

**TOKIO MILLENNIUM RE LTD.**

**Consolidated Financial Statements**  
(With Independent Auditors' Report Thereon)

Years Ended December 31, 2010 and 2009



**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, 2010 and 2009 and the related consolidated statements of operations and comprehensive income, changes in shareholder's equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Chartered Accountants  
Hamilton, Bermuda  
March 14, 2011

**TOKIO MILLENNIUM RE LTD.**

## Consolidated Balance Sheets

December 31, 2010 and 2009

*(Expressed in United States Dollars)*

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	<u>2010</u>	<u>2009</u>
<b>Assets</b>		
Cash and cash equivalents (Note 3)	\$ 137,758,742	\$ 81,981,924
Short term investments (Notes 3, 4 and 10)	59,509,713	100,000,000
Investments in fixed interest securities (Notes 3, 4 and 10)	1,021,262,174	991,791,061
Investments in catastrophe bonds (Note 4)	120,545,487	81,889,015
Collateral held on behalf of counterparties (Note 3)	31,508,019	21,111,199
Accrued interest receivable	8,713,934	10,540,025
Premiums receivable (Note 3)	105,780,602	104,622,676
Prepaid reinsurance premiums (Note 3)	23,622,396	17,440,143
Fair value of derivatives (Note 3)	21,992,406	29,976,231
Outstanding losses recoverable from reinsurers (Notes 3 and 5)	19,459,483	17,082,962
Deferred acquisition expenses	48,838,901	10,107,190
Unearned profit commission	1,480,248	539,536
Prepaid expenses	3,233,435	2,610,628
Capital assets (Note 7)	10,804,182	9,591,867
Funds withheld (Note 3)	24,308,434	21,592,153
Other assets	<u>1,855,406</u>	<u>330,860</u>
Total assets	<u>\$ 1,640,673,562</u>	<u>\$ 1,501,207,470</u>
<b>Liabilities</b>		
Outstanding losses and loss expenses (Note 5)	\$ 213,019,912	\$ 84,411,700
Liability for collateral held on behalf of counterparties (Note 3)	32,615,079	22,611,199
Reinsurance balances payable	18,654,296	43,304,698
Unearned premiums	179,071,233	102,796,794
Deferred commission income	2,358,005	2,189,915
Accounts payable and accrued expenses (Note 11)	7,304,764	4,383,592
Deferred fee income	<u>5,811</u>	<u>5,696</u>
Total liabilities	<u>453,029,100</u>	<u>259,703,594</u>
<b>Shareholder's equity</b>		
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	510,089,431	569,687,078
Foreign currency translation adjustment	1,618,491	-
Accumulated other comprehensive income	<u>25,936,540</u>	<u>21,816,798</u>
Total shareholder's equity	<u>1,187,644,462</u>	<u>1,241,503,876</u>
Total liabilities and shareholder's equity	<u>\$ 1,640,673,562</u>	<u>\$ 1,501,207,470</u>

*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

Years Ended December 31, 2010 and 2009  
(Expressed in United States Dollars)

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	<u>2010</u>	<u>2009</u>
<b>Income</b>		
Reinsurance premiums assumed	\$ 509,173,474	\$ 417,621,522
Change in unearned premiums	<u>(76,274,439)</u>	<u>4,321,180</u>
Reinsurance premiums earned	<u>432,899,035</u>	<u>421,942,702</u>
Reinsurance premiums ceded (Note 6)	90,845,876	57,043,729
Change in prepaid reinsurance	<u>(6,182,252)</u>	<u>8,212,763</u>
Reinsurance premiums ceded	<u>84,663,624</u>	<u>65,256,492</u>
Net premiums earned	348,235,411	356,686,210
Catastrophe bond income	8,239,038	6,372,778
Agency fee income	<u>20,590</u>	<u>22,144</u>
Total operating income	356,495,039	363,081,132
Net investment income (Note 4)	<u>38,627,627</u>	<u>28,833,291</u>
Total income	<u>395,122,666</u>	<u>391,914,423</u>
<b>Expenses</b>		
Loss and loss expenses incurred	201,839,144	37,328,934
Losses recoverable from reinsurers	<u>(14,999,916)</u>	<u>(16,544,253)</u>
Net loss and loss expenses incurred (Note 5)	186,839,228	20,784,681
Acquisition expenses	59,036,819	53,633,296
Profit commission	5,350,089	33,669,933
Net derivative expense (Note 9)	34,758,102	54,093,135
General and administrative expenses (Note 10)	43,145,114	33,390,807
Foreign exchange losses (gains)	<u>1,444,752</u>	<u>(4,177,702)</u>
Total expenses	<u>330,574,104</u>	<u>191,394,150</u>

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**TOKIO MILLENNIUM RE LTD.**

## Consolidated Statements of Operations and Comprehensive Income (Continued)

Years Ended December 31, 2010 and 2009  
(Expressed in United States Dollars)

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	<u>2010</u>	<u>2009</u>
Net income before tax	64,548,562	200,520,273
Deferred tax income	<u>495,054</u>	<u>—</u>
Net income	65,043,616	200,520,273
<b>Other comprehensive income</b>		
Net change in unrealised gains and losses on investments	<u>4,119,742</u>	<u>(13,030,615)</u>
Other comprehensive income (loss)	<u>4,119,742</u>	<u>(13,030,615)</u>
Comprehensive income	<u>\$ 69,163,358</u>	<u>\$ 187,489,658</u>

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*See accompanying notes to consolidated financial statements*

