Flagstone Reinsurance Holdings, S.A.
Form 10-K
March 02, 2011

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

Form 10-K

þ Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2010

OR

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

Commission file number 001-33364

Flagstone Reinsurance Holdings, S.A.
(Exact Name of Registrant as Specified in Its Charter)

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

37 Val St André
L-1128 Luxembourg, Grand Duchy of Luxembourg
(Address of Principal Executive Offices)

+352 273 515 30
(Registrant's telephone number, including area code)

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

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

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

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

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

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

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of most recently completed second fiscal quarter (June 30, 2010), was $563,651,400 based on the closing sales price of the Registrant's common shares of $10.82 on June 30, 2010.

As of February 22, 2011, the Registrant had 68,713,348 common voting shares outstanding, net of treasury shares, with a par value $0.01 per share.

Documents Incorporated by Reference:

Document	Part(s) Into Which Incorporated
Portions of the Registrant’s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended, relating to the Registrant’s Annual General Meeting of Shareholders scheduled to be held May 12, 2011 (the “Proxy Statement”), are incorporated by reference into Part III of this report. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this report.	Part III

FLAGSTONE REINSURANCE HOLDINGS, S.A.
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PART I

References in this Annual Report on Form 10-K (this “Annual Report”) to the “Company”, “Flagstone”, “we”, “us”, and “ refer to Flagstone Reinsurance Holdings, S.A. and/or its subsidiaries, including Flagstone Réassurance Suisse SA, its wholly-owned Switzerland reinsurance company, Flagstone Syndicate Management Limited (formerly Marlborough Underwriting Agency Limited), its United Kingdom Lloyd's managing agency, Island Heritage Holdings Ltd., its Cayman Islands based insurance holding company, Flagstone Alliance Insurance & Reinsurance PLC, its wholly-owned Cyprus insurance and reinsurance company, Flagstone Reinsurance Africa Limited, its wholly-owned South African reinsurance company, Mont Fort Re Ltd., its wholly-owned Bermuda reinsurance company, and any other direct or indirect wholly-owned subsidiary, unless the context suggests otherwise. References to “Flagstone Suisse” refer to Flagstone Réassurance Suisse SA, its wholly-owned subsidiaries and its Bermuda branch. References to “FSML” refer to Flagstone Syndicate Management Limited, its wholly-owned subsidiaries and Syndicate 1861. References to “Island Heritage” refer to Island Heritage Holdings Ltd. and its subsidiaries. References to “Flagstone Alliance” refer to Flagstone Alliance Insurance & Reinsurance PLC and its subsidiaries. References to “Flagstone Africa” refer to Flagstone Reinsurance Africa Limited. References to “Mont Fort” refer to Mont Fort Re Ltd. References in this Annual Report on Form 10-K to “dollars” or “$” are to the lawful currency of the United States of America (the “U.S.”), unless the context otherwise requires. All amounts in the following tables are expressed in thousands of U.S. dollars, except share amounts, per share amounts, percentages or unless otherwise stated. References in this Annual Report to (i) “foreign currency” are to currencies other than U.S. dollars and (ii) “foreign exchange” transactions or “foreign investments” are to transactions or investments, respectively, involving currencies other than U.S. dollars, in each case unless the context otherwise requires. The Company’s references to the URLs for third-party websites in this Annual Report are intended to be inactive textual references only, and none of the information contained on or connected to these websites is incorporated by reference herein.

Cautionary Statement Regarding Forward-Looking Statements.

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

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

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

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ITEM 1. BUSINESS

General Development

The Company, a global reinsurance and insurance company, was originally incorporated under the laws of Bermuda in October 2005 and commenced operations in December 2005. On March 22, 2010, Flagstone Reinsurance Holdings Limited, the predecessor to Flagstone Reinsurance Holdings, S.A., announced that its Board of Directors (the "Board") recommended a proposal for a redomestication to change Flagstone's jurisdiction of incorporation from Bermuda to Luxembourg (the "Redomestication"). On May 14, 2010, the Company's shareholders approved the Redomestication and thereby discontinued its existence as a Bermuda company as provided in Section 132G of The Companies Act 1981 of Bermuda and continued its existence as a société anonyme under the laws of Luxembourg effective May 17, 2010. The Redomestication has not had, and the Company does not expect the Redomestication to have, a material impact on the way the Company operates or on its financial condition or results of operations.

The Company is currently organized into three business segments: Reinsurance, Lloyd's and Island Heritage (previously referred to as the Insurance segment until January 1, 2010). Our Reinsurance segment provides reinsurance through our property, property catastrophe and short-tail specialty and casualty reinsurance lines of business. Our Lloyd's segment primarily provides property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. Our Island Heritage segment includes insurance business generated through Island Heritage, a property insurer based in the Cayman Islands which is primarily in the business of insuring homes, condominiums, office buildings and automobiles in the Caribbean region. We diversify our risks across business lines by risk zones, each of which combines a geographic zone with one or more types of peril (for example, Texas Windstorm, Florida Hurricane or California Earthquake). The majority of our reinsurance contracts contain loss limitation provisions such as fixed monetary limits to our exposure and per event caps. We specialize in underwriting where we believe sufficient data exists to analyze effectively the risk/return profile, and where we are subject to legal systems we believe are reasonably fair and reliable.

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

Our financial statements are prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP") and our fiscal year ends on December 31. Since a substantial portion of the insurance and reinsurance we write provides protection from damages relating to natural and man-made catastrophes, our results depend to a large extent on the frequency and severity of such catastrophic events, and the specific coverages we offer to clients affected by these events. This may result in volatility in our results of operations and financial condition. In addition, the amount of premiums written with respect to any particular line of business may vary from quarter to quarter and year to year as a result of changes in market conditions.

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

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

Our expenses consist primarily of the following types: loss and loss adjustment expenses ("LAE") incurred on the policies of reinsurance and insurance that we sell; acquisition costs which typically represent a percentage of the premiums that we write paid to agents or brokers who produce the business; general and administrative expenses which primarily consist of salaries, benefits and related costs, including costs associated with awards under the Company's Performance Share Unit Plan ("PSU Plan") and Restricted Share Unit Plan ("RSU Plan"), and other general operating expenses; interest expenses related to our debt obligations; and minority interest, which represents the interest of external parties with respect to the net income of Mont Fort, Island Heritage, and Flagstone Africa (on November 10, 2009 Flagstone Africa became a wholly-owned subsidiary of Flagstone Suisse and has not been included in minority interest since that date).

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Business Strategy

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

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

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

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

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

Employ Our Capital Markets Expertise To Optimize Our Return And Expand Our Opportunities. The capital markets experience of our senior management team is being leveraged to access capital markets in innovative ways. For example, we have participated in catastrophe bond structures, including bond structures involving Montana Re Ltd. (“Montana Re”) and Valais Re Ltd. (“Valais Re”), and each provides protection on our global reinsurance portfolio. Montana Re offers Flagstone protection on its insurance and reinsurance portfolio through multiple tranches.

Communicate Proactively and Effectively with the Investor Community. We endeavor to keep our investor base up to date on all recent developments via our website, earnings calls, investor conferences and one on one meetings as requested.

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

Segment Information

To better align the Company's operating and reporting structure with its current strategy, as a result of our acquisition of FSML, the managing agency for Lloyd's Syndicate 1861, the Company modified its internal reporting process and the manner in which the business is managed and as a result, the Company revised its segment structure, effective January 1, 2009. As a result of this process, the Company is now reporting its results to the chief operating decision maker based on three reporting segments: Reinsurance, Lloyd's and Island Heritage (previously referred to as the Insurance segment until January 1, 2010). The gross premiums written in 2010 by each of the Reinsurance, Lloyd's and Island Heritage segments were 74.6%, 17.1% and 8.3%, respectively, (2009 – 76.7%, 14.8%, 8.5% and 2008 – 90.2%, nil, 9.8%) of total gross premium written during the year.

Management regularly reviews our financial results and assesses our performance on the basis of our three reporting segments in accordance with Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") topic on Segment Reporting. Financial data relating to our segments is included in Note 21 "Segment Reporting" to our consolidated financial statements (Item 8 below).

Segments, Products and Operations

Reinsurance Segment and Products

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

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

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

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

Presently, we primarily focus on writing the following products:

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

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

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

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

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

For the years ended December 31, 2010, 2009 and 2008, approximately 47%, 46% and 60%, respectively, of the risks we reinsured were related to natural catastrophes, such as hurricanes and earthquakes, in North America, the Caribbean and Europe, although we also have written a significant amount of catastrophe business in Japan and Australasia.

Lloyd’s Segment and Products

Our Lloyd’s segment includes the business generated through the Lloyd’s Syndicate 1861 and FSML. Syndicate 1861 primarily provides property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation. FSML generates fee income from the provision of services to syndicates and third parties. Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As such there are no comparative numbers for 2008.

On September 23, 2009, the Company announced a new Lloyd's property division and syndicate, Syndicate 1969. The new division began writing business for October 1, 2009, initially on behalf of FSML's existing Syndicate 1861, but was supported for the 2010 underwriting year by a third party new mixed-capital Syndicate 1969, which assumed 100% of international property risks and 75% of other risks, with Syndicate 1861 assuming the balance. Syndicate 1969 uses the managing agency services and systems provided by FSML and Flagstone.

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Island Heritage Segment and Products

Island Heritage is a property insurer domiciled in the Cayman Islands which is primarily in the business of insuring homes, condominiums, office buildings and automobiles in the Caribbean region. The Company gained a controlling interest in Island Heritage in the third quarter of 2007.

Operations - Global Operating Platform

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

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

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

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

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

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

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

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

Flagstone Africa, is licensed as a South African multi-line reinsurer and it writes multiple lines of reinsurance in the South African and sub-Saharan reinsurance markets.

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

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

Ratings

The following are the current financial strength ratings from internationally recognized rating agencies for Flagstone Suisse:

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

Financial strength ratings have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. Ratings also play a significant role in the perception of a market participant’s financial strength, one of the key factors in our ability to compete effectively. Rating organizations, such as A.M. Best, Moody’s and Fitch, continually review the financial positions of insurers and reinsurers, including Flagstone, and provide ratings that are designed to reflect a company’s ability to meet its financial obligations under its policies. Our ability to underwrite business is dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. In the event that our financial strength ratings are downgraded by any of the agencies, we believe our ability to write business would be adversely affected. In the ordinary course of business, we evaluate our capital needs to support the volume of business written in order to maintain our claims paying and financial strength ratings, and we regularly provide financial information to rating agencies to both maintain and enhance existing ratings. A downgrade by any rating organization could result in a significant reduction in the number of reinsurance and insurance contracts we write and in a substantial loss of business as our customers, and brokers that place such business, move to other competitors with higher financial strength ratings.

Our financial strength ratings do not refer to our ability to meet non-reinsurance and non-insurance obligations and are neither a recommendation to purchase any policy or contract issued by us nor are they evaluations directed to the investor community or recommendation to buy, hold or sell our securities. Our ratings may be revised or revoked at the sole discretion of the rating agencies.

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

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

Underwriting and Risk Management

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

Underwriting

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

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

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

Risk Management

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

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

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

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

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

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

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

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

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

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We control our Caribbean coverage exposure through Island Heritage to both single and multiple catastrophe events through the use of catastrophe reinsurance. For individual non-catastrophe exposures we control our risk through the use of per risk reinsurance coverage. We control our individual risk exposure for risks written by Island Heritage through our underwriting guidelines which limit individual exposures by reference to our per risk reinsurance coverage limits.

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

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

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

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

Marketing and Distribution

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

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

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

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

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

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Gross premiums written by broker, shown individually where premiums are 10% or more of the total in any of the last three years, were as follows for the years ended December 31, 2010, 2009 and 2008:

	For the years ended December 31,								
	2010			2009			2008		
		Gross premiums written	Percentage of total		Gross premiums written	Percentage of total		Gross premiums written	Percentage of total
Name of broker									
Aon Benfield	$	343,234	31.3 %	$	366,088	37.0 %	$	369,037	47.2 %
Guy Carpenter		297,429	27.1 %		231,627	23.4 %		162,236	20.7 %
Willis Group		123,771	11.3 %		95,800	9.7 %		56,997	7.3 %
Other brokers (1)		333,416	30.3 %		294,976	29.9 %		193,619	24.8 %
Total	$	1,097,850	100.0 %	$	988,491	100.0 %	$	781,889	100.0 %

(1)Other brokers includes the gross premiums related to Island Heritage segment

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

Claims Management

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

An initial review is conducted by a claims analyst to ensure claims are valid from a coverage perspective, with correct loss and reinstatement premium calculations (as appropriate) prior to approval/entry into our underwriting/claims/accounting system.

