

TOKIO MILLENNIUM RE LTD.

Consolidated Financial Statements
(With Independent Auditors' Report Thereon)

Years Ended December 31, 2008 and 2007



KPMG

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder
Tokio Millennium Re Ltd.

We have audited the accompanying consolidated balance sheets of Tokio Millennium Re Ltd. and subsidiary as of December 31, 2008 and 2007 and the related consolidated statements of operations and comprehensive income, changes in shareholder's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tokio Millennium Re Ltd. and subsidiary as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads 'KPMG'. The letters are stylized and cursive, with the 'K' and 'M' being particularly prominent.

Chartered Accountants
Hamilton, Bermuda
March 2, 2009

TOKIO MILLENNIUM RE LTD.

Consolidated Balance Sheets

December 31, 2008 and 2007

(Expressed in United States Dollars)

	<u>2008</u>	<u>2007</u>
Assets		
Cash and cash equivalents (Notes 3 and 10)	\$ 322,034,210	\$ 308,441,993
Short term investments (Notes 2, 3, 4 and 10)	69,747,829	-
Investments in fixed maturity securities (Notes 2, 3 and 4)	637,737,790	624,931,834
Investments in catastrophe bonds (Notes 2 and 4)	62,421,123	66,934,958
Collateral held on behalf of counterparties (Notes 2 and 3)	58,896,420	111,620,061
Accrued interest receivable	10,135,908	8,977,904
Reinsurance balances receivable (Note 3)	87,635,630	77,801,756
Prepaid reinsurance premiums (Note 3)	25,652,906	28,676,309
Fair value of derivatives (Notes 2 and 3)	23,232,188	18,675,146
Outstanding losses recoverable from reinsurers (Notes 3 and 5)	20,499,995	5,772,918
Deferred acquisition expenses	10,997,706	10,269,238
Unearned profit commission	599,521	544,897
Prepaid expenses	2,055,435	1,571,237
Capital assets (Note 7)	9,374,663	6,564,412
Funds withheld (Note 3)	40,609,967	31,997,748
Other assets	<u>208,965</u>	<u>256,596</u>
Total assets	\$ 1,381,840,256	\$ 1,303,037,007
Liabilities		
Outstanding losses and loss expenses (Note 5)	\$ 103,938,977	\$ 62,964,371
Liability for collateral held on behalf of counterparties (Notes 2 and 3)	60,144,774	111,620,061
Reinsurance balances payable	50,251,890	62,701,656
Amount due to investment brokers	-	10,304,000
Unearned premiums	107,117,974	92,828,886
Deferred fee income	4,062	5,199
Deferred commission income	3,565,964	3,471,220
Accounts payable and accrued expenses	2,802,397	2,460,592
Dividend payable	<u>-</u>	<u>50,313,163</u>
Total liabilities	<u>327,826,038</u>	<u>396,669,148</u>
Shareholder's equity		
Authorised, issued and fully paid, shares of \$1 par value each	250,000,000	250,000,000
Contributed surplus (Note 8)	400,000,000	400,000,000
Retained earnings	369,166,805	242,539,707
Accumulated other comprehensive income	<u>34,847,413</u>	<u>13,828,152</u>
Total shareholder's equity	<u>1,054,014,218</u>	<u>906,367,859</u>
Total liabilities and shareholder's equity	\$ 1,381,840,256	\$ 1,303,037,007

See accompanying notes to consolidated financial statements

Signed on behalf of the Board

Director_____
Director

TOKIO MILLENNIUM RE LTD.

Consolidated Statements of Operations and Comprehensive Income

For the Years Ended December 31, 2008 and 2007
(Expressed in United States Dollars)

	<u>2008</u>	<u>2007</u>
Income		
Reinsurance premiums assumed	\$ 369,785,794	\$ 296,968,570
Change in unearned premiums	<u>(14,289,088)</u>	<u>(41,481,481)</u>
Reinsurance premiums earned	<u>355,496,706</u>	<u>255,487,089</u>
Reinsurance premiums ceded (Note 6)	51,510,118	50,946,286
Change in prepaid reinsurance	<u>3,023,403</u>	<u>(18,254,709)</u>
Reinsurance premiums ceded	<u>54,533,521</u>	<u>32,691,577</u>
Net premiums earned	300,963,185	222,795,512
Catastrophe bond income	5,096,952	5,511,583
Agency fee income	<u>15,116</u>	<u>95,935</u>
Total operating income	306,075,253	228,403,030
Net investment income (Note 4)	<u>36,204,641</u>	<u>43,164,536</u>
Total income	<u>342,279,894</u>	<u>271,567,566</u>
Expenses		
Loss and loss expenses incurred	80,552,537	7,652,352
Losses recoverable from reinsurers	<u>(21,203,291)</u>	<u>(5,008,149)</u>
Net loss and loss expenses incurred (Note 5)	59,349,246	2,644,203
Acquisition expenses	51,260,453	40,075,818
Profit commission	26,951,543	26,915,362
Net derivative expense (Note 9)	37,012,327	19,542,558
General and administrative expenses (Note 10)	27,058,865	20,687,101
Foreign exchange losses (gains) (Note 4)	<u>14,020,362</u>	<u>(6,012,668)</u>
Total expenses	<u>215,652,796</u>	<u>103,852,374</u>
Net income	126,627,098	167,715,192
Other comprehensive income		
Net change in unrealised gains on investments	<u>21,019,261</u>	<u>17,245,909</u>
Other comprehensive income	<u>21,019,261</u>	<u>17,245,909</u>
Comprehensive income	<u>\$ 147,646,359</u>	<u>\$ 184,961,101</u>

