

Harbor Point Reinsurance U.S., Inc.

Financial Statements as of and for the
Years Ended December 31, 2008 and 2007, and
Independent Auditors' Report

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholder's of
Harbor Point Reinsurance U.S., Inc.:

We have audited the accompanying balance sheets of Harbor Point Reinsurance U.S., Inc (the "Company") as of December 31, 2008 and 2007, and the related statements of operations and comprehensive income, changes in stockholder'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 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 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 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, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

April 3, 2009

HARBOR POINT REINSURANCE U.S., INC.

BALANCE SHEETS

AS OF DECEMBER 31, 2008 AND 2007

(Expressed in thousands of U.S. dollars, except share and per share amounts)

	<u>2008</u>	<u>2007</u>
ASSETS		
INVESTMENTS:		
Fixed maturities, at fair value (amortized cost: 2008 - \$451,962; 2007 - \$308,619)	\$ 451,672	\$ 313,134
Short-term investments, at fair value (amortized cost: 2008 - \$48,921; 2007 - \$10,746)	48,921	10,746
Total investments	500,593	323,880
CASH AND CASH EQUIVALENTS	84,378	189,597
ACCRUED INTEREST RECEIVABLE	3,664	2,572
RECEIVABLE FOR INVESTMENTS SOLD	2	82
REINSURANCE BALANCES RECEIVABLE	146,193	10,826
DEFERRED ACQUISITION COSTS	11,515	834
PREPAID REINSURANCE PREMIUMS	172,789	11,873
REINSURANCE BALANCES RECOVERABLE	72,303	1,954
INTANGIBLE ASSETS	6,200	6,200
DEFERRED TAX ASSETS	400	-
OTHER ASSETS	37	72
TOTAL	<u>\$ 998,074</u>	<u>\$ 547,890</u>
LIABILITIES AND STOCKHOLDER'S EQUITY		
LIABILITIES:		
Reserve for losses and loss expenses	\$ 90,031	\$ 1,977
Unearned premiums	215,986	14,841
Accounts payable and accrued expenses	2,374	2,218
Reinsurance balances payable	149,895	8,661
Amounts withheld for account of others	1,012	-
Payable to parent under tax sharing agreement	7,543	1,229
Payable to affiliates under service agreement	931	539
Deferred tax liabilities	-	1,163
Total liabilities	467,772	30,628
STOCKHOLDER'S EQUITY:		
Common stock, par value \$100 per share - issued and outstanding 50,000	5,000	5,000
Additional paid-in capital	510,386	507,865
Accumulated other comprehensive income	-	2,935
Retained earnings	14,916	1,462
Total stockholder's equity	530,302	517,262
TOTAL	<u>\$ 998,074</u>	<u>\$ 547,890</u>

See notes to financial statements.

HARBOR POINT REINSURANCE U.S., INC.

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

(Expressed in thousands of U.S. dollars)

	<u>2008</u>	<u>2007</u>
REVENUES:		
Gross premiums written	\$ 323,999	\$ 15,047
Premiums ceded	(259,195)	(12,037)
Net premiums written	64,804	3,010
Change in net unearned premiums	(40,229)	(2,968)
Net premiums earned	24,575	42
Net investment income	22,952	7,366
Net unrealized investment losses	(4,805)	-
Net realized investment (losses) gains	(491)	179
Total revenues	<u>42,231</u>	<u>7,587</u>
EXPENSES:		
Net loss and loss expenses	18,863	23
Acquisition costs	5,509	12
General and administrative expenses	2,288	5,521
Foreign exchange losses	55	-
Total expenses	<u>26,715</u>	<u>5,556</u>
INCOME BEFORE INCOME TAXES	15,516	2,031
INCOME TAX EXPENSE	(4,997)	(569)
NET INCOME	10,519	1,462
OTHER COMPREHENSIVE INCOME - Unrealized gains on investments arising during the period, net of tax	-	2,935
COMPREHENSIVE INCOME	<u>\$ 10,519</u>	<u>\$ 4,397</u>

See notes to financial statements.

HARBOR POINT REINSURANCE U.S., INC.

STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

(Expressed in thousands of U.S. dollars)

	<u>2008</u>	<u>2007</u>
COMMON STOCK - Balance at beginning and end of year	\$ 5,000	\$ 5,000
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of year	507,865	16,060
Purchase price adjustments	-	6,467
Contribution from parent	-	485,205
Stock compensation expense, net of tax	2,521	451
Other - net	-	(318)
Balance at end of year	<u>510,386</u>	<u>507,865</u>
ACCUMULATED OTHER COMPREHENSIVE INCOME		
Balance at beginning of year	2,935	-
Change in unrealized gains on investments, net of tax	-	2,935
Cumulative effect of adoption of fair value option	(2,935)	-
Balance at end of year	<u>-</u>	<u>2,935</u>
RETAINED EARNINGS		
Balance at beginning of year	1,462	-
Cumulative effect of adoption of fair value option	2,935	-
Net income	10,519	1,462
Balance at end of year	<u>14,916</u>	<u>1,462</u>
TOTAL STOCKHOLDER'S EQUITY	<u>\$ 530,302</u>	<u>\$ 517,262</u>

HARBOR POINT REINSURANCE U.S., INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007 (Expressed in thousands of U.S. dollars)

