the client in order to pay for part of their business origination expenses. In the case of reinsurance written on an excess of loss basis, we receive the premium for the risk assumed and indemnify the cedent against all or a specified portion of losses and expenses in excess of a specified dollar or percentage amount.

The bulk of our portfolio of risks is assumed pursuant to traditional reinsurance contracts. We may also from time to time take underwriting risk by purchasing a catastrophe-linked bond, or via a transaction booked as an industry loss warranty (as described below under "Property Catastrophe Reinsurance") or an indemnity swap. An indemnity swap is an agreement which provides for the exchange between two parties of different portfolios of catastrophe exposure with similar expected loss characteristics (for example, U.S. earthquake exposure for Asian earthquake exposure). We believe our internal capital markets experience is useful in being able to analyze and evaluate underwriting risks independently from their legal form. All underwriting risks, regardless of the form in which they are entered into, are managed by the underwriting team as part of our overall risk portfolio.

Presently, we primarily focus on writing the following products:

Property Catastrophe Reinsurance. Property catastrophe reinsurance contracts are typically "all risk" in nature, meaning that they protect against losses from earthquakes and hurricanes, as well as other natural and man-made catastrophes such as tornados, fires, winter storms, and floods (where the contract specifically provides for coverage). Losses on these contracts typically stem from direct property damage and business interruption. To date, property catastrophe reinsurance has been our most significant product.

We write property catastrophe reinsurance primarily on an excess of loss basis. In the event of a loss, most contracts of this type require us to cover a subsequent event and generally provide for a premium to reinstate the coverage under the contract, which is referred to as a "reinstatement premium". These contracts typically cover only specific regions or geographical areas, but may be on a worldwide basis.

We also provide industry loss warranty covers, which are triggered by loss and loss adjustment expenses incurred by the cedent and some pre-determined absolute level of industry-wide losses resulting from an insured event or by specific parameters of a defined event (such as a magnitude 8 earthquake or a category 4 hurricane).

Property Reinsurance. We also provide reinsurance on a pro rata share basis and per risk excess of loss basis. Per risk reinsurance protects insurance companies on their primary insurance risks on a single risk basis, for example, covering a single large building. Generally, our property per risk and pro rata business is written with loss limitation provisions, such as per occurrence or per event caps, which serve to limit exposure to catastrophic events.

Short-tail Specialty and Casualty Reinsurance. We also provide short-tail specialty and casualty reinsurance for risks such as aviation, energy, personal accident and health, satellite, marine and workers' compensation. Generally, our short-tail specialty and casualty reinsurance is written with loss limitation provisions.

For the years ended December 31, 2009, 2008 and 2007, approximately 46%, 60% and 65%, respectively, of the risks we reinsured were related to natural catastrophes, such as hurricanes and earthquakes, in North America, the Caribbean and Europe, although we also have written a significant amount of catastrophe business in Japan and Australasia.

Index

Insurance Segment and Products

Island Heritage is a property insurer domiciled in the Cayman Islands which is primarily in the business of insuring homes, condominiums and office buildings in the Caribbean region. The Company gained a controlling interest in Island Heritage in the third quarter of 2007, and as a result, the comparatives for the year ended December 31, 2007 set out in the table above include the results of Island Heritage for the six months ended December 31, 2007 only.

Lloyd’s Segment and Products

Our Lloyd’s segment includes the business generated through the Lloyd’s Syndicate 1861 and Marlborough. Syndicate 1861 primarily provides property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As such there are no comparative numbers for 2008 or 2007.

On September 23, 2009, the Company announced a new Lloyd's property division and syndicate, Syndicate 1969. The new division began writing business for October 1, 2009, initially on behalf of Marlborough's existing Syndicate 1861, but will be supported for the 2010 fiscal year by a new mixed-capital Syndicate 1969, which will provide the majority of the capacity. Syndicate 1861 will assume 25% of all risk, and Syndicate 1969 will use the managing agency services and systems provided by Marlborough and Flagstone.

Operations - Global Operating Platform

We have offices in Bermuda, Switzerland, India, the United Kingdom, Canada, Puerto Rico, Dubai, Cayman Islands, Cyprus, South Africa, Isle of Man, Brazil, the United States and Luxembourg. Most of our senior management, primarily underwriting and risk management functions, are located in Switzerland, Bermuda and London and use the support services from the other offices, with lower operating costs or specialized functions, to deliver products and services to brokers and customers. This provides significant efficiencies in our operations and provides us with access to a large and highly qualified staff at a relatively low cost. We believe that we are positioned to perform and grow these functions outside of Switzerland, Bermuda and London to an extent that distinguishes us among global reinsurance companies of comparable capital size.

Flagstone Suisse is based in Martigny in the canton of Valais, Switzerland. Through this local presence, we are in a position to closely follow and respond effectively to the changing needs of the various European and Bermuda insurance markets. Flagstone Suisse is licensed by the Swiss Financial Market Supervisory Authority, or FINMA, in Switzerland. Flagstone Suisse is also a licensed permit company registered in Bermuda as a Class 4 insurer under the Bermuda Insurance Act operating through its Bermuda branch which complements our Swiss based underwriters with a separately staffed Bermuda underwriting platform.

In London, England, we have Marlborough, the managing agency for Lloyd’s Syndicate 1861 - a Lloyd’s syndicate underwriting a specialist portfolio of short-tail insurance and reinsurance and an international reinsurance marketing operation promoting Flagstone to international and multinational clients. In addition, our U.K. operations, through Flagstone Representatives Limited, our London based market intermediary regulated by the Financial Services Authority (“FSA”), work alongside our underwriters to develop global business opportunities and maintain relationships with existing clients. During 2009, we have opened further offices in Rio de Janeiro and New York. The Rio office allows us access to the growing Brazilian market, and the opening of our agency in New York has opened up the North American Marine and Energy market on both a primary and reinsurance basis.

Our research and development efforts, proprietary software development, systems implementation, part of our catastrophe modeling and risk analysis team, part of underwriting administration, finance and accounting, and our investments analysis team are based in Hyderabad, India. Our office is located in the state of Andhra Pradesh, a region with reputed educational institutes, many highly educated and talented financial analyst and software professionals, and the operating costs are substantially below those in Switzerland, Bermuda and London. From support services perspective, Hyderabad center well complements our other support center, Halifax, Nova Scotia, Canada, and we are able to provide 24x7 support to our global underwriting operations.

In Halifax, Nova Scotia, Canada, we have a computer data center where we run support services such as accounting, claims, risk modeling systems implementation and support, IT infrastructure, proprietary systems development and high performance computing. Halifax has a concentration of university graduates with professional backgrounds and credentials in such areas as finance, information technology and science which are appropriate for our operational support functions. In general, the cost of employing a highly skilled work force in Halifax is lower than in Bermuda, Switzerland and London. In addition, Halifax is in the same time zone as Bermuda, which facilitates communications between our offices.

Our Puerto Rico office, established in 2007 and licensed with the Office of the Commissioner of Insurance of Puerto Rico, provides an underwriting platform targeting the Caribbean and Latin American regions, primarily on behalf of Flagstone Suisse.

Index

In Dubai, we have established and licensed a reinsurance intermediary operation with the Dubai Financial Services Authority to provide marketing and underwriting support for the Middle East and North Africa on behalf of Flagstone Suisse.

In the Cayman Islands, we write insurance business generated through Island Heritage, which primarily is in the business of insuring homes, condominiums and office buildings in the Caribbean region.

In the Republic of Cyprus, we write specialty property and casualty reinsurance through Flagstone Alliance.

In South Africa, we write multiple lines of reinsurance through Flagstone Africa.

In Luxembourg, we manage our investment portfolio within Flagstone Capital Management Luxembourg S.A. SICAF FIS ("FCML"). FCML is a fixed capital investment company qualifying as a specialized investment fund under the Luxembourg law of February 13, 2007 and may be constituted with multiple sub funds each corresponding to a distinct part of the assets and liabilities of the investment company.

We believe our operating platform affords us the capability and flexibility to deploy our capital and expertise strategically, efficiently and tactically throughout the global markets. For example, compared to our competitors, we believe these capabilities allow us to process new business submissions quickly and thoroughly, to review relatively more risks in the search for attractive opportunities and to explore new markets where the accumulation and analysis of data is a time-consuming activity.

Ratings

Financial strength ratings have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. Rating organizations continually review the financial positions of insurers and reinsurers, including Flagstone. The following are the current financial strength ratings from internationally recognized rating agencies for Flagstone Suisse:

Rating Agency	Financial Strength Rating	
A.M. Best	A-	Excellent (Stable outlook)
Moody's Investor Services	A3	Strong (Negative outlook)
Fitch	A-	Adequate (Stable outlook)

Flagstone Africa, Flagstone Alliance and Island Heritage each have financial strength ratings of A- from A.M. Best.

Our ability to underwrite business is dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. In the event that we are downgraded by any of the agencies below where our ratings currently are, we believe our ability to write business would be adversely affected. In the normal course of business, we evaluate our capital needs to support the volume of business written in order to maintain our claims paying and financial strength ratings. We regularly provide financial information to rating agencies to both maintain and enhance existing ratings.

These ratings are not evaluations directed to investors in our securities or a recommendation to buy, sell or hold our securities. Our ratings may be revised or revoked at the sole discretion of the rating agencies.

Syndicate 1861 at Lloyd's of London: All Lloyd's syndicates, including Syndicate 1861, benefit from Lloyd's central resources, including the Lloyd's brand, its network of global licenses and the "Central Fund". The "Central Fund" is available at the discretion of the Council of Lloyd's to meet any valid claim that cannot be met by the resources of any member. As all Lloyd's policies are ultimately backed by this common security, a single market rating can be applied. Lloyd's as a market is rated as follows:

Rating Agency	Financial Strength Rating	
A.M. Best	A	Excellent (Stable outlook)
Standard & Poor's	A+	Strong (Stable outlook)
Fitch	A+	Strong (Stable outlook)

The syndicate benefits from these ratings and the Company believes that ratings impairments below A- would materially impair the syndicate's ability to write business.

Index

Underwriting and Risk Management

We view underwriting and risk management as an integrated process. We commence underwriting a risk only after we have an initial understanding of how its addition to our existing portfolio would impact our total single event loss potential by risk zone. After completing our detailed underwriting analysis, and before we provide an indication of terms and price, we ensure that we understand the change this risk will make in the overall risk of our insurance portfolio. We constantly review our global exposures as new opportunities are shown to us, as we bind new business, and as policies mature to ensure that we are continuously aware of our overall underwriting risk. A principal focus of Flagstone is to develop and effectively utilize sophisticated computer models and other analytical tools to assess the risks that we underwrite and to optimize our portfolio of underwriting and investment risks.

Underwriting

Our principal underwriting objective is to create a balanced portfolio of risks, diversified by risk zone. Underwriting and pricing controls are exercised through our chief underwriting officers and our chief actuary. The underwriting team is supported by additional underwriters, catastrophe risk analysts, an actuarial team, a catastrophe modeling and research team and a full complement of underwriting administrative support positions.

We underwrite to specific disciplines as set out in our underwriting guidelines developed by our senior executives and approved by the Underwriting Committee of our Board of Directors. In general our underwriting and risk management approach is to:

- focus on ceding insurers that are leaders in their geographic zone with high quality underlying data;
- devote significant time and resources to data evaluation and cleansing;
- use multiple analytical models to price each risk, including varying techniques and vendor models;
- ensure correct application of vendor model options for each specific risk factor (such as demand surge, which is the tendency for costs such as construction to increase following a large catastrophe);
- leverage our research and development team's in-depth knowledge of the strengths and weaknesses of third-party models in pricing and risk selection;
- subject all risks to peer review, which is the detailed review of each risk we plan to write by an underwriter other than the individual responsible for the transaction, and subject large risks to additional approval by the Chief Executive Officer, the Management Committee, or the Underwriting Committee of the Board of Directors, depending on the size of the risk;
- quickly reject risks that do not meet our requirements;
- identify attractive insurance and reinsurance programs, lines, and markets to enter; and
- devote significant time to data evaluation and cleansing or establish state of the art insurance processes to ensure proper risk classification and selection.

Risk Management

We apply an integrated approach to risk management, employing a variety of tools, both proprietary and commercially available, along with prudent analysis and management from actuarial and underwriting professionals.

We have invested significant resources in developing state of the art risk monitoring capabilities. Our Multiple Operational Sourced and Integrated Control Database & Applications, that we refer to as our MOSAIC platform, provides a flexible framework for assimilating various data and informational formats for risk modeling, pricing, risk controls, underwriting and reporting. Our proprietary systems allow us significant flexibility in evaluating our loss potential from a variety of commercial vendor models and varying segments of our business, primarily regional and peril.

Property catastrophe risks along with other aggregating exposures are monitored in a variety of fashions including probable maximum loss and absolute zonal limits exposed. Internal risk guidelines govern the maximum levels of risk the Company may assume including size of individual risk commitments. We limit risks on both an absolute zonal basis for property and probable maximum loss.

We limit risks on an absolute zonal basis for property reinsurance. Similarly we limit maximum aggregate insurance exposure to specified geographic concentrations through the use of geographic information systems technology.

Probable Maximum Loss (“PML”). We monitor our PML on both a per occurrence and annual aggregate basis as part of our internal risk guidelines. Per occurrence refers to the potential size of loss from a given event versus annual aggregate, which involves the use of simulation to define hypothetical years containing sequences of events. For example, Hurricanes Katrina, Wilma or Rita would qualify as individual events, but annual aggregate calculations identify the Company’s exposure to all three of these events occurring in a single year.

Index

We also manage the risk of estimation error by applying limits in each of our risk zones, which we refer to as zonal limits. Substantially all of our contracts include loss limitation provisions, and we limit the amount of exposure to a single event loss for a particular peril that we can take on or retain from those contracts in any one risk zone. Our approach to risk control imposes an absolute limit on our net maximum potential loss for any single event in any one risk zone, which reduces the risk to Flagstone of model error or inaccuracy.

We apply similar scenario based approaches along with absolute aggregate loss limitations to non- natural catastrophe and/or non-property exposed risks. For example, airline exposure in the aviation line is highly concentrated and therefore essential to monitor maximum potential event and annual aggregate exposures; we have developed a model that simulates 20,000 years of potential airline losses including secondary losses to product manufacturers. In addition, we manage our maximum loss potential to various industry size losses. We apply similar methodologies to U.S. crop, satellite, marine, energy, and property risk.

Ceded Reinsurance. In addition to managing the risks in our portfolio by monitoring the zonal exposures resulting from each underwriting decision, we also may choose to protect our results and capital through the use of retrocessional coverage. This coverage may be purchased on an indemnity basis as well as on an industry basis (for example, industry loss warranties).

When we buy reinsurance and retrocessional coverage on an indemnity basis, we are paid for an agreed-upon portion of the losses we actually suffer. In contrast, when we buy an industry loss warranty cover, we are paid only if both the Company and the industry suffer a loss (as reported by one of a number of independent agencies) in excess of specified threshold amounts. With an industry loss warranty, we bear the risk that we may suffer a loss and yet receive no payment because the industry loss was less than the specified threshold amount.

We control our Caribbean coverage exposure through Island Heritage to both single and multiple catastrophe events through the use of catastrophe reinsurance. For individual non-catastrophe exposures we control our risk through the use of per risk reinsurance coverage.

We only purchase reinsurance and retrocessional coverage from reinsurers with a minimum financial strength rating of “A-” from A.M. Best or S&P or “A3” from Moody’s, from affiliates with whom we are able to control credit risk, or on a collateralized basis.

We cede business to our sidecar, Mont Fort. Mont Fort raises capital from third-party investors through offerings of its preferred shares, and uses the proceeds of those offerings to underwrite reinsurance which will be ceded to Mont Fort by Flagstone. Mont Fort is organized to establish segregated accounts, referred to as cells. Each cell of Mont Fort has a distinct business strategy, underwriting strategy and underwriting risk management program. Flagstone may also cede business to reinsurance companies other than Mont Fort.

We also use capital markets instruments for risk management (e.g., catastrophe-linked bonds, or catastrophe bonds, which is a type of financial instrument that is tied to a specific catastrophic event, and other forms of risk securitization) where the pricing and capacity is attractive and the structures provide a high degree of security and clear loss settlement procedures.

Program Limits. We also seek to control our overall exposure to risk by limiting the amount of reinsurance we will supply in accordance with a particular program or contract. This helps us to diversify within and across risk zones. Our Underwriting Committee sets an absolute dollar limit on our maximum exposure to any one program or contract, which may be exceeded for specific situations at the discretion of the Underwriting Committee.

With regard to our Insurance Segment, we control our individual risk exposure for risks written by Island Heritage through our underwriting guidelines which limit individual exposures by reference to our per risk reinsurance coverage limits.

Marketing and Distribution

Our reinsurance customers generally are sophisticated, long-established insurers who seek the assurance not only that claims will be paid but also that reinsurance will continue to be available after claims are paid. Catastrophic losses can be expected to adversely affect our clients' financial results from time to time, and we believe that our financial stability, ratings, growth of capital, client service and innovation are essential for creating long-term relationships. We believe that such relationships are critical to creating long-term value for the Company and for our shareholders.

Index

The majority of our business is produced through brokers and reinsurance intermediaries, who receive a brokerage commission on industry standard terms, usually equal to a percentage of gross premiums. We seek to become the first choice of brokers and clients by providing:

- a high level of technical expertise in the risks we write;
- rapid and informed quoting;
- timely payment of claims;
- large capacity within our underwriting guidelines on the high quality clients we target; and
- clear indications of the classes of risks we will and will not write.

Our objective is to build long-term relationships with key reinsurance brokers, such as Aon Benfield, Guy Carpenter & Company, Inc. and Willis Group Holdings Ltd., and with many ceding companies.

Our Insurance segment operates from offices in the Cayman Islands and London. Island Heritage produces its business primarily through brokers from its headquarters in Cayman Islands and via its licensed agents in the Caribbean. Marlborough produces its business primarily through brokers and agents from its headquarters in London.

Gross premiums written by broker, shown individually where premiums are 10% or more of the total in any of the last three years, were as follows:

	Year ended December 31, 2009		Year ended December 31, 2008		Year ended December 31, 2007	
	Gross premiums written	Percentage of total	Gross premiums written	Percentage of total	Gross premiums written	Percentage of total
Name of broker						
Aon Benfield	$367,428	37.2 %	$369,037	47.2 %	$245,664	42.6 %
Guy Carpenter	230,663	23.3 %	162,236	20.7 %	153,781	26.6 %
Willis Group	98,662	10.0 %	56,997	7.3 %	77,030	13.3 %
Other brokers (1)	291,738	29.5 %	193,619	24.8 %	100,675	17.5 %
Total	$988,491	100.0 %	$781,889	100.0 %	$577,150	100.0 %

(1) Other brokers includes the gross written premiums related to the insurance segment

We believe that by maintaining close relationships with brokers, we are able to obtain access to a broad range of potential reinsureds. We meet frequently in Bermuda and elsewhere with brokers and senior representatives of clients and prospective clients.

Claims Management

The Company's reinsurance and insurance claims management process is initiated upon receipt of reports from ceding companies, brokers and insureds.

An initial review is conducted by a claims analyst to ensure correct loss and reinstatement premium calculations prior to approval/entry into our underwriting/claims/accounting system.

Underwriters, underwriting managers, claims management and senior management review claims submissions prior to entry and settlement. On occasions where legal contract review is necessary, claims are subject to internal legal review from counsel. Once the validity of the given claim is established, responsibility for management of the claim is transferred to our claims department. As the claim develops, the claims department is empowered to draw on those resources, both internal and external, it deems appropriate to settle the claim appropriately.

Where necessary, we will conduct or contract for on-site audits periodically, particularly for large accounts and for those whose performance differs from our expectations. Through these audits, we will be able to evaluate ceding companies and agents, brokers with claims settlement authority, claims-handling practices, including the organization of their claims departments, their fact-finding and investigation techniques, their loss notifications, the adequacy of their reserves, their negotiation and settlement practices and their adherence to claims-handling guidelines.

Index

As part of a risk based approach to claims management, for catastrophe insurance claims through Island Heritage we reserve the right to remove agent's claims settlement authority in the case of catastrophe events to enable in-house claims management, thereby controlling the claims management process internally and limiting our overall risk exposure.

Loss Reserves

We establish reserves for losses and loss expenses that arise from our insurance and reinsurance products. Loss reserves represent estimates, including actuarial and statistical projections at a given point in time, of the ultimate settlement and administration costs of claims incurred. Loss and loss adjustment expense reserves (or loss reserves) are typically comprised of (1) case reserves, which are established for specific, individual reported claims and (2) reserves for losses that have been incurred but for which claims have not yet been reported to us, referred to as incurred but not reported ("IBNR") reserves. Our estimates are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends in claims severity and frequency and other variable factors such as inflation. It is likely that the ultimate liability will be greater or less than such estimates and that, at times, this variance could be material.

On our reinsurance book, the Company's actuarial group performs a quarterly loss reserve analysis. This analysis incorporates specific exposures, loss payment and reporting patterns, as well as additional loss-sensitive contractual features such as reinstatement premiums, profit commissions, and other relevant factors. This process involves the segregation of risks between catastrophic and non-catastrophic risks to ensure appropriate treatment.

For our property and other catastrophe policies, we initially establish our loss reserves based on loss payments and case reserves reported by ceding companies. We then add to these case reserves our estimates for IBNR. To establish our IBNR estimates, in addition to the loss information and estimates communicated by cedents, we also use industry information, knowledge of the business written by us, management's judgment and general market trends observed from our underwriting activities. We may also use our computer-based vendor and proprietary modeling systems to measure and estimate loss exposure under the actual event scenario, if available. Although the loss modeling systems assist with the analysis of the underlying loss, and provide us with information and the ability to perform an enhanced analysis, the estimation of claims resulting from catastrophic events is inherently difficult because of the variability and uncertainty of property catastrophe claims and the unique characteristics of each loss.

For non-catastrophe business, we utilize a variety of standard actuarial methods in our analysis. The selections from these various methods are based on the loss development characteristics of the specific line of business and specific contracts. The actuarial methods we use to perform our quarterly contract by contract loss reserve analysis include: Paid Loss Development Method, Reported Loss Development Method, Expected Loss Ratio Method, Bornheutter-Ferguson Paid Loss Method and Bornheutter-Ferguson Reported Loss Method. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Estimates—Loss and Loss Adjustment Expense Reserves".

We reaffirm the validity of the assumptions we use in the reserving process on a quarterly basis during an internal review process. During this process, the actuaries verify that the assumptions continue to form a sound basis for projection of future liabilities.

Although we believe that we are prudent in our assumptions and methodologies, we cannot be certain that our ultimate payments will not vary, perhaps materially, from the estimates we have made. If we determine that adjustments to an earlier estimate are appropriate, such adjustments are recorded in the quarter in which they are identified. The establishment of new reserves, or the adjustment of reserves for reported claims, could result in significant upward or downward changes to our financial condition or results of operations in any particular period. We regularly review and update these estimates, using the most current information available to us.

Our estimates are reviewed annually by an independent actuary in order to provide additional insight into the reasonableness of our loss reserves.

The Company's reserve development is composed of the change in ultimate losses from what the Company originally estimated as well as the impact of the foreign exchange revaluation on reserves. The re-estimated ultimate claims and claim expenses reflect additional information received from cedents or obtained through reviews of industry trends, regarding claims incurred prior to the end of the preceding financial year. A redundancy (or deficiency) arises when the re-estimation of reserves is less (or greater) than previously estimated at the preceding year-end. The cumulative redundancies (or deficiencies) reflect cumulative differences between the initial reported net reserves and the currently re-estimated net reserves. Annual changes in the estimates are reflected in the income statement for each year, as the liabilities are re-estimated. Reserves denominated in foreign currencies are revalued at each balance sheet date's foreign exchange rates.

Index

With respect to our insurance operations, we are notified of insured losses by brokers, agents and insureds and record a case reserve for the estimated amount of the ultimate expected liability arising from the claim. The estimate reflects the judgment of our claims personnel based on general reserving practices, the experience and knowledge of such personnel regarding the nature of the specific claim and, where appropriate, advice of counsel, loss adjusters and other relevant consultants.

Frequently our loss reserving is preformed on a contract by contract basis. However, for insurance transactions (or some smaller reinsurance transactions) analysis is performed by grouping exposures with similar characteristics or attributes such as line of business, geography, management segment, average notice periods, settlement lags and claims latency.

The following table presents the development of our loss and loss adjustment expense reserves for December 31, 2006 through December 31, 2009, and the breakdown of our loss and loss adjustment expense reserves as at December 31, 2009 per accident year, net of claims paid (in thousands of U.S. dollars):

	Years ended December 31,			
	2006	2007	2008	2009
Gross liability for unpaid losses and loss expense	$22,516	$180,978	$411,565	$480,660
Retroceded liability for unpaid losses and loss expenses		(1,355)	(16,422)	(19,270)
Net liability for unpaid losses and loss expenses	$22,516	$179,623	$395,143	$461,390
Net reserves re-estimated as of:				
One year later	$18,641	$163,946	$388,553	
Two years later	13,455	149,776		
Three years later	11,357			
Cumulative redundancy	$(11,159)	$(29,847)	$(6,590)	
Cumulative amount of net liability paid through:				
One year later	$6,948	$80,651	$220,126	
Two years later	10,159	113,527		
Three years later	10,329			

Investments

The investment management guidelines of the Company are set by the Finance Committee of our Board of Directors. The Finance Committee establishes investment policies and guidelines for both internal and external investment managers.

In 2007, management under the auspices of, the Finance Committee conducted a comprehensive asset allocation study, consistent with modern practice in portfolio optimization, and developed a sophisticated optimization model using asset classes the Company is allowed to invest in from fiscal, regulatory, and liquidity aspects. The model aims at achieving higher expected total returns while maintaining adequate liquidity to pay potential claims and preserving our financial strength rating. The asset class composition of the model output may include a significant allocation to high grade fixed maturities securities, with the balance invested between other asset classes, such as money markets, U.S. equities, developed and emerging market equities, commodities, private equity, real estate and cash equivalents. Typically a small portion of investments may be allocated to private equity, real estate and commodities. We optimize asset allocation periodically, by taking into consideration the financial market conditions. We implemented such periodically optimized strategic target allocation in 2007 and 2008. Currently, our portfolio is optimized to be conservative in response to the 2008 deterioration in the financial markets with about 90% concentration in fixed maturities and cash equivalents, with the remainder diversified between commodities, real estate, and equities.

We have a bias against active management in favor of indexing and passive securities that are generally the most liquid. A number of our equity and other exposure implementations, when they form part of our asset allocation, use futures contracts and swaps, whereas the assets in a short term portfolio, support the futures contracts as if those assets were pledged and not available for liquidity purposes. This passive implementation strategy gives us a low cost and efficient way, using a mixture of liquid exchange-traded assets. From time to time we use external managers for implementing certain assets classes in order to get the advantage of scale. Our strategic asset allocation and indexing capabilities are also complemented by other in-house strengths for passively indexing fixed income strategies, short term (money markets) portfolio management, overall risk management, liquidity management and hedging.

Index

Competition

We operate in highly competitive markets. We compete with major and mid-sized U.S., Swiss, Bermudian, United Kingdom, Caribbean, South African and other international reinsurers and insurers, some of which have greater financial, marketing and management resources than we do. We also compete with government-sponsored insurers and reinsurers, and with new companies which continue to be formed to enter the reinsurance market. In addition, established competitors have completed or may be planning to complete additional capital raising transactions. Capital markets also offer alternative products that are intended to compete with traditional reinsurance products.

In particular, we compete with insurers and reinsurers that provide property-based lines of reinsurance, such as ACE Tempest Re Group, AXIS Capital Holdings Ltd., other syndicates at Lloyd's of London, Montpelier Re Holdings Ltd., Renaissance Re Holdings Ltd., XL Re Ltd., the Sagicor Financial group of companies, Guardian General Insurance Limited, Munich Re Group, Swiss Re Group, Hannover Reinsurance Africa Limited, Africa Reinsurance Corporation, SCOR S.E. and Everest Re Group Ltd. and similar companies.

Competition in the types of business that we underwrite is based on many factors, including:

- premiums charged and contractual terms and conditions offered;
- services provided, products offered and scope of business (both by size and geographic location);
- strength of client relationships;
- financial strength ratings assigned by independent rating agencies;
- speed of claims payment;
- reputation;
- perceived financial strength; and
- experience of the reinsurer in the line of reinsurance to be written.

Increased competition could result in fewer submissions, lower premium rates, and less favorable policy terms, which could adversely impact our growth and profitability. In addition, capital market participants have recently created alternative products, such as catastrophe bonds, that are intended to compete with reinsurance products. We believe that we are well positioned in terms of client service and underwriting expertise. We also believe that our capitalization and strong financial ratios provide us with a competitive advantage in the marketplace.

In our Insurance segment, where competition is focused on price as well as availability, service and other considerations, we compete with insurers that provide property and casualty based lines of insurance such as other syndicates at Lloyd's of London and local Caribbean insurers.

Other Subsidiaries

Flagstone Africa

On June 26, 2008, Flagstone Suisse purchased 3,714,286 shares (representing a 65% interest) in Imperial Re. In July, 2008, the South Africa Registrar of Companies recorded a change of name from Imperial Re to Flagstone Africa. On November 10, 2009, Flagstone Suisse purchased an additional 1,999,998 shares, representing the remaining 35% interest in Flagstone Africa. Flagstone Africa is domiciled in South Africa and writes multiple lines of reinsurance in sub-Saharan Africa. This acquisition gives the Company capacity in a fast growing and technically adequate market.

Flagstone Alliance

The Company acquired Flagstone Alliance, formerly known as Alliance Re, in 2008. Flagstone Alliance, domiciled in the Republic of Cyprus is a specialty property and casualty reinsurer writing multiple lines of business in Europe, Asia, and the Middle East & North Africa region.

Lloyd's

Our Lloyd’s segment includes the business generated through the Lloyd’s Syndicate 1861 and Marlborough. Syndicate 1861 primarily provides property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As such there are no comparative numbers for 2008 or 2007.

Index

On September 23, 2009, the Company announced a new Lloyd's property division and syndicate, Syndicate 1969. The new division began writing business for October 1, 2009, initially on behalf of Marlborough's existing Syndicate 1861, but will be supported for the 2010 fiscal year by a new mixed-capital Syndicate 1969, which will provide the majority of the capacity and use the managing agency services and systems provided by Marlborough and Flagstone. Syndicate 1861 will assume 25% of all risks written by the division and Syndicate 1969, 75% in 2010.

Mont Fort

The Company owns all of the outstanding common shares of Mont Fort. Mont Fort is organized under the laws of Bermuda as an exempted company which is registered as both a general business Class 3 insurer and long-term insurer and is also registered as a “segregated accounts” company under the Bermuda Segregated Accounts Companies Act 2000 (as amended) (the “SAC Act”). The SAC Act enables Mont Fort to establish segregated accounts, referred to as cells. Each cell of Mont Fort has a distinct business strategy, underwriting strategy and underwriting risk management program. Mont Fort has established three cells: Mont Fort ILW, Mont Fort ILW 2 Cell, and Mont Fort High Layer or Mont Fort HL. Each cell of Mont Fort raises capital through preferred shares issued by Mont Fort and linked to that cell, underwrites its own risks and, to the fullest extent provided by the SAC Act, is solely responsible for liabilities arising from those risks. Each cell uses the proceeds of those offerings to underwrite reinsurance which will be ceded to Mont Fort by Flagstone.

The results of Mont Fort are included in the Company’s consolidated financial statements with effect from January 12, 2007 being the date that the Mont Fort HL cell was established, and which the Company determined was the date that the Company became the primary beneficiary of Mont Fort in accordance with Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”) Topic on Consolidations. The portions of Mont Fort’s net income and shareholders’ equity attributable to holders of the preferred shares for the years ended December 31, 2009, 2008 and 2007 are recorded in the consolidated financial statements of the Company as noncontrolling interest. On August 10, 2009, Mont Fort repurchased 43.6 million preferred shares relating to its first cell, Mont Fort ILW for $63.1 million. As at December 31, 2009, the net assets of each cell total $nil for Mont Fort ILW, $89.4 million for ILW2 and $46.6 million for Mont Fort HL.

In addition, the Company does not count Mont Fort’s contracts against its zonal limits or otherwise consider Mont Fort as a subsidiary for its underwriting and risk management procedures.

Island Heritage

Island Heritage is a property insurer based in the Cayman Islands, Puerto Rico and Barbados which primarily is in the business of insuring homes, condominiums and office buildings in the Caribbean region. On July 3, 2007, the Company purchased 73,110 shares (representing a 21.4% interest) in Island Heritage for a purchase price of $12.6 million. With this acquisition, the Company took a controlling interest in Island Heritage by increasing its ownership to 54.6% of the voting shares. The Company had previously acquired 33.2% of the shares through three purchases in March 2006 (18.7% interest), October 2006 (9.8% interest) and May 2007 (4.7% interest). Following the acquisition, the Company’s representation on Island Heritage’s board and the close working relationship with its management allows us to promote and support best practices in the underwriting of Island Heritage’s underlying business and to consequently enhance the quality of data available to Flagstone to underwrite the reinsurance of such business. On June 30, 2008, the Company acquired an additional 16,919 shares in Island Heritage (representing 5% of its common shares) for total consideration of $3.3 million, taking its total shareholding in Island Heritage to 203,129 shares (representing a 59.6% interest). The Company recorded $1.3 million of goodwill on the acquisition. In July 2008, Island Heritage issued common shares to certain employees under a stock based compensation plan which resulted in a small dilution of the Company’s ownership to 59.2%. In July 2009, Island Heritage issued common shares to certain employees under a stock based compensation plan which resulted in a small dilution of the Company’s ownership to 58.8%.

As a result of the acquisition of the controlling interest, the results of operations of Island Heritage have been included in the Company’s consolidated financial statements from July 1, 2007, with the portions of Island Heritage’s net income and shareholders’ equity attributable to minority shareholders recorded as minority interest in the Company’s consolidated financial statements.

Employees

The Company had 471 employees at February 15, 2010. We believe that our relations with our employees are satisfactory.