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

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

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

Loss Reserves

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

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

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

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

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

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

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

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

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

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

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The following table presents the development of our loss and loss adjustment expense reserves for December 31, 2006 through December 31, 2010, and the breakdown of our loss and loss adjustment expense reserves as at December 31, 2010 per accident year, net of claims paid:

	Years ended December 31,				
	2006	2007	2008	2009	2010
Gross liability for unpaid losses and loss expenses	$ 22,516	$ 180,978	$ 411,565	$ 480,660	$ 721,314
Retroceded liability for unpaid losses and loss expenses		(1,355)	(16,422)	(19,270)	(28,183)
Net liability for unpaid losses and loss expenses	$ 22,516	$ 179,623	$ 395,143	$ 461,390	$ 693,131
Net reserves re-estimated as of:					
One year later	$ 18,641	$ 163,946	$ 388,553	450,292	
Two years later	13,455	149,776	359,160		
Three years later	11,357	139,512			
Four years later	7,097				
Cumulative net (deficiency) redundancy	$ 15,419	$ 40,111	$ 35,983	11,098	
Cumulative amount of net liability paid through:					
One year later	$ 6,948	$ 80,651	$ 220,126	383,749	
Two years later	10,159	113,527	290,619		
Three years later	10,329	115,994			
Four years later	7,202				

Investments

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

Management, under the auspices of the Finance Committee, conducted a comprehensive asset allocation study, consistent with modern practice in portfolio optimization, and developed a sophisticated optimization model using asset classes the Company is allowed to invest in from fiscal, regulatory, and liquidity aspects. The model aims at achieving higher expected total returns while maintaining adequate liquidity to pay potential claims and preserving our financial strength rating. The asset class composition of the model output may include a significant allocation to high grade fixed maturities securities, with the balance invested between other asset classes, such as money markets, U.S. equities, developed and emerging market equities, commodities, private equity, real estate and cash equivalents. Typically a small portion of investments may be allocated to private equity, real estate and commodities. We optimize asset allocation periodically, by taking into consideration the financial market conditions. Currently, our portfolio is optimized to be conservative in response to the 2008 deterioration in the financial markets with about 87% concentration in fixed maturities and cash equivalents, with the remainder diversified between commodities and equities.

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

Competition

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

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In particular, we compete with insurers and reinsurers that provide property-based lines of reinsurance, such as ACE Tempest Re, Aspen Insurance Holdings Limited, Allied World Assurance Company Holdings Limited, Alterra Capital Holdings, Ltd., Arch Capital Group Limited, Axis Capital Holdings Limited, Endurance Specialty Holdings Limited, Everest Re Group Limited, Munich Re, PartnerRe Ltd., Platinum Underwriters Holdings Ltd., Renaissance Reinsurance Holdings Ltd., Swiss Re, Validus Re and XL Re and similar companies.

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

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

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

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

Other Subsidiaries

Flagstone Africa

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

Lloyd's

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

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

Mont Fort

The Company owns all of the outstanding common shares of Mont Fort. Mont Fort is organized under the laws of Bermuda as an exempted company which is registered as both a general business Class 3 insurer and long term insurer and is also registered as a “segregated accounts” company under the Bermuda Segregated Accounts Companies Act 2000 (as amended) (the “SAC Act”). The SAC Act enables Mont Fort to establish segregated accounts, referred to as cells. Each cell of Mont Fort has a distinct business strategy, underwriting strategy and underwriting risk management program. Mont Fort has established three cells: Mont Fort ILW (“ILW 1”), Mont Fort ILW 2 (“ILW 2”) and Mont Fort High Layer (“High Layer”) of which, High Layer is the only one remaining as of December 31, 2010. Each cell of Mont Fort raises capital through preferred shares issued by Mont Fort and linked to that cell, underwrites its own risks and, to the fullest extent provided by the SAC Act, is solely responsible for liabilities arising from those risks. Each cell uses the proceeds of those offerings to underwrite reinsurance which will be ceded to Mont Fort by Flagstone.

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The results of Mont Fort are included in the Company's consolidated financial statements as the Company is the primary beneficiary of Mont Fort in accordance with FASB ASC Topic on Consolidations. The portions of Mont Fort's net income and shareholders' equity attributable to holders of the preferred shares for the years ended December 31, 2010, 2009 and 2008 are recorded in the consolidated financial statements of the Company as noncontrolling interest. During 2010, Mont Fort repurchased 50.0 million preferred shares relating to its second cell, ILW 2, for $79.5 million. As at December 31, 2010, the net assets of the remaining cell, High Layer, totalled $45.9 million.

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

Island Heritage

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

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

Employees

The Company had 440 employees at February 18, 2011. We believe that our relations with our employees are satisfactory.

Regulation

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

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

Luxembourg

Flagstone Reinsurance Holdings, S.A.

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The Company is a société anonyme, a joint stock corporation which is registered with the Registre de Commerce et des Sociétés Luxembourg (the Luxembourg Trade Register) under registration number B153214. The Company is governed by the laws of Luxembourg and acts as a parent holding company.

The Company does not conduct the business of an insurer or reinsurer in Luxembourg and therefore is not required to be registered with the authority in Luxembourg which regulates insurers and reinsurers, being the Commissariat aux Assurances.

The Company complies with the rules and regulations of the New York Stock Exchange ("NYSE").

Flagstone Finance S.A. ("FFSA")

FFSA is a société anonyme, a joint stock corporation which is registered with the Registre de Commerce et des Sociétés Luxembourg (the Luxembourg Trade Register) under registration number B118871 and is governed by the laws of Luxembourg.

FFSA is an indirect subsidiary of the Company, which coordinates the financial holdings of Flagstone throughout Europe. FFSA is not registered with any financial regulator in Luxembourg and need not be registered as such to conduct its business.

Flagstone Capital Management Luxembourg SICAF-FIS, ("FCML")

Certain of the investment management activities of the group are based in Luxembourg and are managed through FCML.

FCML was incorporated on September 8, 2008 in Luxembourg as a société anonyme, a joint stock corporation with a fixed share capital qualifying as a specialized investment fund (fonds d'investissement spécialisé). FCML is governed by the Luxembourg law on specialised investment funds of February 13, 2007 (the SIF Law), as well as its articles of incorporation.

FCML is a closed ended investment fund. Provided that the conditions of the SIF Law are complied with, FCML may be constituted with multiple sub-funds, each sub-fund corresponding to a distinct part of the assets and liabilities of FCML. The terms and conditions of the ownership of shares in, and the functioning of FCML are contained in a Private Placement Memorandum dated January 6, 2010, which is available to shareholders of FCML.

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

FCML is regulated by the Commission de Surveillance du Secteur Financier, the Luxembourg authority charged with supervising collective investments schemes in Luxembourg of this type. The subscription for shares in FCML is restricted to Well Informed Investors which are investors being, either institutional, professional or any other investor within the meaning of Article 2 of the SIF Law, which meet the following conditions:

- they have confirmed in writing that they are a well informed investor, and either
- they invest a minimum of EUR125,000 (or equivalent in US$) in the Specialised Investment Fund; or
- they have been the subject of an assessment made by a credit institution within the meaning of Directive 2006/48/EC, by an investment firm within the meaning of Directive 2004/39/EC, or by a management company within the meaning of Directive 2001/107/EC, certifying their expertise, their experience and their knowledge in adequately appraising an investment in the specialised investment fund.

Subscriptions for shares in FCML are not available to the general public.

As at January 6, 2010 FCML had one sub-fund called the “FCM Sub Fund 1” a sub-fund denominated in U.S. dollars. The minimum incremental investment in FCML is $100,000 with the Minimum Residual Holding being $1.0 million. The Net Asset Value per share is calculated monthly on the applicable valuation day and shareholders receive unaudited statements of the Net Asset Value of the shares in FCML within 30 business days of the end of the relevant month.

As at December 31, 2010, the investment assets of FCML amounted to $1.5 billion.

FCML has J.P. Morgan Bank Luxembourg S.A. as its custodian.

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Bermuda Insurance Regulation

The Bermuda Insurance Act. The Bermuda Insurance Act and related regulations, regulate the insurance business of Flagstone Suisse which operates in Bermuda through its Bermuda branch and Mont Fort. The Bermuda Insurance Act provides that no person shall carry on any insurance business in or from within Bermuda unless registered as an insurer under the Bermuda Insurance Act by the Bermuda Monetary Authority ("BMA"), which is responsible for the day-to-day supervision of insurers. The BMA, in deciding whether to grant registration, has broad discretion to act as it thinks fit in the public interest. The BMA is required by the Bermuda Insurance Act to determine whether the applicant is a fit and proper body to be engaged in the insurance business and, in particular, whether it has, or has available to it, adequate knowledge and expertise to operate an insurance business. Under the Bermuda Insurance Act, insurance business includes reinsurance business. The continued registration of a company as an insurer under the Bermuda Insurance Act is subject to its complying with the terms of its registration and such other conditions as the BMA may impose from time to time.

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

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

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

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

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

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

While Mont Fort is a registered Class 3 insurer in Bermuda the following disclosure focuses on Flagstone Suisse operating through its Bermuda branch, as it is subject to the most onerous regulation and supervision.

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

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

Principal Representative. An insurer is required to maintain a principal office in Bermuda and to appoint and maintain a principal representative in Bermuda.

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The Flagstone Suisse principal representative is David Brown and our principal office is Crawford House, 23 Church Street, Hamilton HM 11, Bermuda.

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

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

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

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

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

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

Enhanced Capital Requirement and Minimum Solvency. The new risk-based regulatory capital adequacy and solvency margin regime introduced under the Amendment Act, which came into effect on December 31, 2008, provides a risk-based capital model as a tool to assist the BMA both in measuring risk and in determining appropriate levels of capitalization (termed the Bermuda Solvency Capital Requirement ("BSCR")). BSCR employs a standard mathematical model that correlates the risk underwritten by Bermuda insurers to the capital that is dedicated to their business. The framework that has been developed and is set out in the Order, published on December 31, 2008, applies a standard measurement format to the risk associated with an insurer's assets, liabilities and premiums, including a formula to take account of the catastrophe risk exposure.

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

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

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

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

- 100,000,000 Bermuda Dollars;
- 50% of net premiums written (being gross premiums written less any reinsurance premiums ceded (not exceeding 25% of gross premiums written)); or
- 15% of net loss and loss expense provisions and other general business insurance reserves.

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

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

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

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

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

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

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

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

- within 14 days of becoming aware of such failure, to provide a written report to the BMA regarding why it failed to comply and proposed steps to be taken to rectify the failure; and

- within 45 days of becoming aware of such failure, to provide to the BMA:

  o unaudited interim statutory financial statements;

  o the opinion of a loss reserve specialist;

  o a general business solvency certificate in respect of those financials; and

  o a capital and solvency return reflecting an ECR prepared using post failure data.

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

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

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

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

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

Under the Bermuda Companies Act, the Bermuda Minister of Finance has been given powers to assist a foreign regulatory authority which has requested assistance in connection with enquiries being carried out by it in the performance of its regulatory functions.

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

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

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

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

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

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

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

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

Permit Company Regulation

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

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

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

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

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

Restrictions on Permit Companies. Flagstone Suisse is registered under the Bermuda Companies Act as a permit company. Under Bermuda law, permit companies are registered, for the purpose of conducting business outside Bermuda from a principal place in Bermuda. They may not, without the express authorization of the Bermuda legislature or under a license granted by the Bermuda Minister of Finance, participate in certain business transactions, including: in Bermuda, including the acquisition or holding of land, the taking of certain mortgages on land, and the acquisition of any bonds or debentures secured by any land and, subject to some exception, the carrying on of business of any kind for which the permit companies are not licensed in Bermuda.

Certain Other Bermuda Law Considerations

Under Bermuda law, non-Bermudians (other than spouses of Bermudians and holders of a permanent resident's certificate) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian or holder of a permanent resident's certificate) is available who meets the minimum standard requirements for the advertised position. In 2001, the Bermuda government announced a policy limiting the duration of work permits to six years, with certain exemptions for key employees. We may not be able to use the services of one or more of our key employees in Bermuda if we are not able to obtain work permits for them, which could have an adverse effect on our business.

As well as having no restrictions on the degree of foreign ownership, Flagstone Suisse has received an assurance from the Ministry of Finance granting an exemption that they will not be subject to taxes computed on profits or income or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax or to any foreign exchange controls in Bermuda until March 28, 2016. The Minister of Finance has recently indicated that this exemption will be extended to 2035.

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

Switzerland

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

Regulation and Supervision

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

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

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

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

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

Adequacy of Financial Resources

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

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

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

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

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

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

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

Sound Corporate Governance, Risk Management and Internal Control System

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

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

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

Supervisory Process

The supervisory process includes the following requirements:

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

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

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

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

External Auditor Involvement

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

Intervention and Enforcement by the Regulator

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

Capital Structure and Dividends

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

United Kingdom

Lloyd's Regulation

General

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

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

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

Capital Requirements

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

Restrictions

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

Ratings

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

Intervention Powers

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

Change of Control

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

FSA Regulation

General

FSML's operations are regulated by the FSA as well as being franchised by Lloyd’s of London. The FSA has substantial powers of intervention in relation to the Lloyd’s managing agents (such as FSML) which it regulates, including the power to remove their authorization to manage Lloyd’s syndicates.

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

In addition, each year the FSA requires Lloyd’s to satisfy an annual solvency test which measures whether Lloyd’s has sufficient assets in the aggregate to meet all outstanding liabilities of its members, both current and run-off. If Lloyd’s fails this test, the FSA may require Lloyd’s to cease trading and/or its members to cease or reduce underwriting.

