

Catlin Insurance Company Ltd.

Consolidated Financial Statements

For the Years Ended 31 December 2010 and 2009
(Expressed in US dollars)



March 25, 2011

Independent Auditors' Report

To the Board of Directors and Stockholder of Catlin Insurance Company Ltd.

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

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Catlin Insurance Company Ltd.

Consolidated Balance Sheets

As at 31 December 2010 and 2009
(US dollars in millions)

	2010	2009
Assets		
Investments		
Fixed maturities, at fair value	\$4,577	\$3,867
Short-term investments, at fair value	594	796
Investments in funds, at fair value	200	530
Total investments	5,371	5,193
Cash and cash equivalents	2,645	2,481
Securities lending collateral	12	15
Accrued investment income	33	32
Premiums and other receivables	1,322	1,133
Reinsurance recoverable	1,229	1,441
Reinsurers' share of unearned premiums	276	213
Deferred policy acquisition costs	354	292
Intangible assets and goodwill	716	718
Catastrophe swaps, at fair value	-	1
Other assets	117	141
Total assets	\$12,075	\$11,660
Liabilities and Stockholder's Equity		
Liabilities:		
Reserves for losses and loss expenses	\$5,549	\$5,392
Unearned premiums	1,886	1,724
Reinsurance payable	559	653
Accounts payable and other liabilities	284	275
Subordinated debt	93	97
Securities lending payable	12	15
Deferred tax liability (net)	237	234
Due to parent	158	13
Total liabilities	\$8,778	\$8,403

Catlin Insurance Company Ltd.
Consolidated Balance Sheets (continued)

As at 31 December 2010 and 2009
(US dollars in millions)

	2010	2009
Stockholder's equity		
Common stock	\$1	\$1
Preferred stock	590	590
Additional paid-in capital	1,807	1,723
Accumulated other comprehensive loss	(184)	(189)
Retained earnings	1,083	1,132
Total stockholder's equity	3,297	3,257
Total liabilities and stockholder's equity	\$12,075	\$11,660

The accompanying notes are an integral part of the consolidated financial statements.

Catlin Insurance Company Ltd.
Consolidated Statements of Operations

For the years ended 31 December 2010 and 2009
(US dollars in millions)

	2010	2009
Revenues		
Gross premiums written	\$4,069	\$3,715
Reinsurance premiums ceded	(751)	(547)
Net premiums written	3,318	3,168
Change in net unearned premiums	(99)	(250)
Net premiums earned	3,219	2,918
Net investment return	205	414
Change in fair value of catastrophe swaps	(15)	(31)
Net (losses)/gains on foreign currency	(1)	26
Other income	8	8
Total revenues	3,416	3,335
Expenses		
Losses and loss expenses	1,852	1,681
Policy acquisition costs	684	586
Administrative and other expenses	446	439
Financing costs	14	15
Total expenses	2,996	2,721
Net income before income tax	420	614
Income tax expense	(25)	(50)
Net income	395	564
Preferred stock dividend	(44)	(44)
Net income to common stockholder	\$351	\$520

The accompanying notes are an integral part of the consolidated financial statements.

Catlin Insurance Company Ltd.
Consolidated Statements of Changes in Stockholder's Equity

For the years ended 31 December 2010 and 2009
(US dollars in millions)

	Common stock	Preferred stock	Additional paid-in capital	Accumulated other comprehensive loss	Retained earnings	Total stockholder's equity
Balance 1 January 2009	\$1	\$590	\$1,500	\$(301)	\$612	\$2,402
Comprehensive income:						
Net income to common stockholder	-	-	-	-	520	520
Other comprehensive income	-	-	-	112	-	112
Total comprehensive income	-	-	-	112	520	632
Capital contribution from parent	-	-	223	-	-	223
Balance 31 December 2009	\$1	\$590	\$1,723	\$(189)	\$1,132	\$3,257
Comprehensive income:						
Net income to common stockholder	-	-	-	-	351	351
Other comprehensive income	-	-	-	5	-	5
Total comprehensive income	-	-	-	5	351	356
Dividends	-	-	-	-	(400)	(400)
Capital contribution from parent	-	-	84	-	-	84
Balance 31 December 2010	\$1	\$590	\$1,807	\$(184)	\$1,083	\$3,297

The accompanying notes are an integral part of the consolidated financial statements.

Catlin Insurance Company Ltd.
Consolidated Statements of Cash Flows

For the years ended 31 December 2010 and 2009
(US dollars in millions)

	2010	2009
Cash flows provided by operating activities		
Net income	\$395	\$564
Adjustments to reconcile net income to net cash provided by operations:		
Amortisation and depreciation	16	17
Amortisation of net discounts of fixed maturities	26	(10)
Net gains on investments	(65)	(232)
Cessation of Syndicate 2020	-	112
Changes in operating assets and liabilities		
Reserves for losses and loss expenses	224	36
Unearned premiums	155	147
Premiums and other receivables	(206)	(15)
Deferred policy acquisition costs	(65)	(36)
Reinsurance payable	(83)	159
Reinsurance recoverable	179	28
Reinsurers' share of unearned premiums	(56)	103
Accounts payable and other liabilities	10	8
Deferred taxes	(9)	27
Other	78	(47)
Net cash flows provided by operating activities	599	861
Cash flows used in investing activities		
Purchases of fixed maturities	(2,939)	(2,163)
Proceeds from sales of fixed maturities	2,051	1,291
Proceeds from maturities of fixed maturities	184	117
Net purchases, sales and maturities of short-term investments	195	(722)
Purchases of investment in funds	(44)	(17)
Redemptions of investments in funds	392	547
Net purchases and sales of property and equipment	(32)	(10)
Net cash flows used in investing activities	(193)	(957)

Catlin Insurance Company Ltd.
Consolidated Statements of Cash Flows (continued)

For the years ended 31 December 2010 and 2009
(US dollars in millions)

	2010	2009
Cash flows provided by financing activities		
Dividends paid on preferred stock	(44)	(44)
Dividends paid on common stock	(285)	-
Contribution from parent	84	223
Net cash flows from/(to) parent	30	(59)
Net cash flows (used in)/provided by financing activities	(215)	120
Net increase in cash and cash equivalents	191	24
Effect of exchange rate changes	(27)	104
Cash and cash equivalents – beginning of year	2,481	2,353
Cash and cash equivalents – end of year	\$2,645	\$2,481
Supplemental cash flow information		
Taxes (received)/paid	\$(19)	\$6
Interest paid	\$3	\$5
Cash and cash equivalents comprise the following:		
Cash at bank and in hand	\$2,210	\$2,004
Cash equivalents	\$435	\$477

The accompanying notes are an integral part of the consolidated financial statements.

Catlin Insurance Company Ltd.

Notes to the Consolidated Financial Statements

For the years ended 31 December 2010 and 2009

1 Nature of operations

Catlin Insurance Company Ltd. ('Catlin Bermuda' or the 'Company') is a Bermuda Class 4 licensed insurer incorporated on 18 December 2000 under the laws of Bermuda. It is a wholly owned subsidiary of Catlin Group Limited ('the Group' or 'parent'), a Bermuda licensed holding company. The Company, together with its subsidiaries, ('CICL Group'), writes insurance and reinsurance on a global basis.

The CICL Group consists of four reporting segments as described in Note 3.

The CICL Group writes a broad range of products, including property, casualty, energy, marine and aerospace insurance and property, catastrophe and per-risk excess, non-proportional treaty, aviation, marine, casualty and motor reinsurance business. Risks are insured worldwide, although risks originating in the United States predominate. The CICL Group currently operates more than 50 offices in 20 countries.

2 Significant accounting policies

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ('US GAAP'). The preparation of financial statements in conformity with US GAAP requires management to make estimates when recording transactions resulting from business operations based on information currently available. The most significant items on the CICL Group's balance sheet that involve accounting estimates and actuarial determinations are reserves for losses and loss expenses, reinsurance recoverables, valuation of investments, intangible assets and goodwill. The accounting estimates are sensitive to market conditions, investment yields and other factors. As additional information becomes available, or actual amounts are determinable, the recorded estimates will be revised and reflected in operating results. Although some variability is inherent in these estimates and actual results may differ from the estimates used in preparing the consolidated financial statements, management believes the amounts recorded are reasonable.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and all of its wholly owned subsidiaries. All significant inter-company transactions and balances are eliminated on consolidation.