Index

Regulation

We conduct business through our Martigny, Switzerland; Hamilton, Bermuda; Limassol, Republic of Cyprus; George Town, Grand Cayman, Cayman Islands; Johannesburg, South Africa; San Juan, Puerto Rico; Luxembourg; and Dubai, UAE offices, with our research and development effort and part of our catastrophe modeling and risk analysis team in our Hyderabad, India office, global marketing and business development in our London, England office, underwriting business commencing in 2009 through our Lloyd's platform in London and back office and operational support in our Halifax, Canada office. We do not intend to conduct any activities which may constitute the actual transaction of the business of insurance or reinsurance in any jurisdiction in which Flagstone or any other subsidiary of the Company is not licensed or otherwise authorized to engage in such activities. However, the definition of such activities is in some jurisdictions ambiguous and susceptible to judicial interpretation. Accordingly, there can be no assurance that enquiries or challenges to our insurance activities in such jurisdictions will not be raised in the future or that our location or regulatory status, or restrictions on its activities resulting therefrom, will not adversely affect us.

In addition to the regulatory requirements imposed by the jurisdictions in which a reinsurer is licensed, a reinsurer's business operations are affected by regulatory requirements governing "credit for reinsurance" in other jurisdictions in which its ceding companies are located. In general, a ceding company which obtains reinsurance from a reinsurer that is licensed, accredited or approved by the jurisdiction in which the ceding company files statutory financial statements is permitted to reflect in its statutory financial statements a credit in an aggregate amount equal to the liability for unearned premiums and loss reserves and loss expense reserves ceded to the reinsurer. Many jurisdictions also permit ceding companies to take credit on their statutory financial statements for reinsurance obtained from unlicensed or non-admitted reinsurers if certain prescribed security arrangements are made. Because we are licensed, accredited or approved in Switzerland, Bermuda, London, Cyprus, Africa, Cayman Islands, Dubai and Puerto Rico, we expect that in certain instances our reinsurance clients will require us to post a letter of credit or enter into other security arrangements.

Bermuda Insurance Regulation

The Bermuda Insurance Act. As a holding company, we are not subject to Bermuda insurance law and regulations. However, the Bermuda Insurance Act and related regulations, regulate the insurance business of Flagstone Suisse which operates in Bermuda through its Bermuda branch, Mont Fort and Haute Route. The Bermuda Insurance Act provides that no person shall carry on any insurance business in or from within Bermuda unless registered as an insurer under the Bermuda Insurance Act by the Bermuda Monetary Authority ("BMA"), which is responsible for the day-to-day supervision of insurers. The BMA, in deciding whether to grant registration, has broad discretion to act as it thinks fit in the public interest. The BMA is required by the Bermuda Insurance Act to determine whether the applicant is a fit and proper body to be engaged in the insurance business and, in particular, whether it has, or has available to it, adequate knowledge and expertise to operate an insurance business. Under the Bermuda Insurance Act, insurance business includes reinsurance business. The continued registration of a company as an insurer under the Bermuda Insurance Act is subject to its complying with the terms of its registration and such other conditions as the BMA may impose from time to time.

An Insurance Advisory Committee appointed by the Bermuda Minister of Finance advises the BMA on matters connected with the discharge of the BMA's functions, and sub-committees thereof supervise and review the law and practice of insurance in Bermuda, including reviews of accounting and administrative procedures.

The Bermuda Insurance Act imposes solvency, liquidity and capital adequacy standards and auditing and reporting requirements on Bermuda insurance companies and grants to the BMA powers to supervise, investigate and intervene in the affairs of insurance companies. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below.

In July 2008 the Insurance Amendment Act 2008 (the “Amendment Act”) was promulgated, which among other things, created a new supervisory framework for Bermuda insurers by establishing new risk-based regulatory capital adequacy and solvency margin requirements. The implementation of the new supervisory framework is to occur in phases, commencing with Class 4 insurers before being extended to certain commercial Class 3, Class 3A and Class 3B insurers. Under the new regulatory framework ushered in by the Amendment Act on December 31, 2008, the BMA promulgated the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Order 2008 , as amended by the Insurance (Prudential Standards) (Class 4 Solvency Requirement) Amendment Order 2009 which came into operation on December 31, 2009 (together the “Order”) which mandates that a Class 4 insurer’s Enhanced Capital Requirement (“ECR”) be calculated by either (a) the model set out in Schedule 1 to the Order or (b) an internal capital model which the BMA has approved for use for this purpose. More information on the ECR and the new risk-based regulatory capital adequacy and solvency margin regime introduced under the Amendment Act can be found in the section below entitled “Enhanced Capital Requirements and Minimum Solvency”.

On December 11, 2008, the Bermuda House of Assembly approved amendments to Bermuda’s existing insurance regulations (the “Regulations”). The amended Regulations, which came into effect on December 31, 2008, complement and in certain respects, are consequential to the changes instituted under the Amendment Act.

Index

The BMA utilizes a risk-based approach when it comes to licensing and supervising insurance companies in Bermuda. As part of the BMA's risk-based system, an assessment of the inherent risks within each particular class of insurer is utilized in the first instance to determine the limitations and specific requirements which may be imposed. Thereafter the BMA keeps its analysis of relative risk within individual institutions under review on an ongoing basis, including through the scrutiny of regular audited statutory financial statements, and, as appropriate, meeting with senior management during onsite visits. The initial meetings with senior management and any proposed onsite visit will primarily focus upon companies that are licensed as Class 4, Class 3, Class 3A and Class 3B insurers. The BMA has also recently issued guidance notes, or the Guidance Notes, in order to ensure those operating in Bermuda have a good understanding of the nature of the requirements of, and the BMA's approach in implementing, the Insurance Act.

Classification of Insurers. The Bermuda Insurance Act distinguishes between insurers carrying on long-term business and insurers carrying on general business. There are six classifications of insurers carrying on general business, with Class 4 insurers subject to the most onerous regulation with the strictest limits on their types of business. Flagstone Suisse and Haute Route are registered to carry on general business as Class 4 and Class 3 insurers in Bermuda, respectively, and are regulated as such under the Bermuda Insurance Act. Flagstone Suisse and Haute Route will not be permitted to carry on long-term business. In general, long-term business includes life and long-term disability insurance. Mont Fort is registered to carry on general business as a Class 3 insurer and long-term business in Bermuda although does not currently write any long-term business.

While each of Mont Fort and Haute Route are registered as Class 3 insurers in Bermuda the following disclosure focuses on Flagstone Suisse operating through its Bermuda branch, as it is subject to the most onerous regulation and supervision.

Cancellation of Insurer's Registration. An insurer's registration may be canceled by the BMA on certain grounds specified in the Bermuda Insurance Act, including failure of the insurer to comply with its obligations under the Bermuda Insurance Act or if, in the opinion of the BMA, the insurer has not been carrying on business in accordance with sound insurance principles.

Principal Representative. An insurer is required to maintain a principal office in Bermuda and to appoint and maintain a principal representative in Bermuda. The Flagstone Suisse principal representative is David Brown and our principal office is Crawford House, 23 Church Street, Hamilton HM 11, Bermuda.

Independent Approved Auditor and GAAP Auditor. Every registered insurer must appoint an independent auditor who will annually audit and report on the statutory financial statements and the statutory financial return of the insurer, both of which, in the case of Flagstone Suisse, are required to be filed annually with the BMA. With effect from December 31, 2008, every Class 4 insurer is required to appoint an auditor of Generally Accepted Accounting Principles ("GAAP") financial statements. The independent auditor of Flagstone Suisse must be approved by the BMA and may be the same person or firm which audits Flagstone Suisse's financial statements and reports for presentation to its shareholders. The independent auditor and GAAP Auditor for Flagstone Suisse's Bermuda branch is Deloitte & Touche, Bermuda.

Loss Reserve Specialist. As a registered Class 4 insurer, Flagstone Suisse is required to submit an opinion of its approved loss reserve specialist with its statutory financial return in respect of its loss and loss expense provisions. The loss reserve specialist, who will normally be a qualified property casualty actuary, must be approved by the BMA. Our Reserving Actuary has been approved as our loss reserve specialist. Our Chief Actuary is also the loss reserve specialist for Mont Fort and Haute Route.

Statutory Financial Statement. Flagstone Suisse must prepare annual statutory financial statements. The Bermuda Insurance Act prescribes rules for the preparation and substance of such statutory financial statements (which include, in statutory form, a balance sheet, an income statement, a statement of capital and surplus and notes thereto). Flagstone Suisse is required to give detailed information and analyses regarding premiums, claims, reinsurance and investments. The statutory financial statements are not prepared in accordance with U.S. GAAP and are distinct from the financial statements prepared for presentation to the shareholders of the Company. Flagstone Suisse, as a general business insurer, is required to submit the annual statutory financial statements as part of the annual statutory financial return. The statutory financial statements and the statutory financial return do not form part of the public records maintained by the BMA.

GAAP or IFRS Financial Statements. The Amendment Act introduced additional financial statement requirements for Class 4 insurers. With effect from December 31, 2008, Class 4 insurers, like Flagstone Suisse, are required to prepare and file with the BMA audited annual financial statements prepared in accordance either with GAAP (that apply in Bermuda, UK, USA or such other GAAP as the BMA may recognize) or International Financial Reporting Standards ("IFRS"). The GAAP or IFRS statements must be submitted within four months from the end of the financial year to which they relate or such longer period as may be specified by the BMA upon application but no longer than seven months. The BMA will publish a Class 4 insurer's audited financial statements.

Index

Annual Statutory Financial Return. Flagstone Suisse is required to file with the BMA a statutory financial return no later than four months after its financial year end (unless specifically extended upon application to the BMA). The statutory financial return for a Class 4 insurer includes, among other matters, a report of the approved independent auditor on the statutory financial statements of such insurer, solvency certificates, the statutory financial statements themselves, the opinion of the loss reserve specialist and a schedule of reinsurance ceded. The solvency certificates must be signed by the principal representative and at least two directors of the insurer who are required to certify, among other matters, as to whether the minimum solvency margin has been met and whether the insurer complied with the conditions attached to its certificate of registration. The independent approved auditor is required to state whether, in its opinion, it was reasonable for the directors to so certify. Where an insurer's accounts have been audited for any purpose other than compliance with the Bermuda Insurance Act, a statement to that effect must be filed with the statutory financial return.

Capital and Solvency Return. With effect from December 31, 2008, Class 4 insurers are required to file with the BMA a capital and solvency return ("CSR") no later than four months after its financial year end (unless specifically extended upon application to the BMA). The CSR is the return comprising a Class 4 insurer's Bermuda Solvency Capital Requirement or, if relevant, approved internal model (see " Enhanced Capital Requirements and Minimum Solvency" below) and setting out the insurers risk management practices and, if appropriate, other information used by the insurer to calculate its approved internal model.

Enhanced Capital Requirement and Minimum Solvency. The new risk-based regulatory capital adequacy and solvency margin regime introduced under the Amendment Act, which came into effect on December 31, 2008, provides a risk-based capital model as a tool to assist the BMA both in measuring risk and in determining appropriate levels of capitalization (termed the Bermuda Solvency Capital

Requirement ("BSCR")). BSCR employs a standard mathematical model that correlates the risk underwritten by Bermuda insurers to the capital that is dedicated to their business. The framework that has been developed and is set out in the Order, published on December 31, 2008, applies a standard measurement format to the risk associated with an insurer's assets, liabilities and premiums, including a formula to take account of the catastrophe risk exposure.

Where the insurer believes that its own internal model for measuring risk and determining appropriate levels of capital better reflects the inherent risk of its business, it may make application to the BMA for approval to use its internal capital model in substitution for the BSCR model. The BMA may approve an insurer's internal model provided certain conditions have been established and may revoke approval of an internal model in the event that the conditions are no longer met or where it determines that such revocation is appropriate. The BMA will review the internal model regularly to confirm that the model continues to meet the conditions.

In order to minimize the risk of a shortfall in capital arising from an unexpected adverse deviation, the BMA seeks that insurers operate at or above a threshold capital level which is referred to as the Target Capital Level ("TCL"), which exceeds the BSCR or approved internal model minimum amounts.

The capital requirements require Class 4 insurers to hold available statutory capital and surplus equal to or exceeding ECR and set TCL at 120% of ECR. The BMA also has a degree of discretion enabling it to impose ECR on insurers in particular cases, for instance where an insurer falls below the TCL. In those cases, the new risk-based capital model should be supplemented by a requirement for the affected insurers to conduct certain stress and scenario testing in order to assess their potential vulnerability to defined extreme events. Where the results of scenario and stress-testing indicate potential capital vulnerability, the BMA would be able to require a higher solvency 'cushion' by increasing the 120% TCL figure. In circumstances where an insurer has failed to comply with an ECR given by the BMA in respect of that insurer, such insurer is prohibited from declaring or paying any dividends until the failure is rectified and the insurer is obliged to (i) provide the BMA, within fourteen days of the failure, with a written report as to why the failure occurred and remedial steps to be taken; and (ii) within forty-five days of the failure to provide the BMA with unaudited interim financial statements. In addition the opinion of the loss reserve specialist, a general business solvency certificate in respect of the unaudited financials and a CSR reflecting an ECR prepared using post-failure data must also be filed.

The new risk-based solvency capital regime described above is the minimum solvency margin test set out in the Insurance Returns and Solvency Amendment Regulations 1980 (as amended). While it must calculate its ECR annually by reference to either the BSCR or an approved internal model, a Class 4 insurer such as Flagstone Suisse must also ensure that, at all times, its ECR is at least equal to the minimum solvency margin for a Class 4 insurer in respect of its general business, which is the greater of:

· 100,000,000 Bermuda Dollars;

· 50% of net premiums written (being gross premiums written less any reinsurance premiums ceded (not exceeding 25% of gross premiums written)); or

· 15% of net loss and loss expense provisions and other general business insurance reserves.

Index

Where an insurer falls below the TCL, the BMA will have discretion to supplement the risk-based model by requiring the affected insurers to conduct certain stress and scenario testing in order to assess its potential vulnerability to defined extreme events. Where the results of scenario and stress testing indicated potential capital vulnerability, the BMA would be able to require a higher solvency "cushion" by increasing the 120% TCL figure.

Restrictions on Dividends and Distributions. In addition, under the Bermuda Insurance Act, a Class 4 insurer is prohibited from declaring or paying any dividends of more than 25% of its total statutory capital and surplus, as shown on its previous financial year statutory balance sheet, unless at least seven days before payment of the dividends it files with the BMA an affidavit that it will continue to meet its required solvency margins. Flagstone Suisse as a Class 4 insurer must obtain the BMA's prior approval before reducing its total statutory capital, as shown on its previous financial year statutory balance sheet, by 15% or more.

Furthermore, under the Companies Act, the Company may only declare or pay a dividend, or make a distribution out of contributed surplus as the case may be, if the Company has no reasonable grounds for believing that it is, or would after the payment be, unable to pay its liabilities as they become due, or if the realizable value of its assets would not be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

Minimum Liquidity Ratio. The Bermuda Insurance Act provides a minimum liquidity ratio for general business insurers, such as Flagstone Suisse. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable and reinsurance balances receivable. There are certain categories of assets which, unless specifically permitted by the BMA, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans. Relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax, sundry liabilities (by interpretation, those not specifically defined), letters of credit and guarantees.

Section 6A Orders. The enhancement of the new risk-based supervisory approach allows the BMA to analyze the impact and probability of failures among insurers and target those insurers, insurer classes, situations and/or activities that the BMA identifies as being "at risk." In such cases, the BMA would issue a Section 6A Order prescribing additional capital and surplus requirements to be met by insurers.

In determining whether an insurer conducts its business in a prudential manner, the BMA will consider whether it maintains sufficient capital to enable it to meet its obligations in light of the size, business mix and risk-profile of the insurer's business.

The BMA is empowered, upon the application of an insurer, to exempt such insurer from any ECR imposed upon it under a Section 6A Order. An exemption to a Section 6A Order may be granted where the BMA concludes that an exemption does not prejudice the policyholders of that insurer and that insurer's risk profile deviates materially from the assumptions which led the BMA to imposing the Section 6A Order. Should the BMA elect not to exercise its discretion in favor of an applicant insurer, then a right of appeal against a decision of the BMA in respect of an adjustment to ECR and available statutory capital and surplus, is available to the Appeals Tribunal.

Failure to Comply with ECR. Should an insurer fail to comply with an ECR applicable to it under a Section 6A Order then such insurer is prohibited from declaring or paying any dividends until such failure is rectified and the onus falls upon the insurer:

- within 14 days of becoming aware of such failure, to provide a written report to the BMA regarding why it failed to comply and proposed steps to be taken to rectify the failure; and
- within 45 days of becoming aware of such failure, to provide to the BMA;
- unaudited interim statutory financial statements;
- the opinion of a loss reserve specialist;
- a general business solvency certificate in respect of those financials; and
- a capital and solvency return reflecting an ECR prepared using post failure data.

Shareholder Controller Notification. Any person who becomes a holder of at least 10%, 20%, 33% or 50% of the common shares of the Company must notify the BMA in writing within 45 days of becoming such a holder or 30 days from the date they have knowledge of having become such a holder, whichever is later. The BMA may, by written notice, object to a person holding 10%, 20%, 33% or 50% of our common shares if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce their shareholding in us and may direct, among other things, that the voting rights attaching to their common shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offense. In addition, Flagstone Suisse will be responsible for giving written notice to the BMA of the fact that any person has become or ceases to be 10%, 20%, 33% or 50% controller of Flagstone Suisse. The Notice has to be given within 45 days of Flagstone Suisse becoming aware of the relevant facts.

Flagstone Suisse is also required to notify the BMA in writing in the event of any person ceasing to be a controller, a controller being a managing director, chief executive or other person in accordance with whose directions or instructions the directors of Flagstone Suisse are accustomed to act, including any person who holds, or is entitled to exercise, 10% or more of the voting shares or voting power or is able to exercise a significant influence over the management of Flagstone Suisse.

Supervision, Investigation and Intervention. The BMA may appoint an inspector with extensive powers to investigate the affairs of an insurer if the BMA believes that an investigation is required in the interest of the insurer's policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to the BMA, the BMA may direct an insurer to produce documents or information relating to matters connected with the insurer's business. The BMA in discharging its supervisory function also conducts on-site visits with Bermuda insurance companies. Flagstone Suisse has had one on-site visit from the BMA in the last twelve months.

If it appears to the BMA that there is a risk of Flagstone Suisse becoming insolvent, or that it is in breach of the Bermuda Insurance Act or any conditions imposed upon its registration, or is in breach of the ECR or a person has become or remains a controller in breach of the Bermuda Insurance Act, the BMA may, among other things, direct the insurer: (1) not to take on any new insurance business; (2) not to vary any insurance contract if the effect would be to increase the insurer's liabilities; (3) not to make certain investments; (4) to realize certain investments; (5) to maintain in, or transfer to the custody of a specified bank, certain assets; (6) not to declare or pay any dividends or other distributions or to restrict the making of such payments; (7) to limit its premium income; (8) to remove a controller or officer; and/or (9) to file a petition for the winding up of Flagstone Suisse.

Disclosure of Information. In addition to powers under the Bermuda Insurance Act to investigate the affairs of an insurer, the BMA may require certain information from an insurer (or certain other persons) to be produced to them. The BMA also may assist other regulatory authorities, including foreign insurance regulatory authorities with their investigations involving insurance and reinsurance companies in Bermuda, subject to restrictions. For example, the BMA must be satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities of the foreign regulatory authority, and the BMA must consider whether to cooperate is in the public interest. The grounds for disclosure are limited and the Bermuda Insurance Act provides sanctions for breach of the statutory duty of confidentiality.

Under the Bermuda Companies Act, the Bermuda Minister of Finance has been given powers to assist a foreign regulatory authority which has requested assistance in connection with enquiries being carried out by it in the performance of its regulatory functions. The Bermuda Minister of Finance's powers include requiring a person to furnish him with information, to produce documents to him, to attend and answer questions and to give assistance in connection with enquiries. The Bermuda Minister of Finance must be satisfied that the assistance requested by the foreign regulatory authority is for the purpose of its regulatory functions and that the request is in relation to information in Bermuda which a person has in his possession or under his control. The Bermuda Minister of Finance must consider, among other things, whether it is in the public interest to give the information sought.

Bermuda Guidance Notes. The BMA has issued Guidance Notes through its website at www.bma.bm on the application of the Bermuda Insurance Act in respect of the duties, requirements and standards to be complied with by persons registered under the Bermuda Insurance Act or otherwise regulated under it and the procedures and sound principles to be observed by such persons and by auditors, principal representatives and loss reserve specialists. The Guidance Notes provides guidance on, among other things, the roles of the principal representative, approved auditor, and approved actuary and corporate governance for Bermuda insurers. The BMA has stated that the Guidance Notes should be understood as reflecting the minimum standard that the BMA expects insurers such as Flagstone Suisse and other relevant parties to observe at all times.

Index

The BMA has published a number of consultation and discussion papers covering the following proposed regulatory changes which may or may not become adopted in present or revised form in the future:

(a) the introduction of a group-wide supervision for insurance groups and insurance subgroups that form part of a financial group or mixed conglomerate;

(b) the introduction of a three-tried capital system designed to assess the quality of an insurer's capital resources eligible to satisfy an insurer's regulatory capital requirement level. It is intended that this regime be introduced effective December, 31 2010;

(c) the issuance of an Insurance Code of Conduct which establishes duties, requirements and standards to be complied with by insurers including the procedures and sound principles to be observed by such insurers;

(d) enhancements to the disclosure and transparency regime by introducing a number of additional qualitative and quantitative public and regulatory disclosure requirements;

(e) the introduction of own risk and solvency assessment which will require insurers to demonstrate the link between capital adequacy, risk governance process and strategic decision making.

Permit Company Regulation

Flagstone Suisse operates in Bermuda (through its Bermuda branch) under a permit dated April 14, 2008, granted by the Bermuda Minister of Finance and is subject to Bermuda law relating to permit companies, significant aspects of which are set forth below.

Annual Fees and Declaration. Bermuda law requires every permit company to pay during March each year its annual fee and at the same time file a declaration, which must be signed by two directors or a director and the secretary, indicating the permit company's principal business, assessable capital and amount of annual fee payable. If the permit company fails to pay the appropriate annual fee then it and every officer of the permit company are liable to a default fine (except where the Bermuda Registrar of Companies ("Registrar") is satisfied that such non compliance is not the result of willful neglect or default by either the permit company or all of the officers of the permit company). If a permit company fails to pay the annual fee within three months its due date, the permit company shall cease to carry on business until a fee and any penalty that may have been incurred has been paid. If an appropriate fee is not paid within three months of the due date and the permit company continues to carry on business, the permit company shall be liable to a fine of 100.00 Bermuda dollars in respect of each day that it carries on business in contravention of not paying its annual fee.

Change of Particulars. Each permit company is required to notify the Registrar within 30 days of any of the following particulars changing: (a) its Memorandum of Association, or in the event of it not having a Memorandum of Association, the objects of such permit company, the names of the directors and their nationalities, the trade or business it is permitted to engage in or carry on in Bermuda and the amount of its authorised and share capital; (b) particulars of its place of business in Bermuda and the address of its registered office outside Bermuda; and (c) lists of persons resident in Bermuda authorized to accept on its behalf service of process and any notices required to be sent on it.

Revocation of Permit. The Bermuda Minister of Finance may at any time revoke the permit of an overseas company if: (a) the permit company or any of its servants or agents contravenes a condition of its permit; (b) in the opinion of the Bermuda Minister of Finance, the permit company is carrying on business in a manner detrimental to the public interest; (c) the permit company ceases to engage in or carry on any trade or business in Bermuda; (d) a court or other competent authority in any country makes an order for the winding up, dissolution or judicial management of the permit company or of any person who directly or indirectly controls the permit company; (e) the permit company is otherwise wound up or if any person who directly or indirectly controls the permit company is wound up or ceases to carry on business; (f) there is a substantial change in the effective control of the permit company; (g) there is a substantial change in the nature of the business carried on by the permit company; (h) the permit company does not pay its annual fee within thirty days of the due date; or (i) the permit company contravenes or fails to comply with certain provision of the Bermuda Companies Act.

Principal Representative. Every permit company shall appoint and retain a principal representative in Bermuda. If at any time the particulars of the principal representative are altered the permit company must notify the Registrar within 21 days after the alteration has been made. Flagstone Suisse's principal representative in Bermuda is David Brown.

Index

Certain Other Bermuda Law Considerations

The Company is incorporated as an exempted company limited by shares under the Bermuda Companies Act. Flagstone Suisse is registered under the Bermuda Companies Act as a permit company. Under Bermuda law, exempted companies are companies formed, and permit companies are registered, for the purpose of conducting business outside Bermuda from a principal place in Bermuda. As a result, we are exempt from Bermuda laws restricting the percentage of share capital that may be held by non-Bermudians, but we may not, without the express authorization of the Bermuda legislature or under a license granted by the Bermuda Minister of Finance, participate in certain business transactions, including:

- the acquisition or holding of land in Bermuda, except land held by way of lease or tenancy agreement which is required for our business and held for a term not exceeding 50 years, or which is used to provide accommodation or recreational facilities for our officers and employees and held with the consent of the Bermuda Minister of Finance for a term not exceeding 21 years;

- the taking of mortgages on land in Bermuda in excess of 50,000 Bermuda dollars;

- the acquisition of any bonds or debentures secured by any land in Bermuda, other than certain types of Bermuda government securities; or

- subject to some exceptions, the carrying on of business of any kind in Bermuda for which we are not licensed in Bermuda.

While an insurer is permitted to reinsure risks undertaken by any company incorporated in Bermuda and permitted to engage in the insurance and reinsurance business, generally it is not permitted without a special license granted by the Bermuda Minister of Finance to insure Bermuda domestic risks or risks of persons of, in or based in Bermuda.

The Company will also need to comply with the provisions of the Bermuda Companies Act regulating the payment of dividends and making distributions from contributed surplus. Under the Bermuda Companies Act, a company may not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that the company is, or would after the payment be, unable to pay its liabilities as they become due or that the realizable value of the company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. Issued share capital is the aggregate par value of a company's issued shares, and the share premium account is the aggregate amount paid for issued shares over and above their par value. Share premium accounts may be reduced in certain limited circumstances. The Bermuda Companies Act also regulates return of capital, reduction of capital and any repurchase or redemption of shares by the Company. In addition, as discussed above under "Bermuda Insurance Regulation- Restrictions on Dividends and Distributions", certain provisions of the Bermuda Insurance Act will limit Flagstone Suisse's ability to pay dividends to the Company.

The Company is incorporated in Bermuda and has been designated as non-resident for exchange control purposes by the BMA. The Company is required to obtain the permission of the BMA for the issue and free transferability of all of their common shares. However, the BMA has pursuant to its statement of June 1, 2005 given its general permission under the Exchange Control Act 1972 (and its related regulations) for the issue and transfer of shares (which includes the common shares of the Company) to persons not resident in Bermuda for exchange control purposes, subject to the condition that our common shares shall be listed on an appointed stock exchange (as designated by the Bermuda Minister of Finance under Section 2(9) of the Bermuda Companies Act), which includes the New York Stock

Exchange. This general permission would cease to apply if the Company's shares were to cease to be so listed.

The transfer or issuance of our common shares to any resident in Bermuda for exchange control purposes requires specific prior approval under the Exchange Control Act 1972. The BMA has granted its consent to the issue and transfer of up to 20% of the Company's common shares in issue to persons resident in Bermuda for exchange control purposes, provided no one such person owns more than 10% of the common shares, and has also given an additional specific consent that Haverford (Bermuda) Ltd. ("Haverford") may hold, and our Executive Chairman, Mr. Byrne, and our Chief Executive Officer, Mr. Brown, each may beneficially own, 10% or more of the common shares. The Company is designated as non-resident for Bermuda exchange control purposes; they are allowed to engage in transactions, and to pay dividends to Bermuda non-residents who are holders of our common shares, in currencies other than the Bermuda dollar.

In accordance with Bermuda law, share certificates are issued only in the names of corporations, other separate legal entities or individuals. In the case of an applicant acting in a special capacity (for example, as an executor or trustee), certificates may, at the request of the applicant, record the capacity in which the applicant is acting. Notwithstanding the recording of any such special capacity, we are not bound to investigate or incur any responsibility in respect of the proper administration of any such estate or trust. We will take no notice of any trust applicable to any of our common shares whether or not we have notice of such trust.

Index

Under Bermuda law, non-Bermudians (other than spouses of Bermudians and holders of a permanent resident's certificate) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian or holder of a permanent resident's certificate) is available who meets the minimum standard requirements for the advertised position. In 2001, the Bermuda government announced a policy limiting the duration of work permits to six years, with certain exemptions for key employees. We may not be able to use the services of one or more of our key employees in Bermuda if we are not able to obtain work permits for them, which could have an adverse effect on our business. In addition, exempted companies, such as the Company, must comply with Bermuda resident representation provisions under the Bermuda Companies Act, which require that a minimum number of offices must be filled by persons who are ordinarily resident in Bermuda. We do not believe that such compliance will result in any material expense to us.

The Bermuda government actively encourages foreign investment in "exempted" entities like the Company that are based in Bermuda, but do not operate in competition with local businesses. As well as having no restrictions on the degree of foreign ownership, the Company and Flagstone Suisse received an assurance from the Ministry of Finance granting an exemption that they will not be subject to taxes computed on profits or income or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax or to any foreign exchange controls in Bermuda until March 28, 2016. To date, the Ministry of Finance has given no indication that the Ministry: (i) would not extend the term of the assurance beyond March 28, 2016; or (ii) would allow the term of the assurance to expire; or (iii) would change the tax treatment afforded to exempted companies either before or after March 28, 2016.

The Company has a secondary listing on the Bermuda Stock Exchange and is subject to regular reporting requirements, compliance with accounting standards and must disclose major events and interests.

Switzerland

Our Swiss reinsurance subsidiary, Flagstone Suisse, is a société anonyme headquartered in Martigny, Switzerland.

Regulation and Supervision

The conduct of reinsurance business by a company headquartered in Switzerland requires a license granted by FINMA. In principle, licensing and supervision requirements are imposed on Flagstone Suisse as a standalone legal entity. However, in certain circumstances FINMA may issue a decision to exercise supplementary supervision over a group of companies.

Flagstone Suisse obtained its reinsurance license from the Swiss Federal Office of Private Insurance in December 2006. On January 1, 2009, Swiss financial services regulation was reformed institutionally pursuant to the law of June 22, 2007 ("FINMALaw"), creating a single regulator (FINMA) covering all financial services and integrating the supervision of financial crime, professional audit firms and rating agencies. The function of the Swiss Federal Office of Private Insurance was replaced by this new single regulator.

In general FINMALaw is an overarching statute applying in as far as there is no contrary provision in the sectoral laws for insurance and reinsurance. Sectoral laws are those laws germane to a particular industry sector such as, for example, insurance, reinsurance and banking. Aside from some inconsequential amendments under FINMALaw unifying cross sectoral issues, the existing sectoral laws governing insurance and reinsurance continue in force, substantially unchanged.

The various legal and regulatory requirements that must be satisfied, are set forth primarily by the three following sets of rules and regulations: the Federal Insurance Supervisory Law ("ISL"); the Federal Private Insurance Supervision Ordinance ("ISO"); and the FINMA Insurance Supervision Ordinance, as well as by various implementing directives and circulars. In general, the approach is principles based and allows for consideration of a justified application by management in relation to such principles.

Under Swiss rules and regulations, Swiss reinsurance companies are generally subject to many, but not all, of the same provisions that apply to direct insurers, and include the following obligations:

Adequacy of Financial Resources

ISL Article 9 and ISO, sets out the minimum capital requirements and solvency requirements.

The minimum capital for a reinsurance firm is CHF 10 million. Firms are also obliged to constitute and maintain an organizational fund. In the case of Flagstone Suisse this was fixed at CHF 10 million by the Swiss Federal Office of Private Insurance prior to commencement of Flagstone Suisse's operations.

Index

In addition Flagstone Suisse must keep adequate disposable and unencumbered capital resources to cover its entire activities. In calculating the solvency margin, account is taken of the risks to which the firm is exposed, the insurance classes involved, the extent of the business, the geographical scope and internationally recognized principles (ISL Article 9). Solvency is determined based on two independent methodologies:

Solvency I: This involves calculating a margin applying defined percentages to a base of the higher of gross annual premium or gross claims for the last three available years and comparing coverage in terms of admissible "own funds" as determined under ISL Article 37.

The Swiss Solvency Test or SST: Under this approach, capital adequacy is given if risk bearing capital exceeds Target Capital. This involves a more sophisticated analysis providing for a market-consistent valuation of all assets and liabilities in the firm with a methodological approach to risk categories (insurance risk, credit risk etc.) subjecting them to scenario stress tests at a basic level in the context of the standard regulatory approach but, where appropriate, permitting the use of internal models in the overall management of risk, once such models are validated. The validation of internal models is a general process which FINMA has pursued with all regulated firms over the past year and is ongoing.

The SST is very close to the "Solvency II" standard of the European Union. We expect that the Swiss regulation will achieve mutual recognition in other parts of the world. On February 1, 2010, Switzerland was formally recognized as equivalent by the EU committee of supervisors, the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS"), firstly as regards the EU Reinsurance Directive of 2005 regulating pure reinsurers and secondly as regards its supervisory regime. This will preserve and facilitate global opportunity and market access of our offering in the reinsurance sector.

For the SST all assets of Flagstone Suisse are considered. There is no direct constraint on permitted investments since the provisions regarding assets linked to reserves in the ISL do not apply to reinsurance firms. However, the use of derivative instruments is required to be fully considered as part of the risk management processes and limited to reducing investment or insurance risk or to secure investment efficiencies.

Sound Corporate Governance, Risk Management and Internal Control System

In addition to quantitative risk measures, FINMA requires full qualitative governance and control of risk in the firm. This includes requirements as to the ongoing fitness, propriety and competence of the directors and senior management, observance of ethical standards, objective and appropriate remuneration procedures, management of conflicts of interests, the institution of a compliance function, independence and adequate resourcing of control functions (including the responsible actuary, the risk management function and the internal audit function), as well as clear terms of reference and systems of delegation and report throughout.

ISL and ISO each require the appointment of a Responsible Actuary - an independent and properly qualified actuary responsible for ensuring that solvency margins are calculated correctly, proper accounting principles are used, and adequate technical reserves are established and that he report to the Board periodically.