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

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Change of Control

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

Other Applicable Laws

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

Cayman Islands

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

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

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

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

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

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

Republic of Cyprus

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

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

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

- Carry on its insurance business in accordance with the terms of its license.
- Must maintain adequate levels of approved investments to cover its technical reserves, in line with the approved percentages and free of any burden, and these must be expressed or liquidated in the appropriate currency according to the currency matching rules set out in the Insurance Law.
- Must submit a return of approved investments to the Superintendent of Insurance quarterly. The return must be in the prescribed format, signed by the managing director and one other director, or, if there is no managing director, by a director and the general manager. The returns for the second and fourth quarters of each financial year must be audited and signed by the auditors.
- An annual return must be submitted within six months of Flagstone Alliance's financial year end. The annual return includes detailed analyses in the prescribed form of assets, liabilities, income and expenses and must be certified by Flagstone Alliance's directors and actuary and accompanied by the auditors' report.

Flagstone Alliance may under the freedom of establishment or the freedom to provide services carry on insurance business in a Member State of the EU or the EEA. Under the freedom of establishment, such business in the Member State may start following the submission by Flagstone Alliance to the Superintendent of Insurance of Cyprus of an application supported by the prescribed by Regulations documents which are passed by the Superintendent of Insurance of Cyprus to the supervisory authority of the Member State which determines the conditions under which the Company may carry on its business in the said Member State.

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

South Africa

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

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

Where You Can Find More Information

The Company's Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, are available free of charge through the investor information pages of its website, located at www.flagstonere.com. The contents of our website are not incorporated by reference into this Annual Report and the reference is included as inactive textual reference only. Alternatively, the public may read or copy the Company's filings with the Securities and Exchange Commission (the "SEC") at the SEC's Public Reference Room at 100 F Street, N.E., Room 1580, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (www.sec.gov).

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ITEM 1A. RISK FACTORS

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

Risks Related to the Company

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Loss and loss adjustment expense reserves (or loss reserves) are typically comprised of case reserves and IBNR reserves. Our IBNR reserves include a provision for unknown future development on loss and loss adjustment expenses which are known to us. However, under U.S. GAAP, we are not permitted to establish loss reserves with respect to our property catastrophe reinsurance until an event which gives rise to a claim occurs. As a result, only loss reserves applicable to losses incurred up to the reporting date may be set aside on our financial statements, with no allowance for the provision of loss reserves to account for possible other future losses with respect to our property catastrophe reinsurance. Our loss reserve estimates do not represent an exact calculation of liability. Rather, they are estimates of what we expect the ultimate settlement and administration of claims will cost. These estimates are based upon actuarial and statistical projections and on our assessment of currently available data, predictions of future developments and estimates of future trends and other variable factors such as inflation. Establishing an appropriate level of our loss reserve estimates is an inherently uncertain process. It is likely that the ultimate liability will be greater or less than these estimates and that, at times, this variance will be material. Our future reserve estimates are refined continually as experience develops and claims are reported and settled. In addition, as a broker market reinsurer, reserving for our business can involve added uncertainty. Because we depend on information from ceding companies, there is a time lag inherent in reporting information from the primary insurer to us, and ceding companies have differing reserving practices. Moreover, these uncertainties are greater for reinsurers like us than for reinsurers with a longer operating history because we do not yet have an established loss history. Because of this uncertainty, it is possible that our estimates for reserves at any given time could prove inadequate.

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

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

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

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

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

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

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

We market our reinsurance and insurance on a worldwide basis primarily through reinsurance brokers and insurance brokers and agents, and we depend on a small number of reinsurance brokers and insurance brokers and agents for a large portion of our revenues. Since we commenced operations in December 2005, substantially all of our gross premiums written were sourced through brokers. The following brokers, [Aon Benfield (31.3%), Guy Carpenter & Company, Inc. (27.1%) and Willis Group Holdings Ltd. (11.3%)], provided a total of 69.7% of our gross premiums written for the year ended December 31, 2010. Affiliates of these and other brokers have historically co-sponsored the formation of reinsurance companies that may compete with us, and these brokers may favor their own reinsurers over other companies. Loss of all or a substantial portion of the business provided by one or more of these brokers could limit our ability to write new reinsurance policies and reduce our revenues.

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

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

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

Ratings have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. Ratings play a significant role in the perception of a market participant's financial strength, one of the key factors in our ability to compete effectively. Our financial strength is rated by a variety of rating agencies, and these ratings are designed to reflect our ability to meet our financial obligations under our policies. These ratings do not refer to our ability to meet non-reinsurance and non-insurance obligations and are not a recommendation to purchase any policy or contract issued by us or to buy, hold or sell our securities.

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

With regard to FSML, as all Lloyd's policies are ultimately backed by this common security, a single market rating can be applied across Lloyd's.

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

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

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

Consolidation in the insurance industry could adversely impact us.

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

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

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

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

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

The impairment of financial institutions increases our counterparty risk.

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

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

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

The investment income derived from our invested assets was $31.5 million for the year ended December 31, 2010. For the year ended December 31, 2010, the total return on invested assets was 4.2% compared to 4.6% for the year ended December 31, 2009. The change in the return on invested assets of (0.4)% during the year ended December 31, 2010, compared to the same period in 2009 is primarily due to lower interest rates and a lower impact of tightening credit spreads during the year. Our investment policies seek capital appreciation and thus will be subject to market-wide risks and fluctuations, as well as to risks inherent in particular securities. In particular, the volatility of our claims may force us to liquidate securities, which could impact our investment portfolio.

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Our investment performance may vary substantially over time, and we cannot assure you that we will achieve our investment objectives.

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

Investment results will also be affected by general economic conditions, market volatility, interest rate fluctuations, liquidity and credit risks beyond our control. In addition, the need for liquidity may result in investment returns below our expectations. With respect to certain of our investments, we are subject to pre-payment or reinvestment risk. In particular, our fixed maturity portfolio is subject to reinvestment risk and as at December 31, 2010, 21.1% of our fixed maturity portfolio comprised mortgage-backed and asset-backed securities which are subject to prepayment risk. A significant increase in interest rates could result in significant losses, realized or unrealized, in the fair value of our investment portfolio and, consequently, could have an adverse affect on our results of operations. Further, our portfolio of fixed income securities may be adversely affected by changes in interest rates. In addition, we are generally exposed to changes in the level or volatility of equity prices that affect the value of securities or instruments that derive their value from a particular equity security, a basket of equity securities or a stock index. As of the date of this annual report, our exposure to equities and other non-investment grade fixed income investments is limited to 6.3% of assets. These conditions are outside of our control and could adversely affect the value of our investments and our financial condition and results of operations.

Profitability may be adversely impacted by claims' inflation.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We currently have the ability to provide up to $750 million in letters of credit under our letter of credit facilities ($550 million in respect of Citibank Europe Plc and $200 million in respect of Barclays Bank Plc), the renewal of which is reviewed annually. As at December 31, 2010, $467.9 million has been drawn under these facilities. If these facilities are not sufficient or if we are unable to renew them or are unable to arrange for other types of security on commercially acceptable terms, the ability of Flagstone Suisse to provide reinsurance to some U.S.-based and international clients may be severely limited.

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

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

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

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

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

Under relevant Luxembourg corporate law, each year at least one-twentieth of our net profits must be allocated to the creation of a reserve. This allocation to reserve ceases to be required when the reserve has reached an amount equal to one-tenth of our corporate capital, but once again becomes required if the reserve falls below one-tenth of our corporate capital.

In addition, certain limitations apply to the declaration of dividends from the Company. Under Luxembourg Law, our shareholders may declare dividends at a general meeting of shareholders through the passage of an ordinary resolution, but, in accordance with our Articles, the dividend may not exceed the amount recommended by our Board of Directors. Dividends may only be declared from our distributable reserves. In accordance with Luxembourg Law, no distributions to shareholders may be made when, on the closing date of the relevant financial year, the net assets as set out in the annual accounts are, or would be following such a distribution, lower than the subscribed capital plus the reserves that may not be distributed under Luxembourg Law or in accordance with our Articles. The amount of a distribution to shareholders may not exceed the amount of profits at the end of the last financial year plus any profits carried forward and any amounts drawn from reserves which are available for that purpose, less any losses carried forward and sums to be placed to reserve in accordance with the Luxembourg Law or in accordance with the Articles.

Our Articles and Luxembourg Law provide for certain restrictions on the purchase of our own shares. We may only purchase our own shares in accordance with Luxembourg Law and the provisions of our Articles. Our Articles provide that we are generally authorized to purchase our own shares provided that: (i) the maximum number of shares repurchased does not exceed the number of our paid up issued shares; (ii) the maximum price that may be paid for each share is the fair market value; (iii) the minimum price that may be paid for each share is the par value per share of US$0.01; (iv) our authority to repurchase our own shares is granted to us by our shareholders and expires on the fifth anniversary of the granting of such authority, at which point our shareholders must provide new authority for further repurchases; (v) the acquisition of shares, including shares previously acquired, may not have the effect of reducing our net assets below the amount required by Luxembourg Law; and (vi) our authority to purchase our own shares relates only to: (a) one or more open-market purchases; or (b) a purchase where we have made an offer on similar terms to repurchase up to the same number of shares from each shareholder appearing on the register of shareholders immediately before the offer was made, other than to those who have consented in writing to be excluded from the offer.

The structure of FCML, our Luxembourg investment subsidiary, provides for the equity to be provided substantially in share premium. As an investment company, FCML has been empowered and operationally equipped to repurchase shares at Net Asset Value at short notice, (subject to board approval and maintaining the minimum share capital of €1,250,000). FCML can also declare dividends (including interim dividends) out of unrealized capital gains.

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

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

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

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

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

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

Risks Related to Laws and Regulations Applicable to Us

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

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

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

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

The insurance and reinsurance regulatory framework of Bermuda recently has become subject to increased scrutiny in many jurisdictions, including the U.S. In the past, there have been Congressional and other initiatives in the U.S. regarding increased supervision and regulation of the insurance industry, including proposals to supervise and regulate offshore reinsurers. Government regulators are generally concerned with the protection of policyholders rather than other constituencies, such as shareholders. Moreover, our exposure to potential regulatory initiatives could be heightened by the fact that certain of our principal operating companies operate from Bermuda. Bermuda is a small jurisdiction and may be disadvantaged when participating in global or cross border regulatory matters as compared with larger jurisdictions such as the U.S. or the leading European Union countries.

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This disadvantage could be amplified by the fact that Bermuda, which is currently an overseas territory of the U.K., may consider changes to its relationship with the U.K. in the future, including potentially seeking independence. We are not able to predict the future impact on Flagstone's operations of changes in the laws and regulations to which we, or companies acquired by us, are or may become subject. Flagstone Suisse operates in Bermuda under a permit issued by the Bermuda Minster of Finance. If Flagstone Suisse's permit were revoked, it would not be permitted to operate its business from within Bermuda.

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

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

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

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

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

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

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

An EU directive covering the capital adequacy, risk management and regulatory reporting for insurers, known as Solvency II was adopted by the European Parliament in April 2009. The proposed Solvency II insurance directive is currently expected to come into force on January 1, 2013. Insurers and reinsurers are undertaking a significant amount of work to ensure that they meet the new requirements and this may divert resources from other operational roles. Final Solvency II guidelines have been published and the Company and FSML implementation plans are well underway. There can be no assurance that future legislation will not have an adverse effect on FSML or the Company.

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We could lose the services of one or more of our key employees if we are unable to obtain or renew work permits required by certain countries in which we operate.

Our success depends on our ability to retain the services of our existing key employees and to attract and retain additional qualified personnel in the future. Many of our key employees work in countries where they are not citizens, such as Bermuda or Switzerland. It is possible that we could lose the services of one or more of our key employees, or be unable to attract new qualified personnel, if we are unable to obtain or renew necessary work permits, which could have an adverse effect on our business.

Risks Related to Our Common Shares

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

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

As of February 22, 2011, we had 68,713,348 common shares outstanding, net of treasury shares. Up to an additional 6,328,978 common shares may be issuable upon the vesting and exercise of outstanding Performance Share Units (PSUs) and Restricted Share Units (RSUs). In addition, our principal shareholders and their transferees have the right to require us to register their common shares under the Securities Act of 1933, as amended (the "Securities Act") for sale to the public. There is one warrant outstanding that will be exercisable for an aggregate 630,194 common shares during the month of December 2013. These shares also will be entitled to demand registration. Following any registration of this type, the common shares to which the registration relates will be freely transferable. We have also filed a registration statement on Form S-8 under the Securities Act to register common shares issued or reserved for issuance under our PSU Plan and our RSU Plan. Subject to the exercise of issued and outstanding stock options, shares registered under the registration statement on Form S-8 will be available for sale to the public.

We have reserved 11.2 million common shares for issuance under the PSU Plan. For the RSU Plan, we annually reserve 0.2% of our outstanding common shares for issuance (or as decided by the Compensation Committee), plus the amount required to satisfy director fees paid in common shares. Subject to the settlement of PSUs, which generally vest over three years, and RSUs, which generally vest over two years, common shares registered under the registration statement on Form S-8 will be available for sale into the public markets after the expiration of the 180-day lock-up agreements. On June 23, 2010, we filed a universal shelf registration statement with the SEC, which was declared effective on August 5, 2010 (the "2010 Shelf Registration Statement"). Under the 2010 Shelf Registration Statement, we may issue and sell up to $500 million worth of common shares, preferred shares and senior and subordinated debt, under one or more prospectus supplements. Additionally, selling stockholders are entitled to sell up to a total of 71,547,891 common shares from time to time under the 2010 Shelf Registration Statement. We have not yet completed an offering under the 2010 Shelf Registration.

