# MS Frontier Reinsurance Limited

ANNUAL REPORT 2011

MSIG | MS Frontier Re

A Member of MS&AD INSURANCE GROUP

# MS&AD Insurance Group

The merger of Mitsui Marine & Fire Insurance Co. and The Sumitomo Marine & Fire Insurance Limited in 2001 formed Mitsui Sumitomo Insurance Company, Limited ("MSI"). Together with its affiliates and subsidiaries (known collectively as "MSIG") the Group has become one of the leading non-life insurance companies in Japan.

In 2010 MSIG, Aioi Insurance Company, Limited and Nissay Dowa General Insurance Company, Limited integrated and established the new group "MS&AD Insurance Group" ("MS&AD").

For the year ended March 31, 2012 MS&AD wrote Net Premium of over US$31 billion (Yen 2,559 billion) and has total assets of over US$177 billion (Yen 14,537 billion).

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# MS Frontier Reinsurance Limited

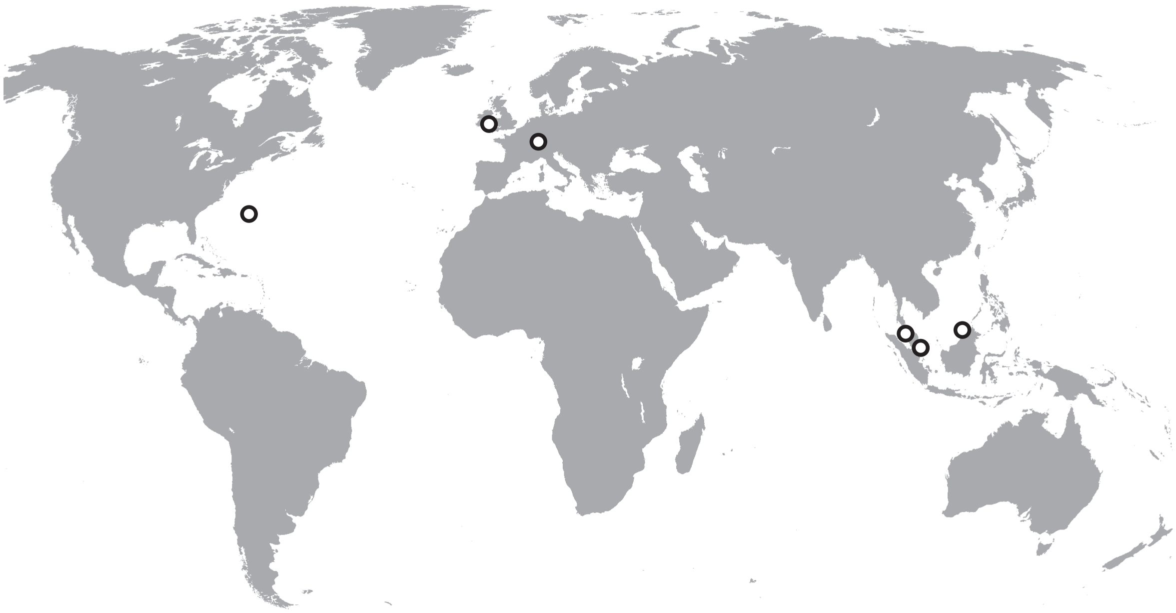
MS Frontier Reinsurance Limited – “MS Frontier Re”, a Class 3B registered reinsurance company incorporated in Bermuda, specializes in Property Catastrophe and North American Risk excess of loss business. The aim is to provide quality reinsurance support and services to business partners around the world.

Its main subsidiary, Mitsui Sumitomo Reinsurance Limited - “MSRe” focuses on Non-Catastrophe property and casualty reinsurance in Europe and Asia with offices in Dublin, Singapore and Malaysia.

MS&AD has had a presence in Bermuda since 1997 and launched its Property Catastrophe Reinsurance underwriting in July 2002 with the formation of MS Frontier Re. This has been a key part in establishing geographical portfolio optimization and risk diversification for the group.

The artwork used on the cover is an original piece commissioned to Graham Foster, a well known and accomplished Bermudian artist; www.grahamfoster.com

# Message from the President & CEO



**To our business partners,**

I would like to report on the activities and performance of MS Frontier Reinsurance Limited for the year ended December 31, 2011.

Several significant events, including major earthquakes in Japan and New Zealand, record tornados & Hurricane Irene in North America and severe flooding  in Thailand, made 2011 a very tough year for reinsurance underwriters.