	<u>2008</u>	<u>2007</u>
CASH FLOWS PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Net income	\$ 10,519	\$ 1,462
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized investment losses (gains)	501	(179)
Net unrealized investment losses	4,805	-
Net accretion on investments	(449)	(8)
Stock compensation expense	3,505	694
Deferred income tax benefit associated with stock compensation expense	(984)	(243)
Change in:		
Accrued interest receivable	(1,093)	(2,438)
Reinsurance balances receivable	(135,368)	(10,639)
Deferred acquisition costs	(10,681)	(834)
Prepaid reinsurance premiums	(160,916)	(10,717)
Reinsurance balances recoverable	(70,349)	1,723
Deferred tax assets	(400)	-
Other assets	35	(72)
Reserve for losses and loss expenses	88,054	(1,700)
Unearned premiums	201,145	13,685
Accounts payable and accrued expenses	156	2,218
Reinsurance balances payable	141,234	8,474
Amounts withheld for account of others	1,012	-
Payable to parent under tax sharing agreement	6,315	1,229
Payable to affiliates under service agreement	392	536
Deferred tax liabilities	(1,163)	(725)
Net cash provided by operating activities	<u>76,270</u>	<u>2,466</u>
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:		
Purchase of fixed maturity investments	(215,692)	(343,162)
Sales and maturities of fixed maturity investments	72,012	42,554
Purchase of short-term investments	(237,017)	(367,119)
Sales and maturities of short-term investments	199,208	369,653
Net cash used in investing activities	<u>(181,489)</u>	<u>(298,074)</u>
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES -		
Contribution from parent	-	485,205
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(105,219)	189,597
CASH AND CASH EQUIVALENTS at beginning of the year	189,597	-
CASH AND CASH EQUIVALENTS at end of the year	<u>\$ 84,378</u>	<u>\$ 189,597</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION -		
Income taxes paid	<u>\$ 1,229</u>	<u>\$ -</u>

See notes to financial statements.

HARBOR POINT REINSURANCE U.S., INC.

NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

1. ORGANIZATION

Harbor Point Reinsurance U.S., Inc. (“HPREUS” or the “Company”) was incorporated on April 21, 1997, and is a wholly owned subsidiary of Harbor Point U.S. Holdings, Inc., (“Harbor Point U.S.”). The Company’s ultimate parent company is Harbor Point Limited (“Harbor Point”) a holding company organized under the laws of Bermuda. The Company is a broadly licensed insurance company acquired in January 2007 to write reinsurance in the United States.

Effective December 15, 2005, Harbor Point acquired the continuing operations and certain assets of Chubb Re, Inc. (“Chubb Re”), the assumed reinsurance division of The Chubb Corporation (“Chubb”), including the renewal rights to the in-force assumed reinsurance business underwritten, placed and serviced by Chubb Re on behalf of Federal Insurance Company (“Federal”), the principal operating subsidiary of Chubb. Harbor Point did not acquire any of the in-force business or related reserves of Chubb Re. Chubb remains an investor in Harbor Point.

Harbor Point Re Limited (“Harbor Point Re”), a wholly owned subsidiary of Harbor Point, was incorporated on October 28, 2005, and is licensed as a Class 4 insurance company in Bermuda.

Harbor Point Europe Investments Limited (“HPEIL”) was incorporated in December 2006 in Ireland as the holding company for all of Harbor Point’s non-Bermuda subsidiaries.

Harbor Point U.S., a wholly owned subsidiary of HPEIL, acts as a holding company for Harbor Point’s United States operations. Harbor Point Services, Inc. (“Harbor Point Services”) is a wholly owned subsidiary of Harbor Point U.S. and provides certain reinsurance services to HPREUS and to Federal through service agreements including underwriting, actuarial and claims management.

On January 2, 2007, Harbor Point U.S. completed the acquisition of all of the issued and outstanding capital stock of the Company formerly know as Quadrant Indemnity Company (“Quadrant”), a Connecticut-domiciled property-casualty insurer and, prior to closing, a wholly-owned subsidiary of Chubb. Effective April 17, 2007, the name of the Company was changed to Harbor Point Reinsurance U.S., Inc. The Company is currently licensed as an insurer in 43 states plus the District of Columbia and accredited as a reinsurer in seven additional states.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The preparation of these financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Actual results could differ significantly from those estimates. The major estimates reflected in the Company's financial statements include the reserve for losses and loss expenses, premium estimates for business written on a quota share basis and the estimate of reinsurance balances recoverable. The terms "FAS" and "FASB" used in these notes refer to Statements of Financial Accounting Standards issued by the United States Financial Accounting Standards Board.

Cash and Investments

Cash and cash equivalents — Cash and cash equivalents include fixed interest deposits, money market funds and commercial paper with a maturity of less than ninety days when purchased. Cash and cash equivalents are valued at cost which approximates fair value.

Investments — The Company adopted FAS No. 157, *Fair Value Measurements* ("FAS 157") and FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("FAS 159") as of January 1, 2008. The Company has elected to fair value all of the Company's investments. Prior to January 1, 2008, all of the Company's investments were classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from net income and included in shareholders' equity as a component of accumulated other comprehensive income. As of January 1, 2008, all of the Company's investments were classified as trading and carried at fair value, with related net unrealized gains or losses included in net income. The Company believes that accounting for all of its investments as trading more closely reflects its investment guidelines. The adoption of the fair value option resulted in a cumulative adjustment to January 1, 2008 retained earnings of \$2.9 million, offset by an adjustment to accumulated other comprehensive income.

Purchases and sales of investments — Purchases and sales of investments are recorded on a trade date basis. Realized gains or losses on sales of investments are determined based on the specific identification method. Net investment income includes interest and dividend income together with amortization of market premiums and discounts and is net of investment fees. Prior to January 1, 2008, for mortgage-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions were evaluated and revised as necessary. Any adjustments required due to the change in effective yields and maturities were recognized on a prospective basis through yield adjustments.