Insurance companies are required to implement documented procedures for risk management and internal control. While FINMA does not require a specific outcome in relation to operational risk, the firm is expected to undertake proper analysis and to account for it.

Supervisory Process

The supervisory process includes the following requirements:

Annual Reporting: Flagstone Suisse is required to prepare an annual report at the end of each financial year on the solvency margins available, as well as an annual report on the calculation of target capital and on risk bearing capital. Flagstone Suisse files a corporate report incorporating financial statements prepared and audited in accordance with Swiss accounting rules and a supervisory report in the prescribed format. The supervisory report is to be submitted to FINMA by June 30 of each year in electronic form together with the annual report.

Ad Hoc Notifications: FINMA requires ad hoc notifications of all changes to the firm’s scheme of operations which include the following: any changes to company statutes, details of its organizational structure or business activities (including expansion into new jurisdictions; changes involving at least a 10% equity holding or at least 10% of votes in the Company, or where there is a change of control allowing persons to exert a significant influence on the Company’s commercial activities; changes in management personnel, including the Responsible Actuary).

In addition, Flagstone Suisse is required to notify changes in levels of control of it (upstream) or by it (downstream) at 10%, 20%, 33% or 50% in terms of capital or voting rights.

Index

There is a general duty to notify FINMA of all matters of which it might want to be advised (FINMALaw Article 29). This includes all solvency material matters, which are specified by circular to include a breach of solvency requirements, fluctuations of 10% or more in terms of assets, technical provisions, or of a significant retrocession contract of the company as well as redemption of any hybrid debt instruments; and any regulatory or criminal investigations brought against the company or the senior management or other significant events.

External Auditor Involvement

Audit firms are subjected to approval and supervision by FINMA and are a significant agent in the supervisory process applying to reinsurance companies (FINMALaw 24 et seq.). Auditors report both to the governing body of the company and to FINMA. They report to the Board on the financial statements of the company and on regulatory shortcomings with a requirement for remediation. Material shortcomings are reported directly to FINMA. A standardized audit report on these topics is prescribed by FINMA Directive. Failure to have an audit conducted in accordance with legal requirements, to fulfill the legal duty of cooperation with auditors or for the auditors to perform their role properly (including whistle blowing or failing to identify regulatory breaches) all attract criminal sanctions.

Intervention and Enforcement by the Regulator

FINMALaw provides for a wider range of supervisory intervention tools than previously provided for under the ISL such as the commencement of formal proceedings, including orders to comply with the law, leading up to withdrawal of license, declarations of unfitness for individuals, disgorgement and the appointment of independent specialists to investigate and implement remediation.

Capital Structure and Dividends

Flagstone Suisse is funded by a combination of subordinated debt (qualifying as regulatory capital under Swiss law) and equity. The equity is held in the form of paid in capital by shares and in share premium. Under Swiss corporate law as modified by insurance supervisory law, a non life insurance company is obliged to contribute to statutory legal reserves a minimum of 20% of any annual profit up to 50% of statutory capital, being paid in share capital. Flagstone Suisse has been substantially funded by share premium. We are advised currently, that as of 2011, share premium can be distributed to shareholders without being subject to withholding tax. However the repayment of subordinated debt and distribution of any special dividend to shareholders remain subject to the approval of FINMA which has regard to the maintenance of solvency and the interests of reinsureds and creditors.

United Kingdom

Lloyd's Regulation

General

We participate in the Lloyd's market through our ownership of Marlborough and Flagstone Corporate Name Limited ("FCNL"). Marlborough is the managing agent for Syndicates 1861 and 1969 (which commenced underwriting in 2010), while FCNL is a corporate member and provides underwriting capacity to Syndicate 1861.

Marlborough's operations are franchised by Lloyd’s. The Lloyd’s Franchise Board was formally constituted on January 1, 2003. The Franchise Board is responsible for setting risk management and profitability targets for the Lloyd’s market and operates a business planning and monitoring process for all syndicates. The Lloyd’s Franchise Board requires annual approval of Marlborough's business plan for the Lloyd's syndicates which it manages, including maximum underwriting capacity, and may require changes to any business plan presented to it or additional capital to be provided to support the underwriting plan. Lloyd’s also imposes various charges and assessments on its members. If material changes in the business plan for Syndicates 1861 or 1969 were required by Lloyd’s, or if charges and assessments payable by FCNL to Lloyd’s were to increase significantly, these events could have an adverse effect on the operations and financial results of Marlborough and FNCL. The Group has provided capital to Lloyd’s to support FCNL's underwriting business at Lloyd's. Dividends from a Lloyd's managing agent and a Lloyd's corporate member can be declared and paid provided the relevant company has sufficient profits available for distribution.

By entering into a membership agreement with Lloyd’s, FNCL undertakes to comply with all Lloyd’s bye-laws and regulations as well as the provisions of the Lloyd’s Acts and the Financial Services and Markets Act 2000 ("FSMA") that are applicable to it.

Index

Capital Requirements

The underwriting capacity of a member of Lloyd’s must be supported by providing a deposit (referred to as “Funds at Lloyd’s”) in the form of cash, securities or letters of credit in an amount determined under the Individual Capital Adequacy regime of the U.K.'s financial services regulator, the Financial Services Authority ("FSA"). The amount of such deposit is calculated for each member through the completion of an annual capital adequacy exercise. Under these requirements, Lloyd’s must demonstrate that each member has sufficient assets to meet its underwriting liabilities plus a required solvency margin.

Restrictions

A Reinsurance to Close (“RITC”) is a contract to transfer the responsibility for discharging all the liabilities that attach to one year of account of a syndicate into a later year of account of the same or different syndicate in return for a premium. An RITC is put in place after the third year of operations of a syndicate year of account. If the managing agency concludes that an appropriate RITC for a syndicate that it manages cannot be determined or negotiated on commercially acceptable terms in respect of a particular underwriting year, it must determine that the underwriting year remain open and be placed into run-off. During this period there cannot be a release of the Funds at Lloyd’s of a corporate member that is a member of that syndicate without the consent of Lloyd’s and such consent will only be considered where the member has surplus Funds at Lloyd’s.

Ratings

The financial security of the Lloyd’s market is regularly assessed by three independent rating agencies (A.M. Best, Standard & Poor’s, Fitch Ratings). A satisfactory credit rating issued by an accredited rating agency is necessary for Lloyd’s syndicates to be able to trade in certain classes of business at current levels. Marlborough and FNCL would be adversely affected if Lloyd’s current ratings were downgraded.

Intervention Powers

The Council of Lloyd’s has wide discretionary powers to regulate members’ underwriting at Lloyd’s. It may, for instance, change the basis on which syndicate expenses are allocated or vary the Funds at Lloyd’s or the investment criteria applicable to the provision of Funds at Lloyd’s. Exercising any of these powers might affect the return on an investment of the corporate member in a given underwriting year. If a member of Lloyd’s is unable to pay its debts to policyholders, such debts may be payable by the Lloyd’s Central Fund, which in many respects acts as an equivalent to a state guaranty fund in the United States. If Lloyd’s determines that the Central Fund needs to be increased, it has the power to assess premium levies on current Lloyd’s members. The Council of Lloyd’s has discretion to call or assess up to 3% of a member’s underwriting capacity in any one year as a Central Fund contribution.

Change of Control

Lloyd's approval is also required before any person can acquire "control" (as defined below in relation to FSMA and giving prior notification to the FSA) of a Lloyd's managing agent or Lloyd's corporate member.

FSA Regulation

General

Marlborough's operations are regulated by the FSA as well as being franchised by Lloyd’s of London. The FSA has substantial powers of intervention in relation to the Lloyd’s managing agents (such as Marlborough) which it regulates, including the power to remove their authorization to manage Lloyd’s syndicates. In addition, each year the FSA requires Lloyd’s to satisfy an annual solvency test which measures whether Lloyd’s has sufficient assets in the aggregate to meet all outstanding liabilities of its members, both current and run-off. If Lloyd’s fails this test, the FSA may require Lloyd’s to cease trading and/or its members to cease or reduce underwriting.

Lloyd’s as a whole is authorized by the FSA and is required to implement certain rules prescribed by the FSA, which it does by the powers it has under the Lloyd’s Act 1982 relating to the operation of the Lloyd’s market. Lloyd’s prescribes, in respect of its managing agents and corporate members, certain minimum standards relating to their management and control, solvency and various other requirements. The FSA directly monitors Lloyd’s managing agents’ compliance with the systems and controls prescribed by Lloyd’s. If it appears to the FSA that either Lloyd’s is not fulfilling its delegated regulatory responsibilities or that managing agents are not complying with the applicable regulatory rules and guidance, the FSA may intervene at its discretion.

Future regulatory changes or rulings by the FSA could interfere with Marlborough’s business strategy or financial assumptions, possibly resulting in an adverse effect on Marlborough's financial condition and operating results.

Index

Change of Control

The FSA regulates the acquisition of “control” of any Lloyd’s managing agent which is authorized under FSMA. Any company or individual that (together with or any other person acting in concert) directly or indirectly acquires 10% or more of the shares in a Lloyd’s managing agent or its parent company, or is entitled to exercise or control the exercise of 10% or more of the voting power such Lloyd's managing agent or its parent company, would be considered to have acquired “control” for the purposes of the relevant legislation, as would a person who had significant influence over the management of such Lloyd's managing agent or its parent company by virtue of his shareholding or voting power in either. A purchaser of 10% or more of the ordinary shares (acting alone or in concert with other persons) would therefore be considered to have acquired “control” of Marlborough. Under FSMA, any person proposing to acquire “control” over a Lloyd's managing agent must give prior notification to the FSA of his intention to do so. The FSA would then have sixty working days to consider that person's application to acquire “control.” Failure to make the relevant prior application could result in action being taken against Marlborough by the FSA. Lloyd's approval is also required before any person can acquire "control" (using the same definition as for the FSA) of a Lloyd's managing agent or Lloyd's corporate member.

Other Applicable Laws

Lloyd’s worldwide insurance and reinsurance business is subject to various regulations, laws, treaties and other applicable policies of the European Union, as well as each nation, state and locality in which it operates. Material changes in governmental requirements and laws could have an adverse affect on Lloyd’s and its member companies, including Marlborough and FNCL.

Cayman Islands

Island Heritage is an ordinary company incorporated under the laws of the Cayman Islands (registered number 63479) and maintains a Class A Insurance License.

Island Heritage holds a Class A insurance license issued in accordance with the terms of the Insurance Law (as revised) of the Cayman Islands, or the Law, and is subject to regulation by the Cayman Islands Monetary Authority, or CIMA, in terms of the Law.

As the holder of a Class A insurance license, Island Heritage is permitted to carry on insurance business generally in or from within the Cayman Islands (e.g., domestic insurance business).

Island Heritage is required to comply with the following principal requirements under the Law:

- the maintenance of a net worth (defined in the Law as the excess of assets, including any contingent or reserve fund secured to the satisfaction of CIMA, over liabilities other than liabilities to partners or shareholders) of at least 100,000 Cayman Islands dollars (which is equal to approximately US$120,000), subject to increase by CIMA depending on the type of business undertaken;
- to carry on its insurance business in accordance with the terms of the license application submitted to CIMA, to seek the prior approval of CIMA to any proposed change thereto, and annually to file a certificate of compliance with this requirement, in the prescribed form, signed by an independent auditor, or other party approved by CIMA;
- to prepare annual accounts in accordance with generally accepted accounting principles, audited by an independent auditor approved by CIMA;

- to seek the prior approval of CIMA in respect of the appointment of directors and officers and to provide CIMA with information in connection therewith and notification of any changes thereto;
- to notify CIMA as soon as reasonably practicable of any change of control of Island Heritage;
- to maintain appropriate business records in the Cayman Islands;
- to pay an annual license fee and;
- it may not issue any dividends without prior approval from CIMA. In order to obtain approval Island Heritage must demonstrate that the issuing of dividends would not render Island Heritage insolvent or affect its ability to pay any future claims.

Index

Republic of Cyprus

Flagstone Alliance is incorporated in the Republic of Cyprus. The Superintendent of Insurance of Cyprus supervises the operation of Flagstone Alliance and its license was given pursuant to the new insurance legislation The Law on Insurance Services and Other Related Issues of 2002 ("Insurance Law") that came into force on January 1, 2003 and has since been amended to fully comply with the EU directives. Flagstone Alliance is licensed to conduct general insurance and reinsurance business.

According to the Insurance Law, as from January 1, 2003, companies are obliged to invest, on a continuous basis, in approved assets to cover their technical reserves and must submit quarterly a register of their investments, accompanied by a statement of the estimation of their technical reserves, in a prescribed form. The Minister of Finance has issued Orders determining the categories of approved investments and the percentage limits that may be invested in each category.

Flagstone Alliance is required to comply with the following principal requirements under the Law:

- Carry on its insurance business in accordance with the terms of its license.

- Must maintain adequate levels of approved investments to cover its technical reserves, in line with the approved percentages and free of any burden, and these must be expressed or liquidated in the appropriate currency according to the currency matching rules set out in the Insurance Law.

- Must submit a return of approved investments to the Superintendent of Insurance quarterly. The return must be in the prescribed format, signed by the managing director and one other director, or, if there is no managing director, by a director and the general manager. The returns for the second and fourth quarters of each financial year must be audited and signed by the auditors.

- An annual return must be submitted within six months of Flagstone Alliance’s financial year end. The annual return includes detailed analyses in the prescribed form of assets, liabilities, income and expenses and must be certified by Flagstone Alliance’s directors and actuary and accompanied by the auditors’ report.

Flagstone Alliance may under the freedom of establishment or the freedom to provide services carry on insurance business in a Member State of the EU or the EEA. Under the freedom of establishment, such business in the Member State may start following the submission by Flagstone Alliance to the Superintendent of Insurance of Cyprus of an application supported by the prescribed by Regulations documents which are passed by the Superintendent of Insurance of Cyprus to the supervisory authority of the Member State which determines the conditions under which the Company may carry on its business in the said Member State. In the case of freedom to provide services, Flagstone Alliance may start business as soon as it receives from the Superintendent of Insurance of Cyprus notification that the prescribed documents have been dispatched to the competent supervisory authority of the Member State.

Companies that are resident in Cyprus for tax purposes are subject to tax in Cyprus. Residence is determined by the locus of management and control. The income tax rate is ten per cent on its taxable profits.

South Africa

The South African insurance industry is governed primarily by the Long-Term Insurance Act No. 52 of 1998 (the "Long-Term Insurance"), and the Short-Term Insurance Act No. 53 of 1998 (the "Short-Term Insurance"). Each piece of legislation covers both insurance and reinsurance. Both the Short-Term Insurance Act and the Long-Term Insurance Act establish the offices of the Registrar of Long-Term Insurance and Registrar of Short-Term Insurance. Each office is filled by the executive officer of the Financial Services Board (the "FSB"). The relevant registrar, through the agency of the FSB, is responsible for regulating insurers and reinsurers within the particular industry grouping. The FSB regulates the South African non-banking financial services industry, which includes the insurance industry.

As a short-term reinsurer Flagstone Reinsurance Africa Limited is registered with FSB as required under the Short-Term Insurance Act. As with any other registered reinsurer, Flagstone Reinsurance Africa Limited must maintain its business in a financially sound condition by complying with the detailed requirements of the Short-Term Insurance Act in regard to the kind and spread of assets required to be held so as to enable it to meet its liabilities determined in accordance with the criteria set out in the Short-Term Insurance Act. The Short-Term Insurance Act provides that reinsurers must at all times maintain its business in a financially sound condition by having assets, providing for its liabilities, and generally conducting its business so as to be in a position to meet its liabilities at all times. In addition, South African reinsurance companies may pay a dividend only if, after payment of the dividend, it will continue to comply with regulatory requirements regarding minimum capital, special reserves and solvency requirements.

Index

Luxembourg

Certain of the investment management activities of the group are based in Luxembourg. Subject to Swiss insurance law limitations regarding the management of insurance company assets belonging to group affiliate companies, it is envisaged that group assets will eventually be managed within FCML.

FCML is a fixed capital investment company qualifying as a specialized investment fund under the Luxembourg law of February 13, 2007, and may be constituted with multiple sub funds each corresponding to a distinct part of the assets and liabilities of the investment company. It is regulated by the Luxembourg Commission de Surveillance du Secteur Financier or CSSF. As at December 31, 2009, only one sub fund was operational and the net investment assets of FCML amounted to $881.7 million.

FCML employs a number of senior investment professionals and its governing bodies are staffed with senior officers from other subsidiaries of Flagstone, including Flagstone Finance S.A., a Luxembourg holding company coordinating the financial holdings of Flagstone throughout Europe.

Where You Can Find More Information

The Company's Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, are available free of charge through the investor information pages of its website, located at www.flagstonere.com. Alternatively, the public may read or copy the Company's filings with the Securities and Exchange Commission (the "SEC") at the SEC's Public Reference Room at 100 F Street, N.E., Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (http:// www.sec.gov).

Index

ITEM 1A. RISK FACTORS

Factors that could cause our actual results to differ materially from those in the forward-looking statements contained in this Form 10-K and other documents we file with the SEC include the following:

Risks Related to the Company

Claims arising from unpredictable and severe catastrophic events could reduce our earnings and shareholders' equity and limit our ability to write new insurance policies.

Our reinsurance and insurance operations expose us to claims arising out of unpredictable natural and other catastrophic events, such as hurricanes, windstorms, tsunamis, severe winter weather, earthquakes, floods, fires and explosions. In recent years, the frequency of major weather-related catastrophes has increased.

The extent of losses from catastrophes is a function of both the number and severity of the insured events and the total amount of insured exposure in the areas affected. Increases in the value and concentrations of insured property, the effects of inflation and changes in cyclical weather patterns may increase the severity of claims from catastrophic events in the future. Claims from catastrophic events could reduce our earnings and cause substantial volatility in our results of operations for any fiscal quarter or year, which could adversely affect our financial condition, possibly to the extent of eliminating our shareholders' equity.

This volatility is compounded by accounting conventions that do not permit reinsurers to reserve for such catastrophic events until they occur. We expect that increases in the values and concentration of insured property will increase the severity of such occurrences per year in the future and that climate change may increase the frequency of severe weather events. Underwriting is inherently a matter of judgment, involving important assumptions about matters that are unpredictable and beyond our control, and for which historical experience and probability analysis may not provide sufficient guidance. One or more catastrophic or other events could result in claims that substantially exceed our expectations.

We may experience significant losses on short notice, which may require us to liquidate our investments rapidly and may limit our ability to write new reinsurance and insurance policies.

Catastrophes such as hurricanes, windstorms, tsunamis, severe winter weather, earthquakes, floods, fires and explosions are difficult to predict. By reinsuring the damages resulting from these catastrophes, we subject ourselves to large potential claims that may arise on short notice. To meet our obligations with respect to those claims, we may be forced to liquidate some of our investments rapidly, which may involve selling a portion of our investments into a depressed market. Those sales would decrease our liquidity, our returns from our investments, and our underwriting capacity.

We could face unanticipated losses from war, terrorism and political unrest, and these or other unanticipated losses could have a material adverse effect on our financial condition and results of operations.

We may have substantial exposure to large, unexpected losses resulting from future man-made catastrophic events, such as acts of war, acts of terrorism and political instability. Although we may attempt to exclude losses from terrorism and certain other similar risks from some coverages we write, we may not be successful in doing so.

To the extent that losses from these risks occur, our financial condition and results of operations could be materially adversely affected.

If our risk management and loss limitation methods fail to adequately manage our exposure to losses from catastrophic events, the losses we incur from a catastrophic event could be materially higher than our expectations and our financial condition and results of operations could be adversely affected.

We manage our exposure to catastrophic losses by analyzing the probability and severity of the occurrence of catastrophic events and the impact of such events on our overall reinsurance and investment portfolio. We use various tools to analyze and manage the reinsurance exposures we assume from ceding companies and risks from a catastrophic event that could impact on our investment portfolio. Among the most important of these is proprietary risk modeling software which we have developed and currently utilize, and on which we expect to rely on to an increasing extent over time. Our proprietary risk modeling software enables us to assess the adequacy of risk pricing and to monitor our overall exposure to risk in correlated geographic zones. We cannot assure you that the models and assumptions used by the software will accurately predict losses in all situations. Further, we cannot assure you that it is free of defects in the modeling logic or in the software code.

Index

In addition, much of the information that we enter into our risk modeling software is based on third-party data that we believe but cannot be certain is reliable, and estimates and assumptions that are dependent on many variables. Assumptions relate to loss adjustment expenses, insurance-to-value, storm intensity in the aftermath of weather-related catastrophes and demand surge, which is the temporary inflation of costs for building materials and labor resulting from increased demand for rebuilding services in the aftermath of a catastrophe. Accordingly, if the estimates and assumptions that we enter into our proprietary risk model are incorrect, or if our proprietary risk model proves to be an inaccurate forecasting tool, the losses we might incur from an actual catastrophe could be materially higher than our expectation of losses generated from modeled catastrophe scenarios, and our financial condition and results of operations could be adversely affected.

We also seek to limit our loss exposure through loss limitation provisions in our policies, such as limitations on the amount of losses that can be claimed under a policy, limitations or exclusions from coverage and provisions relating to choice of forum, which are intended to assure that our policies are legally interpreted as we intend. We cannot assure you that these contractual provisions will be enforceable in the manner we expect or that disputes relating to coverage will be resolved in our favor. If the loss limitation provisions in our policies are not enforceable or disputes arise concerning the application of such provisions, the losses we might incur from a catastrophic event could be materially higher than our expectations, and our financial condition and results of operations could be materially adversely affected.

We may not be able to adequately assess and reserve for the increased frequency and severity of catastrophes due to environmental factors including climate change, which may have a material adverse effect on our financial condition.

To assess our loss exposure, we rely on natural catastrophe models that are built partly on science, partly on historical data and partly on professional judgment of our employees and other industry specialists. Although the accuracy of the models has significantly improved in the last few years, they still yield significant variations in loss estimates due to the quality of underlying data and assumptions. Interpretation of modeling results remains subjective, and none of the existing models reflects our policy language, demand surges and other storm-specific factors such as where the storms will actually travel.

There is little consensus in the scientific community regarding the effect of global environmental factors on catastrophes. Climatologists concur that heat from the ocean drives hurricanes, but they cannot agree on how much it changes the annual outlook. In addition, scientists have recently recorded rising sea temperatures which may result in higher frequency and severity of windstorms. It is unclear whether rising sea temperatures are part of a longer cycle and if they are caused or aggravated by man-made pollution or other factors.

Recent scientific studies have indicated that the frequency of hurricanes has increased and may further increase in the future relative to the historical experience over the past 100 years. We continuously monitor and adjust, as we believe appropriate, our risk management models to reflect our judgment of how to interpret current developments and information, such as these studies. However, it is possible that, even after these adjustments, we have underestimated the frequency or severity of hurricanes or other catastrophes.

Given the scientific uncertainty about the causes of increased frequency and severity of catastrophes and the lack of adequate predictive tools, we may not be able to adequately model the associated losses, which would adversely affect our profitability.

Index

If actual renewals of our existing contracts do not meet expectations, our premiums written in future years and our future results of operations could be materially adversely affected.

Many of our contracts are generally for a one-year term. In our financial forecasting process, we make assumptions about the renewal of our prior year's contracts. If actual renewals do not meet expectations or if we choose not to write on a renewal basis because of pricing conditions, our premiums written in future years and our future operations could be materially adversely affected. This risk is especially prevalent in the first quarter of each year when a larger number of reinsurance contracts are subject to renewal.

The insurance and reinsurance business is historically cyclical, and we expect to experience periods with excess underwriting capacity which may result in fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention, and less favorable policy terms and conditions.

The insurance and reinsurance industries have historically been cyclical businesses. Reinsurers and insurers have experienced significant fluctuations in operating results due to competition, frequency of occurrence or severity of catastrophic events, levels of underwriting capacity, general economic conditions and other factors. The supply of reinsurance and insurance is related to prevailing prices, the level of insured losses and the level of industry surplus which, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance and reinsurance industries.

As a result, the reinsurance and insurance business historically has been characterized by periods of intense competition on price and policy terms due to excessive underwriting capacity as well as periods when shortages of capacity permit favorable premium rates and policy terms and conditions. These cycles have varied by line of business as the level of supply and demand for any particular class of reinsurance and insurance risk does not always coincide with that for other classes of risk.

If we underestimate our loss reserves, so that they are inadequate to cover our ultimate liability for losses, the underestimation could materially adversely affect our financial condition and results of operations.

We are required to maintain adequate reserves to cover our estimated ultimate liabilities for loss and loss adjustment expenses. These reserves are estimates based on actuarial and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Our success depends on our ability to accurately assess the risks associated with the businesses and properties that we reinsure. If unpredictable catastrophic events occur, or if we fail to adequately manage our exposure to losses or fail to adequately estimate our future reserve requirements, our actual loss and loss adjustment expenses may deviate, perhaps substantially, from our future reserve estimates.

Loss and loss adjustment expense reserves (or loss reserves) are typically comprised of case reserves and IBNR reserves. Our IBNR reserves include a provision for unknown future development on loss and loss adjustment expenses which are known to us. However, under U.S. GAAP, we are not permitted to establish loss reserves with respect to our property catastrophe reinsurance until an event which gives rise to a claim occurs. As a result, only loss reserves applicable to losses incurred up to the reporting date may be set aside on our financial statements, with no allowance for the provision of loss reserves to account for possible other future losses with respect to our property catastrophe reinsurance. Our loss reserve estimates do not represent an exact calculation of liability. Rather, they are estimates of what we expect the ultimate settlement and administration of claims will cost. These estimates are based upon actuarial and statistical projections and on our assessment of currently available data, predictions of future developments and estimates of future trends and other variable factors such as inflation. Establishing an appropriate

level of our loss reserve estimates is an inherently uncertain process. It is likely that the ultimate liability will be greater or less than these estimates and that, at times, this variance will be material. Our future reserve estimates are refined continually as experience develops and claims are reported and settled. In addition, as a broker market reinsurer, reserving for our business can involve added uncertainty. Because we depend on information from ceding companies, there is a time lag inherent in reporting information from the primary insurer to us, and ceding companies have differing reserving practices. Moreover, these uncertainties are greater for reinsurers like us than for reinsurers with a longer operating history because we do not yet have an established loss history. Because of this uncertainty, it is possible that our estimates
for reserves at any given time could prove inadequate.

To the extent we determine that actual losses and loss adjustment expenses from events which have occurred exceed our expectations and loss reserves reflected in our financial statements, we will be required to immediately reflect these changes. This could cause a sudden and material increase in our liabilities and a reduction in our profitability, including operating losses and reduction of capital, which could materially restrict our ability to write new business and adversely affect our financial condition and results of operations.

Index

A failure to attract and retain key personnel could impede the implementation of our business strategy, reduce our revenues and decrease our operational effectiveness.

Our success substantially depends upon our ability to attract and retain qualified employees and upon the ability of our senior management and other key employees to implement our business strategy. We believe there are only a limited number of available qualified executives in the business lines in which we compete. We rely substantially upon the services of David Brown, our Chief Executive Officer; Mark Byrne, the Executive Chairman of our Board of Directors; Patrick Boisvert, our Chief Financial Officer; Gary Prestia, our Chief Underwriting Officer North America ; Guy Swayne, Chief Underwriting Officer International; and David Flitman, our Chief Actuary, among other key employees. Although we are not aware of any planned departures, the loss of any of their services or the services of other members of our management team or difficulty in attracting and retaining other talented personnel could impede the further implementation of our business strategy, reduce our revenues and decrease our operational effectiveness. Although we have an employment agreement with each of the above named executives, there is a possibility that these employment agreements may not be enforceable in the event any of these employees leave. The employment agreements for Messrs. Byrne and Brown provide that either party may terminate their agreement upon 365 days' advance written notice, the employment agreements with Messrs. Prestia and Swayne provide that either party may terminate the agreement upon 180 days' advance written notice, and the employment agreements with Messrs. Boisvert and Flitman provide that either party may terminate the agreement upon 90 days' advance written notice. We do not currently maintain key man life insurance policies with respect to them or any of our other employees.

Our success has and will continue to depend, in substantial part upon our ability to attract and retain our team of underwriters in various business lines. Although we are not aware of any planned departures, the loss of one or more of our senior underwriters could adversely impact our business by, for example, making it more difficult to retain clients or other business contacts whose relationship depends in part on the service of the departing personnel. In general, the loss of key services of any members of our current underwriting teams may adversely affect our business and results of operations.

We are dependent on the policies, procedures and expertise of ceding companies; these companies may fail to accurately assess the risks they underwrite, which may lead us to inaccurately assess the risks we assume. As a result, we could face significant underwriting losses on these contracts.

Because we participate in reinsurance markets, we do not separately evaluate each of the individual risks assumed under reinsurance treaties. This is common among reinsurers. Therefore, the success of our underwriting efforts depends, in part, upon the policies, procedures and expertise of the ceding companies making the original underwriting decisions. We face the risk that these ceding companies may fail to accurately assess the risks that they underwrite initially, which, in turn, may lead us to inaccurately assess the risks we assume. If we fail to establish and receive appropriate premium rates, we could face significant underwriting losses on these contracts.

We depend on a small number of reinsurance and insurance brokers and agents for a large portion of our revenues, and the loss of business from one of these reinsurance or insurance brokers and agents could limit our ability to write new reinsurance and insurance policies and reduce our revenues.

We market our reinsurance and insurance on a worldwide basis primarily through reinsurance brokers and insurance brokers and agents, and we depend on a small number of reinsurance brokers and insurance brokers and agents for a large portion of our revenues. Since we commenced operations in December 2005, substantially all of our gross premiums written were sourced through brokers. The following brokers, Aon Benfield (37.2%), Guy Carpenter & Company, Inc. (23.3%) and Willis Group Holdings Ltd. (10.0%), provided a total of 70.5% of our gross premiums written for the year ended December 31, 2009. Affiliates of these and other brokers have historically co-sponsored the formation of Bermuda reinsurance companies that may compete with us, and these brokers may favor their own reinsurers over other companies. Loss of all or a substantial portion of the business provided by one or more of these brokers could limit our ability to write new reinsurance policies and reduce our revenues.

Index

Because payments are frequently made and received through reinsurance and insurance brokers, we could incur liabilities to ceding insurers regardless of fault and lose our recourse to collect payments from ceding insurers.

In accordance with industry practice, we frequently pay amounts owed on claims under our policies to reinsurance and insurance brokers, and these brokers, in turn, pay these amounts to the insureds and the ceding insurers that have reinsured a portion of their liabilities with us. In some jurisdictions, if a broker fails to make such a payment, we may remain liable to the ceding insurer or insured for the deficiency. Conversely, in certain jurisdictions, when the ceding insurer or insured pays premiums to reinsurance or insurance brokers for payment to us, these premiums are considered to have been paid and the ceding insurer or insured will no longer be liable to us for those amounts, regardless of whether we have received the premiums. Consequently, consistent with industry practice, we assume a degree of credit risk associated with reinsurance and insurance brokers.

The financial strength rating of Flagstone may be revised downward which could affect our standing among brokers and customers, result in a substantial loss of business and impede our ability to conduct business.

Ratings have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. Flagstone Suisse has received “A-” financial strength ratings from both A.M. Best and Fitch Ratings and “A3” ratings from Moody’s Investor Services and each of Island Heritage, Flagstone Alliance and Flagstone Africa has received an A- from A.M. Best. These ratings are financial strength ratings and are designed to reflect our ability to meet our financial obligations under our policies. These ratings do not refer to our ability to meet non-reinsurance and non-insurance obligations and are not a recommendation to purchase any policy or contract issued by us or to buy, hold or sell our securities.

Each of Flagstone Suisse’s, Island Heritage’s, Flagstone Alliance’s and Flagstone Africa’s financial strength rating is subject to periodic review by, and may be revised downward or revoked at the sole discretion of the rating agencies in response to a variety of factors, including the risk factors described in this section.

With regard to Marlborough, as all Lloyd’s policies are ultimately backed by this common security, a single market rating can be applied. Lloyd’s as a market has received “A” financial strength rating from A.M. Best and “A+” from each of Standard & Poor’s and Fitch.

If our financial strength ratings are reduced from their current levels, our competitive position in the reinsurance and insurance industries would suffer, and it would be more difficult for us to market our products. A downgrade could result in a significant reduction in the number of reinsurance and insurance contracts we write and in a substantial loss of business as our customers, and brokers that place such business, move to other competitors with higher financial strength ratings.

A downgrade also may require us to establish trusts or post letters of credit for ceding company clients. It is common for our reinsurance contracts to contain terms that would allow the ceding companies to cancel the contract for the remaining portion of our period of obligation if the financial strength ratings of our insurance subsidiaries are downgraded below A- by A.M. Best. Currently, virtually all of our contracts permit cancellation if our financial strength rating is downgraded.   Whether a ceding company would exercise this cancellation right would depend, among other factors, on the reason for such downgrade, the extent of the downgrade, the prevailing market conditions and the pricing and availability of replacement reinsurance coverage. Therefore, we cannot predict in advance the extent to which this cancellation right would be exercised, if at all, or what effect any such cancellations would have on our financial condition or future operations, but such effect could be material.

The indentures governing our Deferrable Interest Debentures would restrict us from declaring or paying dividends on our common shares if the Company (1) is downgraded by A.M. Best to a financial strength rating below A- and fails to renew more than 51% of its net premiums written during any twelve-month period; (2) is downgraded to a financial strength rating below A- and sells more than 51% of its rights to renew net premiums written over the course of a twelve-month period; (3) is downgraded to a financial strength rating below B++; or (4) withdraws its financial strength rating from A.M. Best.

Consolidation in the insurance industry could adversely impact us.

We believe that many insurance industry participants are seeking to consolidate. These consolidated entities may try to use their enhanced market power to negotiate price reductions for our products and services. If competitive pressures reduce our prices, we would expect to write less business. As the insurance industry consolidates, competition for customers will become more intense and the importance of acquiring and properly servicing each customer will become greater. We could incur greater expenses relating to customer acquisition and retention, further reducing our operating margins. In addition, insurance companies that merge may be able to spread their risks across a larger capital base so that they require less reinsurance. The number of companies offering retrocessional reinsurance may decline. Reinsurance intermediaries could also consolidate, potentially adversely impacting our ability to access business and distribute our products. We could also experience more robust competition from larger, better capitalized competitors. Any of the foregoing could adversely affect our business or our results of operation.