Reporting currency

The financial information is reported in United States dollars ('US dollars' or '\$').

Fixed maturities and short-term investments

The CICL Group has elected to apply the fair value option to its fixed maturities and short-term investments. The CICL Group's fixed maturities and short-term investments are carried at fair value. The fair value is based on the quoted market price of these securities provided by either independent pricing services, or, when such prices are not available, by reference to broker or underwriter bid indications. Short-term investments are composed of instruments with original maturities of more than 90 days and less than one year from the date of purchase.

Net investment return includes interest income adjusted for amortisation of premiums and discounts and is net of investment management and custodian fees. Interest income is recognised when earned. Premiums and discounts are amortised or accreted over the lives of the related securities as an adjustment to yield using the effective-interest method and amortisation is recorded in current period income. For mortgage-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the resultant change in effective yields and maturities are recognised prospectively.

All gains or losses on fixed maturities and short-term investments are included in net investment return in the Consolidated Statements of Operations.

Catlin Insurance Company Ltd.

Notes to the Consolidated Financial Statements

For the years ended 31 December 2010 and 2009

Investments in funds

The CICL Group's investments in funds are carried at fair value. The fair value is based on either the net asset value provided by the funds' administrators or, where available, the quoted market price of the funds. All gains or losses on investments in funds are included within net investment return in the Consolidated Statements of Operations.

Derivatives

The CICL Group recognises derivative financial instruments as either assets or liabilities measured at fair value. Gains and losses resulting from changes in fair value are included in net income in the Consolidated Statements of Operations. None of the derivatives used are designated as accounting hedges.

The fair values of the catastrophe swap agreements described in Note 8 are determined by management using internal models based on the valuation of the underlying notes issued by the counterparty. The determination of the fair values takes into account changes in the market for catastrophic reinsurance contracts with similar economic characteristics and the potential for recoveries from events preceding the valuation date.

The fair values of option contracts, equity index futures contracts and interest rate options described in Note 8 are based on prices provided by independent pricing services. Any open option and equity index futures contracts at the balance sheet date are included in investments in funds in the Consolidated Balance Sheets. Any open interest rate option contracts are included in fixed maturity investments. Gains and losses resulting from change in fair value are included in net investment return in the Consolidated Statements of Operations.

The fair values of foreign exchange derivatives described in Note 8 are based on prices provided by counterparties. Gains and losses on foreign exchange derivatives are included in net gains/(losses) on foreign currency in the Consolidated Statements of Operations.

Cash and cash equivalents

Cash equivalents are carried at cost, which approximates fair value, and include all investments with original maturities of 90 days or less.

Securities lending

The CICL Group participates in securities lending arrangements whereby specific securities are loaned to other institutions, primarily banks and brokerage firms, for short periods of time. Under the terms of the securities lending agreements, the loaned securities remain under the CICL Group's control and therefore remain on the CICL Group's balance sheet. Collateral in the form of cash, government securities and letters of credit is required and is monitored and maintained by the lending agent. The CICL Group receives interest income on the invested collateral, which is included in net investment return in the Consolidated Statements of Operations.

Premiums

Premiums are recorded as written at the inception of each policy and are earned over the policy period. Accordingly, unearned premiums represent the portion of premiums written which is applicable to the unexpired risk portion of the policies in force.

Reinsurance premiums assumed are recorded at the inception of the policy and are estimated based on information provided by ceding companies. The information used in establishing these estimates is reviewed and subsequent adjustments are recorded in the period in which they are determined. These premiums are earned over the terms of the related reinsurance contracts.

Reinstatement premiums receivable are recognised and fully earned as they fall due.

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Policy acquisition costs

Policy acquisition costs are those costs, consisting primarily of commissions and premium taxes that vary with and are primarily related to the production of premiums. Policy acquisition costs are deferred and amortised over the period in which the related premiums are earned.

To the extent that future policy premiums, including anticipation of interest income, are not adequate to recover all deferred policy acquisition costs ('DPAC') and related losses and loss expenses, a premium deficiency is recognised immediately by a charge to net income. If the premium deficiency is greater than unamortised DPAC, a liability will be accrued for the excess deficiency.

Reserves for losses and loss expenses

A liability is established for unpaid losses and loss expenses when insured events occur. The liability is based on the expected ultimate cost of settling the claims. The reserve for losses and loss expenses includes: (1) case reserves for known but unpaid claims as at the balance sheet date; (2) incurred but not reported ('IBNR') reserves for claims where the insured event has occurred but has not been reported to the Group as at the balance sheet date (and for additional development on reported claims in instances where the case reserve is viewed to be potentially insufficient); and (3) loss adjustment expense reserves for the expected handling costs of settling the claims.

Reserves for losses and loss expenses are established based on amounts reported from insureds or ceding companies and according to generally accepted actuarial principals. Reserves are based on a number of factors, including experience derived from historical claim payments and actuarial assumptions to arrive at loss development factors. Such assumptions and other factors include trends, the incidence of incurred claims and the extent to which all claims have been reported. The process used in establishing reserves cannot be exact, particularly for liability and catastrophe-related coverages, since actual claim costs are dependent upon such complex factors as inflation, changes in doctrines of legal liability and damage awards. The methods of making such estimates and establishing the related liabilities are periodically reviewed and updated and any adjustments required are reflected in net income in the current year in the Consolidated Statement of Operations.

Reinsurance

In the ordinary course of business, the CICL Group's subsidiaries cede premiums to other insurance companies. These arrangements allow for greater diversification of business and minimise the net loss potential arising from large risks. Ceded reinsurance contracts do not relieve the CICL Group of its obligations to its insureds.

Reinsurance premiums ceded and commissions thereon are recognised over the period that the reinsurance coverage is provided. Reinsurers' share of unearned premiums represents the portion of premiums ceded to reinsurers applicable to the unexpired terms of the reinsurance contracts in force. Reinstatement premiums payable are recognised and fully expensed as they fall due.

Reinsurance recoverables include the balances due from reinsurance companies for paid and unpaid losses and loss expenses that will be recovered from reinsurers, based on contracts in force. A reserve for uncollectible reinsurance is determined based upon a review of the financial condition of the reinsurers and an assessment of other available information.

Intangible assets and goodwill

The CICL Group's intangible assets relate to syndicate capacity, distribution channels and US insurance licenses (as admitted and eligible surplus lines insurers). Intangible assets are valued at their fair value at the time of acquisition.

Purchased syndicate capacity and admitted licenses are considered to have an indefinite life and as such are subject to annual impairment testing. Surplus lines authorisations and distribution channels are considered to have a finite life and are amortised over their estimated useful lives of five years.

The CICL Group evaluates the recoverability of its intangible assets whenever changes in circumstances indicate that an intangible asset may not be recoverable. If it is determined that an

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For the years ended 31 December 2010 and 2009

impairment exists, the excess of the unamortised balance over the fair value of the intangible asset is recognised as a charge to net income in the Consolidated Statements of Operations.

Goodwill represents the excess of purchase price over the net fair value of identifiable assets acquired and liabilities assumed in a business combination. Goodwill is deemed to have an indefinite life and is not amortised, but rather tested at least annually for impairment. Impairment losses are recognised in net income in the Consolidated Statements of Operations.

The impairment tests involve an assessment of the fair values of reporting units and intangible assets. The measurement of fair values is based on an evaluation of a number of factors, including ranges of future discounted earnings and recent market transactions. Certain key assumptions considered include forecasted trends in operating returns and cost of capital.

Other assets

Other assets include prepaid items, property and equipment, income tax recoverable and unsettled trade receivables.

Comprehensive income/(loss)

Comprehensive income/(loss) represents all changes in equity that result from recognised transactions and other economic events during the year. The CICL Group's other comprehensive income/(loss) primarily comprises foreign currency translation adjustments.