Other than temporary impairment in investments — Prior to January 1, 2008, the Company performed a monthly review of its investments to assess whether declines in fair value represented impairments that were other than temporary. The Company, with the assistance of its investment advisors, applied both quantitative and qualitative factors in the assessment of a security, including (i) the time period during which there had been a significant decline below cost, (ii) the extent of the decline below cost, (iii) the potential for the security to recover in value, (iv) the Company's intent and ability to hold the security until recovery, (v) an analysis of the financial condition of the issuer, and (vi) an analysis of the collateral structure and credit support of the security, if applicable. Where the Company had determined that there was an other than temporary impairment in the fair value of the security, the cost of the security was written down to the fair value and the unrealized loss at the time of the determination was charged to net income.

Fair value of financial instruments, within the scope of FAS 157 — FAS 157 defines fair value as the price received to transfer an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date reflecting the highest and best use valuation concepts. Under FAS 157, the Company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy in FAS 157 prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 1 primarily consists of financial instruments whose value is based on quoted market prices or alternative approaches for which the Company typically obtains independent external valuation information. The fair value of U.S. government securities, certificates of deposit and commercial paper are generally based on Level 1 inputs.

Level 2 inputs are observable prices in active markets for similar assets or liabilities, prices for identical or similar assets or liabilities in markets that are not active, directly observable market inputs for substantially the full term of the asset or liability and market inputs that are not directly observable but are derived from, or corroborated by observable market data. Level 2 includes financial instruments that are valued using external valuation information obtained from indices, pricing vendors, broker-dealer quotes, models or other valuation methodologies (“price sources”). In determining fair value, these price sources typically utilize actual trade data, active and indicative bids or quotes and industry-standard models that incorporate various assumptions, including time value, yield curves, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these inputs and assumptions are observable in the marketplace, can be derived from observable data or are corroborated by observable transactions and market data. Financial instruments included in this category include U.S. government agency securities, corporate debt securities, mortgage-backed securities and asset-backed securities.

Level 3 inputs are unobservable inputs based on the reporting entity’s own assumptions about the assumptions that a market participant would use, including inputs derived from extrapolation and interpolation that are not corroborated by observable market data. Level 3 consists of securities held in the fixed income portfolio which do not meet the criteria for inclusion in either the Level 1 or Level 2 classification. The Company currently believes that none of its fixed maturity or short-term investments are valued based on unobservable inputs and therefore does not consider any of these securities to be classified as Level 3.

At each measurement date, the Company estimates the fair value of the financial instruments using various valuation techniques. The Company utilizes, to the extent available, quoted market prices in active markets or observable market inputs in estimating the fair value of the Company’s financial instruments. The following describes the valuation techniques used by the Company to estimate the fair value of financial instruments held as of December 31, 2008 and the FAS 157 fair value hierarchy allocation.

Fixed maturity investments, at fair value

U.S. government and agency securities: Comprised primarily of bonds issued by the U.S. Treasury, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The fair values of U.S. Treasury securities are based on quoted market prices in

active markets, and are included in the Level 1 fair value hierarchy. The Company believes the market for U.S. Treasury securities is an actively traded market given the high level of daily trading volume. The fair values of U.S. government agency securities are based on observed market prices for similar or identical assets in active markets, and inputs other than quoted prices that are observable either directly or indirectly. The fair values of U.S. government agency securities are included in the Level 2 fair value hierarchy.

Corporate debt securities: Comprised of bonds issued by corporations that are diversified across a wide range of issuers and market sectors. The fair values of corporate bonds are priced using the credit spread above the risk-free yield curve. The credit spreads are sourced from dealer quotes, trade prices for identical or similar assets and the new issue market. As the inputs used to price corporate bonds are observable market inputs, the fair values of corporate bonds are included in the Level 2 fair value hierarchy.

Mortgage-backed securities: Principally comprised of pools of residential and commercial mortgages originated by both agency and non-agency institutions. The fair values of mortgage-backed securities are based on a pricing methodology that incorporates yield curves, prepayment speeds, default rates, loss severity and spreads to determine the appropriate average life of mortgage-backed securities. The spreads are sourced from dealer quotes, trade prices for identical or similar assets and the new issue market. As the inputs used to price the mortgage-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy.

Asset-backed securities: Comprised primarily of bonds backed by pools of automobile loan receivables, home equity loans and credit card receivables originated by various financial institutions. The fair values of asset-backed securities are priced using pricing methodology that incorporates yield curves, prepayment speeds, default rates, loss severity and spread inputs that are sourced from dealer quotes, trade prices for identical or similar assets and the new issue market. As the inputs used to price the asset-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy.

Short-term investments, at fair value — Short-term investments are comprised primarily of agency discount notes, certificates of deposit and commercial paper. Short-term investments are primarily valued using amortized cost, which approximates fair value given the short-term nature of these securities. These securities are included in the Level 1 fair value hierarchy.

Fair Value of Financial Instruments, Outside of the Scope of FAS 157 — The carrying value of cash and cash equivalents, receivables, accounts payable and accrued liabilities and any financial instruments included in other assets approximate their fair values principally because of the short-term maturities of these instruments.