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

The Luxembourg companies legislation, which applies to the Company, differs in material respects from laws generally applicable to U.S. corporations and their shareholders. The rights of shareholders under Luxembourg law, although extensive, may differ from the rights of shareholders under legislation or judicial precedent in many U.S. jurisdictions. Class actions and derivative actions are generally not available to shareholders under the laws of

Luxembourg. In addition, the Company's Articles of Incorporation (Statutes) also provide that shareholders waive all claims or rights of action that they may have, individually or in the Company's right, against any of the Company's directors or officers from and against all actions , costs, charges, losses, damages and expenses which they shall incur or sustain by reason of any act done, concurred or omitted in or about the execution of their duty, supposed duty, or respective offices or trusts, provided that this indemnity shall not extend to any actions resulting from fraud, dishonesty, gross degligence or willful misconduct of such director or officer. The cumulative effect of some of these differences between Luxembourg law and the laws generally applicable to U.S. corporations and their shareholders may result in shareholders having greater difficulties in protecting their interests as a shareholder of our Company than as a shareholder of a U.S. corporation. In particular, this affects, among other things, the circumstances under which transactions involving an interested director are voidable, whether an interested director can be held accountable for any benefit realized in a transaction with our company, what approvals are required for business combinations by our company with a large shareholder or a wholly-owned subsidiary, what rights a shareholder may have to enforce specified provisions of the Luxembourg companies legislation or our articles, and the circumstances under which we may indemnify our directors and officers.

Anti-takeover provisions in our articles could diminish the value of our common shares.

Our articles contain provisions that could delay or prevent a change of control of the Company that a shareholder might consider favorable. For example, these provisions may prevent a shareholder from receiving the benefit from any premium over the market price of our common shares offered by a bidder in a potential takeover. Even in the absence of a takeover attempt, these provisions may adversely affect the prevailing market price of our common shares if they are viewed as discouraging takeover attempts in the future.

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Examples of provisions in our articles that could have this effect include:

election of our directors is staggered, meaning that ordinarily the members of only one of the three classes of our directors are elected each year;

except as otherwise specified in the Articles, directors are ordinarily elected by shareholders from persons nominated by the existing directors; and

the affirmative vote of at least 75% of the shares represented will be required to approve any merger, amalgamation or similar transaction involving the Company.

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

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

Bermuda insurance law requires that any person who becomes a holder of at least 10%, 20%, 33% or 50% of the common shares of an insurance or reinsurance company or its parent company must notify the BMA in writing within 45 days of becoming such a holder or 30 days from the date they have knowledge of having such a holding, whichever is later. The BMA may, by written notice, object to a person holding 10%, 20%, 33% or 50% of our common shares if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce their shareholding in us and may direct, among other things, that the voting rights attaching to their shares shall not be exercisable. A person that does not comply with such a notice or direction from the BMA will be guilty of an offense.

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

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

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

We may repurchase your common shares without your consent.

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

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

We are a Luxembourg société anonyme and it may be difficult to enforce judgments against us or our directors and executive officers.

We are organized under the laws of Luxembourg. In addition, some of our directors and officers reside outside the U.S. and all or a substantial portion of their assets and our assets are or may be located in jurisdictions outside the U.S. Therefore, it may be difficult for investors to effect service of process within the U.S. upon our non-U.S. directors and officers or to recover against our company or our non-U.S directors and officers on judgments of U.S. courts, including judgments predicated upon the civil liability provisions of the U.S. Federal securities laws. Further, no claim may be brought in Luxembourg against us or our directors and officers in the first instance for violation of U.S. Federal securities laws because these laws have no extraterritorial jurisdiction under Luxembourg law and do not have force of law in Luxembourg.

We have been advised by our Luxembourg counsel that there is doubt as to whether the courts of Luxembourg would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, as well as the experts named herein, predicated upon the civil liability provisions of the U.S. Federal securities laws. It may be difficult for you to recover against us based upon a judgment of a U.S. court because such judgments are not automatically enforceable in Luxembourg.

The U.S. and Luxembourg are not currently bound by a treaty providing for reciprocal recognition and enforcement of judgments, other than arbitral awards rendered in civil and commercial matters. An enforceable judgment for the payment of monies rendered by any U.S. Federal or state court based on civil liability, whether or not predicated solely upon the U.S. securities laws, would not directly be enforceable in Luxembourg. However a party who received such favorable judgment in a U.S. court may institute enforcement proceedings (exequatur) in Luxembourg by requesting enforcement of the U.S. judgment by the District Court (Tribunal d'Arrondissement) pursuant to Article 678 of the New Luxembourg Code of Civil Procedure.

The District Court will authorize the enforcement of the U.S. judgment in Luxembourg if it is satisfied that all of the following conditions are met:

- the U.S. judgment is enforceable in the U.S.;

- the U.S. court awarding the judgment has jurisdiction to adjudicate the respective matter under the applicable U.S. Federal or state jurisdictions rules, and the jurisdiction of the U.S. court is recognized by Luxembourg private international and local law;

- the U.S. court has applied to the dispute the substantive law which would have been designated by the Luxembourg conflict of law rules;

- the principles of natural justice have been complied with;

- the U.S. judgment does not contravene international public policy (ordre public) or order as understood under the laws of Luxembourg or has been given in proceedings of a criminal nature;

- the U.S. court has acted in accordance with its own procedural laws;

- the U.S. judgment was granted following proceedings in which the counterparty had the opportunity to appear and to present a defense; and

- the U.S. judgment was not granted pursuant to an evasion of Luxembourg law (fraude à la loi luxembourgeoise).

Subject to the above conditions, Luxembourg courts tend not to review the merits of a foreign judgment, although there is no statutory prohibition on this type of review.

Enforcement does not mean that all of the obligations resulting from the judgment are enforced in accordance with their specific terms, but only that they can be enforced if they are of a type that is recognized and enforced under Luxembourg law generally.

Risks Related to Tax Matters

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

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

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Additionally, a U.S. person that was a U.S. 10% shareholder at any time during the five-year period ending on the date such U.S. person disposes of our common shares may be taxable at dividend rates on any gain realized on such sale or other disposition (including by way of repurchase or liquidation) of common shares to the extent of our current and accumulated earnings and profits attributable to such common shares.

A non-U.S. insurance company is a CFC if more than 25% of the total combined voting power of all classes of stock is owned by U.S. 10% shareholders on any day during the taxable year of such a corporation.

Following the Redomestication of the Company from Bermuda to Luxembourg in May 2010, the Company's articles do not contain a provision reducing the voting power of any shareholder owning more than 9.9% of the Company's shares to 9.9%. Accordingly, no assurance can be given that the Company or any of its subsidiaries will not be, or become, a CFC. Investors should consult their own tax advisors regarding the U.S. tax ramifications of owning shares of the Company, and in particular regarding the manner in which ownership is computed for purposes of applying the CFC rules described above, and the potential for U.S. tax ramifications of ownership of shares of the Company with an aggregate voting power of 10% or greater.

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

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

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

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

Passive Foreign Investment Company Rules. A non-U.S. corporation will be treated as a passive foreign investment company ("PFIC") for any taxable year if at least 75% of its gross income for the taxable year is passive income or at least 50% of its gross assets during the taxable year produce or are held for the production of passive income. If the Company was characterized as a PFIC for any taxable year, U.S. holders of common shares generally would be subject to adverse U.S. federal income tax consequences for such year and each subsequent year including (i) taxation of any gain attributable to the sale or other disposition (including by way of repurchase or liquidation) of their common shares or any “excess distribution” with respect to their common shares at the highest marginal income tax rates applicable to ordinary income during the holder’s holding period for the common shares and (ii) an interest charge on the deemed deferral of income tax, unless the holder properly elects to have the Company treated as a qualified electing fund and thus to include in gross income each year a pro rata share of our ordinary earnings and net capital gain for any year in which we constitute a PFIC.

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

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

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

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

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

Any dividends you receive may be subject to Luxembourg dividend withholding tax and Luxembourg income tax.

Luxembourg dividend withholding tax (currently at a rate of 15%) may arise in respect of dividends paid on our shares. A Luxembourg withholding tax levied at a rate of 15% is due on dividends and similar non-exempt distributions to our shareholders. We will be required to withhold at such rate from distributions to the shareholder and to pay such withheld amounts to the Luxembourg tax authorities.

Dividends and similar distributions paid to our shareholders may be exempt from Luxembourg dividend withholding tax if: (1) the shareholder is a qualifying corporate entity holding a stake of at least 10% of the total issued and outstanding share capital of the Company or a stake of such share capital with an acquisition price of at least €1.2 million; and (2) has either held this qualifying stake in our capital for an uninterrupted period of at least 12 months at the time of the payment of the dividend, or if it undertakes to continue to own such qualifying shareholding until such time as the entity has held the shares for an uninterrupted period of at least 12 months. Examples of qualifying corporate shareholders are taxable Luxembourg companies, certain taxable companies resident in other EU member states, capital companies resident in Switzerland subject to income tax and companies fully subject to a tax corresponding to Luxembourg corporate income tax that are resident in countries that have concluded a treaty for the avoidance of double taxation with Luxembourg. Residents of countries that have concluded a treaty for avoidance of double taxation with Luxembourg might claim application of a dividend withholding tax reduced rate (or exemption) depending on the applicable tax treaty.

Under current Luxembourg tax law, payments to shareholders in relation to a reduction of share capital or share premium are not subject to Luxembourg dividend withholding tax if certain conditions are met, including, for example, the condition that we do not have distributable reserves or profits generated after the Redomestication. If we have, at the time of the payment to shareholders with respect to their shares, distributable reserves or profits generated after the Redomestication, a distribution of share capital or share premium will be recharacterized for Luxembourg tax purposes as a distribution of such reserves or earnings subject to withholding tax. While it is our intention to make payments to shareholders in a way that no Luxembourg withholding tax is due, we may not be able to do so or our ability to do so could be limited.

There could be adverse tax consequences if we fail to maintain sufficient presence in Luxembourg.

If we do not maintain sufficient presence in Luxembourg, the Luxembourg tax authorities may not be willing to confirm that we are a tax resident of Luxembourg. In such case, we may not be entitled to tax treaty benefits. In addition, a foreign jurisdiction may claim the right to tax us as if we were a tax resident of that foreign jurisdiction, and ultimately double taxation may result.

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

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

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

None of our companies, except for Flagstone Representatives Limited, FSML, FCNL, Flagstone Holdings (U.K.) Limited, Mosaic Underwriting Services (U.K.) Limited and Syndicate 1861 (the "Flagstone U.K. Group") are incorporated or managed in the U.K.

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Accordingly, none of our other companies should be treated as being resident in the U.K. for corporation tax purposes unless the central management and control of any such company is exercised in the U.K. The concept of central management and control is indicative of the highest level of control of a company, which is wholly a question of fact. Each of our companies currently intends to manage its affairs so that none of our companies, apart from the Flagstone U.K. Group, are resident in the U.K. for tax purposes or carry on a trade through a permanent establishment in the U.K. If any of our companies were treated as being resident in the U.K. for U.K. corporation tax purposes, or if any of our companies, other than the Flagstone U.K. Group, were to be treated as carrying on a trade in the U.K. through a branch or agency or of having a permanent establishment in the U.K., our results of operations could be materially adversely affected.

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

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

In addition, possible changes to the U.K. controlled foreign companies regime are currently under active consideration. Any possible changes may impact on the Flagstone U.K. Group’s tax charge.

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

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

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

Flagstone Reinsurance Holdings, S.A., FCML and FFSA are incorporated and carry on business through a permanent establishment in Luxembourg. However, none of our other companies should be subject to taxation in Luxembourg. Each of our companies currently intends to operate in such a manner so that none of our companies, apart from Flagstone Reinsurance Holdings, S.A., FCML and FFSA, will carry on business through a permanent establishment in Luxembourg. If any of our companies were to be treated as carrying on business in Luxembourg through a branch or agency or of having a permanent establishment in Luxembourg, our results of operations could be materially adversely affected.

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

None of our companies, except for Flagstone Management Services (Halifax) Limited, or Flagstone Halifax, is resident in Canada for corporate tax purposes. Accordingly, none of our other companies should be liable for

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

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

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

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If any of our companies were to be treated as receiving income in India or earning income that arises or accrues in India, our results of operations could be materially adversely affected.

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

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

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

We may become subject to taxation in Bermuda after March 28, 2016, which would negatively affect our results.

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

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

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

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

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

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

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

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

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

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ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We currently occupy office space in Luxembourg, Luxembourg. In addition, we own office space in Hyderābād, India and lease office space in Hamilton, Bermuda; Halifax, Canada; London, England; Martigny, Switzerland; San Juan, Puerto Rico; Dubai, UAE; Johannesburg, South Africa; Limassol, Republic of Cyprus; George Town, Grand Cayman, Cayman Islands; New York, U.S.; Rio de Janeiro, Brazil; and Douglas, Isle of Man. We are constructing new office buildings in Martigny and Luxembourg. We believe that for the foreseeable future our current office spaces combined with the projects in Switzerland and Luxembourg will be sufficient for us to conduct our operations.

