Helmick Kevin J
Form 4
April 24, 2019

FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
Helmick Kevin J

(Last) (First) (Middle)

20 S. BROAD ST., PO BOX 555

(Street)

CANFIELD, OH 44406

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
FARMERS NATIONAL BANC CORP /OH/ [FMNB]

3. Date of Earliest Transaction (Month/Day/Year)
04/22/2019

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
President & CEO

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Farmers National Banc Corp. Common Stock	04/22/2019		A (1)		24,499	A	$ 0	94,932	D	
Farmers National Banc Corp. Common Stock	04/22/2019		F		13,339	D	$ 13.86	81,593	D	
Farmers National								3,875	I	By Minor Child

Banc Corp. Common Stock			
Farmers National Banc Corp. Common Stock	3,875	I	By Minor Child
Farmers National Banc Corp. Common Stock	3,846	I	By Minor Child
Farmers National Banc Corp. Common Stock	12,330	I	By 401k Plan

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other

Helmick Kevin J
20 S. BROAD ST.
PO BOX 555
CANFIELD, OH 44406

X President & CEO

Signatures

/s/ Carl D. Culp, attorney in fact for Kevin J. Helmick — 04/24/2019

**Signature of Reporting Person — Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Acquisition represents the vesting of performance shares granted to the reporting person on April 22, 2016, which vested on the third anniversary of their grant date based upon the Company's return on equity.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. ght"> 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
%

Explanation of Responses:

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

63

Index

	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".

Index

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.

Index

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.

Index

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.

Index

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.

68

Index

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.

Index

- 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.

70

Index

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	104,243	85,694	18,549	21.6 %
Gross premiums written	187,420	145,889	41,531	28.5 %
Premiums ceded	(24,450)	(18,504)	(5,946)	32.1 %
Net premiums written	162,970	127,385	35,585	27.9 %
Net premiums earned	145,246	62,130	83,116	133.8 %
Other related income	13,566	8,749	4,817	55.1 %
Loss and loss adjustment expenses	(115,711)	(40,847)	(74,864)	183.3 %
Acquisition costs	(34,818)	(14,608)	(20,210)	138.3 %
General and administrative expenses	(26,144)	(15,904)	(10,240)	64.4 %
Underwriting loss	$ (17,861)	$ (480)	$ (17,381)	3,621.0 %
Loss ratio	79.7 %	65.7 %		
Acquisition cost ratio	24.0 %	23.5 %		
General and administrative expense ratio	18.0 %	25.6 %		
Combined ratio	121.7 %	114.8 %		

- The increase in the gross property premiums written is primarily due to the growth in direct and facultative and binder business.

- Premiums ceded were 13.0% of gross premiums written compared to 12.7% of gross premiums written for the same period in 2009.

- Premiums ceded to Flagstone Suisse under our intercompany reinsurance programs were $6.1 million compared to $3.8 million for the same period in 2009. The 2009 intercompany reinsurance program began during the second quarter. This amount is eliminated upon consolidation.

- Net premiums earned growth reflects the maturing of the premiums earning pattern from its start up in 2009.

- Other related income, derived from services provided to syndicates and third parties, increased primarily as a result of the recognition of profit commission from Syndicate 1861's 2007 year of account, recorded in the first quarter in the amount of $7.0 million.

- Notable loss events recorded include:

o Second quarter 2010 - loss of $17.3 million related to the Deepwater Horizon oil rig ($14.0 million net of reinstatement premiums), and
o First quarter 2010 - loss of $5.3 million related to the Chile earthquake ($4.9 million net of reinstatement premiums).

- General and administrative expenses include staff and salary related costs, administration expenses and Lloyd's specific costs such as syndicate expenses. The increase is primarily related to the growth in Lloyd's operations.

2011 Outlook

The existing major lines written in London through Syndicate 1861, which includes marine, offshore energy, marine liability, cargo, marine excess of loss, technical property risks, non marine property, general aviation and engineering insurance are expected to see a modest reduction due to the current state of the market and maintenance of our underwriting discipline.

71

Index

Island Heritage Segment

Overview

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. We gained controlling interest of Island Heritage on July 3, 2007.

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

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Gross premiums written	$ 90,896	$ 84,239	$ 6,657	7.9 %
Premiums ceded	(80,580)	(75,289)	(5,291)	7.0 %
Net premiums written	10,316	8,950	1,366	15.3 %
Net premiums earned	9,224	6,781	2,443	36.0 %
Other related income	23,343	20,968	2,375	11.3 %
Loss and loss adjustment expenses	(1,420)	(980)	(440)	44.9 %
Acquisition costs	(18,102)	(14,213)	(3,889)	27.4 %
General and administrative expenses	(9,300)	(11,679)	2,379	(20.4)%
Underwriting income	$ 3,745	$ 877	$ 2,868	327.0 %
Loss ratio (1)	4.4 %	3.5 %		
Acquisition cost ratio (1)	55.6 %	51.2 %		
General and administrative expense ratio (1)	28.6 %	42.1 %		
Combined ratio (1)	88.6 %	96.8 %		

(1)For Island Heritage segment all ratios calculated using expenses divided by net premiums earned plus other related income.

- The slight increase in gross premiums written is primarily related to continued growth in the Bahamas, offset by softening of rates in the U.S. Virgin Islands and the Cayman Islands. Contracts are written on a per risk basis and consist primarily of property lines.

- Premiums ceded were 88.7% of gross premiums written compared to 89.4% of gross premiums written for the same period in 2009.

- Premiums ceded to Flagstone Suisse under our intercompany reinsurance programs were $35.7 million compared to $34.8 million for the same period in 2009. This amount is eliminated upon consolidation.

- Other related income consists primarily of quota share reinsurance ceding commissions. The other related income includes $15.5 million related to the quota share arrangement between Island Heritage and Flagstone Suisse compared to $14.3 million for the same period in 2009. This amount is eliminated upon consolidation.

72

Index

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

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Gross premiums written	$ 84,239	$ 76,926	$ 7,313	9.5 %
Premiums ceded	(75,289)	(75,759)	470	(0.6)%
Net premiums written	8,950	1,167	7,783	666.9 %
Net premiums earned	6,781	12,668	(5,887)	(46.5)%
Other related income	20,968	13,247	7,721	58.3 %
Loss and loss adjustment expenses	(980)	(2,656)	1,676	(63.1)%
Acquisition costs	(14,213)	(13,897)	(316)	2.3 %
General and administrative expenses	(11,679)	(9,000)	(2,679)	29.8 %
Underwriting income	$ 877	$ 362	$ 515	142.3 %
Loss ratio (1)	3.5 %	10.2 %		
Acquisition cost ratio (1)	51.2 %	53.6 %		
General and administrative expense ratio (1)	42.1 %	34.7 %		
Combined ratio (1)	96.8 %	98.5 %		

(1)For Island Heritage segment all ratios calculated using expenses divided by net premiums earned plus other related income.

- The increase in gross premiums written is primarily related to continued growth in the Cayman Islands, Bahamas, and Turks and Caicos, partially offset by a reduction in premiums as a result of the cessation of business of our agents in Jamaica and Bermuda.

- Premiums ceded were 89.4% of gross premiums written compared to 98.5% of gross premiums written for the same period in 2008. Island Heritage's reinsurance program, which is an April 1 renewal, comprising excess of loss and quota share programs, was significantly changed on April 1, 2008, compared to prior years, resulting in the addition of increased net quota share reinsurance as at April 1, 2008 resulted in the addition of increased net quota share reinsurance as at April 1, 2008 and subsequent to April 1, 2009 program renewal. The change in the reinsurance program enabled Island Heritage to enter into new markets as well as increase penetration in existing markets whilst reducing its net loss exposure and results volatility due to the impact of catastrophic losses.

- Premiums ceded to Flagstone Suisse under our intercompany reinsurance programs were $34.8 million and $35.2 million for the years ended December 31, 2009 and 2008, respectively.

- Net premiums earned for 2009 were lower compared to the same period in 2008, primarily due to the difference in the reinsurance program in place for both years.

- The decrease in loss and loss adjustment expenses in the year ended December 31, 2009 is primarily related to the favorable settlement of claims incurred during 2008 in respect of Hurricanes Gustav, Hanna, Ike, Omar and Paloma.

- General and administrative expenses increased as Island Heritage continues to grow its operations including its Puerto Rico office and to enhance its underwriting and claims operating platform.

2011 Outlook

The general economic outlook for the Caribbean is expected to be neutral with little economic growth in 2011. Despite this, the market outlook for Island Heritage for 2011 is positive as we anticipate some organic volume growth throughout existing markets in the Caribbean. This growth will however be offset by continued softening pressure on primary insurance rates as a result of competition and a lack of catastrophic events in recent years.

73

Index

Investment Results

Our investment portfolio is structured to preserve capital and provide us with a high level of liquidity and is managed to produce a total return. In assessing returns under this approach, we include investment income and realized and unrealized gains and losses generated by the investment portfolio.
The total return on our investment portfolio, excluding noncontrolling interests in the investment portfolio, comprises investment income and realized and unrealized gains and losses on investments.

	For the years ended December 31,				
	2010	Change	2009	Change	2008
Investment portfolio return	4.2 %	(0.4)%	4.6 %	18.5 %	(13.9)%

- The change in the return on invested assets 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.

- The change in the return on invested assets of during the year ended December 31, 2009, compared to the same period in 2008 is primarily due to the 2008 return being negatively impacted by the global financial crisis.

Net investment income

Net investment income is derived from interest earned on investments, reduced by investment management and custody fees. We allocate expenses considered to be directly related to investments to investment income.

The following table sets forth net investment income for the years ended December 31, 2010 and 2009:

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Cash and cash equivalents	$ 1,435	$ 3,231	$ (1,796)	(55.6)%
Fixed maturity investments	33,307	28,283	5,024	17.8 %
Short term investments	1,004	1,405	(401)	(28.5)%
Equity investments	-	76	(76)	(100.0)%
Other investments	706	415	291	70.1 %
Investment expenses	(4,970)	(4,879)	(91)	1.9 %
Net investment income	$ 31,482	$ 28,531	$ 2,951	10.3 %

- The increase is principally due to the increase in yield caused by the change in asset allocation, which was partially offset by lower interest rates during the year.

The following table sets forth net investment income for the years ended December 31, 2009 and 2008:

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Cash and cash equivalents	$ 3,231	$ 13,498	$ (10,267)	(76.1)%
Fixed maturity investments	28,283	41,784	(13,501)	(32.3)%
Short term investments	1,405	566	839	148.2 %
Equity investments	76	79	(3)	(3.8)%

Other investments		415		541		(126)	(23.3)%
Investment expenses		(4,879)		(5,070)		191	(3.8)%
Net investment income	$	28,531	$	51,398	$	(22,867)	(44.5)%

- The decrease is principally due to a significant decrease in interest rates and lower amortization on the Treasury Inflation Protected Securities (“TIPS”) caused by the impact of the negative inflation index. On the TIPS, the negative amortization is offset by gains reported in net realized and unrealized gains (losses) – investments.

74

Index

Net realized and unrealized gains and losses - investments

Net realized and unrealized gains and losses – investments is comprised of; fixed maturities, equities, other investments and investment portfolio derivatives. We enter into investment portfolio derivatives including global equity, global bond, commodity and real estate futures, TBAs, total return swaps and interest rate swaps. We enter into index futures contracts and total return swaps to gain or reduce our exposure to an underlying asset or index. We also purchase TBAs as part of our investing activities. We enter into interest rate swaps and interest rate futures in order to manage portfolio duration and interest rate risk. Exposure to these instruments is managed based on guidelines established by management and is approved by the Board.

The following table is the breakdown of net realized and unrealized gains (losses) - investments for the years ended December 31, 2010 and 2009:

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Net realized gains on fixed maturities	$ 24,665	$ 21,005	$ 3,660	17.4 %
Net unrealized gains on fixed maturities	8,730	34,582	(25,852)	(74.8)%
Net realized (losses) on equities	-	(1,927)	1,927	100.0 %
Net unrealized gains on equities	11	2,778	(2,767)	(99.6)%
Net realized and unrealized gains (losses) on derivative instruments - investments	437	(15,145)	15,582	102.9 %
Net realized and unrealized gains (losses) on other investments	9,926	(1,625)	11,551	710.8 %
Total net realized and unrealized gains - investments	$ 43,769	$ 39,668	$ 4,101	10.3 %

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Futures contracts	$ 14,290	$ 12,458	$ 1,832	14.7 %
Total return swaps	1,105	(4,630)	5,735	123.9 %
Foreign currency forward contracts	(15,840)	(25,375)	9,535	37.6 %
Mortgage-backed securities TBA	882	2,402	(1,520)	(63.3)%
Net realized and unrealized gains (losses) on derivatives - investments	$ 437	$ (15,145)	$ 15,582	102.9 %

- The change in net realized and unrealized gains on the fixed maturities are primarily due to foreign exchange on non-U.S. dollar bonds, lower interest rates, and the tightening of credit spreads. Foreign exchange gains were largely offset by losses on derivatives used for foreign exchange hedging.

- The change in net realized and unrealized gains on other investments are primarily due to net realized and unrealized gains on Catastrophe bonds and investment funds.

- The change in net realized and unrealized gains on futures contracts are primarily due to positive performance of equity and commodities markets.

- The change in net realized and unrealized losses on foreign currency forward contracts are related to currency hedges on non-U.S. dollar bonds and are offset by net realized and unrealized gains on the fixed maturities.

75

Explanation of Responses:

Index

The following table is the breakdown of net realized and unrealized gains (losses) – investments for the years ended December 31, 2009 and 2008:

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Net realized gains (losses) on fixed maturities	$ 21,005	$ (9,143)	$ 30,148	329.7 %
Net unrealized gains (losses) on fixed maturities	34,582	(14,130)	48,712	344.7 %
Net realized (losses) on equities	(1,927)	(52,410)	50,483	96.3 %
Net unrealized gains (losses) on equities	2,778	(2,401)	5,179	215.7 %
Net realized and unrealized (losses) on derivative instruments - investments	(15,145)	(164,016)	148,871	90.8 %
Net realized and unrealized (losses) on other investments	(1,625)	(30,106)	28,481	94.6 %
Total net realized and unrealized gains (losses) - investments	$ 39,668	$ (272,206)	$ 311,874	114.6 %

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Futures contracts	$ 12,458	$ (147,493)	$ 159,951	108.4 %
Total return swaps	(4,630)	(18,431)	13,801	74.9 %
Interest rate swaps	-	(295)	295	100.0 %
Foreign currency forward contracts	(25,375)	-	(25,375)	0.0 %
Mortgage-backed securities TBA	2,402	2,203	199	9.0 %
Total net realized and unrealized (losses) on derivatives - investments	$ (15,145)	$ (164,016)	$ 148,871	90.8 %

- The change in net realized and unrealized gains on fixed maturities were due to the tightening of the credit spreads during 2009 and also to the realized and unrealized gains on the foreign currency portfolios caused by the weakening of the U.S. dollar. Foreign exchange gains were largely offset by losses on derivatives used for foreign exchange hedging.

- The change in net realized and unrealized gains on equities were primarily due to the positive performance of the emerging equity markets during the year.

- The change in net realized and unrealized losses on other investments were due to gains on the Catastrophe Bond portfolio and losses on the investment funds held.

- Net change in realized and unrealized gains on futures contracts were primarily due to the positive performance of equity and commodities markets offset by losses on global bond futures.

- The change in net realized and unrealized losses on swap contracts were primarily due to gains on U.S. equity exposure offset by losses on global inflation bond exposure.

-

The change in net realized and unrealized losses on foreign currency forward contracts were related to currency hedges on non-U.S. dollar bonds and are offset by net realized and unrealized gains on the fixed maturities.

Treasury Hedging and Other

Net realized and unrealized gains and losses – other

Our policy is to hedge the majority of our currency exposure with derivative instruments such as currency swaps and foreign currency forward contracts.

Currency swaps and foreign currency forward contracts are used to hedge the economic currency exposure of our investment in foreign subsidiaries and to hedge operational balances such as premiums receivable, loss reserves and the portion of our long term debt issued in Euros.

Reinsurance derivatives relate to ILWs that are structured as derivative transactions. The amounts shown in the tables below are premiums earned on ILWs.

Index

The following table is the breakdown of net realized and unrealized gains - other for the years ended December 31, 2010 and 2009:

	For the years ended December 31,			
	2010	2009	$ Change	% Change
Currency swaps	$ (1,290)	$ 661	$ (1,951)	(295.2)%
Foreign currency forward contracts	13,930	8,202	5,728	69.8 %
Reinsurance derivatives	1,801	2,390	(589)	(24.6)%
Net realized and unrealized gains - other	$ 14,441	$ 11,253	$ 3,188	28.3 %

- The net losses associated with the currency swaps and the gains associated with the foreign currency forward contracts are due to currency fluctuation which is partially offset by losses recorded through balance sheet currency revaluations and are attributable to operational hedges on reinsurance balances.

- The decrease in net realized and unrealized gains on reinsurance derivatives was due to the decreased number of ILWs classified as derivatives written during 2010.

The following table is the breakdown of net realized and unrealized gains – other for the years ended December 31, 2009 and 2008:

	For the years ended December 31,			
	2009	2008	$ Change	% Change
Currency swaps	$ 661	$ (783)	$ 1,444	184.4 %
Interest rate swaps	-	(1,353)	1,353	100.0 %
Foreign currency forward contracts	8,202	7,095	1,107	15.6 %
Reinsurance derivatives	2,390	6,658	(4,268)	(64.1)%
Net realized and unrealized gains - other	$ 11,253	$ 11,617	$ (364)	(3.1)%

- The net gains associated with the currency swaps and foreign currency forward contracts are due to currency fluctuation which is partially offset by losses recorded through balance sheet currency revaluations and are attributable to Flagstone Suisse's net assets (undesignated hedge) and on operational hedges on reinsurance balances.

- The decrease in net realized and unrealized gains on reinsurance derivatives was due to the decreased number of ILWs determined to be derivatives written during 2009.

Interest Expense

Interest expense consists of interest due on outstanding debt securities and the amortization of debt offering expenses.

2010 versus 2009

Interest expense was $10.4 million for the year ended December 31, 2010, compared to $12.1 million for the year ended December 31, 2009. For the year ended December 31, 2010, compared to the same period in 2009, the decrease of $1.7 million in interest expense is primarily related to the decrease in short term interest rates.

2009 versus 2008

Interest expense was $12.1 million for the year ended December 31, 2009, compared to $18.3 million for the year ended December 31, 2008. For the year ended December 31, 2009, compared to the same period in 2008, the decrease of $6.2 million in interest expense is primarily related to the decrease in short term interest rates and the repurchase of $11.25 million of principal amount of our outstanding $100.0 million Notes during the second quarter of 2008.

Foreign Exchange

2010 versus 2009

For the year ended December 31, 2010, we experienced net foreign exchange losses of $4.7 million compared to net foreign exchange losses of $3.2 million for the year ended December 31, 2009. For the year ended December 31, 2010, the net foreign exchange losses were principally experienced on the net monetary asset and liability balances denominated in foreign currencies which generally strengthened against the U.S. dollar, during the year. Our policy is to hedge the majority of our foreign currency exposures with derivative instruments such as foreign currency swaps and foreign currency forward contracts. Net realized and unrealized gains and losses on derivatives used to hedge those balances are included in “Net realized and unrealized gains – other” in the consolidated statements of operations and comprehensive income.

Index

We have entered into certain foreign currency forward contracts that are designated as hedges in order to hedge our net investments in foreign subsidiaries. The accounting for the gains and losses associated with changes in fair value of the designated hedge instruments were recorded in other comprehensive income as part of the cumulative translation adjustment, to the extent that they are effective as hedges. We designated foreign currency forwards with notional contractual value of $43.2 million as hedging instruments, which had a fair value of $(0.5) million as of December 31, 2010. During the year ended December 31, 2010, we recorded $0.2 million of realized and unrealized losses directly into comprehensive income as part of the cumulative translation adjustment for the effective portion of the hedge. All other derivatives are not designated as hedges, and accordingly, the realized and unrealized gains and losses arising during the year are included in income in "Net realized and unrealized gains (losses) — investments" and "Net realized and unrealized gains — other" in the consolidated statements of operations and comprehensive income.

2009 versus 2008

For the year ended December 31, 2009, we experienced net foreign exchange losses of $3.2 million compared to net foreign exchange losses of $21.5 million for the year ended December 31, 2008. For the year ended December 31, 2009, the net foreign exchange losses were principally experienced on the net monetary asset and liability balances denominated in foreign currencies which generally weakened against the U.S. dollar, especially during the third and fourth quarters of 2009. Our policy is to hedge the majority of our foreign currency exposures with derivative instruments such as foreign currency swaps and forward contracts. Net realized and unrealized gains and losses on derivatives used to hedge those balances are included in "Net realized and unrealized gains – other" in the consolidated statements of operations and comprehensive income.

We have entered into certain foreign currency forward contracts that are designated as hedges in order to hedge our net investments in foreign subsidiaries. The accounting for the gains and losses associated with changes in fair value of the designated hedge instruments were recorded in other comprehensive income as part of the cumulative translation adjustment, to the extent that it is effective as a hedge. We designated foreign currency forwards with notional contractual value of $162.0 million as hedging instruments, which had a fair value of $(0.4) million as of December 31, 2009. During the year ended December 31, 2009, we recorded $4.6 million of realized and unrealized losses directly into comprehensive income as part of the cumulative translation adjustment for the effective portion of the hedge. All other derivatives are not designated as hedges, and accordingly, the realized and unrealized gains and losses arising during the year are included in income in "Net realized and unrealized gains (losses) — investments" and "Net realized and unrealized gains — other" in the consolidated statements of operations and comprehensive income.

Income Tax Expense

We have subsidiaries that operate in various other jurisdictions around the world that are subject to tax in the jurisdictions in which they operate. The significant jurisdictions in which our subsidiaries are subject to tax are South Africa, Canada, India, Switzerland, U.S. Virgin Islands ("USVI"), United Kingdom, and the U.S. However since the majority of our income to date has been earned in Bermuda where we are exempt from income tax, the impact of income taxes to date has been minimal.

2010 versus 2009

During the year ended December 31, 2010, income tax recovery (expense) was $4.1 million compared to $(5.4) million for the year ended December 31, 2009. The decrease for the year ended December 31, 2010, compared to the same period in 2009, is primarily attributable the recognition of a deferred tax asset on tax loss carryforward in the U.K. and to lower taxable income in jurisdictions around the world that are subject to tax.

2009 versus 2008

During the year ended December 31, 2009, income tax expense was $5.4 million compared to $1.2 million for the year ended December 31, 2008. The increase for the year ended December 31, 2009, compared to the same period in 2008, is primarily attributable to higher taxable income in jurisdictions around the world that are subject to tax as well as the acquisition of Flagstone Africa in June 2008, which resulted in taxable income being earned in South Africa.

Noncontrolling Interest

2010 versus 2009

The results of Mont Fort have been included in our audited consolidated financial statements, with the portions of Mont Fort's net income and shareholders' equity attributable to the preferred shareholders recorded as noncontrolling interest since January 12, 2007 in accordance with the FASB ASC Topic on Consolidation. In relation to Mont Fort, we recorded losses attributable to noncontrolling interest of $10.5 million for the year ended December 31, 2010, compared to income of $26.3 million for the year ended December 31, 2009, an increase of $36.8 million primarily due to the losses recorded in the second quarter of 2010 of $22.9 million related to the Deepwater Horizon oil rig.

Index

The results of operations of Island Heritage have been included in our audited consolidated financial statements from July 1, 2007, onwards, with the portions of Island Heritage's net income and shareholders' equity attributable to minority shareholders recorded as noncontrolling interest. We recorded income attributable to noncontrolling interest of $1.9 million for the year ended December 31, 2010, compared to losses of $1.7 million for the year ended December 31, 2009.

2009 versus 2008

The results of Mont Fort have been included in our audited consolidated financial statements, with the portions of Mont Fort's net income and shareholders' equity attributable to the preferred shareholders recorded as noncontrolling interest since January 12, 2007 in accordance with the FASB ASC Topic on Consolidation. In relation to Mont Fort, we recorded income attributable to noncontrolling interest of $26.3 million for the year ended December 31, 2009, compared to $14.2 million for the year ended December 31, 2008, an increase of $12.1 million due to the positive underwriting results of Mont Fort in 2009 as the 2008 results were impacted by negative investment returns and Hurricane Ike losses.

On June 30, 2009, Island Heritage, in which we hold a controlling interest, issued 2,709 shares to certain of its employees under a performance share unit plan. Prior to this transaction, we held an ownership interest in Island Heritage of 59.2% and as of December 31, 2009, we held an interest of 58.8%. The results of operations of Island Heritage have been included in our audited consolidated financial statements from July 1, 2007, onwards, with the portions of Island Heritage's net income and shareholders' equity attributable to minority shareholders recorded as noncontrolling interest. The Company recorded income attributable to noncontrolling interest of $1.7 million for the year ended December 31, 2009, compared to losses of $0.6 million for the year ended December 31, 2008.

The results of operations of Flagstone Africa have been included in the Company's audited consolidated financial statements from June 26, 2008, onwards, with the portions of Flagstone Africa's net income and shareholders' equity attributable to minority shareholders recorded as noncontrolling interest. On November 10, 2009, Flagstone Suisse became the sole shareholder of Flagstone Africa by acquiring the remaining 35% of shares owned by Imperial Holdings Limited for a purchase price of $11.4 million. We recorded a noncontrolling interest charge of $0.1 million for the year ending December 31, 2008.

Comprehensive Income (Loss)

2010 versus 2009

Comprehensive income attributable to Flagstone for the year ended December 31, 2010 was $97.9 million compared to $243.5 million for the same period in 2009. For the year ended December 31, 2010, comprehensive income included $88.4 million of net income, $0.6 million for the change in the currency translation adjustment, and $0.2 million for the change in the defined benefit pension plan obligation compared to $270.7 million of net income, $2.6 million for the change in the currency translation adjustment, and $0.1 million for the change in defined benefit pension plan transitional obligation for the year ended December 31, 2009.