We are mindful that behind these insurance losses there are many tragic incidents involving ordinary families and business owners.  We will play our part in helping them to recover financially but recognize also the human cost which can never be replaced.

Our mission to be geographically diversified has meant that we have incurred losses through these tragic events but our controlled underwriting has meant that we have limited our exposure well within our risk appetite.

As a consequence of the severe conditions for the year ended December 31, 2011, MS Frontier Re has reported an operating loss for the first time since 2005. We recognize that we are not alone amongst reinsurance underwriters in recording a loss for 2011 but we are confident that our capital strength and long term perspective will serve us well in 2012 and beyond.

Gross premium income for 2011 was $250m (2010- $247m), which is a slight increase from the previous year. Net income for 2011 was a loss of $75m (2010 profit of $75m).

The nature of our business model means that MS Frontier Re Group is at risk from high severity, low frequency claims and 2011 saw some of the most severe and devastating events of modern times. The series of earthquakes in New Zealand and severe flooding in Thailand have had a direct impact on our financial results. We were not directly exposed to the tsunami losses in Japan due to our strategic underwriting decision to avoid Japanese treaty business outside of the MS&AD Group.

Our investment philosophy continues to complement our underwriting outlook by balancing overall risk and return within the Company. Global growth has remained weak and certain European countries have been under financial strain with a very real risk of default at both the corporate and sovereign level. We will continue to maximize investment returns within acceptable levels of investment risk.

As the headquarters of reinsurance operations for the Group we continue to integrate the operations of MSRE, our Dublin based subsidiary, which writes mainly pro rata business complementing our property cat business. Our Singapore based

**Keiichi Nakajima**
President and Chief Executive Officer

subsidiary MS Frontier Modeling Research, continues to support our business through modeling and research of natural perils.

Despite the losses incurred in 2011, our shareholders funds remains strong at $671m (2010 - $700m). These funds are coupled with a full parental guarantee from MSI which helps us to maintain our position as one of the most stable reinsurers in the world. In recognition of our importance to the MS&AD Group further capital injections have been made to expand our business scope. A total of $150m was injected as at the end of April 2012 which will allow us to expand and grow our business further.

Risk management is a key concept in the management of a reinsurance company and it governs almost everything we do at MS Frontier Re Group. We continue to uphold the highest standards of control and risk management and review these on a regular basis, both internally and via independent review. We devote considerable energy to demonstrating how these controls and reviews are integrated into our daily workflows, both internally and to external parties.

As a final note I would like thank my predecessor Masataka Kitagawa for the contribution he has made to guiding and growing the Company during his tenure as President and CEO. Since April this year he has taken up a new assignment within MS&AD based in Tokyo.

I have joined a very strong team of professionals based around the world in our various offices and hope to enjoy your continued support as we develop our business in 2012 and beyond.

# Business Summary

## 5 Year Historical Highlights

in Millions of US Dollars

| | 2007 | 2008 | 2009 * | 2010 * | 2011 * |
|---|---|---|---|---|---|
| **Net Premium Earned** | 66.2 | 72.8 | 231.1 | 242.2 | 215.5 |
| **Investment Income** | 18.8 | 16.2 | 19.3 | 19.8 | 17.9 |
| **Net Income** | 68.9 | 43.5 | 86.2 | 75.4 | (75.1) |
| **Shareholders' Equity** | 394.2 | 439.5 | 621.9 | 700.2 | 670.6 |

**Includes MSRe*

## Ratios

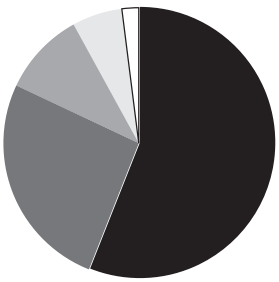
| | 2007 | 2008 | 2009 * | 2010 * | 2011 * |
|---|---|---|---|---|---|
| **Expense** | 20.3% | 23.8% | 33.7% | 34.0% | 35.8% |
| **Loss** | 1.3% | 36.8% | 39.8% | 43.5% | 110.4% |
| **Combined** | 21.6% | 60.6% | 73.5% | 77.5% | 146.2% |

**Includes MSRe*

## Underwriting

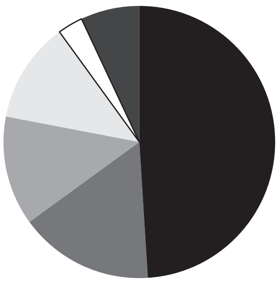
MS Frontier Re
Revenue Segmentation by Region