ITEM 3. LEGAL PROCEEDINGS

As of December 31, 2010, the Company was not a party to any litigation or arbitration that it believes could have a material adverse effect on the financial condition or business of the Company. We anticipate that, similar to the rest of the insurance and reinsurance industry, we will be subject to litigation and arbitration in the ordinary course of business of our business operations. In addition to claims litigation, the Company and its subsidiaries may be subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on reinsurance treaties.

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PART II

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

Market Information

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

	2010		2009	
	High	Low	High	Low
First quarter	$ 11.66	$ 10.23	$ 9.87	$ 7.24
Second quarter	$ 12.29	$ 10.1	$ 10.54	$ 7.64
Third quarter	$ 11.46	$ 9.49	$ 11.47	$ 9.07
Fourth quarter	$ 13.14	$ 9.67	$ 12.45	$ 10.3

At February 18, 2011, the number of record holders of the common shares of the Company was 22.

Distributions

Distributions declared per common share are in the form of a non-dividend return of capital. Prior to the Company's Redomestication to Luxembourg on May 17, 2010, such distributions were in the form of dividends. The Company paid four quarterly cash distributions in 2010, four in 2009 and four in 2008, at the rate of $0.04 per common share. Subject to the approval of our Board, we currently expect to continue to pay quarterly cash distributions of approximately $0.04 per common share. Any future determination to pay cash distributions will be at the discretion of our Board and will be dependent upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, rating agency guidelines, legal, tax, regulatory and any contractual restrictions on the payment of distributions and any other factors our Board deems relevant.

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

Repurchases of Equity Securities

On September 22, 2008, the Company announced that its Board had approved the potential repurchase of company common shares, subject to market conditions, share price and other factors. The buyback program, which does not have a specific expiration date, allows the Company to purchase, from time to time, its outstanding stock up to a value $60.0 million, which was increased by an additional $50.0 million at the May 18, 2010 Board meeting. Purchases under the buyback program are made with cash, at fair market value (as defined in the Company's Articles of Incorporation). There were no share repurchases under the buyback program during the fourth quarter of 2010. As at December 31, 2010, approximately $11.2 million of repurchases remain available under the buyback program.

Shares purchased by a subsidiary

On December 14, 2010, pursuant to the Purchase Agreement between Bermuda Holdings, Mark J. Byrne ("Mr. Byrne"), and certain companies associated with Mr. Byrne, Bermuda Holdings purchased 8,005,024 shares of Flagstone from such companies in connection with the retirement of Mr. Byrne as a member of the Board at a total cost of $91.8 million.

Trading plan

On December 10, 2010, Flagstone adopted a written trading plan under Rule 10b5-1 (“the Plan”) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), to facilitate the continuing repurchase of its shares in accordance with Flagstone’s existing share repurchase authorization. The entry into the Plan does not increase the amount of the Company’s share repurchase program, nor is it related to the recent purchase of shares from companies associated with Mr. Byrne by a subsidiary of the Company, see above.

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Recent Sales of Unregistered Securities

There have been no recent sales of unregistered securities.

Performance Graph

The following graph compares the cumulative return on our common shares including reinvestment of our dividends on our common shares to such return for the Standard & Poor's ("S&P") 500 Composite Stock Price Index ("S&P 500"), S&P Supercomposite Property-Casualty Index ("S&P P/C") and AM Best's Global Reinsurance Stock Index ("AM Best Global Re"), for the period commencing March 30, 2007, the date of our initial IPO, through December 31, 2010, assuming $100.00 was invested on March 30, 2007. Each measurement point on the graph below represents the cumulative shareholder return as measured by the last sale price at the end of each quarter during the period from March 30, 2007 through December 31, 2010. As depicted in the graph below, during this period, the cumulative return was (1) (6.5%) on our common shares; (2) (11.5%) for the S&P 500; (3) (26.1%) for the S&P P/C; and (4) (22.8%) for the AM Best Global Re.

Equity Compensation Plans

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

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ITEM 6. SELECTED FINANCIAL DATA

Statement of operations data for the years ended December 31, 2010, 2009 and 2008 and balance sheet data as of December 31, 2010 and 2009 are derived from our audited consolidated financial statements included in Item 8, "Financial Statements and Supplementary Data" in this Annual Report, which have been prepared in accordance with U.S. GAAP.

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

	For the years ended December 31,				
	2010	2009	2008	2007	2006
Summary Statement of Operations Data:					
Net premiums written	$ 883,854	$ 792,469	$ 694,698	$ 527,031	$ 282,498
Net income (loss) attributable to Flagstone	$ 97,084	$ 242,192	$ (187,302)	$ 167,922	$ 152,338
Net income (loss) per common share outstanding—Basic	$ 1.23	$ 2.87	$ (2.20)	$ 2.05	$ 2.17
Distributions declared per common share (1)	$ 0.16	$ 0.16	$ 0.16	$ 0.08	$ -

	As at December 31,				
	2010	2009	2008	2007	2006
Summary Balance Sheet Data:					
Total investments, cash and cash equivalents and restricted cash	$ 1,997,278	$ 1,945,320	$ 1,700,844	$ 1,865,698	$ 1,018,126
Total assets	$ 2,719,202	$ 2,566,768	$ 2,215,970	$ 2,103,773	$ 1,144,502
Loss and loss adjustment expense reserves	$ 721,314	$ 480,660	$ 411,565	$ 180,978	$ 22,516
Long term debt	$ 251,122	$ 252,402	$ 252,575	$ 264,889	$ 137,159
Shareholders' equity	$ 1,134,733	$ 1,211,018	$ 986,013	$ 1,210,485	$ 864,519

(1)Distributions declared per common share are in the form of a non-dividend return of capital. Prior to the Company's Redomestication to Luxembourg on May 17, 2010, such distributions were in the form of dividends.

As of January 1, 2007, we adopted the Financial Accounting Standards Board Accounting Standards Codification ("FASB ASC") Topic on Fair Value Measurements and Disclosures and the FASB ASC Topic on Financial Instruments. As a result, substantially all of our investments are now carried at fair value with changes in fair value being reported as net realized and unrealized gains (losses) in our statement of operations and comprehensive income (loss). Prior to the adoption of these Topics, our available for sale investments were carried at fair value with changes in fair value with changes therein reported as a component of other comprehensive income.

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

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

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

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

The following is a discussion and analysis of our financial condition as at December 31, 2010 and 2009 and our results of operations for the years ended December 31, 2010, 2009 and 2008. All amounts in the following tables are expressed in thousands of U.S. dollars, except share amounts, per share amounts, percentages, or unless otherwise stated. This discussion should be read in conjunction with our audited consolidated financial statements and related notes included in Item 8 of this Annual Report on Form 10-K (this "Annual Report"). Some of the information contained in this discussion and analysis is included elsewhere in this document, including information with respect to our plans and strategy for our business, and includes forward-looking statements that involve risks and uncertainties. Please see the "Cautionary Statement Regarding Forward-Looking Statements" for more information. You should review Item 1A, "Risk Factors" for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements.

Executive Overview

We are a global reinsurance and insurance company. Our management views us as being organized into three business segments: Reinsurance, Lloyd's and Island Heritage (previously referred to as our Insurance segment). Through our Reinsurance segment, we write primarily property, property catastrophe and short-tail specialty and casualty insurance and reinsurance. Through our Lloyd's segment, we write primarily property and short-tail specialty and casualty insurance and reinsurance focused on the energy, hull, cargo, marine liability, engineering, and aviation business sectors. Island Heritage primarily writes property insurance for homes, condominiums, office buildings and automobiles in the Caribbean region.

We commenced operations in December 2005. On March 30, 2007, our common shares began trading on the New York Stock Exchange ("NYSE"). On May 14, 2010, the Company's shareholders approved a redomestication to change Flagstone's jurisdiction of incorporation from Bermuda to Luxembourg and thereby discontinued its existence as a Bermuda company as provided in Section 132G of The Companies Act 1981 of Bermuda and continued its existence as a société anonyme under the laws of Luxembourg effective May 17, 2010 (the "Redomestication"). The Redomestication has not had, and we do not expect the Redomestication to have, a material impact on the way we operate or on our financial condition or results of operations.

The various components of our operating model, including offices in Luxembourg, Luxembourg; Hamilton, Bermuda; Martigny, Switzerland; and London, England, are integrated through our use of advanced technology. Flagstone Suisse is based in Martigny in the canton of Valais, Switzerland. Through this office, we are in a position to closely follow and respond effectively to the changing needs of the various European insurance markets. Flagstone Suisse is licensed by the Swiss Financial Market Supervisory Authority, or FINMA, in Switzerland. Flagstone Suisse is also licensed as a permit company registered in Bermuda and is registered as a Class 4 insurer under the Bermuda Insurance Act and complements our Swiss based underwriters with a separately staffed Bermuda underwriting platform. Flagstone Africa writes multiple lines of reinsurance in sub-Saharan Africa. Our research and development efforts and part of our catastrophe modeling and risk analysis team, and part of finance and accounting are based in Hyderābād, India, and our international reinsurance marketing operations are conducted from London, England. Our computer data center is in our Halifax, Canada office, where we also run support services such as accounting, claims, application support, administration, risk modeling, proprietary systems development and high performance computing. The result is an operating platform which provides significant efficiencies in our operations and access to a large and highly qualified staff at a relatively low cost.

Our financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") and our fiscal year ends on December 31. Since a substantial portion of the reinsurance we write provides protection from damages relating to natural and man-made catastrophes, our results depend to a large extent on the frequency and severity of such catastrophic events, and the specific insurance coverages we offer to clients affected by these events. This may result in volatility in our results of operations and financial condition. In addition, the amount of premiums written with respect to any particular line of business may vary from quarter to quarter and year to year as a result of changes in market conditions.

We measure our financial success through long term growth in diluted book value per share plus accumulated distributions measured over intervals of three years, which we believe is the most appropriate measure of our performance, a measure that focuses on the return provided to our common shareholders. Diluted book value per share is obtained by dividing Flagstone shareholders' equity by the number of common shares and common share equivalents outstanding including all potentially dilutive securities such as a warrant, Performance Share Units ("PSUs") and Restricted Share Units ("RSUs").

We derive our revenues primarily from net premiums earned from the reinsurance and insurance policies we write, net of any retrocessional or reinsurance coverage purchased, income from our investment portfolio, and fees for services provided. Premiums are generally a function of the number and type of contracts we write, as well as prevailing market prices. Premiums are normally due in installments and earned over the contract term, which ordinarily is 12 or 24 months.

Income from our investment portfolio is primarily comprised of interest on fixed maturity, short term investments and cash and cash equivalents and dividends, net realized and unrealized gains (losses) on our investment portfolio including our derivative positions, net of investment expenses.

Our expenses consist primarily of the following types: loss and loss adjustment expenses (“LAE”) incurred on the policies of reinsurance and insurance that we sell; acquisition costs which typically represent a percentage of the premiums that we write; general and administrative expenses which primarily consist of salaries, benefits and related costs, including costs associated with awards under our Performance Share Unit Plan (“PSU Plan”) and Restricted Share Unit Plan (“RSU Plan”), and other general operating expenses; interest expense related to our debt obligations; and noncontrolling interest, which represents the interest of external parties with respect to the net income of Mont Fort, Island Heritage, and Flagstone Africa. We are also subject to taxes in certain jurisdictions in which we operate; however, since the majority of our income to date has been earned in Bermuda, a non-taxable jurisdiction, the tax impact on our operations has historically been minimal. The Company has become a Luxembourg tax resident entity due to the Redomestication and it will therefore be subject to Luxembourg corporate income tax, municipal business tax, withholding tax, and net wealth tax. Management will attempt to minimize the income tax impact on the Company through effective tax planning.

Despite an unprecedented number of large international events, we grew diluted book value per share by 12.1% in 2010, inclusive of distributions paid during 2010 of $0.16 per share. Since our founding five years ago, our team has worked diligently to build a platform that seeks to produce quality underwriting opportunities from around the globe. We believe that this diversification, both geographically and by business line, provides us with broad global opportunities. We believe our underwriting performance is a result of our selective underwriting approach coupled with this diversification. However, in 2010, North America experienced relatively fewer catastrophic events relative to the historical average, while the opposite was true internationally, a historical anomaly which we believe negatively impacts our diversified portfolio.

Our written premiums for the year 2010 were $1.1 billion, which is an 11.1% increase from 2009, which we believe is a result of our sourcing as much business as possible and then selecting the risks that meet our stringent pricing targets. We believe the increase in our written premiums is a testament to this strict oversight and our approach to underwriting was implemented with a close eye on cycle management. We believe we have continued to prudently manage our balance sheet and capital levels, and given the market conditions, we have exercised discipline in underwriting and instead allocated capital to share buy-backs in 2010. The Company and its affiliates repurchased $91.9 million of shares in the fourth quarter and $164.3 million of shares during the year, representing 7.6% and 13.6%, respectively, of our January 1, 2010 Flagstone shareholders’ equity.

We believe we remained disciplined throughout 2010, which resulted in benefits to our North American portfolio. At January 1, 2011, North American catastrophe pricing in the market was generally down 7 to 10 percent on a risk adjusted basis, and as such we were content to reduce risk by not renewing underpriced business. The Northeast was among the more disappointing regions and we believe that at current market price levels increasing our number of programs is no longer supportable on a marginal pricing basis. The only region that saw some price increases was the Midwest, driven by programs directly affected by the high tornado and hail loss activity of the past three years. Overall, we expect cycle management to play a key role as the year progresses. The recent catastrophe model changes may partially offset this softening trend and increase demand; however, we expect the large industry loss activity to be the major catalyst for change.