The currency translation adjustment is a result of the translation of our foreign subsidiaries into U.S. dollars, net of transactions designated as hedges of net foreign investments. We have entered into certain foreign currency forward contracts that are designated as hedges in order to hedge our net investment in foreign subsidiaries. To the extent that the contract is effective as a hedge, both the realized and unrealized gains and losses associated with the designated hedge instruments are recorded in other comprehensive income as part of the cumulative translation adjustment. We designated $43.2 million and $162.0 million of foreign currency forwards contractual value as hedge instruments, which had a fair value of $(0.5) million and $(0.4) million, at December 31, 2010 and 2009, respectively. The

Company recorded $0.2 million and $4.6 million of realized and unrealized foreign exchange losses on these hedges during the years ended December 31, 2010 and 2009, respectively.

2009 versus 2008

Comprehensive income (loss) attributable to Flagstone for the year ended December 31, 2009, was $243.5 million compared to $(203.0) million for the same period in 2008. For the year ended December 31, 2009, comprehensive income (loss) included $270.7 million of net income, $2.6 million for the change in the currency translation adjustment, and $0.1 million for the change in the defined benefit pension plan obligation compared to a net loss of $173.7, million, $(16.3) million for the change in the currency translation adjustment, and $(0.9) million for the change in defined benefit pension plan transitional obligation for the year ended December 31, 2008.

We designated $162.0 million and $337.7 million of foreign currency forwards contractual value as hedge instruments, which had a fair value of $(0.4) million and $(5.7) million, at December 31, 2009 and 2008, respectively. We recorded $4.6 million and $17.0 million of realized and unrealized foreign exchange losses on these hedges during the years ended December 31, 2009 and 2008, respectively.

79

Index

Financial Condition, Liquidity, and Capital Resources

Financial Condition

Investments

At December 31, 2010, our total investments, cash and cash equivalents, and restricted cash was $2.0 billion, compared to $1.9 billion at December 31, 2009.

The major factors contributing to the increase in 2010, were:

- Lower net income of $182.3 million;
- Increased purchases of fixed maturity investment of $530.0 million;
- Increased sales of fixed maturity investment of $1.1 billion;
- Increased purchase of fixed asset of $18.6 million;
- Decreased restricted cash of $86.0 million;
- Increased common share repurchases of $139.2 million;
- Repurchase of warrant of $14.2 million, inclusive of related expenses of $0.7 million;
- Increased repurchases of Mont Fort preferred shares of $16.4 million; and
- No long term debt repayment as in 2009 of $15.0 million.

Our investment management guidelines are set by the Finance Committee of our Board. The Finance Committee establishes investment policies and guidelines for both internal and external investment managers. Our investment philosophy is to maintain a high-quality, well-balanced and liquid portfolio having the dual objectives of optimizing current investment income and achieving capital appreciation.

We have a bias against active management in favor of indexing and passive securities that are generally the most liquid. When they are part of the asset allocation, a number of our equity and other exposure implementations 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. The portfolio managers are required to adhere to investment guidelines as to minimum ratings and issuer and sector concentration limitations. This implementation strategy gives us a low cost and efficient way, using a mixture of passive assets and outside managers, to complement our in-house capability for overall portfolio management, liquidity management and hedging.

Our investment portfolio on a risk basis, at December 31, 2010, comprised 87.1% fixed maturities, short-term investments and cash and cash equivalents, 6.0% equities and the balance in other investments. We believe our investments can be liquidated and converted into cash within a very short period of time. However, our investment funds, which represent 2.0% of our total investments and cash and cash equivalents at December 31, 2010, do not trade in active markets and are subject to redemption provisions that prevent us from converting them into cash immediately.

At December 31, 2010, all of the fixed maturity securities in our investment portfolio were rated investment-grade (BBB- or higher) by Standard & Poor’s (or an equivalent rating by another rating agency) with an average rating of AA+. At December 31, 2009, all of the fixed maturity securities in our investment portfolio, with the exception of $0.5 million were rated investment-grade (BBB- or higher) by Standard & Poor’s (or estimated equivalent by another rating agency) with an average rating of AA+.

At December 31, 2010 and 2009, the average duration of our investment portfolio was 2.0 years and 2.3 years, respectively. The decrease is mostly due to the interest rate futures contracts used to manage duration.

As noted above, our investment strategy allows the use of derivative instruments such as futures contracts, total return swaps, foreign exchange forward contracts, interest rate swaps, and TBAs, subject to strict limitations. Derivative instruments may be used to replicate investment positions or to manage currency and market exposures and duration risk that would be allowed under our investment policy if implemented in other ways. These derivatives seek investment results that generally correspond to the price and yield performance of the underlying markets. The fair value of our derivatives at December 31, 2010 was $(5.1) million, compared to $9.7 million at December 31, 2009.

80

Index

The cost or amortized cost, gross unrealized gains and losses and carrying values of our fixed maturity, short term, equity and other investments as at December 31, 2010 and 2009, are as follows:

	As at December 31, 2010			
	Amortized cost or cost	Gross unrealized gains	Gross unrealized losses	Fair value
Fixed maturity investments				
U.S. government and agency securities	$ 266,329	$ 5,882	$ (375)	$ 271,836
U.S. states and political subdivisions	90	2	-	92
Other foreign governments	267,787	18,618	(480)	285,925
Corporates	586,523	20,260	(4,239)	602,544
Mortgage-backed securities	222,171	2,910	(2,224)	222,857
Asset-backed securities	90,968	261	(621)	90,608
	1,433,868	47,933	(7,939)	1,473,862
Short term investments				
U.S. government and agency securities	2,998	-	-	2,998
Corporates	11,256	1	(4)	11,253
	14,254	1	(4)	14,251
Equity investments	7,931	4	(7,652)	283
	7,931	4	(7,652)	283
Other investments				
Investment funds	42,728	3,798	(6,533)	39,993
Catastrophe bonds	75,484	1,226	(19)	76,691
	118,212	5,024	(6,552)	116,684
Totals	$ 1,574,265	$ 52,962	$ (22,147)	$ 1,605,080

	As at December 31, 2009			
	Amortized cost or cost	Gross unrealized gains	Gross unrealized losses	Fair value
Fixed maturity investments				
U.S. government and agency securities	$ 421,215	$ 12,186	$ (1,686)	$ 431,715
U.S. states and political subdivisions	1,907	11	(15)	1,903
Other foreign governments	112,119	3,426	(1,118)	114,427
Corporates	504,855	15,763	(1,376)	519,242
Mortgage-backed securities	108,652	3,969	(554)	112,067
Asset-backed securities	49,439	253	(485)	49,207
	1,198,187	35,608	(5,234)	1,228,561
Short term investments				
	145,600	6	(2)	145,604

U.S. government and agency securities				
Other foreign governments	3,877	136	-	4,013
Corporates	80,223	1,419	(738)	80,904
Asset-backed securities	1,909	4	-	1,913
	231,609	1,565	(740)	232,434
Equity investments	8,516	124	(8,350)	290
	8,516	124	(8,350)	290
Other investments				
Investment funds	13,239	-	(7,753)	5,486
Catastrophe bonds	35,777	402	(51)	36,128
	49,016	402	(7,804)	41,614
Totals	$ 1,487,328	$ 37,699	$ (22,128)	$ 1,502,899

Other investments do not include an investment accounted for under the equity method in which the Company is deemed to have a significant influence and accordingly is not accounted for at fair value under the FASB ASC guidance for financial instruments.

81

Index

This investment is recorded at $3.1 million and $4.3 million at December 31, 2010 and 2009, respectively.

Other investments

At December 31, 2010, other investments amounted to $119.8 million compared to $45.9 million at December 31, 2009. At December 31, 2010, the other investments comprised of $76.7 million in catastrophe bonds and $40.0 million in investment funds, which are recorded at fair value and our equity method investment of $3.1 million. The increase in other investments during the year ended December 31, 2010 is principally related to net purchases of catastrophe bonds and investment funds.

	As at December 31,			
		2010		2009
Investment funds	$	39,993	$	5,486
Catastrophe bonds		76,691		36,128
Equity investment		3,080		4,320
Total other investments	$	119,764	$	45,934

Rating Distribution

The following table presents a breakdown of the credit quality of the Company's fixed maturity and short term investments as at December 31, 2010 and 2009:

	As at December 31,									
	2010				2009					
	Fair value		Percentage of total		Fair value		Percentage of total			
Rating Category										
AAA	$	903,230	60.7	%	$	1,043,223	71.4	%		
AA		193,302	13.0	%		111,300	7.6	%		
A		262,086	17.6	%		214,214	14.7	%		
BBB		129,495	8.7	%		91,723	6.3	%		
Below investment grade		-	0.0	%		535	0.0	%		
Total	$	1,488,113	100.0	%	$	1,460,995	100.0	%		

Maturity Distribution

The following table presents the contractual maturity dates of fixed maturity and short term investments as at December 31, 2010 and 2009:

	As at December 31,							
	2010				2009			
	Amortized cost		Fair value		Amortized cost		Fair value	
Due within one year	$	38,558	$	39,909	$	308,865	$	312,253
Due after 1 through 5 years		808,954		836,825		577,634		588,707
Due after 5 through 10 years		196,683		202,136		311,819		324,095

Due after 10 years	90,788	95,778	71,478	72,753
Mortgage and asset-backed securities	313,139	313,465	160,000	163,187
Total	$ 1,448,122	$ 1,488,113	$ 1,429,796	$ 1,460,995

Actual maturities may differ from contractual maturities because certain borrowers have the right to prepay certain obligations with or without prepayment penalties.

Loss and Loss Adjustment Expense Reserves

We establish loss reserves to estimate the liability for the payment of all loss and loss adjustment expenses incurred with respect to premiums earned on our contracts. Loss reserves do not represent an exact calculation of the liability.

Index

Loss reserves represent estimates, including actuarial and statistical projections at a given point in time to reflect our expectations of the ultimate settlement and administration costs of claims incurred. Estimates of ultimate liabilities are contingent on many future events and the eventual outcome of these events may be different from the assumptions underlying the reserve estimates. We believe that the recorded unpaid loss and loss adjustment expenses represent management's best estimate of the cost to settle the ultimate liabilities based on information available at December 31, 2010. See "Critical Accounting Estimates — Loss and Loss Adjustment Expense Reserves" for additional information concerning loss and loss adjustment expenses.

The following table represents an analysis of paid and incurred losses and a reconciliation of the beginning and ending loss and loss adjustment expense reserves as at and for the years ended December 31, 2010 and 2009:

	As at and for the years ended December 31,			
		2010		2009
Gross liability at beginning of year	$	480,660	$	411,565
Reinsurance recoverable at beginning of year		(19,270)		(16,422)
Net liability at beginning of year		461,390		395,143
Net incurred losses related to:				
Current year		541,234		289,775
Prior year		(11,098)		(6,590)
		530,136		283,185
Net paid losses related to:				
Current year		148,592		90,964
Prior year		163,623		139,475
		312,215		230,439
Effects of foreign exchange rate changes		12,587		13,501
Other		1,233		-
Net liability at end of year		693,131		461,390
Reinsurance recoverable at end of year		28,183		19,270
Gross liability at end of year	$	721,314	$	480,660

The prior year reduction in the net incurred losses arose from the revision of our loss estimates upon receipt of updated information from our clients and brokers. During the year ended December 31, 2010, we had total net positive development of $11.1 million; $(18.3) million relating to the 2009 year and $29.4 million relating to the 2008 year and prior. The net favorable development in 2010 was primarily due to actual loss emergence in the property catastrophe, property, and the short-tail specialty and casualty lines of business being lower than the initial expected loss emergence.

The significant increase in the reserves in 2010 is primarily attributable to more severe catastrophe losses in 2010 than in 2009 resulting from the Chile earthquake, the New Zealand earthquake and the Queensland floods and the Australia aggregate cover.

Shareholders' Equity and Capital Resources Management

As at December 31, 2010, Flagstone's shareholders' equity was $1.1 billion, a 6.3% decrease compared to $1.2 billion at December 31, 2009. The decrease in shareholders' equity is principally due to net income attributable to Flagstone for the year ended December 31, 2010 of $97.1 million, offset by share repurchases of $164.3 million, distributions

declared of $17.5 million and repurchase of Mont Fort ILW 2 preferred shares of $79.5 million.

We actively manage our capital to support our underwriting operations and for the benefit of our shareholders, subject to the ability to maintain strong ratings from the rating agencies and maintain our ability to pay claims as they arise. Generally, we will seek to raise additional capital when our current capital position is not sufficient to support attractive business opportunities available. Conversely, we will seek to reduce our capital, through dividends or stock repurchases, when the opportunity set is insufficient to achieve our targeted long term returns. For further information on share repurchases refer to Note 14 “Shareholders’ Equity” in Item 8 – Financial Statements and Supplementary Data of this Annual Report.

Management uses growth in diluted book value per share as a prime measure of value generated for our common shareholders. Diluted book value per 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 the warrant, PSU and RSU. In 2010, our diluted book value per share increased from $13.97 at December 31, 2009 to $15.51 at December 31, 2010, an increase of 12.1% inclusive of distributions paid during 2010 of $0.16 per share.

Index

Long Term Debt

On August 23, 2006, we raised gross and net proceeds of $136.7 million and $132.8 million, respectively, of Deferrable Interest Debentures. The Deferrable Interest Debentures have a floating rate of interest equal to (i) LIBOR plus 354 basis points per annum, reset quarterly for the dollar-denominated principal amount and (ii) Euro Interbank Offered Rated ("Euribor") plus 354 basis points per annum, reset quarterly for the Euro-denominated principal amount. The Deferrable Interest Debentures mature on September 15, 2036, and may be called at par by us at any time after September 15, 2011. We may defer payment of the interest for up to 20 consecutive quarterly periods, but no later than September 15, 2011. Any deferred interest payments would accrue interest quarterly on a compounded basis.

In June 2007, we, through our wholly-owned subsidiary Flagstone Finance S.A., raised gross and net proceeds of $100.0 million and $98.9 million, respectively, through a private placement of Junior Subordinated Deferrable Interest Notes. These notes have a floating rate of interest equal to LIBOR plus 300 basis points per annum, reset quarterly. These notes mature on July 30, 2037, and may be called at par by us at any time after July 30, 2012. We may defer interest payment for up to 20 consecutive quarterly periods, but no later than July 30, 2012. Any deferred interest payments would accrue interest quarterly on a compounded basis.

In September 2007, we raised gross and net proceeds of $25.0 million and $24.7 million, respectively, through a private placement of Junior Subordinated Deferrable Interest Notes. These notes have a floating rate of interest equal to LIBOR plus 310 basis points per annum, reset quarterly. These notes mature on September 15, 2037, and may be called at par by us at any time after September 15, 2012. We may defer interest payment for up to 20 consecutive quarterly periods, but no later than September 15, 2012. Any deferred interest payments would accrue interest quarterly on a compounded basis.

The indenture governing our Deferrable Interest Debentures would restrict us from declaring or paying distributions on our common shares if the Company:

- 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;
- is downgraded by A.M. Best 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;
- is downgraded by A.M. Best to a financial strength rating below B++; or
- withdraws its financial strength rating from A.M. Best.

In May 2008, we repurchased, in a privately negotiated transaction, $11.25 million of principal amount of our outstanding $100.0 million notes. The purchase price paid for the notes was 81% of face value, representing a discount of 19%. The repurchase resulted in a gain of $1.8 million, net of unamortized debt issuance costs of $0.1 million that were written off. The gain has been included in other income as a gain on early extinguishment of debt.

At December 31, 2010 and 2009, we were in compliance with all required covenants, and no conditions of default existed related to our long term debt. We may incur additional indebtedness in the future if we determine that it would be an efficient component of our capital structure.

Our capital management strategy is to preserve sufficient capital to support our financial strength ratings and our future growth while maintaining conservative financial leverage and earnings coverage ratios.

Index

The table below sets forth the capital structure of the Company as at December 31, 2010 and 2009:

	As at December 31,					
		2010			2009	
Long term debt	$	251,122	18.1 %	$	252,402	17.2 %
Common shares		845	0.0 %		850	0.1 %
Common shares held in treasury		(178,718)	(12.9)%		(19,750)	(1.3)%
Additional paid-in capital		904,235	65.3 %		912,547	62.3 %
Accumulated other comprehensive loss		(6,178)	(0.4)%		(6,976)	(0.5)%
Retained earnings		414,549	29.9 %		324,347	22.2 %
Total capital	$	1,385,855	100.0 %	$	1,463,420	100.0 %

Liquidity

Liquidity is a measure of our ability to access sufficient cash flows to meet the short term and long term cash requirements of our business operations. Management believes that our significant cash flows from operations and high quality liquid investment portfolio will provide sufficient liquidity for the foreseeable future. For the three years ended December 31, 2010, we have had sufficient cash flows from operations to meet our liquidity requirements. We expect that our operational needs for liquidity for at least the next twelve months will be met by our balance of cash, funds generated from underwriting activities, investment income and the proceeds from sales and maturities of our investment portfolio. In the current financial environment, it may be difficult for the insurance industry generally, and Flagstone in particular, to raise additional capital when required, on acceptable terms or at all. Cash and cash equivalents were $345.7 million as at December 31, 2010.

We are a holding company that conducts no operations of our own. We rely primarily on cash distributions and return of capital from our subsidiaries to pay our operating expenses and make principal and interest payments on our long term debt. There are restrictions on the payment of dividends from Flagstone Suisse to us, which are described in more detail below. We have paid a quarterly cash distribution of $0.04 per common share beginning in the third quarter of 2007 and for each quarter thereafter. 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. Our subsidiaries' sources of funds consist primarily of premium receipts net of commissions, investment income, capital raising activities including the issuance of common shares, long term debt and proceeds from sales and maturities of investments. Cash is used primarily to pay losses and loss adjustment expenses, reinsurance purchased, brokerage, general and administrative expenses and dividends, with the remainder made available to our investment managers for investment in accordance with our investment policy. In the future, we may use cash to fund any authorized share repurchases and acquisitions.

Cash flows from operations for the year ended December 31, 2010 decreased to $292.5 million from $338.4 million as compared to the same period in 2009. This decrease in cash flows from operations was primarily related to a lower net income and increased reinsurance premium receivables, offset by increased loss and loss adjustment expense reserves. Because a large portion of the coverages we provide typically can produce losses of high severity and low frequency, it is not possible to accurately predict our future cash flows from operating activities. As a consequence, cash flows from operating activities may fluctuate, perhaps significantly, between individual quarters and years.

Cash used in investing activities was $25.6 million for 2010, compared with $660.0 million for 2009. The decrease for 2010 was due primarily to less net purchases and sales of fixed income securities, increased purchases of fixed assets and decreased restricted cash.

Cash flows relating to financing activities include the payment of distributions to shareholders, share related transactions and the issuance or repayment of debt. During the year ended December 31, 2010, net cash of $269.8 million was used in financing activities, compared to $110.8 million provided by financing activities for the year ended December 31, 2009. In 2010, the net cash used in financing activities related principally to the redemption of preferred shares in Mont Fort ILW 2, the repurchase of common shares held in treasury, and the repurchase of a warrant. In 2009, the net cash used in financing activities related principally to the payment of distributions, the redemption of preferred shares in Mont Fort ILW 1, the repurchase of common shares and the repayment of debt.

We may incur additional indebtedness in the future if we determine that it would be an efficient part of our capital structure.

Generally, positive cash flows from our operating and financing activities are invested in our investment portfolio. For further discussion of our investment activities, including our strategy and current durations, refer to “Business” and also Note 7 “Investments” to our consolidated financial statements included in Item 8 of this report.

We monitor our long term liquidity needs with regard to our annual aggregate Probable Maximum Loss (“PML”).

Index

Our annual aggregate PML for a given number of years is our estimate of the maximum aggregate loss and loss adjustment expenses that we are likely to incur in any one year during that number of years.

Financial strength ratings and senior unsecured debt ratings represent the opinions of rating agencies on our capacity to meet our obligations. In the event of a significant downgrade in ratings, our ability to write business and to access the capital markets could be impacted. Some of our reinsurance treaties contain special funding and termination clauses that are triggered in the event we or one of our subsidiaries is downgraded by one of the major rating agencies to levels specified in the treaties, or our capital is significantly reduced. If such an event were to occur, we would be required, in certain instances, to post collateral in the form of letters of credit and/or trust accounts against existing outstanding losses, if any.

In 2011, we anticipate capital expenditures of approximately $2.0 million for our information technology infrastructure and systems enhancements, including proprietary software expenditures and $12.2 million for building costs primarily associated with the construction of our office buildings in Luxembourg and Martigny and leasehold improvements for other offices. We expect our operating cash flows, together with our existing capital base, to be sufficient to meet these requirements and to operate our business.

Letter of credit facilities

On June 5, 2009, Flagstone Suisse entered into a secured $50.0 million standby letter of credit facility with BNP Paribas (the “BNP Facility”). The BNP Facility had an initial term of one year and the Company let the facility expire on June 4, 2010, as per the terms of the agreement.

On March 5, 2009, Flagstone Suisse entered into a $200.0 million secured committed letter of credit facility with Barclays Bank Plc (the “Barclays Facility”). The Barclays Facility is used to support the reinsurance obligations of the Company and its subsidiaries. As at December 31, 2010, $32.3 million had been drawn under the Barclays Facility, and the drawn amount was secured by $35.9 million of fixed maturity securities from the Company’s investment portfolio.

On April 28, 2010, Flagstone Suisse and Flagstone Capital Management Luxembourg SICAF – FIS entered into a secured $450.0 million standby letter of credit facility with Citibank Europe Plc (the “Citi Facility”). The Citi Facility comprised a $225.0 million facility for letters of credit with a maximum tenor of 15 months, to be used to support reinsurance obligations of the Company and its subsidiaries, and a $225.0 million facility for letters of credit drawn in respect of Funds at Lloyd’s with a maximum tenor of 60 months. On December 21, 2010, the Citi Facility was amended to increase the amount available under the facility by $100.0 million to $550.0 million, with all the terms and conditions remaining unchanged. The Citi Facility now comprises a $275.0 million facility for letters of credit with a maximum tenor of 15 months, to be used to support reinsurance obligations of the Company and its subsidiaries, and a $275.0 million facility for letters of credit drawn in respect of Funds at Lloyds’s with a maximum tenor of 60 months. As at December 31, 2010, $435.6 million had been drawn under the Citi Facility, and the drawn amount of the facility was secured by $502.6 million of fixed maturity securities from the Company’s investment portfolio. This facility replaced a $450.0 million credit facility with Citibank Europe Plc which commenced on January 22, 2009.

These facilities are used to provide security to reinsureds and for Funds at Lloyd’s, and they are fully collateralized by the Company, to the extent of the letters of credit outstanding at any given time.

Shelf registration

On June 23, 2010, the Company filed an unallocated universal shelf registration statement with the SEC that was declared effective on August 5, 2010 (the “Registration Statement”). Under the shelf registration statement, the Company may issue up to $500 million of equity, debt, preferred shares or a combination of these securities. In addition, up to 71,547,891 common shares may be sold from time to time pursuant to this Registration Statement.

Restrictions and Specific Requirements

Luxembourg

We do not conduct the business of an insurer or reinsurer in Luxembourg and therefore are not required to be registered with the Commissairiat aux Assurances , which is the authority in Luxembourg that regulates insurers and reinsurers.

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.

Index

Subject to Luxembourg Company Law, our Board of Directors may declare interim dividends. The declaration of interim dividends is subject to the approval of shareholders at the next general meeting. Where the payments made on account of interim dividends exceed the amount of dividends subsequently approved by shareholders at the general meeting, they shall, to the extent of the overpayment, be deemed to have been paid on account of the next dividend. Our Articles allow for the declaration of interim dividends, but any payment of interim dividends is subject to the conditions that: (i) interim accounts shall be drawn up showing that the funds available for distribution are sufficient; (ii) the amount to be distributed may not exceed total profits made since the end of the last financial year for which the accounts have been approved, plus any profits carried forward and sums drawn down from reserves available for this purpose, less losses carried forward any sums to be placed to reserve pursuant to the requirements of the law or our Articles; (iii) the decision of our Board of Directors to distribute an interim dividend may not be taken more than two months after the date at which the interim accounts have been made up; (iv) in their report, our Board of Directors and the statutory auditor shall verify whether the above conditions have been satisfied.

Certain of our investment management activities are based in Luxembourg and managed through Flagstone Capital Management Luxembourg SICAF – FIS ("FCML"). FCML is a closed ended investment fund and is regulated by the Luxembourg Commission de Surveillance du Secteur Financier. In accordance with the various documents governing the operation of FCML, a general meeting shall determine how the profits (including net realized capital gains) of FCML shall be disposed of and may from time to time declare, or authorize the Board of Directors of FCML to declare dividends, provided however that the capital of FCML including issue premiums does not fall below €1,250,000 or the equivalent thereof in any currency in which shares in FCML are issued. Dividends may also be paid out of net unrealized capital gains after deduction of realized losses. The Board of Directors of FCML is further authorized to pay interim dividends subject to the relevant provisions of Luxembourg law.

Switzerland

Flagstone Suisse is licensed to operate as a reinsurer in Switzerland and is also licensed in Bermuda through the Flagstone Suisse branch office and is not licensed in any other jurisdictions. Because many jurisdictions do not permit insurance companies to take credit for reinsurance obtained from unlicensed or non-admitted insurers on their statutory financial statements unless appropriate security mechanisms are in place, we anticipate that our reinsurance clients will typically require Flagstone Suisse to post a letter of credit or other collateral.

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 requirements.

Bermuda

The Bermuda Insurance Act requires Flagstone Suisse to maintain a minimum solvency margin (being the minimum amount that the statutory assets must exceed the statutory liabilities as required by the Bermuda Insurance Act) equal to the greatest of (i) $100 million, (ii) 50% of net premiums written or (iii) 15% of the reserve for losses and loss adjustment expenses. To satisfy these requirements, Flagstone Suisse was required to maintain a minimum level of statutory capital and surplus of $316.6 million as at December 31, 2009. In addition, Flagstone Suisse is required to maintain a minimum liquidity ratio. As at December 31, 2010, 2009, and 2008, Flagstone Suisse was in compliance with all of the requirements of the Bermuda Insurance Act.

In addition, each Class 4 insurer must maintain its capital at a level equal to its enhanced capital requirement ("ECR") which is established by reference to the Bermuda Solvency Capital Requirement ("BSCR") model which came into force in 2008 to assist the BMA to better assess the adequacy of a Class 4 insurer's capital.