See accompanying notes to consolidated financial statements

TOKIO MILLENNIUM RE LTD.

Consolidated Statements of Changes in Shareholder's Equity

For the Years Ended December 31, 2008 and 2007
(Expressed in United States Dollars)

	<u>2008</u>	<u>2007</u>
Share capital		
Balance at beginning and end of year	\$ <u>250,000,000</u>	\$ <u>250,000,000</u>
Contributed surplus		
Balance at beginning and end of year	<u>400,000,000</u>	<u>400,000,000</u>
Retained earnings		
Balance at beginning of year	242,539,707	125,137,678
Net income	126,627,098	167,715,192
Dividends	<u>—</u>	<u>(50,313,163)</u>
Balance at end of year	<u>369,166,805</u>	<u>242,539,707</u>
Other comprehensive income (loss)		
Balance at beginning of year	13,828,152	(3,417,757)
Net change in unrealised gains on investments	<u>21,019,261</u>	<u>17,245,909</u>
Balance at end of year	<u>34,847,413</u>	<u>13,828,152</u>
Total shareholder's equity	<u>\$ 1,054,014,218</u>	<u>\$ 906,367,859</u>

See accompanying notes to consolidated financial statements

TOKIO MILLENNIUM RE LTD.

Consolidated Statements of Cash Flows

For the Years Ended December 31, 2008 and 2007
(Expressed in United States Dollars)

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities		
Net income	\$ 126,627,098	\$ 167,715,192
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of capital assets	2,170,146	1,334,666
Loss on disposal of fixed assets	7,663	48,285
Amortisation of fixed maturity securities	1,765,076	806,698
Amortisation of catastrophe bonds	5,833	-
Other than temporary impairment charge on short term investments	12,333,958	-
Change in:		
Collateral held on behalf of counterparties	52,723,641	6,307,223
Accrued interest receivable	(1,158,004)	(436,834)
Reinsurance balances receivable	(9,833,874)	(26,394,201)
Prepaid reinsurance premiums	3,023,403	(18,254,709)
Fair value of derivatives	(4,557,042)	(8,237,005)
Outstanding losses recoverable from reinsurers	(14,727,077)	(2,317,877)
Deferred acquisition expenses	(728,468)	(4,523,911)
Unearned profit commission	(54,624)	(171,745)
Prepaid expenses	(484,198)	(454,274)
Funds withheld	(8,612,219)	748,112
Other assets	47,631	90,282
Outstanding losses and loss expenses	40,974,606	(89,714,996)
Liability for collateral held on behalf of counterparties	(51,475,287)	(6,307,223)
Reinsurance balances payable	(12,449,766)	37,282,701
Unearned premiums	14,289,088	41,481,481
Deferred fee income	(1,137)	108
Deferred commission income	94,744	2,737,040
Accounts payable and accrued expenses	<u>341,805</u>	<u>442,887</u>
Cash provided by operating activities	<u>150,322,996</u>	<u>102,181,900</u>
Cash flows from investing activities		
Purchase of short term investments	(82,081,787)	-
Purchase of fixed maturity securities	(138,564,936)	(154,060,272)
Proceeds on sale or maturity of fixed maturity securities	146,890,000	145,170,000
Purchase of catastrophe bonds	(28,814,000)	(12,000,000)
Proceeds on maturity of catastrophe bonds	21,141,167	15,000,000
Purchase of capital assets, net of sales proceeds	<u>(4,988,060)</u>	<u>(4,797,128)</u>
Cash used in investing activities	<u>(86,417,616)</u>	<u>(10,687,400)</u>
Cash flows from financing activities		
Dividends paid	<u>(50,313,163)</u>	<u>(37,178,039)</u>
Cash used in financing activities	<u>(50,313,163)</u>	<u>(37,178,039)</u>
Net increase in cash and cash equivalents	13,592,217	54,316,461
Cash and cash equivalents at beginning of year	<u>308,441,993</u>	<u>254,125,532</u>
Cash and cash equivalents at end of year	<u>\$ 322,034,210</u>	<u>\$ 308,441,993</u>

See accompanying notes to consolidated financial statements

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Amounts in tables expressed in United States Dollars)

1. General

Tokio Millennium Re Ltd. (the "Company") was incorporated under the laws of Bermuda on March 15, 2000 and is licenced as a Class 3 reinsurer under the Insurance Act, 1978 of Bermuda and related regulations to write all classes of property and casualty business. The Company is a wholly-owned subsidiary of the Tokio Marine and Nichido Fire Insurance Co., Ltd.. The ultimate parent company is Tokio Marine Holdings, Inc. (formerly Millea Holdings, Inc.), a company incorporated in Japan.