Internationally, the January 1, 2011 renewals saw challenging market conditions, but we believe that the reinsurance market in general has remained disciplined. The business we write in Europe and South Africa was stable in 2010 and we were able to maintain our price levels as we continue to manage our portfolio. Furthermore, due to the recent losses in Australasia, we saw significant increases on rates in that region in 2010. Lastly, the specialty business was mixed with some areas such as the marine and energy markets as well as our engineering business showing improved pricing and good submission flow.

Critical Accounting Estimates

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

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

Loss and Loss Adjustment Expense Reserves

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

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

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

For a breakdown of reserves for losses and loss adjustment expenses refer to Note 8 "Loss and Loss Adjustment Expense Reserves" and Note 9 "Reinsurance" in Item 8, "Financial Statements and Supplementary Data" of this Annual Report.

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

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

For reinsurance written on an excess of loss basis, which represents approximately 66.2%, 72.0% and 65.0% of the premiums we wrote for the years ended December 31, 2010, 2009 and 2008, respectively, our exposure is limited by the fact that most treaties have a defined limit of liability arising from a single loss event. Once the limit has been reached, we have no further exposure to additional losses from that relevant treaty for the same loss event. For reinsurance on a pro rata basis, we typically have event caps so these liabilities are contained.

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

For our property catastrophe policies which comprise 43.2%, 47.4% and 58.5% of our total gross premiums written for the years ended December 31, 2010, 2009 and 2008, respectively, and other catastrophe policies, we initially establish our loss reserves based on loss payments and case reserves reported by ceding companies. We then add to these case reserves our estimates for IBNR. To establish our IBNR estimates, in addition to the loss information and estimates communicated by cedents, we use industry information, knowledge of the business written by us, management's judgment and general market trends observed from our underwriting activities.

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

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

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

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

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

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

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

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

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

Our critical underlying assumptions are:

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

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All of our critical assumptions can be thought of as key assumptions in the sense that they can have a material impact on the adequacy of our reserves. In general, the various actuarial techniques we use assume that loss reporting and payment patterns in the future can be estimated from past experience. Future payment and reporting patterns could differ from historical experience. In practice it is difficult to be precise on the effect of each assumption. However, due to a greater potential for estimation error, and thus greater volatility, our reserves may be more sensitive to the effects of deviations from assumptions (iv), (v) and (vi) above than the other assumptions.

Our reserving methodology, as discussed above, uses a loss reserving model that calculates a point estimate for our ultimate losses, as opposed to a methodology that develops a range of estimates. We then use this point estimate, deducting cumulative paid claims and current case reserves, to record our estimate of IBNR.

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

For our non-catastrophe business, the key factors used to arrive at our best estimate of loss and loss adjustment expense reserves are the expected loss ratios, rate of loss cost inflation, selection of benchmarks and reported and paid loss emergence patterns. Our reporting patterns and expected loss ratios were based on either benchmarks or historical reporting patterns. The benchmarks selected are those that we believe are most similar to our underwriting business. There was no material change in any of these key factors during the year ended December 31, 2010.

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

During the year ended December 31, 2010, the losses on our catastrophe business were primarily from the Chile earthquake ($62.2 million), the Deepwater Horizon oil rig explosion ($41.3 million), the New Zealand earthquake ($75.5 million) and the Australian floods ($10.0 million). During the year ended December 31, 2009, the significant losses on our catastrophe business were primarily from a series of small catastrophe events and one significant event, floods in Ireland ($13.6 million). During the year ended December 31, 2008, the significant losses on our catastrophe business were as follows: Hurricane Ike ($158.4 million), Hurricane Gustav ($14.5 million), Chinese winter storms ($18.2 million) and the U.S. Memorial Day Weekend storms ($11.1 million). Because we expect a small volume of large claims, we believe the variability in our catastrophe related loss ratio could be relatively large. Claims from catastrophic events could reduce our earnings and cause substantial volatility in our results of operations for any fiscal quarter or year which could adversely affect our financial condition and liquidity position.

A significant component of our loss ratio relates to non-catastrophe business for the years ended December 31, 2010, 2009 and 2008. As we commonly write net lines of non-catastrophe business exceeding $10.0 million, we expect that the ultimate loss ratio for non-catastrophe business could vary significantly from our initial loss ratios. Thus, a 10%

increase or decrease in loss ratios for non-catastrophe business is reasonably likely to occur and, for the years ended December 31, 2010, 2009 and 2008, this would have resulted in an approximate increase or decrease in our net income or shareholders' equity of approximately $29.1 million, $27.7 million and $21.4 million, respectively.

Premiums and Acquisition Costs

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

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

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

For pro rata contracts, gross premiums written and related acquisition costs are normally estimated on a quarterly basis based on discussions with ceding companies, together with historical experience and management’s judgment. Premiums written on pro rata contracts are earned over the risk periods of the underlying policies issued and renewed. As a result, the earning pattern of pro rata contracts may extend up to 24 months. This is generally twice the contract period due to the fact that some of the underlying exposures may attach towards the end of our contracts (i.e., risks attaching basis), and such underlying exposures generally have a one year coverage period. Total premiums written and earned on our pro rata business for the year ended December 31, 2010 were $288.5 million (26.3%), and $222.1 million (26.1%), respectively, for the year ended December 31, 2009 were $220.6 million (22.3%), and $213.0 million (28.1%), respectively and were $195.0 million (24.9%), and $159.7 million (24.4%), respectively, for the year ended December 31, 2008. Total earned acquisition costs estimated on pro rata contracts for the year ended December 31, 2010, 2009 and 2008 were $61.8 million (37.5%), $64.2 million (47.0%) and $41.9 million (39.6%), respectively. On a quarterly basis, we track the actual premium received and acquisition costs incurred and compare this to the estimates previously booked. Such estimates are subject to adjustment in subsequent periods when actual figures are recorded.

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

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

Investments

In accordance with the Financial Instruments Topic of the FASB ASC, we elect the fair value option for all fixed maturity and short term investments, equity investments (excluding investments accounted for under the equity method of accounting), investment funds, and catastrophe bonds. We also apply the Fair Value Measurements and Disclosures Topic of the FASB ASC.

We elected to use the fair value option because we focus on the total return of our portfolio. Any movement in unrealized gains and losses is recorded within net realized and unrealized gains (losses) within the consolidated statements of operations and comprehensive income (loss).

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

Fair value disclosure

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

Fixed maturity, short term, equity and other investments

In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, we determined that investments in U.S. government treasury securities and listed equity securities are classified as Level 1 fair value as determined by the quoted market price of these securities, as provided either by independent pricing services or exchange market prices. The U.S. government treasury securities represented 12.1% of our total fixed maturities portfolio.

Investments in U.S. government agency securities, corporate bonds, mortgage-backed securities, foreign government bonds and asset-backed securities are classified as Level 2 fair value. The fair value of these securities is derived from broker quotes based on inputs that are observable for the asset, either directly or indirectly, such as yield curves and transactional history. Catastrophe bonds are classified as Level 2 fair value as determined by reference to broker indications. Those indications are based on current market conditions, including liquidity and transactional history, recent issue price of similar catastrophe bonds and seasonality of the underlying risks.

Investments in private equity funds and mortgage-backed investment funds are classified as Level 3 in the fair value hierarchy. The fair value of the private equity funds is determined by the investment fund managers using the net asset value provided by the administrator or manager of the funds on a quarterly basis and adjusted based on analysis and discussions with the fund managers. The fair value of the mortgage-backed investment fund is determined by the net asset valuation provided by the independent administrator of the fund. These valuations are then adjusted for cash flows since the most recent valuation, which is a methodology generally employed in the investment industry.

At December 31, 2010, the fair value of the securities classified as Level 3 under the Fair Value Measurements and Disclosures Topic of the FASB ASC was $40.0 million, or approximately 2.5% of total investment assets measured at fair value. We do not carry investments accounted for under the equity method at fair value. Refer to Note 7 “Investments” in Item 8, “Financial Statements and Supplementary Data” of this Annual Report for a breakdown of the fair value measurements.

Pricing Services

At December 31, 2010, pricing for all of our fixed maturities, excluding U.S. government securities, was based on prices provided by nationally recognized independent pricing services. Generally, pricing services provide pricing for less-complex, liquid securities based on market quotations in active markets. For fixed maturities that do not trade on a listed exchange, these pricing services may use matrix pricing consisting of observable market inputs to estimate the fair value of a security. These observable market inputs include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-side markets, benchmark securities, bids, offers, reference data, and industry and economic factors. Additionally, pricing services may use a valuation model such as an option adjusted spread model commonly used for estimating fair values of mortgage-backed and asset-backed securities. At December 31, 2010, we have not adjusted any pricing provided by independent pricing services.

Broker-Dealers

In some cases, we obtain a minimum of two quotes directly from broker-dealers who actively trade in the corresponding markets when prices are unavailable from independent pricing services. This may also be the case if the pricing from these pricing services is not reflective of current market levels. At December 31, 2010, there were no fixed maturities priced using non-binding broker quotes. Generally, broker-dealers value securities through their trading desks based on observable market inputs. Their pricing methodologies include mapping securities based on trade data, bids or offers, observed spreads and performance on newly issued securities. They may also establish pricing through observing secondary trading of similar securities. All broker quotes are reviewed by the investment managers to determine if they reflect the fair value of the securities by comparing them to both internal models and the valuation of comparable securities. The evaluation of whether or not actual transactions in the current financial markets represent distressed sales requires significant management judgment. We do not believe quotes received from broker-dealers reflect distressed transactions that would warrant an adjustment to fair value.

Derivative instruments

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

At December 31, 2010, the fair value of the derivative instruments classified as Level 3 under the Fair Value Measurements and Disclosures Topic of the FASB ASC was $(0.2) million. Refer to Note 10 "Derivatives" in Item 8, "Financial Statements and Supplementary Data" of this Annual Report for a breakdown of the fair value measurements.

Share Based Compensation

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

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

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

The total number of PSUs outstanding under the PSU Plan at December 31, 2010, 2009 and 2008 were 3,998,558, 3,305,713 and 2,189,982, respectively (or up to 5,751,765 common shares at December 31, 2010, should the maximum factor for each of the performance periods apply). Taking into account the results to date and the expected results for the remainder of the performance periods, we have established the most probable factor at 100%, with the exception of one series which has been established to have the most probable factor of 150%. As such, the expected number of common shares to be issued under the plan is 3,998,558 at December 31, 2010. As at December 31, 2010, 2009 and 2008, there was a total of $12.2 million, $19.4 million and $21.0 million, respectively, of unrecognized compensation cost related to non-vested PSUs, the cost of which is expected to be recognized over a period of approximately 1.5 years, 1.6 years and 2.5 years, respectively.

New Accounting Pronouncements

In October 2010, the FASB issued Accounting Standards Update No. 2010-26, “Financial Services and Insurance (Topic 944) – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts” (“ASU 2010-26”). The objective of ASU 2010-26 is to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. ASU 2010-26 is effective for interim and annual periods beginning after December 15, 2011. The adoption of ASU 2010-26 is not expected to have a material impact on the consolidated results of operations and financial condition.

In December 2010, the FASB issued Accounting Standards Update No. 2010-28, “Intangibles – Goodwill and Other (Topic 350) – When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts” (“ASU 2010-28”). This update modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists, regardless of whether the carrying amount of the reporting unit is zero or negative. For public entities, this update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted. The adoption of ASU 2010-28 is not expected to have a material impact on the consolidated results of operations and financial condition.

In December 2010, the FASB issued Accounting Standards Update No. 2010-29, “Business Combinations (Topic 805) – Disclosures of Supplementary Pro Forma Information for Business Combinations” (“ASU 2010-29”). This update specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The update also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU 2010-29 is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning after December 15, 2010. Early adoption is permitted. The adoption of ASU 2010-29 is not expected to have a material impact on the consolidated results of operations and financial condition.

Recent Developments

In January 2011, following the December 2010 Queensland floods subsequent flooding occurred in large areas of Australia; and on February 3, 2011, Cyclone Yasi hit Northern Queensland, Australia. These 2011 events are expected to have a net impact the Company's first quarter 2011 financial results of between $60 million to $80 million.

On February 22, 2011, a powerful 6.3 magnitude earthquake struck Christchurch, New Zealand, causing widespread damage and business interruption. This event is expected to cause sizeable losses to the insurance industry. The Company has commenced the estimation process for expected claims relating to its exposures from these events but believes it is too early to issue an estimate of claims given the significant unknowns and early stages of the claims reporting process.

Results of Operations

The following is a discussion and analysis of our financial condition as at December 31, 2010 and 2009 and our results of operations for the years ended December 31, 2010, 2009 and 2008.