**TOKIO MILLENNIUM RE LTD.**

## Consolidated Statements of Changes in Shareholder's Equity

Years Ended December 31, 2010 and 2009  
(Expressed in United States Dollars)

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	<u>2010</u>	<u>2009</u>
<b>Share capital</b>		
Balance at beginning and end of year	\$ <u>250,000,000</u>	\$ <u>250,000,000</u>
<b>Contributed surplus</b>		
Balance at beginning and end of year	<u>400,000,000</u>	<u>400,000,000</u>
<b>Retained earnings</b>		
Balance at beginning of year	569,687,078	369,166,805
Net income	65,043,616	200,520,273
Dividends	<u>(124,641,263)</u>	<u>—</u>
Balance at end of year	<u>510,089,431</u>	<u>569,687,078</u>
<b>Foreign currency translation adjustment</b>		
Balance at beginning of year	—	—
Net change during the year	<u>1,618,491</u>	<u>—</u>
Balance at end of year	<u>1,618,491</u>	<u>—</u>
<b>Accumulated other comprehensive income</b>		
Balance at beginning of year	21,816,798	34,847,413
Net change in unrealised gains and losses on investments	<u>4,119,742</u>	<u>(13,030,615)</u>
Balance at end of year	<u>25,936,540</u>	<u>21,816,798</u>
Total shareholder's equity	\$ <u><u>1,187,644,462</u></u>	\$ <u><u>1,241,503,876</u></u>

*See accompanying notes to consolidated financial statements*

**TOKIO MILLENNIUM RE LTD.**

## Consolidated Statements of Cash Flows

Years Ended December 31, 2010 and 2009  
(Expressed in United States Dollars)

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	<u>2010</u>	<u>2009</u>
<b>Cash flows from operating activities</b>		
Net income	\$ 65,043,616	\$ 200,520,273
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of capital assets	4,527,274	3,804,241
Amortisation of fixed interest securities	4,214,056	2,967,816
Amortisation of catastrophe bonds	-	4,167
Gain on sale of fixed interest securities	(5,865,824)	-
Gain on sale of catastrophe bonds	(60,000)	-
Gain on disposal of capital assets	(1,906)	-
Foreign exchange gains on cash and cash equivalents	(710,930)	(6,372,543)
Other than temporary impairment charge on fixed interest securities	1,119,421	-
Change in:		
Collateral held on behalf of counterparties	(10,396,820)	37,785,221
Accrued interest receivable	1,826,091	(404,117)
Premiums receivable	(1,157,926)	(16,987,046)
Prepaid reinsurance premiums	(6,182,253)	8,212,763
Fair value of derivatives	7,983,825	(6,744,043)
Outstanding losses recoverable from reinsurers	(2,376,521)	3,417,033
Deferred acquisition expenses	(38,731,711)	890,516
Unearned profit commission	(940,712)	59,985
Prepaid expenses	(622,807)	(555,193)
Funds withheld	(2,716,281)	19,017,814
Other assets	(1,524,546)	(121,895)
Outstanding losses and loss expenses	128,608,212	(19,527,277)
Liability for collateral held on behalf of counterparties	10,003,880	(37,533,575)
Reinsurance balances payable	(24,650,402)	(6,947,192)
Unearned premiums	76,274,439	(4,321,180)
Deferred commission income	168,090	(1,376,049)
Accounts payable and accrued expenses	2,921,172	1,581,195
Deferred fee income	115	1,634
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Cash provided by operating activities	206,751,552	177,372,548
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<b>Cash flows from investing activities</b>		
Purchase of short term investments	(58,286,475)	(200,000,000)
Proceeds on maturity of short term investments	100,000,000	169,747,829
Purchase of fixed interest securities	(442,310,585)	(486,827,256)
Proceeds on sales and maturity of fixed interest securities	419,116,289	112,897,395
Purchase of catastrophe bonds	(47,281,200)	(57,093,900)
Proceeds on sales and maturity of catastrophe bonds	7,060,000	41,500,000
Purchase of capital assets	(5,737,683)	(4,021,445)
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Cash used in investing activities	(27,439,654)	(423,797,377)
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**TOKIO MILLENNIUM RE LTD.**

## Consolidated Statements of Cash Flows (continued)

Years Ended December 31, 2010 and 2009  
(Expressed in United States Dollars)

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	<u>2010</u>	<u>2009</u>
<b>Cash flows from financing activities</b>		
Dividends paid	<u>(124,641,263)</u>	<u>—</u>
Cash used in financing activities	<u>(124,641,263)</u>	<u>—</u>
Net increase (decrease) in cash and cash equivalents	54,670,635	(246,424,829)
Foreign exchange gains on cash and cash equivalents	1,106,183	6,372,543
Cash and cash equivalents at beginning of year	<u>81,981,924</u>	<u>322,034,210</u>
Cash and cash equivalents at end of year	\$ <u>137,758,742</u>	\$ <u>81,981,924</u>

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*See accompanying notes to consolidated financial statements*

# TOKIO MILLENNIUM RE LTD.

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

*(Expressed in United States Dollars)*

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### 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 3B 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.

From 2010 the Company has begun to offer non-catastrophe property and casualty covers on both proportional and per risk excess of loss treaties, with an emphasis on the higher frequency/lower severity category of exposures. Casualty lines of business include general liability, auto liability and workers’ compensation.

The Company also provides non-traditional customised 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.