Index

We may encounter difficulties maintaining the information technology systems necessary to run our business which could result in a loss or delay of revenues, higher than expected loss levels, diversion of management resources, harm to our reputation or an increase in costs.

The performance of our information technology systems is critical to our business and reputation and our ability to process transactions and provide high quality customer service. Such systems are and will continue to be a very important part of our underwriting process. We license the catastrophe modeling software of AIR Worldwide, Eqecat and Risk Management Solutions Inc., which are the three major vendors of industry-standard catastrophe modeling software, and we enhance the output from these models with our proprietary software. We cannot be certain that we will be able to replace these service providers or consultants, if necessary, without slowing our underwriting response time, or that our proprietary technology will operate as intended. Any defect or error in our information technology systems could result in a loss or delay of revenues, higher than expected loss levels, diversion of management resources, harm to our reputation or an increase in costs.

We may be unable to purchase reinsurance for our own account on commercially acceptable terms or to collect under any reinsurance we have purchased.

We may acquire reinsurance purchased for our own account to mitigate the effects of large or multiple losses on our financial condition. From time to time, market conditions have limited, and in some cases prevented, insurers and reinsurers from obtaining the types and amounts of reinsurance they consider adequate for their business needs. For example, following the September 11, 2001 terrorist attacks, terms and conditions in the reinsurance markets generally became less attractive to buyers of such coverage. Similar conditions occurred as a result of Hurricanes Katrina, Rita and Wilma in 2005 and Ike and Gustav in 2008, and may occur in the future, and we may not be able to purchase reinsurance in the areas and for the amounts required or desired. Even if reinsurance is generally available, we may not be able to negotiate terms that we deem appropriate or acceptable or to obtain coverage from entities with satisfactory financial resources. Our inability to obtain adequate reinsurance or other protection for our own account could have a material adverse effect on our business, results of operations and financial condition.

The impairment of financial institutions increases our counterparty risk.

We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial service industry, including brokers and dealers, banks and other institutions which is experiencing unprecedented deterioration and volatility as a result of the current financial crisis (see the risk factor headed “Deterioration in the public debt, equity and commodities markets could lead to additional investment losses, and could materially and adversely affect our business and results of operations”). Many of these transactions expose us to credit risk in the event of default of our counterparty. In addition, with respect to secured transactions, our credit risk may be exacerbated when our collateral cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due to it. We also may have exposure to these financial institutions in the form of unsecured debt instruments, derivative transactions and equity investments. Any such losses or impairments to the carrying value of these assets could materially and adversely affect our business and results of operations.

Our investment portfolio may suffer reduced returns or losses which could adversely affect our results of operations and financial condition. Any change in interest rates, abrupt changes in credit markets or volatility in the equity and debt markets could result in significant losses in the fair value of our investment portfolio.

Our strategy is to derive a meaningful portion of our income from our invested assets. As a result, our operating results depend in part on the performance of our investment portfolio, as well as the ability of our investment managers to effectively implement our investment strategy.

The investment income derived from our invested assets was $28.5 million for the year ended December 31, 2009. For the year ended December 31, 2009, the total return on invested assets was 4.6% compared to (13.9%) for the year ended December 31, 2008. The change in the return on invested assets of 18.5% during the year ended December 31, 2009, compared to the same period in 2008 is primarily due to the significant declines in the global equity, bond and commodities markets in 2008. Such declines in the equity, bond and commodities markets were attributable to the broader deterioration and volatility in the credit markets, the widening of credit spreads in fixed income sectors, significant failures of large financial institutions, uncertainty regarding the effectiveness of governmental solutions and the lingering impact of the sub-prime residential mortgage crisis. In October 2008, given the turbulent worldwide financial markets, the Finance Committee of the Board decided to revise the Company's asset allocation and accordingly, significantly reduced the risk of the Company's portfolio by eliminating its direct exposure to equities and to non-U.S. real estate and by lowering its exposure to commodities. However, our more conservative investment portfolio also limits our potential return on invested assets. Our investment policies seek capital appreciation and thus will be subject to market-wide risks and fluctuations, as well as to risks inherent in particular securities. In particular, the volatility of our claims may force us to liquidate securities, which may cause us to incur capital losses.

Index

Our investment performance may vary substantially over time, and we cannot assure you that we will achieve our investment objectives. Unlike more established reinsurance companies with longer operating histories, the Company has a limited performance record to which investors can refer (see the risk factor headed "Our historical financial results may not accurately indicate our future performance due to our limited operating history.").

Investment returns are an important part of our growth in diluted book value, and fluctuations in the fixed income or equity markets could impair our financial condition and results of operations. A significant period of time normally elapses between the receipt of insurance premiums and the disbursement of insurance claims. We cannot assure you that we will successfully match the structure of our investments with our operating subsidiaries' liabilities under their reinsurance and insurance contracts. If our calculations with respect to these reinsurance liabilities are incorrect, or if we improperly structure our investments to match such liabilities, we could be forced to liquidate investments before maturity, potentially at a significant loss.

Investment results will also be affected by general economic conditions, market volatility, interest rate fluctuations, liquidity and credit risks beyond our control. In addition, the need for liquidity may result in investment returns below our expectations. With respect to certain of our investments, we are subject to pre-payment or reinvestment risk. In particular, our fixed maturity portfolio is subject to reinvestment risk and as at December 31, 2009, 10.8% of our total investments is comprised of mortgage backed and asset backed securities which are subject to prepayment risk. A significant increase in interest rates could result in significant losses, realized or unrealized, in the fair value of our investment portfolio and, consequently, could have an adverse affect on our results of operations. Further, our portfolio of fixed income securities may be adversely affected by changes in interest rates. In addition, we are generally exposed to changes in the level or volatility of equity prices that affect the value of securities or instruments that derive their value from a particular equity security, a basket of equity securities or a stock index. As of the date of this annual report, our exposure to equities and other non-investment grade fixed income investments is limited to 15% of assets. These conditions are outside of our control and could adversely affect the value of our investments and our financial condition and results of operations.

Profitability may be adversely impacted by claims' inflation.

The effects of claims inflation could cause the severity of claims from catastrophes or other events to rise in the future. Our calculation of reserves for losses and loss expenses includes assumptions about future payments for settlement of claims and claims-handling expenses, such as medical treatment and litigation costs. We write business in the United States and the United Kingdom, where claims inflation has grown particularly strong in recent years. To the extent inflation causes these costs to increase above reserves established for these claims, we will be required to increase our loss reserves with a corresponding reduction in our net income in the period in which the deficiency is identified.

The movement in foreign currency exchange rates could adversely affect our operating results because we enter into reinsurance and insurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar and we maintain a portion of our investments and liabilities in currencies other than the U.S. dollar.

Through our global reinsurance and insurance operations, we conduct business in a variety of foreign (non-U.S.) currencies, the principal exposures being the Euro, the British pound, the Swiss franc, the Canadian dollar and the Japanese yen. Assets and liabilities denominated in foreign currencies are exposed to changes in currency exchange rates. Our reporting currency is the U.S. dollar, and exchange rate fluctuations relative to the U.S. dollar may materially impact our results and financial position. We employ various strategies (including hedging) to manage our exposure to foreign currency exchange risk. To the extent that these exposures are not fully hedged or the hedges are ineffective, our results and level of capital may be reduced by fluctuations in foreign currency exchange rates.

We may need additional capital in the future, which may not be available to us or may not be available on favorable terms, may have rights, preferences and privileges superior to those of our common shares, could dilute your ownership in the Company, and may cause the market price of our common shares to fall.

We may need to raise additional capital in the future, through public or private debt or equity financings, to repay our long term debt, comply with the terms of our letter of credit facility, write new business successfully, cover loss and loss adjustment expense reserves following losses, respond to any changes in the capital requirements that rating agencies use to evaluate us, to manage investments and preserve capital in volatile markets, to acquire new businesses or invest in existing businesses, or otherwise respond to competitive pressures in our industry. Due to the uncertainty relating to some of these items, we are not able to quantify our total future capital requirements. Our ability to obtain financing or to access the capital markets for future offerings may be limited by our financial condition at the time of any such financing or offering, as well as by adverse market conditions resulting from, among other things, general economic conditions, weakness in the financial markets and contingencies and uncertainties that are beyond our control.

Index

Significant contraction, de-leveraging and reduced liquidity in credit markets worldwide is reducing the availability and increasing the cost of credit. Any additional financing we may seek may not be available on terms favorable to us, or at all. Furthermore, the securities may have rights, preferences and privileges that are senior or otherwise superior to those of our common shares. Any additional capital raised through the sale of equity will dilute your ownership percentage in our company and may decrease the market price of our common shares.

Our complex global operating platform increases our exposure to systems or human failures, which may limit our revenues, increase our costs and decrease our net income from operations.

We are subject to operational risks including fraud, employee errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures, or external events. Our reliance in large part on the integration of our operations in Bermuda, the United Kingdom, Switzerland, India, Canada, the Cayman Islands, Puerto Rico, Isle of Man, Republic of Cyprus, South Africa, Luxembourg and Dubai increases the likelihood that losses from these risks, which may occur from time to time, could be significant. As our business and operations grow more complex we are exposed to a broader scope of risk in these areas. The occurrence of these types of events may limit our revenues, increase our costs and decrease our net income from operations.

We may fail at acquiring and integrating other reinsurance and insurance businesses in the future, and we may need to incur indebtedness or issue additional equity due to these future acquisition opportunities.

Part of our business strategy may involve growing the Company in the future by acquiring other reinsurance and insurance companies or parts or all of their businesses. Our ability to make these acquisitions will depend upon many factors, including the availability of suitable financing and the ability to identify and acquire businesses on a cost-effective basis. Our ability to effectively integrate acquired personnel, operations, products and technologies, to retain and motivate key personnel, and to retain the goodwill and customers of acquired companies or businesses will also be important. There can be no assurance that we can or will successfully acquire and integrate such operations in the future. Furthermore, in connection with future acquisition opportunities, we may need to incur indebtedness or issue additional equity. If and when achieved, new acquisitions may adversely affect our near-term operating results due to increased capital requirements, transitional management and operating adjustments, interest costs associated with acquisition debt, and other factors.

Some of our related parties have continuing agreements and business relationships with us and these persons could pursue business interests or exercise their voting power as shareholders in ways that are detrimental to us.

Some of our executive officers, directors, underwriters and affiliates of our principal shareholders engage in transactions with our Company.

These persons could pursue business interests or exercise their voting power as shareholders in ways that are detrimental to us, but beneficial to themselves or their affiliates or to other companies in which they invest or with whom they have a material relationship.

Unexpected industry practices and conditions could extend coverage beyond our underwriting intent or increase the number or size of claims, causing us to incur significant losses.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until sometime after we have issued reinsurance or insurance contracts that are affected by the changes. As a result, the full extent of liability under our reinsurance and insurance contracts may not be known for many years after a contract is issued.

One example involves coverage for losses arising from terrorist acts. Substantially all of the reinsurance contracts that we have written exclude coverage for losses arising from the peril of terrorism caused by nuclear, biological, chemical or radiological attack. We are unable to predict the extent to which our future reinsurance and insurance contracts will cover terrorist acts. We also are unsure how terrorist acts will be defined in our current and future contracts and cannot assure you that losses resulting from future terrorist attacks will not be incidentally or inadvertently covered. If there is a future terrorist attack, the possibility remains that losses resulting from such event could prove to be material to our financial condition and results of operations. Terrorist acts may also cause multiple claims, and there is no assurance that our policy limits will be effective.

Index

Although the Terrorism Risk Insurance Act, or TRIA, was scheduled to expire at the end of 2007, the Terrorism Risk Insurance Program Reauthorization Act of 2007 was signed into law by the U.S. President on December 26, 2007. This law renews the existing terrorism risk insurance program for seven years, through December 31, 2014. Certain provisions of TRIA were modified by the 2007 reauthorization. The program was expanded to include domestic terrorism by eliminating from the definition of a certified act of terrorism the requirement that such an act be perpetrated "on behalf of any foreign person or foreign interest". The insurer deductible is now fixed at 20% of an insurer's direct earned premium, and the federal share of compensation is fixed at 85% of insured losses that exceed insurer deductibles. The U.S. Treasury Department is required to promulgate regulations to determine the pro-rata share of insured losses if they exceed the $100 billion cap. In addition, clear and conspicuous notice to policyholders of the $100 billion cap is required. Under the program reauthorization, the trigger at which federal compensation becomes available remains fixed at $100 million per year through 2014.

The effects of these and other unforeseen emerging claim and coverage issues are extremely difficult to predict. If we are required to cover losses that we did not anticipate having to cover under the terms of our reinsurance and insurance contracts, we could face significant losses and as a result, our financial condition and results of operation could be adversely affected.

The insurance and reinsurance industries are highly competitive. Competitive pressures may result in fewer contracts written, lower premium rates, increased expense for customer acquisition and retention, and less favorable policy terms and conditions.

The reinsurance and insurance industries are highly competitive. We compete with major global insurance and reinsurance companies and underwriting syndicates, many of which have extensive experience in reinsurance and insurance and may have greater financial resources available to them than us. Other financial institutions, such as banks and hedge funds, now offer products and services similar to our products and services. Alternative products, such as catastrophe bonds, compete with our products. In the future, underwriting capacity will continue to enter the market from these identified competitors and perhaps other sources. After the September 11, 2001, terrorist attacks in the United States, and then again following the three major hurricanes of 2005 (Katrina, Rita and Wilma), new capital flowed into Bermuda, and much of these new proceeds went to a variety of Bermuda-based start-up companies. The full extent and effect of this additional capital on the reinsurance and insurance markets will not be known for some time and current market conditions could reverse. These continued increases in the supply of reinsurance and insurance may have negative consequences for us, including fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention, and less favorable policy terms and conditions. Insurance company customers of reinsurers may choose to retain larger shares of risk, thereby reducing overall demand for reinsurance. Further, insureds have been retaining a greater proportion of their risk portfolios than previously, and industrial and commercial companies have been increasingly relying upon their own subsidiary insurance companies, known as captive companies, self-insurance pools, risk retention groups, mutual insurance companies and other mechanisms for funding their risks, rather than risk transferring insurance. This has put downward pressure on insurance premiums.

In addition, while we believe our global operating platform currently differentiates us among Bermuda-based reinsurance and insurance companies of comparable capital size and provides significant efficiencies in our operations, it is possible that our competitors will aim to employ a similar platform in the future, or implement their own platforms with equivalent or superior operational and cost structures to ours.

Also, insurance/risk-linked securities, catastrophe bonds and derivatives and other non-traditional risk transfer mechanism and vehicles are being developed and offered by other parties, including non-insurance company entities, which could impact the demand for traditional insurance and reinsurance. A number of new, proposed or potential legislative or industry developments could also increase competition in our industries. These developments include programs in which state-sponsored entities provide property insurance or reinsurance in catastrophe-prone areas. These legislative developments could eliminate or reduce opportunities for us and other reinsurers to write those coverages, and increase competition with our competitors for contracts not covered by such state-sponsored programs. New competition from these developments could result in fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention and less favorable policy terms and conditions.

New competition could cause the demand for insurance or reinsurance to fall or the expense of customer acquisition and retention to increase, either of which could have a material adverse effect on our growth and profitability and our results of operations.

The availability and cost of security arrangements for reinsurance transactions may impact our ability to provide reinsurance to ceding insurers.

Flagstone Suisse is required to post collateral security with respect to reinsurance liabilities it assumes from many ceding insurers, especially those in many U.S. jurisdictions. The posting of collateral security is generally required in order for these ceding companies to obtain credit on their statutory financial statements with respect to reinsurance liabilities ceded to reinsurers who are not licensed or accredited in these jurisdictions. Under applicable statutory provisions, the security arrangements may be in the form of letters of credit, reinsurance trusts maintained by third-party trustees or " funds withheld" arrangements whereby the assets are held in trust by the ceding company.

Index

The Company currently has the ability to provide up to $700 million in letters of credit under the Company's letter of credit facilities ($450.0 million in respect of Citibank Europe Plc, $200.0 million in respect of Barclays Bank Plc and $50 million in respect of BNP Paribas), the renewal of which is reviewed annually. As at December 31, 2009, $444.3 million has been drawn under these facilities. If these facilities are not sufficient or if the Company is unable to renew them or is unable to arrange for other types of security on commercially acceptable terms, the ability of Flagstone Suisse to provide reinsurance to some U.S.-based and international clients may be severely limited.

At a Lloyd's market level, Lloyd's is required to demonstrate to the FSA that each member's capital resources requirement is met by that member's available capital resources, which for this purpose comprises its Funds at Lloyd's, its share of member capital held at syndicate level and the funds held within the Lloyd's Central Fund.

In addition, the security arrangements may subject our assets to security interests or require that a portion of our assets be pledged to, or otherwise held by, third parties. Although the investment income derived from our assets while held in trust typically accrues to our benefit, the investment of these assets is governed by the investment regulations of the jurisdiction of domicile of the ceding insurer, which may be more restrictive than the investment regulations applicable to us under Bermuda law. These restrictions may result in lower investment yields on these assets, which could adversely affect our profitability.

We are a holding company and we and our subsidiaries are subject to restrictions on paying dividends, repurchasing common shares or otherwise returning capital to shareholders.

The Company is a holding company with no significant operations or assets other than its ownership of its subsidiaries, the most important of which is Flagstone Suisse. Dividends, distributions and other permitted payments from Flagstone Suisse, which are limited under Bermuda and Swiss law and regulations, are expected to be the Company's primary source of funds to pay expenses and fund dividends, if any, or share repurchases.

Under the Insurance Act and related regulations, Flagstone Suisse will be required to maintain certain capital and solvency requirements and paid-up share capital levels and will be prohibited from declaring or paying dividends that would result in noncompliance with such requirement. As a Bermuda Class 4 reinsurer, Flagstone Suisse may not pay dividends in any financial year which would exceed 25% of its total statutory capital and surplus as set out in its previous year's statements, unless at least seven days before payment of those dividends it files an affidavit with the BMA signed by at least two directors and Flagstone Suisse's principal representative, which states that in their opinion, declaration of those dividends will not cause Flagstone Suisse to fail to meet its capital and solvency requirements and liquidity ratio. Further, Flagstone Suisse may not reduce by 15% or more its total statutory capital as set out in its previous year's statements without the prior approval of the BMA. This may limit the amount of funds available for distribution to the Company, restricting the Company's ability to pay dividends, make distributions and repurchase any of its common shares.

In addition, under the Bermuda Companies Act and related regulations the Company may only declare or pay a dividend or make a distribution if, among other matters, there are reasonable grounds for believing that each is, and will after the payment be, able to pay their respective liabilities as they become due and that the realizable value of their assets will not thereby be less than the sum of their liabilities and their issued share capital and share premium accounts. In connection with any share repurchase, as stipulated by the Bermuda Companies Act, the Company may not repurchase any of its common shares if the repurchase would reduce its minimum share capital below the minimum share capital specified in the Company's memorandum of association or, if the Company is, or, as a result of such repurchase would be, rendered insolvent.

Swiss law permits dividends to be declared only after profits have been allocated to the reserves required by law and to any reserves required by the articles of incorporation. The articles of incorporation of Flagstone Suisse do not require any specific reserves. Therefore, Flagstone Suisse must allocate any profits first to the reserve required by Swiss law generally, and may pay as dividends only the balance of the profits remaining after that allocation. In the case of Flagstone Suisse, Swiss law requires that 20% of the company's profits be allocated to a "general reserve" until the reserve reaches 50% of its paid-in share capital.

In addition, a Swiss reinsurance company may pay a dividend only if, after payment of the dividend, it will continue to comply with regulatory requirements regarding minimum capital, special reserves and solvency margin requirements.

Under the relevant South African insurance regulation, a short term insurer such as Flagstone Reinsurance Africa Limited will not be permitted to declare dividends unless it has sufficient assets and has conducted itself in such manner that it is able to meet its liabilities at all times.

Index

Under relevant Luxembourg corporate law an amount of 5% of the annual profit of a Luxembourg company must be transferred to the legal reserve until the legal reserve equals 10% of the paid in share capital. The structure of FCML, our Luxembourg investment subsidiary, provides for the equity to be provided substantially in share premium. As an investment company, FCML has been empowered and operationally equipped to redeem shares at Net Asset Value at short notice. FCML can also declare dividends (including interim dividends) out of unrealized capital gains.

UK company law prohibits Marlborough and Flagstone Corporate Name Limited from declaring a dividend to its shareholders unless it has “profits available for distribution”. The determination of whether a company has profits available for distribution is based on its accumulated realized profits less its accumulated realized losses. While the UK insurance regulatory laws impose no statutory restrictions on a Lloyd’s managing agent’s ability to declare a dividend, the FSA’s rules require maintenance of adequate resources, including each company’s solvency margin within its jurisdiction. In addition, under Lloyd’s rules, a managing agent must maintain a minimum level of capital based, among other things, on the amount of capacity it manages subject to a minimum of £400,000.

Island Heritage is domiciled in the Cayman Islands and is required to maintain a minimum net worth of 100,000 Cayman Islands dollars (which is equal to approximately US$120,000). In addition, Island Heritage may not issue any dividends without prior approval from the Cayman Islands Monetary Authority. In order to obtain approval Island Heritage must demonstrate that the issuing of dividends would not render Island Heritage insolvent or affect its ability to pay any future claims.

Flagstone Alliance operates under license issued by the Cyprus Insurance Superintendent to conduct general reinsurance and insurance business. Cyprus Companies law permits dividends to be declared only if there are available sufficient distributable reserves after profits have been allocated to the reserves required by law and to any reserves required by the articles of incorporation. The articles of incorporation of Flagstone Alliance do not require any specific reserves. Irrespective of the Cyprus Companies Law, Cap 113 requirements and Flagstone Alliance’s articles of association, Flagstone Alliance should maintain at any time reserves and assets that meet the Solvency criteria and Orders of the Cyprus Insurance Superintendent. Flagstone Alliance complies and reports to the Superintendent of Insurance under Solvency I requirements and the Solvency II requirements will be adopted in 2012. Revenue reserves are distributable to the extent permitted by the Companies Law, and Flagstone Alliance’s Articles of Association. The share premium account cannot be used for the distribution of dividends but can be used to issue bonus shares. The reserve arising on the conversion of share capital to Euro may be capitalized by way of a future capital increase; alternatively, Flagstone Alliance may decide at a shareholders’ general meeting to distribute the decrease by way of a dividend.

Risks Related to Laws and Regulations Applicable to Us

Insurance statutes and regulations in various jurisdictions could restrict our ability to operate.

Our reinsurance and insurance intermediary subsidiaries may not be able to maintain necessary licenses, permits, authorizations or accreditations in territories where we currently engage in business or obtain them in new territories, or may be able to do so only at significant cost. Failure to comply with or to obtain appropriate authorizations and/or exemptions under any applicable laws could result in restrictions on our ability to do business or to engage in certain activities that are regulated in one or more of the jurisdictions in which we operate and could subject us to fines and other sanctions, which could have a material adverse effect on our business. In addition, changes in the laws or regulations to which our insurance and reinsurance subsidiaries are subject could have a material adverse effect on our business.

The insurance laws of each state in the United States and many non-U.S. jurisdictions regulate the sale of insurance within that jurisdiction by alien insurers, such as Flagstone Suisse, which are not authorized or admitted to do business in that jurisdiction. The laws and regulations applicable to direct insurers could indirectly affect us, such as collateral requirements in various U.S. states to enable such insurers to receive credit for reinsurance ceded to us. We expect that for so long as Flagstone Suisse follows its operating guidelines, it will conduct its activities in compliance with applicable insurance statutes and regulations. However, insurance regulators in the United States or other jurisdictions who review the activities of Flagstone may successfully take the position that Flagstone is subject to the jurisdiction's licensing requirements.

A number of new, proposed or potential legislative developments could further increase competition in our industry. These developments include programs in which state-sponsored entities provide property insurance or reinsurance in catastrophe-prone areas. These legislative developments could eliminate or reduce opportunities for us and other reinsurers to write those coverages, and increase competition with our competitors for contracts not covered by such state-sponsored programs. New competition from these developments could result in fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention and less favorable policy terms and conditions.

Index

The insurance and reinsurance regulatory framework of Bermuda recently has become subject to increased scrutiny in many jurisdictions, including the United States. In the past, there have been Congressional and other initiatives in the United States regarding increased supervision and regulation of the insurance industry, including proposals to supervise and regulate offshore reinsurers. Government regulators are generally concerned with the protection of policyholders rather than other constituencies, such as shareholders. Moreover, our exposure to potential regulatory initiatives could be heightened by the fact that certain of our principal operating companies operate from Bermuda. Bermuda is a small jurisdiction and may be disadvantaged when participating in global or cross border regulatory matters as compared with larger jurisdictions such as the U.S. or the leading European Union countries. This disadvantage could be amplified by the fact that Bermuda, which is currently an overseas territory of the United Kingdom, may consider changes to its relationship with the United Kingdom in the future, including potentially seeking independence. We are not able to predict the future impact on Flagstone's operations of changes in the laws and regulations to which we, or companies acquired by us, are or may become subject. Flagstone Suisse operates in Bermuda under a permit issued by the Bermuda Minster of Finance. If Flagstone Suisse's permit was revoked, it would not be permitted to operate its business from within Bermuda.

The attorneys general for multiple states and other insurance regulatory authorities have previously investigated a number of issues and practices within the insurance industry, and in particular insurance brokerage practices. In addition, the European Commission has clarified its approach to the application of EU competition law in the commercial insurance and reinsurance sectors. On September 25, 2007, the European Commission published a report (Sector Inquiry under Article 17 of Regulation (EC) No 1/2003 on business insurance (Final Report) COM (2007) 556) setting out its main findings. No company in the group was among the many companies to receive formal requests for information about business practices from the European Commission. The Company does not currently consider that the Report has implications for the group's business practices, but the Commission's approach may well change.

To the extent that state regulation of brokers and intermediaries becomes more onerous, costs of regulatory compliance for the Company's insurance intermediary subsidiaries will increase. Finally, to the extent that any of the brokers with whom we do business suffer financial difficulties as a result of the investigations or proceedings, we could suffer increased credit risk. Since we depend on a few brokers for a large portion of our insurance and reinsurance revenues, loss of business provided by any one of them could adversely affect us.

These investigations of the insurance industry in general, whether involving the company specifically or not, together with any legal or regulatory proceedings, related settlements and industry reform or other changes arising therefrom, may materially adversely affect our business and future financial results or results of operations.

Our Indian subsidiary, Flagstone Underwriting Support Services (India) Private Limited ("Flagstone (India)"), has been duly incorporated under the Companies Act, 1956 in India and has specified as its main object the provision of business process outsourcing services, which permits it to provide us with back office information technology support services. Flagstone (India) is not considered to be engaged in the insurance or reinsurance business and is not registered with India's Insurance Development & Regulatory Authority. In the future, however, it is possible that regulators in India will take the position that Flagstone (India) is subject to the India's Insurance Development & Regulatory Authority or other insurance/reinsurance regulatory restrictions in India.

Due to various governmental investigations into contingent commission practices, various market participants have modified or eliminated acquisition expenses formerly arising from Placement Service Agreements (''PSAs''). As a result, it is possible that policy commissions or brokerage that we pay may increase in the future and/or that different forms of contingent commissions will develop in the future. It is also possible that some market participants may seek to reinsure some version of contingent commission arrangements. Any such additional expense could have a material adverse effect on our financial conditions or results.

Index

Regulatory regimes and changes to accounting standards may adversely impact financial results irrespective of business operations.

Accounting standards and regulatory changes may require modifications to our accounting principles, both prospectively and for prior periods and such changes could have an adverse impact on our financial results. In particular, the SEC and the Financial Accounting Standards Board, or "FASB," are considering whether U.S. GAAP will ultimately be replaced by or harmonized with International Financial Reporting Standards ("IFRS"). It is also possible that the adoption of IFRS would be extended to U.S. issuers on either an optional or mandatory basis. Any such change could have a significant impact on our financial reporting, impacting key matters such as our loss reserving policies and premium and expense recognition. For example, IFRS is considering adopting an accounting standard that would require all reinsurance and insurance contracts to be accounted for under a new measurement basis, current exit value, which is considered to be closely related to fair value. We cannot currently assess how the FASB and SEC staff's ultimate resolution of these initiatives will impact us, including aspects of our loss reserving policy or the effect it might have on recognizing premium revenue and policy acquisition costs. Until final guidance is issued, we intend to apply existing U.S. GAAP. There can be no certainty, however, that the SEC or the FASB will not require us to modify our current principles, either on a going-forward basis or for prior periods. Any required modification of our existing principles, either with respect to these issues or other issues in the future, could have an impact on our results of operations, including changing the timing of the recognition of underwriting income, increasing the volatility of our reported earnings and changing our overall financial statement presentation.

We could lose the services of one or more of our key employees if we are unable to obtain or renew work permits required by Bermuda employment restrictions.

We may need to hire additional employees to work in Bermuda. Under Bermuda law, non-Bermudians (other than spouses of Bermudians and permanent resident permit holders) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian) who meets the minimum standard requirements for the advertised position is available. Bermuda government policy limits the duration of work permits to six years, with certain exemptions for key employees. All of our Bermuda-based professional employees who require work permits, including Mr. Byrne, our Executive Chairman; Mr. Prestia, our Chief Underwriting Officer—North America; and Mr. Flitman, our Chief Actuary, have been granted permits by the Bermuda government. The terms of these permits range from three to five years depending on the individual.

It is possible that we could lose the services of one or more of our key employees if we are unable to obtain or renew their work permits, which could have an adverse effect on our business.

Risks Related to Our Common Shares

Future sales may affect the market price of our common shares.

We cannot predict what effect, if any, future sales of our common shares, or the availability of common shares for future sale, will have on the market price of our common shares. Sales of substantial amounts of our common shares in the public market, or the perception that such sales could occur, could adversely affect the market price of our common shares and may make it more difficult for you to sell your common shares at a time and price which you deem appropriate.

As of February 22, 2010, we had 82,985,219 common shares outstanding, net of treasury shares. Up to an additional 4,593,512 common shares may be issuable upon the vesting and exercise of outstanding performance share units (PSUs) and restricted share units (RSUs). In addition, our principal shareholders and their transferees have the right to require us to register their common shares under the Securities Act of 1933, as amended (the "Securities Act") for sale to the public. The outstanding founder's Warrant, which we refer to as the Warrant, will be exercisable for 8,585,747 common shares during the month of December 2013. These shares also will be entitled to demand registration. Following any registration of this type, the common shares to which the registration relates will be freely transferable. We have also filed a registration statement on Form S-8 under the Securities Act to register common shares issued or reserved for issuance under Flagstone Reinsurance Holdings Limited Performance Share Unit Plan, as amended (the " PSU Plan ") and the Amended and Restated Flagstone Reinsurance Holdings Limited Employee Restricted Share Unit Plan (the " RSU Plan "). Subject to the exercise of issued and outstanding stock options, shares registered under the registration statement on Form S-8 will be available for sale to the public.

Index

We have reserved 11.2 million common shares for issuance under the PSU Plan. For the RSU Plan, we annually reserve 0.2% of our outstanding common shares for issuance (or as decided by the Compensation Committee), plus the amount required to satisfy director fees paid in common shares. Subject to the settlement of PSUs, which generally vest over three years, and RSUs, which generally vest over two years, common shares registered under the registration statement on Form S-8 will be available for sale into the public markets after the expiration of the 180-day lock-up agreements. On September 22, 2009, we filed a universal shelf registration statement with the SEC, which was declared effective on December 17, 2009 (the "2009 Shelf Registration Statement"). Under the 2009 Shelf Registration Statement, we may issue and sell up to $500 million worth of common shares, preferred shares and senior and subordinated debt, under one or more prospectus supplements. Additionally, selling stockholders are entitled to sell up to a total of 71,547,891 common shares from time to time under the 2009 Shelf Registration Statement. We have not yet completed an offering under the 2009 Shelf Registration.

There are provisions in our charter documents that may reduce or increase the voting rights of our common shares.

There are provisions in our bye-laws which may reduce or increase the voting rights of the common shares. In general, and except as provided below, shareholders have one vote for each common share held by them and are entitled to vote at all meetings of shareholders. However, if, and so long as, the common shares of a shareholder are treated as "controlled shares" (as generally determined under section 958 of the Internal Revenue Code of 1986, as amended (the "Code") and the Treasury Regulations promulgated thereunder and under Section 957 of the Code) of any U.S. Person (as defined in Section 7701(a)(30) of the Code) and such controlled shares constitute 9.9% or more of the votes conferred by the Company's issued shares, the voting rights with respect to the controlled shares of such U.S. Person (a "9.9% U.S. Shareholder") shall be limited, in the aggregate, to a voting power of less than 9.9% under a formula specified in our bye-laws. The reduction in votes is generally to be applied proportionately among all the "controlled shares" of the 9.9% U.S. Shareholder. The formula is applied repeatedly until the voting power of each 9.9% U.S. Shareholder has been reduced below 9.9%. In addition, the Board of Directors may limit a shareholder's voting rights where it deems it appropriate to do so to (i) avoid the existence of any 9.9% U.S. Shareholder; and (ii) avoid certain adverse tax, legal or regulatory consequences to the Company or any of the Company's subsidiaries or any shareholder or its affiliates. "Controlled shares" include all shares that a U.S. Person is deemed to own directly, indirectly or constructively (within the meaning of Section 958 of the Code). The amount of any reduction of votes that occurs by operation of the above limitations will generally be reallocated proportionately among all other shareholders of the Company so long as the reallocation does not cause any U.S. shareholder to become a 9.9% U.S. Shareholder.

Under these provisions, certain shareholders may have their voting rights limited to less than one vote per share, while other shareholders may have voting rights increased to in excess of one vote per share. Moreover, these provisions could have the effect of reducing the votes of certain shareholders who would not otherwise be subject to the 9.9% limitation by virtue of their direct share ownership. Our bye-laws provide that shareholders will be notified of their voting interests before each shareholder vote.

The Company also has the authority to request information from any shareholder for the purpose of determining whether a shareholder's voting rights are to be reallocated pursuant to our bye-laws. If a shareholder fails to respond to a request for information from the Company or submits incomplete or inaccurate information in response to a request, the Company, in its reasonable discretion, may reduce or eliminate the shareholder's voting rights.