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

	For the years ended December 31,			
U.S. dollar (weakened) strengthened against:	2010		2009	
Canadian dollar	(5.4)	%	(17.8)	%
Swiss franc	(10.6)	%	(3.0)	%
Euro	6.9	%	(3.2)	%
British pound sterling	3.5	%	(12.3)	%
Indian rupee	(4.1)	%	(4.7)	%
South African rand	(11.8)	%	(25.5)	%

Summary Overview

We generated $97.1 million of net income in 2010, compared to a net income of $242.2 million and net loss of $187.3 million in 2009 and 2008, respectively. As highlighted in the tables below, the two most significant items impacting our 2010 financial performance compared to 2009 and 2009 compared to 2008 include: (1) A decrease in underwriting income due to significant catastrophe losses (net of reinsurance and reinstatements) in the year 2010 compared to 2009. The main loss events in the year ended December 31, 2010 which caused the decrease are the Chile earthquake ($62.2 million; Reinsurance segment - $57.3 million, Lloyd's segment $4.9 million), which occurred in the first quarter; the Deepwater Horizon oil rig explosion ($41.5 million; Reinsurance segment - $27.5 million, Lloyd's segment $14.0 million), which occurred in the second quarter; the New Zealand earthquake ($75.5 million; Reinsurance segment - $74.2 million, Lloyd's segment $1.3 million), which occurred during the third quarter; a number of losses in Australia during 2010 covered under an aggregate excess cover (Reinsurance segment - $25.0 million) and the Queensland floods (Reinsurance segment - $10.0 million), the first of which occurred in the fourth quarter. As described in the year to date reinsurance segment discussion below, $22.9 million of loss expenses related to the Deepwater Horizon oil rig during the second quarter relate to losses incurred by Mont Fort. Although such loss expenses are consolidated within our results, they do not impact Flagstone's net income as they are attributable to the noncontrolling interest; and (2) a significant increase in 2009 in net realized and unrealized gains (losses) - investments primarily due to recoveries from the significant declines in the global equity, bond and commodities markets in 2008, attributable to the broader deterioration and volatility in the credit markets and financial markets and the lingering impact of the sub-prime crisis, partially offset by a decrease in net investment income in 2009 resulting from lower interest rates.

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The following sets forth financial highlights for the years ended December 31, 2010 and 2009:

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Underwriting income	$ 10,563	$ 210,813	$ (200,250)	(95.0)%
Net investment income	$ 31,482	$ 28,531	$ 2,951	10.3 %
Net realized and unrealized gains - investments	$ 43,769	$ 39,668	$ 4,101	10.3 %
Net realized and unrealized gains - other	$ 14,441	$ 11,253	$ 3,188	28.3 %
Net income attributable to Flagstone	$ 97,084	$ 242,192	$ (145,108)	(59.9)%
Net income attributable to Flagstone per common share - Basic	$ 1.23	$ 2.87	$ (1.64)	
Net income attributable to Flagstone per common share - Diluted(1)	$ 1.23	$ 2.87	$ (1.64)	
Loss ratio	62.2 %	37.3 %		
Expense ratio	39.4 %	37.4 %		
Combined ratio	101.6 %	74.7 %		

	As at December 31,			
	2010	2009	$ Change	% Change
Basic book value per common share	$ 16.48	$ 14.56	$ 1.92	13.2 %
Diluted book value per common share	$ 15.51	$ 13.97	$ 1.54	11.0 %
Diluted book value per common share plus accumulated distributions(2)	$ 16.07	$ 14.36	$ 1.71	11.9 %

The following table sets forth financial highlights for the years ended December 31, 2009 and 2008:

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Underwriting income	$ 210,813	$ 73,385	$ 137,428	187.3 %
Net investment income	$ 28,531	$ 51,398	$ (22,867)	(44.5)%
Net realized and unrealized gains (losses) - investments	$ 39,668	$ (272,206)	$ 311,874	(114.6)%
Net realized and unrealized gains - other	$ 11,253	$ 11,617	$ (364)	(3.1)%
Net income (loss) attributable to Flagstone	$ 242,192	$ (187,302)	$ 429,494	(229.3)%

Net income (loss) attributable to Flagstone per common share - Basic	$ 2.87	$ (2.20)	$ 5.07	
Net income (loss) attributable to Flagstone per common share - Diluted(1)	$ 2.87	$ (2.20)	$ 5.07	
Loss ratio	37.3 %	58.1 %		
Expense ratio	37.4 %	31.3 %		
Combined ratio	74.7 %	89.4 %		

	As at December 31,			
	2009	2008	$ Change	% Change
Basic book value per common share	$ 14.56	$ 11.61	$ 2.95	25.4 %
Diluted book value per common share	$ 13.97	$ 11.30	$ 2.67	23.6 %
Diluted book value per common share plus accumulated distributions(2)	$ 14.36	$ 11.53	$ 2.83	24.5 %

(1)Net income (loss) attributable to Flagstone per common share - Diluted for years ended December 31, 2010, 2009 and 2008 does not contain the effect of:

a. a warrant conversion as this would be anti-dilutive for U.S. GAAP purposes

b. the PSU conversion until the end of the performance period, when the number of shares issuable under the PSU Plan will be known. There were 3,998,558 PSU's expected to vest under the PSU plan as at December 31, 2010.

(2)Distributions paid per common share are in the form of a non-dividend return of capital. Prior to the Redomestication, such distributions were in the form of dividends.

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Non-GAAP Reconciliation

In addition to the U.S. GAAP financial measures set forth in this Annual Report, we have presented “basic book value per common share” and “diluted book value per common share”, which are non-GAAP financial measures. Our management uses growth in diluted book value per common share as a prime measure of the value we are generating for our common shareholders, as we believe that growth in our diluted book value per common share ultimately translates into growth in our stock price.

Basic book value per common share is defined as total Flagstone shareholders’ equity divided by the number of common shares outstanding at the end of the period plus vested restricted share units, giving no effect to dilutive securities. Diluted book value per common share is defined as total Flagstone shareholders’ equity divided by the number of common shares and common share equivalents outstanding at the end of the period including all potentially dilutive securities such as a warrant, PSUs and RSUs. When the effect of securities would be anti-dilutive, these securities are excluded from the calculation of diluted book value per common share. A warrant was anti-dilutive and was excluded from the calculation of diluted book value per common share as at December 31, 2010 and 2009.

While the Company and its management believe that these non-GAAP financial measures provide useful supplemental information to investors, there are limitations associated with the use of these non-GAAP financial measures. Basic book value per common share does not reflect the number of common shares that may be issued upon vesting or exercise of dilutive securities. On the other hand, by giving effect to dilutive securities, diluted book value per common share takes into account common share equivalents and not just the number of common shares actually outstanding. These non-GAAP financial measures are not prepared in accordance with GAAP, are not based on any comprehensive set of accounting rules or principles, are not reported by all of Flagstone’s competitors and may not be directly comparable to similarly titled measures of Flagstone’s competitors due to potential differences in the exact method of calculation. In light of these limitations, Flagstone uses these non-GAAP financial measures only as supplements to GAAP financial measures and provides a reconciliation of the non-GAAP financial measures to their most comparable GAAP financial measures.

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	As at December 31, 2010		2009	
Flagstone shareholders' equity	$	1,134,733	$	1,211,018
Potential net proceeds from assumed:				
Exercise of PSU (1)		-		-
Exercise of RSU (1)		-		-
Conversion of warrant (2)		-		-
Diluted Flagstone shareholders' equity	$	1,134,733	$	1,211,018
Cumulative distributions paid per outstanding common share (3)	$	0.56	$	0.40
Common shares outstanding - end of period		68,585,588		82,985,219
Vested RSUs		262,013		205,157
Total common shares outstanding - end of period		68,847,601		83,190,376
Potential shares to be issued:				
PSUs expected to vest		3,998,558		3,305,713
RSUs outstanding		315,200		168,000
Conversion of warrant (2)		-		-
Common shares outstanding - diluted		73,161,359		86,664,089
Basic book value per common share	$	16.48	$	14.56
Diluted book value per common share	$	15.51	$	13.97
Basic book value per common share plus accumulated distributions	$	17.04	$	14.96
Diluted book value per common share plus accumulated distributions	$	16.07	$	14.36
Distributions per common share paid during the period (3)	$	0.16	$	0.16

(1)No proceeds due when exercised
(2)Below strike price - not dilutive
(3)Distributions paid per common share are in the form of a non-dividend return of capital. Prior to the Redomestication, such distributions were in the form of dividends.

Comparison of Years Ended December 31, 2010, 2009 and 2008

Underwriting Results by Segment

Our management views us as being organized into three reportable segments: Reinsurance, Lloyd's and Island Heritage (previously referred to as the Insurance segment until January 1, 2010). The Lloyd's segment includes the business generated through the Lloyd's Syndicate 1861 and FSML. Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As such, there are no comparative numbers for 2008. We regularly review our financial results and assess performance on the basis of these three reporting segments in accordance with the Segment Reporting Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC").

Those segments are more fully described as follows:

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Reinsurance

Our Reinsurance segment has three main units:

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

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

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

Lloyd's

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

Island Heritage

Island Heritage is a property and casualty insurer based in the Cayman Islands which is primarily in the business of insuring homes, condominiums, office buildings and automobiles in the Caribbean region.

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The following tables provide a summary of gross and net written and earned premiums, underwriting results, total assets, and ratios for each of our business segments for the years ended December 31, 2010, 2009 and 2008:

	For the year ended December 31, 2010				
	Reinsurance	Lloyd's	Island Heritage	Inter-segment Eliminations (1)	Total
Gross premiums written	$ 861,388	$ 187,420	$ 90,896	$ (41,854)	$ 1,097,850
Premiums ceded	(150,820)	(24,450)	(80,580)	41,854	(213,996)
Net premiums written	710,568	162,970	10,316	-	883,854
Net premiums earned	$ 697,614	$ 145,246	$ 9,224	$ -	$ 852,084
Other related income	3,817	13,566	23,343	(15,598)	25,128
Loss and loss adjustment expenses	(413,005)	(115,711)	(1,420)	-	(530,136)
Acquisition costs	(127,498)	(34,818)	(18,102)	15,598	(164,820)
General and administrative expenses	(136,249)	(26,144)	(9,300)	-	(171,693)
Underwriting income (loss)	$ 24,679	$ (17,861)	$ 3,745	$ -	$ 10,563
Loss ratio (2)	59.2 %	79.7 %	4.4 %		62.2 %
Acquisition cost ratio (2)	18.3 %	24.0 %	55.6 %		19.3 %
General and administrative expense ratio (2)	19.5 %	18.0 %	28.6 %		20.1 %
Combined ratio (2)	97.0 %	121.7 %	88.6 %		101.6 %
Total assets	$ 2,351,967	$ 273,454	$ 93,781		$ 2,719,202
Reconciliation:					
Underwriting income					$ 10,563
Net investment income					31,482
Net realized and unrealized gains - investments					43,769
Net realized and unrealized gains - other					14,441
Other income					417
Interest expense					(10,352)
Net foreign exchange losses					(4,719)
Income before income taxes and interest in earnings of equity investments					$ 85,601

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	For the year ended December 31, 2009				
	Reinsurance	Lloyd's	Island Heritage	Inter-segment Eliminations (1)	Total
Gross premiums written	$ 796,984	$ 145,889	$ 84,239	$ (38,621)	$ 988,491
Premiums ceded	(140,850)	(18,504)	(75,289)	38,621	(196,022)
Net premiums written	656,134	127,385	8,950	-	792,469
Net premiums earned	$ 689,544	$ 62,130	$ 6,781	$ -	$ 758,455
Other related income	3,622	8,749	20,968	(14,187)	19,152
Loss and loss adjustment expenses	(241,358)	(40,847)	(980)	-	(283,185)
Acquisition costs	(121,837)	(14,608)	(14,213)	14,187	(136,471)
General and administrative expenses	(119,555)	(15,904)	(11,679)	-	(147,138)
Underwriting income (loss)	$ 210,416	$ (480)	$ 877	$ -	$ 210,813
Loss ratio (2)	35.0 %	65.7 %	3.5 %		37.3 %
Acquisition cost ratio (2)	17.7 %	23.5 %	51.2 %		18.0 %
General and administrative expense ratio (2)	17.3 %	25.6 %	42.1 %		19.4 %
Combined ratio (2)	70.0 %	114.8 %	96.8 %		74.7 %
Total assets	$ 2,298,821	$ 177,355	$ 90,592		$ 2,566,768
Reconciliation:					
Underwriting income					$ 210,813
Net investment income					28,531
Net realized and unrealized gains - investments					39,668
Net realized and unrealized gains - other					11,253
Other income					2,576
Interest expense					(12,105)
Net foreign exchange losses					(3,231)
Income before income taxes and interest in earnings of equity investments					$ 277,505

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	For the year ended December 31, 2008			
	Reinsurance	Island Heritage	Inter-segment Eliminations (1)	Total
Gross premiums written	$ 740,169	$ 76,926	$ (35,206)	$ 781,889
Premiums ceded	(46,638)	(75,759)	35,206	(87,191)
Net premiums written	693,531	1,167	-	694,698
Net premiums earned	$ 641,500	$ 12,668	$ -	$ 654,168
Other related income	305	13,247	(9,691)	3,861
Loss and loss adjustment expenses	(377,228)	(2,656)	-	(379,884)
Acquisition costs	(101,528)	(13,897)	9,691	(105,734)
General and administrative expenses	(90,026)	(9,000)	-	(99,026)
Underwriting income	$ 73,023	$ 362	$ -	$ 73,385
Loss ratio (2)	58.8 %	10.2 %		58.1 %
Acquisition cost ratio (2)	15.8 %	53.6 %		16.2 %
General and administrative expense ratio (2)	14.0 %	34.7 %		15.1 %
Combined ratio (2)	88.6 %	98.5 %		89.4 %
Total assets	$ 2,167,853	$ 48,117		$ 2,215,970

Reconciliation:	
Underwriting income	$ 73,385
Net investment income	51,398
Net realized and unrealized losses - investments	(272,206)
Net realized and unrealized gains - other	11,617
Other income	4,354
Interest expense	(18,297)
Net foreign exchange losses	(21,477)
Loss before taxes and interest in earnings of equity investments	$ (171,226)

(1)Inter-segment eliminations relate to Flagstone Suisse quota share arrangements with Island Heritage and beginning in 2009, also with Lloyd's
(2)For Island Heritage segment all ratios calculated using expenses divided by net premiums earned plus other related income.