The Company formed branches in Switzerland on August 31, 2010 and in Australia on October 22, 2010. The branch in Switzerland is operational and will be regulated by the Bermuda Monetary Authority. The Australian Prudential Regulation Authority issued a license to the Company’s Australian branch to conduct business as a general insurer on March 1, 2011. No insurance business was written by these branches in 2010.

### 2. **Summary of significant accounting policies**

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The consolidated financial statements include the accounts of the Company, its branches and its wholly-owned subsidiary, TMA. All significant intercompany transactions and balances are eliminated on consolidation.

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.

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## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

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, changes in estimates are recognized in the period in which they are determined.

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.

Reserves for non-catastrophe property and casualty covers are based on individual claims, case reserve and other reserve estimates reported by insureds and ceding companies as well as the Company's actuarial estimates of ultimate losses. Inherent in the estimates of ultimate losses are expected trends in claim severity and frequency and other factors which could vary significantly as claims are settled. The Company does not have the benefit of a significant amount of its own historical experience with non-catastrophe lines of business. Accordingly, the setting and reserving for incurred losses in these lines of business could be subject to greater variability.

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## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

#### (b) Outstanding losses and loss expenses (continued)

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

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

#### (c) Investments

Short term investments, investments in fixed interest securities and investments in 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 of greater than 90 days but less than one year. The carrying value reported in the consolidated balance sheets for these instruments approximates their fair values due to the short term nature of the investments. The fair value of fixed interest securities is based on prices provided by internationally recognized independent pricing services. The independent pricing sources obtain actual transaction prices for securities that have quoted prices in active markets. For securities that are not actively traded the pricing services typically uses "market pricing" which uses observable inputs including reported trades, benchmark fields, broker/dealer quotes, interest rate spreads, prepayment spreads and other such inputs from market sources to determine a reasonable fair value. Fair value for catastrophe bonds is based on independent broker quotes. The cost of investments is adjusted for amortisation of premiums and discounts. Realised gains and losses on investments are recognised in net income using the specific identification method. Interest income on short term investments, fixed interest securities and catastrophe bonds is accrued to the balance sheet date.

Impairment losses are recognized on investments on an individual security basis when the investment is considered to be other than temporarily impaired. Impairment occurs when it is deemed probable that the Company will be unable to collect all amounts due according to contractual terms of the individual security. If there is no objective evidence to support recovery in value before disposal and the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its adjusted amortized cost basis, these impairments will be included as a separate component of investment income and the cost basis of the investment reduced accordingly.

If the Company does not intend to sell the security and it is unlikely that the Company will be required to sell the security before recovery of its adjusted amortized cost basis, the other than temporary impairment is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other than temporary impairment related to credit loss is recognized in earnings. The amount of the total other than temporary impairment related to other factors is recognized in other comprehensive income. The Company will not change the revised cost basis for subsequent recoveries in value.

The Company's investments are managed following prudent standards of diversification. Specific provisions limit the allowable holdings of a single issue and issuers.

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## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

#### (d) Derivative financial instruments

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. The Company does this to facilitate institutional investors who seek to diversify their portfolios by adding non-correlated reinsurance risks to their portfolio. The Company transforms such risks by selling reinsurance and buying derivatives from the institutional investors, or vice versa. The Company earns a fee for its role in facilitating such transactions. Since there is no right of offset all transactions are presented on a gross basis in the financial statements. Although the derivatives provide an economic hedge against the assumed or ceded reinsurance contract, the Company designates its derivatives as non-hedging derivative instruments based upon criteria established by FASB ASC 815, Derivative and Hedging Activities. 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	3 years
Computer software	3 years
Fixtures and fittings	5 years
Leasehold improvements	Over the term of the underlying lease
Motor vehicles	5 years
Office equipment	4 years

#### (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.

The reporting currency of the Company is the U.S. dollar. The functional currencies of the Company's branches are the Euro and Australian dollar. In translating the financial statements of those branches whose functional currency is other than the U.S. dollar, assets and liabilities are converted into U.S. dollars using the rates of exchange in effect at the balance sheet dates, and revenues and expenses are converted using the average foreign exchange rates for the period. The effect of translation adjustments are reported in the Consolidated Balance Sheets as currency translation adjustment, a separate component of shareholder's equity.

#### (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 at the date of purchase, and money market funds which can be redeemed without penalty, as equivalent to cash.

#### (h) Fair value measurements

Fair values measurements are established in accordance with the framework provided by FASB 820, Fair Value Measurements and Disclosures ("FASB ASC 820"). FASB ASC 820 establishes a fair value hierarchy with the highest priority given to quoted prices in active markets and the lowest priority given to unobservable inputs.

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**TOKIO MILLENNIUM RE LTD.**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(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.

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

<u>At December 31, 2010</u>	<u>Total</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>
Investment in fixed interest securities				
US treasuries	\$ 413,712,065	\$ 413,712,065	\$ —	\$ —
Agencies	172,093,064	—	172,093,064	—
Non-U.S. government	10,617,601	—	10,617,601	—
FDIC guaranteed corporate	13,773,915	—	13,773,915	—
Corporate	208,522,258	—	208,522,258	—
Agency mortgage-backed	192,988,229	—	192,988,229	—
Asset-backed	9,555,042	—	9,555,042	—
Investments in catastrophe bonds	120,545,487	—	120,545,487	—
Fair value of derivatives	<u>21,992,406</u>	<u>—</u>	<u>—</u>	<u>21,992,406</u>
	<u>\$ 1,163,800,067</u>	<u>\$ 413,712,065</u>	<u>\$ 728,095,596</u>	<u>\$ 21,992,406</u>

## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

#### (h) Fair value measurements (continued)

##### *Investments in fixed interest securities*

Investments in fixed interest securities included in Level 1 consist of the Company's investments in U.S. Treasuries. Investments in fixed interest securities included in Level 2 consist of the Company's investments in agencies, non-U.S. government, FDIC guaranteed corporate, corporate, agency mortgage-backed and asset-backed securities. The Company's fixed interest securities are priced using pricing services, such as index providers and pricing vendors. The pricing vendors provide pricing for a high volume of liquid securities that are actively traded. For securities that do not trade on an exchange, the pricing services generally utilize market data and other observable inputs in pricing models to determine prices. Prices are generally verified using third party data. The Company considers these Level 2 inputs as they are corroborated with other externally obtained information. The techniques generally used to determine the fair value of our fixed interest securities are detailed below by asset class.