As a result of any reallocation of votes, your voting rights might increase above 5% of the aggregate voting power of the outstanding common shares, thereby possibly resulting in your becoming a reporting person subject to Schedule 13D or 13G filing requirements under the Exchange Act. In addition, the reallocation of your votes could result in your becoming subject to filing requirements under Section 16 of the Exchange Act.

41

Index

U.S. persons who own our common shares may have more difficulty in protecting their interests than U.S. persons who are shareholders of a U.S. corporation.

The Bermuda Companies Act, which applies to the Company, differs in material respects from laws generally applicable to U.S. corporations and their shareholders. Generally, the rights of shareholders under Bermuda law are not as extensive as the rights of shareholders under legislation or judicial precedent in many United States jurisdictions. Class actions and derivative actions are generally not available to shareholders under the laws of Bermuda. In addition, the Company's bye-laws also provide that shareholders waive all claims or rights of action that they may have, individually or in the Company's right, against any of the Company's directors or officers for any act or failure to act in the performance of such director's or officer's duties, except with respect to any fraud or dishonesty of such director or officer. The cumulative effect of some of these differences between Bermuda law and the laws generally applicable to U.S. corporations and their shareholders may result in shareholders having greater difficulties in protecting their interests as a shareholder of our Company than as a shareholder of a U.S. corporation. In particular, this affects, among other things, the circumstances under which transactions involving an interested director are voidable, whether an interested director can be held accountable for any benefit realized in a transaction with our company, what approvals are required for business combinations by our company with a large shareholder or a wholly-owned subsidiary, what rights a shareholder may have to enforce specified provisions of the Bermuda Companies Act or our bye-laws, and the circumstances under which we may indemnify our directors and officers.

Anti-takeover provisions in our bye-laws could impede an attempt to replace or remove our directors, which could diminish the value of our common shares.

Our bye-laws contain provisions that may entrench directors and make it more difficult for shareholders to replace directors even if the shareholders consider it beneficial to do so. In addition, these provisions could delay or prevent a change of control that a shareholder might consider favorable. For example, these provisions may prevent a shareholder from receiving the benefit from any premium over the market price of our common shares offered by a bidder in a potential takeover. Even in the absence of an attempt to effect a change in management or a takeover attempt, these provisions may adversely affect the prevailing market price of our common shares if they are viewed as discouraging changes in management and takeover attempts in the future.

Examples of provisions in our bye-laws that could have this effect include:

- election of our directors is staggered, meaning that the members of only one of the three classes of our directors are elected each year, thus limiting your ability to replace directors;
- the total voting power of any U.S. shareholder owning more than 9.9% of our common shares will be reduced below 9.9% of the total voting power of our common shares; and
- the affirmative vote of at least 75% of the directors then in office will be required to approve any merger, consolidation, amalgamation, continuation or similar transaction involving the Company.

There are regulatory limitations on the ownership and transfer of our common shares.

The transfer of ownership of our common shares may require the prior approval of certain regulators in the jurisdictions in which we operate, including Bermuda and the United Kingdom.

Common shares may be offered or sold in Bermuda only in compliance with the provisions of the Bermuda Companies Act and the Bermuda Investment Business Act 2003, which regulates the sale of securities in Bermuda. In addition, the BMA must approve all issues and transfers of shares of a Bermuda exempted company. However, the BMA has pursuant to its statement of June 1, 2005 given its general permission under the Exchange Control Act 1972 (and related regulations) for the issue and free transfer of shares (which includes our common shares) to and among persons who are non-residents of Bermuda for exchange control purposes as long as the shares are listed on an appointed stock exchange, which includes the New York Stock Exchange. This general permission would cease to apply if the Company were to cease to be so listed. Bermuda insurance law requires that any person who becomes a holder of at least 10%, 20%, 33% or 50% of the common shares of an insurance or reinsurance company or its parent company must notify the BMA in writing within 45 days of becoming such a holder or 30 days from the date they have knowledge of having such a holding, whichever is later. The BMA may, by written notice, object to a person holding 10%, 20%, 33% or 50% of our common shares if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce their shareholding in us and may direct, among other things, that the voting rights attaching to their shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offense.

Index

Except in connection with the settlement of trades or transactions entered into through the facilities of the New York Stock Exchange, our Board of Directors may generally require any shareholder or any person proposing to acquire our shares to provide the information required under our bye-laws. If any such shareholder or proposed acquirer does not provide such information, or if the Board of Directors has reason to believe that any certification or other information provided pursuant to any such request is inaccurate or incomplete, the Board of Directors may decline to register any transfer or to effect any issuance or purchase of shares to which such request is related. Although these restrictions on transfer will not interfere with the settlement of trades on the New York Stock Exchange, we may decline to register transfers in accordance with our bye-laws and Board of Directors resolutions after a settlement has taken place.

The FSA regulates the acquisition of ‘‘control’’ of any U.K. person, such as Marlborough, authorized under the FSMA. Similarly, Lloyd’s approval is required prior to acquiring control of a Lloyd’s managing agent. Any company or individual that (together with its or his associates) directly or indirectly acquires 10% or more of the shares of a U.K. authorized insurance company or its parent company, or is entitled to exercise or control the exercise of 10% or more of the voting power in such authorized insurance company or its parent company, would be considered to have acquired ‘‘control’’ for the purposes of FSMA, as would a person who had significant influence over the management of such authorized insurance company or its parent company by virtue of his shareholding or voting power in either. A purchaser of 10% or more of our ordinary shares would therefore be considered to have acquired ‘‘control’’ of Marlborough. Under FSMA, any person proposing to acquire ‘‘control’’ over a U.K. authorized insurance company must notify the FSA of his intention to do so and obtain the FSA’s prior approval. The FSA would then have three months to consider that person’s application to acquire ‘‘control.’’ In considering whether to approve such application, the FSA must be satisfied both that the acquirer is a fit and proper person to have such ‘‘control’’ and that the interests of consumers would not be threatened by such acquisition of ‘‘control.’’ Failure to make the relevant prior application would constitute a criminal offense, whereas a failure to obtain Lloyd's approval could result in Lloyd’s taking action against the relevant managing agent.

Lloyd’s also regulates the acquisition of control over Lloyd’s corporate members, such as Flagstone Corporate Name Limited. The test for acquisition of control is the same as that described above in relation to FSMA. Accordingly, any person who proposed to acquire 10% or more of the ordinary shares in Flagstone Corporate Name Limited or a parent company would have to obtain the prior approval of Lloyd’s.

We may repurchase your common shares without your consent.

Under our bye-laws and subject to Bermuda law, we have the option, but not the obligation, to require a shareholder to sell to us at fair market value the minimum number of common shares which is necessary to avoid or cure any adverse tax consequences or materially adverse legal or regulatory treatment to us, our subsidiaries or our shareholders if our Board of Directors reasonably determines, in good faith, that failure to exercise our option would result in such adverse consequences or treatment.

It may be difficult to enforce a judgment or effect service of process under Bermuda law on the Company or related persons.

The Company is a Bermuda exempted company limited by shares and it may be difficult to enforce judgments against it or its directors and executive officers.

The Company is incorporated pursuant to the laws of Bermuda and its business is based in Bermuda. In addition, several of our directors and most of our officers reside outside the United States, and all or a substantial portion of our assets and the assets of such persons are located in jurisdictions outside the United States. As such, it may be difficult or impossible to effect service of process within the United States upon us or those persons or to recover against us or them on judgments of U.S. courts, including judgments predicated upon civil liability provisions of the U.S. federal securities laws. Further, no claim may be brought in Bermuda against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial jurisdiction under Bermuda law and do not have force of law in Bermuda.

We have been advised by Bermuda counsel, that there is doubt as to whether the courts of Bermuda would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, as well as the experts named herein, predicated upon the civil liability provisions of the U.S. federal securities laws or original actions brought in Bermuda against us or such persons predicated solely upon U.S. federal securities laws. Further, we have been advised by Bermuda council that there is no treaty in effect between the United States and Bermuda providing for the enforcement of judgments of U.S. courts, and there are grounds upon which Bermuda courts may not enforce judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Bermuda courts as contrary to that jurisdiction's public policy. Because judgments of U.S. courts are not automatically enforceable in Bermuda, it may be difficult for you to recover against us based upon such judgments.

Index

In addition to and irrespective of jurisdictional issues, the Bermuda courts will not enforce a U.S. federal securities law that is either penal or contrary to public policy. It is the advice of our Bermuda counsel that an action brought pursuant to a public or penal law, the purpose of which is the enforcement of a sanction, power or right at the instance of the state in its sovereign capacity, will not be entertained by a Bermuda court. Certain remedies available under the laws of U.S. jurisdictions, including certain remedies under U.S. federal securities laws, would not be available under Bermuda law or enforceable in a Bermuda court, as they would be contrary to Bermuda public policy. Further, no claim may be brought in Bermuda against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial jurisdiction under Bermuda law and do not have force of law in Bermuda. A Bermuda court may, however, impose civil liability on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda law.

Risks Related to Tax Matters

U.S. persons who hold common shares may be subject to U.S. income taxation at ordinary income rates on undistributed earnings and profits.

Controlled Foreign Corporation Rules. If the Company or any of its subsidiaries is characterized as a controlled foreign corporation (" CFC") for an uninterrupted period of 30 days or more during a taxable year, then any United States person who owns, directly, indirectly through non-U.S. entities or constructively (under applicable constructive ownership rules), 10% or more of the shares of the Company or any of its subsidiaries (based on voting power) on the last day of the taxable year in which the Company or any of its subsidiaries is a CFC, whom we refer to as a " U.S. 10% shareholder, " would be required to include in its U.S. federal gross income for the taxable year, as income subject to taxation at ordinary income tax rates, its pro rata share of the relevant company's undistributed earnings and profits characterized as " subpart F income. " Subpart F income generally includes passive investment income (such as interest, dividends and certain rent or royalties) and subpart F insurance income, which includes certain insurance underwriting income and related investment income. Additionally, a U.S. 10% shareholder may be taxable at dividend rates on any gain realized on a sale or other disposition (including by way of repurchase or liquidation) of common shares to the extent of our current and accumulated earnings and profits attributable to such common shares.

Because of the anticipated dispersion of the Company's share ownership, provisions in our bye-laws that limit voting power and other factors, no United States person who owns common shares of the Company directly or indirectly through one or more non-U.S. entities should be treated as a U.S. 10% shareholder. We cannot be certain, however, that the Internal Revenue Service (" IRS") will not challenge the effectiveness of these provisions or that a court would not sustain such a challenge, in which case an investor in common shares could be adversely affected.

Related Person Insurance Income Rules. If (i) the gross "related person insurance income," or RPII, of any insurance subsidiary of the Company were to equal or exceed 20% of its gross insurance income in any taxable year and (ii) direct or indirect insureds (and related persons) were to own 20% or more of either the voting power or value of the common shares either directly or indirectly through entities, then a United States person owning any common shares directly or indirectly through non-U.S. entities on the last day of the relevant subsidiary's taxable year could be required to include in gross income for U.S. federal income tax purposes that person's share of the subsidiary's RPII for up to the entire taxable year, determined as if all such RPII were distributed proportionately only to such United States persons at that date, but limited by that person's share of the subsidiary's current-year earnings and profits as reduced by the person's share, if any, of certain prior-year deficits in earnings and profits attributable to the subsidiary's insurance business. Upon the sale or other disposition of any common shares, the person may also be subject to U. S. federal income tax at dividend rates to the extent of the holder's pro rata share of the subsidiary's undistributed earnings and profits, although we do not believe this should be the case since the Company will not be directly engaged in the insurance business.

We do not expect the gross RPII of any subsidiary of the Company to equal or exceed 20% of its gross insurance income in any taxable year for the foreseeable future and do not expect direct or indirect insureds (and related persons) to directly or indirectly through entities own 20% or more of either the voting power or value of the common shares, but we cannot be certain that this will be the case.

The RPII provisions have never been interpreted by the courts or the U.S. Treasury Department in final regulations. Regulations interpreting the RPII provisions of the Code exist only in proposed form. It is not certain whether these regulations will be adopted in their proposed form or what changes or clarifications might ultimately be made thereto or whether any such changes, as well as any interpretation or application of RPII by the IRS, the courts, or otherwise, might have retroactive effect. The Treasury Department has authority to impose, among other things, additional reporting requirements with respect to RPII. Accordingly, the meaning of the RPII provisions and the application thereof is uncertain.

Index

U.S. holders of common shares may be subject to U.S. income taxation at the highest marginal income tax rates applicable to ordinary income and be required to pay an interest charge.

Passive Foreign Investment Company Rules. If the Company was characterized as a passive foreign investment company, or PFIC, for any taxable year, U.S. holders of common shares generally would be subject to adverse U.S. federal income tax consequences for such year and each subsequent year including (i) taxation of any gain attributable to the sale or other disposition (including by way of repurchase or liquidation) of their common shares or any " excess distribution " with respect to their common shares at the highest marginal income tax rates applicable to ordinary income during the holder's holding period for the common shares and (ii) an interest charge on the deemed deferral of income tax, unless the holder properly elects to have the Company treated as a qualified electing fund and thus to include in gross income each year a pro rata share of our ordinary earnings and net capital gain for any year in which we constitute a PFIC.

The Company believes that it is not a PFIC because it (through its insurance subsidiaries) will engage predominantly in the active conduct of an insurance business. We cannot be certain, however, that the IRS or a court will concur that based on our activities and the composition of our income and assets that we are not a PFIC.

U.S. tax-exempt organizations that own common shares may recognize unrelated business taxable income.

A U.S. tax-exempt organization that owns any of our common shares will be required to treat certain subpart F insurance income, including RPII, as unrelated business taxable income. Although we do not believe that any United States holders, including U.S. tax-exempt organizations, should be allocated any subpart F insurance income, we cannot be certain that this will be the case. Potential U.S. tax-exempt investors are advised to consult their tax advisors.

We may be subject to taxation in the United States, which would negatively affect our results.

If the Company or its subsidiaries is considered to be engaged in a business in the United States, such company may be subject to current U.S. corporate income and branch profits taxes on the portion of such company's earnings that are effectively connected to its U.S. business, including premium income from U.S. sources (which represents a large portion of the reinsurance written by Flagstone) and certain related investment income. The Company and its subsidiaries are incorporated under the laws of Bermuda and other non-U.S. jurisdictions and intend to conduct substantially all of their activities outside the United States and, except as described below, to limit their U.S. contacts so that each of them will not be subject to material U.S. taxation on their income (other than excise taxes on reinsurance premium income attributable to reinsuring U.S. risks and U.S. withholding taxes on certain U.S. source investment income).

Changes in U.S. tax laws may be retroactive and could subject a U.S. holder of common shares to U.S. income taxation on the Company's undistributed earnings and to other adverse tax consequences.

The tax laws and interpretations regarding whether a company is engaged in a U.S. trade or business, is a CFC, is a PFIC or has RPII are subject to change, possibly on a retroactive basis. There are currently no regulations regarding the application of the PFIC provisions to an insurance company and the regulations regarding RPII are in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be forthcoming. We are not able to predict if, when or in what form such guidance will be provided or whether such guidance will have a retroactive effect. The tax treatment of non-U.S. insurance companies has been the subject of discussion in the U.S. Congress. We cannot assure you that future legislative action will not increase the amount of U.S. tax payable by us. If this happens, our financial condition and results of operations could be adversely affected.

We may be subject to taxation in the United Kingdom, which would negatively affect our results.

None of our companies, except for Flagstone Representatives Limited, Marlborough, Flagstone Corporate Name Limited, Marlborough Pension Trustee Limited, Flagstone Holdings (UK) Limited, Flagstone Services (UK) Limited, Syndicate 1861 and MJ Tullberg & Co. (the " Flagstone UK Group ") are incorporated or managed in the United Kingdom. Accordingly, none of our other companies should be treated as being resident in the United Kingdom for corporation tax purposes unless the central management and control of any such company is exercised in the United Kingdom. The concept of central management and control is indicative of the highest level of control of a company, which is wholly a question of fact. Each of our companies currently intends to manage its affairs so that none of our companies, apart from the Flagstone UK Group, are resident in the United Kingdom for tax purposes or carry on a trade through a permanent establishment in the United Kingdom. If any of our companies were treated as being resident in the United Kingdom for U.K. corporation tax purposes, or if any of our companies, other than the Flagstone UK Group, were to be treated as carrying on a trade in the United Kingdom through a branch or agency or of having a permanent establishment in the United Kingdom, our results of operations could be materially adversely affected.

Index

The Flagstone UK Group is subject to UK tax in respect of their world wide income and gains. Rates of taxation in the UK may change in the future. Any change in the basis or rate of UK corporation tax could materially affect the Company's ability to provide returns to shareholders.

Any reinsurance arrangements between Flagstone Corporate Name Limited and other Flagstone companies will be subject to the UK transfer pricing regime. Consequently, if the reinsurance is found not to be on arm's length terms and as a result a UK tax advantage is obtained, an adjustment will be required to compute UK taxable profits as if the reinsurance were on arm's length terms. Any transfer pricing adjustment could adversely impact the Company's tax charge.

Possible changes to the UK system of taxation of the foreign profits of companies continue to be under active consideration. As a result of a public consultation exercise, in November 2008, the UK Government announced some proposed changes, which are expected to be enacted in the Finance Act 2009. These include:

- an exemption for foreign dividends received by large and medium sized groups on a wide range of ordinary shareholdings, subject to certain targeted anti-avoidance rules;

- a restriction on the deductibility of interest costs in computing taxable profits for UK tax purposes, whereby UK tax deductions for intra-group financing expenses will be restricted by reference to (if less) the amount of external finance expenses of the non-UK members of the group, net of the worldwide external finance income of the group as a whole. This so-called "worldwide debt cap" is expected to be subject to some exceptions for, inter alia, certain borrowings by insurance companies to fund working capital and regulatory capital.

In addition, HM Treasury is continuing to consult on possible changes to the UK controlled foreign companies regime. Any of these proposed or possible changes may impact on the Flagstone UK Group's tax charge.

We may be subject to taxation in Switzerland which would negatively affect our results.

None of our companies, except for Flagstone Suisse and Haverford Suisse, is incorporated or managed in Switzerland. Accordingly, none of our other companies should be liable for Swiss corporation taxation unless it carries on business through a permanent establishment in Switzerland. From a Swiss tax perspective, a permanent establishment is a fixed place of business through which a company performs business activities that are considered as being quantitatively and qualitatively significant by the tax authorities, and may include a branch, office, agency or place of management. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from Flagstone Suisse and Haverford Suisse, will carry on business through a permanent establishment in Switzerland. If any of our companies were to be treated as carrying on business in Switzerland through a branch or agency or of having a permanent establishment in Switzerland, our results of operations could be materially adversely affected.

We may be subject to taxation in Canada which would negatively affect our results.

None of our companies, except for Flagstone Management Services (Halifax) Limited, or Flagstone Halifax, is resident in Canada for corporate tax purposes. Accordingly, none of our other companies should be liable for Canadian corporate tax unless it is determined to be carrying on business in Canada. Canada applies both a common law test and a statutory test to determine whether a non-resident is carrying on business in Canada. The common law test looks to where the contracts of the business are made, and the location of operations from which profits arise. The statutory test extends the concept of carrying on business to include a transaction by which a non-resident solicits orders or offers anything for sale in Canada through an agent or servant, whether the contract or transaction is to be completed inside or outside Canada or partly inside or outside Canada. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from Flagstone Halifax, will be deemed to be carrying on business in Canada. If any of our companies were to be treated as carrying on business in Canada, our results of operations could be materially adversely affected.

We may be subject to taxation in India which would negatively affect our results.

None of our companies, except for Flagstone (India), should be treated as being resident in India for corporate tax purposes. Accordingly, none of our other companies should be liable for corporate tax in India unless it receives or is deemed to receive income, from whatever source derived, in India or it has income that arises or accrues (or is deemed to arise or accrue) in India. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from Flagstone (India), receives or is deemed to receive income in India or has income that arises or accrues in India for purposes of corporate tax in India, including Flagstone Suisse which has a marketing office in Mumbai, the activities of which, however, are not subject to taxation in India. If any of our companies were to be treated as receiving income in India or earning income that arises or accrues in India, our results of operations could be materially adversely affected.

Index

Flagstone (India) is registered under the software technology park of India, or STPI, Scheme. Tax incentives associated with businesses which are registered under the STPI Scheme generally provide a complete exemption from Indian tax on business income generated through these operations, and Flagstone (India) has been granted a complete tax holiday valid through March 31, 2010 subject to compliance with the applicable requirements of the Income Tax Act, 1961 of India. Under the STPI tax holiday, the entire income of the Indian operations from services provided to Flagstone and other companies based outside India is exempt from tax in India through the fiscal year ending March 31, 2010 subject to compliance with the applicable requirements of the Income Tax Act, 1961 of India. However, Flagstone (India) is subject to Minimum Alternate Tax on its book profits, according to section 115JB of the Income Tax Act, 1961 of India.

We may be subject to taxation in the United States Virgin Islands which would negatively affect our results.

None of our Companies is incorporated or managed in the United States Virgin Islands ("USVI"), and none of our companies, except for Island Heritage, operates a trade or business in the USVI. Accordingly, none of our companies, except for Island Heritage, should be subject to taxation in the USVI. If the Company or any of its subsidiaries is considered to be engaged in a trade business in the USVI, such company may be subject to current USVI corporate or branch profits taxes on the portion of such company's earnings effectively connected to the USVI business.

We may become subject to taxation in Bermuda which would negatively affect our results.

Flagstone Reinsurance Holdings Limited has received an assurance from the Bermuda Minister of Finance under The Exempted Undertakings Tax Protection Act 1966 of Bermuda that if there is enacted in Bermuda any legislation imposing tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax shall not be applicable to us or to any of our operations or common shares, debentures or other obligations until March 28, 2016, except in so far as such tax applies to persons ordinarily resident in Bermuda or is payable by us in respect of real property owned or leased by us in Bermuda. The duration of the assurance granted to the us under the Exempted Undertakings Tax Protection Act, 1966 is limited and expires on March 28, 2016. Tax policy and legislation in Bermuda could change in the future (as is the case in other jurisdictions) and as such we cannot give any guarantee as to whether the current tax treatment afforded to us would continue after March 28, 2016. If we were to become subject to taxation in Bermuda, our results of operations could be adversely affected.

The impact of Bermuda's letter of commitment to the Organization for Economic Cooperation and Development to eliminate harmful tax practices is uncertain and could adversely affect our tax status in Bermuda.

The Organization for Economic Cooperation and Development, or the OECD, has published reports and launched a global dialogue among member and non-member countries on measures to limit "harmful" tax competition. These measures are largely directed at counteracting the effects of low-tax regimes in countries around the world. In the OECD's report dated April 18, 2002 and updated as at June 2004 and November 2005 via a " Global Forum", Bermuda was not listed as an uncooperative tax haven jurisdiction because it had previously signed a letter committing itself to eliminate harmful tax practices and to embrace international tax standards for transparency, exchange of information and the elimination of any aspects of the regimes for financial and other services that attract business with no substantial domestic activity. We are not able to predict what changes will arise from the commitment or whether such changes will subject us to additional taxes.

We may be subject to taxation in South Africa, which would negatively affect our results.

None of our companies, except for Flagstone Africa, is incorporated or managed in South Africa. Accordingly, none of our other companies should be liable for income tax in South Africa unless it receives or is deemed to receive income, from whatever source derived, in South Africa or it has income that arises or accrues (or is deemed to arise or accrue) in South Africa. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from Flagstone Africa, receives or is deemed to receive income in South Africa or has income that arises or accrues in South Africa for purposes of income tax in South Africa. If any of our companies were to be treated as receiving income in South Africa or earning income that arises or accrues in South Africa, our results of operations could be materially adversely affected.

Profits realised by Flagstone Africa may be distributed to its shareholders by means of dividends subject of course to compliance with the relevant insurance legislation applicable in South Africa. The transfer of dividends, profits and/or income distributions from quoted companies, non-quoted companies and other entities, to non-residents in proportion to their percentage shareholding and/or ownership is permitted by the South African Reserve Bank.

Index

South Africa requires that any subsidiary of ours which is a resident of South Africa must withhold certain taxes on any dividends made by that subsidiary to us.

We may be subject to taxation in Luxembourg which would negatively affect our results.

None our companies, except for Flagstone Capital Management Luxembourg SA SICAF SIF and Flagstone Finance SA is incorporated or carries on business through a permanent establishment in Luxembourg. Accordingly, none of our other companies should be subject to taxation in Luxembourg. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from Flagstone Capital Management Luxembourg SA SICAF SIF and Flagstone Finance SA, will carry on business through a permanent establishment in Luxembourg. If any of our companies were to be treated as carrying on business in Luxembourg through a branch or agency or of having a permanent establishment in Luxembourg, our results of operations could be materially adversely affected.

We may be subject to taxation in Cyprus which would negatively affect our results.

None our companies, except for Flagstone Alliance, Alliance Insurance Agents Limited, Alliance Forfalting Limited, Flagstone Reinsurance Agency Limited, and Limassol Power Plant Limited (the “Cyprus Group”), is incorporated or managed in Cyprus or carries on business through a permanent establishment in Cyprus. Accordingly, none of our other companies should be subject to taxation in Cyprus. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from the Cyprus Group will carry on business through a permanent establishment in Cyprus. If any of our companies were to be treated as carrying on business in Cyprus through having a permanent establishment in Cyprus, our results of operations could be materially adversely affected.

Index

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We currently occupy office space in Hamilton, Bermuda. In addition, we own office space in Hyderabad, India and lease office space in Halifax, Canada; London, England; Martigny, Switzerland; San Juan, Puerto Rico; Dubai, UAE; Johannesburg, South Africa; Limassol, Republic of Cyprus; George Town, Grand Cayman, Cayman Islands; Luxembourg, Luxembourg; and Douglas, Isle of Man. We are constructing new office buildings in Martigny and Luxembourg. While we believe that for the foreseeable future our current office spaces combined with the projects in Switzerland and Luxembourg will be sufficient for us to conduct our operations, we anticipate future growth and we will likely need to expand into additional facilities to accommodate this growth.

ITEM 3. LEGAL PROCEEDINGS

As of December 31, 2009, the Company was not a party to any litigation or arbitration that it believes could have a material adverse effect on the financial condition or business of the Company. We anticipate that, similar to the rest of the insurance and reinsurance industry, we will be subject to litigation and arbitration in the ordinary course of business of our business operations. In addition to claims litigation, the Company and its subsidiaries may be subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on reinsurance treaties.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of shareholders of the Company during the fourth quarter of the fiscal year ended December 31, 2009.

Index

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

The common shares of the Company are listed on the New York Stock Exchange under the symbol “FSR”. The following table presents, for the periods indicated, the high and low prices per share of our common shares as reported for New York Stock Exchange composite transactions:

	2009		2008	
	High	Low	High	Low
First quarter	$9.87	$7.24	$14.26	$11.96
Second quarter	$10.54	$7.64	$13.00	$11.67
Third quarter	$11.47	$9.07	$13.34	$10.27
Fourth quarter	$12.45	$10.30	$11.10	$7.26

At February 22, 2010, the number of record holders of the common shares of the Company was 25.

Dividends

The Company paid four quarterly cash dividends in 2009 and four in 2008, at the rate of $0.04 per common share. Subject to the approval of our Board of Directors, we currently expect to continue to pay a quarterly cash dividend of approximately $0.04 per common share. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, rating agency guidelines, legal, tax, regulatory and any contractual restrictions on the payment of dividends and any other factors our Board of Directors deems relevant.

As a holding company, our principal source of income is dividends or other permissible payments from our subsidiaries. The ability of our subsidiaries to pay dividends is limited by applicable laws and regulations of the various countries in which we operate. See Item 1, “Business—Regulation.”

Repurchases of Equity Securities

On September 22, 2008, the Company announced that its Board of Directors had approved the potential repurchase of company stock. The buyback program, which does not have a specific expiration date, allows the Company to purchase, from time to time, our outstanding stock up to a value $60.0 million. Purchases under the buyback program are made with cash, at market prices, through a brokerage firm. There were no share repurchases during the fourth quarter of 2009. As at December 31, 2009, approximately $33.6 million of repurchases remain available under the buyback program.

Recent Sales of Unregistered Securities

There have been no recent sales of unregistered securities.

50

Index

Performance Graph

The following graph compares the cumulative return on our common shares including reinvestment of our dividends on our common shares to such return for the Standard & Poor's ("S&P") 500 Composite Stock Price Index ("S&P 500"), S&P Supercomposite Property-Casualty Index ("S&P P/C") and AM Best's Global Reinsurance Stock Index ("AM Best Global Re"), for the period commencing March 30, 2007, the date of our initial IPO, through December 31, 2009, assuming $100.00 was invested on March 30, 2007. Each measurement point on the graph below represents the cumulative shareholder return as measured by the last sale price at the end of each quarter during the period from March 30, 2007 through December 31, 2009. As depicted in the graph below, during this period, the cumulative return was (1) (18.8%) on our common shares; (2) (21.5%) for the S&P 500; (3) (31.7%) for the S&P P/C; and (4) (29.8%) for the AM Best Global Re.

Equity Compensation Plans

The information required by this Item is incorporated by reference to Item 12, "Security Ownership of Certain Beneficial Owners, Management and Related Stockholders Matters" in this Form 10-K.

Index

ITEM 6. SELECTED FINANCIAL DATA

Statement of operations data for the years ended December 31, 2009, 2008 and 2007 and balance sheet data as of December 31, 2009 and 2008 are derived from our audited consolidated financial statements included in Item 8, "Financial Statements and Supplementary Data" in this Form 10-K, which have been prepared in accordance with U.S. GAAP.

The following selected financial data should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related notes, under Item 8.

	Year ended December 31, 2009	Year ended December 31, 2008	Year ended December 31, 2007	Year ended December 31, 2006	Period October 4, 2005 through December 31, 2005
	($ in thousands, except share amounts, per share amounts)				
Summary Statement of Operations Data:					
Net premiums written	$ 792,469	$ 694,698	$ 527,031	$ 282,498	$ -
Net income (loss)	$ 242,192	$ (187,302)	$ 167,922	$ 152,338	$ (12,384)
Net income (loss) per common share outstanding—Basic	$ 2.87	$ (2.20)	$ 2.05	$ 2.17	$ (0.22)
Dividends declared per common share	$ 0.16	$ 0.16	$ 0.08	$ -	$ -

	As at December 31, 2009	As at December 31, 2008	As at December 31, 2007	As at December 31, 2006	As at December 31, 2005
	($ in thousands, except share amounts)				
Summary Balance Sheet Data:					
Total investments, cash and cash equivalents and restricted cash	$ 1,945,320	$ 1,700,844	$ 1,865,698	$ 1,018,126	$ 548,255
Total assets	$ 2,566,768	$ 2,215,970	$ 2,103,773	$ 1,144,502	$ 548,356
Loss and loss adjustment expense reserves	$ 480,660	$ 411,565	$ 180,978	$ 22,516	$ -
Long term debt	$ 252,402	$ 252,575	$ 264,889	$ 137,159	$ -
Shareholders' equity	$ 1,211,018	$ 986,013	$ 1,210,485	$ 864,519	$ 547,634

As of January 1, 2007, we adopted SFAS No. 157, "Fair Value Measurements" and SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" (currently FASB Accounting Standards Codification Topics on Fair Value Measurements and Disclosures and on Financial Instruments (see Item 8, Note 1 "Significant Accounting Policies" for additional details regarding the adoption of the FASB Accounting Standards Codification)). As a result, substantially all of our investments are now carried at fair value with changes in fair value being reported as net realized and unrealized gains (losses) in our statement of operations. Prior to the adoption of these Topics, our available for sale investments were carried at fair value with changes in fair value with changes therein reported as a component of other comprehensive income.

On January 12, 2007, we began to consolidate the operations of Mont Fort in accordance with the FASB ASC Topic on Consolidation.

On July 1, 2007, we began to consolidate the operations of Island Heritage in accordance with the FASB ASC Topic on Consolidation.

On July 1, 2008, we began to consolidate the operations of Flagstone Africa, on October 1, 2008, we began to consolidate the operations of Flagstone Alliance and on November 18, 2008, we began to consolidate the operations of Marlborough in accordance with the FASB ASC Topic on Consolidation.

Index

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial condition as at December 31, 2009 and 2008 and our results of operations for the years ended December 31, 2009, 2008 and 2007. All amounts in the following tables are expressed in thousands of U.S. dollars, except share amounts, per share amounts and percentages. This discussion should be read in conjunction with our audited consolidated financial statements and related notes included in Item 8 of this Form 10-K. Some of the information contained in this discussion and analysis is included elsewhere in this document, including information with respect to our plans and strategy for our business, and includes forward-looking statements that involve risks and uncertainties. Please see the "Cautionary Statement Regarding Forward-Looking Statements" for more information. You should review Item 1A, "Risk Factors" for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements.

Executive Overview

We are a global reinsurance and insurance company. Effective January 1, 2009, as a result of our acquisition of Marlborough Underwriting Agency Limited ("Marlborough"), the managing agency for Lloyd's Syndicate 1861, management views the Company as being organized into three business segments: Reinsurance, Lloyd's and Insurance. Through our Reinsurance segment, we write primarily property, property catastrophe and short-tail specialty and casualty insurance and reinsurance. Through our Lloyd's segment, we write primarily property and short-tail specialty and casualty reinsurance focused on the energy, hull, cargo, marine liability, engineering, and aviation business sectors. Through our Insurance segment, comprised of Island Heritage, we primarily write property insurance for homes, condominiums and office buildings in the Caribbean region.

We were formed by Haverford, a company controlled and capitalized by Mark Byrne, the Executive Chairman of our Board of Directors, and David Brown, our Chief Executive Officer, and we commenced operations in December 2005. On March 30, 2007, the Company's common shares began trading on the New York Stock Exchange.