Gross Premiums Written

Gross reinsurance premiums written in our Reinsurance segment of $861.4 million ($819.5 million net of intercompany reinsurance with Island Heritage and Lloyd's), $797.0 million ($758.4 million net of intercompany reinsurance with Island Heritage and Lloyd's), and $740.2 million ($705.0 million net of intercompany reinsurance with Island Heritage) for the years ended December 31, 2010, 2009, and 2008, respectively, were primarily driven by excess of loss reinsurance contracts, generally with a twelve-month term, which for the years ended December 31, 2010, 2009, and 2008 accounted for $542.9 million (66.3 % of gross premiums written), $545.8 million (72.0 % of gross premiums written), and $509.9 million (65.2% of gross premiums written), respectively. Gross premiums written relating to our Island Heritage segment primarily relate to a select property insurance portfolio in the Caribbean region. Intercompany reinsurance relates to quota share and excess of loss reinsurance arrangements between Flagstone Suisse, Island Heritage and Lloyd's. As mentioned above, our Lloyd's segment began writing business for the benefit of Flagstone effective January 1, 2009, primarily providing property and short-tail specialty and casualty insurance and reinsurance for risks such as energy, hull and cargo, marine liability, engineering and aviation.

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

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

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

	For the years ended December 31,					
	2010		2009		2008	
	Gross premiums written	Percentage of total	Gross premiums written(5)	Percentage of total	Gross premiums written	Percentage of total
Line of business						
Reinsurance and Lloyd's (1)						
Property catastrophe	$ 474,501	43.2 %	$ 468,158	47.4 %	$ 457,549	58.5 %
Property	259,006	23.6 %	202,378	20.5 %	94,706	12.1 %
Short-tail specialty and casualty	273,447	24.9 %	233,716	23.6 %	152,708	19.5 %
Island Heritage						
Insurance	90,896	8.3 %	84,239	8.5 %	76,926	9.9 %
Total	$ 1,097,850	100.0 %	$ 988,491	100.0 %	$ 781,889	100.0 %

	For the years ended December 31,					
	2010		2009		2008	
	Gross premiums written	Percentage of total	Gross premiums written(5)	Percentage of total	Gross premiums written	Percentage of total
Geographic area of risk insured (2)						
Caribbean(3)	$ 105,327	9.6 %	$ 94,483	9.6 %	$ 88,482	11.3 %
Europe	144,217	13.1 %	123,938	12.5 %	104,185	13.4 %
Japan and Australasia	67,995	6.2 %	59,466	6.0 %	47,866	6.1 %
North America	440,728	40.1 %	391,758	39.6 %	359,684	46.0 %
Worldwide risks (4)	252,997	23.0 %	237,207	24.0 %	153,442	19.6 %
Other	86,586	8.0 %	81,639	8.3 %	28,230	3.6 %
Total	$ 1,097,850	100.0 %	$ 988,491	100.0 %	$ 781,889	100.0 %

(1)Gross premiums written relating to Lloyd's segment are primarily included in property and short-tail specialty and casualty.
(2)Except as otherwise noted, each of these categories includes contracts that cover risks located primarily in the designated geographic area.
(3)Includes gross premiums written related to Island Heritage segment.
(4)Includes contracts that cover risks in two or more geographic zones.
(5)Gross premiums written in 2009 have been reclassified to conform to current year presentation.

Reinsurance Segment

Overview

2010 versus 2009

The net underwriting income for the Reinsurance segment for the year ended December 31, 2010 amounted to $24.7 million as compared to $210.4 million for the year ended December 31, 2009. The decrease in net underwriting income for the Reinsurance segment is primarily related to incurred losses on more significant catastrophic events in 2010, such as the Queensland floods and aggregate cover losses in Australia which occurred in the fourth quarter, the New Zealand earthquake, which occurred in the third quarter, Deepwater Horizon loss, which occurred in the second quarter and the net losses on the first quarter Chile earthquake, as compared to 2009.

2009 versus 2008

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

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

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Gross Premiums Written

a. Property Catastrophe Reinsurance

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

b. Property Reinsurance

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

c. Short-tail Specialty and Casualty Reinsurance

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

Premiums Ceded

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

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

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

Net Premiums Earned

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

Underwriting Expenses

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

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

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a. Loss and Loss Adjustment Expenses

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

losses paid, which are actual cash payments to insureds, net of recoveries, if any, from our own reinsurers;

movement in outstanding loss or case reserves, which represent the change in management's best estimate of the likely settlement amount for reported claims, less the portion that can be recovered from reinsurers; and

movement in IBNR reserves, which are reserves established by us for claims that are not yet reported but can reasonably be expected to have occurred based on industry information, management's experience and actuarial evaluation, less expected recoveries from reinsurers, if any.

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

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

b. Acquisition Costs

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

c. General and Administrative Expenses

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

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Below is a summary of the underwriting results and ratios for our Reinsurance segment for the years ended December 31, 2010 and 2009:

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Property catastrophe reinsurance	$ 512,466	$ 503,006	$ 9,460	1.9 %
Property reinsurance	173,585	142,182	31,403	22.1 %
Short tail specialty and casualty reinsurance	175,337	151,796	23,541	15.5 %
Gross premiums written	861,388	796,984	64,404	8.1 %
Premiums ceded	(150,820)	(140,850)	(9,970)	7.1 %
Net premiums written	710,568	656,134	54,434	8.3 %
Net premiums earned	697,614	689,544	8,070	1.2 %
Other related income	3,817	3,622	195	5.4 %
Loss and loss adjustment expenses	(413,005)	(241,358)	(171,647)	71.1 %
Acquisition costs	(127,498)	(121,837)	(5,661)	4.6 %
General and administrative expenses	(136,249)	(119,555)	(16,694)	14.0 %
Underwriting income	$ 24,679	$ 210,416	$ (185,737)	(88.3)%
Loss ratio	59.2 %	35.0 %		
Acquisition cost ratio	18.3 %	17.7 %		
General and administrative expense ratio	19.5 %	17.3 %		
Combined ratio	97.0 %	70.0 %		

- The decrease in net underwriting results is primarily related to incurred losses on more significant catastrophic events in 2010, such as the Australian floods and aggregate cover, the New Zealand earthquake, Deepwater Horizon and the Chile earthquake, as compared to 2009, and to the increase in general and administrative expenses which is related to asset impairment charges.

- The increase in gross property and short tail specialty and casualty reinsurance premiums written is primarily due to increased business with existing clients and the addition of new clients.

- Premiums ceded were 17.5% of gross reinsurance premiums written compared to 17.7% for the same period in 2009.

- The increase in the loss ratio was primarily due to more significant losses from catastrophic events in the current year compared to last year, including net incurred losses related to the Queensland floods ($10.0 million), the New Zealand earthquake ($74.2 million), the Chile earthquake ($64.0 million), Deepwater Horizon oil rig ($27.5 million) and a number of events impacting an Australia aggregate cover ($25.0 million), The Deepwater Horizon loss is driven by an ILW loss of $25.0 million, approximately 91.0% of which is attributable to Mont Fort. While such loss expenses are consolidated within our results, they do not impact Flagstone's net income as they are attributable to the noncontrolling interest. The loss (net of recoveries and reinstatement premiums) to Flagstone's reinsurance segment from the Deepwater Horizon rig was $4.4 million.

- Each quarter we revisit our loss estimates for previous loss events. During the year ended December 31, 2010, based on updated estimates provided by clients and brokers, we recorded net favorable developments for prior accident years of $11.1 million. During the year ended December 31, 2009, the net favorable developments for prior catastrophe events were $6.6 million.

- The increase in general and administrative expenses is mainly attributable to charges of $15.0 million related to our decision to sell corporate aircraft ($13.6 million of impairment charge related to assets held for sale and $1.4 million loss on sale) and an impairment charge of $1.1 million for intangible assets.

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Below is a summary of the underwriting results and ratios for our Reinsurance segment for the years ended December 31, 2009 and 2008:

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Property catastrophe reinsurance	$ 503,006	$ 492,755	$ 10,251	2.1 %
Property reinsurance	142,182	94,706	47,476	50.1 %
Short tail specialty and casualty reinsurance	151,796	152,708	(912)	(0.6)%
Gross premiums written	796,984	740,169	56,815	7.7 %
Premiums ceded	(140,850)	(46,638)	(94,212)	202.0 %
Net premiums written	656,134	693,531	(37,397)	(5.4)%
Net premiums earned	689,544	641,500	48,044	7.5 %
Other related income	3,622	305	3,317	1,087.7 %
Loss and loss adjustment expenses	(241,358)	(377,228)	135,870	(36.0)%
Acquisition costs	(121,837)	(101,528)	(20,309)	20.0 %
General and administrative expenses	(119,555)	(90,026)	(29,529)	32.8 %
Underwriting income	$ 210,416	$ 73,023	$ 137,393	188.2 %
Loss ratio	35.0 %	58.8 %		
Acquisition cost ratio	17.7 %	15.8 %		
General and administrative expense ratio	17.3 %	14.0 %		
Combined ratio	70.0 %	88.6 %		

- The increase in property catastrophe premiums written of $10.3 million, excluding the impact of acquisitions, or 2.1%, is primarily due to hardening of prices in the property catastrophe market partially offset by our non-renewal of certain treaties that no longer met our profitability objectives.

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

- Gross property premiums written for the year ended December 31, 2009 were $142.2 million ($117.9 million excluding acquisitions in 2008), compared to $94.7 million ($89.6 million excluding acquisitions in 2008) for the year ended December 31, 2008, an increase of $28.3 million, or 31.6%, excluding the impact of acquisitions. The increase is primarily due to an increase in proportional property premiums due to new business as well as increased shares by existing clients. The acquisitions of Flagstone Africa and Flagstone Alliance during 2008, which were not subsidiaries for the full twelve month period in 2008, contributed $24.3 million for the year ended December 31, 2009 compared to $5.1 million for the year ended December 31, 2008.

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

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

- As the levels of net premiums written increase, the levels of net premiums earned also increase. The increase in reinsurance net premiums earned is primarily due to ongoing growth in premium writings, partially offset by the increase in premiums ceded.

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

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

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

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

2011 Outlook

North American
At January 1, 2011, we saw North American catastrophe pricing generally down 7 to 10 percent on a risk adjusted basis, and as such we were content to reduce risk by not renewing underpriced business. The Northeast was among the more disappointing regions and we believe it has reached a point where an increasing number of programs is no longer supportable on a marginal pricing basis. The only region that saw some price increases was the Midwest, driven by programs directly affected by the high tornado and hail loss activity of the past three years. Overall, we expect cycle management to play a key role as the year progresses. The recent catastrophe model changes may partially offset this softening trend and increase demand; however, large industry loss activity will likely be the major catalyst for change.

Specialty Lines
Treaty and direct and facultative specialty all remain mixed. Construction and engineering has seen increased opportunities as major construction projects return to the pre 2008 levels. Marine and energy has seen positive change following the Deep Horizon loss but capacity appears to remain plentiful so we cannot predict whether or if the terms and conditions will remain at current levels. Marine hull rates continue to soften, albeit modestly. Aviation, with the exception of treaty excess of loss, remains very challenging with significant over capacity in all aviation segments. Property facultative rates continue their decline and we expect the same to continue in 2011.

International
Internationally, the January 1, 2011 renewals saw challenging market conditions but we believe that the reinsurance market in general has remained disciplined. In line with North America, our main International catastrophe unit in Bermuda saw aggregate reduction in exposure of approximately 10%, although overall premium levels were flat due to price increases on loss affected programs. The business we write in Europe and South Africa was stable and we were able to maintain our price levels as we continue to optimize our portfolio. Latin America and Asia in general remained competitive with new capacity appearing and causing pricing and conditions to generally remain

unattractive. Furthermore, due to the recent losses in Australasia, a positive development was the significant increase on rates in that region.

Lloyd's Segment

Overview

Syndicate 1861 began writing business for the benefit of Flagstone effective January 1, 2009. As a result, there are no comparative numbers for 2008. Due to the start-up nature of the 2009 year of account for Syndicate 1861, the level of earned premium income has gradually ramped up with new business writings, placing strain on the underwriting results as we have incurred expenses for the full periods.

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

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Below is a summary of the underwriting results and ratios for our Lloyd's segment for the years ended December 31, 2010 and 2009:

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Property reinsurance	$ 83,177	$ 60,195	$ 22,982	38.2 %
Short tail specialty and casualty reinsurance				