Alternatively, under the Insurance Act, insurers may, subject to the terms of the Insurance Act and to the BMA's oversight, elect to utilize an approved internal capital model to determine regulatory capital. The BMA believes that use of an internal model to substantiate the required regulatory capital requirement may in many circumstances better reflect a specific insurer's particular business profile than a market-wide regulatory model. An insurer's internal model must satisfy certain criteria to be approved for the determination of regulatory capital. In either case, the ECR shall at all times equal or exceed the Class 4 insurer's Minimum Solvency Margin and may be adjusted in circumstances where the BMA concludes that the insurer's risk profile deviates significantly from the assumptions underlying its ECR or the insurer's assessment of its risk management policies and practices used to calculate the ECR applicable to it.

Index

In 2009, the BMA launched its Bermuda Insurance Solvency Framework, which is designed to enable Bermuda to achieve "equivalence" with Solvency II. The impact of this initiative is currently being monitored by the Company.

Bermuda law limits the maximum amount of annual dividends or distributions payable by Flagstone Suisse to the Company and in certain cases requires the prior notification to, or the approval of, the Bermuda Monetary Authority (the “BMA”). 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 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 prescribed solvency margin 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. Flagstone Suisse must also maintain, as a Class 4 Bermuda reinsurer, paid-up share capital of $1 million.

Cayman Islands
Island Heritage is domiciled in the Cayman Islands and maintains a Class A Domestic Insurance License issued under the Insurance Law (as revised) of the Cayman Islands. It is thereby subject to regulation by the Cayman Islands Monetary Authority (“CIMA”), which enforces the applicable provisions of the Insurance Law and also the Monetary Authority Law.

A Class “A” Insurer’s license permits an insurer to carry on insurance business generally in or from within the islands. The Insurance Law mandates that changes to the information provided upon application for a license be approved or notified to CIMA, including director and ownership changes and the nature of the business. A relatively low capital requirement is currently prescribed in the Insurance Law, in order to accommodate the large captive insurance market in the Cayman Islands, but CIMA is able to attach conditions to licenses and thereby prescribe an appropriate capital and solvency requirement. A new law was passed in 2010 and is due to come into effect in 2011 pending the finalization of subsidiary legislation. It is expected that the 2010 Law will prescribe a risk based capital requirement comprising a minimum and a prescribed amount, which failure to meet will lead to enforcement and remedial action respectively.

South Africa
Flagstone Africa is licensed to operate as a reinsurer in South Africa and is subject to statutory minimum capital requirements under applicable legislation. In addition, a South African 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 requirements.

United Kingdom
FSML and Syndicate 1861 are regulated by the Financial Services Authority (“FSA”) in the U.K. The FSA is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. Although accountable to treasury ministers and through them to Parliament, it is funded entirely by the firms it regulates. The FSA has wide ranging powers in relation to rule-making, investigation and enforcement to enable it to meet its four statutory objectives, which are summarized as one overall aim: “to promote efficient, orderly and fair markets and to help retail consumers achieve a fair deal”.

In relation to insurance business, the FSA regulates insurers, insurance intermediaries and Lloyd’s itself. The FSA and Lloyd’s have common objectives in ensuring that Lloyd’s market is appropriately regulated and, to minimize duplication, the FSA has agreed arrangements with Lloyd’s for cooperation on supervision and enforcement.

FSML’s underwriting activities are therefore regulated by the FSA as well as being subject to the Lloyd’s “franchise”. Both FSA and Lloyd’s have powers to remove their respective authorization to manage Lloyd’s syndicates. Lloyd’s

approves annually Syndicate 1861's business plan and any subsequent material changes, and the amount of capital required to support that plan. Lloyd's may require changes to any business plan presented to it or additional capital to be provided to support the underwriting (known as Funds at Lloyd's).

Solvency II

The European Parliament passed the Solvency II directive in April 2009, to establish a revised set of European Union (EU) wide capital requirements and risk management standards. All (re)insurers, including Lloyd's and its managing agents, within the EU need to be compliant with Solvency II by January 1, 2013.

Flagstone's existing risk management framework and mechanisms closely mirror the requirements for Solvency II. Since its inception, Flagstone has invested in its internal model that generates the Group's risk profile and is currently also used to calculate the internal capital requirements for Lloyd's. Flagstone is working closely with Lloyd's to ensure full compliance with the regulations. Flagstone believes that Solvency II will have a positive impact on its operations and risk management framework.

Off-Balance Sheet Arrangements

Valais Re is a special purpose Cayman Islands exempted company licensed as a restricted Class B reinsurer in the Cayman Islands and formed solely for the purpose of entering into certain reinsurance agreements and other risk transfer agreements with subsidiaries of Flagstone Suisse.

Index

During 2008, we entered into a reinsurance agreement with Valais Re that provides us with $104.0 million of aggregate indemnity protection for certain losses from global catastrophe events.

The Company has determined that Valais Re has the characteristics of a variable interest entity that are addressed by the Consolidation Topic of the FASB ASC. In accordance with the Consolidation Topic, Valais Re is not consolidated because the Company is not the primary beneficiary.

Montana Re is a special purpose reinsurer established in the Cayman Islands and was formed as a program structure enabling further issuance of additional series of notes in the future. During 2009, we entered into a reinsurance agreement with Montana Re that provides us with $175.0 million of protection for certain losses from global catastrophe events. During 2010, we entered into an additional reinsurance agreement with Montana Re, incepting on January 1, 2011, that provides us with $210.0 million of protection for certain losses from global catastrophe events.

The Company has determined that Montana Re has the characteristics of a variable interest entity that are addressed by the Consolidation Topic of the FASB ASC. In accordance with the Consolidation Topic, Montana Re is not consolidated because the Company is not the primary beneficiary.

We are not party to any transaction, agreement or other contractual arrangement to which a Flagstone affiliated unconsolidated entity is a party, other than those noted above with Valais Re and Montana Re, that management believes is reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

For details relating to our letter of credit facilities, see "Financial Condition, Liquidity and Capital Resources - Financial Condition – Letter of Credit Facilities".

Contractual Obligations and Commitments

The following table shows our aggregate contractual obligations by time period remaining to due date as at December 31, 2010:

	Less than 1 year	1-3 years	3-5 years	More than 5 years	Total
Long term debt - Interest(1)	$ 9,183	$ 18,366	$ 18,366	$ 202,781	$ 248,696
Long term debt - Principal	-	-	-	251,122	251,122
Operating lease obligations	5,035	8,088	4,350	5,121	22,594
Loss and loss adjustment expense reserves(2)	439,914	238,993	35,670	6,737	721,314
Capital commitments(3)	9,339	2,567	-	-	11,906
Investment commitments(4)	13,700	-	-	-	13,700
Total contractual obligations	$ 477,171	$ 268,014	$ 58,386	$ 465,761	$ 1,269,332

(1) The interest on the long term debt is based on a spread above LIBOR and Euribor. We have reflected interest due in the table based on the current interest rates on the facility. See “Long Term Debt” above for further details.
(2) We have based our estimate of future claim payments upon benchmark payment patterns constructed internally, drawing upon available relevant industry sources of loss and allocated loss adjustment expense development data which may include both internal and external data sources. We also supplement these benchmark payment patterns with information received from treaty submissions and periodically update them. We believe that it is likely that this benchmark data will not be predictive of our future claim payments and that material fluctuations may occur due to the nature of the losses which we insure and the coverages which we provide. Because of the nature of the coverages that we provide, the amount and timing of the cash flows associated with our policy liabilities will fluctuate, perhaps significantly, and therefore are highly uncertain. See “Critical Accounting Estimates—Loss and Loss Adjustment Expense Reserves.”
(3) We have entered into commitment for the construction of office buildings located in Luxembourg and Martigny.
(4) We have made certain commitments with respect to investment funds and may receive capital call requests in 2011.

Currency

Our reporting currency is the U.S. dollar. We have exposure to foreign currency risk due to the following: our investments in foreign subsidiaries whose functional currencies are typically their national currencies; our underwriting reinsurance exposures; the collection of premiums and payment of claims and other general operating expenses denominated in currencies other than the U.S. dollar; and holding certain net assets in foreign currencies. Our most significant foreign currency exposures are to the Euro and the British pound sterling.

Index

We designated $43.2 million of foreign currency forwards contractual value as hedge instruments, which had a fair value of $(0.5) million at December 31, 2010. During the year ended December 31, 2010, we recorded $0.2 million of realized and unrealized losses directly into comprehensive income as part of the cumulative translation adjustment for the effective portion of the hedge. The losses on forward contracts resulted from the continued weakening of the U.S. dollar against the Swiss franc.

At December 31, 2010, the value of the U.S. dollar strengthened approximately 3.5% against the British pound sterling, 6.9% against the Euro and weakened approximately 10.6% against the Swiss franc, compared to December 31, 2009. Since a large proportion of our assets and liabilities are expressed in these currencies, there was a net decrease in the U.S. dollar value of the assets and liabilities denominated in these currencies in 2010.

Net foreign exchange losses amounted to $4.7 million $3.2 million, and $21.5 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Effects of Inflation

The effects of inflation are considered implicitly in pricing and estimating reserves for unpaid losses and loss expenses. The actual effects of inflation on the results of operations of the Company cannot be accurately known until claims are ultimately settled.

We do not believe that inflation has had a material effect on our consolidated results of operations, except insofar as (a) inflation may affect interest rates, and (b) losses and loss expenses may be affected by inflation. The potential exists, after a catastrophe loss, for the development of inflationary pressures in a local economy. The effects of inflation are considered implicitly in pricing through the modeled components such as demand surge. Loss reserves are established to recognize likely loss settlements at the date payment is made. Those reserves inherently recognize the effects of inflation. The actual effects of inflation on our results cannot be accurately known, however, until claims are ultimately resolved.

Index

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We measure and manage market risks and other risks as part of an enterprise-wide risk management process. The market risks described in this section relate to financial instruments, primarily in our investment portfolio, that are sensitive to changes in interest rates, credit risk premiums or spreads, foreign exchange rates and equity prices.

We are exposed principally to four types of market risk: interest rate risk, equity price risk, credit risk and foreign currency risk.

Interest Rate Risk

Our primary market risk exposure is to changes in interest rates. Fluctuations in interest rates have a direct impact on the market valuation of our fixed maturity portfolio. As interest rates rise, the market value of our fixed maturity portfolio falls and we have the risk that cash outflows will have to be funded by selling assets, which will be trading at depreciated values. As interest rates decline, the market value of our fixed maturity portfolio increases and we have reinvestment risk since funds reinvested may earn less than is necessary to match anticipated liabilities. We expect to manage interest rate risk by selecting investments with characteristics such as duration, yield, currency and liquidity which can be tailored to the anticipated cash outflow characteristics of our reinsurance liabilities. In addition, from time-to-time, we may enter into interest rate swap contracts as protection against unexpected shifts in interest rates, which would affect the fair value of the fixed maturity portfolio. By using swaps in the portfolio, the overall duration or interest rate sensitivity of the portfolio can be altered.

As at December 31, 2010, the impact on our fixed maturity securities and cash and cash equivalents from an immediate 100 basis point increase in market interest rates would have resulted in an estimated decrease in market value of 1.9%, or approximately $32.2 million. As at December 31, 2010, the impact on our fixed maturity securities and cash and cash equivalents from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 1.8%, or approximately $29.3 million. As at December 31, 2009, the impact on our fixed maturity securities and cash and cash equivalents, from an immediate 100 basis point increase in market interest rates would have resulted in an estimated decrease in market value of 2.3%, or approximately $40.3 million. As at December 31, 2009, the impact on our fixed maturity securities and cash and cash equivalents, from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated increase in market value of 2.3%, or approximately $40.5 million.

The Company uses interest rate futures to manage the duration of the investment portfolio. As at December 31, 2010, the total exposure of the interest rate futures contracts held was $1.1 billion and these positions had a fair value of $(2.3) million. The interest rate futures contracts held were for three month exposure to U.S. and Euro interest rates, and we held short positions which reduced the duration of our portfolio. As at December 31, 2010, the impact of these futures on our fixed maturity securities and cash and cash equivalents was a reduction of duration by 0.7 years. The impact from an immediate 100 basis point increase in market interest rates would have resulted in an estimated increase in market value of the interest rate futures contracts by approximately $10.8 million. The impact from an immediate 100 basis point decrease in market interest rates would have resulted in an estimated decrease in market value of the interest rate futures contracts by approximately $10.1 million. As at December 31, 2009, the Company did not hold any interest rates futures contracts for the purpose of duration management within the investment portfolio.

As at December 31, 2010, we held $313.5 million, or 21.1%, of our fixed maturity portfolio in asset-backed and mortgage-backed securities. As at December 31, 2009, we held $163.2 million, or 11.2%, of our fixed maturity portfolio in asset-backed and mortgage-backed securities. We did not hold any sub-prime securities at December 31, 2010 or 2009. These assets are exposed to prepayment risk, which occurs when holders of underlying loans increase

the frequency with which they prepay the outstanding principal before the maturity date and refinance at a lower interest rate cost. The adverse impact of prepayment is more evident in a declining interest rate environment. As a result, we would also be exposed to reinvestment risk, as cash flows received by us could be accelerated and would be reinvested at the prevailing interest rates.

Equity Price Risk

We gain exposure to the equity, commodities and real estate markets through the use of various equity securities and index-linked futures. The total of such exposure as of December 31, 2010 and 2009 were $170.4 and $151.1 million, respectively. The fair value of these positions as at December 31, 2010 and 2009 amounted to $4.9 and $4.5 million, respectively, and were recorded in both equity investments, other assets and other liabilities with net realized and unrealized gains of $17.4 million and $6.0 million, respectively, for the years ended December 31, 2010 and 2009, and were recorded in net realized and unrealized gains – investments. The total exposure of the index-linked futures was $170.1 million as at December 31, 2010 compared to $150.8 million at December 31, 2009.

Credit Risk

We have exposure to credit risk primarily as a holder of fixed maturity securities. Our risk management strategy and investment guidelines have been defined to ensure we invest in debt instruments of high credit quality issuers and to limit the amount of credit exposure with respect to particular ratings categories and any one issuer. As at December 31, 2010, our fixed maturity investments consisted of investment grade securities with an average rating of AA+.

Index

We believe this high-quality portfolio reduces our exposure to credit risk on fixed income investments to an acceptable level. We have included credit rating information with respect to our investment portfolio because it enhances the reader's understanding of its composition and consistency with our investment philosophy.

To a lesser extent, we also have credit risk exposure as a party to over-the-counter derivative instruments. These derivative instruments include foreign currency forward contracts, currency swaps, total return swaps, and reinsurance derivatives. To mitigate this risk, we monitor our exposure by counterparty and ensure that counterparties to these contracts are high-credit-quality international banks or counterparties.

In addition, we have exposure to credit risk as it relates to our insurance and reinsurance balances receivable. Premium balances receivable from our clients at December 31, 2010 and 2009, were $318.5 million and $279.0 million, respectively, including balances both currently due and accrued. We believe that credit risk exposure related to these balances is mitigated by several factors, including but not limited to credit checks performed as part of the underwriting process, monitoring of aged receivable balances, our right to cancel the cover for non-payment of premiums, and our right to offset premiums yet to be paid against losses due to the cedent. Since our inception in October 2005, we have recorded $4.0 million in bad debt expenses related to our insurance and reinsurance balances receivable.

We purchase retrocessional reinsurance and we require our reinsurers to have adequate financial strength. We evaluate the financial condition of our reinsurers and monitor our concentration of credit risk on an ongoing basis.

In addition, consistent with industry practice, we assume a degree of credit risk associated with reinsurance and insurance brokers. We frequently pay amounts owed on claims under our policies to reinsurance brokers, and these brokers, in turn, pay these amounts to 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 for the deficiency. Conversely, in certain jurisdictions, when the ceding insurer pays premiums to reinsurance brokers for payment to us, these premiums are considered to have been paid and the ceding insurer will no longer be liable to us for those amounts, regardless of whether we have received the premiums.

For risk management purposes, we use catastrophe bonds to manage our reinsurance risk and treat the catastrophe risks related to Catastrophe bonds as part of our underwriting risks. Catastrophe bonds are selected by our reinsurance underwriters however they are held in our investment portfolio as floating rate bonds for performance purposes.

Foreign Currency Risk

We and our subsidiaries use foreign currency forward contracts and currency swaps to manage currency exposure. The net notional exposure of foreign currency forward contracts in U.S. dollars as of December 31, 2010 and 2009, was $854.2 million and $373.7 million, respectively. These contracts had a fair value of $(5.2) million and $5.8 million, respectively. The change results from an increased allocation to our non-U.S. dollar strategy, which we hedge back to U.S. dollars. For the years ended December 31, 2010 and 2009, we recorded net realized and unrealized losses of $1.9 million and $17.2 million, respectively, on foreign currency forward contracts.

Premiums, Reserves, and Claims

The U.S. dollar is our principal reporting currency and the functional currencies of our operating subsidiaries are generally their national currencies, except for our Bermuda, Cayman Islands, Luxembourg, Gibraltar, FSML subsidiaries and Flagstone Suisse, each of whose functional currency is the U.S. dollar. We enter into reinsurance contracts where the premiums receivable and losses payable are denominated in currencies other than the U.S. dollar. When we incur a loss in a non-U.S. dollar currency, we carry the liability on our books in the original

currency. As a result, we have an exposure to foreign currency risk resulting from fluctuations in exchange rates between the time premiums are collected and the time claims are paid.

With respect to loss reserves denominated in non-U.S. dollar currencies, our policy is to hedge our non-U.S. dollar foreign currency exposure with foreign exchange forward contracts.

Investments

A large portion of the securities held in our investment portfolios are measured in U.S. dollars, with a portion of our fixed maturities portfolio invested in non-U.S. dollar currencies. At the time of purchase, each investment is identified as either a hedged investment, to be maintained with an appropriate currency hedge to U.S. dollars or an unhedged investment, one not to be maintained with a hedge. Generally, fixed income investments will be hedged, listed equity investments may or may not be hedged, and other investments such as investment funds will not be hedged.

Index

Financing

Certain of our subsidiaries have a functional currency other than U.S. dollar. Our practice is to hedge the net investment in those subsidiaries and designate foreign currency forward contracts as hedging instruments. The contractual amount of these contracts as at December 31, 2010 and 2009 was $43.2 million and $88.3 million, respectively, and the contracts had a fair value of $(0.5) million and $(0.4) million, respectively. During the years ended December 31, 2010 and December 31, 2009, we recorded $0.2 million and $4.6 million, respectively, of realized and unrealized losses directly into comprehensive income as part of the cumulative translation adjustment for the effective portion of the hedge.

We entered into a currency swap agreement to hedge the Euro-denominated deferrable interest debentures recorded as long term debt. Under the terms of the foreign currency swap, we exchanged €13.0 million for $18.4 million, and will receive Euribor plus 354 basis points and pay LIBOR plus 367 basis points. The swap expires on September 15, 2011 and had a fair value of $1.0 million as at December 31, 2010.

Foreign currency exchange contracts will not eliminate fluctuations in the value of our assets and liabilities denominated in foreign currencies but rather allow us to establish a rate of exchange for a future point in time. Of our business written in the years ended December 31, 2010 and 2009, approximately 32.5% and 32.1%, respectively, was written in currencies other than the U.S. dollar. For the year ended December 31, 2010, we had net foreign exchange losses of $4.7 million compared to $3.2 million for the same period in 2009.

We do not hedge currencies for which our asset or liability exposures are not material or where we are unable or it is impractical to do so. In such cases, we are exposed to foreign currency risk. However, we do not believe that the foreign currency risks corresponding to these unhedged positions are material.

Index

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Report of Independent Registered Public Accounting Firm	95
Consolidated Balance Sheets as at December 31, 2010 and 2009	96
Consolidated Statements of Operations and Comprehensive Income (Loss) for the Years Ended December 31, 2010, 2009 and 2008	97
Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2010, 2009 and 2008	98
Consolidated Statements of Cash Flows for the Years Ended December 31, 2010, 2009 and 2008	101
Notes to the Consolidated Financial Statements	102

Index

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Flagstone Reinsurance Holdings, S.A.
Luxembourg, Luxembourg

We have audited the accompanying consolidated balance sheets of Flagstone Reinsurance Holdings, S.A. and subsidiaries (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedules listed in the Index at Item 15. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Flagstone Reinsurance Holdings, S.A. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 2, 2011 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche
Hamilton, Bermuda
March 2, 2011

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
CONSOLIDATED BALANCE SHEETS
As at December 31, 2010 and 2009
(Expressed in thousands of U.S. dollars, except share data)

	As at December 31, 2010	2009
ASSETS		
Investments:		
Fixed maturities, at fair value (Amortized cost: 2010 - $1,433,868; 2009 - $1,198,187)	$ 1,473,862	$ 1,228,561
Short term investments, at fair value (Amortized cost: 2010 - $14,254; 2009 - $231,609)	14,251	232,434
Equity investments, at fair value (Amortized cost: 2010 - $7,931; 2009 - $8,516)	283	290
Other investments	119,764	45,934
Total investments	1,608,160	1,507,219
Cash and cash equivalents	345,705	352,185
Restricted cash	43,413	85,916
Premium balances receivable	318,455	278,956
Unearned premiums ceded	68,827	52,690
Reinsurance recoverable	28,183	19,270
Accrued interest receivable	15,599	11,223
Receivable for investments sold	1,795	5,160
Deferred acquisition costs	65,917	54,637
Funds withheld	25,934	22,168
Goodwill	16,381	16,533
Intangible assets	31,549	35,790
Asset held for sale	2,300	-
Other assets	146,984	125,021
Total assets	$ 2,719,202	$ 2,566,768
LIABILITIES		
Loss and loss adjustment expense reserves	$ 721,314	$ 480,660
Unearned premiums	378,804	330,416
Insurance and reinsurance balances payable	82,134	62,864
Payable for investments purchased	3,106	11,457
Long term debt	251,122	252,402
Other liabilities	86,127	63,155
Total liabilities	1,522,607	1,200,954
EQUITY		
Common voting shares, 300,000,000 authorized, $0.01 par value, issued (2010 - 84,474,758; 2009 - 84,985,219) and outstanding (2010 - 68,585,588; 2009 - 82,985,219)	845	850
Common shares held in treasury, at cost (2010 -15,889,170; 2009 - 2,000,000)	(178,718)	(19,750)

Additional paid-in capital	904,235	912,547
Accumulated other comprehensive loss	(6,178)	(6,976)
Retained earnings	414,549	324,347
Total Flagstone shareholders' equity	1,134,733	1,211,018
Noncontrolling interest in subsidiaries	61,862	154,796
Total equity	1,196,595	1,365,814
Total liabilities and equity	$ 2,719,202	$ 2,566,768

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

96

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
For the Years Ended December 31, 2010, 2009 and 2008
(Expressed in thousands of U.S. dollars, except share and per share data)

	For the years ended December 31,		
	2010	2009	2008
REVENUES			
Gross premiums written	$ 1,097,850	$ 988,491	$ 781,889
Premiums ceded	(213,996)	(196,022)	(87,191)
Net premiums written	883,854	792,469	694,698
Change in net unearned premiums	(31,770)	(34,014)	(40,530)
Net premiums earned	852,084	758,455	654,168
Net investment income	31,482	28,531	51,398
Net realized and unrealized gains (losses) - investments	43,769	39,668	(272,206)
Net realized and unrealized gains - other	14,441	11,253	11,617
Other income	25,545	21,728	8,215
Total revenues	967,321	859,635	453,192
EXPENSES			
Loss and loss adjustment expenses	530,136	283,185	379,884
Acquisition costs	164,820	136,471	105,734
General and administrative expenses	171,693	147,138	99,026
Interest expense	10,352	12,105	18,297
Net foreign exchange losses	4,719	3,231	21,477
Total expenses	881,720	582,130	624,418
Income (loss) before income taxes and interest in earnings of equity investments	85,601	277,505	(171,226)
Recovery (provision) for income tax	4,053	(5,412)	(1,178)
Interest in earnings of equity investments	(1,240)	(1,356)	(1,299)
Net income (loss)	88,414	270,737	(173,703)
Less: Loss (income) attributable to noncontrolling interest	8,670	(28,545)	(13,599)
NET INCOME (LOSS) ATTRIBUTABLE TO FLAGSTONE	$ 97,084	$ 242,192	$ (187,302)
Net income (loss)	$ 88,414	$ 270,737	$ (173,703)
Change in currency translation adjustment	607	2,600	(16,251)
Change in defined benefit pension plan obligation	191	136	(887)
Comprehensive income (loss)	89,212	273,473	(190,841)
Less: Comprehensive loss (income) attributable to noncontrolling interest	8,670	(29,986)	(12,158)
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO FLAGSTONE	$ 97,882	$ 243,487	$ (202,999)
	78,656,688	84,279,777	85,328,704

Weighted average common shares outstanding—Basic						
Weighted average common shares outstanding—Diluted		78,880,590		84,503,792		85,328,704
Net income (loss) attributable to Flagstone per common share—Basic	$	1.23	$	2.87	$	(2.20)
Net income (loss) attributable to Flagstone per common share—Diluted	$	1.23	$	2.87	$	(2.20)
Distributions declared per common share (1)	$	0.16	$	0.16	$	0.16

(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.

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

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Year Ended December 31, 2010
(Expressed in thousands of U.S. dollars)

			Flagstone Shareholders' Equity					
For the year ended December 31, 2010	Total equity	Comprehensive income	Retained earnings	Accumulated other comprehensive loss	Common voting shares	Treasury shares	Additional paid-in capital	Noncontrolling interest in subsidiaries
Beginning balance	$ 1,365,814	$ -	$ 324,347	$ (6,976)	$ 850	$ (19,750)	$ 912,547	$ 154,796
Repurchase of preferred shares	(79,529)							(79,529)
Comprehensive income:								
Net income	88,414	88,414	97,084					(8,670)
Other comprehensive income:								
Change in currency translation adjustment	607	607		607				
Defined benefit pension plan obligation	191	191		191				
	798	798						
Comprehensive income	89,212	$ 89,212						
Stock based compensation	18,130						18,130	
Subsidiary stock based compensation	(274)							(274)
Purchase of noncontrolling interest	(750)						(411)	(339)
Warrant repurchase	(14,200)						(14,200)	
Shares repurchased and cancelled	(5,375)				(5)		(5,370)	
Shares repurchased and held in treasury	(158,968)					(158,968)		
	(17,465)		(6,882)				(6,461)	(4,122)

Distributions declared per common share (1)							
Ending balance	$ 1,196,595	$ 414,549	$ (6,178)	$ 845	$ (178,718)	$ 904,235	$ 61,862

(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.