Estimates of fair value are subjective in nature and are not necessarily indicative of the amounts that the Company would actually realize in a current market exchange. However, any differences would not be expected to be material. Certain instruments such as deferred acquisition costs, intangible assets, prepayments and deferred taxes, reserve for losses and loss expenses and unearned premiums are excluded from fair value disclosure. Thus, the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

Premiums and Acquisition Costs — For excess of loss contracts, the Company records the estimated ultimate premium, which is generally the deposit premium as written at the inception of the contract, and records premium adjustments in the period in which they are reasonably determinable. For quota share contracts, management estimates the ultimate premium and records the estimate at the inception of the contract. The Company actively monitors the emergence of actual premium on quota share contracts and adjusts its estimates of written premium as information becomes available. Premiums are earned over the term of the contract in proportion to the risks covered, which is generally one to two years, depending upon whether the reinsurance contracts are written on an excess of loss basis or a quota share basis. Unearned premiums represent the portion of reinsurance premiums written that is applicable to the unexpired portion of the contracts in force.

Acquisition costs, primarily ceding commissions, brokerage, fronting fees and taxes, which vary with and are directly related to the acquisition of policies, are deferred and amortized over the period in which the related premiums are earned. Deferred acquisition costs are reviewed to determine if they are recoverable from future income, including investment income. If such costs are determined to be unrecoverable, they are expensed.

Reinsurance — In the normal course of business, the Company seeks to reduce the loss that may arise from events that could cause unfavorable underwriting results by reinsuring certain levels of risk with other reinsurers. Reinsurance premiums ceded are expensed over the period of the reinsurance coverage. Prepaid reinsurance premiums represent the portion of premiums ceded on the unexpired term of the policies in force. Reinsurance losses recoverable are based on contracts in force and are presented net of any reserve for uncollectible reinsurance. The method for determining the reinsurance losses recoverable is based on management's estimates of the underlying reserve for losses and loss expenses.

Losses and Loss Expenses — Reserves for losses and loss expenses include unpaid reported losses and loss expenses and losses incurred but not reported ("IBNR"). IBNR reserves have been estimated by management based on ultimate loss ratio projections determined by reference to the Company's underwriting and pricing practices, industry statistics and exposure as well as premium and loss data reported by the ceding companies.

Inherent in the estimates of ultimate losses and loss expenses are expected trends in claims severity and frequency and other factors that may vary significantly as claims are settled. Accordingly, the ultimate cost to settle unpaid losses may differ materially from the amounts recorded in the financial statements. The methods of determining such estimates and establishing the resulting reserves are reviewed regularly and any adjustments are reflected in income in the period in which they become known.

Premium Deficiency Reserves — A premium deficiency reserve is maintained where the unearned premium for any class of business is not sufficient to cover the net liability expected to be incurred after the balance sheet date in respect of the in force business in that class at the balance sheet date. The Company anticipates investment income when evaluating the need for premium deficiency reserves. As of December 31, 2008 and 2007, the Company has determined that no premium deficiency reserves are necessary.

Foreign Currency Translation — The functional currency of the Company is the U.S. dollar. Monetary assets and liabilities denominated in foreign currencies are translated at year end exchange rates, with the resulting foreign exchange gains and losses recognized in the statements of operations and comprehensive income. Revenues and operating expenses are translated at average rates during the year.

Intangible Assets — Identifiable intangible assets that arise from business combinations are accounted for in accordance with FAS No. 141, *Business Combinations* and FAS No. 142, *Goodwill and Other Intangible Assets*.

The insurance licenses acquired were recorded at their estimated fair value. This intangible asset has an indefinite useful life and is not being amortized. Rather, its value is adjusted for impairment, if appropriate.

Taxation — The Company utilizes the liability method of accounting for Federal income taxes. Current and deferred income taxes are provided based upon enacted tax laws and rates. Deferred income taxes are provided on all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

A valuation allowance against deferred tax assets is recorded when management's assessment indicates that it is more likely than not that a portion of the deferred tax asset will not be realized in the foreseeable future.

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement No. 109* (“FIN 48”) effective January 1, 2008. Under FIN 48, the tax benefits of uncertain tax positions may only be recognized when the position is more-likely-than-not to be sustained upon audit by the relevant taxing authorities. FIN 48 did not have a material effect on the Company's statements of operations or financial condition or disclosures.

Stock-Based Employee Compensation Plans — Harbor Point accounts for stock-based compensation awards in accordance with FAS No. 123(R), *Share-Based Payment* using the fair value method. FAS No. 123(R) requires that Harbor Point recognize compensation expense related to all share-based compensation transactions with employees, including incentive stock options and restricted stock awards. The amount of compensation cost is measured based on the grant-date fair value of such awards and is recognized over the period during which the employee is required to provide service in exchange for the award — the requisite service period. Compensation cost for awards with a graded vesting schedule is recognized on a straight-line basis over the requisite service period for each separately vesting portion of the award. That portion of total stock compensation expense related to the Company's employees is allocated to the Company by Harbor Point and accounted for by Harbor Point as an additional investment in the Company. The stock compensation expense allocated to the Company is recorded as an expense and an increase to additional paid in capital.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Lives of Intangible Assets* (“FSP FAS 142-3”). FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of an intangible asset. FSP FAS 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company does not believe that FSP FAS 142-3 will have a material effect on its statements of operations or financial condition or disclosures.

In May 2008, the FASB issued FAS No. 163, *Accounting for Financial Guarantee Insurance Contracts, and interpretation of FASB Statement No. 60*, (“FAS 163”). FAS 163 decreases the inconsistencies in Statement No. 60 in the accounting for financial guarantee insurance contracts by insurance companies. FAS 163 addresses the differing views in Statement No. 60 regarding the recognition and measurement of premium revenues and claim liabilities and enhances the disclosure requirements for insurance contracts. FAS 163 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The adoption of FAS 163 is not expected to have a material impact on the Company’s statements of operations or financial condition or disclosures.