Foreign currency translation and transactions

Foreign currency translation

The reporting currency of the CICL Group is US dollars. The financial statements of each of the CICL Group's entities are initially measured using the entity's functional currency, which is determined based on its operating environment and underlying cash flows. For entities with a functional currency other than US dollars, foreign currency assets and liabilities are translated into US dollars using period-end rates of exchange, while Statements of Operations are translated at average rates of exchange for the period. The resulting translation differences are recorded as a separate component of accumulated other comprehensive income/(loss) within stockholder's equity.

Foreign currency transactions

Monetary assets and liabilities denominated in currencies other than the functional currency are re-valued at period-end rates of exchange, with the resulting gains and losses included in income.

Income taxes

Income taxes have been provided for those operations that are subject to income taxes. Deferred tax assets and liabilities result from temporary differences between the amounts recorded in the consolidated financial statements and the tax basis of the CICL Group's assets and liabilities. Such temporary differences are primarily due to the recognition of untaxed profits and intangible assets arising from the acquisition of Wellington Underwriting plc ('Wellington') in December 2006. The effect on deferred tax assets and liabilities of a change in tax rates is recognised in income in the period that includes the enactment date. A valuation allowance against deferred tax assets is recorded if it is more likely than not that all or some portion of the benefits related to deferred tax assets will not be realised.

Stock compensation

The fair value of awards under stock-based compensation arrangements is calculated on the grant date based on the share price and the exchange rate in effect on that date and is recognised on a straight-line basis over the vesting period. The calculation is updated on a regular basis to reflect revised vesting expectations and actual experience.

Pensions

The CICL Group operates defined contribution pension schemes for eligible employees, the costs of which are expensed as incurred.

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For the years ended 31 December 2010 and 2009

The CICL Group also sponsors a defined benefit pension scheme which was closed to new members in 1993. Any surplus or deficit on the scheme is carried as an asset or liability on the balance sheet.

New accounting pronouncements

In October 2010 the Financial Accounting Standards Board ('FASB') issued new accounting guidance specifying how costs associated with acquiring or renewing insurance contracts should be identified and capitalised. This guidance is effective for periods beginning after 15 December 2011. Earlier adoption is permitted. Retrospective application is also permitted but not required. Catlin is evaluating the impact this new guidance will have on the CICL Group's financial position and results of operations.

In 2010, the CICL Group adopted amendments to accounting guidance, none of which had a material impact on the CICL Group's financial position or results of operations on the following topics: consolidations; fair value measurements and disclosures; and disclosures about the credit quality of financing receivables.

3 Segmental information

From 2010 the focus of management's review of results is by underwriting hubs, whereas in previous years it was by risk-bearing legal entities. As a result, Catlin has modified its basis of segmental reporting from 2010. In 2009 Catlin had four reportable segments, corresponding to the CICL Group's risk-bearing legal entities: Catlin Syndicate, Catlin Bermuda, Catlin UK and Catlin US.

From 2010 Catlin has four reportable segments aligned to underwriting hubs, which correspond to where the business is written:

- London/UK, which comprises direct insurance and reinsurance business underwritten in the United Kingdom;
- Bermuda, which primarily underwrites reinsurance business;
- US, which underwrites direct insurance and reinsurance business in the United States; and
- International, which comprises the Group's Asia-Pacific, Europe and Canada underwriting hubs which provide a full complement of insurance and reinsurance services for their markets.

The comparatives have been represented accordingly.

The table below illustrates which legal entities bear the risks originating in each underwriting hub. Some hubs underwrite on behalf of more than one legal entity.

	Risk-bearing entities			
	Catlin Syndicate	Catlin Bermuda	Catlin UK	Catlin US
London/UK	•		•	
Bermuda		•		
US	•		•	•
International	•		•	

At 31 December 2010 there were four significant intra-Group reinsurance contracts in place: a 45 per cent Quota Share, which cedes Catlin Syndicate risk to Catlin Bermuda; a 75 per cent Quota Share contract which cedes Catlin UK risk to Catlin Bermuda; a Whole Account Stop Loss contract which cedes 5 per cent of premiums and up to 20 per cent of losses above a net loss ratio of 87.5 per cent from Catlin Syndicate to Catlin Bermuda; and also a 75 per cent Quota Share contract which cedes Catlin US risk to Catlin Bermuda. The effects of each of these reinsurance contracts are excluded from segmental revenue and results, as this is the basis upon which the performance of each segment is assessed.

Catlin Insurance Company Ltd.

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For the years ended 31 December 2010 and 2009

Net underwriting contribution by underwriting hub for the year ended 31 December 2010 is as follows:

(US dollars in millions)	London/ UK	Bermuda	US	International	Total
Gross premiums written	\$2,323	\$502	\$707	\$537	\$4,069
Net premiums earned	1,827	427	538	427	3,219
Losses and loss expenses	(1,052)	(177)	(349)	(274)	(1,852)
Policy acquisition costs	(409)	(99)	(94)	(82)	(684)
Net underwriting contribution	\$366	\$151	\$95	\$71	\$683

Net underwriting contribution by underwriting hub for the year ended 31 December 2009 is as follows:

(US dollars in millions)	London/ UK	Bermuda	US	International	Total
Gross premiums written	\$2,347	\$421	\$581	\$366	\$3,715
Net premiums earned	1,891	348	409	270	2,918
Losses and loss expenses	(1,103)	(150)	(232)	(196)	(1,681)
Policy acquisition costs	(391)	(75)	(72)	(48)	(586)
Net underwriting contribution	\$397	\$123	\$105	\$26	\$651

Net underwriting contribution is the primary measure used by management for review and decision making. Assets are reviewed in total by management for purposes of decision making. The CICL Group does not allocate assets to the reporting segments.

4 Investments

Fixed maturities

The fair values of fixed maturities at 31 December 2010 and 2009 are as follows:

(US dollars in millions)	2010 Fair value	2009 Fair value
US government and agencies	\$1,071	\$745
Non-US governments	1,002	836
Corporate securities	1,566	1,243
Asset-backed securities	274	260
Mortgage-backed securities	662	783
Interest rate options	2	-
Total fixed maturities	\$4,577	\$3,867

\$477 million (2009: \$409 million) of the total mortgage-backed securities at 31 December 2010 is represented by investments in Government National Mortgage Association, Federal National Mortgage Association, Federal Home Loan Bank and Federal Home Loan Mortgage Corporation bonds.

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The composition of the fair values of fixed maturities by ratings assigned by rating agencies is as follows:

(US dollars in millions)	2010		2009	
	Fair value	%	Fair value	%
US government and agencies	\$1,071	23	\$745	19
Non-US governments	1,002	22	836	22
AAA	1,329	29	1,254	32
AA	550	12	262	7
A	503	11	600	16
BBB and other	122	3	170	4
Total fixed maturities	\$4,577	100	\$3,867	100

Fixed maturities at 31 December 2010, by contractual maturity, are shown below. Expected maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

(US dollars in millions)	Fair value
Due in one year or less	\$564
Due after one through five years	2,561
Due after five years through ten years	438
Due after ten years	78
	3,641
Asset-backed securities	274
Mortgage-backed securities	662
Total	\$4,577

The CICL Group did not have an aggregate investment with a single counterparty, other than the US government, in excess of 10 per cent of total investments at 31 December 2010 and 2009.

Investments in funds

Investments in funds by category at 31 December 2010 and 2009 are as follows:

(US dollars in millions)	2010	2009
Hedge funds	\$200	\$358
Funds of funds	-	121
Bond fund	-	47
Equity market option contracts	-	4
Total investments in funds	\$200	\$530

Hedge funds are a portfolio comprising of 14 individual hedge funds, 11 of which are in the process of being redeemed. The timing of the redemptions is governed by the terms of the agreements which vary from 30 days' notice and monthly redemptions to 65 days' notice and 25 per cent of funds being redeemable each quarter.