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

98

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Year Ended December 31, 2009
(Expressed in thousands of U.S. dollars)

			Flagstone Shareholders' Equity					
For the year ended December 31, 2009	Total equity	Comprehensive income	Retained earnings	Accumulated other comprehensive loss	Common voting shares	Treasury shares	Additional paid-in capital	Noncontrolling interest in subsidiaries
Beginning balance	$ 1,183,463	$ -	$ 96,092	$ (8,271)	$ 848	$ -	$ 897,344	$ 197,450
Repurchase of preferred shares	(63,117)							(63,117)
Comprehensive income:								
Net loss	270,737	270,737	242,192					28,545
Other comprehensive income:								
Change in currency translation adjustment	2,600	2,600		1,159				1,441
Defined benefit pension plan obligation	136	136		136				
	2,736	2,736						
Comprehensive income	273,473	$ 273,473						
Stock based compensation	15,814						15,814	
Subsidiary stock based compensation	105							105
Subsidiary stock issuance	-						(184)	184
Purchase of noncontrolling interest	(10,989)						(771)	(10,218)
Sale of noncontrolling interest	750						344	406
Issue of shares, net	2				2			
Shares repurchased and	(19,750)					(19,750)		

held in treasury								
Dividends declared	(13,937)		(13,937)					
Ending balance	$ 1,365,814		$ 324,347	$ (6,976)	$ 850	$ (19,750)	$ 912,547	$ 154,796

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

99

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Year Ended December 31, 2008
(Expressed in thousands of U.S. dollars)

			Flagstone Shareholders' Equity				
For the year ended December 31, 2008	Total equity	Comprehensive income	Retained earnings	Accumulated other comprehensive loss	Common voting shares	Additional paid-in capital	Noncontrolling interest in subsidiaries
Beginning balance	$ 1,395,263	$ -	$ 296,890	$ 7,426	$ 853	$ 905,316	$ 184,778
Repurchase of preferred shares	(6,639)						(6,639)
Acquisition of subsidiaries	7,567						7,567
Comprehensive income:							
Net income	(173,703)	(173,703)	(187,302)				13,599
Other comprehensive income:							
Change in currency translation adjustment	(16,251)	(16,251)		(14,810)			(1,441)
Defined benefit pension plan obligation	(887)	(887)		(887)			
	(17,138)	(17,138)					
Comprehensive income	(190,841)	$ (190,841)					
Stock based compensation	(4,020)					(4,020)	
Subsidiary stock based compensation	(449)						(449)
Subsidiary stock issuance	-					(126)	126
Fair value of issued warrant	3,565					3,565	
Issue of shares, net	(748)				2	(750)	
Shares repurchased and cancelled	(6,648)				(7)	(6,641)	
	(13,496)		(13,496)				

Dividends declared											
Other		(91)									(91)
Ending balance	$	1,183,463	$	96,092	$	(8,271)	$	848	$	897,344	$ 197,450

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

100

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2010, 2009, and 2008
(Expressed in thousands of U.S. dollars)

	For the years ended December 31,		
	2010	2009	2008
Cash flows provided by (used in) operating activities:			
Net income (loss)	$ 88,414	$ 270,737	$ (173,703)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Net realized and unrealized (gains) losses	(58,210)	(50,921)	260,589
Net unrealized foreign exchange (gains) losses	(2,060)	710	30,792
Depreciation and amortization expense	7,400	7,125	4,797
Share based compensation expense (recovery)	17,345	15,932	(325)
Interest in earnings of equity investments	1,240	1,356	1,299
Accretion/amortization on fixed maturity investments	5,290	3,194	(11,560)
Asset impairment charge	15,883	-	-
Changes in assets and liabilities, excluding net assets acquired:			
Premium balances receivable	(35,907)	(59,999)	(42,773)
Unearned premiums ceded	(16,170)	(21,050)	(13,799)
Reinsurance recoverable	(9,666)	(1,523)	(6,615)
Deferred acquisition costs	(11,352)	(9,316)	(6,834)
Funds withheld	(3,982)	(7,561)	(7,677)
Loss and loss adjustment expense reserves	241,253	60,093	165,926
Unearned premiums	48,365	53,815	61,038
Insurance and reinsurance balances payable	18,472	35,884	5,157
Other changes in assets and liabilities, net	(13,781)	39,973	(37,905)
Net cash provided by operating activities	292,534	338,449	228,407
Cash flows (used in) provided by investing activities:			
Net cash paid in acquisition/disposal of subsidiaries	(750)	(12,354)	(37,344)
Purchases of fixed maturity investments	(3,000,458)	(2,470,554)	(1,313,953)
	2,998,971	1,887,700	1,610,242

Sales and maturities of fixed maturity investments						
Purchases of equity investments		-		(37,679)		(121,901)
Sales of equity investments		-		43,851		143,505
Purchases of other investments		(76,906)		(31,460)		(579,832)
Sales and maturities of other investments		39,032		15,737		592,083
Purchases of fixed assets		(31,480)		(12,831)		(21,420)
Sales of fixed asset		3,477		1,101		1,550
Change in restricted cash		42,503		(43,513)		(39,571)
Net cash (used in) provided by investing activities		(25,611)		(660,002)		233,359
Cash flows (used in) provided by financing activities:						
Issue of common shares, net of issuance costs paid		-		(586)		(878)
Shares repurchased and cancelled		(5,375)		-		(6,648)
Shares repurchased and held in treasury		(158,968)		(19,750)		-
Warrant repurchased		(14,200)		-		-
Contribution (distribution) of noncontrolling interest		-		289		(415)
Repurchase of noncontrolling interest		(79,529)		(63,117)		(6,639)
Distributions paid on common shares (1)		(12,571)		(13,414)		(13,496)
Repayment of long term debt		-		(15,042)		(9,167)
Other		852		827		(3,311)
Net cash used in financing activities		(269,791)		(110,793)		(40,554)
Effect of foreign exchange rate on cash		(3,612)		826		(129)
(Decrease) increase in cash and cash equivalents		(6,480)		(431,520)		421,083
Cash and cash equivalents - beginning of year		352,185		783,705		362,622
Cash and cash equivalents - end of year	$	345,705	$	352,185	$	783,705
Supplemental cash flow information:						
Receivable for investments sold	$	1,795	$	5,160	$	9,634
Payable for investments purchased	$	3,106	$	11,457	$	7,776
Interest paid	$	9,327	$	11,716	$	17,863

(1)Distributions paid 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 accompanying notes to the consolidated financial statements are an integral part of the consolidated financial statements.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

1. ORGANIZATION

Flagstone Reinsurance Holdings, S.A ("Flagstone" or the "Company") is a holding company incorporated as a société anonyme under the laws of Luxembourg. On May 14, 2010, the Company's shareholders approved the redomestication to change the Company's jurisdiction of incorporation from Bermuda to Luxembourg and the Company 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"). As a result of the Redomestication, the Company changed its name from Flagstone Reinsurance Holdings Limited to Flagstone Reinsurance Holdings, S.A. The Company was originally incorporated on October 4, 2005 under the laws of Bermuda.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). These consolidated financial statements include the accounts of the Company and its subsidiaries, including those that meet the consolidation requirements of variable interest entities ("VIEs"). The Company assesses the consolidation of VIEs based on whether the Company is the primary beneficiary of the entity in accordance with the Consolidation Topic of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). Entities in which the Company has an ownership of more than 20% and less than 50% of the voting shares are accounted for using the equity method. All inter-company accounts and transactions have been eliminated on consolidation.

Prior to 2009, the Company operated through two reportable segments: Reinsurance and Insurance. Following a review of its operating segments in 2009, the Company revised its reportable business segments and is currently organized into three reportable business segments: Reinsurance, Lloyd's and Island Heritage (previously referred to as the Insurance segment until January 1, 2010).

These financial statements contain certain reclassifications of prior period amounts to be consistent with the current period presentation with no effect on net income or loss.

Use of Estimates in Financial Statements

The preparation of these consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the disclosed amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's principal estimates are for loss and loss adjustment expenses ("LAE"), estimates of premiums written, premiums earned, acquisition costs, fair value of investments and share based compensation. The Company reviews and revises these estimates as appropriate based on current information. Any adjustments made to these estimates are reflected in the period the estimates are revised.

Loss and Loss Adjustment Expense Reserves

Loss and loss adjustment expense reserves, including losses incurred but not reported ("IBNR") and provisions for settlement expenses, include amounts determined from loss reports on individual cases, independent actuarial determinations and amounts based on the Company's own historical experience. To the extent that the Company's own historical experience is inadequate for estimating reserves, such estimates may be determined based upon industry data and management estimates.

A significant portion of the Company's business is property catastrophe and programs with high attachment points of coverage. Reserving for losses in such programs is inherently judgmental in that losses in excess of the attachment level on those programs are characterized as high severity and low frequency and losses are impacted by other factors which could vary significantly as claims are settled. This limits the volume of relevant industry claims experience available from which to reliably predict ultimate losses following a loss event. In addition, the Company has limited past loss experience due to its relatively short operating history, which increases the inherent uncertainty in estimating ultimate loss levels.

Loss and loss adjustment expense reserves include a component for outstanding case reserves for which claims have been reported and a component for IBNR. Case reserve estimates are initially set on the basis of loss reports received from insureds and ceding companies. Estimated IBNR reserves consist of a provision for additional development in excess of the case reserves reported by insureds and ceding companies as well as a provision for claims which have occurred but which have not yet been reported to the Company's insureds and by ceding companies.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

IBNR reserves are estimated by management using various actuarial methods as well as a combination of the Company's loss experience, insurance industry loss experience, underwriters' experience, general market trends, and management's judgment. The Company's internal actuaries review the reserving assumptions and methodologies on a quarterly basis.

While management believes the reserves for case and IBNR reserves are sufficient, the uncertainties inherent in the reserving process, delays in insureds and ceding companies reporting losses to the Company together with the potential for unforeseen adverse developments, may result in loss and loss adjustment expense reserves significantly greater or less than the reserve provided at the time of the loss event. Loss and loss adjustment expense reserve estimates are regularly reviewed and updated as new information becomes known. Any resulting adjustments are reflected in the period in which they become known.

Premiums and Acquisition Costs

Premiums are first recognized as written as at the date that the contract is bound. The Company writes both excess of loss and pro rata reinsurance contracts, and also writes a select property insurance portfolio.

For excess of loss contracts, premiums written are based on the deposit premium as defined in the contract, which is generally based on an estimate at the inception of the contract of the underlying exposure (e.g., values of properties insured) during the contract period. At the end of the policy term, a final premium is calculated based on the actual underlying exposure during the contract period and an adjustment to the deposit premium, if any, is recognized in the period in which it is determined. For pro rata contracts where no deposit premium is specified in the contract, premiums written are based on estimates of ultimate premiums provided by the ceding companies. Initial estimates of premiums written are reflected quarterly from the period in which the underlying risks incept. Subsequent adjustments, based on reports of actual premiums written by the ceding companies, or revisions in estimates, are recorded in the period in which they are determined.

The Company has entered into industry loss warranty ("ILW") transactions that are structured as reinsurance or derivatives. The Company evaluates each contract in accordance with Derivatives Implementation Group B26, "Dual Trigger Property and Casualty Contracts" to determine if the amounts received from these contracts should be recorded as reinsurance transactions or as derivatives. When the transactions are determined to be reinsurance, the consideration received is recorded as premiums written and earned over the contract period.

Premiums receivable are recorded as amounts due less any required provision for doubtful accounts.

Premiums are earned over a period that is consistent with the risks covered under the terms of the contract, which is generally one to two years. For contracts written on a policies attaching basis, the risk period is based on the terms of the underlying contracts and is generally assumed to be two years. The portion of the premium related to the unexpired portion of the risk period is reflected in unearned premiums. Where contract terms require the reinstatement of coverage after a ceding company's loss, the mandatory reinstatement premiums are recorded as written and are recognized as premiums earned when the loss event occurs.

Reinsurance and insurance premiums ceded are expensed over the period the reinsurance coverage is provided. Unearned ceded premiums represent the portion of premiums ceded related to the unexpired portion of the risk period.

Acquisition costs are comprised of ceding commissions, brokerage, premium taxes, profit commissions and other expenses that relate directly to the writing of reinsurance contracts. Deferred acquisition costs are amortized over the underlying term of the related contracts and are limited to their estimated realizable value based on the related unearned premiums, anticipated loss and loss adjustment expenses and investment income.

Investments, Cash and Cash Equivalents

In accordance with the Financial Instruments Topic of the FASB ASC, the Company elects 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. In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, any movement in unrealized gains and losses has been recorded within net realized and unrealized gains (losses) on investments 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, the amortization of premiums and discounts on investments, using the effective interest rate method and investment management related expenses.

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The Company's 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.

Investments in U.S. government agency securities, corporate bonds, mortgage-backed securities, other 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.

Short term investments comprise fixed maturity investments with a maturity greater than three months but less than one year from the date of purchase. Cash and cash equivalents and restricted cash include amounts held in banks, money market funds and time deposits with maturities of less than three months at the date of purchase.

Investments in preferred or voting common shares in which the Company has significant influence over the operating and financial policies of the investee are classified as other investments and are accounted for under the equity method of accounting. Under this method, the Company records its proportionate share of income or loss from such investments in interest in earnings of equity investments for the period. Any decline in value of the equity method investments considered by management to be other-than-temporary is charged to income in the period in which it is determined.

Net investment income is stated net of investment management and custody fees. Investment income is recognized when earned and includes interest and dividend income together with the amortization of premiums and the accretion of discounts calculated under the interest method on fixed maturity investments purchased at amounts different from their par value.

Share Based Compensation

The Company accounts for share based compensation in accordance with the Compensation – Stock Compensation Topic of the FASB ASC which requires entities to measure the cost of services received from employees and directors in exchange for an award of equity instruments based on the grant date fair value of the award. The cost of such services will be recognized as compensation expense over the period during which an employee or director is required to provide service in exchange for the award.

The Company’s share based compensation plans consists of Performance Share Units (“PSUs”) and Restricted Share Units (“RSUs”). The PSUs are designed to maximize shareholder value over long periods of time by aligning the financial interests of the Company’s management with those of its shareholders. The Company estimates the fair value of PSUs granted under the PSU Plan on the date of grant using the grant date fair value and the most probable performance factor for the two-year and three-year performance period and records the compensation expense in its consolidated statements of operations and comprehensive income (loss) over the course of such period. At the end of each quarter, the Company reassesses the projected results for each two-year and three-year performance period as its financial results evolve. The Company recalculates the compensation expense under the PSU Plan and reflects any adjustments in the consolidated statements of operations and comprehensive income (loss) in the period in which they are determined.

The RSUs are granted to employees and directors of the Company. RSUs granted to employees generally vest two years after the date of grant and RSUs granted to directors vest on the date of grant. The company estimates the fair value of RSUs on the date of grant and records the compensation expense in its consolidated statements of operations and comprehensive income (loss) over the vesting period.

Derivative Instruments

The Company accounts for its derivative instruments using the Derivatives and Hedging Topic of the FASB ASC which requires an entity to recognize all derivative instruments as either assets or liabilities in the balance sheet and measure those instruments at fair value, with the fair value recorded in other assets or liabilities.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The accounting for realized and unrealized gains and losses associated with changes in the fair value of derivatives depends on its hedge designation and if designated as a hedging instrument whether the hedge is effective in achieving offsetting changes in the fair value of the asset or liability being hedged. The realized and unrealized gains and losses on derivatives not designated as hedging instruments are included in net realized and unrealized gains and losses in the consolidated statements of operations and comprehensive income (loss). Gains and losses associated with changes in fair value of the designated hedge instruments are recorded with the gains and losses on the hedged items, to the extent that the hedge is effective. Derivative instruments are stated at fair value in accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC based on a quoted market price for futures contracts and based on observable market inputs (such as currency spot and forward rates, underlying exchange traded securities yield curves and transactional history) for foreign currency forwards, total return swaps, currency swaps, interest rates swaps and "to be announced" mortgage-backed securities ("TBAs"). The Company estimates the fair value of reinsurance derivative contracts using internal valuation models, with the significant inputs to the valuation models being the underlying risk exposure and remaining contract duration.

Derivatives used in hedging activities

The Company utilizes foreign currency forward contracts to manage its foreign currency exposure. On the date the Company enters into a forward contract, it designates whether the derivative is to be used as a hedge of an identified foreign currency exposure (a designated hedge). As part of the overall currency risk management strategy, the Company uses forward contracts to hedge the currency exposure of their investments and loans to subsidiaries (hedged items).

The Company formally documents all relationships between designated hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company specifically identifies the investments in or loans to subsidiaries that have been designated as hedged items and states how the hedging instruments are expected to hedge the risks related to the hedged items. The Company formally measures effectiveness of its designated hedging relationships, both at the hedge inception and at least once every three months. The Company assesses the effectiveness of its designated foreign currency hedges, using the spot method, based on the value of the investment in and loans to subsidiaries and the currency translation adjustment recorded upon consolidation. The time value component of the designated fair value hedges is excluded from the assessment of hedge effectiveness.

The Company will discontinue hedge accounting prospectively if management determines that a derivative no longer qualifies as an effective hedge in offsetting changes in the foreign currency exposure of a hedged item. If hedge accounting is discontinued for foreign currency hedging of investment in and loans to subsidiaries, the derivative would continue to be carried in the consolidated balance sheets at fair value, with changes in fair value recognized in current period net income.

Other derivative instruments

The Company generally uses currency swaps and foreign currency forward contracts to manage its duration and currency exposures. The Company may acquire TBAs and for the period between the purchase of the TBAs and the

issuance of the underlying securities, the Company's position is accounted for as a derivative. The Company also uses futures contracts and total return swaps for the purpose of replicating investment positions, managing market exposure and enhancing investment performance.

Reinsurance derivative contracts

The Company has entered into ILW transactions that are structured as reinsurance or derivatives. When ILW transactions are determined to be derivatives, they are recorded at fair value in other assets or liabilities with the changes in fair value reported in realized gains and losses in the consolidated statements of operations and comprehensive income (loss).

The Company has entered into futures options contracts, both purchased and written, on major hurricane indexes that are traded on the Chicago Mercantile Exchange. The Company uses these futures options contracts to manage exposures as part of its reinsurance activities. These derivatives are recorded at fair value in other assets or liabilities with changes in fair value recorded in net realized and unrealized gains and losses in the consolidated statements of operations and comprehensive income (loss).

Goodwill and Intangible Assets

The Company accounts for intangible assets that arise from business combinations in accordance with the Business Combinations Topic of the FASB ASC. Intangible assets with a finite life are amortized over the estimated useful life of the asset. Intangible assets with an indefinite useful life are not amortized.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired by the Company. Goodwill is recorded as an asset and is not amortized.

In accordance with the Intangibles – Goodwill and Other Topic of the FASB ASC, the Company performs, at a minimum, an annual valuation of its goodwill and intangible assets to test for impairment or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. For purposes of annual impairment evaluation, goodwill is assigned to the applicable reporting unit of the acquired entities giving rise to the goodwill. Fair value is determined using widely acceptable valuation techniques, such as discounted cash flows and market multiple models. These types of analyses contain uncertainties because they require management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. It is the Company’s policy to conduct impairment testing based on the Company’s current business strategy in light of present industry and economic conditions, as well as the Company’s future expectations. If, as a result of the assessment, the Company determines that the value of its goodwill and intangible assets are impaired, the Company will record an impairment charge in the period in which the determination is made.

Equity method investments will be reviewed annually, at a minimum, for potential impairment in accordance with FASB ASC Topic on Investments – Equity Method and Joint Ventures. If it is determined the Company would be unable to recover the carrying amount of its equity investment or if its equity investment would be unable to sustain an earning capacity to justify its carrying amount, the Company would record an impairment charge in the period the determination is made by lowering the carrying value recorded on the equity method investment.

The Company conducted its annual reviews and determined that the recorded goodwill, intangible assets and the equity method investment were not impaired and the fair values were significantly greater than the carrying values.

Funds Withheld

The Company, from time to time, writes business on a funds held basis. Under these contractual arrangements the cedent holds the net funds that would otherwise be remitted to the Company for a mutually agreed period. Generally, the Company earns investment income on these balances while held by the cedent.

Foreign Currency Translation

The reporting currency of the Company is the U.S. dollar. The functional currencies of the Company’s operating subsidiaries are generally their national currencies. In translating the financial statements of subsidiaries that have a functional currency other than the U.S. dollar, assets and liabilities are converted into U.S. dollars using the rates of exchange in effect at the balance sheet dates, and revenues and expenses are converted using the weighted average foreign exchange rates for the period. The cumulative translation adjustment is reported in the consolidated balance sheets as a separate component of accumulated other comprehensive income (loss).

In recording foreign currency transactions, revenues and expense items are converted at the prevailing exchange rate at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date, which may result in the recognition of exchange gains or losses. The exchange

gains and losses are reported in the consolidated statements of operations and comprehensive income (loss) as net foreign exchange losses.

Earnings (Loss) Per Common Share

The calculation of basic earnings (loss) per common share is based on weighted average common shares and weighted average vested RSUs outstanding and excludes any dilutive effects of warrants and share equivalents. Diluted earnings (loss) per common share assume the exercise of all dilutive warrant and share equivalents.

The issuance of shares with respect to the PSUs is contingent upon the attainment of certain levels of diluted return-on-equity (“DROE”). Because the number of common shares contingently issuable under the Performance Share Unit Plan (“PSU Plan”) depends on the geometric average DROE over a two-year or three year period, the PSUs are excluded from the calculation of diluted earnings per share until the end of the performance period, when the number of shares issuable under the PSU Plan will be known.

Taxation

Certain subsidiaries of the Company operate in jurisdictions where they are subject to taxation. Current and deferred income taxes are charged or credited to net income based upon enacted tax laws and rates applicable in the relevant jurisdiction in the period in which the tax becomes realizable. Deferred income taxes are provided for all temporary differences between the bases of assets and liabilities used in the consolidated balance sheets and those used in the various jurisdictional tax returns.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

When management's assessment indicates that it is more likely than not that deferred income tax assets will not be realized, a valuation allowance is recorded against the deferred tax assets. In accordance with the FASB ASC Topic on Income Taxes, the tax benefits of uncertain tax positions may only be recognized when the position is more-likely-than-not to be sustained upon audit by the relevant taxing authorities.

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.

3. ACQUISITIONS AND DISPOSITIONS

Flagstone Africa

On November 10, 2009, Flagstone Réassurance Suisse SA ("Flagstone Suisse") purchased 1,999,998 shares (representing the remaining 35% noncontrolling interest) in Flagstone Africa for a purchase price of $11.4

million. The acquisition of the noncontrolling interest did not result in a change of control of Flagstone Africa. As a result, the transaction was accounted for as an equity transaction using the Consolidation Topic of the FASB ASC, resulting in the elimination of the related minority interest and $0.8 million recorded to additional paid-in capital.

Flagstone Africa is domiciled in South Africa and writes multiple lines of reinsurance in sub-Saharan Africa.

Flagstone Alliance

On June 30, 2009, Flagstone Alliance Insurance & Reinsurance PLC (“Flagstone Alliance”) disposed of 100% of the share capital in Uni-Alliance Holdings Limited, a subsidiary of Flagstone Alliance since January 1, 2007. The transaction was completed with Mr. Khader Hemsi, Chief Executive Officer of Flagstone Alliance, who retired from Flagstone Alliance during the third quarter of 2009. The sale was completed to eliminate conflict with existing broker relationships and resulted in a net loss of $1.2 million, which has been recorded in other income.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

4. GOODWILL AND INTANGIBLES

The following tables detail goodwill and intangible assets at December 31, 2010 and 2009:

Goodwill relates to the following reportable segments:	Reinsurance	Lloyd's	Island Heritage	Unallocated	Total
Balance as at December 31, 2008	$ 4,118	$ -	$ 10,050	$ 2,973	$ 17,141
Allocated to Lloyd's segment	-	2,973	-	(2,973)	-
Purchase price allocation finalized (1)	(1,043)	-	-	-	(1,043)
Purchase of noncontrolling interest	36	-	-	-	36
Impact of foreign exchange	33	366	-	-	399
Balance as at December 31, 2009	3,144	3,339	10,050	-	16,533
Impact of foreign exchange	(36)	(116)	-	-	(152)
Balance as at December 31, 2010	$ 3,108	$ 3,223	$ 10,050	$ -	$ 16,381

	As at December 31, 2010				
	Carrying value at beginning of period	Impairment loss	Accumulated amortization (2)	Impact of foreign exchange	Carrying value at end of period
Finite life intangibles					
Tradename	$ 1,308	$ (1,173)	$ -	$ (135)	$ -
Software	3,924	-	(406)	(150)	3,368
Distribution network	3,356	-	(300)	(128)	2,928
	$ 8,588	$ (1,173)	$ (706)	$ (413)	$ 6,296
Indefinite life intangibles					
Lloyd's syndicate capacity	$ 25,353	$ -	$ -	$ (875)	$ 24,478
Licenses	1,849	(1,074)	-	-	775
	$ 27,202	$ (1,074)	$ -	$ (875)	$ 25,253
Aggregate amortization expenses (2)					
For the year ended December 31, 2010					$ 784

	As at December 31, 2009				
	Carrying value at beginning of period	Impairment loss	Accumulated amortization (2)	Impact of foreign exchange	Carrying value at end of period
Finite life intangibles					
Tradename	$ 1,294	$ -	$ (145)	$ 159	$ 1,308
Software	3,882	-	(436)	478	3,924
Distribution network	3,306	-	(358)	408	3,356
	$ 8,482	$ -	$ (939)	$ 1,045	$ 8,588
Indefinite life intangibles					
Lloyd's syndicate capacity	$ 22,573	$ -	$ -	$ 2,780	$ 25,353
Licenses	1,818	-	-	31	1,849
	$ 24,391	$ -	$ -	$ 2,811	$ 27,202
Aggregate amortization expenses (2)					
For the year ended December 31, 2009					$ 917

108

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Estimated amortization expense	For the years ending December 31,	Amount	
	2011	$	703
	2012		676
	2013		651
	2014		629
	2015		609

(1) The purchase price allocation for Flagstone Alliance Insurance and Reinsurance Plc "Flagstone Alliance" was finalized in the first quarter of 2009.
(2) Accumulated amortization is converted at the end of period foreign exchange rate and amortization expense is converted at an average foreign exchange rate for the period.