In October 2008, the FASB issued FASB Staff Position No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (“FSP FAS 157-3”), which was effective upon issuance. FSP FAS 157-3 clarifies the application of FAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 did not have a material effect on the Company’s statements of operations or financial condition or disclosures.

4. ACQUISITION OF THE COMPANY BY HARBOR POINT U.S.

On January 2, 2007, Harbor Point U.S. completed the acquisition of all of the issued and outstanding capital stock of the Company formerly know as Quadrant, a Connecticut-domiciled property-casualty insurer and, prior to closing, a wholly-owned subsidiary of Chubb. Harbor Point U.S. paid a purchase price of \$27.5 million. Quadrant was fully licensed as an insurer in 44 states and was an accredited reinsurer in an additional four states at the time of purchase. Effective April 17, 2007, the name of the Company was changed to Harbor Point Reinsurance U.S., Inc.

The following table summarizes the fair values of the net assets acquired (amounts in 000’s):

Investments:	
U.S. Treasury securities	\$ 7,930
Short-term investments	13,281
Accrued interest	130
Intangible assets with an indefinite life:	
Insurance licenses	6,200
Assumed loss and loss expenses	(3,000)
Losses recoverable from Chubb	3,000
	<u>\$ 27,541</u>

The acquisition of the Company has been accounted for under the purchase method of accounting. The fair values of the assets acquired as indicated above were reflected in the accounts of the Company as of the acquisition date. There was no goodwill associated with this purchase. Prior to closing, Chubb transferred or cancelled essentially all of the existing insurance policies. Chubb has indemnified the Company via a reinsurance agreement for any development on the small amount of pre-acquisition business that remains in the Company. The primary reason for the transaction was to acquire the licenses in order to establish a U.S. based reinsurance operating company.

5. INVESTMENTS

Effective January 1, 2008, the Company adopted FAS 157 and FAS 159. Prior to January 1, 2008, all of the Company's investments were classified as available-for-sale and carried at fair value, with related net unrealized gains or losses excluded from net income and included in shareholders' equity as a component of accumulated other comprehensive income. Beginning on January 1, 2008, all of the Company's investments were classified as trading and carried at fair value, with related net unrealized gains or losses included in net income.

Adoption of FAS 157 — Under FAS 157, the Company must determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy in FAS 157 prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement. Level 3 inputs are unobservable inputs for the asset or liability.

As of December 31, 2008, the Company's investments that are carried at fair value are allocated between levels 1 and 2 as follows (amounts in 000's):

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
U.S. government and agency securities	\$ 107,869	\$ 20,715	\$ 128,584
Corporate debt securities	-	114,639	114,639
Mortgage-backed securities	-	185,566	185,566
Asset-backed securities	-	22,883	22,883
Total fixed maturity investments	<u>107,869</u>	<u>343,803</u>	<u>451,672</u>
Total short-term investments	<u>48,921</u>	-	<u>48,921</u>
Total	<u>\$ 156,790</u>	<u>\$ 343,803</u>	<u>\$ 500,593</u>

The Company did not have any level 3 investments during 2008.

Net investment income — Net investment income for the years ended December 31, 2008 and 2007, are derived from the following sources (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Cash equivalents	\$ 3,817	\$ 2,446
Fixed maturities	19,201	4,388
Short-term investments	736	739
Net investment expenses	<u>(802)</u>	<u>(207)</u>
Net investment income	<u>\$ 22,952</u>	<u>\$ 7,366</u>

The following represents an analysis of gross realized gains (losses) and unrealized gains (losses) on investments included in net income for the year ended December 31, 2008 and comprehensive income for the year ended December 31, 2007 (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Gross realized gains	\$ 61	\$ 186
Gross realized losses, excluding other than temporary impairments	(552)	(7)
Other than temporary impairments	-	-
Net realized (losses) gains on investments	<u>(491)</u>	<u>179</u>
Net unrealized losses on investments included in net income	(4,805)	-
Net unrealized gains on investments included in other comprehensive income	-	4,515
Total net realized and unrealized (losses) gains on investments	<u><u>\$ (5,296)</u></u>	<u><u>\$ 4,694</u></u>

Fixed maturity investments — The amortized cost and fair market value as of December 31, 2008 and 2007 are as follows (amounts in 000's):

	<u>2008</u>			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Market Value</u>
U.S. government and agency securities	\$ 122,851	\$ 5,810	\$ (77)	\$ 128,584
Corporate debt securities	117,181	1,782	(4,324)	114,639
Mortgage-backed securities	188,651	5,597	(8,682)	185,566
Asset-backed securities	23,279	13	(409)	22,883
Total fixed maturities	<u>451,962</u>	<u>13,202</u>	<u>(13,492)</u>	<u>451,672</u>
Total short-term investments	48,921	-	-	48,921
Total	<u><u>\$ 500,883</u></u>	<u><u>\$ 13,202</u></u>	<u><u>\$ (13,492)</u></u>	<u><u>\$ 500,593</u></u>
	<u>2007</u>			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Market Value</u>
U.S. government and agency securities	\$ 63,429	\$ 995	\$ -	\$ 64,424
Corporate debt securities	37,467	408	(47)	37,828
Mortgage-backed securities	184,390	3,029	(4)	187,415
Asset-backed securities	23,333	135	(1)	23,467
Total fixed maturities	<u>308,619</u>	<u>4,567</u>	<u>(52)</u>	<u>313,134</u>
Total short-term investments	10,746	-	-	10,746
Total	<u><u>\$ 319,365</u></u>	<u><u>\$ 4,567</u></u>	<u><u>\$ (52)</u></u>	<u><u>\$ 323,880</u></u>