Funds of funds were two funds invested across a diversified set of managers, strategies and underlying asset classes. The bond fund was a portfolio of government and corporate bonds with an objective to outperform the OECD bond benchmark over a two-year period. The funds of funds and the bond fund were redeemed in July 2010.

There are unfunded commitments related to investment in funds of \$25 million as at 31 December 2010.

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Net investment return

The components of net investment return for the years ended 31 December 2010 and 2009 are as follows:

(US dollars in millions)	2010	2009
Interest income	\$147	\$187
Net gains on fixed maturities and short-term investments	46	91
Net gains on investments in funds	19	141
Total investment return	212	419
Investment expenses	(7)	(5)
Net investment return	\$205	\$414

The CICL Group has elected to apply the fair value option to its fixed maturities and short-term investments. In 2010 net gains of \$46 million (2009: \$91 million) were included in the Consolidated Statements of Operations in relation to changes in the fair values of these assets.

Gains in 2010 on fixed maturities and short-term investments still held at 31 December 2010 were \$33 million (2009: \$91 million). Gains in 2010 on investments in funds still held at 31 December 2010 were \$15 million (2009: \$87 million).

Restricted assets

The CICL Group is required to maintain assets on deposit with various regulatory authorities to support its insurance and reinsurance operations. These requirements are generally promulgated in the statutory regulations of the individual jurisdictions. These funds on deposit are available to settle insurance and reinsurance liabilities. The CICL Group also has investments in segregated portfolios primarily to provide collateral for Letters of Credit ('LOCs'), as described in Note 17. Finally, the CICL Group also utilises trust funds set up for the benefit of certain ceding companies as alternative to LOCs.

The total value of these restricted assets by category at 31 December 2010 and 2009 is as follows:

(US dollars in millions)	2010	2009
Fixed maturities	\$2,275	\$2,134
Short-term investments	503	41
Cash and cash equivalents	656	567
Total restricted assets	\$3,434	\$2,742

Securities lending

The CICL Group participates in a securities lending programme under which certain of its fixed maturity investments are loaned to third parties through a lending agent. Collateral in the form of cash, government securities and letters of credit is required at a minimum rate of 102 per cent of the market value of the loaned securities and is monitored and maintained by the lending agent. The CICL Group had \$12 million (2009: \$15 million) of securities on loan at 31 December 2010.

5. Fair value measurement

The FASB accounting guidance on fair value measurements and disclosures defines fair value as the price that would be received to sell an asset or paid to transfer a liability (i.e. the 'exit price') in an orderly transaction between market participants at the measurement date. In determining fair value, management uses various valuation approaches, including market and income approaches. The FASB accounting guidance establishes a hierarchy for inputs used in measuring fair value that maximises the use of observable inputs and minimises the use of unobservable inputs by requiring that the most observable inputs be used when available. The three levels of the FASB accounting guidelines on fair value measurements and disclosures hierarchy are described below.

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Level 1 - Valuations based on quoted prices in active markets for identical assets or liabilities that the CICL Group 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 products does not entail a significant degree of judgment.

Assets utilising Level 1 inputs comprise US government securities and exchange-traded derivatives.

Level 2 - Valuations based on quoted prices in markets that are not active or for which significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

Assets and liabilities utilising Level 2 inputs include: US agency securities; non-US government obligations, corporate and municipal bonds, residential mortgage-backed securities ('RMBS'), commercial mortgage-backed securities ('CMBS') and asset-backed securities ('ABS') to the extent that they are not identified as Level 3 items; over-the-counter ('OTC') derivatives (e.g. foreign exchange contracts); fixed-term cash deposits classified as short-term investments; and investments in funds with few restrictions on redemptions or new investors.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement. The unobservable inputs reflect our own assumptions about assumptions that market participants might use.

Assets and liabilities utilising Level 3 inputs include: insurance and reinsurance derivative contracts ('cat swaps'); investments in funds with significant redemption restrictions; collateralised debt obligations ('CDO'); sub-prime securities, Alt-A securities and securities rated CCC and below, where the unobservable inputs reflect individual assumptions and judgments regarding ultimate delinquency and foreclosure rates and estimates regarding the likelihood and timing of events of defaults.

The availability of observable inputs can vary from financial instrument to financial instrument and is affected by a wide variety of factors, including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. Accordingly, the degree of judgment exercised by management in determining fair value is greatest for instruments categorised in Level 3. The CICL Group uses prices and inputs that are current as of the measurement date, including during periods of market dislocation. In periods of market dislocation, the observability of prices and inputs may be reduced for many instruments. This condition could cause an instrument to be reclassified between levels.

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Assets measured at fair value on a recurring basis

The table below shows the values at 31 December 2010 of assets and liabilities measured at fair value on a recurring basis, analysed by the level of inputs used.

(US dollars in millions)	Balance as at 31 December 2010	Level 1 inputs	Level 2 inputs	Level 3 inputs
Assets				
US government and agencies	\$1,071	\$745	\$326	\$-
Non-US governments	1,002	-	1,002	-
Corporate securities	1,566	-	1,566	-
RMBS	503	-	501	2
CMBS	159	-	159	-
ABS	271	-	268	3
CDO	3	-	-	3
Interest rate options	2	-	2	-
Total fixed maturities	4,577	745	3,824	8
Short-term investments	594	501	93	-
Investments in funds	200	-	40	160
Total assets at fair value	\$5,371	\$1,246	\$3,957	\$168

In 2010 the Company reclassified US Treasuries to Level 1 securities as it determined that the level of trading activity for all US Treasuries is high and that quoted prices are readily and regularly available for these securities.

The table below shows the values at 31 December 2009 of assets and liabilities measured at fair value on a recurring basis, analysed by the level of inputs used.

(US dollars in millions)	Balance as at 31 December 2009	Level 1 inputs	Level 2 inputs	Level 3 inputs
Assets				
US government and agencies	\$745	\$-	\$745	\$-
Non-US governments	836	-	836	-
Corporate securities	1,243	-	1,243	-
RMBS	580	-	514	66
CMBS	203	-	203	-
ABS	256	-	252	4
CDO	4	-	-	4
Total fixed maturities	3,867	-	3,793	74
Short-term investments	796	-	796	-
Investments in funds (excluding options)	526	-	169	357
Equity market option contracts	4	4	-	-
Catastrophe swaps	1	-	-	1
Total assets at fair value	\$5,194	\$4	\$4,758	\$432

In 2009, there were no significant transfers between Level 1 and Level 2 of the fair value hierarchy.

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The changes in the year ended 31 December 2010 in balances measured at fair value on a recurring basis using Level 3 inputs were as follows:

(US dollars in millions)	Total	RMBS	ABS	CDO	Investments in funds	Catastrophe swaps
Balance, 1 January 2010	\$432	\$66	\$4	\$4	\$357	\$1
Total net gains/(losses) included in income	27	6	1	1	20	(1)
Net (disposals)/purchases	(290)	(70)	(2)	(2)	(216)	-
Level 3 transfers in	-	-	-	-	-	-
Foreign exchange	(1)	-	-	-	(1)	-
Balance, 31 December 2010	\$168	\$2	\$3	\$3	\$160	\$-
Amount of gains relating to balances still held at year end	\$17	\$2	\$-	\$-	\$15	\$-

The changes in the year ended 31 December 2009 in balances measured at fair value on a recurring basis using Level 3 inputs were as follows:

(US dollars in millions)	Total	RMBS	ABS	CDO	Investments in funds	Catastrophe swaps
Balance, 1 January 2009	\$378	\$31	\$3	\$3	\$334	\$7
Total net gains/(losses) included in income	100	9	-	(3)	100	(6)
Net (disposals)/purchases	(87)	(8)	(2)	-	(77)	-
Level 3 transfers in	41	34	3	4	-	-
Balance, 31 December 2009	\$432	\$66	\$4	\$4	\$357	\$1
Amount of gains/(losses) relating to balances still held at year end	\$86	\$8	\$1	\$(4)	\$87	\$(6)

Level 3 transfers in from Level 2 for RMBS, ABS and CDO occurred because of lack of observable market data due to a decrease in market activity for these securities.