During the year ended December 31, 2010, the Company recognized an impairment charge of $1.1 million related to a license no longer being used by Flagstone Alliance, which was included in the Reinsurance segment and classified as an indefinite life intangible. Also recognized, was an impairment charge of $1.2 million related to a tradename no longer used within our Lloyd’s segment, which was classified as a finite life intangible. The impairment charges are included in general and administrative expenses on the consolidated statements of operations and comprehensive income (loss).

5. ASSET HELD FOR SALE

During the year ended December 31, 2010, the Company decided to dispose of certain corporate aircraft that it leased and owned. As a result, the Company terminated all operational lease agreements at the casualty value stipulated under the lease agreements. As at December 31, 2010, the Company had disposed of two aircraft and has reflected one as an asset held for sale on the consolidated balance sheet as at December 31, 2010. The Company recorded impairment charges in its Reinsurance segment of $13.6 million and loss on sale of assets of $1.4 million during the year ended December 31, 2010, which are included in general and administrative expenses on the consolidated statements of operations and comprehensive income (loss).

6. MONT FORT RE LIMITED

Mont Fort Re Limited (“Mont Fort”) is a Bermuda insurer registered under the Segregated Accounts Companies Act 2000, which gives Mont Fort the power to allocate assets and liabilities to segregated accounts. Assets allocated to a segregated account may only be used to meet the liabilities of that segregated account. Mont Fort enables third party investors to participate in insurance risk. To date Mont Fort has formed three segregated accounts, which have been capitalized by third party investors. The Company cedes industry loss warranty policies risks to the cells and charges a ceding commission on those ceded premiums. The Company also charges the cells investment management fees and a performance fee of 15% of the increase, if any, in the net asset value of each cell during the year.

Because the Company is the primary beneficiary of Mont Fort, the results of Mont Fort are included in the Company's consolidated financial statements. Net income and shareholders' equity attributable to segregated account beneficiaries are recorded in the consolidated financial statements as noncontrolling interest.

In 2009, Mont Fort repurchased 43.6 million preferred shares relating to its first cell, Mont Fort ILW for $63.1 million.

Mont Fort has repurchased 55.0 million (2010 - 50.0 million, 2008 - 5.0 million) preferred shares relating to its second cell, Mont Fort ILW 2 for $86.1 million (2010 – $79.5 million, 2008 – $6.6 million).

Included in the Company's assets as at December 31, 2010 and December 31, 2009 were cash and cash equivalents, short term investments and fixed maturity investments of $52.1 million and $150.4 million, respectively, held for the sole benefit of preferred shareholders of each specific Mont Fort cell and available to settle the specific current and future liabilities of each cell.

109

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

7. INVESTMENTS

Fixed maturity, short term, equity and other investments

The cost or amortized cost, gross unrealized gains and losses, and carrying values as at December 31, 2010 and 2009 are as follows:

	As at December 31, 2010			
	Amortized cost or cost	Gross unrealized gains	Gross unrealized losses	Fair value
Fixed maturity investments				
U.S. government and agency securities	$ 266,329	$ 5,882	$ (375)	$ 271,836
U.S. states and political subdivisions	90	2	-	92
Other foreign governments	267,787	18,618	(480)	285,925
Corporates	586,523	20,260	(4,239)	602,544
Mortgage-backed securities	222,171	2,910	(2,224)	222,857
Asset-backed securities	90,968	261	(621)	90,608
	1,433,868	47,933	(7,939)	1,473,862
Short term investments				
U.S. government and agency securities	2,998	-	-	2,998
Corporates	11,256	1	(4)	11,253
	14,254	1	(4)	14,251
Equity investments	7,931	4	(7,652)	283
	7,931	4	(7,652)	283
Other investments				
Investment funds	42,728	3,798	(6,533)	39,993
Catastrophe bonds	75,484	1,226	(19)	76,691
	118,212	5,024	(6,552)	116,684
Totals	$ 1,574,265	$ 52,962	$ (22,147)	$ 1,605,080

110

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

	As at December 31, 2009			
	Amortized cost or cost	Gross unrealized gains	Gross unrealized losses	Fair value
Fixed maturity investments				
U.S. government and agency securities	$ 421,215	$ 12,186	$ (1,686)	$ 431,715
U.S. states and political subdivisions	1,907	11	(15)	1,903
Other foreign governments	112,119	3,426	(1,118)	114,427
Corporates	504,855	15,763	(1,376)	519,242
Mortgage-backed securities	108,652	3,969	(554)	112,067
Asset-backed securities	49,439	253	(485)	49,207
	1,198,187	35,608	(5,234)	1,228,561
Short term investments				
U.S. government and agency securities	145,600	6	(2)	145,604
Other foreign governments	3,877	136	-	4,013
Corporates	80,223	1,419	(738)	80,904
Asset-backed securities	1,909	4	-	1,913
	231,609	1,565	(740)	232,434
Equity investments	8,516	124	(8,350)	290
	8,516	124	(8,350)	290
Other investments				
Investment funds	13,239	-	(7,753)	5,486
Catastrophe bonds	35,777	402	(51)	36,128
	49,016	402	(7,804)	41,614
Totals	$ 1,487,328	$ 37,699	$ (22,128)	$ 1,502,899

Other investments do not include an investment accounted for under the equity method in which the Company is deemed to have a significant influence and accordingly is not accounted for at fair value under the FASB ASC guidance for financial instruments. This investment is recorded at $3.1 million and $4.3 million at December 31, 2010 and 2009, respectively.

Proceeds from the sale and maturity of fixed maturity, short term and equity investments during the year ended December 31, 2010 and 2009 amounted to $3.0 billion and $1.9 billion, respectively.

The following table presents the contractual maturity dates of fixed maturity and short term investments as at December 31, 2010 and 2009:

	As at December 31,			
	2010		2009	
	Amortized cost	Fair value	Amortized cost	Fair value
Due within one year	$ 38,558	$ 39,909	$ 308,865	$ 312,253
Due after 1 through 5 years	808,954	836,825	577,634	588,707
Due after 5 through 10 years	196,683	202,136	311,819	324,095
Due after 10 years	90,788	95,778	71,478	72,753
Mortgage and asset-backed securities	313,139	313,465	160,000	163,187
Total	$ 1,448,122	$ 1,488,113	$ 1,429,796	$ 1,460,995

Actual maturities may differ from contractual maturities because certain borrowers have the right to prepay certain obligations with or without prepayment penalties.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The following table presents a breakdown of the credit quality of the Company's fixed maturity and short term investments as at December 31, 2010 and 2009:

	As at December 31,			
	2010		2009	
	Fair value	Percentage of total	Fair value	Percentage of total
Rating Category				
AAA	$ 903,230	60.7 %	$ 1,043,223	71.4 %
AA	193,302	13.0 %	111,300	7.6 %
A	262,086	17.6 %	214,214	14.7 %
BBB	129,495	8.7 %	91,723	6.3 %
Below investment grade	-	0.0 %	535	0.0 %
Total	$ 1,488,113	100.0 %	$ 1,460,995	100.0 %

We have included credit rating information with respect to our investment portfolio because it enhances the reader's understanding of its composition and consistency with our investment philosophy.

Fair value disclosure

The valuation technique used to determine the fair value of the financial instruments is the market approach which uses prices and other relevant information generated by market transactions involving identical or comparable assets.

In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, the Company has classified its investments in U.S. government treasury securities and listed equity securities as Level 1 in the fair value hierarchy. The fair value of these securities is the quoted market price of these securities, as provided either by independent pricing services or exchange market prices.

Investments in U.S. government agency securities, corporate bonds, mortgage-backed securities, foreign government bonds and asset-backed securities are classified as Level 2 in the fair value hierarchy. 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.

112

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

As at December 31, 2010 and 2009, the Company's investments are allocated among fair value levels as follows:

		Fair Value Measurement at December 31, 2010 using:		
	Fair value measurements	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Fixed maturity investments				
U.S. government and agency securities	$ 271,836	$ 176,831	$ 95,005	$ -
U.S. states and political subdivisions	92	-	92	-
Other foreign governments	285,925	-	285,925	-
Corporates	602,544	-	602,544	-
Commercial mortgage-backed securities	1,064	-	1,064	-
Residential mortgage-backed securities	221,793	-	221,793	-
Asset-backed securities	90,608	-	90,608	-
	1,473,862	176,831	1,297,031	-
Short term investments				
U.S. government and agency securities	2,998	2,998	-	-
Corporates	11,253	-	11,253	-
	14,251	2,998	11,253	-
Equity investments				
Financial services	283	283	-	-
	283	283	-	-
Other investments				
Investment funds	39,993	-	-	39,993
Catastrophe bonds	76,691	-	76,691	-
	116,684	-	76,691	39,993
Totals	$ 1,605,080	$ 180,112	$ 1,384,975	$ 39,993

113

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

	Fair Value Measurement at December 31, 2009 using:			
	Fair value measurements	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Fixed maturity investments				
U.S. government and agency securities	$ 431,715	$ 380,843	$ 50,872	$ -
U.S. States and political subdivisions	1,903	-	1,903	-
Other foreign governments	114,427	-	114,427	-
Corporates	519,242	-	519,242	-
Mortgage-backed securities	112,067	-	111,290	777
Asset-backed securities	49,207	-	47,686	1,521
	1,228,561	380,843	845,420	2,298
Short term investments				
U.S. government and agency securities	145,604	125,755	19,849	-
Other foreign governments	4,013	-	4,013	-
Corporates	80,904	-	80,904	-
Asset-backed securities	1,913	-	1,913	-
	232,434	125,755	106,679	-
Equity investments				
Financial services	290	290	-	-
	290	290	-	-
Other investments				
Investment funds	5,486	-	-	5,486
Catastrophe bonds	36,128	-	36,128	-
	41,614	-	36,128	5,486
Totals	$ 1,502,899	$ 506,888	$ 988,227	$ 7,784

Other investments do not include an investment accounted for under the equity method in which the Company is deemed to have a significant influence and accordingly is not accounted for at fair value under the FASB ASC guidance for financial instruments. This investment is recorded at $3.1 million and $4.3 million at December 31, 2010 and 2009, respectively.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The reconciliation of the fair value for the Level 3 investments for the years ended December 31, 2010 and 2009, including purchases and sales and change in realized and unrealized gains (losses) in earnings, is set out below:

	For the years ended December 31, 2010 and 2009			
	Fixed maturity investments	Investment funds	Catastrophe bonds	Total
Fair value, December 31, 2008	$ 926	$ 9,158	$ 39,174	$ 49,258
Total realized losses included in earnings	(148)	-	-	(148)
Total unrealized gains (losses) included in earnings	675	(4,493)	899	(2,919)
Net purchases and sales	(676)	821	(27,075)	(26,930)
Total investment income included in earnings	-	-	406	406
Transfers in (out) of Level 3	1,521	-	(13,404)	(11,883)
Fair value, December 31, 2009	$ 2,298	$ 5,486	$ -	$ 7,784
Total realized losses included in earnings	(226)	-	-	(226)
Total unrealized gains included in earnings	512	5,018	-	5,530
Purchases	-	29,489	-	29,489
Sales	(2,584)	-	-	(2,584)
Fair value, December 31, 2010	$ -	$ 39,993	$ -	$ 39,993

For the Level 3 items still held as of December 31, 2010, the total change in fair value for the year was $5.0 million. Transfers between levels, if necessary, are done as of the actual date of the event or change in circumstance that caused the transfer. There were no transfers between levels during the year ended December 31, 2010.

Other investments

The Catastrophe bonds held pay a variable and fixed interest coupon and generate investment return, and their performance is contingent upon climatological and geological events.

The Company's investment funds consist of investments in private equity and mortgage-backed investment funds. As at December 31, 2010 and 2009, the Company had total outstanding investment commitments of $13.7 million and $3.4 million, respectively. Redemptions from these investments occur at the discretion of the general partner, board of directors or, in other cases, subject to a majority vote by the investors. The Company is not able to redeem a significant portion of these investments prior to 2017.

The following table presents the fair value of the Company's investments funds as at December 31, 2010 and 2009:

As at December 31,

	2010	2009
Private equity funds	$ 8,143	$ 5,486
Mortgage-backed investment funds	31,850	-
Total	$ 39,993	$ 5,486

115

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Net investment income

Net investment income for the years ended December 31, 2010, 2009, and 2008 was $31.5 million, $28.5 million, and $51.4 million, respectively. The components are set out below:

	For the years ended December 31,		
	2010	2009	2008
Cash and cash equivalents	$ 1,435	$ 3,231	$ 13,498
Fixed maturity investments	33,307	28,283	41,784
Short term investments	1,004	1,405	566
Equity investments	-	76	79
Other investments	706	415	541
Investment expenses	(4,970)	(4,879)	(5,070)
Net investment income	$ 31,482	$ 28,531	$ 51,398

The following table is a breakdown of the total net realized and unrealized gains (losses) for the years ended December 31, 2010, 2009 and 2008:

	For the years ended December 31,		
	2010	2009	2008
Net realized gains (losses) on fixed maturities	$ 24,665	$ 21,005	$ (9,143)
Net unrealized gains (losses) on fixed maturities	8,730	34,582	(14,130)
Net realized (losses) on equities	-	(1,927)	(52,410)
Net unrealized gains (losses) on equities	11	2,778	(2,401)
Net realized and unrealized gains (losses) on derivative instruments - investments	437	(15,145)	(164,016)
Net realized and unrealized gains on derivative instruments - other	14,441	11,253	11,617
Net realized and unrealized gains (losses) on other investments	9,926	(1,625)	(30,106)
Total net realized and unrealized gains (losses)	$ 58,210	$ 50,921	$ (260,589)

Realized investment gains (losses) on the sale of fixed maturity, short term and equity investments for the years ended December 31, 2010, 2009 and 2008 are as follows:

	For the years ended December 31,		
	2010	2009	2008

Fixed maturity and short term investments						
Gross realized gains	$	28,302	$	38,051	$	29,178
Gross realized losses		(3,637)		(17,046)		(38,321)
Equity investments						
Gross realized gains		-		1,394		39
Gross realized losses		-		(3,321)		(52,449)
Net realized gains (losses)	$	24,665	$	19,078	$	(61,553)

Pledged assets

The Company holds cash and cash equivalents and fixed maturity securities that were deposited or pledged in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions, Lloyd’s of London requirements and insurance laws.

116

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The total amount of such cash and cash equivalents and fixed maturity securities as at December 31, 2010 and 2009 are as follows:

	As at December 31,			
		2010		2009
Cash and cash equivalents	$	43,413	$	85,916
Fixed maturity securities		539,738		425,109
Total	$	583,151	$	511,025

8. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

Loss and loss adjustment expense reserves consist of:

	As at December 31,			
		2010		2009
Case reserves	$	388,470	$	232,334
IBNR reserves		332,844		248,326
Loss and loss adjustment expense reserves	$	721,314	$	480,660

The following table represents an analysis of paid and incurred losses and a reconciliation of the beginning and ending loss and loss adjustment expense reserves for the years ended December 31, 2010 and 2009:

	As at and for the years ended December 31,			
		2010		2009
Gross liability at beginning of year	$	480,660	$	411,565
Reinsurance recoverable at beginning of year		(19,270)		(16,422)
Net liability at beginning of year		461,390		395,143
Net incurred losses related to:				
Current year		541,234		289,775
Prior year		(11,098)		(6,590)
		530,136		283,185
Net paid losses related to:				
Current year		148,592		90,964
Prior year		163,623		139,475
		312,215		230,439
Effects of foreign exchange rate changes		12,587		13,501
Other		1,233		-
Net liability at end of year		693,131		461,390

Reinsurance recoverable at end of year		28,183		19,270
Gross liability at end of year	$	721,314	$	480,660

Certain business written by the Company has loss experience generally characterized as low frequency and high severity in nature. This may result in volatility in the Company's financial results. Actuarial assumptions used to establish the liability for losses and loss adjustment expenses are periodically adjusted to reflect comparisons to actual losses and loss adjustment expenses development, inflation and other considerations. Prior period development arises from changes to loss estimates recognized in the current year that relate to loss reserves first reported in the previous calendar year. These reserve changes were made as part of the Company's regular quarterly reserving process and primarily arose from better than expected emergence of actual claims relative to the Company's prior year estimates.

117

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

During the year ended December 31, 2010, the Company had total net positive development of $11.1 million; $(18.3) million relating to the 2009 loss year and $29.4 million relating to the 2008 and prior loss years. The positive development was primarily due to actual loss emergence in the property catastrophe, property, and the short-tail specialty and casualty lines of business being lower than the initial expected loss emergence.

For the year ended December 31, 2009, the Company had total net positive development of $6.6 million; $(7.6) million relating to the 2008 loss year and $14.2 million relating to the 2007 and prior loss years. The favorable development was primarily due to actual loss emergence in the property catastrophe, property, and the short-tail specialty and casualty lines of business being lower than the initial expected loss emergence.

9. REINSURANCE

The Company purchases reinsurance to reduce its net exposure to losses. Reinsurance provides for recovery by the Company of a portion of gross losses and loss adjustment expenses from its reinsurers. The Company remains liable to the extent that its reinsurers do not meet their obligations under these agreements and the Company therefore regularly evaluates the financial condition of its reinsurers and monitors concentration of credit risk. The reinsurance claims recoverable as at December 31, 2010 and 2009 was $28.2 million and $19.3 million, respectively, against which the Company has determined that no provision for doubtful debt is required.

Assumed and ceded net premiums written and earned and loss and loss adjustment expenses for the years ended December 31, 2010, 2009 and 2008 are as follows:

	For the years ended December 31,								
	2010			2009			2008		
	Premiums written	Premiums earned	Loss and LAE	Premiums written	Premiums earned	Loss and LAE	Premiums written	Premiums earned	Loss and LAE
Assumed	$ 1,097,850	$ 1,050,915	$ 548,358	$ 988,491	$ 934,151	$ 294,582	$ 781,889	$ 730,411	$ 392,535
Ceded	(213,996)	(198,831)	(18,222)	(196,022)	(175,696)	(11,397)	(87,191)	(76,243)	(12,651)
Net	$ 883,854	$ 852,084	$ 530,136	$ 792,469	$ 758,455	$ 283,185	$ 694,698	$ 654,168	$ 379,884

As at December 31, 2010, 2009 and 2008, the provision for doubtful accounts was $1.9 million, $2.0 million, and $2.1 million, respectively, which has been recorded in premiums receivable on the balance sheet.

10. DERIVATIVES

The Company accounts for its derivative instruments using the Derivatives and Hedging Topic of the FASB ASC, which requires an entity to recognize all derivative instruments as either assets or liabilities on the balance sheet and measure those instruments at fair value, with the fair value recorded in other assets or liabilities. The accounting for realized and unrealized gains and losses associated with changes in the fair value of derivatives depends on the hedge designation and, if designated as a hedging instrument, whether the hedge is effective in achieving offsetting changes in the fair value of the asset or liability being hedged. The realized and unrealized gains and losses on derivatives not

designated as hedging instruments are included in net realized and unrealized gains and losses in the consolidated financial statements. Gains and losses associated with changes in fair value of the designated hedge instruments are recorded with the gains and losses on the hedged items, to the extent that the hedge is effective.

The Company enters into derivative instruments such as interest rate futures contracts, interest rate swaps, foreign currency forward contracts and currency swaps in order to manage portfolio duration and interest rate risk, borrowing costs and foreign currency exposure. The Company enters into index futures contracts and total return swaps to gain exposure to the underlying asset or index. The Company also purchases TBAs as part of its investing activities. The Company manages the exposure to these instruments based on guidelines established by management and approved by the Company's Board of Directors (the "Board").

118

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The Company has entered into certain foreign currency forward contracts in order to hedge its net investments in foreign subsidiaries, and has designated these as hedging instruments. These foreign currency forward contracts are carried at fair value and the realized and unrealized gains and losses are recorded in other comprehensive income as part of the cumulative translation adjustment, to the extent that these are effective as hedges. All other derivatives are not designated as hedges, and accordingly, these instruments are carried at fair value, with the fair value recorded in other assets or liabilities with the corresponding realized and unrealized gains and losses included in net realized and unrealized gains and losses.

The details of the derivatives held by the Company as at December 31, 2010 and 2009 are as follows:

	As at December 31, 2010			
	Asset derivatives recorded in other assets	Liability derivatives recorded in other liabilities	Total derivatives	
	Fair value	Fair value	Net notional exposure	Fair value
Derivatives designated as hedging instruments				
Foreign currency forward contracts (1)	$ -	$ 534	$ 43,201	$ (534)
	-	534		(534)
Derivatives not designated as hedging instruments				
Purpose - risk management				
Currency swaps	$ -	$ 1,020	$ 17,375	$ (1,020)
Foreign currency forward contracts	14,701	19,396	820,114	(4,695)
Futures contracts	1,822	4,125	1,100,498	(2,303)
	16,523	24,541		(8,018)
Purpose - exposure				
Futures contracts	$ 4,866	$ 223	$ 170,105	$ 4,643
Mortgage-backed securities TBA	4	17	4,275	(13)
Other reinsurance derivatives	-	241	-	(241)
	4,870	481		4,389
	21,393	25,022		(3,629)
Total derivatives	$ 21,393	$ 25,556		$ (4,163)

119

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

	As at December 31, 2009			
	Asset derivatives recorded in other assets	Liability derivatives recorded in other liabilities	Total derivatives	
	Fair value	Fair value	Net notional exposure	Fair value
Derivatives designated as hedging instruments				
Foreign currency forward contracts(1)	$ 148	$ 512	$ 88,312	$ (364)
	148	512		(364)
Derivatives not designated as hedging instruments				
Purpose - risk management				
Currency swaps	$ 260	$ -	$ 18,655	$ 260
Foreign currency forward contracts	12,532	6,386	288,832	6,146
	12,792	6,386		6,406
Purpose - exposure				
Futures contracts	$ 3,847	$ -	$ 150,770	$ 3,847
Total return swaps	409	436	45,948	(27)
Mortgage-backed securities TBA	-	399	41,496	(399)
Other reinsurance derivatives	-	1,596		(1,596)
	4,256	2,431		1,825
	17,048	8,817		8,231
Total derivatives	$ 17,196	$ 9,329		$ 7,867

Designated

Derivatives designated as hedging instruments	Amount of Gain or (Loss) on Derivatives Recognized in Comprehensive loss (Effective portion) For the years ended December 31, 2010	2009	2008	Location	Net income (loss) (Ineffective portion) For the years ended December 31, 2010	2009	2008
Foreign currency forward contracts(1)	$ (178)	$ (4,586)	$ (16,989)	Net realized and unrealized (losses) gains -	$ (744)	$ (1,665)	$ 5,996

		other				
$ (178)	$ (4,586)	$ (16,989)		$ (744)	$ (1,665)	$ 5,996

(1)Recognized as a foreign currency hedge under the Derivatives and Hedging Topic of the ASC

120

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Non Designated

Derivatives not designated as hedging instruments	Location	Gain or (Loss) on Derivatives Recognized in Net Income — For the years ended December 31, 2010	2009	2008
Futures contracts	Net realized and unrealized gains (losses) - investments	$ 14,290	$ 12,458	$ (147,493)
Total return swaps	Net realized and unrealized gains (losses) - investments	1,105	(4,630)	(18,431)
Currency swaps	Net realized and unrealized (losses) gains - other	(1,290)	661	(783)
Interest rate swaps	Net realized and unrealized losses - investments	-	-	(295)
Interest rate swaps	Net realized and unrealized losses - other	-	-	(1,353)
Foreign currency forward contracts	Net realized and unrealized losses - investments	(15,840)	(25,375)	-
Foreign currency forward contracts	Net realized and unrealized gains - other	14,674	9,867	1,099
Mortgage-backed securities TBA	Net realized and unrealized gains - investments	882	2,402	2,203
Other reinsurance derivatives	Net realized and unrealized gains - other	1,801	2,390	6,658
		$ 15,622	$ (2,227)	$ (158,395)

Foreign currency forward contracts

The Company enters into foreign currency forward contracts for the purpose of hedging its net investment in foreign subsidiaries which are recorded as designated hedges. All other foreign currency forward contracts are not designated as hedges and are entered into for the purpose of hedging our foreign currency fixed maturities investments and our net foreign currency operational assets and liabilities.

Futures contracts

The Company uses futures contracts to gain exposure to US equity, global equity, emerging market equity and commodities. The Company uses interest rate futures contracts to manage the duration of the fixed maturities investments.

Total return swaps

The Company uses total return swaps to gain exposure to a global inflation linked bond index and a global equity index. The total return swaps allow the Company to earn the return of the underlying index while paying floating interest plus a spread to the counterparty.

Currency swaps

The Company uses currency swaps to minimize the effect of fluctuating foreign currencies. The currency swaps relate to the Company's Euro denominated debentures.

To be announced mortgage-backed securities

The Company also purchases TBAs as part of its investing activities. By acquiring a TBA, the Company makes a commitment to purchase a future issuance of mortgage-backed securities.

Other reinsurance derivatives

The Company writes certain reinsurance contracts that are classified as derivatives in accordance with the FASB ASC Topic for Derivatives and Hedging. The Company has entered into ILW transactions that may be structured as reinsurance or derivatives.