The various components of our operating model are unified through our centralized management in Hamilton, Bermuda; Martigny, Switzerland; London, United Kingdom and integrated through our use of advanced technology. Flagstone Suisse is based in Martigny in the canton of Valais, Switzerland. We believe that for many lines of business we can be more effective in marketing and attracting continental European business in Switzerland than in Bermuda, and that for many clients, a Swiss counterparty would be preferred. Through this local presence, we are in a position to closely follow and respond effectively to the changing needs of the various European insurance markets. Flagstone Suisse is licensed by the Swiss Financial Market Supervisory Authority, or FINMA, in Switzerland. Flagstone Suisse is also licensed as a permit company registered in Bermuda and is registered as a Class 4 insurer under the Bermuda Insurance Act and complements our Swiss based underwriters with a separately staffed Bermuda underwriting platform. On November 10, 2009, the Company acquired the remaining 35% of the outstanding common shares of Flagstone Reinsurance Africa Limited ("Flagstone Africa"), formerly known as Imperial Re, a South African reinsurer who primarily writes multiple lines of reinsurance in sub-Saharan Africa. We had previously acquired a 65% majority shareholding of Imperial Re in 2008. For further information on these acquisitions refer to Note 3 "Acquisitions and Dispositions" in Item 8 - Financial Statements and Supplementary Data of this Form 10-K. Our research and development efforts and part of our catastrophe modeling and risk analysis team, and part of finance and accounting are based in Hyderabad, India, and our international reinsurance marketing operations are conducted from London, England. Our computer data center is in our Halifax, Canada office, where we also run support services such as accounting, claims, application support, administration, risk modeling, proprietary systems development and high performance computing. The result is an operating platform which provides significant efficiencies in our operations and access to a large and highly qualified staff at a relatively low cost.

Index

Because we have a limited operating history, period to period comparisons of our results of operations are limited and may not be meaningful in the near future. Our financial statements are prepared in accordance with U.S. GAAP and our fiscal year ends on December 31. Since a substantial portion of the reinsurance we write provides protection from damages relating to natural and man-made catastrophes, our results depend to a large extent on the frequency and severity of such catastrophic events, and the specific insurance coverages we offer to clients affected by these events. This may result in volatility in our results of operations and financial condition. In addition, the amount of premiums written with respect to any particular line of business may vary from quarter to quarter and year to year as a result of changes in market conditions.

We measure our financial success through long term growth in diluted book value per share plus accumulated dividends measured over intervals of three years, which we believe is the most appropriate measure of the performance of the Company, a measure that focuses on the return provided to the Company's common shareholders. Diluted book value per share is obtained by dividing shareholders' equity by the number of common shares and common share equivalents outstanding including all potentially dilutive securities such as the warrant, performance share units and restricted share units.

We derive our revenues primarily from net premiums earned from the reinsurance and insurance policies we write, net of any retrocessional or reinsurance coverage purchased, net investment income from our investment portfolio, and fees for services provided. Premiums are generally a function of the number and type of contracts we write, as well as prevailing market prices. Premiums are normally due in installments and earned over the contract term, which ordinarily is twelve or twenty four months.

Income from our investment portfolio is primarily comprised of interest on fixed maturity, short term investments and cash and cash equivalents, dividends and proportionate share of net income for those investments accounted for on an equity basis, net realized and unrealized gains (losses) on our investment portfolio including our derivative positions, net of investment expenses.

Our expenses consist primarily of the following types: loss and loss adjustment expenses ("LAE") incurred on the policies of reinsurance and insurance that we sell; acquisition costs which typically represent a percentage of the premiums that we write; general and administrative expenses which primarily consist of salaries, benefits and related costs, including costs associated with awards under our Performance Share Unit ("PSU") and Restricted Share Unit ("RSU") Plans, and other general operating expenses; interest expenses related to our debt obligations; and noncontrolling interest, which represents the interest of external parties with respect to the net income of Mont Fort, Island Heritage, and Flagstone Africa. We are also subject to taxes in certain jurisdictions in which we operate; however, since the majority of our income to date has been earned in Bermuda, a non-taxable jurisdiction, the tax impact on our operations has historically been minimal. As a result of the merger between Flagstone Reinsurance Limited and Flagstone Suisse on September 30, 2008, we expect our tax expense to increase to approximate our effective Swiss Federal tax rate of approximately 8% on the portion of underwriting profits, if any, generated by Flagstone Suisse, excluding the underwriting profits generated in Bermuda through the Flagstone Suisse branch office.

As a result of the acquisition of Marlborough, the managing agency for Lloyd's Syndicate 1861, in November 2008, the Company established a new reporting segment which took effect January 1, 2009, when Syndicate 1861 began writing business for the benefit of the Company. The Company reports its results to the chief operating decision maker based on three reporting segments: Reinsurance, Lloyd's and Insurance. The Company regularly reviews its financial results and assesses performance on the basis of these three operating segments.

Those segments are more fully described as follows:

Reinsurance

Our Reinsurance segment has three main units:

(1) Property Catastrophe Reinsurance. Property catastrophe reinsurance contracts are typically “all risk” in nature, meaning that they protect against losses from earthquakes and hurricanes, as well as other natural and man-made catastrophes such as tornados, wind, fires, winter storms, and floods (where the contract specifically provides for coverage). Losses on these contracts typically stem from direct property damage and business interruption. To date, property catastrophe reinsurance has been our most important product. We write property catastrophe reinsurance primarily on an excess of loss basis. In the event of a loss, most contracts of this type require us to cover a subsequent event and generally provide for a premium to reinstate the coverage under the contract, which is referred to as a “reinstatement premium”. These contracts typically cover only specific regions or geographical areas, but may be on a worldwide basis.

Index

(2) Property Reinsurance. We also provide reinsurance on a pro rata share basis and per risk excess of loss basis. Per risk reinsurance protects insurance companies on their primary insurance risks on a single risk basis, for example, covering a single large building. Generally, our property per risk and pro rata business is written with loss limitation provisions, such as per occurrence or per event caps, which serve to limit exposure to catastrophic events.

(3) Short-tail Specialty and Casualty Reinsurance. We also provide short-tail specialty and casualty reinsurance for risks such as aviation, energy, accident and health, satellite, marine and workers' compensation catastrophe. Generally, our short-tail specialty and casualty reinsurance is written with loss limitation provisions.

Lloyd's

Our Lloyd's segment includes the business generated through the Lloyd's Syndicate 1861 and Marlborough. Syndicate 1861 primarily provides property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. Marlborough generates fee income for the provision of services to Syndicates and third parties.

Insurance

Our Insurance segment includes insurance business generated through Island Heritage. Island Heritage is a property insurer based in the Cayman Islands which is primarily in the business of insuring homes, condominiums and office buildings in the Caribbean region.

Critical Accounting Estimates

It is important to understand our accounting policies in order to understand our financial position and results of operations. Our audited consolidated financial statements contain certain amounts that are inherently subjective in nature and have required management to make assumptions and best estimates to determine the reported values. If events or other factors, including those described in Item 1A, "Risk Factors," cause actual events or results to differ materially from management's underlying assumptions or estimates, there could be a material adverse effect on our results of operations, financial condition and liquidity.

The following are the accounting estimates that, in management's judgment, are critical due to the judgments, assumptions and uncertainties underlying the application of those policies and the potential for results to differ from management's assumptions.

Loss and Loss Adjustment Expense Reserves

Because a significant amount of time can lapse between the assumption of a risk, the occurrence of a loss event, the reporting of the event to an insurance company (the primary company or the cedent), the subsequent reporting to the reinsurance company (the reinsurer) and the ultimate payment of the claim by the reinsurer, our liability for loss reserves is based largely upon estimates. We believe that the most significant accounting judgment we make is our estimate of loss reserves.

Under U.S. GAAP, we are not permitted to establish loss reserves, which include case and Incurred But Not Reported ("IBNR") reserves, until the occurrence of an event which may give rise to a claim. As a result, only loss reserves applicable to losses incurred up to the reporting date are established, with no allowance for the establishment of loss reserves to account for expected future losses. Claims arising from future catastrophic events can be expected to require the establishment of substantial loss reserves from time to time.

Our loss reserve estimates do not represent an exact calculation of liability. Rather, they represent estimates of our expectations of the ultimate settlement and administration costs of claims incurred. These estimates are based upon actuarial and statistical projections and on our assessment of currently available data, predictions of future developments and estimates of future trends in claims severity and frequency and other variable factors such as inflation. Establishing an appropriate level of our loss reserve estimates is an inherently uncertain process. It is likely that the ultimate liability will be greater or less than these estimates and that, at times, this variance will be material.

For a breakdown of reserves for losses and loss adjustment expenses refer to Note 7 “Loss and Loss Adjustment Expense Reserves” and Note 8 “Reinsurance” in Item 8, “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K.

Index

As we are primarily a broker market reinsurer, reserving for our business can involve added uncertainty because we depend on information from ceding companies. There is a time lag inherent in reporting information from the primary insurer to us and ceding companies have differing reserving practices. The information we receive varies by cedent and broker and may include paid losses and estimated case reserves. We may also receive an estimated provision for IBNR reserves, especially when the cedent is providing data in support of a request for collateral for loss reserves ceded. The information received from ceding companies is typically in the form of bordereaux, which are reports providing premium or loss data with respect to identified risks, broker notifications of loss and/or discussions with ceding companies or their brokers. This information can be received on a monthly, quarterly or transactional basis. As a reinsurer, our reserve estimates may be inherently less reliable than the reserve estimates of our primary insurer cedents.

Because a significant component of our business is generally characterized by loss events of low frequency and high severity reporting of claims in general tends to be prompt (as compared to reporting of claims for casualty or other “long-tail” lines of business). However, the timing of claims reporting can vary depending on various factors, including: the nature of the event (e.g., hurricane, earthquake and hail); the quality of the cedent’s claims management and reserving practices; the geographic area involved; and whether the claims arise under reinsurance or insurance contracts for primary companies, or reinsurance of other reinsurance companies. Because the events from which catastrophe claims arise are typically prominent, public occurrences, we are often able to use independent reports of such events to augment our loss reserve estimation process. Because of the degree of reliance that we place on ceding companies for claims reporting, the associated time lag, the low frequency and high severity nature of the business we underwrite and the varying reserving practices among ceding companies, our reserve estimates are highly dependent on management’s judgment and are therefore subject to significant variability from one quarter to another. During the loss settlement period, additional facts regarding individual claims and trends may become known, and current laws and case law may change.

For reinsurance written on an excess of loss basis, which represents approximately 72.0%, 65.0% and 68.0% of the premiums we wrote for the years ended December 31, 2009, 2008 and 2007, respectively, our exposure is limited by the fact that most treaties have a defined limit of liability arising from a single loss event. Once the limit has been reached, we have no further exposure to additional losses from that treaty for the same loss event. For reinsurance on a pro rata basis, we typically have event caps so these liabilities are contained.

The Company’s actuarial group performs a quarterly loss reserve analysis. This analysis incorporates specific exposures, loss payment and reporting patterns and other relevant factors. This process involves the segregation of risks between catastrophic and non-catastrophic risks to ensure appropriate treatment.

For our property catastrophe policies which comprise 47.4%, 58.5% and 65.6% of our total gross premiums written for the years ended December 31, 2009, 2008 and 2007, respectively, and other catastrophe policies, we initially establish our loss reserves based on loss payments and case reserves reported by ceding companies. We then add to these case reserves our estimates for IBNR. To establish our IBNR estimates, in addition to the loss information and estimates communicated by cedents, we use industry information, knowledge of the business written by us, management’s judgment and general market trends observed from our underwriting activities.

When a catastrophic event occurs, we first determine which treaties may be affected using our zonal monitoring of exposures. We contact the respective brokers and ceding companies involved with those treaties, to determine their estimate of involvement and the extent to which the reinsurance program is affected. We may also use our computer-based vendor and proprietary modeling systems to measure and estimate loss exposure under the actual event scenario, if available. Although the loss modeling systems assist with the analysis of the underlying loss, and provide us with information and the ability to perform an enhanced analysis, the estimation of claims resulting from catastrophic events is inherently difficult because of the variability and uncertainty of property and other catastrophe claims and the unique characteristics of each loss.

Index

For non-catastrophe business, we utilize a variety of standard actuarial methods in our analysis. The selections from these various methods are based on the loss development characteristics of the specific line of business and specific contracts. The actuarial methods we use to perform our quarterly contract by contract loss reserve analysis include:

Paid Loss Development Method. We estimate ultimate losses by calculating past paid loss development factors and applying them to exposure periods with further expected paid loss development. The paid loss development method assumes that losses are paid at a consistent rate. It provides an objective test of reported loss projections because paid losses contain no reserve estimates. For many coverages, claim payments are made very slowly and it may take years for claims to be fully reported and settled. This method is a key input into the Bornheutter-Ferguson paid loss method discussed below.

Reported Loss Development Method. We estimate ultimate losses by calculating past reported loss development factors and applying them to exposure periods with further expected reported loss development. Since reported losses include payments and case reserves, changes in both of these amounts are incorporated in this method. This approach provides a larger volume of data to estimate ultimate losses than paid loss methods. Thus, reported loss patterns may be less varied than paid loss patterns, especially for coverages that have historically been paid out over a long period of time but for which claims are reported relatively early and case loss reserve estimates established. This method is a key input into the Bornheutter-Ferguson reported loss method discussed below.

Expected Loss Ratio Method. To estimate ultimate losses under the expected loss ratio method, we multiply earned premiums by an expected loss ratio. The expected loss ratio is selected utilizing industry data, historical company data and professional judgment. The Company uses this method for lines of business and contracts where there are no historical losses or where past loss experience is not credible.

Bornheutter-Ferguson Paid Loss Method. The Bornheutter-Ferguson paid loss method is a combination of the paid loss development method and the expected loss ratio method. The amount of losses yet to be paid is based upon the expected loss ratios. These expected loss ratios are modified to the extent paid losses to date differ from what would have been expected to have been paid based upon the selected paid loss development pattern. This method avoids some of the distortions that could result from a large development factor being applied to a small base of paid losses to calculate ultimate losses. This method will react slowly if actual loss ratios develop differently because of major changes in rate levels, retentions or deductibles, the forms and conditions of reinsurance coverage, the types of risks covered or a variety of other changes.

Bornheutter-Ferguson Reported Loss Method. The Bornheutter-Ferguson reported loss method is similar to the Bornheutter-Ferguson paid loss method with the exception that it uses reported losses and reported loss development factors. The Company uses this method for lines of business and contracts where there are limited historical paid and reported losses.

Initially selected expected loss ratios are used while the exposure is earning. We assign payment and reporting patterns for attritional business to use with paid development, incurred development, and paid and reported Bornheutter-Ferguson methods. We maintain an expected loss ratio through the exposure earning period followed by selections of Bornheutter-Ferguson paid and reported during intermediate reporting periods. Later, through the development, we revert from Bornheutter-Ferguson paid and reported to paid and reported development methods to fully reflect account experience. This entails a reasonable evolution from initial expected loss ratios to full account experience through a tempering phase of Bornheutter-Ferguson weightings. We maintain a conservative bias toward the selection of Bornheutter-Ferguson paid and reported methods on accounts with losses paid or reported earlier while holding expected loss ratios on loss free accounts where no paid or reported losses have yet occurred early in the account’s maturation.

We reaffirm the validity of the assumptions we use in the reserving process on a quarterly basis during our internal review process. During this process, the Company’s actuaries verify that the assumptions continue to form a sound basis for projection of future liabilities.

Index

Our critical underlying assumptions are:

(i) the cedent's business practices will proceed as in the past with no material changes either in submission of accounts or cash flow receipts;
(ii) case reserve reporting practices, particularly the methodologies used to establish and report case reserves, are unchanged from historical practices;
(iii) for the expected loss ratio method, ultimate losses vary proportionately with premiums;
(iv) historical levels of claim inflation can be projected into the future;
(v) in cases where benchmarks are used, they are derived from the experience of similar business; and
(vi) we form a credible initial expectation of the ultimate loss ratios through a review of pricing information supplemented by qualitative information on market events.

All of our critical assumptions can be thought of as key assumptions in the sense that they can have a material impact on the adequacy of our reserves. In general, the various actuarial techniques we use assume that loss reporting and payment patterns in the future can be estimated from past experience. To the extent that any of the above assumptions is not valid, future payment and reporting patterns could differ from historical experience. In practice it is difficult to be precise on the effect of each assumption. However, due to a greater potential for estimation error, and thus greater volatility, our reserves may be more sensitive to the effects of deviations from assumptions (iv), (v) and (vi) than the other assumptions.

Our reserving methodology, as discussed above, uses a loss reserving model that calculates a point estimate for the Company's ultimate losses, as opposed to a methodology that develops a range of estimates. The Company then uses this point estimate, deducting cumulative paid claims and current case reserves, to record its estimate of IBNR. The Company employs sensitivity analysis in selecting our point estimate, which involves varying industry loss estimates for catastrophe events and estimated loss ratio for non-catastrophe business.

Our reserve estimates for reported catastrophe losses are based upon industry loss estimates and our modeled loss scenarios. Because any catastrophe event loss reserve estimate is simply an insurer's estimate of its ultimate liability, and because there are numerous factors which affect reserves but cannot be determined with certainty in advance, our ultimate payments will vary, perhaps materially, from our initial estimate of reserves. Therefore, because of these inherent uncertainties, we have developed a reserving philosophy which attempts to incorporate prudent assumptions and estimates in making our loss selection based on both the potential for adverse development and historical experience among industry participants. Our reserving philosophy does not include an explicit adjustment to our point estimate of ultimate losses. There may be instances in the future in which it would be beneficial to develop a range of estimates, but at present, due to our short operating history, we have not found it necessary to do so.

For our non-catastrophe business, the key factors used to arrive at our best estimate of loss and loss adjustment expense reserves are the expected loss ratios, rate of loss cost inflation, selection of benchmarks and reported and paid loss emergence patterns. Our reporting patterns and expected loss ratios were based on either benchmarks or historical reporting patterns. The benchmarks selected are those that we believe are most similar to our underwriting business. There was no material change in any of these key factors during the year ended December 31, 2009.

Although we believe that we are prudent in our assumptions and methodologies, we cannot be certain that our ultimate payments will not vary, perhaps materially, from the estimates we have made. If we determine that adjustments to an earlier estimate are appropriate, such adjustments are recorded in the quarter in which they are identified. The establishment of new reserves, or the adjustment of reserves for reported claims, could result in significant upward or downward changes to our financial condition or results of operations in any particular period. We regularly review and update these estimates using the most current information available to us. Our estimates are reviewed annually by an independent actuary in order to provide additional insight into the reasonableness of our loss reserves.

Index

During the year ended December 31, 2009, the losses on our catastrophe business were primarily from a series of small catastrophe events and one significant event, floods in Ireland ($13.6 million). During the year ended December 31, 2008, the significant losses on our catastrophe business were as follows: Hurricane Ike ($158.4 million), Hurricane Gustav ($14.5 million), Chinese winter storms ($18.2 million) and the U.S. Memorial Day Weekend storms ($11.1 million). During the year ended December 31, 2007, the significant losses on our catastrophe business were as follows: United Kingdom floods in June and July ($38.0 million); European Windstorm Kyrill ($32.4 million); New South Wales (Australia) floods ($18.5 million); three satellite losses during 2007 ($13.8 million); and the Sydney Hailstorm ($11.4 million). Because we expect a small volume of large claims, we believe the variance of our catastrophe related loss ratio could be relatively wide. Claims from catastrophic events could reduce our earnings and cause substantial volatility in our results of operations for any fiscal quarter or year which could adversely affect our financial condition and liquidity position.

A significant component of our loss ratio relates to non-catastrophe business for the years ended December 31, 2009, 2008 and 2007. As we commonly write net lines of non-catastrophe business exceeding $10.0 million, we expect that the ultimate loss ratio for non-catastrophe business can vary significantly from our initial loss ratios. Thus, a 10% increase or decrease in loss ratios for non-catastrophe business is likely to occur and, for the years ended December 31, 2009, 2008 and 2007, this would have resulted in an approximate increase or decrease in our net income or shareholders' equity of approximately $27.7 million, $21.4 million and $6.3 million, respectively.

Premiums and Acquisition Costs

We recognize premiums as revenue ratably over the terms of the related contracts and policies. Our gross premiums written are based on policy and contract terms and include estimates based on information received from both insured and ceding companies. The information received is typically in the form of bordereaux, broker notifications and/or discussions with ceding companies or their brokers. This information can be received on a monthly, quarterly or transactional basis and normally includes estimates of gross premiums written (including adjustment premiums and reinstatement premiums), net premiums earned, acquisition costs and ceding commissions. Adjustment premiums are premiums due to either party when the contract's subject premium is adjusted at expiration and is recorded in subsequent periods. Reinstatement premiums are premiums charged for the restoration of a reinsurance limit of an excess of loss contract to its full amount after payment of losses as a result of an occurrence.

We write treaty and facultative reinsurance on either a non-proportional (also referred to as excess of loss) basis or a proportional (also referred to as pro rata) basis. Insurance premiums written are recorded in accordance with the terms of the underlying policies.

We book premiums on excess of loss contracts in accordance with the contract terms and earn them over the contract period. Since premiums for our excess of loss contracts are usually established with some certainty at the outset of the contract and the reporting lag for such premiums is minimal, estimates for premiums written for these contracts are usually not significant. The minimum and deposit premiums on excess of loss contracts are usually set forth in the language of the contract and are used to record premiums on these contracts. Actual premiums are determined in subsequent periods based on actual exposures and any adjustments are recorded in the period in which they are identified.

Index

For pro rata contracts, gross premiums written and related acquisition costs are normally estimated on a quarterly basis based on discussions with ceding companies, together with historical experience and management's judgment. Premiums written on pro rata contracts are earned over the risk periods of the underlying policies issued and renewed. As a result, the earning pattern of pro rata contracts may extend up to 24 months. This is generally twice the contract period due to the fact that some of the underlying exposures may attach towards the end of our contracts (i.e., risks attaching basis), and such underlying exposures generally have a one year coverage period. Total premiums written and earned on our pro rata business for the year ended December 31, 2009 were $220.6 million (22.3%), and $213.0 million (28.1%), respectively, for the year ended December 31, 2008 were $195.0 million (24.9%), and $159.7 million (24.4%), respectively and were $152.0 million (26.3%), and $101.5 million (21.3%), respectively, for the year ended December 31, 2007. Total earned acquisition costs estimated on pro rata contracts for the year ended December 31, 2009, 2008 and 2007 were $64.2 million (47.0%), $41.9 million (39.6%) and $35.1 million (42.6%), respectively. On a quarterly basis, we track the actual premium received and acquisition costs incurred and compare this to the estimates previously booked. Such estimates are subject to adjustment in subsequent periods when actual figures are recorded.

Acquisition costs, which are primarily comprised of ceding commissions, brokerage, premium taxes, profit commissions, sliding scale commissions and other expenses that relate directly to the writing of reinsurance contracts are expensed over the underlying risk period of the related contracts. Acquisition costs relating to the unearned portion of premiums written are deferred and carried on the balance sheet as deferred acquisition costs. Deferred acquisition costs are amortized over the period of the related contract and are limited to their estimated realizable value based on the related unearned premiums, anticipated claims expenses and investment income.

Reinstatement premiums are estimated after the occurrence of a significant loss and are recorded in accordance with the contract terms based upon the amount of loss reserves expected to be paid, including IBNR. Reinstatement premiums are earned when written.

Investments

In accordance with the Financial Instruments Topic of the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC"), the Company elects the fair value option for all fixed maturity investments, equity investments (excluding investments accounted for under the equity method of accounting), real estate investment trusts ("REITs"), investment funds, catastrophe bonds, and fixed income funds. The Company also applies the Fair Value Measurements and Disclosures Topic of the FASB ASC. The valuation technique used to value the financial instruments is the market approach which uses prices and other relevant information generated by market transactions involving identical or comparable assets.

The Company elects the fair value option to simplify the accounting, as this election reduces the burden of monitoring differences between the cost and fair value of our investments, including the assessment as to whether declines in value are temporary in nature and, therefore, further removes an element of management judgment. Any movement in unrealized gains and losses is recorded within net realized and unrealized gains (losses) on investments within the consolidated statements of operations and comprehensive income (loss).

Investments are recorded on a trade date basis and realized gains and losses on sales of investments continue to be determined on a first-in, first-out basis. Net investment income includes interest income on fixed maturity investments, recorded when earned, dividend income on equity investments, recorded when declared, and the amortization of premiums and discounts on investments net of investment management and custody expenses.

Fair value disclosure

The valuation technique used to fair value the financial instruments is the market approach which uses prices and other relevant information generated by market transactions involving identical or comparable assets. The following is a summary of valuation methodologies we used to measure our financial instruments:

Index

Fixed maturities and short term investments

The Company's U.S. government securities are stated at fair value as determined by the quoted market price of these securities as provided by exchange market prices, which represented 39.5% of our total fixed maturities portfolio. These securities are classified within Level 1.

The fair value of the corporate bonds, mortgage-backed securities, foreign government bonds, and asset-backed securities are provided by independent pricing services or by broker quotes based on inputs that are observable for the asset, either directly or indirectly. These securities are classified within Level 2 and Level 3, and the specific details of the sources are described below.

Pricing Services

At December 31, 2009, pricing for approximately 94.0% of our total fixed maturities, excluding U.S. government securities, was based on prices provided by nationally recognized independent pricing services. Generally, pricing services provide pricing for less-complex, liquid securities based on market quotations in active markets. For fixed maturities that do not trade on a listed exchange, these pricing services may use a matrix pricing consisting of observable market inputs to estimate the fair value of a security. These observable market inputs include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-side markets, benchmark securities, bids, offers, reference data, and industry and economic factors. Additionally, pricing services may use a valuation model such as an option adjusted spread model commonly used for estimating fair values of mortgage-backed and asset-backed securities. At December 31, 2009, we have not adjusted any pricing provided by independent pricing services.

Broker-Dealers

In some cases, we obtain a minimum of two quotes directly from broker-dealers who actively trade in the corresponding markets when prices are unavailable from independent pricing services. This may also be the case if the pricing from these pricing services is not reflective of current market levels. At December 31, 2009, approximately 0.1% of our fixed maturities were priced using non-binding broker quotes, for which the lowest broker quotes were used for the valuation. Generally, broker-dealers value securities through their trading desks based on observable market inputs. Their pricing methodologies include mapping securities based on trade data, bids or offers, observed spreads and performance on newly issued securities. They may also establish pricing through observing secondary trading of similar securities. All broker quotes are reviewed by the investment managers to determine if they reflect the fair value of the securities by comparing them to both internal models and the valuation of comparable securities. The evaluation of whether or not actual transactions in the current financial markets represent distressed sales requires significant management judgment. We do not believe quotes received from broker-dealers reflect distressed transactions that would warrant an adjustment to fair value. At December 31, 2009, we have not adjusted any pricing provided by broker-dealers based on the review performed by our investment managers.

Equities

The Company's listed equity securities are stated at fair value as determined by the quoted market price of these securities. These investments are classified within Level 1.

The Company's equity exchange traded funds are stated at fair value as determined by the quoted market price of these securities as provided either by independent pricing services or exchange market prices. The Company held no equity exchange traded funds as at December 31, 2009.

Other investments

Catastrophe bonds are stated at fair value as determined by reference to broker indications. Those indications are based on current market conditions, including liquidity and transactional history, recent issue price of similar catastrophe bonds and seasonality of the underlying risks. The catastrophe bonds held prior to September 30, 2009, and still held at December 31, 2009, were transferred from Level 3 to Level 2 due to the increase in pricing sources obtained and the increased activity within the market.

The investment funds, being private equity funds, are valued by investment fund managers using the net asset value provided by the general partners of the funds on a quarterly basis. These valuations are then adjusted by the investment fund managers for cash flows since the most recent valuation. The valuation methodology used for the investment funds is consistent with the investment industry and we have classified them within Level 3.

Index

At December 31, 2009, the fair value of the securities classified as Level 3 under the Fair Value Measurements and Disclosures Topic of the FASB ASC was $7.8 million, or approximately 0.5% of total investment assets measured at fair value. The Company does not carry equity method investments at fair value. Refer to Note 6 "Investments" in Item 8, "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K for a breakdown of the fair value measurements.

Derivative instruments

Derivative instruments are stated at fair value as determined by the quoted market price for futures contracts within Level 1 and by observable market inputs for foreign currency forwards, total return swaps, currency swaps, interest rates swaps and "to be announced" mortgage-backed securities ("TBAs") within Level 2. The Company fair values reinsurance derivative contracts by approximating the present value of cash flows as the carrying value equal to the unearned premium as these contracts are under one year in duration and we have classified them within Level 3.

At December 31, 2009, the fair value of the derivative instruments classified as Level 3 under the Fair Value Measurements and Disclosures Topic of the FASB ASC was $(1.6) million. Refer to Note 9 "Derivatives" in Item 8, "Financial Statements and Supplementary Data" of this Form 10-K for a breakdown of the fair value measurements.

Share Based Compensation

The Performance Share Unit Plan ("PSU Plan") is the Company's shareholder approved primary executive long-term incentive scheme. Pursuant to the terms of the PSU Plan, at the discretion of the Compensation Committee of the Board of the Directors, PSUs may be granted to executive officers and certain other key employees. The current series of PSUs vests over a period of approximately two or three years and vesting is contingent upon the Company meeting certain diluted return-on-equity ("DROE") goals and service period. Future series of PSUs may be granted with different terms and measures of performance.

Upon vesting, the PSU holder shall be entitled to receive a number of common shares of the Company (or the cash equivalent, at the election of the Company) equal to the product of the number of PSUs granted multiplied by a factor. The factor will range between 50% and 150%, depending on the DROE achieved during the vesting period.

The grant date fair value of the common shares underlying the PSUs was valued on the closing price of our common shares on the grant date.

We estimate the fair value of PSUs granted under the PSU Plan on the date of grant using the grant date fair value and the most probable DROE outcome and record the compensation expense in our consolidated statement of operations over the course of each two-year or three-year performance period. At the end of each quarter, we reassess the projected results for each two-year or three-year performance period as our financial results evolve. If we determine that a change in estimate is required, we recalculate the compensation expense under the PSU Plan and reflect any adjustments in the consolidated statements of operations in the period in which they are determined.

The total number of PSUs outstanding under the PSU Plan at December 31, 2009, 2008 and 2007 were 3,305,713, 2,189,982 and 1,658,700, respectively (or up to 4,220,355 common shares at December 31, 2009, should the maximum factor for each of the performance periods apply). Taking into account the results to date and the expected results for the remainder of the performance periods, we have established the most probable factor at 100%, with the exception of one series which has been established to have a probable factor of 150%. As such, the expected number of common shares to be issued under the plan is 3,305,713 at December 31, 2009. As at December 31, 2009, 2008 and 2007, there was a total of $19.4 million, $21.0 million and $11.9 million, respectively, of unrecognized compensation cost related to non-vested PSUs, the cost of which is expected to be recognized over a period of approximately 1.6 years, 2.5 years and 2.1 years, respectively.

Index

New Accounting Pronouncements

New accounting pronouncements issued during 2009

In December 2009, the FASB issued ASC Topic 860, "Transfers and Servicing," ("ASC 860") which codifies FASB Statement No. 166, "Accounting for Transfers of Financial Assets" which was issued on June 12, 2009. ASC 860 requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of financial assets accounted for as a sale. It is a revision to FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," and requires more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. ASC 860 is effective on a prospective basis in fiscal years beginning on or after November 15, 2009 and interim periods within those fiscal years, and will be adopted by the Company in the first quarter of fiscal year 2010. The Company does not expect the adoption of ASC 860 to have a material impact on its consolidated results of operations and financial condition.

In December 2009, the FASB amended ASC Topic 810, "Consolidation" ("ASC 810") to codify FASB Statement No. 167, "Amendments to FASB Interpretation No. 46(R)" which was released on June 12, 2009. ASC 810 amends FASB Statement No. 46 (revised December 2003), "Consolidation of Variable Interest Entities," to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. It determines whether a reporting entity is required to consolidate another entity based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impact the other entity's economic performance. The amendments to ASC 810 are effective on a prospective basis in fiscal years beginning on or after November 15, 2009, and interim periods within those fiscal years, and will be adopted by the Company in the first quarter of fiscal year 2010. The Company does not expect the adoption of the amendments to ASC 810 to have a material impact on its consolidated results of operations and financial condition.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, "Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements" ("ASU 2010-06"). This update requires new disclosures about fair value measurement as set forth in Codification Subtopic 820-10. Specifically, this update requires disclosing (1) the amounts of significant transfers in and out of Level 1 and 2 fair value measurements and the reasons for the transfers, and (2) information about purchases, sales, issuances, and settlements separately in the reconciliation for fair value measurements using significant unobservable inputs. The ASU 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal year beginning after December 15, 2010, and for interim periods within those fiscal years. The Company does not expect the adoption of the amendments to ASU 2010-06 to have a material impact on its consolidated results of operations and financial condition.

Recent Developments

Windstorm Xynthia struck western Europe on February 26 thru 28, 2010, impacting France, Portugal, Spain, Germany and Belgium. The storm caused widespread damage to homes and commercial property.

On February 27, 2010, a powerful 8.8 magnitude earthquake struck the southwest coast of Chile, causing widespread damage, business interruption, and tsunami warnings across the Pacific.

Both events are expected to cause sizeable losses to the insurance industry. The Company has commenced the estimation process for expected claims relating to its exposures from these events but believes it is too early to issue an estimate of claims given the significant unknowns and early stages of the claims reporting process.

Index

Results of Operations

The following is a discussion and analysis of our financial condition as at December 31, 2009 and 2008 and our results of operations for the years ended December 31, 2009, 2008 and 2007. All amounts in the following tables are expressed in thousands of U.S. dollars.

The Company's reporting currency is the U.S. dollar. The Company's subsidiaries have one of the following functional currencies: U.S. dollar, Euro, Swiss franc, Indian rupee, British pound, Canadian dollar or South African rand. As a significant portion of the Company's operations are transacted in foreign currencies, fluctuations in foreign exchange rates may affect period-to-period comparisons. To the extent that fluctuations in foreign currency exchange rates affect comparisons, their impact has been quantified, when possible, and discussed in each of the relevant sections. See Note 2 "Significant Accounting Policies" to the consolidated financial statements in Item 8, "Financial Statements and Supplementary Data", for a discussion on translation of foreign currencies.