The Company participates in various excess of loss property catastrophe, workers' compensation catastrophe, crop/hail and terrorism reinsurance contracts. Catastrophe reinsurance covers unpredictable events such as hurricanes, windstorms, hailstorms, earthquakes, fires, freezes, floods and other man-made or natural disasters. Because the Company has large aggregate exposures to these risks, the Company expects that its claims experience will be characterised by relatively low frequency and high severity claims. The occurrence of claims from catastrophic events is likely to result in substantial volatility in the Company's financial results for any particular period. The Company endeavours to manage its exposures to catastrophic events by limiting the amount of its exposure in each geographic zone.

The Company also provides non-traditional customised insurance, reinsurance and financial solutions for its clients' world-wide property and casualty exposures on both a treaty and facultative basis.

Tokio Millennium Agency Ltd. ("TMA"), a wholly-owned subsidiary of the Company, was incorporated in Bermuda on June 6, 2003, with an initial share capital of \$12,000. Its primary activity is to facilitate risk swap agreements between Tokio Marine and Nichido Fire Insurance Co., Ltd. and other insurance companies for which it receives agency fees.

2. Summary of significant accounting policies

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, TMA. All significant intercompany transactions and balances have been eliminated on consolidation. To facilitate comparison of information across periods, certain prior year amounts have been reclassified to conform to the current year presentation.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported and disclosed amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The major estimates reflected in the Company's consolidated financial statements include, but are not limited to, the outstanding losses and loss expenses, outstanding losses recoverable from reinsurers, estimates of written and earned premiums and the fair value of catastrophe swap derivatives.

The following are the significant accounting policies adopted by the Company:

(a) Premiums earned and acquisition expenses

Premiums assumed are recorded on the accruals basis and are included in income over the period of exposure to risk with the unearned portion deferred in the balance sheet. Reinsurance premiums ceded are similarly earned over the period of exposure to risk with the unearned portion being deferred in the balance sheet as prepaid reinsurance premiums.

For excess of loss contracts, the ultimate premium is estimated at contract inception. Subsequent premium adjustments, if any, are recorded in the period in which they are determined. For proportional treaties, the amount of premium is normally estimated at inception by the ceding company. The Company accounts for such premium using initial estimates, which are reviewed regularly with respect to the actual premium reported by the ceding company.

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Amounts in tables expressed in United States Dollars)

2. Summary of significant accounting policies (continued)

(a) Premiums earned and acquisition expenses (continued)

The Company earns reinstatement premiums upon the occurrence of a loss under the reinsurance contract. Reinstatement premiums are calculated in accordance with the contract terms based upon the ultimate loss estimate associated with each contract.

Acquisition expenses, mainly commissions and brokerage, related to unearned premiums are deferred and amortised to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition expenses limits the amount of the deferral to its realisable value by giving consideration to losses and expenses expected to be incurred as premiums are earned.

Where applicable, no claims bonuses and profit commissions are accrued based on claim experience.

(b) Outstanding losses and loss expenses

Losses and loss expenses paid are recorded when advised by the ceding insurance companies. Outstanding losses comprise estimates of the amount of reported losses and loss expenses received from the ceding insurance companies plus a provision for losses incurred but not reported ("IBNR"). The IBNR provision is estimated by management based on reports from industry sources, including initial estimates of aggregate industry losses, individual loss estimates received from ceding companies and brokers, output from commercially available catastrophe loss models and actuarial analysis using historical data available to the Company on the business assumed together with industry data.

Given the inherent nature of major catastrophic events, considerable uncertainty underlies the assumptions and associated estimated reserve for losses and loss expenses. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in income in the period in which they are determined. Due to the inherent uncertainty in estimating the liability for losses and loss expenses, there can be no assurance that the ultimate liability will not be settled for a significantly greater or lesser amount than that recorded. Based on the current assumptions used, management believes that the Company's recorded amount is a reasonable estimate of the ultimate cost of losses incurred to the balance sheet date.

Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

(c) Investments

Investments in short term investments, fixed maturity securities and catastrophe bonds are classified as available for sale and are carried at fair value with any unrealised gains and losses included in accumulated other comprehensive income as a separate component of shareholder's equity. Short term investments represent bank deposits with an original term greater than 90 days. The carrying value reported in the consolidated balance sheets for these instruments approximates their fair value due to the short nature of the investments. The fair value of fixed maturity securities is based on quoted market prices, if available. If a quoted price is not available, fair value is estimated using quoted prices for similar securities or other market-corroborated data. Fair value for catastrophe bonds is based on independent broker quotes. The cost of fixed maturity securities is adjusted for amortisation of premiums and discounts. Realised gains and losses on investments are recognised in net income using the specific identification method and include adjustments for declines in value that are considered other-than-temporary. Interest income on short term investments, fixed maturity securities and catastrophe bonds is accrued to the balance sheet date.