Fair value of financial instruments

The following methods and assumptions are used by the CICL Group in estimating the fair value of its financial instruments:

Investments: Fair values of fixed maturities and short-term investments are based on the quoted market price of these securities provided by either independent pricing services, or, when such prices are not available, by reference to broker or underwriting bid indications. The fair value of investments in funds is based on either the net asset value provided by the funds' administrators, or where available, the quoted price of the funds.

Derivatives: The fair values of the catastrophe swap agreements were determined using internal models based on the valuation of the underlying notes issued by the counterparty. The determination of the fair values takes into account changes in the market for catastrophic reinsurance contracts with similar economic characteristics and the potential for recoveries from events preceding the valuation date. The fair values of option contracts are based on prices provided by independent pricing services. The fair values of foreign exchange derivatives are based on prices provided by counterparties.

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Subordinated debt: Subordinated debt is not carried at fair value but at amortised cost. At 31 December 2010, the fair value of the subordinated debt was \$68 million which compared to a carrying value of \$93 million. The fair value of the subordinated debt is estimated by comparing Catlin Bermuda's preferred stock and other peer group instruments to determine market required yields, which were used to estimate market value.

Other assets and liabilities: The fair values of cash and cash equivalents, securities lending collateral, premiums and other receivables, securities lending payable, and accounts payable approximate their carrying value due to the immediate or short term maturity of these financial instruments.

6 Reserves for losses and loss expenses

The CICL Group establishes reserves for losses and loss expenses, which are estimates of future payments of reported and unreported losses and related expenses, with respect to insured events that have occurred. The process of establishing reserves is complex and imprecise, requiring the use of informed estimates and judgments. The CICL Group's estimates and judgments may be revised as additional experience and other data become available and are reviewed, as new or improved methodologies are developed or as current laws change. Any such revisions could result in future changes in estimates of losses or reinsurance recoverable, and would be reflected in earnings in the period in which the estimates are changed. Management believes that they have made a reasonable estimate of the level of reserves at 31 December 2010 and 2009.

The reconciliation of unpaid losses and loss expenses for the years ended 31 December 2010 and 2009 is as follows:

(US dollars in millions)	2010	2009
Gross unpaid losses and loss expenses, beginning of year	\$5,392	\$4,606
Reinsurance recoverable on unpaid loss and loss expenses	(1,172)	(1,070)
Net unpaid losses and loss expenses, beginning of year	4,220	3,536
Net incurred losses and loss expenses for claims related to:		
Current year	1,996	1,775
Prior years	(144)	(94)
Total net incurred losses and loss expenses	1,852	1,681
Net paid losses and loss expenses for claims related to:		
Current year	(461)	(232)
Prior years	(1,050)	(1,305)
Total net paid losses and loss expenses	(1,511)	(1,537)
Foreign exchange and other	(51)	109
Loss portfolio transfer	-	431
Net unpaid losses and loss expenses, end of year	4,510	4,220
Reinsurance recoverable on unpaid losses and loss expenses	1,039	1,172
Gross unpaid losses and loss expenses, end of year	\$5,549	\$5,392

As a result of the changes in estimates of insured events in prior years, the 2010 reserves for losses and loss expenses net of reinsurance recoveries decreased by \$144 million (2009: \$94 million). The decrease in reserves relating to prior years was due to reductions in expected ultimate loss costs and reductions in uncertainty surrounding the quantification of the net cost claim events.

Loss portfolio transfer

As part of the purchase of Wellington Underwriting plc in 2006, the CICL Group acquired approximately two-thirds of the capacity on Lloyd's Syndicate 2020. In a simultaneous but separate transaction, CICL Group effectively acquired the remaining capacity from unaligned members by way of a cessation agreement. In 2009 Syndicate 2020 closed its 2006 Lloyd's underwriting year of account by way of a Lloyd's reinsurance to close ('RITC'). RITC is a contract between the Lloyd's members on one

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syndicate underwriting year of account and the members on another syndicate underwriting year of account, whereby the members on the earlier year reinsure all their outstanding liabilities with the members on the later year

As a result of the transaction, Catlin's wholly owned Syndicate ('Syndicate 2003') assumed the 33 per cent of Syndicate 2020's outstanding losses previously attributable to the syndicate's third-party members, in addition to the 67 per cent share already held by the CICL Group.

The remaining net liability in Syndicate 2020, calculated as \$431 million, was assumed by Syndicate 2003 through a payment in the form of cash and investments in the same amount. The transaction has been treated as a loss portfolio transfer, recorded as an increase in net loss reserves with no impact on the Consolidated Statements of Operations.

7 Reinsurance

The CICL Group purchases reinsurance to limit various exposures including catastrophe risks. Although reinsurance agreements contractually obligate the CICL Group's reinsurers to reimburse it for the agreed-upon portion of its gross paid losses, they do not discharge the primary liability of the CICL Group. The effect of reinsurance and retrocessional activity on premiums written and earned is as follows:

(US dollars in millions)	2010			2009		
	Premiums written	Premiums earned	Losses incurred	Premiums written	Premiums earned	Losses incurred
Direct	\$2,712	\$2,653	\$1,538	\$2,586	\$2,473	\$1,614
Assumed	1,357	1,261	580	1,129	1,094	403
Ceded	(751)	(695)	(266)	(547)	(649)	(336)
Net premiums	\$3,318	\$3,219	\$1,852	\$3,168	\$2,918	\$1,681

The CICL Group's reinsurance recoverable as at 31 December 2010 and 2009 is as follows:

(US dollars in millions)	2010	2009
Gross reinsurance recoverable	\$1,288	\$1,489
Provision for uncollectible balances	(59)	(48)
Net reinsurance recoverable	\$1,229	\$1,441

The CICL Group evaluates the financial condition of its reinsurers on a regular basis and also monitors concentrations of credit risk with reinsurers. All current reinsurers have financial strength rating of at least 'A' from Standard and Poor's or 'A-' from A.M. Best at the time of placement, or provide appropriate collateral. However, certain reinsurers from prior years have experienced a reduced ratings which has led to the need for the provision. At 31 December 2010 there were two reinsurers which accounted for 5 per cent or more of the total reinsurance recoverable balance.

	% of reinsurance recoverable	Best rating
Munich Re	17%	A+
Hannover Ruck-AG	5%	A

8 Derivative financial instruments

Catastrophe swap agreement

On 17 December 2007 Catlin Bermuda entered into a contract that provided up to \$225 million in coverage in the event of one or more natural catastrophes. Catlin Bermuda's counterparty in the catastrophe swap ('cat swap') was a special purpose vehicle, Newton Re. Newton Re issued to investors \$225 million in three-year floating rate notes, divided into Class A and Class B notes. The

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proceeds of those notes provided the collateral for Newton Re's potential obligations to Catlin Bermuda under the cat swap. The cat swap expired in 2010 without being triggered.

The cat swap was measured in the balance sheet at fair value with any changes in the fair value included in the Consolidated Statements of Operations. As at 31 December 2009, the fair value of the cat swaps was \$1 million. As there is no liquid market for this derivative, the fair value is derived from indicative prices for the notes issued by the cat swap counterparties. No cat swaps were held at 31 December 2010.

Options and futures contracts

The CICL Group is exposed to certain risks relating to its ongoing business operations. A primary risk managed by using derivative instruments is market risk including equity risk and interest rate risk.

Equity risk

A portion of the investment portfolio is invested in hedge funds and funds of funds. Equity market put option contracts and equity market futures contracts are entered into to manage the market risk associated with holding these investments in funds.

Equity market put option contracts provide the option purchaser with the right but not the obligation to sell a financial instrument at a predetermined exercise price during a defined period. Options contracts are marked to market on a daily basis.

Gains and losses on equity market options and futures contracts are included in net investment return together with related gains on investments in funds in the Consolidated Statements of Operations. Equity market put option contracts' fair value is included in investment in funds of the Consolidated Balance Sheet. No equity futures contracts were held at 31 December 2010 or 2009.