The following table sets forth certain information regarding the credit ratings of the Company's fixed income portfolio as of December 31, 2008 and 2007 (amounts in 000's):

	2008		
	Amortized Cost	Fair Market Value	Percentage of Total Fair Market Value
Ratings:			
AAA	\$ 350,131	\$ 352,461	78.0%
AA	8,760	8,868	2.0%
A	79,844	79,248	17.6%
BBB	11,751	10,952	2.4%
NR	1,476	143	0.0%
Total	<u>\$ 451,962</u>	<u>\$ 451,672</u>	<u>100.0%</u>
	2007		
	Amortized Cost	Fair Market Value	Percentage of Total Fair Market Value
Ratings:			
AAA	\$ 278,599	\$ 282,847	90.3%
AA	12,068	12,179	3.9%
A	9,278	9,329	3.0%
BBB	8,674	8,779	2.8%
NR	-	-	0.0%
Total	<u>\$ 308,619</u>	<u>\$ 313,134</u>	<u>100.0%</u>

The contractual maturities of fixed maturity investments as of December 31, 2008 and 2007 are shown below (amounts in 000's). Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2008		
	Amortized	Fair Market	Percentage of
	Cost	Value	Total Fair
			Market Value
Due in one year or less	\$ 12,282	\$ 12,526	2.8%
Due in one year through five years	176,363	177,924	39.4%
Due in five years through ten years	44,295	45,021	9.9%
Due after ten years	7,092	7,752	1.7%
	<u>240,032</u>	<u>243,223</u>	<u>53.8%</u>
Mortgage-backed securities	188,651	185,566	41.1%
Asset-backed securities	23,279	22,883	5.1%
Total	<u>\$ 451,962</u>	<u>\$ 451,672</u>	<u>100.0%</u>

	2007		
	Amortized	Fair Market	Percentage of
	Cost	Value	Total Fair
			Market Value
Due in one year or less	\$ 9,900	\$ 9,938	3.2%
Due in one year through five years	68,128	69,060	22.1%
Due in five years through ten years	22,209	22,619	7.2%
Due after ten years	659	635	0.2%
	<u>100,896</u>	<u>102,252</u>	<u>32.7%</u>
Mortgage-backed securities	184,390	187,415	59.8%
Asset-backed securities	23,333	23,467	7.5%
Total	<u>\$ 308,619</u>	<u>\$ 313,134</u>	<u>100.0%</u>

Fair market value for mortgage-backed securities includes \$142.3 million and \$122.3 million of residential and \$43.3 million and \$65.1 million of commercial mortgage-backed securities as of December 31, 2008 and 2007, respectively.

The following is an analysis of how long each of the fixed maturity investments held as of December 31, 2007 had been in a continued unrealized loss position (amounts in 000's):

	12 Months or Greater		Less Than 12 Months		Total	
	Unrealized		Unrealized		Unrealized	
	Fair Value	Losses	Fair Value	Losses	Fair Value	Losses
U.S. government and agency securities	\$ -	\$ -	\$ 5,000	\$ -	\$ 5,000	\$ -
Corporate debt securities	-	-	5,128	(47)	5,128	(47)
Mortgage-backed securities	6,801	(4)	-	-	6,801	(4)
Asset-backed securities	-	-	4,626	(1)	4,626	(1)
Total fixed maturity investments	<u>\$ 6,801</u>	<u>\$ (4)</u>	<u>\$ 14,754</u>	<u>\$ (48)</u>	<u>\$ 21,555</u>	<u>\$ (52)</u>

As of December 31, 2007, there were 8 securities in an unrealized loss position. Of these securities, there were 2 securities that had been in an unrealized loss position for 12 months or greater. In determining that any securities in an unrealized loss position did not require that the Company record an other than temporary impairment charge, the Company considered the amount of the unrealized loss relative to its amortized cost, the time expected to recover and the credit rating of the issuer. In addition, the Company does have the ability and the intent to hold all of the securities in an unrealized loss position at December 31, 2007 until recovery. The unrealized losses from these securities were not a result of credit, collateral or structural issues.

During the year ended December 31, 2007, the Company recorded no other than temporary impairment charges.

6. LOSSES AND LOSS EXPENSES

The reserve for losses and loss expenses as of December 31, 2008 and 2007 (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Reported but unpaid losses and loss expenses	\$ 5,556	\$ 791
Losses incurred but not reported	<u>84,475</u>	<u>1,186</u>
	<u>\$ 90,031</u>	<u>\$ 1,977</u>

Net loss and loss expenses for the years ended December 31, 2008 and 2007 (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Loss and loss expenses paid	\$ 5,834	\$ 2,271
Loss and loss expenses recovered	(4,676)	(2,271)
Change in unpaid loss and loss expenses	88,054	(1,700)
Change in reinsurance losses recoverable	<u>(70,349)</u>	<u>1,723</u>
	<u>\$ 18,863</u>	<u>\$ 23</u>

The loss and loss expenses paid includes \$150,000 and \$0 of unallocated loss adjustment expenses paid for the years ended December 31, 2008 and 2007, respectively.