##### U.S. treasuries

These securities are primarily priced by pricing vendors. When pricing these securities, the vendor may utilize daily data from many real time market sources, including active broker dealers, as such, the Company considers it U.S. Treasury fixed interest securities as Level 1.

##### Agencies

The issuers of the Company's agency fixed interest securities primarily consist of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other agencies' debentures. Fixed interest securities included in agencies are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. These are considered observable inputs therefore, the fair value of the securities are classified as Level 2.

##### Non-U.S. government

The issuers for securities in this sector are supranational organizations. Fixed interest investments included in non-U.S. government are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. For securities in which trade volume is low, the pricing vendor may also utilize data from more frequently traded securities with similar attributes. These are considered observable inputs therefore, the fair value of the securities are classified as Level 2.

##### FDIC guaranteed corporate

The issuers consist of well known corporate issuers who participate in the FDIC program. The Company's FDIC guaranteed corporate fixed interest securities are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources regarding the issuer of the security, obtain credit data, as well as other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing vendor may also consider the specific terms and conditions of the securities, including any specific features which may influence risk. These are considered observable inputs therefore, the fair value of the securities are classified as Level 2.

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## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

#### (h) Fair value measurements (continued)

##### Corporate

The issuers consist of well known corporate issuers with ratings ranging from A- to AAA assigned by major rating agencies. The Company's corporate fixed interest securities are primarily priced by pricing vendors and are considered as Level 2. When evaluating these securities, the vendor may gather information from market sources regarding the issuer of the security, obtain credit data, as well as other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing vendor may also consider the specific terms and conditions of the securities, including any specific features which may influence risk. These are considered observable inputs therefore, the fair value of the securities are classified as Level 2.

##### Agency mortgage-backed

The issuers of the Company's agency mortgage-backed fixed interest securities primarily consist of the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association and other agencies. The Company's agency mortgage-backed fixed interest securities are primarily priced by pricing vendors utilizing daily inputs from the active TBA market which is extremely liquid, as well as the U.S. treasury market. The vendor inputs may also utilize additional information, such as the weighted average maturity, weighted average coupon and other pool level data which is provided by the sponsoring agency. Valuations may also be corroborated by daily active market quotes. These are considered observable inputs therefore, the fair value of the securities are classified as Level 2.

##### Asset-backed

The underlying collateral for the Company's asset-backed fixed interest securities consists of automobile loans. Securities held in this sector are primarily priced by pricing vendors and are considered as Level 2 by the Company as inputs are observable. The pricing vendor may apply dealer quotes and other available trade information such as bid and offers, prepayment speeds which may be adjusted for the underlying collateral or current price data, the U.S. treasury curve, swap curve and TBA values as well as cash settlement.

##### *Investments in catastrophe bonds*

The Company's investments in catastrophe bonds are recorded at fair value based on quoted market prices, or when such prices are not available, by reference to published broker or underwriter bid and offer indications. As such, the Company considers its investments in catastrophe bonds as Level 2.

##### *Fair value of derivatives*

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 Company's catastrophe swap derivatives are initially priced at fair value in a non-stressed market and amortization reflects the change in fair value in the absence of any loss events. The inputs for catastrophe swap derivatives are purely based on management's evaluation and are unobservable.

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**TOKIO MILLENNIUM RE LTD.**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009  
(Expressed in United States Dollars)

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

(h) *Fair value measurements (continued)*

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

	Fair value measurements using significant unobservable inputs (Level 3)
<b><u>Year ended December 31, 2010</u></b>	
<b><u>Fair value of derivatives</u></b>	
Balance – January 1	\$ 29,976,231
Total unrealized losses	
Included in net derivative expense	(4,799,533)
Total realized losses	
Included in net derivative expense	(29,976,231)
Total foreign exchange gains	
Included in net derivative expense	17,662
Net purchases, issuances, and settlements	26,774,277
Net transfers in and/or out of Level 3	<u>                  –</u>
Balance – December 31	<u>\$ 21,992,406</u>

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

*Cash and cash equivalents; Short term investments and Collateral held on behalf of counterparties*

The carrying amounts reported in the balance sheet for these instruments approximate their fair values.

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## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

#### (h) Fair value measurements (continued)

##### *Other assets and liabilities*

The fair value of accrued interest receivable, premiums receivable, funds withheld, other assets, reinsurance balances payable, accounts payable and accrued expenses approximates their carrying value due to their short term nature. The estimates of fair values 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. The Company had no provision for doubtful debts in 2010 or 2009.