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Amounts in tables expressed in United States Dollars)

2. Summary of significant accounting policies (continued)

(c) Investments (continued)

The Company's assessment of a decline in value deemed to be other-than-temporary includes judgement as to the financial position and future prospects of the entity that issued the security. If that judgement changes in the future, the Company may ultimately record a realised loss after originally concluding that the decline in value was temporary. Factors which management consider in evaluating other-than-temporary declines in value include the extent of decline, the length of time the security is below cost, the Company's intent and ability to hold the security, the future prospects of the issuer and other qualitative and quantitative factors.

(d) Derivative financial instruments

The Company designates its derivatives based upon criteria established by Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). From time to time the Company enters into catastrophe swap derivatives, under which certain catastrophe reinsurance exposures are ceded to or assumed from the swap counterparty. Catastrophe swaps are recorded at fair value with changes in fair values recorded in the income statement.

(e) Capital assets

Capital assets are stated at cost less accumulated depreciation calculated on a straight-line basis over the estimated useful lives of the assets which are as follows:

Computer equipment & software	3 years
Office equipment	4 years
Fixtures and fittings	5 years
Motor vehicles	5 years
Leasehold improvements	Over the term of each lease

(f) Translation of foreign currencies

Foreign currency assets and liabilities considered monetary items, are translated at exchange rates in effect at the balance sheet date. Foreign currency revenues and expenses are translated at the transaction date exchange rates. Exchange gains and losses are included in the determination of net income.

(g) Cash and cash equivalents

For purposes of the statements of cash flows, the Company considers all instruments and deposits with a maturity of ninety days or less as at the date of purchase, and money market funds which can be redeemed without penalty as equivalent to cash.

(h) Fair Value Measurements

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* ("FAS 157"). FAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 clarifies that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets and the lowest priority being unobservable data. Further, FAS 157 requires tabular disclosures of the fair value measurements by level within the fair value hierarchy. The Company adopted FAS 157 effective January 1, 2008. The adoption of FAS 157 did not have a significant impact on the Company's consolidated statements of operations or financial condition, except for additional required disclosures in the consolidated financial statements.

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Amounts in tables expressed in United States Dollars)

2. **Summary of significant accounting policies** (continued)

(h) *Fair Value Measurements* (continued)

The following are the levels within the fair value hierarchy:

- Level 1—Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these instruments does not entail a significant degree of judgment.
- Level 2—Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals, broker quotes and certain pricing indices.
- Level 3—Valuations based on inputs that are unobservable and significant to the overall fair value measurement. These measurements include circumstances where there is little, if any, market activity for the asset or liability. In these cases, significant management assumptions can be used to establish management's best estimate of the assumptions used by other market participants in determining the fair value of the asset or liability.

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

There have been no material changes in the Company's valuation techniques since the adoption of FAS 157 effective January 1, 2008.

Below is a summary of the assets and liabilities that are measured at fair value on a recurring basis:

At December 31, 2008	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Short term investments	\$ 69,747,829	\$ 69,747,829	\$ —	\$ —
Investments in fixed maturity securities	637,737,790	341,334,467	296,403,323	—
Investments in catastrophe bonds	62,421,123	—	62,421,123	—
Collateral held on behalf of counterparties	58,896,420	58,896,420	—	—
Fair value of derivatives	23,232,188	—	—	23,232,188
Liability for collateral held on behalf of counterparties	<u>(60,144,774)</u>	<u>(60,144,774)</u>	<u>—</u>	<u>—</u>
	<u>\$ 791,890,576</u>	<u>\$ 409,833,942</u>	<u>\$ 358,824,446</u>	<u>\$ 23,232,188</u>

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

*(Amounts in tables expressed in United States Dollars)***2. Summary of significant accounting policies** (continued)*(h) Fair Value Measurements* (continued)

Investments in fixed maturity securities included in Level 1 consist of the Company's investments in U.S. Treasuries; also included in Level 1 are short term investments and collateral held on behalf of counterparties, which consists of cash and cash equivalents.

Investments in fixed maturity securities included in Level 2 consist of the Company's investments in U.S. agencies, non-U.S. governments and corporates. Investments in catastrophe bonds are also included in Level 2. The fair value of catastrophe bonds is determined using the midpoint of the bid and offer price provided by an independent pricing agent. As such they are categorized as level 2 due to the inactive nature of this market.

Included in Level 3 are the Company's catastrophe swap derivatives. Catastrophe swap derivatives are stated at fair value as estimated by management primarily based on the unexpired period of risk, an evaluation of the probability of loss and other unobservable inputs. The inputs for catastrophe swap derivatives are purely based on management's evaluation and are unobservable.