The following table represents an analysis of paid and unpaid losses and a reconciliation of the beginning and ending unpaid losses and loss expenses for the years ended December 31, 2008 and 2007 (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Reserve for losses and loss expenses at the beginning of year	\$ 1,977	\$ 3,677
Less: reinsurance recoverable at the beginning of year	<u>1,954</u>	<u>3,677</u>
Net reserve for losses and loss expenses at the beginning of year	<u>23</u>	<u>-</u>
Net loss and loss expenses incurred in respect of losses occurring in:		
Current year	18,863	23
Prior years	<u>-</u>	<u>-</u>
Total incurred loss and loss expenses	<u>18,863</u>	<u>23</u>
Net loss and loss expenses paid in respect of losses occurring in:		
Current year	1,154	-
Prior years	<u>3</u>	<u>-</u>
Total net paid losses	<u>1,157</u>	<u>-</u>
Net reserve for losses and loss expenses at the end of year	17,729	23
Add: reinsurance losses recoverable at the end of year	<u>72,302</u>	<u>1,954</u>
Reserve for losses and loss related expenses at the end of year	<u>\$ 90,031</u>	<u>\$ 1,977</u>

As referenced in Note 4, Chubb has indemnified the Company with respect to reserve development on all in force policies written by the Company prior to January 1, 2007, under a 100% quota share reinsurance agreement. Accordingly for business written prior to January 1, 2007, there is no net development of prior year reserves reflected in operations in 2008 and 2007. Additionally, the Company did not incur any net development on prior year reserves from any business written after January 1, 2007 during 2008.

7. REINSURANCE

In addition to the 100% quota share cession of pre-acquisition business to Chubb as described in Note 6, the Company has entered into a quota share reinsurance agreement with Harbor Point Re whereby 80% of all reinsurance contracts written by the Company are ceded to Harbor Point Re. The Company remains liable to the extent that reinsurers do not meet their obligations under these agreements either due to solvency issues, contractual disputes or other reasons. Harbor Point Re has provided the Company with a letter of credit in the amount of \$93.8 million securing all recoverable balances in excess of amounts payable by the Company to Harbor Point Re.

Gross, ceded and net amounts of premium written, premiums earned and losses incurred for the years ended December 31, 2008 and 2007, are as follows (amounts in 000's):

	2008			2007		
	Premiums Written	Premiums Earned	Losses Incurred	Premiums Written	Premiums Earned	Losses Incurred
Gross	\$ 323,999	\$ 122,854	\$ 93,888	\$ 15,047	\$ 1,362	\$ 571
Ceded	(259,195)	(98,279)	(75,025)	(12,037)	(1,320)	(548)
Net	\$ 64,804	\$ 24,575	\$ 18,863	\$ 3,010	\$ 42	\$ 23

8. CREDIT FACILITY

On June 12, 2007, Harbor Point entered into an \$850 million five-year senior unsecured credit facility amending and replacing its previous \$500 million three-year unsecured credit facility. The credit facility allows Harbor Point and its subsidiaries, including the Company, to issue letters of credit up to the full amount of the facility and to borrow up to \$250 million for general corporate purposes. In addition, there is a \$50 million sublimit for the issuance of secured letters of credit for Harbor Point's investment affiliates. Total usage under the credit facility is limited to \$850 million. Harbor Point may request an increase in the credit facility of up to \$150 million, subject to there being sufficient participation by the syndicate of participating banks. As of December 31, 2008, Harbor Point had unsecured letters of credit of \$561.1 million and secured letters of credit of \$30 million outstanding. Also, as of December 31, 2008, Harbor Point had one outstanding loan of \$200 million. The credit facility contains various covenants with which Harbor Point was in compliance as of December 31, 2008 and 2007. The Company has not used the credit facility as of December 31, 2008 and 2007.

9. BENEFIT PLANS

The Company participates in the 2006 equity compensation plan of Harbor Point (the "Equity Plan") which provides for the issuance of stock options and restricted shares of Harbor Point common stock. Harbor Point has reserved 1,750,000 shares for issuance of awards pursuant to the Equity Plan. The Equity Plan is administered by the Compensation Committee of Harbor Point's Board of Directors.

As of December 31, 2008 and 2007, 593,000 and 599,500 shares, respectively, of Harbor Point's common stock were subject to options granted under the Equity Plan with a weighted average option price of \$100.61 (\$100.60 in 2007) of which 187,500 (192,750 in 2007) were allocated to employees of the Company. During 2008 and 2007, no shares of Harbor Point's common stock were exercised under options subject to the Equity Plan. Also, as of December 31, 2008 and 2007, under the Equity Plan, Harbor Point has issued 547,970 and 437,450 restricted shares of its common stock, respectively, of which 166,925 (144,175 in 2007) restricted shares were allocated to employees of the Company. During the years ended December 31, 2008 and 2007, the Company recorded stock compensation expense and additional paid in capital of \$3,505,000 and \$694,000, respectively, for costs allocated to it by Harbor Point.

The Company also provides its employees with a Company-matched 401(k) plan and other defined contribution retirement plans. A total of 9% of eligible compensation is contributed to these plans totaling \$351,000 and \$255,000 for the years ended December 31, 2008 and 2007, respectively.

10. TAXATION

The provision for federal income taxes has been determined under the provisions of the United States Internal Revenue Code and Regulations thereunder. The Company is included in the consolidated U.S. tax return of Harbor Point U.S., along with Harbor Point Services. The Company also files separate company income or other tax returns in Florida, Illinois, Louisiana, Mississippi, Nebraska, New Hampshire, New York and Oregon.