#### (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 accounts for the compensation program in accordance with FASB ASC 718, *Compensation – Stock Compensation* (“FASB ASC 718”). FASB ASC 718 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. As a liability award, the cost is remeasured each reporting period. The cost of such services is recognized over the service period. The fair value of the accumulation units is accounted for as a liability classified award. The Company has applied a narrow based interpretation of authorisation, as defined in FASB ASC 718, for the determination of the grant date of the awards. As such, the grant date of the units is determined to be upon authorisation of the awards in accordance with the Company’s governance structure.

#### (k) Taxation

The Company has adopted FASB ASC 740 (FIN 48) for the fiscal year beginning on January 1, 2009 with no resulting impact on the Company’s operating results or financial condition.

The branches of the Company operate in jurisdictions where they are subject to taxation. Income taxes have been provided in accordance with the provisions of FASB ASC 740, Income Taxes. Current and deferred income taxes are charged or credited to net income. Deferred income taxes are provided for all temporary differences between the bases of assets and liabilities used in the Consolidated Balance Sheets and those used in the various jurisdictional tax returns. When management’s assessment indicates that it is more likely than not that deferred income tax assets will not be realized, a valuation allowance is recorded against the deferred tax assets.

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## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

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

#### (k) Taxation (continued)

The Company recognizes a tax benefit relating to uncertain tax positions only where the position is more likely than not to be sustained assuming examination by tax authorities. A liability must be recognized for any tax benefit (along with any interest and penalty, if applicable) claims in a tax return in excess of the amount allowed to be recognized in the financial statements under U.S. GAAP. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### 3. Concentrations of credit risk

As at December 31, 2010, cash and cash equivalents of \$81.6 million (2009 - \$2.1 million) and short term investment of \$Nil (2009 - \$100.0 million) are held with one banking institution which had a credit rating of AA-. As at December 31, 2010, cash and cash equivalents of \$21.9 million (2009 - \$Nil) and short term investment of \$59.5 million (2009 - \$Nil) are held with one banking institution which had a credit rating of AA. The Company's management evaluates the financial strength and stability of these institutions on a periodic basis.

As at December 31, 2010, 51% and 38% of the Company's funds withheld is held in trust by two trustees with credit ratings of AA- and BB+ respectively. At December 31, 2009, 71% of the Company's funds withheld was held in trust by a trustee with a credit rating of AA-. The remaining balance consists of several small amounts held by various different cedents and does not represent a significant concentration of credit risk.

The Company's investment portfolio is managed by an external investment manager in accordance with the Company's investment guidelines. These guidelines follow prudent standards of diversification and a prudent investment philosophy. Within the fixed income portfolio, the Company attempts to limit 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 premiums 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, collateralisation of exposures ceded to unrated counterparties credit checks performed as part of the underwriting process and monitoring of aged receivables. As of December 31, 2010 and 2009, 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 of factors including, among others, the counterparty, country and credit exposure limits.

At December 31, 2010, the maximum credit risk exposure in relation to unrated counterparties to reinsurance ceded agreements is \$359.6 million (2009 - \$290.8 million). The Company's credit risk in relation to reinsurance ceded is fully collateralised. The collateral consists of assets held in trusts by the reinsurance counterparty for the benefit of the Company of \$121.1 million (2009 - \$95.3 million), cash held by the Company of nil (2009 - \$16.6 million), and letters of credit of \$253.0 million (2009 - \$258.0 million). The Company has no entitlement to income earned on the collateral held, and any diminution in the market value of these assets is the responsibility of the counterparty.

At December 31, 2010, the maximum exposure to credit risk of the counterparties to catastrophe swap agreements is \$488.4 million (2009 - \$415.4 million) which is fully collateralised. The collateral consists of assets held in trust by the swap counterparty for the benefit of the Company of \$12.5 million (2009 - \$2.5 million), letters of credit of \$474.4 million (2009 - \$408.4 million) cash held by the Company of \$31.5 million (2009 - \$4.5 million). The Company has no entitlement to income earned on the collateral held, and any diminution in the market value of these assets is the responsibility of the counterparty.

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 any deficiency.

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**TOKIO MILLENNIUM RE LTD.**

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

*(Expressed in United States Dollars)***4. Investments***(a) Fixed interest securities**(i) The amortised cost, fair value and unrealised gains and losses of investments in fixed interest securities are as follows:*

<u>At December 31, 2010</u>	<u>Amortised cost</u>	<u>Unrealised gains</u>	<u>Unrealised losses</u>	<u>Fair value</u>
U.S. treasuries	\$ 402,406,540	\$ 13,252,802	\$ (1,947,277)	\$ 413,712,065
Agencies	162,758,995	9,334,069	–	172,093,064
Non U.S. government	10,002,953	614,648	–	10,617,601
FDIC guaranteed corporate	13,555,918	217,997	–	13,773,915
Corporate	207,977,211	2,805,280	(2,260,233)	208,522,258
Agency mortgage-backed	190,131,957	3,196,156	(339,884)	192,988,229
Asset-backed	<u>9,499,615</u>	<u>55,427</u>	<u>–</u>	<u>9,555,042</u>
	<u>\$ 996,333,189</u>	<u>\$ 29,476,379</u>	<u>\$ (4,547,394)</u>	<u>\$ 1,021,262,174</u>
<u>At December 31, 2009</u>	<u>Amortised cost</u>	<u>Unrealised gains</u>	<u>Unrealised losses</u>	<u>Fair value</u>
U.S. treasuries	\$ 397,628,124	\$ 8,659,902	\$ (1,378,112)	\$ 404,909,914
Agencies	204,261,865	11,009,135	(328,368)	214,942,632
Non-U.S. government	30,023,014	744,695	–	30,767,709
FDIC guaranteed corporate	13,597,087	47,363	–	13,644,450
Corporate	129,734,654	1,824,741	(274,257)	131,285,138
Agency mortgage-backed	<u>197,361,803</u>	<u>–</u>	<u>(1,120,585)</u>	<u>196,241,218</u>
	<u>\$ 972,606,547</u>	<u>\$ 22,285,836</u>	<u>\$ (3,101,322)</u>	<u>\$ 991,791,061</u>