121

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Fair value disclosure

In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, the fair value of derivative instruments held as at December 31, 2010 and 2009 is allocated between levels as follows:

	Fair Value Measurement at December 31, 2010, using:			
	Fair value measurements	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Description				
Futures contracts	$ 2,340	$ 2,340	$ -	$ -
Swaps	(1,020)	-	(1,020)	-
Foreign currency forward contracts	(5,229)	-	(5,229)	-
Mortgage-backed securities TBA	(13)	-	(13)	-
Other reinsurance derivatives	(241)	-	-	(241)
Total derivatives	$ (4,163)	$ 2,340	$ (6,262)	$ (241)

For the Level 3 items still held as of December 31, 2010, the total change in fair value for the year, recorded in net realized and unrealized gains (losses) – other, is $nil.

	Fair Value Measurement at December 31, 2009, using:			
	Fair value measurements	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant other unobservable inputs (Level 3)
Description				
Futures contracts	$ 3,847	$ 3,847	$ -	$ -
Swaps	233	-	233	-
Foreign currency forward contracts	5,782	-	5,782	-
Mortgage-backed securities TBA	(399)	-	(399)	-
Other reinsurance derivatives	(1,596)	-	-	(1,596)
Total derivatives	$ 7,867	$ 3,847	$ 5,616	$ (1,596)

The reconciliation of the fair value for the Level 3 derivative instruments, including net purchases and sales, realized gains and changes in unrealized gains, is as follows:

		For the years ended December 31,		
		2010		2009
Other reinsurance derivatives				
Beginning balance	$	(1,596)	$	(541)
Total unrealized gains included in earnings		1,892		2,299
Net purchases		(537)		(3,354)
Closing fair value	$	(241)	$	(1,596)

Transfers between levels, if necessary, are done as of the actual date of the event or change in circumstance that caused the transfer. There were no transfers between levels during these periods.

11. TAXATION

On May 17, 2010, the Company became a Luxembourg tax resident and therefore became subject to corporate income tax and municipal business tax on its worldwide income at the Luxembourg statutory tax rate, currently of 28.6% (for companies registered in Luxembourg City). Qualifying dividend income and net capital gains on the sale of qualifying investments in subsidiaries generally are exempt from corporate income tax and municipal business tax under Luxembourg's "participation exemption". Consequently, qualifying dividends received by the Company from subsidiaries and capital gains from the sale by the Company of investments in subsidiaries should be exempt from corporate income tax and municipal business tax.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

In addition, the Company is subject to net wealth tax on its worldwide wealth. Qualifying investments in subsidiaries generally are exempt from net wealth tax.

The Company has subsidiaries that operate in various other jurisdictions around the world that are subject to tax and examination by taxing authorities in the jurisdictions in which they operate. The significant jurisdictions in which the Company's subsidiaries are subject to tax are South Africa, Canada, India, Switzerland, U.S. Virgin Islands ("USVI"), the U.K. and the U.S.

In Switzerland, Flagstone Suisse has been granted a partial tax holiday from the cantonal tax administration of the canton of Valais providing an exemption from cantonal and municipal corporate income and capital taxes for a period of 10 years. Operations of Flagstone Suisse's branch office in Bermuda are not subject to Bermuda income or capital gains tax under current Bermuda law.

Income tax returns open for examination are as follows: tax years 2009-2010 in South Africa, Switzerland and the U.K.; tax years 2006-2010 in Canada; tax years 2007-2010 in India and the USVI; and tax years 2008-2010 in the U.S.

As a global organization, the Company may be subject to a variety of transfer pricing or permanent establishment challenges by taxing authorities in various jurisdictions. Management has deemed all material tax positions to have a greater than 50% likelihood of being fully sustained on technical merits if challenged.

The Company does not expect any material unrecognized tax benefits within 12 months of December 31, 2010.

Income tax expense for the years ended December 31, 2010, 2009 and 2008 is as follows:

	For the years ended December 31,					
		2010		2009		2008
Current income tax (recovery) expense						
Luxembourg	$	-	$	107	$	4
Non-Luxembourg		2,584		2,917		1,862
Deferred income tax (recovery) expense						
Non-Luxembourg		(6,637)		2,388		(688)
Total income tax (recovery) expense	$	(4,053)	$	5,412	$	1,178

	As at December 31,					
		2010		2009		2008
Net current tax (liabilities) assets	$	(104)	$	(1,741)	$	118
Net deferred tax assets (liabilities)		4,424		(2,478)		(1,774)
Net tax assets (liabilities)	$	4,320	$	(4,219)	$	(1,656)

123

Explanation of Responses:

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Deferred tax assets and liabilities reflect the tax impact of temporary differences between the carrying amount of assets and liabilities for financial reporting and income tax purposes. Significant components of the net deferred tax assets (liabilities) as of December 31, 2010 and 2009 are as follows:

	As at December 31,	
Deferred tax inventory	2010	2009
Deferred tax assets		
Tax loss carryforward	$ 36,733	$ 22,855
Other	1,678	-
Valuation allowance	(29,798)	(22,009)
Deferred tax assets net of valuation allowance	$ 8,613	$ 846
Deferred tax liabilities		
Property and fixed assets	(3,990)	-
Other	(199)	(3,324)
	(4,189)	(3,324)
Net deferred tax assets (liabilities)	$ 4,424	$ (2,478)

Realization of deferred tax assets is dependent on generating sufficient taxable income in the future periods. Although realization is not assured, management believes it is more likely than not that the tax benefit of the deferred tax assets net of valuation allowance will be realized.

The valuation allowance relates to operating and capital losses of the Company's foreign subsidiaries in Cyprus, Luxembourg, Switzerland and the U.S. Local tax laws allow tax losses to be carried forward and offset against future taxable income. However, the Company believes it is necessary to establish a valuation allowance against these operating loss and capital loss deferred tax assets due to the Company's short operating history and uncertainty regarding its ability to generate sufficient future taxable income to utilize the loss carried forward and realize the deferred tax asset.

As of December 31, 2010, the company had deferred tax assets net of valuation allowance of $6.9 million ($nil as of December 31, 2009) relating to operating and capital losses, primarily relating to operating loss in the U.K., where local tax laws allow tax losses to be carried forward for an unlimited period of time.

The following table is a reconciliation of the difference between the actual tax rate and the Luxembourg statutory rate of 28.59%. For the years ended December 31, 2009 and 2008, the Company was a Bermuda domiciled company subject to a 0% statutory rate under Bermuda law. As a result, the reconciliation has been presented starting with a 0% rate for these periods.

	For the years ended December 31,		
	2010	2009	2008
Tax rate reconciliation			
Expected statutory tax rate	28.6 %	0.0 %	0.0 %
Foreign taxes at local expected rates	(27.0)%	2.2 %	(0.6)%

Net expected statutory tax rate pre-tax benefits	1.6 %	2.2 %	(0.6)%
Gross tax benefits	(10.8)%	(3.9)%	3.7 %
Valuation allowance	4.1 %	3.9 %	(3.7)%
Tax exempt income and expenses not deductible	1.4 %	0.0 %	0.0 %
Prior years tax adjustments	(0.8)%	0.0 %	0.0 %
Other	0.1 %	0.0 %	0.0 %
	(4.4)%	2.2 %	(0.6)%

12. RETIREMENT BENEFIT ARRANGEMENTS

For employee retirement benefits, the Company maintains active defined-contribution plans and a defined benefit plan.

Defined Contribution Plans

Contributions are made by the Company, and these contributions are supplemented by the local plan participants. Contributions are based on a percentage of the participant’s base salary depending upon competitive local market practice. Vesting provisions meet legal compliance standards and market trends; the accumulated benefits for the majority of these plans vest immediately or over a two year period.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The Company incurred expenses for these defined contribution arrangements of $3.5 million, $2.0 million, and $0.9 million for the years ended December 31, 2010, 2009, and 2008, respectively.

Defined Benefit Plan

Under Swiss pension law, the Company is required to maintain a pension plan for its employees in Switzerland, which is classified and accounted for as a defined benefit plan. As at December 31, 2010 and 2009, the net unfunded status at the end of the year was $1.2 million and $1.4 million, respectively and was included in other liabilities in the Consolidated Balance Sheets. The fair value of plan assets as at December 31, 2010, and 2009 was $4.3 million and $4.4 million, respectively.

13. DEBT AND FINANCING ARRANGEMENTS

Long term debt

The Company's debt outstanding as at December 31, 2010 and 2009 is as follows:

Issue Type	Issued In		Notional Amount	Interest Rate	First Call In	Maturity In		Outstanding balance as at December 31, 2010		2009
Deferrable Interest Debentures	2006	$	120,000	LIBOR + 3.54%	2011	2036	$	120,000		120,000
Junior Subordinated Deferrable Interest Notes	2006	€	13,000	Euribor + 3.54%	2011	2036		17,372		18,652
Junior Subordinated Deferrable Interest Notes	2007	$	100,000	LIBOR + 3.00%	2012	2037		88,750		88,750
Junior Subordinated Deferrable Interest Notes	2007	$	25,000	LIBOR + 3.10%	2012	2037		25,000		25,000
							$	251,122	$	252,402

The FASB ASC Topic on Financial Instruments requires disclosure of fair value information of financial instruments. For financial instruments where quoted market prices are not available, the fair value of these financial instruments is estimated by discounting future cash flows or by using similar recent transactions. Because considerable judgment is used, these estimates are not necessarily indicative of amounts that could be realized in a current market exchange. The Company does not carry its long term debt at fair value on its consolidated balance sheets. As at December 31, 2010 and 2009, the Company estimated the fair value of its long term debt to be approximately $220.5 million and $203.9 million, respectively.

The Note Indentures contain various covenants, including limitations on liens on the stock restricted subsidiaries, restrictions as to the disposition of the stock of restricted subsidiaries and limitations on mergers and consolidations. The Company was in compliance with all the covenants contained in the Note Indentures at December 31, 2010 and 2009.

Interest expense includes interest payable and amortization of debt offering expenses. The debt offering expenses are amortized over the period from the issuance of the Deferrable Interest Debentures to the earliest date that they may be called by the Company. For the years ended December 31, 2010, 2009 and 2008, the Company incurred interest expense of $10.4 million, $11.1 million and $18.3 million, respectively, on the Deferrable Interest Debentures. Also, at December 31, 2010 and 2009, the Company had $0.8 million and $0.8 million, respectively, of interest payable included in other liabilities.

125

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Future principal and interest payments on long term debt are expected to be as follows:

Year		Estimated future principal and interest payments
2011	$	9,183
2012		9,183
2013		9,183
2014		9,183
2015		9,183
Later years		453,903
Total	$	499,818

Letter of credit facilities

On June 5, 2009, Flagstone Suisse entered into a secured $50.0 million standby letter of credit facility with BNP Paribas (the "BNP Facility"). The BNP Facility had an initial term of one year and the Company let the facility expire on June 4, 2010, as per the terms of the agreement.

On March 5, 2009, Flagstone Suisse entered into a $200.0 million secured committed letter of credit facility with Barclays Bank Plc (the "Barclays Facility"). The Barclays Facility is used to support the reinsurance obligations of the Company and its subsidiaries. As at December 31, 2010, $32.3 million had been drawn under the Barclays Facility, and the drawn amount was secured by $35.9 million of fixed maturity securities from the Company's investment portfolio.

On April 28, 2010, Flagstone Suisse and Flagstone Capital Management Luxembourg SICAF – FIS entered into a secured $450.0 million standby letter of credit facility with Citibank Europe Plc (the "Citi Facility"). The Citi Facility comprised a $225.0 million facility for letters of credit with a maximum tenor of 15 months, to be used to support reinsurance obligations of the Company and its subsidiaries, and a $225.0 million facility for letters of credit drawn in respect of Funds at Lloyd's with a maximum tenor of 60 months. On December 21, 2010, the Citi Facility was amended to increase the amount available under the facility by $100.0 million to $550.0 million, with all the terms and conditions remaining unchanged. The Citi Facility now comprises a $275.0 million facility for letters of credit with a maximum tenor of 15 months, to be used to support reinsurance obligations of the Company and its subsidiaries, and a $275.0 million facility for letters of credit drawn in respect of Funds at Lloyds's with a maximum tenor of 60 months. As at December 31, 2010, $435.6 million had been drawn under the Citi Facility, and the drawn amount of the facility was secured by $502.6 million of fixed maturity securities from the Company's investment portfolio. This facility replaced a $450.0 million credit facility with Citibank Europe Plc which commenced on January 22, 2009.

These facilities are used to provide security to reinsureds and for Funds at Lloyd's, and they are fully collateralized by the Company, to the extent of the letters of credit outstanding at any given time.

14. SHAREHOLDERS' EQUITY

Common shares

At December 31, 2010 and 2009, the total authorized common voting shares of the Company were 300,000,000 and 300,000,000, respectively, with a par value of $0.01 per common share.

The holders of common voting shares are entitled to receive distributions (previously in the form of dividends prior to the Redomestication) as declared from time to time and are entitled to one vote per common share, subject to certain restrictions.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The following table is a summary of common shares issued and outstanding:

	For the years ended December 31,		
	2010	2009	2008
Common voting shares:			
Balance at beginning of period	82,985,219	84,801,732	85,309,107
Conversion of performance share units (1)	-	42,000	-
Conversion of restricted share units (1)	10,499	141,487	190,224
Shares repurchased and cancelled	(520,960)	-	(697,599)
Shares repurchased and held in treasury	(13,889,170)	(2,000,000)	-
Balance at end of period	68,585,588	82,985,219	84,801,732

(1) Conversion of performance share units and restricted share units are net of shares withheld for the payment of tax on the employee's behalf.

Share buyback

On September 22, 2008, the Company announced that its Board had approved the repurchase of company common shares, subject to market conditions, share price and other factors. The buyback program allows the Company to purchase, from time to time, its outstanding stock up to a value of $60.0 million. During the year ended December 31, 2009, the Company entered into a private placement purchase agreement to repurchase 2.0 million common shares at a total cost of $19.8 million.

On March 11, 2010, the Company entered into a private purchase agreement to repurchase 2,984,146 common shares pursuant to its buyback program at a total cost of $33.6 million.

On May 18, 2010, the Company announced that its Board had approved an increase in its share buyback program allowing the Company to purchase, from time to time, subject to market conditions, share price and other factors, its outstanding common shares up to a value of $50.0 million.

On May 21, 2010, in connection with the resignation of Mr. Byrne as Executive Chairman of the Company’s Board, the Company entered into a General Release and Settlement Agreement for the repurchase of 2,000,000 common shares from Limestone Business Limited, a company controlled and capitalized by Mr. Byrne. These shares were repurchased pursuant to the Company’s buyback program on May 25, 2010, at a total cost of $24.0 million.

During the third quarter of 2010, the Company repurchased 1,420,960 common shares pursuant to its buyback program at a total cost of $14.8 million. Of the common shares repurchased, 900,000 common shares were purchased on August 20, 2010, under a private purchase agreement for the employee share compensation plans (PSU Plan and Restricted Share Unit Plan (“RSU Plan”)), while the remaining 520,960 common shares were purchased on the open market. As of December 31, 2010, authority to repurchase up to $11.2 million of common shares remained available under the buyback program.

Shares purchased by a subsidiary

On December 14, 2010, pursuant to the Purchase Agreement between Bermuda Holdings, 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 $91.9 million.

Warrant

In connection with the initial closing of the private placement for the Company's common shares in December 2005, the Company issued the Warrant to Haverford for its role in these capital raising activities. The Warrant has been classified as an equity instrument, in accordance with the FASB ASC Subtopic on Derivatives and Hedging – Contracts in Entity's Own Equity. The Company has determined the Warrant to be compensatory and has recorded its fair value as compensation in the issuance period as there is no required service period. The Warrant granted the holder the right, at any time during the period commencing on December 1, 2010 and ending December 31, 2010, to purchase from the Company up to 12.0% of the issued share capital of the Company at the consummation of the initial private placements of the Company at an exercise price of $14.00 per common share.

127

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Subsequently, in connection with the February 1 and February 23, 2006, additional closings of the private placement of 1,957,008 common shares, the Warrant was amended such that the number of common shares that could be issuable upon exercise of the Warrant would be 8,585,747, being 12.0% of the issued share capital as at February 23, 2006.

At the Company's Board meeting held on November 14, 2008, the Warrant was amended to change the exercise date from December 1, 2010 to December 31, 2010, to December 1, 2013 to December 31, 2013, to change the strike price to $14.80 from $14.00 and to include a provision that amends the strike price for all dividends paid by the company from the issuance of the Warrant to its exercise date. As a result of the amendments additional compensation expense of $3.6 million was recognized in general and administrative expenses and in additional paid-in capital in the consolidated financial statements for the year ended December 31, 2008. This value was calculated using the Black-Scholes option pricing model. The assumptions used were: risk-free interest rate 2.8%; expected life 5.05 years; volatility 38.6%; dividend yield 1.59%. The volatility assumption was based on the average historical volatility of a group of comparable companies over a period equal to the expected life of the Warrant.

On June 25, 2010, the Warrant was amended and restated so that Haverford could transfer the Leyton Warrant to Leyton Limited., a company associated with Flagstone's chief executive officer David Brown. Haverford continued to hold the Haverford Warrant and all other terms of each Warrant remained unchanged.

On December 14, 2010, in connection with the retirement of Mr. Byrne as a member of the Board of the Company and pursuant to the Purchase Agreement between Bermuda Holdings, Mr. Byrne and Haverford and Limestone, companies associated with Mr. Byrne, Bermuda Holdings purchased the Haverford Warrant at a total cost of $14.2 million, which includes $0.7 million of transaction costs. In accordance with Compensation – Stock Compensation Topic of the FASB ASC, as the Haverford Warrant purchase price was based on an estimate of the Haverford Warrant purchase date fair value, additional paid-in capital was charged for the amount of the Haverford Warrant purchase price and related transaction expenses .

On December 14, 2010, the Company purchased the Haverford Warrant from Bermuda Holdings. The Company subsequently cancelled the Haverford Warrant. The Leyton Warrant, exercisable at maturity for 630,194 common shares of the Company, remains outstanding.

15. SHARE BASED COMPENSATION

The Company accounts for share based compensation in accordance with the Compensation – Stock Compensation Topic of the FASB ASC which requires entities to measure the cost of services received from employees and directors in exchange for an award of equity instruments based on the grant date fair value of the award. The cost of such services will be recognized as compensation expense over the period during which an employee or director is required to provide service in exchange for the award. The Company's share based compensation plans consist of PSUs and RSUs.

Performance Share Units

The Company's PSU Plan is the Company's shareholder approved primary executive long term incentive scheme. Pursuant to the terms of the PSU Plan, at the discretion of the Compensation Committee of the Board, PSUs may be granted to executive officers and certain other key employees and vesting is contingent upon the Company meeting certain DROE goals.

At the Company's Compensation Committee meeting on November 13, 2008, the PSU Plan was amended. Considering the net loss incurred in the nine months ended September 30, 2008, and the subsequent impact on the value of the existing PSUs (2006-2008, 2007-2009 and 2008-2010 series) the Committee resolved to cancel all unvested PSUs and issued 2009-2010 and 2009-2011 series grants as replacements.

Upon vesting, the PSU holder shall be entitled to receive a number of common shares of the Company (or the cash equivalent, at the election of the Company) equal to the product of the number of PSUs granted multiplied by a factor based on the Company's DROE during the vesting period. The factor will range between 0.5 and 1.5, depending on the DROE achieved during the vesting period. This factor was amended on November 13, 2008, from the previous factor which ranged between 0.0 and 2.0. PSUs vest over a period of two or three years. The fair value of PSUs granted under the PSU Plan is estimated on the date of grant using the fair value on the grant date and the most probable DROE outcome.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

At the Company's Annual General Meeting of shareholders held on May 14, 2010, the PSU Plan was amended to modify the treatment of PSUs upon the retirement of an employee and to cancel PSUs if (a) the Company is required to make a financial restatement due to a material misstatement and (b) those PSUs were granted based upon the erroneous financial information.

A summary of the activity under the PSU Plan as at December 31, 2010, 2009 and 2008, and changes during the years ended December 31, 2010, 2009, and 2008, is as follows:

	For the years ended December 31,								
	2010			2009			2008		
	Number expected to vest	Weighted average grant date fair value	Weighted average remaining contractual term	Number expected to vest	Weighted average grant date fair value	Weighted average remaining contractual term	Number expected to vest	Weighted average grant date fair value	Weighted average remaining contractual term
Outstanding at beginning of period	3,305,713	$ 10.04	1.6	2,189,982	$ 10.13	2.5	1,658,700	$ 12.07	1.7
Granted	878,000	11.05		1,357,143	9.93		3,004,940	11.09	
Forfeited	(185,155)	10.28		(181,412)	10.14		(105,000)	12.35	
Exercised in the period	-	-		(60,000)	10.25		-	-	
Cancelled	-	-		-	-		(2,368,658)	12.61	
Outstanding at end of period	3,998,558	10.25	0.9	3,305,713	10.04	1.6	2,189,982	10.13	2.5

The Company reviews its assumptions in relation to the PSUs on a quarterly basis. 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 a probable factor of 150%. For the years ended December 31, 2010, 2009 and 2008, respectively, $14.9 million, $13.2 million and $(6.9) million has been recorded in general and administrative expenses in relation to the PSU Plan. Considering the net loss incurred in the nine months ended September 30, 2008, the Company reviewed its DROE estimates for the applicable performance periods and accordingly revised the number of PSUs expected to vest, resulting in the reversal of related compensation expense at December 31, 2008. The issuance of shares with respect to the PSUs is contingent upon the attainment of certain levels of average DROE over a two or three year period. 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; that cost is expected to be recognized over a period of approximately 1.5 years, 1.6 years and 2.5 years, respectively.

Since the inception of the PSU Plan, 60,000 PSUs have vested and 2,368,658 PSUs have been cancelled.

Restricted Share Units

The purpose of the Company’s Amended and Restated Employee Restricted Share Unit Plan (the “RSU Plan”) is to encourage employees and directors of the Company to further the development of the Company and to attract and retain key employees for the Company’s long term success. The RSUs granted to employees vest over a period of approximately two years while RSUs granted to directors vest on the grant date.

129

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

A summary of the activity under the RSU Plan as at December 31, 2010, 2009 and 2008, and changes during the years ended December 31, 2010, 2009, and 2008, is as follows:

	For the years ended December 31,								
	2010			2009			2008		
	Number expected to vest	Weighted average grant date fair value	Weighted average remaining contractual term	Number expected to vest	Weighted average grant date fair value	Weighted average remaining contractual term	Number expected to vest	Weighted average grant date fair value	Weighted average remaining contractual term
Outstanding at beginning of period	373,157	$ 10.89	0.5	282,876	$ 13.13	0.5	326,610	$ 12.45	0.6
Granted	272,836	11.11		307,797	10.00		286,361	13.25	
Forfeited	(60,740)	10.16		(43,985)	11.26		(74,500)	13.65	
Exercised in the period	(8,040)	10.51		(173,531)	12.85		(255,595)	12.24	
Outstanding at end of period	577,213	11.08	0.3	373,157	10.89	0.5	282,876	13.13	0.5

As at December 31, 2010, 2009 and 2008, there was a total of $0.9 million, $0.9 million and $1.0 million, respectively, of unrecognized compensation cost related to non-vested RSUs; that cost is expected to be recognized over a period of approximately 1.0 year, 1.0 year, and 1.0 year, respectively. A compensation expense of $2.4 million, $2.7 million and $3.0 million has been recorded in general and administrative expenses for the years ended December 31, 2010, 2009 and 2008, respectively, in relation to the RSU Plan.

Since the inception of the RSU Plan in July 2006, 400,842 RSUs granted to employees have vested and no RSUs granted to employees have been cancelled. During the years ended December 31, 2010, 2009 and 2008, 64,896, 72,666, and 55,715 RSUs, respectively, were granted to the directors. During the years ended December 31, 2010, 2009 and 2008, 8,040, 2,985, and 25,299 RSUs, respectively, granted to directors were converted into common shares of the Company as elected by the directors.

The Company uses a nil forfeiture assumption for its PSUs and RSUs. The intrinsic value of the PSUs and RSUs outstanding as of December 31, 2010 was $50.4 million and $7.3 million, respectively.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

16 EARNINGS (LOSS) PER COMMON SHARE

The computation of basic and diluted earnings (loss) per common share for the years ended December 31, 2010, 2009, and 2008 is as follows:

	For the years ended December 31,		
	2010	2009	2008
Basic earnings per common share			
Net income (loss) attributable to Flagstone	$ 97,084	$ 242,192	$ (187,302)
Weighted average common shares outstanding	78,391,591	84,074,056	85,175,484
Weighted average vested restricted share units	265,097	205,721	153,220
Weighted average common shares outstanding—Basic	78,656,688	84,279,777	85,328,704
Basic earnings (loss) per common share	$ 1.23	$ 2.87	$ (2.20)
Diluted earnings per common share			
Net income (loss) attributable to Flagstone	$ 97,084	$ 242,192	$ (187,302)
Weighted average common shares outstanding	78,391,591	84,074,056	85,175,484
Weighted average vested restricted share units outstanding	265,097	205,721	153,220
	78,656,688	84,279,777	85,328,704
Share equivalents:			
Weighted average unvested restricted share units	223,902	224,015	-
Weighted average unvested performance share units	-	-	-
Weighted average common shares outstanding—Diluted	78,880,590	84,503,792	85,328,704
Diluted earnings (loss) per common share	$ 1.23	$ 2.87	$ (2.20)

Dilutive share equivalents have been excluded in the weighted average common shares used for the calculation of earnings per share in periods of net loss because the effect of such securities would be anti-dilutive. The number of anti-dilutive share equivalents that were excluded in the computation of diluted earnings per share for the year ended December 31, 2008, was 243,124. Also at December 31, 2010, 2009, and 2008, there was a warrant outstanding which would result in the issuance of 630,194, 8,585,747 and 8,585,747 common shares, respectively, that were excluded from the computation of diluted earnings per common share because the effect would be anti-dilutive. Because the number of shares contingently issuable under the PSU Plan depends on the average DROE over a two or three year

period, the PSUs are excluded from the calculation of diluted earnings per common share until the end of the performance period, at which time the number of shares issuable under the PSU Plan will be known. As at December 31, 2010, 2009, and 2008, there were 3,998,558, 3,305,713, and 2,189,982 PSUs, respectively, which were expected to vest. The maximum number of common shares that could be issued under the PSU Plan at December 31, 2010, 2009, and 2008, was 5,751,765, 4,712,498, and 3,284,973 respectively.