Income tax expense for the years ended December 31, 2008 and 2007 was as follows (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Current income tax expense	\$ 7,543	\$ 1,229
Net deferred income tax benefit	(2,546)	(660)
Net income tax expense	<u>\$ 4,997</u>	<u>\$ 569</u>

Deferred income taxes reflect the tax impact of temporary differences between carrying amounts of assets and liabilities for financial reporting and tax purposes. The significant components of the net deferred tax assets (liabilities) as of December 31, 2008 and 2007 are as follows (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Incentive compensation expense	\$ 602	\$ 506
Deferred acquisition costs	(4,030)	(292)
Unearned premium and loss reserve discount	3,731	208
Net unrealized investment gains (losses)	101	(1,580)
Other	(4)	(5)
Net deferred tax assets (liabilities)	<u>\$ 400</u>	<u>\$ (1,163)</u>

Additionally, the Company recorded a deferred income tax benefit related to stock-based compensation of \$1,227,000 and \$243,000 as a reduction to additional paid in capital for the years ended December 31, 2008 and 2007, respectively.

There were no unrecognized tax benefits related to uncertain tax positions as of December 31, 2008 and 2007.

A reconciliation between the expected tax expense based on income before taxes at the U.S. statutory federal rate of 35% and the provision for income taxes for the years ended December 31, 2008 and 2007 is provided below (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Tax on pre-tax income at U.S. statutory federal rate of 35%	\$ 5,431	\$ 711
Expected tax on permanent differences:		
Dividends paid on vested stock options	(256)	-
Amortization of insurance licenses	(145)	(145)
Nondeductible expenses	25	3
Other	(58)	-
Total income tax expense	<u>\$ 4,997</u>	<u>\$ 569</u>

The Company is a party to a tax sharing agreement with Harbor Point U.S. as is Harbor Point Services. The tax sharing agreements provide for an allocation of consolidated U.S. income tax expense among the affiliates based on the current U.S. income tax that would be recognized if each affiliate had filed a separate U.S. income tax return.

11. RELATED PARTY TRANSACTIONS

The following is a summary of the amounts recognized in the accompanying financial statements for the years ended December 31, 2008 and 2007, related to the 80% quota share reinsurance agreement with Harbor Point Re described in Note 7 (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Premiums written	\$ (259,215)	\$ (12,040)
Acquisition costs	(22,036)	(47)
General and administrative expenses	(9,754)	-
Net loss and loss expense	(74,851)	(93)
Foreign exchange losses	(218)	-
Prepaid reinsurance premium	172,789	11,873
Reinsurance balances payable	149,895	8,657
Deferred acquisition costs	46,059	3,336
Reinsurance balances recoverable	70,914	93

The Company is party to a service agreement with Harbor Point Services whereby Harbor Point Services provides accounting, systems, legal and administrative services to the Company. Billings from Harbor Point Services to the Company are rendered monthly based on an allocation of time spent by each employee. The Company incurred \$2,055,000 and \$2,079,000 of fees during the years ended December 31, 2008 and 2007, respectively, under these agreements. Harbor Point Services also advances funds to the Company for semi-monthly payrolls. Additionally, the Company reimburses Harbor Point Re for amounts paid on the Company's behalf to its investment manager.

The table below summarizes amounts payable to related parties under the services agreement described above and the tax allocation agreement described in Note 10 as of December 31, 2008 and 2007 (amounts in 000's):

	<u>2008</u>	<u>2007</u>
Amounts due in connection with:		
Service agreements	\$ 488	\$ 183
Payroll advances	201	356
Investment management advances	242	-
Tax sharing agreements	7,543	1,229
Total amounts due to affiliates	<u>\$ 8,474</u>	<u>\$ 1,768</u>

During 2008 and 2007, the Company received capital contributions totaling \$2.5 million and \$485.7 million, respectively. Capital contributions for the portion of Harbor Point stock compensation expense allocated to the Company, recorded as an expense and an increase to additional paid-in capital was \$2.5 million and \$0.5 million during 2008 and 2007, respectively. Accordingly the cumulative amount related to stock compensation reflected in additional paid-in capital as of December 31, 2008 and December 31, 2007 was \$3.0 million and \$0.5 million, respectively. The 2007 capital contributions also included a transfer of cash in the amount of \$192 million and securities with a fair market value of \$292.4 million inclusive of accrued interest of \$1.7 million on September 28, 2007 and various other cash contributions totaling \$0.8 million during the year.

12. STOCKHOLDERS' EQUITY

Authorized and Issued Shares — The authorized and issued share capital is 50,000 Class A common shares of par value \$100 per share. The amount received in excess of par value was recorded in additional paid in capital.

Dividends Declared — No dividends have been declared by the Company during the years ended December 31, 2008 and 2007.

13. STATUTORY FINANCIAL INFORMATION

The Company's reinsurance operations are subject to laws and regulations in the jurisdictions in which it is licensed to operate, principally Connecticut, the Company's state of domicile. These regulations include certain restrictions on the amount of dividends or other distributions available to stockholders without prior approval of the regulatory authorities. Under Connecticut law, the Company is prohibited from paying any dividends without the prior approval of the Commissioner of Insurance for a period of two years from the date of acquisition, which is January 2, 2009.

The Company's net income (loss) for the years ended December 31, 2008 and 2007, determined on a statutory basis was \$667,924 and \$(45,418), respectively. The Company's statutory capital and surplus at December 31, 2008 and 2007, was \$514,401,459 and \$507,562,685, respectively.

14. CONTINGENCIES

In the normal course of business, the Company may become involved in various claims and legal proceedings. The Company is currently not aware of any pending or threatened litigation.

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