- USA **56%**
- Europe **26%**
- Australasia **10%**
- Canada/Caribbean **6%**
- Worldwide **2%**



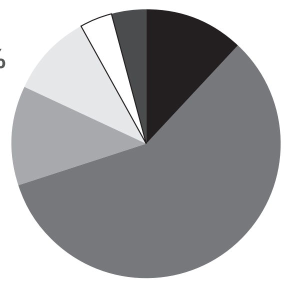
MSRe Classes of Business

- Property **49%**
- Engineering **16%**
- Hull **13%**
- Cargo **12%**
- Personal Accident **3%**
- Other **7%**



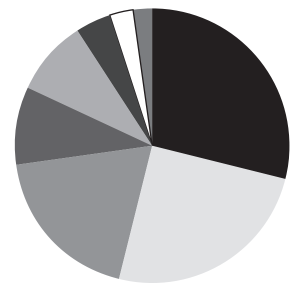
## Rating Profile of Fixed Income Investments

- Sovereign **41%**
- AAA & AA+ **28%**
- AA & AA- **15%**
- A+ & A **12%**
- BBB **2%**
- Cat Bonds **2%**



## Investment portfolio by type

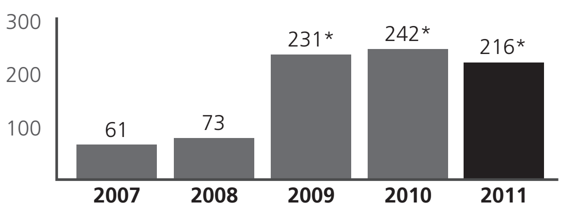
- US Corporate **29%**
- Non US Corporate **25%**
- US Treasuries **19%**
- Non US Govt & Agencys **9%**
- Short Term Investments **9%**
- US Agencies **4%**
- Structured Deposits **3%**
- Cat Bonds **2%**



## Revenue Growth

in Millions of US Dollars

Earned Premium

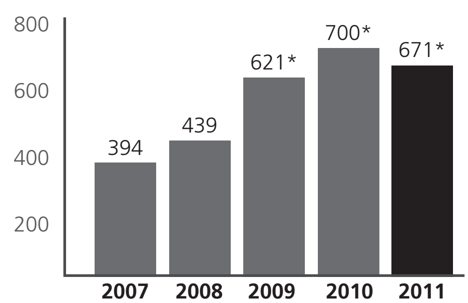



*Includes MSRe*

## Shareholders' Funds Growth

in Millions of US Dollars

Shareholders' Equity




*Includes MSRe*

## Ratings

**AM Best rating:** A Excellent

**Standard & Poor's rating:** A+ Strong

# Financial Statements

**INDEPENDENT AUDITORS' REPORT**

To the Board of Directors and Shareholder of
MS Frontier Reinsurance Limited

We have audited the accompanying consolidated balance sheets of MS Frontier Reinsurance Limited as of December 31, 2011 and 2010 and the related consolidated statements of income and comprehensive income, changes in shareholder's equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of MS Frontier Reinsurance Limited as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG

Chartered Accountants
Hamilton, Bermuda
May 7, 2012

# Consolidated Balance Sheets

**Years ended December 31, 2011 and 2010 (Expressed in United States Dollars)**

| | 2011 | 2010 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents (Note 3) | $ 234,273,308 | $ 183,390,460 |
| Investments (Note 3) | 728,170,271 | 653,169,240 |
| Accrued interest receivable | 6,601,411 | 7,447,519 |
| Reinsurance balances receivable (Note 8) | 51,771,175 | 42,957,530 |
| Losses recoverable | 54,886,536 | 18,263,391 |
| Funds withheld | 27,877,153 | 30,482,863 |
| Deferred acquisition expenses | 17,405,854 | 22,113,855 |
| Deferred reinsurance premium | 12,426,142 | 10,676,958 |
| Deferred tax (Note 9) | 2,443,879 | 314,088 |
| Prepaid expenses (Note 8) | 2,164,735 | 2,304,606 |
| Other Assets | 192,620 | 170,951 |
| Capital assets (Note 6) | 2,526,544 | 3,522,241 |
| Total assets | $1,140,739,628 | $ 974,813,702 |
| **Liabilities** | | |
| Outstanding losses and loss expenses (Notes 7 and 8) | $ 378,598,412 | $ 180,901,314 |
| Unearned premiums (Note 8) | 73,114,724 | 76,614,831 |
| Reinsurance balances payables | 14,919,269 | 13,582,881 |
| Accounts payable and accrued expenses (Note 8) | 3,351,344 | 2,740,644 |
| Corporation tax payable | 10,795 | 581,169 |
| Deferred tax (Note 9) | 163,108 | 180,685 |
| Total liabilities | 470,157,652 | 274,601,524 |
| **Shareholder's equity** | | |
| Share capital (Note 11) | 294,588,584 | 294,588,584 |
| Contributed surplus (Note 11) | 150,000,000 | 100,000,000 |
| Accumulated other comprehensive income | 7,301,092 | 11,866,548 |
| Retained earnings | 218,692,300 | 293,757,046 |
| Total shareholder's equity | 670,581,976 | 700,212,178 |
| Total liabilities and shareholder's equity | $1,140,739,628 | $ 974,813,702 |