Below is a reconciliation of the beginning and ending balances of derivatives measured at fair value on a recurring basis using Level 3 inputs:

<u>Year ended December 31, 2008</u>	<u>Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Fair Value of Derivatives</u>
Balance – January 1	\$ 18,675,146
Total unrealized losses	
Included in net derivative expense	(18,337,181)
Total realized losses	
Included in net derivative expense	(18,675,146)
Net purchases, issuances, and settlements	41,569,369
Net transfers in and/or out of Level 3	<u>–</u>
Balance – December 31	<u>\$ 23,232,188</u>

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Amounts in tables expressed in United States Dollars)

2. Summary of significant accounting policies (continued)

(h) Fair Value Measurements (continued)

The following methods and assumptions were used by the Company in estimating fair value disclosures for other financial instruments:

Cash and cash equivalents: The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

Other assets and liabilities: The fair value of accrued interest receivable, reinsurance balances receivable, funds withheld, other assets, reinsurance balances payable, amounts due to investment brokers, accounts payable and accrued expenses and dividend payable approximates their carrying value due to their short term nature. The estimates of fair values presented herein are subjective in nature and are not necessarily indicative of the amounts that the Company would actually realise in a current market exchange. However, any differences would not be expected to be material. Certain instruments such as prepaid reinsurance premiums, deferred acquisition expenses, outstanding losses recoverable from reinsurers, unearned profit commission, prepaid expenses, capital assets, outstanding losses and loss expenses, unearned premiums, deferred fee income and deferred commission income are excluded from fair value disclosure. Thus the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

(i) Bad Debt Provision

The company reviews receivables on a quarterly basis. A bad debt provision is generally provided for any receivables that are greater than six months overdue. In addition the company considers known and emerging credit events to determine if other provisions are necessary.

(j) Long term incentive compensation plan

In 2008, the Board approved a compensation program for employees. The compensation program consists of accumulation units which are based on movements in the net asset value of the Company and are settled in cash once the cliff vesting service period has been rendered. The Company is required to account for the compensation program in accordance with Financial Accounting Standards Board ("FASB") Statement No. 123 (Revised 2004) "Share-Based Payment" ("SFAS 123R"). SFAS 123R requires the Company to measure the cost of employee services received in exchange for an accumulation unit award based on the grant-date fair value of the award and as a liability award is remeasured each reporting period. The cost of such services will be recognized over the period during which an employee is required to provide service in exchange for the award. The fair value of the accumulation units is accounted for as a liability classified award. The Company has applied a narrow based interpretation of authorization, as defined in SFAS 123R, for the determination of the grant date of the awards. As such, the grant date of the units is determined to be upon authorization of the awards in accordance with the Company's governance structure.

As at December 31, 2008, the Company has not awarded any options and therefore there is no impact on the Company's consolidated balance sheets or consolidated statements of operations.

TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(Amounts in tables expressed in United States Dollars)

3. Concentration of credit risk

As at December 31, 2008, cash and cash equivalents of \$322,034,210 (2007 - \$308,441,993) and short term investments of \$69,747,829 (2007 - \$nil) are held with two banking institutions with credit ratings of AA and AA-, respectively, as assigned by rating agencies (e.g., A.M. Best and S&P). The Company's management evaluates the financial strength and stability of these institutions on a periodic basis.

As at December 31, 2008, 78% of the Company's funds withheld is held in trust by two ceding companies with credit ratings of A- and A, respectively. At December 31, 2007, 98% of the Company's funds withheld was held in trust by a single ceding company with a credit rating of A-.

The Company's investment portfolio is managed by an external investment manager in accordance with our investment guidelines. These guidelines follow prudent standards of diversification and a prudent investment philosophy. Within our fixed income portfolio, we attempt to limit our credit exposure by purchasing fixed income securities rated AA- and higher. The Company is not exposed to any significant concentration risk on its investments.

The Company has exposure to credit risk related to reinsurance balance receivable and reinsurance recoverable on paid and unpaid losses. The credit risk exposure related to these balances is mitigated by several factors, including but not limited to, collateralization of exposures ceded to unrated counterparties, credit checks performed as part of the underwriting process and monitoring of aged receivables. As of December 31, 2008 and 2007, the Company has no significant aged receivables.

The creditworthiness of any counterparty is evaluated by the Company, taking into account credit ratings assigned by rating agencies. The credit approval process involves an assessment factors, including, among others, the counterparty, country and credit exposure limits.

At December 31, 2008, the maximum credit risk exposure in relation to unrated counterparties for reinsurance ceded agreements is \$416.7 million (2007 - \$250.6 million). The Company's credit risk in relation to reinsurance ceded is fully collateralised by assets held in trusts for which the Company is a beneficiary of \$219.6 million (2007 - \$180.7 million), collateral held on behalf of counterparties of \$56.6 million (2007 - \$81.4 million), and letters of credit of \$140.4 million (2007 - \$nil).