**TOKIO MILLENNIUM RE LTD.**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

4. **Investments** (continued)

(a) *Fixed interest securities* (continued)

(ii) The following table summarises for all fixed interest securities in an unrealised loss position at December 31, 2010, 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, 2010</u>	<u>Less than 12 months</u>		<u>Greater than 12 months</u>	
	<u>Fair value</u>	<u>Unrealised losses</u>	<u>Fair value</u>	<u>Unrealised losses</u>
U.S. treasuries	\$ 69,408,302	\$ (1,947,277)	\$ —	\$ —
Corporate	111,390,845	(2,260,233)	—	—
Agency mortgage-backed	<u>22,172,580</u>	<u>(339,884)</u>	<u>—</u>	<u>—</u>
	<u>\$ 202,971,727</u>	<u>\$ (4,547,394)</u>	<u>\$ —</u>	<u>\$ —</u>

  

<u>At December 31, 2009</u>	<u>Less than 12 months</u>		<u>Greater than 12 months</u>	
	<u>Fair value</u>	<u>Unrealised losses</u>	<u>Fair value</u>	<u>Unrealised losses</u>
U.S. treasuries	\$ 74,873,110	\$ (1,378,112)	\$ —	\$ —
Agencies	27,585,530	328,368	—	—
Corporate	40,654,980	(274,257)	—	—
Agency mortgage-backed	<u>196,241,218</u>	<u>(1,120,585)</u>	<u>—</u>	<u>—</u>
	<u>\$ 339,354,838</u>	<u>\$ (3,101,322)</u>	<u>\$ —</u>	<u>\$ —</u>

As of December 31, 2010, the Company held 26 out of a total of 99 fixed interest securities in an unrealised loss position. The securities have been in an unrealised loss position for one to three months. These 26 fixed interest securities in an unrealised loss position, for which an other-than-temporary impairment charge has not been taken, are rated between A- and AAA.

Unrealised losses on investments held as of December 31, 2010 and 2009 comprise 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, 2010 and 2009, the Company had no significant unrealised losses caused by other factors or circumstances, including an issuer specific credit risk or due to industry or geographic risk.

(iii) The amortised cost and estimated fair value of fixed interest securities as of December 31, 2010, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to repay obligations with or without prepayment penalties:

	<u>Amortised cost</u>	<u>Fair value</u>
Within one year	\$ 81,777,614	\$ 83,335,928
From one to five years	587,611,163	607,986,301
From five to ten years	<u>127,312,840</u>	<u>127,396,674</u>
Subtotal	796,701,617	818,718,903
Agency mortgage-backed	190,131,957	192,988,229
Asset-backed	<u>9,499,615</u>	<u>9,555,042</u>
Total	<u>\$ 996,333,189</u>	<u>\$ 1,021,262,174</u>

## TOKIO MILLENNIUM RE LTD.

### Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

#### 4. Investments (continued)

##### (a) Fixed interest securities (continued)

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

The rating profile of the Company's fixed interest securities is shown in the table below:

	<u>2010</u>	<u>2009</u>
AAA	\$ 814,589,804	\$ 877,532,278
AA	131,856,764	114,258,783
A	<u>74,815,606</u>	<u>—</u>
	<u>\$1,021,262,174</u>	<u>\$ 991,791,061</u>

- (v) The components of net investment income for the years ended December 31, 2010 and 2009 were as follows:

	<u>2010</u>	<u>2009</u>
Interest on fixed interest securities	\$ 37,093,780	\$ 28,048,300
Amortisation of fixed interest securities	(4,214,056)	(2,967,816)
Interest on cash and cash equivalents	466,129	1,732,547
Interest on short term investments	899,979	1,971,272
Interest on funds withheld	587,222	569,929
Realised gains	5,865,824	—
Other-than-temporary impairment charge	(1,119,422)	—
Investment management fees	<u>(951,829)</u>	<u>(520,941)</u>
Net investment income	<u>\$ 38,627,627</u>	<u>\$ 28,833,291</u>

- (vi) In the normal course of business, fixed interest securities and cash and cash equivalents with fair values of \$103,182,356 as at December 31, 2010 (2009 - \$67,718,380), were deposited in trust for the benefit of ceding companies and credit institutions.

- (vii) During the year ended December 31, 2010, the Company recorded an other-than-temporary impairment charge of \$1,119,422 on a fixed interest investment due to an unexpected credit event. The impairment charge has been recorded as part of investment income in the consolidated statements of operations. There was no impairment charge recorded during 2009.

##### (b) Catastrophe bonds

- (i) The Company's investments in catastrophe bonds comprise nineteen bonds. All catastrophe bonds have credit ratings with Standard and Poor's ranging from B to BB+. Maturities on these bonds range from 2011 to 2014. The issuers of these securities have used the proceeds raised to collateralize certain catastrophe reinsurance obligations, mainly North American 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.