*See accompanying notes to consolidated financial statements*

# Consolidated Statements of Income and Comprehensive Income

**Years ended December 31, 2011 and 2010 (Expressed in United States Dollars)**

| | 2011 | 2010 |
|---|---|---|
| **Income** | | |
| Premiums assumed (Note 8) | $ 249,530,630 | $ 246,960,808 |
| Change in unearned premiums | 1,733,244 | 15,620,189 |
| Premiums earned | 251,263,874 | 262,580,997 |
| Premiums ceded (Notes 5 and 8) | (38,626,823) | (28,370,974) |
| Change in prepaid reinsurance | 2,875,379 | 7,957,886 |
| Ceded premiums earned | (35,751,444) | (20,413,088) |
| Net premiums earned | 215,512,430 | 242,167,909 |
| Catastrophe bond income | 1,248,691 | 1,746,784 |
| Net investment income (Note 3) | 17,926,052 | 19,804,787 |
| Net gain on sale of investments (Note 3) | 6,413,016 | 5,334,850 |
| Other income | 790,201 | 683,292 |
| Foreign exchange loss | (4,177,306) | (5,426,518) |
| Total income | 237,713,084 | 264,311,104 |
| **Expenses** | | |
| Losses and loss expenses incurred (Notes 7 and 8) | 237,990,258 | 105,350,977 |
| Acquisition expenses | 51,568,736 | 59,695,319 |
| General and administrative expenses (Note 8) | 25,491,128 | 22,726,424 |
| Total expenses | 315,050,122 | 187,772,720 |
| (Loss) Income before taxes | (77,337,038) | 76,538,384 |
| Income taxes (Note 9) | (2,272,292) | 1,136,153 |
| Net (loss) income | (75,064,746) | 75,402,231 |
| **Other comprehensive income** | | |
| Unrealized holding gains arising during year | 9,753,540 | 3,359,935 |
| Foreign currency translation adjustment | (7,724,968) | 4,835,321 |
| Less: reclassification adjustment for gains included in net (loss) income | (6,594,028) | (5,334,850) |
| Other comprehensive (loss) income | (4,565,456) | 2,860,406 |
| Comprehensive (loss) income | $ (79,630,202) | $ 78,262,637 |

*See accompanying notes to consolidated financial statements*

# Consolidated Statements of Changes in Shareholder's Equity

**Years ended December 31, 2011 and 2010 (Expressed in United States Dollars)**

| | 2011 | 2010 |
|---|---|---|
| **Share capital** (Note 11) | | |
| Balance at beginning and end of year | $ 294,588,584 | $ 294,588,584 |
| **Contributed surplus** | | |
| Balance at beginning and end of year | 100,000,000 | 100,000,000 |
| Contributions in the year | 50,000,000 | - |
| Balance at end of year | 150,000,000 | 100,000,000 |
| **Accumulated other comprehensive income** | | |
| Balance at beginning of year | 11,866,548 | 9,006,142 |
| Unrealized gains and losses on available for sale securities | 3,159,512 | (1,974,916) |
| Foreign currency translation adjustment | (7,724,968) | 4,835,322 |
| Balance at end of year | 7,301,092 | 11,866,548 |
| **Retained earnings** | | |
| Balance at beginning of year | 293,757,046 | 218,354,815 |
| Net (loss) income | (75,064,746) | 75,402,231 |
| Balance at end of year | 218,692,300 | 293,757,046 |
| Total shareholders' equity | $ 670,581,976 | $ 700,212,178 |