At December 31, 2008, prepaid reinsurance premiums of \$25.7 million (2007 - \$28.7 million) are related to exposures ceded to unrated reinsurers.

At December 31, 2008, the maximum exposure to credit risk of the counterparties for catastrophe swap agreements is \$422.8 million (2007 - \$342.5 million) which is fully collateralised by assets held in trust by the swap counterparty for the benefit of the Company of \$15.9 million (2007 - \$56.3 million), letters of credit of \$403.3 million (2007 - \$256 million) and collateral held on behalf of counterparties of \$3.5 million (2007 - \$30.2 million). The Company has no entitlement to income earned on the collateral held on behalf of counterparties, and any diminution in the market value of these assets is the responsibility of the counterparty and results in a reduction in the liability for collateral held on behalf of counterparties.

The Company also has exposure to credit risk as it relates to its business written through brokers, if any of the Company's brokers is unable to fulfill their contractual obligations with respect to payments to the Company. In addition, in some jurisdictions, if the broker fails to make payments to the insured under the Company's policy, the Company might remain liable to the insured for deficiency.

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*(Amounts in tables expressed in United States Dollars)***4. Investments***(a) Fixed maturity securities*

(i) The amortised cost, fair value and unrealised gains and losses of investments in fixed maturity securities are as follows:

<u>At December 31, 2008</u>	<u>Amortised Cost</u>	<u>Unrealised Gains</u>	<u>Unrealised Losses</u>	<u>Fair Value</u>
U.S. government and government agency securities	\$ 529,736,675	\$ 35,427,085	\$ –	\$ 565,163,760
Non U.S. government and government agency securities	30,255,374	1,207,375	–	31,462,749
U.S. corporate securities	12,885,978	355,182	–	13,241,160
Non U.S. corporate securities	<u>28,766,474</u>	<u>23,249</u>	<u>(919,602)</u>	<u>27,870,121</u>
	<u>\$ 601,644,501</u>	<u>\$ 37,012,891</u>	<u>\$ (919,602)</u>	<u>\$ 637,737,790</u>
 <u>At December 31, 2007</u>				
U.S. government and government agency securities	\$ 519,509,815	\$ 11,298,313	\$ (134,970)	\$ 530,673,158
Non U.S. government and government agency securities	30,479,702	218,401	(2,354)	30,695,749
U.S. corporate securities	22,955,530	572,556	(4,000)	23,524,086
Non U.S. corporate securities	<u>38,789,593</u>	<u>1,253,982</u>	<u>(4,734)</u>	<u>40,038,841</u>
	<u>\$ 611,734,640</u>	<u>\$ 13,343,252</u>	<u>\$ (146,058)</u>	<u>\$ 624,931,834</u>

The Company's management has evaluated the Company's investments in fixed maturity securities for exposure to sub prime mortgages and structured credit products. The Company does not invest in asset-backed or mortgage-backed securities and therefore the Company has insignificant direct exposure to sub prime mortgages.

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4. **Investments** (continued)

(a) *Fixed maturity securities* (continued)

(ii) The following table summarises for all fixed maturity securities in an unrealised loss position at December 31, 2008, the unrealised loss and fair value by the length of time the security has been continuously in an unrealised loss position.

<u>At December 31, 2008</u>	<u>Less than 12 months</u>		<u>Greater than 12 months</u>	
	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>losses</u>	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>losses</u>
U.S. government and government agency securities	\$ -	\$ -	\$ -	\$ -
Non U.S. government and government agency securities	-	-	-	-
U.S. corporate securities	-	-	-	-
Non U.S. corporate securities	<u>26,047,440</u>	<u>(919,602)</u>	<u>-</u>	<u>-</u>
	<u>\$ 26,047,440</u>	<u>\$ (919,602)</u>	<u>\$ -</u>	<u>\$ -</u>
<u>At December 31, 2007</u>	<u>Less than 12 months</u>		<u>Greater than 12 months</u>	
	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>losses</u>	<u>Fair</u> <u>value</u>	<u>Unrealised</u> <u>losses</u>
U.S. government and government agency securities	\$ 22,696,080	\$ (3,209)	\$ 20,602,991	\$ (131,761)
Non U.S. government and government agency securities	-	-	5,370,900	(2,354)
U.S. corporate securities	-	-	9,998,824	(4,000)
Non U.S. corporate securities	<u>-</u>	<u>-</u>	<u>10,030,389</u>	<u>(4,734)</u>
	<u>\$ 22,696,080</u>	<u>\$ (3,209)</u>	<u>\$ 46,003,104</u>	<u>\$ (142,849)</u>

As of December 31, 2008, the Company held 2 out of a total of 63 fixed maturity securities in an unrealized loss position, which carried total gross unrealized losses of \$919,602. The securities have been in an unrealized loss position for one to two months. These 2 fixed maturity securities in an unrealized loss position, for which an other-than-temporary impairment charge has not been taken, are rated AA+ and AAA, respectively.