Interest rate risk

The investment portfolio is predominantly invested in cash and fixed income securities and so is exposed to interest rate risk. Interest rate option contracts are entered into to manage the market risk associated with holding cash and fixed income securities.

Gains and losses on interest rate options are included in net investment return together with related gains on fixed maturities in the Consolidated Statements of Operations. Interest rate options' fair value is included in fixed maturities on the Consolidated Balance Sheet.

Foreign exchange contracts

During the year, the CICL Group held various foreign currency derivatives (forward contracts) to manage currency risk. Gains and losses on foreign exchange contracts are included in net gains on foreign currency in the Consolidated Statements of Operations. There were no foreign exchange derivatives held at 31 December 2010 or 2009.

Impact of derivatives

The fair values of derivatives at 31 December 2010 and 2009 are as follows:

(US dollars in millions)	2010		2009	
	Assets	Liabilities	Assets	Liabilities
Equity market option contracts	\$-	\$-	\$4	\$-
Interest rate options	2	-	-	-
Catastrophe swaps	-	-	1	-
Total derivatives	\$2	\$-	\$5	\$-

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The notional values of exchange traded and OTC open derivatives at 31 December 2010 and 2009 are as follows:

(US dollars in millions)	Notional value	
	2010	2009
Equity market option contracts	\$-	\$115
Interest rate options	\$850	\$-

The net losses on derivatives at 31 December 2010 and 2009 are as follows:

(US dollars in millions)	2010	2009
Equity market options contracts	\$(4)	\$(6)
Equity market futures contracts	-	(7)
Interest rate options	(6)	-
	(10)	(13)
Foreign exchange contracts	(8)	4
Catastrophe swaps	(15)	(31)
Net losses on derivatives	\$(33)	\$(40)

The derivatives contracts held by CICL Group at 31 December 2010 contain no credit risk-related contingent features.

9 Subordinated debt

The CICL Group's outstanding subordinated debt as at 31 December 2010 and 2009 consisted of the following:

(US dollars millions)	2010	2009
Variable rate, face amount €7, due 15 March 2035	\$9	\$11
Variable rate, face amount \$27, due 15 March 2036	27	28
Variable rate, face amount \$31, due 15 September 2036	32	32
Variable rate, face amount \$10, due 15 September 2036	10	10
Variable rate, face amount €11, due 15 September 2036	15	16
Total subordinated debt	\$93	\$97

On 12 May 2006 Catlin Underwriting (formerly known as Wellington Underwriting plc) issued \$27 million and €7 million of variable rate unsecured subordinated notes. The notes are subordinated to the claims of all Senior Creditors, as defined in the agreement. The notes pay interest based on the rate on three-month deposits in US dollars plus a margin of 317 basis points for the Dollar note and 295 basis points for the Euro note. Interest is payable quarterly in arrears. The notes are redeemable at the discretion of the issuer beginning on 15 March 2011 with respect to the Dollar notes and 22 May 2011 with respect to the Euro notes.

On 20 July 2006 Catlin Underwriting issued \$31 million, \$10 million and €11 million of variable rate unsecured subordinated notes. The notes are subordinated to the claims of all Senior Creditors, as defined in the agreement. The notes pay interest based on the rate on three-month deposits in US dollars plus a margin of 310 basis points for the \$31 million notes and 300 basis points for the other two notes. Interest is payable quarterly in arrears. The notes are each redeemable at the discretion of the issuer on 15 September 2011.

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10 Intangible assets and goodwill

The CICL Group's intangible assets relate to the purchase of syndicate capacity, distribution channels and US insurance licenses (as admitted and eligible surplus lines insurers). Goodwill represents the excess of purchase price over the net fair value of identifiable assets acquired and liabilities assumed in a business combination.

Net intangible assets and goodwill as at 31 December 2010 and 2009 consist of the following:

(US dollars in millions)	Goodwill	Indefinite life intangibles	Finite life intangibles	Total
Net value at 1 January 2009	\$70	\$575	\$6	\$651
Movements during 2009:				
Foreign exchange revaluation	7	62	-	69
Amortisation charge	-	-	(2)	(2)
Total movements during 2009	7	62	(2)	67
Net value at 31 December 2009	77	637	4	718
Movements during 2010:				
Foreign exchange revaluation	(3)	-	-	(3)
Acquisition of Angel	3	-	-	3
Amortisation charge	-	-	(2)	(2)
Total movements during 2010	-	-	(2)	(2)
Net value at 31 December 2010	\$77	\$637	\$2	\$716

Goodwill, syndicate capacity and admitted licenses are considered to have an indefinite life and as such are tested annually for impairment as at 30 September. Neither goodwill nor intangibles were considered impaired in 2010 or 2009.

The syndicate capacity comprises underwriting capacity that the CICL Group purchased through business combination, syndicate cessation and direct purchases.

Syndicate capacity is tested annually for impairment by comparing management's estimate of its fair value to the amount at which it is carried in the CICL Group's consolidated balance sheet.

The fair value of the CICL Group's syndicate capacity is assessed by reference to market activity where relevant and internally developed cash flow models. In 2010 and 2009, management determined that the fair value of syndicate capacity exceeded its carrying value.

Distribution channels and surplus lines authorisations are considered to have a finite life and are amortised over their estimated useful lives of five years. As at 31 December 2010 the gross carrying amount of finite life intangibles was \$10 million (2009: \$10 million) and accumulated amortisation was \$8 million (2009: \$6 million). Amortisation of intangible assets at current exchange rates will amount to approximately \$2 million in 2011 and nil thereafter.

Of the total amount of intangible assets and goodwill at 31 December 2009 of \$718 million, \$634 million (88 per cent) related to syndicate capacity and was measured in UK sterling. With effect from 1 January 2010, the syndicate capacity and related tax liability of \$95 million have been measured in US dollars. This reflects that the majority of business written in the Syndicate is in US dollars. The value of syndicate capacity was fixed at \$634 million at the date of remeasurement.

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11 Taxation

Bermuda

Under current Bermuda law neither the Company nor its Bermuda subsidiaries are required to pay any taxes in Bermuda on their income or capital gains. Both the Company and its Bermuda subsidiaries have received undertakings from the Minister of Finance in Bermuda that, in the event of any taxes being imposed, they will be exempt from taxation in Bermuda until March 2016.

United Kingdom

The CICL Group also operates in the UK through its UK subsidiaries and the income of the UK companies is subject to UK corporation taxes.

Income from the CICL Group's operations at Lloyd's is also subject to US income taxes. Under a Closing Agreement between Lloyd's and the Internal Revenue Service ('IRS'), Lloyd's Members pay US income tax on US connected income written by Lloyd's syndicates. US income tax due on this US connected income is calculated by Lloyd's and remitted directly to the IRS and is charged by Lloyd's to Members in proportion to their participation on the relevant syndicates. The CICL Group's Corporate Members are all subject to this arrangement but, as UK residents, will receive UK corporation tax credits for any US income tax incurred up to the value of the equivalent UK corporation income tax charge on the US income.

United States

The CICL Group also operates in the United States through its subsidiaries and their income is subject to both US state and federal income taxes.

Other international income taxes

The CICL Group has a network of international operations and they also are subject to income taxes imposed by the jurisdictions in which they operate, but they do not constitute a material component of the CICL Group's tax charge.

The CICL Group is not subject to taxation other than as stated above. There can be no assurance that there will not be changes in applicable laws, regulations or treaties, which might require the CICL Group to change the way it operates or become subject to taxation.

The income tax expense for the years ended 31 December 2010 and 2009 is as follows:

(US dollars in millions)	2010	2009
Current tax expense/(benefit)	\$12	\$(31)
Deferred tax expense	13	81
Expense for income taxes	\$25	\$50

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The effective tax rate for the CICL Group is 6 per cent (2009: 8.3 per cent). A reconciliation of the difference between the expense for income taxes and the expected tax expense at the weighted average tax rate for the years ended 31 December 2010 and 2009 is provided below. The weighted average expected tax expense has been calculated using pre-tax accounting income in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate.