Also at December 31, 2010, 2009, and 2008, there was a warrant outstanding which would result in the issuance of common shares that were excluded from the computation of diluted earnings per common share because the effect would be anti-dilutive. These securities were as follows:

	For the years ended December 31,		
	2010	2009	2008
Warrant	630,194	8,585,747	8,585,747

17. NONCONTROLLING INTEREST

At December 31, 2010, the Company's consolidated results include the results of Mont Fort from January 12, 2007 onwards (see Note 6). 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. On February 8, 2008, Mont Fort repurchased 5.0 million preferred shares relating to its second cell, Mont Fort ILW 2 for $6.6 million. On August 10, 2009, Mont Fort repurchased 43.6 million preferred shares relating to its first cell, Mont Fort ILW for $63.1 million. On June 3, 2010 and July 27, 2010, Mont Fort repurchased 17.3 million and 32.7 million preferred shares relating to its second cell, Mont Fort ILW 2, for $32.0 million and $47.5 million, respectively. In relation to Mont Fort, the Company recorded income (loss) attributable to noncontrolling interest of $10.5 million, $(26.3) million, and $(14.2) million, respectively, for the years ended December 31, 2010, 2009 and 2008 and $45.9 million and $135.9 million, respectively, was included in noncontrolling interest on the consolidated balance sheets as at December 31, 2010 and 2009.

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

At December 31, 2010, the Company's consolidated results include the results of Island Heritage from July 1, 2007 onwards. The portions of Island Heritage's net income and shareholders' equity attributable to the minority shareholders for the years ended December 31, 2010, 2009 and 2008 are recorded in the consolidated financial statements of the Company as noncontrolling interest. In relation to Island Heritage, the Company recorded income (loss) attributable to noncontrolling interest of $(1.9) million, $(1.7) million, and $0.6 million for the years ended December 31, 2010, 2009 and 2008, respectively, and $15.9 million and $18.4 million, respectively, was included in noncontrolling interest on the consolidated balance sheets as at December 31, 2010 and 2009.

On October 1, 2009, the Company sold 25% of the common shares of IAL King Air Limited for proceeds of $0.8 million, maintaining a controlling interest. As a result, $0.4 million was recorded as noncontrolling interest on the consolidated balance sheet as at December 31, 2009. On July 1, 2010, the Company repurchased the 25% of common shares sold on October 1, 2009, for a purchase price of $0.8 million. On October 27, 2010, IAL King Air Limited was subsequently sold for total proceeds of $2.0 million.

The Company's consolidated results include the results of Flagstone Africa from June 30, 2008 onwards. On November 10, 2009, Flagstone Suisse became the sole shareholder of Flagstone Africa by acquiring the remaining 35% of shares owned by Imperial Holdings Limited for a purchase price of $11.4 million (see Note 3). In accordance with the Consolidation Topic of the FASB ASC, Flagstone Africa has been fully consolidated in the Company's financial statements for the years ending December 31, 2010 and 2009. The portions of Flagstone Africa's net income and shareholders' equity attributable to minority shareholders for the year ended December 31, 2008 was recorded in the consolidated financial statements of the Company as noncontrolling interest. In relation to Flagstone Africa, the Company recorded income attributable to noncontrolling interest of $0.5 million for the year ended December 31, 2009, and $nil was included in noncontrolling interest on the consolidated balance sheets as at December 31, 2010 and 2009.

18. RELATED PARTY TRANSACTIONS

On March 6, 2009, the Company entered into a Share Purchase Agreement ("IAL 7X Agreement") with Mr. Byrne to acquire 100% of the issued and outstanding common voting shares of IAL 7X Leasing Limited ("IAL 7X") for a cash purchase price of $10,000. IAL 7X owned, as its principal asset, a delivery slot for a Dassault Falcon 7X aircraft ("7X Purchase Agreement"). Mr. Byrne and the Company agreed that upon delivery of the aircraft, the Company would either sell the aircraft or retain it as determined by the Board according to the Company's needs at that time. The parties further agreed that any gain on disposition or delivery would be split 85% to Mr. Byrne and 15% to the Company, and any loss would be borne 100% by Mr. Byrne.

On July 29, 2009, the Company elected to sell the aircraft back to Dassault Falcon Jet Corp ("DFJ") by terminating the 7X Purchase Agreement. Thereafter on August 11, 2009, IAL 7X entered into a Termination Agreement with DFJ to terminate the 7X Purchase Agreement. In accordance with the agreement between Mr. Byrne and the Company, the Company paid Mr. Byrne $0.3 million, representing 85% of the gain on disposition of $0.35 million.

On November 24, 2009, Flagstone Suisse entered into a senior unsecured loan agreement with Star and Shield Holdings LLC ("Star and Shield"), a member owned insurance company in which the Company holds a 43.3% equity

investment interest. Under the terms of the agreement, the Company agreed to a revolving basis commitment of $2.5 million with an interest rate of LIBOR plus 8.5% per annum, adjusted and compounded quarterly on any unpaid balance of principal and interest until the maturity of the loan which is no later than November 24, 2012. On December 21, 2010, the agreement was amended to increase the commitment to $3.5 million. As at December 31, 2010 and December 31, 2009, the Company had advanced $2.5 million and $0.4 million, respectively, as a loan receivable from Star and Shield on its consolidated balance sheet.

On May 21, 2010, Mr. Byrne stepped down as Executive Chairman of the Board. In connection with his resignation, Mr. Byrne and Bermuda Holdings entered into a General Release and Settlement Agreement (the “Release Agreement”) which was filed as Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q for the quarter ending June 30, 2010, and filed with the SEC on August 3, 2010.

Under the terms of the Release Agreement, Bermuda Holdings paid Mr. Byrne a lump-sum cash severance payment of $1.1 million on May 24, 2010, and agreed to pay a second lump-sum cash severance payment of $1.1 million on May 20, 2012, in respect of amounts payable to Mr. Byrne pursuant to the terms of his employment agreement and other compensation rights. All equity, equity-based, bonus or incentive compensation awards (including performance share units under the PSU Plan) held by Mr. Byrne have been forfeited without payment. The Release Agreement also provides Mr. Byrne with continuation of certain benefits, including medical insurance. Pursuant to the Release Agreement, Mr. Byrne and Bermuda Holdings mutually released one another from, amongst other things, any and all existing liabilities and agreements relating to Mr. Byrne’s employment with the Company.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

On December 8, 2010 Bermuda Holdings entered into a Share Purchase and Warrant Agreement (the “Purchase Agreement”) with Mr. Byrne, Limestone, and Haverford pursuant to which Bermuda Holdings (i) purchased from Limestone 5,155,156 shares of the Company at a price of $11.4823 per share, (ii) purchased from Haverford 2,849,868 shares of Flagstone at a price of $11.4823 per share, and (iii) purchased from Haverford, at a price of $13,500,000, the Haverford Warrant. The transactions contemplated by the Purchase Agreement were completed on December 14, 2010. For further information on these purchases, refer to Note 14 “Shareholders’ Equity”.

On December 14, 2010, Mr. Byrne retired as a member of the Board. In connection with his retirement, the Company, Mr. Byrne, Limestone and Haverford entered into a letter agreement dated December 8, 2010 (the “Letter Agreement”), pursuant to which the Company agreed to continue to indemnify Mr. Byrne for actions taken by him while an employee or a director of the Company to the same extent as other former employees and directors of the Company.

On May 17, 2010, the Company entered into a commitment agreement to purchase $25.0 million of Marathon Legacy Securities Public-Private Investment Funds, Ltd. On September 30, 2010, the Company entered into a further commitment agreement to purchase $9.0 million of the fund. A member of the Company’s Board is also a managing director of Marathon Asset Management, L.P., the investment manager of the fund. As of December 31, 2010, the market value of the Company’s investment in this fund was $31.9 million and the remaining capital commitment was $6.8 million.

Three of the Company’s subsidiaries have investment management agreements in place with Neuberger Berman Fixed Income LLC, which owns shares in the Company. Investment management fees under these agreements during 2010 were $0.3 million.

Flagstone Suisse has cash and cash equivalent investments in money market funds that are managed by the BlackRock group, which owns shares in the Company. As of December 31, 2010, the Company held $4.3 million in these investments.

19. COMMITMENTS AND CONTINGENCIES

Concentrations of credit risk

Credit risk arises out of the failure of a counterparty to perform according to the terms of the contract. The Company is exposed to credit risk in the event of non-performance by the counterparties to the Company’s foreign exchange forward contracts, currency swaps and interest rate swaps. However, because the counterparties to these agreements are high credit quality international banks, the Company does not anticipate any non-performance. The Company also holds counterparty collateral or posts collateral with the derivative counterparties, as allowed for in the International Swaps and Derivatives Association (“ISDA”) agreements, in order to mitigate the counterparty exposure risk related to the fair value of the derivatives. The difference between the contract amounts and collateral held or posted is the Company’s credit exposure with these counterparties.

As at December 31, 2010 and 2009, substantially all of the Company's portfolio cash and investments were held with one custodian bank.

The Company's investment portfolio is managed in accordance with the diversification strategy outlined in the Company's investment policy guidelines. Specific provisions limit the allowable holdings of a single issue or issuer. The Company believes that there are no significant concentrations of credit risk associated with its investments.

Brokers

The Company also underwrites the majority of its reinsurance business through brokers and a credit risk exists should any of these brokers be unable to fulfill their contractual obligations with respect to the payments of reinsurance balances to the Company. Concentrations of credit risk with respect to reinsurance balances are as described in Note 21 "Segment Reporting".

For the year ended December 31, 2010, two brokers accounted for approximately 59% of gross premiums written and for the year ended December 31, 2009, two brokers accounted for approximately 61% of gross premiums written.

Lease commitments

The Company and its subsidiaries lease office space and guest accommodations in the countries in which they operate under operating leases which expire at various dates. The Company renews and enters into new leases in the ordinary course of business as required. Total rent expense with respect to these operating leases for the years ended December 31, 2010 and 2009 and 2008 was approximately $3.8 million, $4.2 million, and $2.6 million.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Future minimum rental lease payments under the leases are expected to be as follows:

For the years ending December 31,		Rental Leases
2011	$	5,035
2012		4,201
2013		3,887
2014		2,524
2015		1,826
2016 and thereafter		5,121
Total minimum future lease commitments	$	22,594

Capital Commitments

During 2008, the Company entered into an agreement to acquire an office building in Luxembourg. The building is currently under construction and is expected to be completed in 2011. During 2009, the Company, entered into an agreement to acquire an office building in Martigny. The building is currently under construction and is expected to be completed in 2012. The remaining balance of $1.6 million and $10.3 million, respectively, for Luxemburg and Martigny is to be paid as specific milestones are reached in the construction.

Investment commitments

The Company has made certain commitments with respect to investments in a private equity fund and a mortgage backed investment fund. As at December 31, 2010 and 2009, the total outstanding investment commitment was $13.7 million and $3.4 million, respectively.

Legal proceedings

In the normal course of business, the Company may become involved in various claims litigation and legal proceedings.

As at December 31, 2010 and 2009, the Company was not a party to any material litigation or arbitration proceedings.

20. DIVIDEND RESTRICTIONS AND STATUTORY REQUIREMENTS

Luxembourg

The shareholders may declare dividends at a general meeting of shareholders, but, in accordance with the Articles of Incorporation of the Company, the dividend may not exceed the amount recommended by the Board. Dividends may only be declared from the distributable reserves of the Company. In accordance with the provisions of Luxembourg law, no distributions to shareholders may be made when on the closing date of the financial year of the Company, the net assets as set out in the annual accounts are, or would following such a distribution, be lower than the subscribed capital plus the reserves which may not be distributed under the Luxembourg law or by virtue of the 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.

Shareholders may declare dividends at a general meeting by means of ordinary resolution, being a resolution passed by a simple majority of shareholders present at a general meeting, with a quorum of at least two shareholders present.

Share premium will be available for repayment to the shareholders in the discretion of the Board.

Dividends may be paid in (1) cash in the form a check, or by warrant, or (2) wholly or partly in kind by the distribution of assets (in particular, paid up shares, debentures or debenture stock) to shareholders.

No dividend or other monies payable in respect of a share in the Company will bear interest against the Company unless otherwise provided by the rights attached to the share.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Subject to the Luxembourg Company law, interim dividends may be declared by the Board. The declaration of interim dividends is subject to the approval of shareholders at the next general meeting. Where the payments made on account of interim dividends exceed the amount of dividends subsequently approved by shareholders at the general meeting, they shall, to the extent of the overpayment, be deemed to have been paid on account of the next dividend. The Articles of Incorporation of the Company allow for the declaration of interim dividends, but any payment of interim dividends shall be subject to the conditions that: (i) interim accounts shall be drawn up showing that the funds available for distribution are sufficient; (ii) the amount to be distributed may not exceed total profits made since the end of the last financial year for which the accounts have been approved, plus any profits carried forward and sums drawn down from reserves available for this purpose, less losses carried forward any sums to be placed to reserve pursuant to the requirements of the law or the Articles of Incorporation; (iii) the decision of the Board to distribute an interim dividend may not be taken more than two months after the date at which the interim accounts (before mentioned) have been made up; (iv) in their report, the Board and the statutory auditor shall verify whether the above conditions have been satisfied.

Since the Redomestication of the Company from Bermuda to Luxembourg in May 2010, the Company has, on September 15 and December 15, 2010, paid two distributions to shareholders in the amount of $0.04 per share, which are subject to the provisions of article 72-2 of the Law of 10 August 1915 on commercial companies, as amended.

Switzerland
Flagstone Suisse is licensed to operate as a reinsurer in Switzerland and is also licensed in Bermuda through the Flagstone Suisse Branch office and is not licensed in any other jurisdictions. Because many jurisdictions do not permit insurance companies to take credit for reinsurance obtained from unlicensed or non-admitted insurers on their statutory financial statements unless appropriate security mechanisms are in place, the Company anticipates that the Company's reinsurance clients will typically require Flagstone Suisse to post a letter of credit or other collateral.

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 requirements.

Bermuda
While Mont Fort is a registered as 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.

Bermuda law limits the maximum amount of annual dividends or distributions that can be paid by Flagstone Suisse to the Company and in certain cases requires the prior notification to, or the approval of, the Bermuda Monetary Authority (the "BMA"). 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 shown on its statutory balance sheet in relation to

the previous financial year, 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 prescribed solvency margin 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 financial statements, without the prior approval of the BMA. This may limit the amount of funds available for distribution to the Company, restricting the Company's ability to pay dividends, make distributions and repurchase any of its common shares. Flagstone Suisse was required to maintain a minimum level of statutory capital and surplus of $345.8 million (unaudited) and $316.6 million (unaudited), as at December 31, 2010 and 2009, respectively. Actual statutory capital and surplus as at December 31, 2010 and 2009 was $1.7 billion (unaudited) and $1.6 billion (unaudited), respectively.

In 2008, new statutory legislation was enacted in Bermuda, which included, among other things, the Bermuda Solvency Capital Requirement ("BSCR") which is a standard mathematical model designed to give the BMA more advanced methods for determining an insurer's capital adequacy. Underlying the BSCR is the belief that all insurers should operate on an ongoing basis with a view to maintaining their capital at a prudent level in excess of the minimum solvency margin otherwise prescribed under the Bermuda Insurance Act. Effective December 31 2008, the BMA required all Class 4 insurers to maintain their capital at a target level which is set at 120% of the minimum amount calculated in accordance with the BSCR or an approved in-house model. The Company is currently completing the 2010 BSCR for its Class 4 insurers and at this time believes that Flagstone Suisse will exceed the target level of capital.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

Cayman Islands
Island Heritage is domiciled in the Cayman Islands and is required to maintain a Class A Domestic Insurance License issued under the Insurance Law (as revised) of the Cayman Islands. It is thereby subject to regulation by the Cayman Islands Monetary Authority ("CIMA") which enforces the applicable provisions of the Insurance Law and also the Monetary Authority Law. Whilst there is no general requirement to prohibit dividend payments in the law, if a dividend policy has been previously agreed and filed with the regulator then any change must be approved. Furthermore, once the 2010 capital requirements are applied, assuming subsidiary legislation as drafted on February 7, 2011 is implemented, insurers must notify the regulator where its capital falls below the prescribed amount and will then be subject to remedial action and thus proposed dividend payments could be restricted.

United Kingdom
U.K. company law prohibits Flagstone Syndicate Management Limited ("FSML") and Flagstone Corporate Name Limited 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 Financial Services Authority's ("FSA") 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.

The financial services industry in the U.K. is regulated by the FSA. The FSA is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. Although accountable to treasury ministers and through them to Parliament, it is funded entirely by the firms it regulates. The FSA has wide ranging powers in relation to rule-making, investigation and enforcement to enable it to meet its four statutory objectives, which are summarized as one overall aim: "to promote efficient, orderly and fair markets and to help retail consumers achieve a fair deal".

In respect of the Lloyd's market, while the FSA regulates all insurers, insurance intermediaries and Lloyd's itself, the FSA and Lloyd's have common objectives in ensuring that the Lloyd's market is appropriately regulated. To minimize duplication, the FSA has agreed arrangements with Lloyd's by which the Council of Lloyd's undertakes primary supervision of Lloyd's managing agents in relation to certain aspects of the FSA's regulatory regime.

Accordingly, as a Lloyd's managing agent, FSML is not only regulated by the FSA but is also bound by the rules of the Society of Lloyd's, which are prescribed by Byelaws and requirements made by the Council of Lloyd's under powers conferred by the Lloyd's Act 1982. Both FSA and Lloyd's have powers to withdraw their respective authorization of any person to manage Lloyd's syndicates. Lloyd's approves annually Syndicate 1861's business plan and any subsequent material changes, and the amount of capital required to support that plan. Lloyd's may require changes to any business plan presented to it or additional capital to be provided to support the underwriting (known as Funds at Lloyd's).

South Africa
Flagstone Africa is licensed to operate as a reinsurer in South Africa and is subject to statutory minimum capital requirements under applicable legislation. In addition, a South African 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 requirements.

Reserve

The Company is required by Luxembourg law to allocate a sum of at least one twentieth of the net profits of the Company to the creation of a legal reserve. This allocation ceases to be compulsory when the reserve has reached an amount equal to one-tenth of the corporate capital, but shall again be compulsory if the reserve falls below such one-tenth.

The Company has reserves in excess of one-tenth of the corporate capital of the Company.

Flagstone Capital Management Luxembourg – SICAF FIS (“FCML”)

In accordance with the Private Placement Memorandum of FCML, the general meeting of FCML shall determine how the profits (including net realized capital gains) of FCML shall be disposed of and may from time to time declare, or authorize the board of directors of FCML to declare dividends, provided however that the capital of FCML including issue premiums does not fall below €1,250,000 or the equivalent thereof in any currency in which shares in FCML are issued. Dividends may also be paid out of net unrealized capital gains after deduction of realized losses. Dividends declared will be paid in the applicable sub-funds base currency and may be paid at such places and times as may be determined by the board of directors of FCML.

136

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The board of directors of FCML is further authorized to pay interim dividends subject to the relevant provisions of the Luxembourg law and any conditions or procedures as resolved by the board of directors.

21. SEGMENT REPORTING

As a result of the acquisition of FSML, the managing agency for Lloyd's Syndicate 1861, the Company revised its segment structure, effective January 1, 2009, to include a new Lloyd's segment. As a result of this process, the Company now reports 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 Company regularly reviews its financial results and assesses performance on the basis of these three reporting segments in accordance with the Segment Reporting Topic of the FASB ASC.

The comparative information below reflects the Company's current segment structure.

Those segments are more fully described as follows:

Reinsurance

The Company's 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 the Company's most important product. The Company writes 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. The Company also provides 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. All 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. The Company also provides short-tail specialty and casualty reinsurance for risks such as aviation, energy, personal accident and health, satellite, marine and workers' compensation catastrophe. Most short-tail specialty and casualty reinsurance is written with loss limitation provisions.

Lloyd’s

The Company’s Lloyd’s segment includes the business generated through the Lloyd’s Syndicate 1861 and FSML. Syndicate 1861, based in London, 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 the Lloyd’s segment for the prior year. 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.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The following tables provide a summary of gross and net written and earned premiums, underwriting results, a reconciliation of underwriting income to income before income taxes, and interest in earnings of equity investments, total assets and ratios for each reportable segment 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

138

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

	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

139

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

	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.

Explanation of Responses:

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

The following tables set forth a breakdown of the Company’s gross premiums written by line of business and geographic area of risks insured for the periods indicated:

	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.

141

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

For the years ended December 31, 2010, 2009 and 2008, gross premiums written by brokers were as follows:

	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

22. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through to the date the financial statements were available to be issued.

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.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

23. UNAUDITED QUARTERLY FINANCIAL INFORMATION

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
2010				
Net premiums written	$ 106,855	$ 159,376	$ 293,842	$ 323,781
Net premiums earned	204,496	198,694	232,079	216,815
Net investment income	8,490	7,488	8,219	7,285
Net realized and unrealized investment gains (losses)	9,536	47,842	(14,637)	15,469
Other income	6,188	1,785	6,531	11,041
Total revenues	228,710	255,809	232,192	250,610
Loss and loss adjustment expenses	131,805	119,089	151,863	127,379
Acquisition costs	45,784	30,615	45,584	42,837
General and administrative expenses	38,458	49,338	42,722	41,175
Interest expense	2,603	2,690	2,545	2,514
Net foreign exchange (gains) losses	(541)	17,072	(7,856)	(3,956)
Total expenses	218,109	218,804	234,858	209,949
Income (loss) before income taxes and interest in earnings of equity investments	10,601	37,005	(2,666)	40,661
Provision (recovery) for income tax	8,309	(966)	(438)	(2,852)
Interest in earnings of equity investments	(334)	(364)	(283)	(259)
Net income (loss)	18,576	35,675	(3,387)	37,550
Less: (Income) loss attributable to noncontrolling interest	(3,526)	1,586	16,656	(6,046)
NET INCOME ATTRIBUTABLE TO FLAGSTONE	$ 15,050	$ 37,261	$ 13,269	$ 31,504
Net income attributable to Flagstone per common share - Basic	$ 0.20	$ 0.48	$ 0.17	$ 0.38
Net income attributable to Flagstone per common share - Diluted	$ 0.20	$ 0.48	$ 0.17	$ 0.38

Distributions declared per common share(1)	$	0.04	$	0.04	$	0.04	$	0.04

(1)Distributions declared 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.

143

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for share amounts, per share amounts and percentages)

	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
2009				
Net premiums written	$ 102,877	$ 134,809	$ 268,967	$ 285,816
Net premiums earned	203,127	195,517	186,976	172,835
Net investment income	8,859	10,779	10,646	(1,753)
Net realized investment gains	13,179	22,659	9,552	5,531
Other income	9,957	4,269	2,333	5,169
Total revenues	235,122	233,224	209,507	181,782
Loss and loss adjustment expenses	68,775	80,175	57,641	76,594
Acquisition costs	37,007	35,224	36,203	28,037
General and administrative expenses	42,994	35,266	34,578	34,300
Interest expense	2,615	2,814	3,119	3,557
Net foreign exchange losses (gains)	106	2,390	(362)	1,097
Total expenses	151,497	155,869	131,179	143,585
Income before income taxes and interest in earnings of equity investments	83,625	77,355	78,328	38,197
(Recovery) provision for income tax	(5,336)	(532)	(250)	706
Interest in earnings of equity investments	(308)	(370)	(300)	(378)
Net income	77,981	76,453	77,778	38,525
Less: (Income) attributable to noncontrolling interest	(6,476)	(9,323)	(9,964)	(2,782)
NET INCOME ATTRIBUTABLE TO FLAGSTONE	$ 71,505	$ 67,130	$ 67,814	$ 35,743
Net income attributable to Flagstone per common share - Basic	$ 0.86	$ 0.80	$ 0.80	$ 0.42
Net income attributable to Flagstone per common share - Diluted	$ 0.86	$ 0.80	$ 0.80	$ 0.42
Dividends declared per common share	$ 0.04	$ 0.04	$ 0.04	$ 0.04

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

REPORT ON SCHEDULES I-IV

Schedule		Page
I	Summary of Investments	146
II	Condensed Financial Information of Registrant	147
III	Supplementary Insurance Information	151
IV	Reinsurance	152

All other schedules specified in Regulation S-X are omitted for the reason that they are not required, are not applicable, or that equivalent information has been included in the consolidated financial statements, and notes thereto.

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE I
SUMMARY OF INVESTMENTS - OTHER THAN INVESTMENTS IN RELATED PARTIES
As At December 31, 2010

(Expressed in thousands of U.S. dollars)

Type of investments	Amortized cost or cost	Fair value	Balance sheet amount
Fixed maturity:			
Bonds:			
United States Government and government agencies and authorities	$ 266,329	$ 271,836	$ 271,836
States, municipalities and political subdivisions	90	92	92
Foreign government	267,787	285,925	285,925
Public utilities	-	-	-
Convertible and bonds with warrants attached	-	-	-
All other corporate bonds	899,662	916,009	916,009
Certificates of deposit	-	-	-
Redeemable preferred stock	-	-	-
Total fixed maturity investments	1,433,868	1,473,862	1,473,862
Equity:			
Common stock			
Public utilities	-	-	-
Banks, trust and insurance companies	-	-	-
Industrial, miscellaneous and all other	7,931	283	283
Nonredeemable preferred stocks	-	-	-
Total equity investments	7,931	283	283
Mortgage loans on real estate	-	-	-
Real estate	-	-	-
Policy loans	-	-	-
Other long term investments	121,292	119,764	119,764
Short term investments	14,254	14,251	14,251
Total investments	$ 1,577,345	$ 1,608,160	$ 1,608,160

146

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT

FLAGSTONE REINSURANCE HOLDINGS, S.A.
BALANCE SHEETS
As at December 31, 2010 and 2009
(PARENT COMPANY)

(Expressed in thousands of U.S. dollars)

		2010		2009
ASSETS				
Cash and cash equivalents	$	7	$	4,376
Investment in subsidiaries		1,372,254		1,341,844
Goodwill		-		2,000
Intercompany loans receivable		-		201,368
Due from subsidiaries		916		-
Other assets		982		3,202
Total assets	$	1,374,159	$	1,552,790
LIABILITIES				
Due to subsidiaries	$	-	$	4,978
Long term debt		162,372		163,652
Accrued interest payable		1,092		-
Intercompany loans payable		72,647		171,415
Other liabilities		3,315		1,727
Total liabilities		239,426		341,772
SHAREHOLDERS' EQUITY				
Common voting shares, 300,000,000 authorized, $0.01 par value, issued (2010 - 84,474,758; 2009 - 84,985,219) and outstanding (2010 - 68,585,588; 2009 - 82,985,219)		845		850
Common shares held in treasury, at cost (2010 - 15,889,170; 2009 - 2,000,000)(1)		(178,718)		(19,750)
Additional paid-in capital		904,235		912,547
Accumulated other comprehensive loss		(6,178)		(6,976)
Retained earnings		414,549		324,347
Total shareholders' equity		1,134,733		1,211,018
Total liabilities and shareholders' equity	$	1,374,159	$	1,552,790

(1)10,905,024 treasury shares are held in a subsidiary of Flagstone and are included in the consolidated balance sheet as at December 31, 2010.