Unrealised losses on investments held in 2007 comprise of an accumulation of relatively small unrealised losses on a security by security basis caused by general interest rate movements rather than credit events. As of December 31, 2008 and 2007, the Company had no significant unrealized losses caused by other factors or circumstances, including an issuer's specific corporate risk or due to industry or geographic risk. There are no amounts in respect of declines in the value of individual securities considered to be other than temporary that were included in gross realised losses on fixed maturity investments for the years ended December 31, 2008 and 2007.

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(Amounts in tables expressed in United States Dollars)

4. Investments (continued)

(a) Fixed maturity securities (continued)

(iii) For fixed maturity securities held on December 31, 2008 the maturity distribution is as follows:

	Amortised <u>cost</u>	Fair <u>value</u>
Within one year	\$ 110,315,969	\$ 112,159,021
From one to five years	403,172,828	427,166,341
From five to ten years	<u>88,155,704</u>	<u>98,412,428</u>
	<u>\$ 601,644,501</u>	<u>\$ 637,737,790</u>

(iv) The Company's investments in fixed maturity securities carry a weighted average credit rating of AAA, as assigned by Standard & Poor's. The minimum credit rating of securities within the fixed maturity securities portfolio is AA.

(v) The components of net investment income for the years ended December 31, 2008 and 2007 were as follows:

	<u>2008</u>	<u>2007</u>
Interest on fixed maturity securities	\$ 27,662,307	\$ 29,054,456
Amortisation of fixed maturity securities	(1,765,076)	(806,698)
Interest on cash and cash equivalents	8,618,031	13,877,907
Interest on short term investments	1,344,690	-
Interest on funds withheld	701,687	1,379,423
Investment expenses	<u>(356,998)</u>	<u>(340,552)</u>
Net investment income	<u>\$ 36,204,641</u>	<u>\$ 43,164,536</u>

(vi) In the normal course of business, fixed maturity securities and cash and cash equivalents with fair values of \$101,871,968 as at December 31, 2008 (2007 - \$74,536,432), were deposited in trust for the benefit of ceding companies.

(vii) During the year ended December 31, 2008, the Company recorded an other than temporary impairment charge of \$12,333,958 (2007 - \$nil) on short term investments due to movements in exchange rates. The impairment charge has been recorded as part of foreign exchange losses (gains) in the consolidated statements of operations.

(b) Catastrophe bonds

(i) The Company's investments in catastrophe bonds consists of \$63.2 million, comprised of eight catastrophe bonds with Standard and Poor's credit ratings ranging from BB+ to BBB and Moody's credit ratings ranging from Ba2 to Baa2. Maturities on these bonds range from 2009 to 2011. The issuers of these securities have used the proceeds raised to collateralize certain catastrophe reinsurance obligations, mainly U.S. and European wind and earthquake risks. The investment in these securities is therefore at risk of loss, in whole or in part, if a covered catastrophe occurs.

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5. **Outstanding losses and loss expenses** (continued)

During 2008, the Company incurred net losses of \$59.3 million, of which \$48.9 million related to Hurricane Ike, \$7.2 million related to quota share business written and the balance related to smaller events and development on prior year losses.

Hurricane Ike was a major Storm that affected Texas and inland. The Company has identified all contracts that they believe may have potential exposure to this event. As of December 31, 2008, cedents have reported losses to the Company for all the contracts identified as having potential exposure to Hurricane Ike. The Company has assessed each contract individually and applied IBNR where appropriate, based on a historical assessment of industry loss development and management judgement.

Of the total incurred net losses, \$4.9 million is fully recoverable under catastrophe swap derivatives.

During 2008, the Company reported net incurred losses of \$1.9 million relating to development of prior year loss reserves, as a result of changes in estimates of the ultimate cost of settling outstanding claims.

During 2007, the Company incurred net losses of \$2.6 million, of which \$3.5 million related to quota share business written. The adverse development on these programs is offset by a reduction in ceding commission expenses of \$1 million and profit commission of \$2.2 million. A further \$1.2 million of the net losses relate to transformer policies. The losses on these policies are fully recoverable under catastrophe swap derivatives. Reductions in loss estimates for prior years' losses resulted in a release of reserves of \$2.1 million, most of which related to the 2005 US hurricanes and the 2005 Swiss floods.

For certain catastrophic events, particularly significant events such as Hurricane Ike, there is considerable uncertainty underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Reserves are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments could require a material change in the amount estimated. The uncertainty surrounding reserves for property catastrophe exposures arises from problems such as policy coverage issues, multiple events affecting one geographic area and the impact on claims adjusting by ceding companies. These issues can cause significant delays to the timing of notification of changes to loss estimates reported by ceding companies. Adjustments, if necessary, are reflected in results of operations in the period in which they become known.