(US dollars in millions)	2010	2009
Expected tax expense at weighted average rate	\$15	\$33
Permanent differences:		
Disallowed expenses	4	14
Valuation allowances	7	3
Prior year adjustments including changes in uncertain tax positions	5	-
Impact of tax rate change in the UK	(6)	-
Expense for income taxes	\$25	\$50

The components of the CICL Group's net deferred tax liability as at 31 December 2010 and 2009 are as follows:

(US dollars in millions)	2010	2009
Deferred tax assets:		
Net operating loss carry forwards	\$346	\$378
Stock options	5	-
Accelerated capital allowances	10	5
Syndicate capacity amortisation and other	(15)	3
Valuation allowance	(30)	(23)
Total deferred tax assets	\$316	\$363
Deferred tax liabilities:		
Untaxed profits	(459)	(502)
Intangible assets arising on business combination	(94)	(95)
Total deferred tax liabilities	\$(553)	\$(597)
Net deferred tax liability	\$(237)	\$(234)

As at 31 December 2010 the CICL Group has net operating loss carry forwards of \$1,152 million (2009: \$1,268 million) which are available to offset future taxable income. The net operating loss carry forwards primarily arise in UK subsidiaries and relate to accelerated tax deductions for member-level reinsurance premiums. These are taxed on a declarations basis and are therefore only timing items. There are no time restrictions on the use of these losses, and they are expected to be fully utilised. Certain reclassifications have been made to the basis of presenting components of deferred tax. There is no impact on net deferred tax liability, and prior year comparatives have been represented accordingly.

As at 31 December 2010 there are potential deferred tax assets of \$30 million (2009: \$23 million) in US companies relating to prior year losses, but a 100 per cent valuation allowance has been recognised in respect of the losses in both 2010 and 2009.

Uncertain tax positions

As at 31 December 2010 the amount of uncertain tax benefits was \$13 million (2009: \$4 million). All unrecognised tax benefits would affect the effective tax rate if recognised.

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A reconciliation of the beginning and ending amount of unrecognised tax benefits arising from uncertain tax positions is as follows:

(US dollars in millions)	2010	2009
Unrecognised tax benefits balance at 1 January	\$4	\$8
Gross increases/(decreases) for tax positions of prior years	9	(4)
Unrecognised tax benefits balance at 31 December	\$13	\$4

The CICL Group does not believe it will be subject to any penalties in any open tax years and has not accrued any such amounts. The CICL Group accrues interest and penalties (if applicable) as income tax expenses in the consolidated financial statements. The CICL Group did not pay or accrue any interest or penalties in 2010 or 2009 relating to uncertain tax positions.

The following table lists the open tax years that are still subject to examinations by local tax authorities in major tax jurisdictions:

Major tax jurisdiction	Years
United Kingdom	2009-2010
United States	2007-2010

12 Stockholder's equity

The following sets out the number and par value of shares authorised, issued and outstanding as at 31 December 2010 and 2009:

	2010	2009
Common stock, par value \$0.01		
Authorised	1,034,000	1,034,000
Issued and outstanding	1,000,100	1,000,100
Preferred stock, par value \$0.01		
Authorised, issued and outstanding	600,000	600,000

Capital contribution

In December 2010, the CICL Group received a contribution of \$84 million from its parent as additional paid-in capital. In April 2009, the CICL Group received a cash contribution of \$223 million from its parent as additional paid-in capital.

Preferred stock

On 18 January 2007 Catlin Bermuda issued 600,000 non-cumulative perpetual preferred shares, par value of \$0.01 per unit, with liquidation preference of \$1,000 per unit, plus declared and unpaid dividends. Dividends at a rate of 7.249 per cent on the liquidation preference are payable semi-annually on 19 January and 19 July in arrears as and when declared by the Board of Directors, commencing on 19 July 2007 up to but not including 19 January 2017. Thereafter, if the stock has not yet been redeemed, dividends will be payable quarterly at a rate equal to 2.975 per cent plus the three-month LIBOR rate of the liquidation preference. Catlin Bermuda received proceeds of approximately \$590 million net of issuance costs. The preferred shares do not have a maturity date and are not convertible into or exchangeable into any of Catlin Bermuda's or the Group's other securities.

Dividends

Dividends on common stock

The Board of Directors of the Company declared a \$400 million dividend to the parent in 2010 of which \$285 million was settled in the period. As at 31 December 2010 \$115 million still remains payable and is included in the Due to parent balance.

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Dividends on preferred stock

On both 19 January and 19 July 2010, the Catlin Bermuda paid a semi-annual dividend of \$22 million to the stockholders of the non-cumulative perpetual preferred stock.

13 Employee stock compensation schemes

Employees of the CICL Group participate in two stock compensation schemes in place at its parent, under which awards are outstanding: the Performance Share Plan ('PSP'), adopted in 2004 and the Long Term Incentive Plan ('LTIP'), adopted in 2002.

In addition, the CICL Group also has three Employee Share Plans in place. The expense related to the Employee Share Plans is considered to be insignificant. These financial statements include the total cost of stock compensation for all plans, calculated using the fair value method of accounting for stock-based employee compensation.

The total amount expensed to income in respect of all plans in the year ended 31 December 2010 was \$21 million (2009: \$21 million) included in administrative and other expenses. As described below, the valuation of the PSP is periodically revised to take into account changes in performance against vesting conditions.

Performance Share Plan

On 11 February 2010 a total of 5,569,159 options with \$nil exercise price and 2,491,158 non-vested shares (total of 8,060,317 securities) were awarded to CICL Group employees under the PSP. In August to December 2010 a further 151,268 options with \$nil exercise price and 21,023 non-vested shares (total of 172,291 securities) were awarded, resulting in a total of 8,232,608 securities granted to CICL Group employees under the PSP in 2010. Up to half of the securities will vest in 2013 and up to half will vest in 2014, subject to certain performance conditions.

These securities have been treated as non-vested shares and as such have been measured at their fair value on the grant date as if they were fully vested and issued and assuming an annual attrition rate amongst participating employees of 4 per cent for grants made in 2010, 6 per cent for grants made in 2009, 7 per cent for grants made in 2008 and 7 per cent for grants made in 2007. This initial valuation is revised at each balance sheet date to take account of actual achievement of the performance condition that governs the level of vesting and any changes that may be required to the attrition assumption. The difference is charged or credited to the Statement of Operations, with a corresponding adjustment to the balance due to the parent. As a result of the Rights Issue, at the parent level, the number of awards was adjusted in 2009. The total number of shares in respect of which PSP securities were outstanding at 31 December 2010 was 20,441,966 (2009: 15,623,155), and the total amount of expense relating to PSP for the year ended 31 December 2010 was \$21 million (2009: \$21 million).

The weighted average grant date fair value of the options awarded in 2010 is \$5.39 (2009: \$5.18) and the total fair value of shares vested during the year is \$10 million (2009: \$9 million).

The table below shows the PSP securities as at 31 December 2010:

	Outstanding	Non-vested	Vested
Beginning of year	15,623,155	15,129,112	494,043
Granted during year	8,232,608	8,232,608	-
Vested during year	(624,538)	(2,384,336)	1,759,798
Forfeited during year	(838,183)	(838,183)	-
Exercised during year	(1,951,076)	-	(1,951,076)
End of year	20,441,966	20,139,201	302,765
Exercisable, end of year	302,765	-	302,765

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The weighted average remaining contractual life of the options is 8 years. The maximum contractual term of the equity share options outstanding is 9 years. The weighted average fair value of non-vested shares outstanding at the year end is \$5.70.

The weighted average fair value of the 1,759,798 shares vested in the year is \$5.41, and the weighted average fair value of the 838,183 shares forfeited in the year is \$5.44.

The total compensation to be expensed in future periods relating to unvested awards outstanding at the year end is \$50 million. The weighted average period of recognition of these shares is 2.4 years.