U.S. dollar (weakened) strengthened against:	For the years ended December 31, 2009	2008
Canadian dollar	(17.8)%	20.1 %
Swiss franc	(3.0)%	(6.4)%
Euro	(3.2)%	4.9 %
British pound	(12.3)%	27.8 %
Indian rupee	(4.7)%	19.1 %
South African rand	(25.5)%	25.8 %

Summary Overview

We generated $242.2 million of net income in 2009, compared to a net loss of $187.3 million and net income of $167.9 million in 2008 and 2007, respectively. As highlighted in the table below, the two most significant items impacting our 2009 financial performance compared to 2008 and 2007 include: (1) An increase in underwriting income due to an increase in our net premiums earned, principally resulting from the growth in business by increased participation in programs from our existing clients, the addition of new clients, contribution from our 2008 acquisitions, growth in our franchise and due to the absence in 2009 of significant loss and loss adjustment expenses as incurred in 2008 from significant catastrophic events, such as Hurricanes Ike and Gustav and 2007 from Windstorm Kyrill and U.K. floods; and (2) A significant increase in 2009 in net realized and unrealized gains (losses) - investments primarily due to the significant declines in the global equity, bond and commodities markets in 2008, attributable to the broader deterioration and volatility in the credit markets and financial markets and the lingering impact of the sub-prime crisis, partially offset by a decrease in net investment income in 2009 resulting from lower interest rates.

Index

	For the years ended December 31,		
	2009	2008	2007
Highlights:			
Underwriting income(1)	210,813	73,385	133,953
Net investment income	28,531	51,398	73,808
Net realized and unrealized gains (losses) - investments	39,668	(272,206)	17,174
Net realized and unrealized gains (losses) - other	11,253	11,617	(9,821)
Interest expense	(12,105)	(18,297)	(18,677)
Net foreign exchange (losses) gains	(3,231)	(21,477)	5,289
Provision for income tax	(5,412)	(1,178)	(783)
Non-controlling interest	(28,545)	(13,599)	(35,794)
Net income (loss)	242,192	(187,302)	167,922

Key Ratios			
Loss ratio(2)	37.3 %	58.1 %	40.4 %
Acquisition cost ratio(3)	18.0 %	16.2 %	17.2 %
General and administration expense ratio(4)	19.4 %	15.1 %	15.2 %
Combined ratio(5)	74.7 %	89.4 %	72.8 %

(1) Underwriting income is calculated as net premiums earned plus other reinsurance related income less loss and loss adjustment expenses, acquisition costs and general and administrative expenses.
(2) The loss ratio is calculated by dividing loss and loss adjustment expenses (including estimates for IBNR losses) by net premiums earned.
(3) The acquisition ratio is calculated by dividing acquisition costs by net premiums earned.
(4) The general and administration expense ratio is calculated by dividing general and administrative expenses by net premiums earned.
(5) The combined ratio is the sum of the loss and loss adjustment expenses, acquisition costs and general and administration expenses divided by net premiums earned.

These items are discussed in the following sections.

Comparison of Years Ended December 31, 2009 and 2008

Underwriting Results by Segment

Effective January 1, 2009, as a result of the acquisition of Marlborough, the managing agency for Lloyd's Syndicate 1861 and Syndicate 1969, management views the Company as being organized into three reporting segments: Reinsurance, Lloyd's, and Insurance. The Lloyd's segment includes the business generated for Lloyd's Syndicate 1861 by Marlborough. Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As such, there are no comparative numbers for the prior years.

Our Reinsurance segment provides reinsurance through our property, property catastrophe and short-tail specialty and casualty reinsurance business units. Our Lloyd's segment primarily provides property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. Our Insurance segment provides insurance through Island Heritage

The following tables provide a summary of gross and net written and earned premiums, underwriting results, total assets, and ratios for each of our business segments for the years ended December 31, 2009, 2008 and 2007:

Index

	For the year ended December 31, 2009					For the year ended December 31, 2008			
	Reinsurance	Lloyd's	Insurance	Inter-segment Eliminations (1)	Total	Reinsurance	Insurance	Inter-segment Eliminations (1)	Total
Gross premiums written	$796,984	$145,889	$84,239	$(38,621)	$988,491	$740,169	$76,926	$(35,206)	$781,889
Premiums ceded	(140,850)	(18,504)	(75,289)	38,621	(196,022)	(46,638)	(75,759)	35,206	(87,191)
Net premiums written	656,134	127,385	8,950	-	792,469	693,531	1,167	-	694,698
Net premiums earned	$689,544	$62,130	$6,781	$-	$758,455	$641,500	$12,668	$-	$654,168
Other related income	3,622	8,749	20,968	(14,187)	19,152	305	13,247	(9,691)	3,861
Loss and loss adjustment expenses	(241,358)	(40,847)	(980)	-	(283,185)	(377,228)	(2,656)	-	(379,884)
Acquisition costs	(121,837)	(14,608)	(14,213)	14,187	(136,471)	(101,528)	(13,897)	9,691	(105,734)
General and administrative expenses	(119,555)	(15,904)	(11,679)	-	(147,138)	(90,026)	(9,000)	-	(99,026)
Underwriting Income (Loss)	$210,416	$(480)	$877	$-	$210,813	$73,023	$362	$-	$73,385
Loss ratio (2)	35.0 %	65.7 %	3.5 %		37.3 %	58.8 %	10.2 %		58.1 %
Acquisition cost ratio (2)	17.7 %	23.5 %	51.2 %		18.0 %	15.8 %	53.6 %		16.2 %
General and administrative expense ratio (2)	17.3 %	25.6 %	42.1 %		19.4 %	14.0 %	34.7 %		15.1 %
Combined ratio (2)	70.0 %	114.8 %	96.8 %		74.7 %	88.6 %	98.5 %		89.4 %
Total assets	$2,298,821	$177,355	$90,592		$2,566,768	$2,167,853	$48,117		$2,215,970

Reconciliation:		
Underwriting income	$210,813	$73,385
Net investment income	28,531	51,398
Net realized and unrealized gains (losses) - investments	39,668	(272,206)
	11,253	11,617

Net realized and unrealized gains (losses) - other		
Other income	2,576	4,354
Interest expense	(12,105)	(18,297)
Net foreign exchange losses	(3,231)	(21,477)
Income before income taxes and interest in earnings of equity investments	$277,505	$(171,226)

(1) Inter segment eliminations relate to Flagstone Suisse quota share arrangements with Island Heritage and Lloyd's. For 2007, purchased by Island Heritage from Flagstone Reinsurance Limited.
(2) For insurance segment all ratios calculated using expenses divided by net premiums earned plus other related income.

Gross Premiums Written

Gross reinsurance premiums written in our reinsurance segment of $797.0 million ($758.4 million net of intercompany reinsurance with Island Heritage and Lloyd's), $740.2 million ($705.0 million net of intercompany reinsurance with Island Heritage), and $544.3 million for the years ended December 31, 2009, 2008, and 2007, respectively, were primarily driven by excess of loss reinsurance contracts, generally with a twelve-month term, which for the years ended December 31, 2009, 2008, and 2007 accounted for $545.8 million (72.0 % of gross premiums written), $509.9 million (65.2% of gross premiums written) and $392.3 million (68.0% of gross premiums written), respectively. Gross premiums written relating to the Insurance segment primarily relate to a select property insurance portfolio in the Caribbean region. Intercompany reinsurance relates to quota share and excess of loss reinsurance arrangements between Flagstone Suisse, Island Heritage and Lloyd's. As mentioned above, our Lloyds segment began writing business for the benefit of Flagstone effective January 1, 2009.

Renewal dates for reinsurance business tend to be concentrated at the beginning of quarters, and the timing of premiums written varies by line of business. Most property catastrophe business is written in the January 1, April 1, June 1 and July 1 renewal periods, while the property lines and the short-tail specialty and casualty lines are written throughout the year. Seasonality is inherent for most Caribbean insurers given that the storm season begins June 1 and concludes November 30. Therefore, proportionally higher volumes of insurance property business are traditionally written in the first two quarters of the year.

Index

Our property catastrophe business is primarily on an excess of loss basis. Our property business and our short-tail specialty and casualty business are on both an excess of loss and a pro rata basis. See Item 1, “Business—Reinsurance Products and Operations—Reinsurance Products”.

Details of consolidated gross premiums written by line of business and geographic area of risk insured are provided below:

	Year ended December 31, 2009		Year ended December 31, 2008		Year ended December 31, 2007	
	Gross premiums written	Percentage of total	Gross premiums written	Percentage of total	Gross premiums written	Percentage of total
Line of business (1)						
Property catastrophe	$468,158	47.4 %	$457,549	58.5 %	$378,671	65.6 %
Property	202,378	20.5 %	94,706	12.1 %	94,503	16.4 %
Short-tail specialty and casualty	233,716	23.6 %	152,708	19.5 %	71,081	12.3 %
Insurance	84,239	8.5 %	76,926	9.9 %	32,895	5.7 %
Total	$988,491	100.0 %	$781,889	100.0 %	$577,150	100.0 %

	Year ended December 31, 2009		Year ended December 31, 2008		Year ended December 31, 2007	
	Gross premiums written	Percentage of total	Gross premiums written	Percentage of total	Gross premiums written	Percentage of total
Geographic area of risk insured (2)						
Caribbean (3)	$93,628	9.5 %	$88,482	11.3 %	$48,103	8.3 %
Europe	122,269	12.4 %	104,185	13.4 %	79,894	13.8 %
Japan and Australasia	58,633	5.9 %	47,866	6.1 %	39,547	6.9 %
North America	392,375	39.7 %	359,684	46.0 %	297,928	51.6 %
Worldwide risks (4)	244,416	24.7 %	153,442	19.6 %	99,365	17.2 %
Other	77,170	7.8 %	28,230	3.6 %	12,313	2.2 %
Total	$988,491	100.0 %	$781,889	100.0 %	$577,150	100.0 %

(1) Gross premiums written relating to Lloyd's segment are primarily included in short-tail specialty and casualty and property.
(2) Except as otherwise noted, each of these categories includes contracts that cover risks located primarily in the designated geographic area.
(3) Gross written premiums related to the Insurance segment are included in the Caribbean geographic area.
(4) This geographic area includes contracts that cover risks in two or more geographic zones.

Reinsurance Segment

Overview

On June 26, 2008 and October 1, 2008, the Company acquired a controlling interest in Flagstone Africa and Flagstone Alliance, respectively. As a result, the year over year results are not directly comparable. Where appropriate, the impact of the acquisitions has been quantified in the results of operations for our reinsurance segment.

2009 versus 2008
The net underwriting income for the Reinsurance segment for the year ended December 31, 2009 amounted to $210.4 million ($217.2 excluding the impact of acquisitions during 2008) as compared to $73.0 million ($74.3 excluding the impact of acquisitions during 2008) for the year ended December 31, 2008. The increase in net underwriting income is primarily related to higher levels of premiums earned in 2009 and net losses incurred in 2008 due to Hurricanes Ike and Gustav of $158.4 million and $14.5 million, respectively, which struck the Caribbean and US Gulf coast.

2008 versus 2007
The net underwriting income for the Reinsurance segment for the year ended December 31, 2008 amounted to $73.0 million ($74.3 excluding the impact of acquisitions during 2008) as compared to $129.3 million for the year ended December 31, 2007. The decrease in net underwriting income is primarily related to losses incurred in 2008 exceeding those in 2007 due to Hurricanes Ike and Gustav, which struck the Caribbean and US Gulf coast during the fall of 2008, losses on Chinese winter storms which occurred during late January and early February 2008, and losses from the U.S. Memorial Day Weekend storms, partially offset by higher levels of premiums earned.

Index

Our Reinsurance segment comprises three lines of business outlined below.

Gross Premiums Written

a. Property Catastrophe Reinsurance

Our property catastrophe reinsurance contracts provide protection for most catastrophic losses that are covered in the underlying insurance policies written by our ceding company clients. Property catastrophe reinsurance contracts are typically "all risk" in nature, meaning that they protect against losses from earthquakes and hurricanes, as well as other natural and man-made catastrophes such as tornados, fires, winter storms, and floods (where the contract specifically provides for coverage). Contracts are primarily written on the key renewal dates of January 1, April 1, June 1 and July 1. Losses on these contracts typically stem from direct property damage and business interruption.

2009 versus 2008
Gross property catastrophe premiums written for the year ended December 31, 2009 were $503.0 million compared to $492.7 million for the year ended December 31, 2008. The increase in property catastrophe premiums written of $10.3 million, excluding the impact of acquisitions, or 2.0%, is primarily due to hardening of prices in the property catastrophe market partially offset by the Company's non-renewal of certain treaties that no longer met the Company's profitability objectives.

During the year ended December 31, 2009, we recorded $11.4 million of gross reinstatement premiums compared to $28.2 million recorded for the year ended December 31, 2008, which was primarily related to Hurricanes Gustav and Ike.

2008 versus 2007
For the years ended December 31, 2008 and 2007, gross property catastrophe premiums written were $492.7 million and $378.7 million, respectively. The increase in property catastrophe premiums written of $114.0 million, or 30.1%, results primarily from a $74.2 million increase in excess of loss reinsurance premiums and $35.2 million related to the quota share arrangement with Island Heritage. Our property catastrophe book of business grew due to the addition of clients and increased business through participation in new programs and increased signed shares on existing programs by our Bermuda operations due to our growth in franchise.

During the year ended December 31, 2008, the Company recorded $28.2 million of gross reinstatement premiums primarily related to Hurricanes Ike and Gustav, compared to $10.4 million recorded for the year ended December 31, 2007, which were primarily related to European Windstorm Kyrill and the United Kingdom floods.

b. Property Reinsurance

Property reinsurance contracts are written on a pro rata basis and a per risk excess of loss basis. Per risk reinsurance protects insurance companies on their primary insurance risks on a single risk basis, for example covering a single large building. All property per risk and pro rata business is written with loss limitation provisions, such as per occurrence or per event caps, in place to limit exposure to catastrophic events.

2009 versus 2008
Gross property premiums written for the year ended December 31, 2009 were $142.2 million ($117.9 million excluding acquisitions in 2008), compared to $94.7 million ($89.6 million excluding acquisitions in 2008) for the year ended December 31, 2008, an increase of $28.3 million, or 31.6%, excluding the impact of acquisitions. The increase

is primarily due to an increase in proportional property premiums due to new business as well as increased shares by existing clients. The acquisitions of Flagstone Africa and Flagstone Alliance during 2008, which were not subsidiaries for the full twelve month period in 2008, contributed $24.3 million for the year ended December 31, 2009 compared to $5.1 million for the year ended December 31, 2008.

During the year ended December 31, 2009, we recorded $1.3 million gross reinstatement premiums compared to $4.6 million for the year ended December 31, 2008.

Index

2008 versus 2007
Gross property premiums written for the year ended December 31, 2008 were $94.7 million ($89.6 million excluding acquisitions in 2008), compared to $94.5 million for the year ended December 31, 2007, a decrease of $4.9 million, excluding the impact of acquisitions. There was a decrease in proportional property premiums of $25.0 million which was mostly offset by an increase in non-proportional premiums of $20.1 million, excluding the impact of acquisitions, for the year ended December 31, 2008, compared to the same period in 2007. The decline in proportional premiums was due to the non-renewal of contracts during 2008 as well as decreased revenues on existing contracts partially offset by the impact of new contracts signed in 2008. The increase in non-proportional premiums was due to the addition of new clients as well as increased business with existing clients.

During the year ended December 31, 2008, we recorded $4.6 million gross reinstatement premiums with various traditional property per risk covers primarily related to Hurricanes Ike and Gustav and the application of attritional loss ratios and known property loss events throughout 2008, compared to $0.9 million recorded for the year ended December 31, 2007.

c.Short-tail Specialty and Casualty Reinsurance

Short-tail specialty and casualty reinsurance is comprised of reinsurance programs such as aviation, energy, accident and health, workers compensation, catastrophe, satellite and marine. Most short-tail specialty and casualty reinsurance is written with loss limitation provisions.

2009 versus 2008
Short-tail specialty and casualty reinsurance premiums were $151.8 million ($125.6 million excluding the impact of acquisitions made in 2008) for the year ended December 31, 2009, compared to $152.7 ($150.1 million excluding the impact of acquisitions made in 2008) million for the year ended December 31, 2008, representing an decrease of $24.5 million excluding the impact of acquisitions, or 16.3% primarily driven by the non renewal of aviation treaties that did not meet the Company's profitability targets. The acquisitions of Flagstone Africa and Flagstone Alliance during 2008, which were not subsidiaries for the full twelve month period in 2008, contributed $26.2 million for the year ended December 31, 2009 compared to $2.6 million for the year ended December 31, 2008.

During the years ended December 31, 2009 and 2008, we recorded $3.4 million and $4.3 million of gross reinstatement premiums, respectively, which were primarily attributable to aviation, energy, and marine losses.

2008 versus 2007
Short-tail specialty and casualty reinsurance premiums were $152.7 million ($150.1 million excluding the impact of acquisitions made in 2008) for the year ended December 31, 2008, compared to $71.1 million for the year ended December 31, 2007, representing an increase of $79.0 million excluding the impact of acquisitions, or 111.2% primarily driven by increased participation on existing accounts and expansion of our client base, mainly in the energy, marine, space and aviation programs. Proportional premiums increased $57.4 million and non-proportional premiums increased $21.6 million, excluding the impact of acquisitions, for the year ended December 31, 2008, compared to the same period in 2007. The increase in proportional premiums was principally due to the addition of new clients in 2008, and the addition of new contracts and increasing lines from existing clients. The increase in non-proportional premiums was primarily due to the addition of new specialty covers that originated from Flagstone Suisse during 2008.

During year ended December 31, 2008, we recorded $4.3 million of gross reinstatement premiums primarily due to aviation, energy and marine losses incurred in the year ended December 31, 2008, compared to $2.6 million in the year ended December, 31, 2007, which were primarily attributable to aviation and marine losses.

Index

Premiums Ceded

In the normal course of its business, the Company purchases reinsurance in order to manage its exposures. The amount and type of reinsurance that it enters into is dependent on a variety of factors, including the cost of a particular reinsurance cover and the nature of its gross premiums written during a particular period.

Reinsurance purchases to date have represented prospective cover; that is, ceded reinsurance purchased to protect it against the risk of future losses as opposed to covering losses that have already incurred but have not been paid. The majority of these contracts are excess-of-loss contracts covering one or more lines of business. To a lesser extent we have also purchased quota share reinsurance with respect to specific lines of business. We also purchase protection through catastrophe bond structures, Valais Re and Montana Re, and industry loss warranty policies (“ILWs”) which provide coverage for certain losses provided they are triggered by events exceeding a specified industry loss size.

Various factors will continue to affect our appetite and capacity to write and retain risk. These include the impact of changes in frequency and severity assumptions used in our models and the corresponding pricing required to meet our return targets, evolving industry-wide capital requirements, increased competition, and other considerations.

2009 versus 2008
Reinsurance premiums ceded for the years ended December 31, 2009 and 2008, were $140.9 million and $46.6 million (17.7% and 6.3% of gross reinsurance premiums written), respectively, representing an increase of $94.3 million. The increase in amount of reinsurance premiums ceded for the year ended December 31, 2009 was designed to increase our underwriting capacity and to provide additional protection against potential high severity loss events.

2008 versus 2007
Reinsurance premiums ceded for the years ended December 31, 2008 and 2007, were $46.6 million and $30.6 million (6.3% and 5.6% of gross reinsurance premiums written), respectively, representing an increase of $16.0 million excluding the impact of acquisitions in 2008. The increase in premiums ceded for the year ended December 31, 2008 was primarily related to new core reinsurance protection to optimize our overall risk profile.

Net Premiums Earned

We write the majority of our business on a losses occurring basis. A “losses occurring” contract covers claims arising from loss events that occur during the term of the reinsurance contract, although not necessarily reported during the term of the contract. The premium from a losses occurring contract is earned over the term of the contract, usually twelve months. In contrast, a “risks attaching” contract covers claims arising on underlying insurance policies that incept during the term of the reinsurance contract. The premium from a risks attaching contract generally is earned over a period longer than twelve months.

2009 versus 2008
As the levels of net premiums written increase, the levels of net premiums earned also increase. Reinsurance net premiums earned were $689.5 million for the year ended December 31, 2009, compared to $641.5 million for the year ended December 31, 2008, representing an increase of $48.0 million, or 7.5%. The increase is primarily due to ongoing growth in premium writings, partially offset by the increase in premiums ceded.

2008 versus 2007
Reinsurance net premiums earned were $641.5 million for the year ended December 31, 2008, compared to $464.2 million for the year ended December 31, 2007, representing an increase of $177.3 million, or 35.2%. The increases

were primarily due to higher levels of premium writings and the impact of reinstatements earned in 2008 on Hurricanes Ike and Gustav. The majority of our business was written at the January 1, April 1, June 1 and July 1 renewal periods and therefore it was reasonable to anticipate that the earned premiums would generally increase over the course of the fiscal year as premiums written in earlier months were increasingly earned.

Index

Underwriting Expenses

The underwriting results of a reinsurance company are often measured by reference to its loss ratio and expense ratios. The loss ratio is calculated by dividing loss and loss adjustment expenses (including estimates for IBNR losses) by net premiums earned. The two components of the expense ratio may be expressed as separate ratios; the acquisition cost ratio and the general and administrative expense ratio. The acquisition cost ratio is calculated by dividing acquisition costs by net premiums earned. The general and administrative expense ratio is calculated by dividing general and administrative expenses by net premiums earned. The combined ratio is the sum of these three ratios.

Our combined ratio and components thereof related to the Reinsurance segment are set out below for the years ended December 31, 2009, 2008 and 2007:

	For the years ended December 31,					
	2009		2008		2007	
Loss ratio	35.0	%	58.8	%	41.2	%
Acquisition cost ratio	17.7	%	15.8	%	16.3	%
General and administration expense ratio	17.3	%	14.0	%	14.9	%
Combined ratio	70.0	%	88.6	%	72.4	%

See the discussion below for an explanation of the fluctuations in these ratios.

a. Loss and Loss Adjustment Expenses

Loss and loss adjustment expenses are comprised of three main components:

- losses paid, which are actual cash payments to insureds, net of recoveries, if any, from our own reinsurers;
- movement in outstanding loss or case reserves, which represent the change in management's best estimate of the likely settlement amount for reported claims, less the portion that can be recovered from reinsurers; and
- movement in IBNR reserves, which are reserves established by us for claims that are not yet reported but can reasonably be expected to have occurred based on industry information, management's experience and actuarial evaluation, less expected recoveries from reinsurers, if any.

The portion recoverable from our reinsurers is deducted from the gross estimated loss and loss adjustment expenses in the statement of operations.

Because of our short operating history, our loss experience is limited and reliable evidence of changes in trends of numbers of claims incurred, average settlement amounts, numbers of claims outstanding and average losses per claim could take years to develop. A significant portion of our business is property catastrophe reinsurance and other classes of reinsurance with high attachment points of coverage. Attachment points refer to the dollar amount of loss above which excess of loss reinsurance becomes operative. Reserving for losses in such programs is inherently complicated in that losses in excess of the attachment level of our policies are characterized by high severity and low frequency. In addition, as a broker market reinsurer, we must rely on loss information reported to such brokers by primary insurers who must estimate their own losses at the policy level, often based on incomplete and changing information. See "Critical Accounting Estimates—Loss and Loss Adjustment Expense Reserves" and Item 1A, "Risk Factors—Risks Related to the Company." If we underestimate our loss reserves, so that they are inadequate to cover our ultimate liability for losses, the underestimation could materially adversely affect our financial condition and results of operations.

Index

2009 versus 2008
The decrease in the loss ratio of 23.8% in 2009 from 2008 was primarily due to the absence of significant losses described below.

Loss and loss adjustment expenses for the year ended December 31, 2009 were $241.4 million, or 35.0% of net premiums earned ($230.4 million, or 34.0% of net premiums earned, excluding the impact of acquisitions made in 2008), compared to $377.2 million, or 58.8% of net premiums earned ($370.7 million, or 58.8% of net premiums earned, excluding the impact of acquisitions made in 2008), for the year ended December 31, 2008. The decrease in the loss ratio was primarily due to more severe catastrophic events during 2008 than during 2009. Significant loss events for 2008 included Hurricane Ike ($158.4 million), Hurricane Gustav ($14.5 million), Chinese winter storms ($18.2 million) and the U.S. Memorial Day weekend storms ($11.1 million). During the year ended December 31, 2009, based on updated estimates provided by clients and brokers, we have recorded net favorable developments for prior period loss events of $6.6 million, related to small releases on several catastrophe events. During the year ended December 31, 2008, the net favorable developments for prior catastrophe events were $15.7 million.

2008 versus 2007
The increase in the loss ratio of 17.6% in 2008 is as a result of the more severe catastrophe events that occurred in 2008 (described below) compared to the catastrophe activity experienced in 2007.

Loss and loss adjustment expenses for the year ended December 31, 2008 were $377.2 million, or 58.8% of net premiums earned, ($370.7 million, or 58.8% of net premiums earned, excluding the impact of acquisitions made in 2008) compared to $191.3 million, or 41.2% of net premiums earned, for the year ended December 31, 2007. The increase in the loss ratio was primarily due to more severe catastrophic events during 2008 than during 2007. Significant loss events for 2008 included Hurricane Ike ($158.4 million), Hurricane Gustav ($14.5 million), Chinese winter storms ($18.2 million) and the U.S. Memorial Day weekend storms ($11.1 million). During the year ended December 31, 2008, we also revisited our loss estimates for previous loss events. During 2007, the significant loss events included the European Windstorm Kyrill ($32.4 million), United Kingdom floods ($38.0 million), and New South Wales (Australia) floods ($18.5 million), three satellite losses during 2007 ($13.8 million), and the Sydney (Australia) hailstorm in December 2007 ($11.4 million).

b. Acquisition Costs

Acquisition costs consist principally of ceding commissions, brokerage, premium taxes, sliding scale and profit commissions and other expenses that relate directly to the writing of reinsurance contracts. Acquisition costs are driven by contract terms and are generally determined based upon a set percentage of premiums. Acquisition costs are expensed over the period of their related contracts.

2009 versus 2008
Acquisition costs for the year ended December 31, 2009 were $121.8 million compared to $101.5 million for the year ended December 31, 2008. The increase in acquisition costs for the year ended December 31, 2009 is primarily related to higher levels of premium writings and also includes $14.3 million of acquisition costs in relation to the quota share arrangement with Island Heritage.

2008 versus 2007
Acquisition costs for the year ended December 31, 2008 were $101.5 million ($97.7 million excluding acquisitions) compared to $75.9 million for the year ended December 31, 2007. The increase in acquisition costs for the year ended December 31, 2008 was primarily related to higher levels of premium writings and also includes $9.7 million of

acquisition costs in relation to the quota share arrangement with Island Heritage.

c. General and Administrative Expenses

General and administrative expenses consist primarily of salaries, benefits, and related costs, including costs associated with our PSU and RSU Plans and other general operating expenses.

Index

2009 versus 2008

General and administrative expenses for the year ended December 31, 2009, were $119.6 million ($108.5 million excluding acquisitions made in 2008) compared to $90.0 million ($86.8 million excluding acquisitions made in 2008) in the year ended December 31, 2008. The increase of $21.7 million, in 2009 as compared to 2008, excluding the impact of acquisitions, is primarily due to the increase in stock compensation expense of $16.3 million as a result of the net loss incurred in 2008.

2008 versus 2007

General and administrative expenses for the year ended December 31, 2008, were $90.0 million ($86.8 million excluding acquisitions) compared to $68.9 million in the year ended December 31, 2007. The increase of $17.9 million, excluding the impact of acquisitions, in 2008 as compared to 2007 was primarily due to the cost of additional staff and infrastructure as we built our global operations and enhanced our technology platform, partially offset by a decrease in stock compensation expenses. Considering the net loss incurred in the year ended December 31, 2008, the Company reviewed its DROE estimates for the performance periods and revised accordingly the number of PSUs expected to vest. As a result of the revised DROE estimates, the Company reversed previously expensed stock compensation related to the PSU Plan of $8.1 million. At the Company's board meeting held on November 14, 2008, the Warrant was amended. As a result of the amendments, additional compensation expense of $3.6 million was recognized in the year ended December 31, 2008.

2010 Outlook

North America

As a result of the benign hurricane loss activity in 2009 coupled with the recovering global financial markets, capital and surplus levels have rapidly been restored for many insurers and reinsurers. Therefore we anticipate any new demand for US catastrophe reinsurance will be met by an increasingly available over-supply, particularly as the mid-year approaches. This softening US catastrophe market is expected to continue upon the January 1 trend and may build toward 10% rate decreases or more as we approach the June and July 1 renewals. Some new demand will arise from the Florida Hurricane Cat Fund's further $2 billion TICL layer reduction as well as new interest in frequency loss driven coverage such as proportional cover, mainly for surplus relief.

Specialty Lines

Specialty lines around the world were mixed, presenting select opportunities for us to grow overall in on-shore energy and some tailored programs. Commercial aviation and workers compensation catastrophe business presented less opportunity to grow as we believe rates need to improve. We expect specialty lines will grow overall, allowing us to continue to diversify our portfolio from the core property catastrophe lines.

International

The clear observation from the January renewals was that the capacity limitations of a year ago following the 2008 financial crisis had disappeared with there were signs of excess capacity in nearly all lines with many programs over subscribed and very few programs struggling to achieve full placement. However, in general the reinsurance market was disciplined with modest rate easing across the board. Many clients continued to dilute their exposures to the big professional insurers despite their renewed appetite for market share and we achieved gains in a number of areas as a result of this combined with our continued support from brokers and core clients. We expect the international catastrophe market to continue to soften in 2010 in the absence of any significant loss activity.

Lloyd's Segment

Overview

As a result of the acquisition of Marlborough, the managing agency for Lloyd's Syndicate 1861, in November 2008, the Company established a new reporting segment. Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As such there are no comparative numbers for the prior year. The net underwriting loss for the Lloyd's segment for the year ended December 31, 2009 amounted to $0.5 million. Due to the startup nature of the 2009 year of account for Syndicate 1861, the level of earned premium income is slowly ramping up with new business writings, placing strain on the underwriting results as we have incurred expenses for the full periods. In addition, due to the start up nature of the operations, there is a very limited level of funds available to invest and therefore minimal investment income has been earned to date.

Gross Premiums Written

Gross premiums written were $145.9 million for the year ended December 31, 2009, and consist primarily of property and specialty lines. For the year ended December 31, 2009, the property line gross premiums written were $60.2 million and the specialty lines were $85.7 million.

Premiums Ceded

Premiums ceded for the year ended December 31, 2009, were $18.5 million (12.7% of gross premiums written). In the normal course of its business, the Company purchases reinsurance in order to manage its exposures. Premiums ceded to Flagstone Suisse under our intercompany reinsurance programs were $3.8 million for the year ended December 31, 2009. The amount and type of reinsurance that it enters into is dependent on a variety of factors, including the cost of a particular reinsurance cover and the nature of its gross premiums written during a particular period.

Index

Net Premiums Earned

Net premiums earned totaled $62.1 million for the year ended December 31, 2009. The net premiums earned are a function of the timing and amount of premiums written and given the start up nature of the syndicate's writings, premiums earned are small relative to the writings.

Other Related Income

Other related income, derived from services provided to syndicates and third parties, totaled $8.7 million for the year ended December 31, 2009.

Underwriting Expenses

a. Loss and loss adjustment expenses

Loss and loss adjustment expenses amounted to $40.8 million for the year ended December 31, 2009. There were no significant loss events recorded during the year ended December 31, 2009.

b. Acquisition costs

Acquisition costs totaled $14.6 million for the year ended December 31, 2009. The acquisition ratio, which is equal to acquisition cost expenses over net premiums earned, for the year ended December 31, 2009, was 23.5%. Acquisition costs include brokerage, gross commission costs, profit commission and premium taxes.

c. General and administration expenses

General and administrative expenses for the year ended December 31, 2009, were $15.9 million. General and administrative expenses include staff and salary related costs, administration expenses and Lloyd's specific costs such as syndicate expenses.

2010 Outlook

The existing major business lines written in London through Syndicate 1861, including marine and energy excess of loss, offshore energy, marine, technical property risk and engineering insurance, are expected to show modest growth overall through 2010. However, during 2009, Marlborough also implemented a number of business initiatives designed to increase the flow of new business to the Syndicate including the establishment of a property division in London, a representative office in Rio de Janeiro, and an underwriting agency in New York. These initiatives began developing business flow towards the end of 2009 and it is expected that they will each contribute significantly to the overall portfolio of risks for 2010, in particular, US and International direct and facultative property risks, US marine liability and associated vessel risks and, from Brazil, non-marine and specialty lines treaty and facultative reinsurance.

Insurance Segment

Overview

The Insurance segment includes insurance business generated through Island Heritage, a property insurer based in the Cayman Islands which is primarily in the business of insuring homes, condominiums and office buildings in the

Caribbean region. The Company gained controlling interest of Island Heritage on July 3, 2007, and as a result, the comparatives for the year ended December 31, 2007 include the results of Island Heritage for the six months ended December 31, 2007 only.

The net underwriting income for the year ended December 31, 2009 amounted to $0.9 million compared to $0.4 million for the year ended December 31, 2008.

Gross Premiums Written

2009 versus 2008
Gross premiums written were $84.2 million for the year ended December 31, 2009, compared to $76.9 million for the year ended December 31, 2008. The increase is primarily related to continued growth in the Cayman Islands, Bahamas, and Turks and Caicos, partially offset by a reduction in premiums as a result of the cessation of business of the Company's agents in Jamaica and Bermuda. Contracts are written on a per risk basis and consist primarily of property lines. Seasonality is inherent for most Caribbean insurers given that the storm season begins June 1 and concludes November 30. Therefore, proportionally higher volumes of property business are traditionally written in the first two quarters in the fiscal year.

Index

2008 versus 2007
Gross premiums written were $76.9 million for the year ended December 31, 2008, compared to $33.0 million for the six months ended December 31, 2007.

Premiums Ceded

2009 versus 2008
Insurance premiums ceded for the year ended December 31, 2009 were $75.3 million (89.4% of gross insurance premiums written), compared to $75.8 million (98.5% of gross insurance premiums written) for the year ended December 31, 2008. Island Heritage's reinsurance program, which is an April 1 renewal, comprising excess of loss and quota share programs, was significantly changed on April 1, 2008, compared to prior years, resulting in the addition of increased net quota share reinsurance as at April 1, 2008 and subsequent to April 1, 2009 program renewal. Premiums ceded to Flagstone Suisse under our intercompany reinsurance programs were $34.8 million and $35.2 million for the years ended December 31, 2009 and 2008, respectively. The change in the reinsurance program enabled Island Heritage to enter into new markets as well as increase penetration in existing markets whilst reducing its net loss exposure and results volatility due to the impact of catastrophic losses.