6. **Ceded Reinsurance**

The Company uses retrocessional agreements to reduce its exposure to risk of loss on reinsurance assumed. These agreements generally provide for recovery of a portion of losses and loss expenses from retrocessionaires. The Company remains liable to its cedants to the extent that the retrocessionaires do not meet their obligations under these agreements. Failure of reinsurers to honor their obligations could result in losses to the Company. Therefore the Company evaluates the financial condition of its reinsurers and monitors concentration of credit risk, on an ongoing basis, arising from similar geographic regions, activities, or economic characteristics of the reinsurers in order to minimize its exposure to significant losses from reinsurer insolvencies. Provisions are made for amounts considered potentially uncollectible.

As discussed in note 3, the Company's maximum exposure to unrated reinsurers is fully collateralized.

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Notes to Consolidated Financial Statements

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7. Capital assets

Capital assets comprise:

	2008			2007
	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net book value</u>	<u>Net book value</u>
Fixtures and fittings	\$ 1,026,063	\$ 327,105	\$ 698,958	\$ 619,090
Office equipment	21,259	21,259	–	440
Computer equipment & software	8,857,340	3,427,824	5,429,516	2,853,178
Leasehold improvements	4,672,444	1,472,561	3,199,883	3,020,955
Motor vehicles	<u>127,551</u>	<u>81,245</u>	<u>46,306</u>	<u>70,749</u>
	<u>\$ 14,704,657</u>	<u>\$ 5,329,994</u>	<u>\$ 9,374,663</u>	<u>\$ 6,564,412</u>

8. Contributed surplus

Contributed surplus represents cash contributed by the shareholder in excess of the issued share capital.

9. Net derivative expense

Net derivative expense consists of catastrophe swap derivative premiums expensed of \$41.9 million (2007 - \$20.8 million), offset by recoveries made under the Company's catastrophe swap derivatives of \$4.9 million (2007 - \$1.2 million).

As discussed in note 3, the Company's maximum exposure to unrated counterparties is fully collateralized.

10. Commitments

- (a) On September 1, 2001, the Company entered into an agreement to lease office space. The term of the lease was ten years. Rent for the current year of the contract amounts to \$244,022 (2007 - \$235,296) which has been included in general and administrative expenses. This amount will increase by a factor dependent on the Bermuda consumer price index on an annual basis. Rent is payable in equal monthly installments.
- (b) On October 6, 2005 the Company entered into an agreement to lease additional office premises for a period of ten years commencing in 2006. Rent for the current year of the contract amounts to \$1,326,993 (2007 - \$1,251,133) which has been included in general and administrative expenses. This amount will increase by a factor dependent on the Bermuda consumer price index on an annual basis. Rent is payable in equal monthly installments.
- (c) The above lease agreements also include a maintenance commitment. Maintenance expense for the current year amounts to \$291,388 (2007 - \$293,764) which has been included in general and administrative expenses.
- (d) The Company's bankers have issued letters of credit for \$7.2 million (2007 - \$12.5 million) in favour of ceding companies. Cash equivalents and short term investments with a fair value of \$7.2 million (2007 - \$19.5 million) have been pledged as security for these letters of credit.

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11. Statutory requirements

The Company is required by its license to maintain capital and surplus greater than a minimum statutory amount determined as the greater of a percentage of outstanding losses or a given fraction of net written premiums. At December 31, 2008, the Company is required to maintain a minimum statutory capital and surplus of \$48,041,351. Actual statutory capital and surplus is \$1,034,526,131 and accordingly there is no restriction on the amount of retained earnings available for the payment of dividends to the shareholder.

Actual statutory capital and surplus, as determined using statutory accounting principles, is as follows:

Total shareholder's equity	\$ 1,054,014,218
Less non-admitted assets:	
Deferred acquisition expenses	10,997,706
Prepaid expenses	2,050,562
Ceded deferred acquisition expenses	(3,565,964)
Unearned profit commission	599,521
Capital assets	9,374,663
Investment in subsidiary	<u>31,599</u>
Statutory capital and surplus	<u>\$ 1,034,526,131</u>

The Company is also required to maintain a minimum liquidity ratio whereby the value of its relevant assets is not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and cash equivalents, long term bank deposits, catastrophe bonds, fixed maturity securities, accrued interest receivable, reinsurance balances receivable, funds withheld and other assets. Certain categories of assets do not qualify as relevant assets under the statute. Relevant liabilities are outstanding losses and loss expenses, unearned premiums, deferred fee income, dividend payable, accounts payable and accrued expenses, net of outstanding losses recoverable from reinsurers and prepaid reinsurance premiums.

At December 31, 2008 the Company was required to maintain relevant assets of \$208,576,580. At that date, relevant assets were \$1,312,610,796 and the minimum liquidity ratio was therefore met.

12. Taxation

Under current Bermuda law, the Company is not required to pay any taxes in Bermuda on either income or capital gains. The Company has received an undertaking from the Minister of Finance in Bermuda that in the event of any such taxes being imposed, the Company will be exempted from taxation until the year 2016.