**TOKIO MILLENNIUM RE LTD.**

## Notes to Consolidated Financial Statements

December 31, 2010 and 2009

*(Expressed in United States Dollars)***4. Investments** (continued)*(b) Catastrophe bonds* (continued)

The cost, fair value and unrealised gains and losses of catastrophe bonds are as follows:

<u>At December 31, 2010</u>	<u>Cost</u>	<u>Unrealised gains</u>	<u>Unrealised losses</u>	<u>Fair value</u>
Catastrophe bonds	\$ <u>119,537,933</u>	\$ <u>2,723,300</u>	\$ <u>(1,715,746)</u>	\$ <u>120,545,487</u>
<u>At December 31, 2009</u>				
Catastrophe bonds	\$ <u>79,256,733</u>	\$ <u>3,008,195</u>	\$ <u>(375,913)</u>	\$ <u>81,889,015</u>

Unrealised losses on catastrophe bonds held as of December 31, 2010 and 2009 comprise an accumulation of relatively small unrealised losses on a security by security basis caused by general market movements rather than credit events. As of December 31, 2010 and 2009, the Company had no significant unrealised losses caused by other factors or circumstances, including an issuer specific credit risk or due to catastrophe event.

**5. Outstanding losses and loss expenses**

The summary of changes in outstanding losses and loss expenses for 2010 and 2009 is as follows:

	<u>2010</u>	<u>2009</u>
Gross balance as of January 1	\$ 84,411,700	\$ 103,938,977
Less outstanding losses recoverable from reinsurers	<u>(17,082,962)</u>	<u>(20,499,995)</u>
Net balance at January 1	<u>67,328,738</u>	<u>83,438,982</u>
Incurred losses related to:		
Current year	170,527,007	31,925,501
Prior years	<u>16,312,221</u>	<u>(11,140,820)</u>
Total incurred	<u>186,839,228</u>	<u>20,784,681</u>
Paid losses related to:		
Current year	17,181,362	6,352,730
Prior years	<u>43,426,175</u>	<u>30,542,195</u>
Total paid	<u>60,607,537</u>	<u>36,894,925</u>
Net balance at December 31	193,560,429	67,328,738
Plus outstanding losses recoverable from reinsurers	<u>19,459,483</u>	<u>17,082,962</u>
Gross balance at December 31	<u>\$ 213,019,912</u>	<u>\$ 84,411,700</u>

## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

*(Expressed in United States Dollars)*

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

During 2010, the Company incurred net losses of \$186.8 million, of which \$101.7 million related to the 2010 New Zealand earthquake. The Company recorded a total of \$45.7 million incurred losses related to quota share business written. The Company experienced \$16.3 million of adverse development related to prior years, during 2010. Of this total, \$6.4 million related to Hurricane Ike losses and \$8.1 million related to various prior year covers written under the transformer line of business. The transformer losses are fully recoverable under catastrophe swap derivatives.

Of the total incurred net losses for 2010, \$13.1 million was recoverable under catastrophe swap derivatives.

During 2009, the Company incurred net losses of \$20.8 million, of which \$18.9 million related to quota share business written and the balance related to smaller events and development on prior year losses. In 2009, the Company had a \$11.7 million favorable development related to Hurricane Ike.

For certain catastrophic events 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. In particular the estimate for the New Zealand earthquake has been based on a review of contracts potentially affected by the events, information received from both clients and brokers, industry insured loss estimates, output from both industry and proprietary models and management judgment. It has also been assumed that underlying policy terms and conditions are upheld during the loss adjustment process. The magnitude and recent occurrence of the event as well as the long reporting period, the occurrence of aftershocks and limited access by claims adjusters, introduce additional uncertainty to the normally difficult process of estimating catastrophic losses. This is compounded by the potential for legal and regulatory issues arising regarding the scope of coverage. Consequently, the ultimate net impact of losses from this event on the Company's net income might differ substantially from the foregoing estimate. Such adjustments, if necessary, are reflected in results of operations in the period in which they become known. At the balance sheet date the Company is reserved for this event at its maximum exposure.

### 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 minimise 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 collateralised.

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## TOKIO MILLENNIUM RE LTD.

### Notes to Consolidated Financial Statements

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(Expressed in United States Dollars)

#### 7. Capital assets

Capital assets comprise:

	2010			2009
	Cost	Accumulated depreciation	Net book value	Net book value
Computer equipment	\$ 3,327,509	\$ 2,249,982	\$ 1,077,527	\$ 670,803
Computer software	11,712,642	6,784,450	4,928,192	5,130,978
Fixtures and fittings	1,674,550	680,088	994,462	778,292
Leasehold improvements	4,468,992	685,689	3,783,303	2,985,355
Motor vehicles	99,326	85,787	13,539	26,439
Office equipment	<u>16,894</u>	<u>9,735</u>	<u>7,159</u>	<u>—</u>
	<u>\$ 21,299,913</u>	<u>\$10,495,731</u>	<u>\$ 10,804,182</u>	<u>\$ 9,591,867</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 \$47.8 million (2009 - \$54.1 million), offset by recoveries made under the Company's catastrophe swap derivatives of \$13.1 million (2009 - \$Nil).

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

#### 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 \$237,314 (2009 - \$256,100) which has been included in general and administrative expenses. Rent is payable in equal monthly installments. On February 19, 2010, this lease was terminated by mutual agreement. On January 22, 2010 the Company entered into an agreement to lease additional office premises for a period of ten years commencing January 1, 2010. The expected annual charge per the contract amounts to \$853,423. Total rent for the current year of the contract amounts to \$502,651. 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 \$1,321,166 (2009 - \$1,308,530) 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 \$552,144 (2009 - \$446,885) which has been included in general and administrative expenses.
- (d) All lease agreements for office space provide an option to extend for a further five years after termination.

## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(Expressed in United States Dollars)

### 10. Commitments (continued)

- (e) Effective August 6, 2010, the Company entered into a Revolving Letter of Credit Facility Agreement (“the Credit Agreement”) with Barclays Bank PLC (“the Bank”). The Credit Agreement provides commitments from the Bank in an aggregate amount of \$100 million and provides for the issuance and renewal of letters of credit which are used to support the Company’s reinsurance obligations. The Credit Agreement expires on December 31, 2012 and the maturity of any letters of credit issued under the Credit agreement will not extend beyond this expiry date. Under the Credit Agreement, the Company is required to pledge cash or eligible securities with collateral value (as determined as therein provided) that equals or exceeds 100% of the aggregate amount of its outstanding letters of credit. The unutilized portion of the Credit Agreement may be cancelled in whole or in part (if in part, in minimum amounts of \$500,000) by the Company without penalty upon due written notice to the Bank. Amounts so cancelled may not be re-instated. The Credit Agreement contains representations, warranties and covenants customary for facilities of this type. In addition to the customary covenants, the Company is required to maintain a financial strength rating of at least A- by A.M. Best and A by S&P.

The Bank has issued letters of credit for \$45.2 million in favour of ceding companies. The Company pledged as security \$40.0 million worth of fixed interest securities in 2010 to collateralize the letters of credit.

In 2009 a different banking institution issued \$11.9 million worth of letters of credit in favour of ceding companies. The Company pledged \$11.9 million worth of short term investments to collateralize the letters of credit.

### 11. Long term incentive compensation plan

On April 1, 2009 and April 1, 2010, the Company granted its accumulation units under its long term incentive compensation plan. The value of the units are based on movements in the net asset value of the Company and will be settled in cash four years from the date of issue if the fair value of units at that date exceeds the grant date fair value. At December 31, 2010, there were 526,196 and 367,296 units with the grant date fair values of \$3.14 and \$3.16 for the 2010 and 2009 grants respectively.

In accordance with FASB ASC 718, the fair value of options granted is estimated using a pricing model with the following assumptions:

Grant year	<u>2010</u>	<u>2009</u>
Expected unit life	4 years	4 years
Expected volatility	61%	39.0%
Risk-free interest rate	1.2%	0.7%
Forfeiture rate	0.0%	0.0%

At year end, the fair value per unit discounted at the risk free rate for the 2010 grant was \$2.17. At year end, the fair value per unit discounted at the risk free rate for the 2009 grant was \$3.53. The Company revises fair value on a quarterly basis based on the latest estimate of fair value and number of units in issue.

The table below shows the recognised and unrecognised expense for 2010 and 2009:

Grant year	<u>2010</u>	<u>2009</u>
Expense during the year:		
2009	\$ –	\$ 292,074
2010	214,096	275,169
Unrecognized expense (to be recognised over remaining service period)	927,749	729,312
Remaining service period (in months)	39	27

**TOKIO MILLENNIUM RE LTD.**

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

*(Expressed in United States Dollars)***11. Long term incentive compensation plan (continued)**

The activity during 2010 related to number of accumulation units is summarised as follows:

Grant year	<u>2010</u>	<u>2009</u>
Outstanding at beginning of year	–	384,692
Granted	550,562	–
Exercised	(17,970)	(11,887)
Forfeited	<u>(6,396)</u>	<u>(5,509)</u>
Outstanding at end of year	<u>526,196</u>	<u>367,296</u>

**12. 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, 2010, the Company is required to maintain a minimum statutory capital and surplus of \$63,049,140. Actual statutory capital and surplus is \$1,125,116,746 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	\$ 1,187,644,462
Less non-admitted assets:	
Deferred acquisition expenses	48,838,901
Prepaid expenses	3,227,902
Deferred commission income	(2,358,005)
Unearned profit commission	1,480,248
Capital assets	10,804,182
Deferred tax asset (included in other assets)	499,854
Investment in subsidiary	<u>34,634</u>
Statutory capital and surplus	<u>\$ 1,125,116,746</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, short term investments, catastrophe bonds, fixed interest securities, accrued interest receivable, premiums 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, fund withheld ceded, accounts payable and accrued expenses, net of outstanding losses recoverable from reinsurers and prepaid reinsurance premiums.

At December 31, 2010 the Company was required to maintain relevant assets of \$305,687,555. At that date, relevant assets were \$1,532,690,270 and the minimum liquidity ratio was therefore met.

## TOKIO MILLENNIUM RE LTD.

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

*(Expressed in United States Dollars)*

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### 13. **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.

The Company's branches in Switzerland and Australia are subject to income taxes at effective rates of 21.17% and 30%, respectively. The Company's deferred tax asset is included in other assets on the balance sheet and results from an operating loss carry forward. No provision has been made for tax benefits which will not be realized as the Company believes that the full amount will be utilized against future taxable profits

### 14. **Subsequent events**

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date of December 31, 2010, through March 14, 2011, the date the consolidated financial statements were available for issuance.

On February 22, 2011 a 6.3 magnitude earthquake hit the city of Christchurch New Zealand. Initial estimates are that the earthquake appears to have caused even greater damage than the earthquake that struck the same region less than six month earlier. The detailed damage assessment is on going at this time and the available information is insufficient to arrive at a reasonable estimate for the Company's net exposure. However it is possible that the losses to the Company from this event could be similar to, or larger than those incurred for the first New Zealand earthquake.

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