Long Term Incentive Plan

Options over a total of 10,370,952 ordinary common shares were granted to eligible employees in 2004 and prior years. The LTIP options were fully exercisable and expensed by 31 December 2007. There was no compensation expense in relation to the LTIP for the years ended 31 December 2010 and 2009. All options will expire by 4 July 2012. As at 31 December 2010 there were 1,625,046 (2009: 2,159,758) options outstanding with an exercise price of \$4.37 and 78,097 (2009: 204,334) options outstanding with an exercise price of £3.06. As a result of the Rights Issue, the number of options and the exercise price were adjusted in 2009.

14 Other comprehensive income (loss)

The following table details the individual components of other comprehensive loss for 2010 and 2009:

2010 (US dollars in millions)	Amount before tax	Tax benefit/ (expense)	Amount after tax
Defined benefit pension plan	\$1	\$-	\$1
Cumulative translation adjustments	15	(11)	4
Other comprehensive income	\$16	\$(11)	\$5

2009 (US dollars in millions)	Amount before tax	Tax benefit/ (expense)	Amount after tax
Defined benefit pension plan	\$-	\$-	\$-
Cumulative translation adjustments	112	-	112
Other comprehensive income	\$112	\$-	\$112

The following table details the components of accumulated other comprehensive loss as at 31 December:

(US dollars in millions)	2010	2009
Cumulative translation adjustments	\$(185)	\$(189)
Funded status of defined benefit pension plan adjustment	1	-
Accumulated other comprehensive loss	\$(184)	\$(189)

15 Pension commitments

The CICL Group operates various pension schemes for employees in the different countries of operation.

In the UK, the CICL Group operates defined contribution schemes for certain directors and employees, which are administered by third-party insurance companies. The pension cost for the UK scheme was \$10 million for the year ended 31 December 2010 (2009: \$9 million).

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In Bermuda, the CICL Group operates a defined contribution scheme, under which the CICL Group contributes a specified percentage of each employee's earnings. The pension cost for the Bermuda scheme was \$1 million for the year ended 31 December 2010 (2009: \$1 million).

In the US, the CICL Group has adopted a 401(k) Profit Sharing Plan qualified under the Internal Revenue Code and a Non-Qualified Deferred Compensation Plan under which the Group contributes a specified percentage of each employee's earnings. The pension cost for the US scheme was \$8 million for the year ended 31 December 2010 (2009: \$5 million).

In connection with the acquisition of Wellington in December 2006, the CICL Group assumed liabilities associated with a defined benefit pension scheme which Wellington sponsored. The scheme has been closed to new members since 1993. The current membership consists only of pensioners and deferred members. Projected benefit obligations at 31 December 2010 were \$25 million (2009: \$27 million) and fair value of plan assets was \$27 million (2009: \$28 million). The pension costs for the defined benefit scheme were insignificant for the years ended 31 December 2010 and 2009.

Pension costs for pension schemes in other countries of operation are considered insignificant.

16 Statutory financial data

The Company is registered under The Insurance Act 1978 (Bermuda), amendments thereto and related Regulations (the "1978 Act") as a Class 4 insurer. Under the 1978 Act, the Company is required to maintain minimum paid up share capital of \$1 million and to meet minimum liquidity ratios, a minimum solvency margin ("MSM") equal to the greater of \$100 million, 50% of net premiums written or 15% of the loss and loss expense provisions as at 31 December 2010. The Company has satisfied these requirements for 2010 and 2009.

Effective 31 December 2008, the Bermuda Monetary Authority ("BMA") has required all Class 4 insurers to determine an enhanced capital requirement ("ECR") and a Target Capital Level ("TCL") using a risk-based capital model, the Bermuda Solvency Capital Requirement ("BSCR"). While the required statutory capital and surplus has increased under BSCR requirements, the Company has capital and surplus in excess of its TCL (which is defined as 120% of the ECR).

The 1978 Act also imposes restrictions on the maximum amount of annual dividends and distributions that may be paid by the Company. The Company shall not pay dividends in any year which would exceed 25% of its prior year statutory capital and surplus without prior notification to the BMA or reduce its prior year statutory capital by 15% or more, without the prior approval of the BMA. In addition, The Bermuda Companies Act 1981 (the "Companies Act") limits the Company's ability to pay dividends and distributions to shareholders and prohibits the declaration and payment thereof if there are reasonable grounds for believing that the company would, after such payment, be unable to pay its liabilities as they become due or if the realisable value of its assets would be less than the aggregate of its liabilities, issued share capital and share premium accounts.

The statutory capital and surplus of the Company and each of its principal operating subsidiaries is in excess of regulatory requirements.

The CICL Group is also subject to restrictions on some of its assets to support its insurance and reinsurance operations, as described in Note 17.

17 Commitments and contingencies

Legal proceedings

The CICL Group is party to a number of legal proceedings arising in the ordinary course of the CICL Group's business which have not been finally adjudicated. While the results of the litigation cannot be predicted with certainty, management believes that the outcome of these matters will not have a material impact on the results of operations or financial condition of the CICL Group.

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Concentrations of credit risk

Areas where significant concentration of risk may exist include investments, reinsurance recoverable, and cash and cash equivalent balances.

The cash balances and investment portfolio are managed following prudent standards of diversification. Specific provisions limit the allowable holdings of a single institution issue and issuers. Similar principles are followed for the purchase of reinsurance. The CICAL Group believes that there are no significant concentrations of credit risk associated with its investments or its reinsurers. Note 7 describes concentrations of more than 5 per cent of the CICAL Group's total reinsurance recoverable asset.

Letters of credit

The CICAL Group arranges letter of credit facilities to support its reinsurance business and for general corporate purposes.

As at 31 December 2010, the CICAL Group has access to the following letter of credit facilities:

- A three-year \$650 million unsecured multi-bank facility available for utilisation by appointed members of the CICAL Group and its parent company and guaranteed by the Company. As at 31 December 2010 \$223 million letters of credit were issued under this facility. The facility has an expiry date of 31 December 2013.
- A bilateral facility available for utilisation by the Company collateralised by pledged financial assets. As at 31 December 2010 \$116 million letters of credit were issued under this facility.
- A facility managed by Lloyd's, acting for the Syndicates. As at 31 December 2010 \$7 million letters of credit were issued under this facility.

In addition, Catlin US has letters of credit amounting to \$6 million issued for the benefit of state regulators and other parties.

Future lease commitments

The CICAL Group leases office space and equipment under non-cancellable operating lease agreements, which expire at various times. Future minimum annual lease commitments for non-cancellable operating leases as at 31 December 2010 are as follows:

(US dollars in millions)	
2011	\$23
2012	17
2013	21
2014	22
2015 and thereafter	112
Total	\$195

Under non-cancellable sub-lease agreements, the CICAL Group is entitled to receive future minimum sub-lease payments of \$9 million (2009: \$11 million).

18 Related parties

The CICAL Group purchased services from Catlin Estates Limited and Burnhope Lodge, both of which are controlled by a Director of the CICAL Group. The cost of the services purchased from Catlin Estates Limited and Burnhope Lodge in 2010 and 2009 was insignificant to the CICAL Group Financial Statements.

The CICAL Group purchases services from 4C Associates Ltd. In 2009, 4C Associates was controlled by a party related to a member of management of the CICAL Group. The cost of the services purchased from 4C Associates Ltd in 2009 was insignificant to the CICAL Group Financial Statements.

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All transactions with related parties were entered into on normal commercial terms.

The balances due to the company's parent represent expenses paid on behalf of the other party, as well as balances related to the portion of dividends still outstanding as described in Note 12.

19 Subsequent events

Preferred share dividend

The Board of Catlin Bermuda approved a dividend of \$22 million to the shareholders of the non-cumulative perpetual preference shares. This dividend was paid on 19 January 2011.

Management has evaluated subsequent events until 25 March 2011, the date of issuance of the financial statements. The Company has exposure to losses arising from the Christchurch, New Zealand earthquake which occurred on 22 February 2011 and the Japan earthquake which occurred on 11 March 2011. The Company has estimated its losses related to the New Zealand earthquake as approximately \$125 million, net of reinsurance and reinstatements. At this stage it is too early to quantify the estimate of loss arising from the Japan earthquake.