147

Explanation of Responses:

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT - CONTINUED

FLAGSTONE REINSURANCE HOLDINGS, S.A.
STATEMENT OF OPERATIONS
For the Years Ended December 31, 2010, 2009 and 2008
(PARENT COMPANY)

(Expressed in thousands of U.S. dollars)

	2010	2009	2008
REVENUES			
Net investment income	$ 140	$ 1,479	$ 3,047
Net realized and unrealized (losses) gains - investments	(926)	2,385	(2,539)
Dividend income	-	-	327,853
Total revenues	(786)	3,864	328,361
EXPENSES			
General and administrative expenses	51,024	7,629	6,876
Share based compensation expense	17,333	15,879	(325)
Interest expense	8,246	9,195	12,579
Net foreign exchange (gains) losses	(770)	16,824	4,273
Total expenses	75,833	49,527	23,403
(Loss) income before income taxes, noncontrolling interest and interest in earnings of equity investments	(76,619)	(45,663)	304,958
Interest in earnings of equity investments	173,703	287,855	(492,260)
NET INCOME (LOSS)	$ 97,084	$ 242,192	$ (187,302)

148

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT - CONTINUED

FLAGSTONE REINSURANCE HOLDINGS, S.A.
STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2010, 2009 and 2008
(PARENT COMPANY)

(Expressed in thousands of U.S. dollars)

	2010	2009	2008
Cash flows (used in) provided by operating activities:			
Net income (loss)	$ 97,084	$ 242,192	$ (187,302)
Adjustments to reconcile net income to net cash provided by operating activities:			
Net realized and unrealized losses (gains)	926	(2,385)	2,539
Net unrealized (gains) losses foreign exchange	(1,280)	581	(2,579)
Share based compensation expense	17,333	15,879	(325)
Interest in (earnings) loss of equity investments	(173,703)	(287,855)	492,260
Changes in assets and liabilities, excluding net assets acquired:			
Due to subsidiaries	(5,894)	64,772	(159,674)
Other	21,298	(1,900)	(2,005)
Net cash (used in) provided by operating activities	(44,236)	31,284	142,914
Cash flows (used in) provided by investing activities:			
Net cash (paid) received in acquisitions of subsidiaries	(20)	352	(119,280)
Other	1,090	1,303	247
Net cash provided by (used in) investing activities	1,070	1,655	(119,033)
Cash flows (used in) provided by financing activities:			
Issue of common shares, net of issuance costs paid	-	(586)	(885)
Shares repurchased and held in treasury	(67,051)	(19,750)	-
Shares repurchased and cancelled	(5,376)	-	(6,641)
Warrant repurchase	(14,200)	-	-

Intercompany financing		137,142		-		-
Distributions paid on common shares		(12,571)		(13,414)		(13,496)
Other		853		826		1,447
Net cash provided by (used in) financing activities		38,797		(32,924)		(19,575)
(Decrease) increase in cash and cash equivalents		(4,369)		15		4,306
Cash and cash equivalents - beginning of year		4,376		4,361		55
Cash and cash equivalents - end of year	$	7	$	4,376	$	4,361
Supplemental cash flow information:						
Interest paid	$	6,325	$	11,716	$	11,604
Dividends received from subsidiaries	$	9,727	$	-	$	327,853

149

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE II
CONDENSED FINANCIAL INFORMATION OF REGISTRANT - CONTINUED

FLAGSTONE REINSURANCE HOLDINGS, S.A.
NOTE TO CONDENSED FINANCIAL STATEMENTS

(PARENT COMPANY)

(Expressed in thousands of U.S. dollars)

DEBT AND FINANCING ARRANGEMENTS

Long term debt

The Company's debt outstanding as at December 31, 2010 and 2009 is as follows:

Issue Type	Issued In		Notional Amount	Interest Rate	First Call In	Maturity In		Outstanding balances as at December 31, 2010		2009
Deferrable Interest Debentures	2006	$	120,000	LIBOR + 3.54%	2011	2036	$	120,000	$	120,000
Junior Subordinated Deferrable Interest Notes	2006	€	13,000	Euribor + 3.54%	2011	2036		17,372		18,652
Junior Subordinated Deferrable Interest Notes	2007	$	25,000	LIBOR + 3.10%	2012	2037		25,000		25,000
							$	162,372	$	163,652

The FASB ASC Topic on Financial Instruments requires disclosure of fair value information of financial instruments. For financial instruments where quoted market prices are not available, the fair value of these financial instruments is estimated by discounting future cash flows or by using similar recent transactions. Because considerable judgment is used, these estimates are not necessarily indicative of amounts that could be realized in a current market exchange. The Company does not carry its long term debt at fair value on its consolidated balance sheets. As at December 31, 2010, the Company estimated the fair value of its long term debt to be approximately $146.0 million and as at December 31, 2009, the Company estimated the fair value of its long term debt to be approximately $135.1 million.

The Notes indentures contain various covenants, including limitations on liens on the stock restricted subsidiaries, restrictions as to the disposition of the stock of restricted subsidiaries and limitations on mergers and consolidations. The Company was in compliance with all the covenants contained in the Notes indentures at December 31, 2010.

Interest expense includes interest payable and amortization of debt offering expenses. The debt offering expenses are amortized over the period from the issuance of the Notes to the earliest they may be called by the Company. For the years ended December 31, 2010, 2009, and 2008, the Company incurred interest expense and amortization of debt offering expenses of $7.2 million, $8.3 million, and $11.5 million on the Notes. Also, at December 31, 2010 and 2009, the Company had $0.3 million and $0.3 million, respectively, of interest payable included in other liabilities in

the consolidated balance sheets.

Future principal and interest payments on long term debt are expected to be as follows:

Year		Estimated future principal and interest payments
2011	$	6,252
2012		6,252
2013		6,252
2014		6,252
2015		6,252
Later years		305,451
Total	$	336,711

150

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE III

SUPPLEMENTARY INSURANCE INFORMATION
As at and For the Years Ended December 31, 2010, 2009 and 2008

(Expressed in thousands of U.S. dollars)

	As at December 31, 2010				For the years ended December 31, 2010				
	Deferred policy acquisition costs	Future policy benefits, losses, claims and loss expenses	Unearned premiums	Premium revenue	Net investment income	Benefits, claims, losses and settlement expenses	Amortization of deferred policy acquisition costs	Other operating expenses	Premiums written
Reinsurance	$ 39,924	$ 583,267	$ 246,256	$ 697,614	$ -	$ 413,005	$ 127,498	$ 136,249	$ 861,388
Lloyd's	19,495	133,489	91,499	145,246	-	115,711	34,818	26,144	187,420
Island Heritage (1)	6,498	4,558	41,049	9,224	-	1,420	18,102	9,300	90,896
Inter-segment eliminations	-	-	-	-	-	-	(15,598)	-	(41,854)
Unallocated	-	-	-	-	31,482	-	-	-	-
	$ 65,917	$ 721,314	$ 378,804	$ 852,084	$ 31,482	$ 530,136	$ 164,820	$ 171,693	$ 1,097,850

	As at December 31, 2009				For the years ended December 31, 2009				
	Deferred policy acquisition costs	Future policy benefits, losses, claims and loss expenses	Unearned premiums	Premium revenue	Net investment income	Benefits, claims, losses and settlement expenses	Amortization of deferred policy acquisition costs	Other operating expenses	Premiums written
Reinsurance	$ 32,570	$ 436,193	$ 219,865	$ 689,544	$ -	$ 241,358	$ 121,837	$ 119,555	$ 796,984
Lloyd's	16,950	39,782	74,017	62,130	-	40,847	14,608	15,904	145,889
Island Heritage (1)	5,194	4,685	36,534	6,781	-	980	14,213	11,679	84,239
Inter-segment eliminations	(77)	-	-	-	-	-	(14,187)	-	(38,621)
Unallocated	-	-	-	-	28,531	-	-	-	-
	$ 54,637	$ 480,660	$ 330,416	$ 758,455	$ 28,531	$ 283,185	$ 136,471	$ 147,138	$ 988,491

	As at December 31, 2008				For the years ended December 31, 2008				

	Deferred policy acquisition costs	Future policy benefits, losses, claims and loss expenses	Unearned premiums	Premium revenue	Net investment income	Benefits, claims, losses and settlement expenses	Amortization of deferred policy acquisition costs	Other operating expenses	Premiums written
Reinsurance	$ 40,086	$ 400,957	$ 239,529	$ 641,500	$ -	$ 377,228	$ 101,528	$ 90,026	$ 740,169
Island Heritage (1)	4,515	10,608	31,362	12,668	-	2,656	13,897	9,000	76,926
Inter-segment elimination	-	-	-	-	-	-	(9,691)	-	(35,206)
Unallocated	-	-	-	-	51,398	-	-	-	-
	$ 44,601	$ 411,565	$ 270,891	$ 654,168	$ 51,398	$ 379,884	$ 105,734	$ 99,026	$ 781,889

(1) Previously referred to as the Insurance segment until January 1, 2010.

151

Index

FLAGSTONE REINSURANCE HOLDINGS, S.A.

SCHEDULE IV

REINSURANCE
As at and For the Years Ended December 31, 2010, 2009 and 2008

(Expressed in thousands of U.S. dollars)

	Gross amount	Ceded to other companies	Assumed from other companies	Net amount	Percentage of amount assumed to net
2010 - Property and casualty	$ -	$ 213,996	$ 1,097,850	$ 883,854	124 %
2009 - Property and casualty	$ -	$ 196,022	$ 988,491	$ 792,469	125 %
2008 - Property and casualty	$ -	$ 87,191	$ 781,889	$ 694,698	113 %

Index

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this report, our management has performed an evaluation pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the “Exchange Act”), with the participation of our Chief Executive Officer and Chief Financial Officer, of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act, as amended). Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by SEC rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow for timely decisions regarding required disclosures. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2010, our company’s disclosure controls and procedures were effective.

Management’s Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). and 15d-15(f). Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that:

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statement in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance authorizations of management and directors; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of assets that could have a material effect on the financial statements.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2010, based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

Our management, including the Chief Executive Officer and the Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. The Company's internal control over financial reporting was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with

U.S. generally accepted accounting principles and to reflect management's judgments and estimates concerning effects of events and transactions that are accounted for or disclosed. Because of the inherent limitations in all control systems, no evaluation of controls can provide an absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected.

Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our fiscal year of 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

153

Index

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Flagstone Reinsurance Holdings, S.A.
Luxembourg, Luxembourg

We have audited the internal control over financial reporting of Flagstone Reinsurance Holdings, S.A. and subsidiaries (the "Company") as of December 31, 2010, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2010 of the Company and our

report dated March 2, 2011 expressed an unqualified opinion on those financial statements and financial statement schedules.

/s/ Deloitte & Touche
Hamilton, Bermuda
March 2, 2011

Index

ITEM 9B. OTHER INFORMATION

None.

155

Index

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference in a definitive proxy statement ("the Proxy Statement") that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2010 pursuant to Regulation 14A under the Exchange Act.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference in the Proxy Statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2010 pursuant to Regulation 14A under the Exchange Act.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS, MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference in the Proxy Statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2010 pursuant to Regulation 14A under the Exchange Act.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference in the Proxy Statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2010 pursuant to Regulation 14A under the Exchange Act.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated by reference in the Proxy Statement that will be filed with the SEC not later than 120 days after the close of the fiscal year ended December 31, 2010 pursuant to Regulation 14A under the Exchange Act.

Index

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements, Financial Statement Schedules and Exhibits.

1. Financial Statements

Included in Part II – See Item 8 of this report.

2. Financial Statement Schedules

Report of Independent Registered Public Accounting Firm
Schedule I - Summary of Investments
Schedule II - Condensed Financial Information of Registrant
Schedule III - Supplementary Insurance Information
Schedule IV - Supplementary Reinsurance Information

Included in Part II – See Item 8 of this report. Schedules V and VI have been omitted as the information is provided in Item 8, Consolidated Financial Statements, or in the above schedules.

3. Exhibits – see Exhibit Index.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 2, 2011.

FLAGSTONE REINSURANCE HOLDINGS, S.A.

By: /s/ David A. Brown
Name: David A. Brown
Title: Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ David A. Brown David A. Brown	Chief Executive Officer (Principal Executive Officer) and Director	March 2, 2011
/s/ Patrick Boisvert Patrick Boisvert	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 2, 2011
/s/ E. Daniel James E. Daniel James	Non-Executive Chairman and Director	March 2, 2011
/s/ Gary Black Gary Black	Director	March 2, 2011
/s/ Stephen Coley Stephen Coley	Director	March 2, 2011
/s/ Thomas Dickson Thomas Dickson	Director	March 2, 2011
/s/ Stewart Gross Stewart Gross	Director	March 2, 2011
/s/ Tony Knap Tony Knap	Director	March 2, 2011

/s/ Anthony Latham Anthony Latham	Director	March 2, 2011
/s/ Jan Spiering Jan Spiering	Director	March 2, 2011
/s/ Wray T. Thorn Wray T. Thorn	Director	March 2, 2011
/s/ Peter Watson Peter Watson	Director	March 2, 2011

158

EXHIBIT INDEX
Pursuant to Item 601 of Regulation S-K

Exhibit No.	Description of Exhibit
3.1	Articles of Incorporation of Flagstone Reinsurance Holdings, S.A. (incorporated by reference to Exhibit 3.1 to Current Report on Form 8-K filed May 19, 2010).
4.1	Specimen Share Certificate (incorporated by reference to Exhibit 4.4 to Current Report on Form 8-K filed May 19, 2010).
4.2*	Amended and Restated Share Purchase Warrant, dated June 25, 2010.
4.3	Junior Subordinated Indenture dated as of August 23, 2006 between Flagstone Reinsurance Holdings Limited and JPMorgan Chase Bank, N.A., as Trustee (incorporated by reference to Exhibit 4.3 to Amendment No. 1 to the Registration Statement filed December 8, 2006)
4.4	First Supplemental Indenture dated as of May 17, 2010, among Flagstone Reinsurance Holdings, S.A., Flagstone Reinsurance Holdings Limited and The Bank of New York Mellon Trust, successor in interest to JPMorgan Chase Bank, National Association, as Trustee (incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K filed May 19, 2010).
4.5	Indenture, dated as of June 8, 2007, between Flagstone Finance S.A., as Issuer, Flagstone Reinsurance Holdings Limited, as Guarantor, and Wilmington Trust Company, as Trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated June 14, 2007)
4.6	First Supplemental Indenture dated as of May 17, 2010, among Flagstone Finance S.A., a Luxembourg Company, Flagstone Reinsurance Holdings, S.A., and Wilmington Trust Company, a Delaware banking corporation, as Trustee (incorporated by reference to Exhibit 4.2 to Current Report on Form 8-K filed May 19, 2010).
10.1	Amended and Restated Shareholders' Agreement dated as of May 17, 2010 among Flagstone Reinsurance Holdings, S.A. and the shareholders listed therein (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed May 19, 2010).
10.2	Flagstone Reinsurance Holdings, S.A. Performance Share Unit Plan, dated May 17, 2010 (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed May 19, 2010).
10.3	Flagstone Reinsurance Holdings, S.A. Restricted Share Unit Plan, dated May 19, 2010 (incorporated by reference to Exhibit 10.3 to Current Report on Form 8-K filed May 19, 2010).
10.4	Insurance Letters of Credit - Master Agreement dated as of April 28, 2010 between Flagstone Réassurance Suisse SA, Flagstone Capital Management Luxembourg SICAF - FIS and Citibank Europe plc (incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed May 4, 2010).
10.5	Pledge Agreement dated as of April 28, 2010 between Flagstone Capital Management Luxembourg SICAF – FIS and Citibank Europe plc (incorporated by reference to Exhibit 99.2 to Current Report on Form 8-K filed May 4, 2010).
10.6	Account Control Agreement dated as of April 28, 2010 among Citibank Europe plc, Flagstone Capital Management Luxembourg SICAF – FIS and JP Morgan Bank Luxembourg S.A. (incorporated by reference to Exhibit 99.3 to Current Report on Form 8-K filed May 4, 2010).
10.7	Amendment Letter and Revised Summary of Terms relating to the Insurance Letters of Credit – Master Agreement between Flagstone Réassurance Suisse SA, Flagstone Capital Management Luxembourg SICAF – FIS and Citibank Europe SA dated as of December 21, 2010

	(incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed December 23, 2010).
10.8	$200,000,000 Multi-Currency Letter of Credit Facility Agreement dated as of March 6, 2009 between Flagstone Réassurance Suisse SA, as Borrower, and Barclays Bank plc, as Issuing Bank (incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed March 11, 2009).

10.9	Security Agreement dated as of March 5, 2009 between Flagstone Réassurance Suisse SA, as Grantor, and Barclays Bank plc, as Secured Party (incorporated by reference to Exhibit 99.2 to Current Report on Form 8-K filed March 11, 2009).
10.10	Deed of Charge Over Securities dated March 5, 2009 granted by Flagstone Réassurance Suisse SA in favor of Barclays Bank plc (incorporated by reference to Exhibit 99.3 to Current Report on Form 8-K filed March 11, 2009).
10.11	Deed of Charge Over Credit Balances dated March 5, 2009 granted by Flagstone Réassurance Suisse SA in favor of Barclays Bank plc (incorporated by reference to Exhibit 99.4 to Current Report on Form 8-K filed March 11, 2009).
10.12	Securities Account Control Agreement dated as of March 6, 2009 between Flagstone Réassurance Suisse SA and JP Morgan Chase Bank, National Association (incorporated by reference to Exhibit 99.5 to Current Report on Form 8-K filed March 11, 2009).
10.13	Side Letter Agreement dated March 5, 2009 in respect of the $200,000,000 Multicurrency Letter of Credit Facility Agreement dated on or about the date hereof between Flagstone Réassurance Suisse SA and Barclays Bank plc (incorporated by reference to Exhibit 99.6 to Current Report on Form 8-K filed March 11, 2009).
10.14	Employment Agreement dated October 15, 2006 between David Brown and Flagstone Reinsurance Holdings Limited (incorporated by reference to Exhibit 10.9 to the Registration Statement filed October 24, 2006).
10.15*	Amended and Restated Employment Agreement dated March 31, 2009 between Gary Prestia and Flagstone Réassurance Suisse SA – Bermuda Branch and Amendment Letter, dated as of January 1, 2011, to the Amended and Restated Employment Agreement between Gary Prestia and Flagstone Réassurance Suisse SA – Bermuda Branch..
10.16*	Amended and Restated Employment Agreement dated June 24, 2009 between Guy Swayne and Flagstone Réassurance Suisse SA – Bermuda Branch and Amendment Letter, dated as of January 1, 2011, to the Amended and Restated Employment Agreement between Guy Swayne and Flagstone Réassurance Suisse SA – Bermuda Branch.
10.17*	Amended and Restated Employment Agreement dated April 24, 2009 between Patrick Boisvert and Flagstone Réassurance Suisse SA and Amendment Letter, dated as of January 1, 2011, to the Amended and Restated Employment Agreement between Patrick Boisvert and Flagstone Réassurance Suisse SA.
10.18*	Amended and Restated Employment Agreement dated March 31, 2009 between David Flitman and Flagstone Réassurance Suisse SA – Bermuda Branch and Amendment Letter, dated as of January 1, 2011, to the Amended and Restated Employment Agreement between David Flitman and Flagstone Réassurance Suisse SA – Bermuda Branch.
10.19	Charter agreement dated December 20, 2005 with Longtail Aviation Ltd. (incorporated by reference to Exhibit 10.14 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.20	Quota Share Reinsurance Treaty dated August 28, 2006 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as ILW Cell (incorporated by reference to Exhibit 10.16 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.21	Operational Support Agreement dated as of December 20, 2005 between Flagstone Reinsurance Limited and West End Capital Management (Bermuda) Limited (incorporated by reference to Exhibit 10.18 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.22	Letter Agreement dated February 23, 2006 between Lightyear Fund II (Cayman) L.P. and Flagstone Reinsurance Holdings, S.A. (incorporated by reference to Exhibit 10.19 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.23	

	2006 Residential Property Catastrophe Excess of Loss Reinsurance Agreement between Flagstone Reinsurance Limited and Island Heritage Insurance Company Limited (incorporated by reference to Exhibit 10.24 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.24	2006 Umbrella Property Catastrophe Excess of Loss Reinsurance Agreement between Flagstone Reinsurance Limited and Island Heritage Insurance Company Limited (incorporated by reference to Exhibit 10.25 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.25	Lease of Office Space dated July 26, 2005 between Crombie Developments Limited and West End Capital Services (Halifax) Limited (incorporated by reference to Exhibit 10.27 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.26	Agreement to Lease Amendment dated October 30, 2007 between Crombie Developments Limited, as Landlord and Flagstone Management Services (Halifax) Limited, as Tenant (incorporated by reference to Exhibit 10.42 to Annual Report on Form 10-K filed March 13, 2009).

10.27	Amending Agreement dated February 26, 2008 between Crombie Developments Limited, as Landlord, and Flagstone Management Services (Halifax) Limited, as Tenant (incorporated by reference to Exhibit 10.43 to Annual Report on Form 10-K filed March 13, 2009).
10.28	Facultative Obligatory Surplus Reinsurance Contract effective June 5, 2006 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as ILW Cell (incorporated by reference to Exhibit 10.28 to Amendment No. 1 to the Registration Statement filed December 8, 2006).
10.29	Quota Share Reinsurance Treaty dated January 4, 2007 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as ILW 2 Cell (incorporated by reference to Exhibit 10.30 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.30	Facultative Obligatory Surplus Reinsurance Contract effective January 1, 2007 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as ILW 2 Cell (incorporated by reference to Exhibit 10.31 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.31	Quota Share Reinsurance Treaty dated January 12, 2007 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as High Layer Cell (incorporated by reference to Exhibit 10.32 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.32	Facultative Obligatory Surplus Reinsurance Contract effective January 1, 2007 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as High Layer Cell (incorporated by reference to Exhibit 10.33 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.33	Quota Share Reinsurance Treaty dated January 4, 2007 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as ILW Cell (incorporated by reference to Exhibit 10.30 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.34	Facultative Obligatory Surplus Reinsurance Contract effective June 5, 2006 between Flagstone Reinsurance Limited and Mont Fort Re Ltd. in respect of its segregated account, designated as ILW Cell (incorporated by reference to Exhibit 10.31 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.35	Discretionary Investment Management Agreement dated as of June 5, 2006 between West End Capital Management (Bermuda) Limited and Mont Fort Re Ltd. ILW Cell (incorporated by reference to Exhibit 10.34 to Amendment No. 4 to the Registration Statement filed February 14, 2007).
10.36	Discretionary Investment Management Agreement dated as of January 1, 2007 between West End Capital Management (Bermuda) Limited and Mont Fort Re Ltd. ILW 2 Cell (incorporated by reference to Exhibit 10.35 to Amendment No. 6 to the Registration Statement filed March 14, 2007).
10.37	Discretionary Investment Management Agreement dated as of January 1, 2007 between West End Capital Management (Bermuda) Limited and Mont Fort Re Ltd. High Layer Cell (incorporated by reference to Exhibit 10.35 to Amendment No. 6 to the Registration Statement filed March 14, 2007).
10.38	Merger Agreement dated September 25, 2008 between Flagstone Reinsurance Limited and Flagstone Réassurance Suisse SA (incorporated by reference to Exhibit 10.54 to Annual Report on Form 10-K filed March 13, 2009).
10.39	Share Purchase Agreement between Flagstone Leasing Services Limited and Mark Byrne dated as of August 22, 2007 (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed September 15, 2009).
10.40	

	Share Purchase Agreement among Flagstone Leasing Services Limited, Mark Byrne, Haverford (Bermuda) Limited, West End Capital Management (Bermuda) Limited and Flagstone Leasing Services Limited dated as of August 23, 2007 (incorporated by reference to Exhibit 10.2 to Current Report on Form 8-K filed September 15, 2009).
10.41	Amalgamation Agreement between Longtail Aviation International Limited and Longtail Aviation Limited dated as of August 29, 2007 (incorporated by reference to Exhibit 10.3 to Current Report on Form 8-K filed September 15, 2009).
10.42	Lease Agreement among Gibbons Management Services Limited, West End Capital Management (Bermuda) Limited and Eyepatch Holdings Limited dated as of February 10, 2006 (incorporated by reference to Exhibit 10.4 to Current Report on Form 8-K filed September 15, 2009).
10.43	Compensation Philosophy dated June 15, 2006 (incorporated by reference to Exhibit 10.55 to Annual Report on Form 10-K filed March 13, 2009).

10.44*	Share and Warrant Purchase Agreement, dated December 8, 2010, between Flagstone (Bermuda) Holdings, Mr. Byrne, Haverford (Bermuda) Limited, and Limestone Business Limited.
10.45*	Letter Agreement, dated December 8, 2010, between Flagstone Reinsurance Holdings, S.A., Mr. Byrne, Limestone Business Limited and Haverford (Bermuda) Limited.
21.1*	Subsidiaries of the Company.
23.1*	Consent of Deloitte & Touche, Independent Registered Public Accounting Firm.
31.1*	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.
31.2*	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, with respect to the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.
32.1*	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, with respect to the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.
32.2*	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, with respect to the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.

* Filed herewith.