*See accompanying notes to consolidated financial statements*

# Consolidated Statements of Cash Flows

**Years ended December 31, 2011 and 2010 (Expressed in United States Dollars)**

| | 2011 | 2010 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net (loss) income | $ (75,064,746) | $ 75,402,231 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of investments | 3,519,038 | 2,099,852 |
| Depreciation of capital assets | 1,561,895 | 1,649,146 |
| Net (gain) on sale of investments | (6,413,016) | (5,334,850) |
| (Loss) /gain on sale of capital assets | (26,672) | 25,940 |
| Other than temporary impairment | 732,351 | (167,649) |
| Accrued interest receivable | 846,108 | (174,558) |
| Reinsurance balances receivable | (8,813,645) | (18,259,601) |
| Funds withheld | 2,605,710 | 1,542,906 |
| Deferred acquisition expenses | 4,708,001 | 3,115,891 |
| Deferred reinsurance premium | (1,749,184) | (7,653,364) |
| Prepaid expenses | 118,202 | (715,743) |
| Outstanding losses and loss expenses | 161,073,953 | 28,197,483 |
| Unearned premiums | (3,500,107) | (17,046,334) |
| Reinsurance balances payable | 1,336,388 | 8,869,632 |
| Deferred tax asset | (2,147,368) | 1,439,422 |
| Corporation tax | (570,374) | 144,461 |
| Currency translation difference | (1,424,578) | 5,760,876 |
| Bad debt provision | 18,632 | 67,127 |
| Capital asset exchange | – | 10,544 |
| Accounts payable and accrued expenses | 610,700 | 411,082 |
| Cash provided by operating activities | 77,421,290 | 79,384,494 |
| **Cash flows from investing activities** | | |
| Purchase of investments | (865,751,818) | (624,120,923) |
| Proceeds from sale of investments | 667,416,707 | 472,446,993 |
| Proceeds from maturities of investments | 122,336,195 | 83,172,853 |
| Purchase of capital assets | (715,378) | (1,691,407) |
| Proceeds from sale of capital assets | 175,852 | 178,274 |
| Capital injection | 50,000,000 | – |
| Cash used by investing activities | (26,538,442) | (70,014,210) |
| Net increase in cash and cash equivalents | 50,882,848 | 9,370,284 |
| Cash and cash equivalents at beginning of year | 183,390,460 | 174,020,176 |
| Cash and cash equivalents at end of year | $ 234,273,308 | $ 183,390,460 |

# Notes to Consolidated Financial Statements

**December 31, 2011 and 2010**

## 1. General

MS Frontier Reinsurance Limited was incorporated under the laws of Bermuda on September 9, 1997 and is licenced as a Class 3B and Long Term Class A reinsurer under the Insurance Act, 1978 of Bermuda and related regulations to write all classes of property and casualty business and long-term business, respectively. Unless the context otherwise requires, the "Company" refers to the consolidated financial statements of MS Frontier Reinsurance Limited and its wholly owned subsidiaries, MS Frontier Modeling Research Pte Ltd. (MSFMR), a company incorporated in Singapore and Mitsui Sumitomo Reinsurance Limited (MSRe), a company incorporated in Ireland.

MS Frontier Reinsurance Limited is a wholly owned subsidiary of Mitsui Sumitomo Insurance Company Limited, which is the main trading subsidiary of Mitsui Sumitomo Insurance Group Holdings Inc., a company incorporated in Japan.

On March 31, 2010, the Company acquired MSRe from Mitsui Sumitomo Insurance Company, Limited, a company under common control for consideration of $94,588,584, representing the book value at the date of change in ownership. On December 30, 2011 a capital injection of $39,955,622 was made to MS Re.

The Company participates in various excess of loss property catastrophe reinsurance contracts. Property catastrophe reinsurance covers unpredictable events such as hurricanes, windstorms, hailstorms, earthquakes, fires, industrial explosions, freezes, floods and other man-made or natural disasters. Because the Company has large aggregate exposures to these risks, the Company expects that its claims experience will be characterized by relatively low frequency and high severity claims. The occurrence of claims from catastrophic events is likely to result in substantial volatility in the Company's financial results for any particular period. The Company endeavours to manage its exposures to catastrophic events by limiting the amount of its exposure in each geographic zone.

In prior years the Company participated in various quota share pools covering risks such as fire, property and other man-made or natural disasters and provided excess of loss coverage of cargo, windstorm and property risks of its ultimate parent company. This business has been in run-off since 2002.

Mitsui Sumitomo Reinsurance Limited (MSRe), is domiciled in Dublin with branch offices in Singapore and Labuan and a co-location office in Kuala Lumpur. Their main business focus is on regional short-tailed proportional and risk excess of loss business, predominantly from Europe and Asia (excluding Japan).