2008 versus 2007
Insurance premiums ceded for the year ended December 31, 2008 were $75.8 million (98.5% of gross insurance premiums written) which amounted to $40.6 million net of premiums ceded to Flagstone Suisse through the quota share arrangement, compared to $20.4 million (61.7% of gross insurance premiums written) for the six months ended December 31, 2007. As described above, Island Heritage's reinsurance program was significantly changed on April 1, 2008 compared to prior years, resulting in a significant net quota share reinsurance portfolio transfer. The change in the reinsurance program enabled Island Heritage to enter into new markets as well as increase penetration in existing markets.

Net Premiums Earned

2009 versus 2008
Net premiums earned totaled $6.8 million for the year ended December 31, 2009, compared to $12.7 million for the year ended December 31, 2008. Net premiums earned for 2009 were lower compared to the same period in 2008, primarily due to the difference in the reinsurance program in place for both years.

2008 versus 2007
Net premiums earned totaled $12.7 million for the year ended December 31, 2008, compared to $13.0 million for the six months ended December 31, 2007. Net premiums earned for 2008 are lower due to the changes in the reinsurance program referred to above.

Underwriting Expenses

a. Loss and Loss Adjustment Expenses

2009 versus 2008
Loss and loss adjustment expenses amounted to $1.0 million for the year ended December 31, 2009, compared to $2.7 million for the year ended December 31, 2008. The decrease in loss and loss adjustment expenses in the year ended December 31, 2009 is primarily related to the favorable settlement of claims incurred during 2008 in respect of Hurricanes Gustav, Hanna, Ike, Omar and Paloma.

2008 versus 2007

Loss and loss adjustment expenses amounted to $2.7 million for the year ended December 31, 2008, compared to $1.6 million for the six months ended December 31, 2007. The increase in loss and loss adjustment expense in the year ended December 31, 2008 was primarily related to the claims incurred in respect of Hurricanes Gustav, Hanna, Ike, Omar and Paloma.

b. Acquisition Costs

2009 versus 2008

Acquisition costs totaled $14.2 million for the year ended December 31, 2009, compared to $13.9 million for the year ended December 31, 2008. The acquisition cost ratio, which is equal to acquisition cost expenses over net premiums earned plus other reinsurance and insurance income, for the year ended December 31, 2009 was 51.2% compared to 53.6% for the year ended December 31, 2008. Acquisition costs include gross commission costs, profit commission, premium taxes, and the change in deferred acquisition costs.

Index

2008 versus 2007
Acquisition costs totaled $13.9 million for the year ended December 31, 2008, compared to $6.5 million for the six months ended December 31, 2007. The acquisition cost ratio, which is equal to acquisition cost expenses over net premiums earned plus other reinsurance and insurance income, for the year ended December 31, 2008 was 53.6% compared to 40.0% for the six months ended December 31, 2007. The increase in the acquisition cost ratio for the year ended December 31, 2008 reflected the lower net premiums earned for the same period.

c. General and Administrative Expenses

2009 versus 2008
General and administrative expenses for the year ended December 31, 2009 were $11.7 million compared to $9.0 million for the year ended December 31, 2008, as Island Heritage continues to grow its operations including its Puerto Rico office and enhance its underwriting and claims operating platform.

2008 versus 2007
General and administrative expenses for the year ended December 31, 2008 were $9.0 million compared to $3.5 million for the six months ended December 31, 2007. During 2008, Island Heritage expanded its operations into the Latin America market with the opening of an office in Puerto Rico. The increase in general and administrative expenses for 2008 was primarily related to increased costs associated with expanding into this market and the fact that 2008 included a full year of expenses.

2010 Outlook

The general economic outlook for the Caribbean is expected to be neutral with little or no economic growth in 2010. Despite this the market outlook for Island Heritage for 2010 is positive as measured organic volume growth is planned throughout existing markets in the Caribbean. It is expected that whilst there will be softening pressure on primary insurance rates as a result of market pressures this should be offset by expected decreases in reinsurance costs.

Investment Results

2009 versus 2008
Our investment portfolio on a risk basis, as at December 31, 2009, comprised 89.7% fixed maturities, short-term investments and cash and cash equivalents, 4.0% equities and the balance in other investments.

The total return on our investment portfolio, excluding minority interests in the investment portfolio, comprises investment income and realized and unrealized gains and losses on investments. For the year ended December 31, 2009, the total return on invested assets was 4.6% compared to (13.9)% for the year ended December 31, 2008. The change in the return on invested assets of 18.5% during the year ended December 31, 2009, compared to the same period in 2008 is primarily due to the 2008 return being negatively impacted by the global financial crisis.

2008 versus 2007
Our investment portfolio on a risk basis, as at December 31, 2008, comprised 91.7% fixed maturities, short-term investments and cash and cash equivalents, 3.1% equities and the balance in other investments. In October 2008, given the turbulent worldwide financial markets, the Finance Committee of the Board decided to revise the Company's asset allocation and accordingly, significantly reduce the risk of the Company's portfolio by eliminating its direct exposure to equities and to non-U.S. real estate and by lowering its exposure to commodities.

For the year ended December 31, 2008, the total return was (13.9) % compared to 7.0% for the year ended December 31, 2007. The change in the return on invested assets of (20.9)% during the year ended December 31, 2008, compared to the same period in 2007 is primarily due to the 2008 return being negatively impacted by the global financial crisis.

a. Net investment income

Index

Investment income is principally derived from interest and dividends earned on investments and amortization income, partially offset by investment management and custody fees. The components are set forth in the table below:

	For the years ended December 31, 2009	2008	2007
Interest and dividend income			
Cash and cash equivalents	$3,231	$13,498	$12,911
Fixed maturities	31,600	30,579	45,830
Short term	1,687	138	150
Equity investments	76	79	308
Other investments	9	518	7,456
Amortization income			
Fixed maturities	(3,317)	11,205	8,128
Short term	(282)	428	102
Other investments	406	23	-
Investment expenses	(4,879)	(5,070)	(1,077)
Net investment income	$28,531	$51,398	$73,808

2009 versus 2008
Net investment income for the year ended December 31, 2009 was $28.5 million compared to $51.4 million for the same period in 2008.

Net investment income decreased by $22.9 million in the year ended December 31, 2009, compared to the same period in 2008, principally due to a significant decrease in interest rates and lower amortization on the Treasury Inflation Protected Securities (“TIPS”) caused by the impact of negative inflation index. On the TIPS, the negative amortization is offset by gains reported in net realized and unrealized gains (losses) – investments. The Company allocates all investment related expenses to investment income, including salaries and overhead expenses, considered to be directly related to and supporting the investment income.

Substantially all of our fixed maturity investments consisted of investment grade securities. As at December 31, 2009, the average credit rating provided by a recognized national rating agency of our fixed maturity portfolio was AA+ with an average duration of 2.3 years.

2008 versus 2007
Net investment income for the year ended December 31, 2008 was $51.4 million compared to $73.8 million for the same period in 2007.

Net investment income decreased by $22.4 million in the year ended December 31, 2008, compared to the same period in 2007, principally due to a significant decrease in interest rates since the previous year and changes in the Company’s process regarding the allocation to investment income of a portion of general and administrative expenses, attributable to investment management expenses. The Company allocates all investment related expenses to investment income, including salaries and overhead expenses, considered to be directly related to and supporting the investment income. The decrease in interest income on fixed maturities in 2008 was partially offset by an increase in amortization income on fixed maturities.

Net realized and unrealized gains and losses – investments b.

Our investment portfolio is structured to preserve capital and provide us with a high level of liquidity and is managed to produce a total return. In assessing returns under this approach, we include investment income and realized and unrealized gains and losses generated by the investment portfolio.

The Company enters into investment portfolio derivatives including global equity, global bond, commodity and real estate futures, TBAs, total return swaps and interest rate swaps. The Company enters into index futures contracts and total return swaps to gain or reduce its exposure to an underlying asset or index. The Company also purchases TBAs as part of its investing activities. The Company enters into interest rate swaps in order to manage portfolio duration and interest rate risk. The Company manages the exposure to these instruments based on guidelines established by management and approved by the Board of Directors.

Index

The following table is the breakdown of net realized and unrealized gains (losses) - investments in the audited consolidated statements of operations into its various components:

	For the years ended December 31, 2009	2008	2007
Net realized gains (losses) on fixed maturities	$21,005	$(9,143)	$(7,252)
Net unrealized gains (losses) on fixed maturities	34,582	(14,130)	15,069
Net realized (losses) gains on equities	(1,927)	(52,410)	9,362
Net unrealized gains (losses) on equities	2,778	(2,401)	346
Net realized and unrealized (losses) gains on derivative instruments - investments	(15,145)	(164,016)	(983)
Net realized and unrealized (losses) gains on other investments	(1,625)	(30,106)	632
Total net realized and unrealized gains (losses) - investments	$39,668	$(272,206)	$17,174

The following table is a breakdown of the net realized and unrealized (losses) gains on derivatives included in the table above:

	For the years ended December 31, 2009	2008	2007
Futures contracts	$12,458	$(147,493)	$4,416
Total return swaps	(4,630)	(18,431)	(4,658)
Interest rate swaps	-	(295)	68
Foreign currency forward contracts	(25,375)	-	-
Mortgage-backed securities TBA	2,402	2,203	(809)
Net realized and unrealized (losses) gains on derivatives - investments	$(15,145)	$(164,016)	$(983)

2009 versus 2008

Net realized and unrealized gains (losses) on our investment portfolio amounted to a $39.7 million gain for the year ended December 31, 2009, compared to a $272.2 million loss for the year ended December 31, 2008. These amounts comprise net realized and unrealized gains and losses on our fixed maturities, equities, other investments and on our investment portfolio of derivatives which includes US equity, global equity, global bond, commodity and real estate futures, TBA securities, interest rate swaps and total return swaps. The increase during the year ended December 31, 2009 compared to the same period in 2008, was primarily due to our allocation to equities and commodities in 2008 being negatively impacted by the global financial crisis.

Net realized and unrealized gains on fixed maturities of $55.6 million for the year ended December 31, 2009, were due to the tightening of the credit spreads during 2009 and also to the realized and unrealized gains on the foreign currency portfolios caused by the weakening of the U.S. dollar. Foreign exchange gains were offset by losses on derivatives used for hedging, as described in the note below.

Net realized and unrealized gains on equities of $0.9 million for the year ended December 31, 2009 were primarily due to the positive performance of the emerging equity markets during the year ended December 31, 2009.

Net realized and unrealized loss on other investments of $1.6 million for the year ended December 31, 2009 were due to $2.9 million of gains on the Catastrophe Bond portfolio and $4.5 million of losses on the investment funds held.

Net realized and unrealized gains on futures contracts of $12.5 million for the year ended December 31, 2009 were primarily due to $3.7 million of gains on U.S. and global equity index futures, $8.9 million of gains on commodity index futures and $0.2 million of losses on global bond futures.

Net realized and unrealized losses on swap contracts of $4.6 million during the year ended December 31, 2009, were primarily due to $2.9 million of gains on U.S. equity exposure and $7.5 million of losses on global inflation bond exposure.

Net realized and unrealized losses on foreign currency forward contracts during the year ended December 31, 2009 are related to currency hedges on non-U.S. dollar investment assets and are offset by net realized and unrealized gains on the fixed maturities as described above.

Index

2008 versus 2007

Net realized and unrealized losses and gains on our investment portfolio amounted to a $272.2 million loss for the year ended December 31, 2008, compared to a $17.2 million gain for the year ended December 31, 2007. These amounts comprised net realized and unrealized gains and losses on our fixed maturities, equities, and other investments and on our investment portfolio of derivatives which includes global equity, global bond, commodity and real estate futures, TBA securities, interest rate swaps and total return swaps. The decrease during the year ended December 31, 2008 compared to the same period in 2007, was primarily due to our allocation to equities and commodities in 2008 being negatively impacted by the global financial crisis.

Net realized and unrealized losses on fixed maturities of $23.3 million for the year ended December 31, 2008, were primarily due to the widening of the credit spreads during 2008 and the losses incurred in relation to Alt-A securities of $5.5 million.

Net realized and unrealized losses on equities of $54.8 million for the year ended December 31, 2008 were primarily due to the negative performance of the emerging equity markets during the year ended December 31, 2008.

Net realized and unrealized losses on other investments of $30.1 million during the year ended December 31, 2008, were primarily due to the negative performance of the real estate markets and our increased position in REIT funds during the year.

Net realized and unrealized losses on futures contracts of $147.5 million during the year ended December 31, 2008 were primarily due to $96.5 million of losses on U.S. and global equity index futures, $52.8 million of losses on commodity index futures and $1.8 million of gains on global bond futures.

Net realized and unrealized losses on swap contracts of $18.7 million during the year ended December 31, 2008, were primarily due to $20.3 million of losses on index total return swaps offset by $1.6 million of gains on interest rate swaps within our fixed maturity portfolios.

Treasury Hedging and Other

Net realized and unrealized gains and losses – other

The Company's policy is to hedge the majority of its non-investment currency exposure with derivative instruments such as foreign currency swaps and foreign currency forward contracts.

Currency swaps and foreign currency forward contacts are used to hedge the economic currency exposure of the Company's investment in foreign subsidiaries, primarily our Swiss subsidiary, and to hedge operational balances such as premiums receivable, loss reserves and the portion of our long term debt issued in Euros.

The following table is the breakdown of net realized and unrealized gains (losses) - other in the consolidated statements of operations into its various components:

	For the years ended December 31,		
	2009	2008	2007
Currency swaps	$661	$(783)	$2,009
Interest rate swaps	-	(1,353)	437

Foreign currency forward contracts	8,202	7,095	(14,016)
Reinsurance derivatives	2,390	6,658	1,749
Net realized and unrealized gains (losses) - other	$11,253	$11,617	$(9,821)

2009 versus 2008
Net realized and unrealized gains (losses) related to these derivative instruments amounted to $11.3 million for the year ended December 31, 2009, compared to $11.6 million for the year ended December 31, 2008. These amounts comprise net realized and unrealized gains (losses) on foreign currency forward contracts, interest rate and currency swaps on our subordinated debt and on reinsurance derivatives.

We recorded $0.7 million of net realized and unrealized gains (losses) on foreign currency swaps on our subordinated debt in 2009 versus $(0.8) million in 2008 and $nil on interest rate swaps on our subordinated debt in 2009 versus $(1.4) million in 2008. In 2009, we recorded an $8.2 million gain on foreign currency forwards on Flagstone Suisse's net assets (undesignated hedge), on operational hedges on reinsurance balances, on non-U.S. investments, and on a portion of long term debt incurred versus a $7.1 million gain in 2008.

Index

Reinsurance derivatives relate to industry loss warranty contracts (“ILWs”) that are structured as derivative transactions and exchange traded futures options contracts on major hurricane indexes. The Company recorded unrealized gains on ILWs determined to be derivatives of $2.4 million in 2009, versus $4.1 million in 2008. The decrease was due to the decreased number of ILWs determined to be derivatives written during 2009. The realized and unrealized gains recorded on the futures options contracts were $nil for 2009 compared to $2.5 million for 2008.

2008 versus 2007
Net realized and unrealized gains (losses) related to these derivative instruments amounted to $11.6 million for the year ended December 31, 2008, compared to $(9.8) million for the year ended December 31, 2007. These amounts comprise net realized and unrealized gains (losses) on foreign currency forward contracts, interest rate and currency swaps on our subordinated debt and on reinsurance derivatives.

We recorded $(0.8) million of net realized and unrealized gains (losses) on foreign currency swaps on our subordinated debt in 2008 versus $2.0 million in 2007 and $(1.4) million on interest rate swaps on our subordinated debt in 2008 versus $0.5 million in 2007. In 2008 we recorded a $7.1 million gain on foreign currency forward contracts on Flagstone Suisse’s net assets (undesignated hedge), on operational hedges on reinsurance balances and a portion of long term debt incurred versus $(14.0) million in 2007.

The Company recorded unrealized gains on ILW’s determined to be derivatives of $4.1 million in 2008, versus $1.7 million in 2007. The increase was due to the increased number of ILW’s determined to be derivatives written during 2008. The realized and unrealized gains recorded on futures options contracts were $2.5 million for 2008. The Company did not enter into futures options contracts in 2007.

Interest Expense

Interest expense consists of interest due on outstanding debt securities and the amortization of debt offering expenses.

2009 versus 2008
Interest expense was $12.1 million for the year ended December 31, 2009, compared to $18.3 million for the year ended December 31, 2008. For the year ended December 31, 2009, compared to the same period in 2008, the decrease of $6.2 million in interest expense is primarily related to the decrease in short term interest rates from period to period and the repurchase of $11.25 million of principal amount of the Company’s outstanding $100.0 million Notes during the second quarter of 2008.

2008 versus 2007
Interest expense was $18.3 million for the year ended December 31, 2008, compared to $18.7 million for the year ended December 31, 2007. For the year ended December 31, 2008 compared to the same period in 2007, the primary cause for the increase is additional debt offerings of $100.0 million and $25.0 million which occurred in June and September 2007, respectively, and accordingly increased our interest expense in 2008 with a full year of interest expense. This increase was partially offset by the repurchase of $11.25 million of principal amount of the Company’s outstanding $100.0 million Notes during the second quarter of 2008.

Foreign Exchange

2009 versus 2008
For the year ended December 31, 2009, we experienced net foreign exchange losses of $3.2 million compared to net foreign exchange losses of $21.5 million for the year ended December 31, 2008. For the year ended December 31,

2009, the net foreign exchange losses were principally experienced on the net monetary asset and liability balances denominated in foreign currencies which generally weakened against the U.S. dollar, especially during the third and fourth quarters of 2009. The Company's policy is to hedge the majority of its foreign currency exposures with derivative instruments such as foreign currency swaps and forward contracts. Net realized and unrealized gains and losses on derivatives used to hedge those balances are included in "Net realized and unrealized gains and losses – other" in the consolidated financial statements.

The Company has entered into certain foreign currency forward contracts that are designated as hedges in order to hedge its net investments in foreign subsidiaries. The accounting for the gains and losses associated with changes in fair value of the designated hedge instruments were recorded in other comprehensive income as part of the cumulative translation adjustment, to the extent that it is effective as a hedge. The Company designated foreign currency forwards with notional contractual value of $162.0 million as hedging instruments, which had a fair value of $(0.4) million as of December 31, 2009. During the year ended December 31, 2009, the Company recorded $4.6 million of realized and unrealized losses directly into comprehensive income as part of the cumulative translation adjustment for the effective portion of the hedge. All other derivatives are not designated as hedges, and accordingly, the realized and unrealized gains and losses arising during the year are included in income in "Net realized gains and losses —investments" and "Net realized gains and losses —other" in the consolidated financial statements.

Index

2008 versus 2007
For the year ended December 31, 2008, we experienced net foreign exchange losses of $21.5 million compared to net foreign exchange gains of $5.3 million for the year ended December 31, 2007. For the year ended December 31, 2008, the net foreign exchange losses were principally experienced on the net monetary asset and liability balances denominated in foreign currencies which generally weakened against the U.S. dollar, especially during the third and fourth quarters of 2008. The Company's policy is to hedge the majority of its foreign currency exposures with derivative instruments such as foreign currency swaps and forward contracts.

The Company has entered into certain foreign currency forward contracts that are designated as hedges in order to hedge its net investments in foreign subsidiaries. The accounting for the gains and losses associated with changes in fair value of the designated hedge instruments were recorded in other comprehensive income as part of the cumulative translation adjustment, to the extent that it is effective as a hedge. The Company designated foreign currency forwards with notional contractual value of $337.7 million as hedging instruments, which had a fair value of $(5.7) million as of December 31, 2008. During the year ended December 31, 2008, the Company recorded $17.0 million of realized and unrealized losses directly into comprehensive income as part of the cumulative translation adjustment for the effective portion of the hedge. All other derivatives are not designated as hedges, and accordingly, the realized and unrealized gains and losses arising during the year are included in "Net realized gains and losses —investments" and "Net realized gains and losses —other" in the consolidated financial statements.

Income Tax Expense

The Company has subsidiaries that operate in various other jurisdictions around the world that are subject to tax in the jurisdictions in which they operate. The significant jurisdictions in which the Company's subsidiaries are subject to tax are Canada, Cyprus, India, Luxembourg, South Africa, Switzerland, U.S. Virgin Islands ("USVI") and the United Kingdom. However since the majority of our income to date has been earned in Bermuda where we are exempt from income tax, the Company's tax impact to date has been minimal.

2009 versus 2008
During the year ended December 31, 2009, income tax expense was $5.4 million compared to $1.2 million for the year ended December 31, 2008. The increase for the year ended December 31, 2009, compared to the same period in 2008, is primarily attributable to higher taxable income in jurisdictions around the world that are subject to tax as well as the acquisition of Flagstone Africa in June 2008, which resulted in taxable income being earned in Africa. As a result of the merger between Flagstone Reinsurance Limited and Flagstone Suisse, we expect our tax expense to increase to approximate our effective Swiss Federal tax rate of approximately 8% on the portion of underwriting profits, if any, generated by Flagstone Suisse, excluding the underwriting profits generated in Bermuda through the Flagstone Suisse branch office.

2008 versus 2007
During the year ended December 31, 2008, income tax expense was $1.2 million compared to $0.8 million for the year ended December 31, 2007.

Noncontrolling Interest

2009 versus 2008
The results of Mont Fort have been included in the Company's audited consolidated financial statements, with the portions of Mont Fort's net income and shareholders' equity attributable to the preferred shareholders recorded as noncontrolling interest since January 12, 2007 in accordance with the FASB ASC Topic on Consolidation. In relation

to Mont Fort, the Company recorded income attributable to noncontrolling interest of $26.3 million for the year ended December 31, 2009, compared to income attributable to noncontrolling interest of $14.2 million for the year ended December 31, 2008, an increase of $12.1million due to the positive underwriting results of Mont Fort in 2009 as the 2008 results were impacted by negative investment returns and Hurricane Ike losses.

On June 30, 2009, Island Heritage, in which the company holds a controlling interest, issued 2,709 shares to certain of its employees under a performance share unit plan. Prior to this transaction, the Company held an ownership interest in Island Heritage of 59.2% and as of December 31, 2009, now holds an interest of 58.8%. The results of operations of Island Heritage have been included in the Company's audited consolidated financial statements from July 1, 2007, onwards, with the portions of Island Heritage's net income and shareholders' equity attributable to minority shareholders recorded as noncontrolling interest. The Company recorded income (loss) attributable to noncontrolling interest of $1.7 million for the year ended December 31, 2009, compared to ($0.6) million for the year ended December 31, 2008.

Index

The results of operations of Flagstone Africa have been included in the Company's audited consolidated financial statements from June 26, 2008, onwards, with the portions of Flagstone Africa's net income and shareholders' equity attributable to minority shareholders recorded as noncontrolling interest. On November 10, 2009, Flagstone Suisse became the sole shareholder of Flagstone Africa by acquiring the remaining 35% of shares owned by Imperial Holdings Limited for a purchase price of $11.4 million. The Company recorded a noncontrolling interest charge of $0.1 million for the year ending December 31, 2008.

2008 versus 2007

On February 8, 2008, Mont Fort repurchased 5.0 million preferred shares relating to its second cell, Mont Fort ILW 2 for $6.6 million. In relation to Mont Fort, the Company recorded income (loss) attributable to noncontrolling interest of $14.2 million for the year ended December 31, 2008, compared to $33.6 million for the year ended December 31, 2007. The 2008 results of Mont Fort were impacted by the negative investment returns and Hurricane Ike losses.

The Company recorded income (loss) attributable to noncontrolling interest of $(0.6) million for the year ended December 31, 2008, compared to $2.2 million for the year ended December 31, 2007 with respect to its controlling interest in Island Heritage. On July 1, 2008, Island Heritage issued 1,789 shares to certain of its employees under a performance share unit plan. Prior to this transaction, the Company held an ownership interest in Island Heritage of 59.6% and as of December 31, 2008, held an interest of 59.2%. The Company elected to record gains and losses resulting from the issuance of subsidiary's stock as an equity transaction. Accordingly, the Company recorded a noncontrolling interest charge of $0.1 million as a decrease to additional paid-in capital.

On June 26, 2008, Flagstone Suisse purchased 3,714,286 shares (representing a 65% interest) in Flagstone Africa (previously known as Imperial Reinsurance Company Limited) for a purchase price of $18.6 million. The results of operations of Flagstone Africa were included in the Company's consolidated financial statements from June 26, 2008, onwards, with the portions of Flagstone Africa's net income and shareholders' equity attributable to minority shareholders recorded as noncontrolling interest. The Company recorded a noncontrolling interest charge of $0.1 million for the year ended December 31, 2008.

Comprehensive Income (Loss)

2009 versus 2008

Comprehensive income (loss) attributable to Flagstone for the year ended December 31, 2009, was $243.5 million compared to $(203.0) million for the same period in 2008. For the year ended December 31, 2009, comprehensive income (loss) included $270.7 million of net income, $2.6 million for the change in the currency translation adjustment, and $0.1 million for the change in the defined benefit pension plan obligation compared to a net loss of $173.7, million, $(16.3) million for the change in the currency translation adjustment, and $(0.9) million for the change in defined benefit pension plan transitional obligation for the year ended December 31, 2008.

The currency translation adjustment is as a result of the translation of our foreign subsidiaries into U.S. dollars, net of transactions designated as hedges of net foreign investments. The Company has entered into certain foreign currency forward contracts that it has designated as hedges in order to hedge its net investment in foreign subsidiaries. To the extent that the contract is effective as a hedge, both the realized and unrealized gains and losses associated with the designated hedge instruments are recorded in other comprehensive income as part of the cumulative translation adjustment. The Company designated $162.0 million and $337.7 million of foreign currency forwards contractual value as hedge instruments, which had a fair value of $(0.4) million and $(5.7) million, at December 31, 2009 and 2008, respectively. The Company recorded $4.6 million and $17.0 million of realized and unrealized foreign exchange losses on these hedges during the years ended December 31, 2009 and 2008, respectively.

2008 versus 2007

Comprehensive (loss) income attributable to Flagstone for the year ended December 31, 2008, was $(203.0) million compared to $175.9 million for the same period in 2007. For the year ended December 31, 2008, comprehensive (loss) income included $(173.7) million of net loss, $(16.3) million for the change in the currency translation adjustment, and $(0.9) million for the change in the defined benefit pension plan transitional obligation compared to $167.9 million of net income and $7.9 million for the change in the currency translation adjustment for the year ended December 31, 2007.

The Company designated $337.7 million and $264.4 million of foreign currency forwards contractual value as hedge instruments, which had a fair value of $(5.7) million and $(3.4) million, at December 31, 2008 and 2007, respectively. The Company recorded $17.0 million and $3.5 million of realized and unrealized foreign exchange losses on these hedges during the years ended December 31, 2008 and 2007, respectively.

Index

Financial Condition, Liquidity, and Capital Resources

Financial Condition

Investments

The total of investments, cash and cash equivalents, and restricted cash was $1.9 billion at December 31, 2009, compared to $1.7 billion at December 31, 2008.

The major factors influencing the increase in 2009 were:
- Cash from operations of $338.4 million
- Net investment income of $28.5 million
- Total net realized and unrealized gains on investments and other of $50.9 million
- Dividends paid of $13.4 million
- Cash contributions into the portfolios from underwriting activities.

The investment management guidelines of the Company are set by the Finance Committee of our Board of Directors. The Finance Committee establishes investment policies and guidelines for both internal and external investment managers. The Company employs a prudent investment philosophy. It maintains a high-quality, well-balanced and liquid portfolio having the dual objectives of optimizing current investment income and achieving capital appreciation.

The Company has a strong bias against active management in favor of indexing and passive securities that are generally the most liquid. When they are part of the asset allocation, a number of our equity and other exposure implementations use futures contracts and swaps, whereas the assets in a short term portfolio, managed by external managers, support the futures contracts as if those assets were pledged and not available for liquidity purposes. The portfolio managers are required to adhere to investment guidelines as to minimum ratings and issuer and sector concentration limitations. This implementation strategy gives us a low cost and efficient way, using a mixture of passive assets and outside managers, to complement our in-house capability for overall portfolio management, liquidity management and hedging.

Our investment portfolio on a risk basis, at December 31, 2009, comprised 89.7% fixed maturities, short-term investments and cash and cash equivalents, 4.0% equities and the balance in other investments. We believe our investments can be liquidated and converted into cash within a very short period of time. However, our investment funds, which represent 0.3% of our total investments and cash and cash equivalents at December 31, 2009, do not trade on liquid markets or are subject to redemption provisions that prevent us from converting them into cash immediately.

At December 31, 2009, all of our fixed maturity securities, with the exception of three bonds with a fair value of $0.5 million, were rated investment-grade (BBB- or higher) by Standard & Poor’s (or estimated equivalent) with an average rating of AA+. At December 31, 2008, all of our fixed maturity securities, with the exception of $0.3 million were rated investment-grade (BBB- or higher) by Standard & Poor’s (or estimated equivalent) with an average rating of AA+.

Index

At December 31, 2009 and 2008, the average duration of the Company's investment portfolio was 2.3 years and 2.9 years, respectively. The duration decreased mostly due to the change in asset allocation during the year.

As noted above, the Company's investment strategy allows the use of derivative instruments such as futures contracts, total return swaps, foreign exchange forward contracts, interest rate swaps, and TBAs, subject to strict limitations. Derivative instruments may be used to replicate investment positions or to manage currency and market exposures and duration risk that would be allowed under the Company's investment policy if implemented in other ways. These derivatives seek investment results that generally correspond to the price and yield performance of the underlying markets. The fair value of these derivatives held by the Company at December 31, 2009 was $9.5 million, compared to $(5.3) million at December 31, 2008.

The cost or amortized cost, gross unrealized gains and losses and carrying values of the Company's fixed maturity, short term and equity investments as at December 31, 2009 and 2008, are as follows:

	As at December 31, 2009			
	Amortized cost or cost	Gross unrealized gains	Gross unrealized losses	Fair Value
Fixed maturities				
U.S. government and government agency	$421,215	$12,186	$(1,686)	$431,715
U.S. states and political subdivision	1,907	11	(15)	1,903
Other foreign governments	112,119	3,426	(1,118)	114,427
Corporates	504,855	15,763	(1,376)	519,242
Mortgage-backed securities	108,652	3,969	(554)	112,067
Asset-backed securities	49,439	253	(485)	49,207
Total fixed maturities	$1,198,187	$35,608	$(5,234)	$1,228,561
Short term investments				
U.S. government and government agency	$145,600	$6	$(2)	$145,604
Other foreign governments	3,877	136	-	4,013
Corporates	80,223	1,419	(738)	80,904
Asset-backed securities	1,909	4	-	1,913
Total short term investments	$231,609	$1,565	$(740)	$232,434
Equity investments	$8,516	$124	$(8,350)	$290
Total investments	$1,438,312	$37,297	$(14,324)	$1,461,285

Index

	As at December 31, 2008			
	Amortized cost or cost	Gross unrealized gains	Gross unrealized losses	Fair Value
Fixed maturities				
U.S. government and government agency	$487,667	$9,533	$(10,359)	$486,841
Other foreign governments	15,109	104	(7)	15,206
Corporates	139,057	4,298	(2,931)	140,424
Mortgage-backed securities	115,478	2,406	(5,810)	112,074
Asset-backed securities	30,481	35	(706)	29,810
Total fixed maturities	$787,792	$16,376	$(19,813)	$784,355
Short term investments				
U.S. government and government agency	$30,491	$-	$(78)	$30,413
Total short term investments	$30,491	$-	$(78)	$30,413
Equity investments	$16,266	$784	$(11,737)	$5,313
Total investments	$834,549	$17,160	$(31,628)	$820,081

Sub-prime exposure

At December 31, 2009 and 2008, we had no exposure to sub-prime backed investments or collateralized debt obligations ("CDOs") of sub-prime backed investments. At December 31, 2009 and 2008, our holdings of Alt–A securities were $0.8 million with an average rating of AAA and $3.0 million with an average rating of AA+, respectively. Alt–A securities are defined as a classification of mortgages where the risk profile falls between prime and sub-prime. The borrowers behind these mortgages will typically have clean credit histories, but the mortgage itself will generally have some features that increase its risk profile compared to prime securities, but less risky than sub-prime backed investments. These features include higher loan-to-value and debt-to-income ratios or inadequate documentation of the borrower's income. The Company's exposure to traditional monoline insurers emanates from our non subprime asset-backed holdings. We did not hold securities with credit enhancement from the traditional monoline insurers at December 31, 2009 and we had $1.2 million at December 31, 2008. We do not have any collateralized loan obligations or CDO exposures in our portfolio.

Other investments

Other investments as at December 31, 2009 amounted to $45.9 million compared to $54.7 million at December 31, 2008. The December 31, 2009 investments are comprised mainly of our investment in catastrophe bonds of $36.1 million, in private equity and hedge funds of $5.5 million and the Company's $4.3 million equity investment. The Company's other investments as of December 31, 2009 and 2008 are as follows:

	As at December 31,	
	2009	2008

Investment funds	$5,486	$9,805
Catastrophe bonds	36,128	39,174
Equity investment	4,320	5,676
Total other investments	$45,934	$54,655

Index

Rating Distribution

The following table provides a breakdown of the credit quality of the Company's fixed maturity investments at December 31, 2009 and 2008:

	As at December 31,					
	2009			2008		
	% of Total fixed maturity investments		Fair values	% of Total fixed maturity investments		Fair values
Rating Category						
AAA	71.4	%	$ 1,043,223	82.5	%	$ 646,881
AA	7.6	%	111,300	3.2	%	24,868
A	14.7	%	214,214	10.4	%	81,849
BBB	6.3	%	91,723	3.9	%	30,434
Below investment grade	0.0	%	535	0.0	%	323
Total	100.0	%	$ 1,460,995	100.0	%	$ 784,355

Maturity Distribution

The contractual maturity dates of fixed maturity and short term investments as at December 31, 2009 and 2008 is shown below. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

	As at December 31,			
	2009		2008	
	Amortized	Fair Value	Amortized	Fair Value