## 2. Summary of significant accounting policies

The accompanying consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions that affect the reported 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 major estimates reflected in the Company's consolidated financial statements include, but are not limited to, outstanding losses and loss expenses, estimates of written and earned premiums and the assessment of other than temporary impairment of investments. The following are the significant accounting policies adopted by the Company:

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

**(a) Basis of consolidation**

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

**(b) Premiums assumed and ceded, acquisition expenses and commission income**

Premiums assumed are recorded on the accruals basis and are included in income on a pro-rated basis over the period of underlying coverage with the unearned portion deferred in the balance sheet. Reinsurance premiums are similarly pro-rated over the period of coverage with the unearned portion deferred in the balance sheet as unearned ceded premiums. Premium estimates on certain policies are made using the latest information available to management. Adjustments to estimates are recorded in the period in which they are determined.

Reinstatement premiums are recognized in accordance with the provisions of the reinsurance contracts. Reinstatement premiums are accrued at the time losses are incurred and, where coverage of the original contract is reinstated under pre-defined contract terms, are earned pro-rata over the reinstated coverage period.

Acquisition expenses and income, mainly commissions, federal excise tax and brokerage, related to unearned premiums and unearned ceded premiums are deferred and amortized to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition expenses limits the amount of the deferral to its realizable value by giving consideration to losses and loss expenses expected to be incurred as premiums are earned.

**(c) Outstanding losses and loss expenses**

Losses and loss expenses are recorded when advised by the ceding insurance companies. Outstanding losses represent management's estimate of the amount of reported losses and loss expenses based on reports received from the ceding insurance companies plus a provision for losses incurred but not reported ("IBNR"). The IBNR provision is estimated by management based on reports from industry sources, including initial estimates of aggregate industry losses, individual loss estimates received from ceding companies and brokers, output from commercially available catastrophe loss models and actuarial analysis using historical data available to the Company on the business assumed together with industry data.

Given the inherent nature of major catastrophic events, considerable uncertainty underlies the assumptions and associated estimated reserve for losses and loss expenses. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in income in the period in which they are determined. Due to the inherent uncertainty in estimating the liability for losses and loss expenses, there can be no assurance that the ultimate liability will not be settled for a significantly greater or lesser amount than that recorded. Based on the current assumptions used management believes that the Company's recorded amount is a reasonable estimate of the ultimate cost of losses incurred to the balance sheet date.

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

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

**(d) Profit commissions**

Certain policies include terms and conditions which may result in the payment of profit commissions. Estimates of profit commissions are continually reviewed based on the underwriting experience to date, and as adjustments become necessary, such adjustments are reflected in current operations. Profit commissions are accrued to the balance sheet date and are included within accounts payable and accrued expenses.

**(e) Investments**

All investments are classified as available-for-sale securities. Unrealized gains and losses are included within accumulated other comprehensive income as a separate component of shareholder's equity in the consolidated balance sheet. Fair values for fixed maturity securities are based on quoted market prices. Fair values for catastrophe bonds are based on independent broker quotes.

Realized gains and losses are derived using the specific identification method for determining the cost of securities sold.

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

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

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

**(f) Investment income and catastrophe bond income**

Investment income is accrued to the balance sheet date, and includes the amortization of premium or discount on the Company's investments in marketable securities purchased at amounts different from their par value and other than temporary impairment.

Catastrophe bond income is accrued to the balance sheet date.

**(g) Amortization of capital assets**

Amortization of capital assets is computed using the declining balance method at rates estimated to amortize their cost over their estimated useful lives. The following annual amortization rates are used:

| | |
|---|---|
| Furniture and fixtures | 10-20% |
| Computer equipment | 33% |
| Motor vehicles | 20% |

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

### (h) Translation of foreign currencies

Foreign currency assets and liabilities considered monetary items are translated at exchange rates in effect at the balance sheet date. Foreign currency revenues and expenses are translated at the transaction date exchange rates. Exchange gains and losses are included in the determination of net income.

The reporting currency of the Company is the U.S. dollar. The functional currencies of the Company's subsidiaries are the Euro, the U.S. dollar and Singapore dollar. In translating the financial statements of those subsidiaries whose functional currency is other than the U.S. dollar, assets and liabilities are converted into U.S. dollars using the rates of exchange in effect at the balance sheet dates, and revenues and expenses are converted using the average foreign exchange rates for the period. The effect of translation adjustments are reported as foreign currency translation adjustments within other comprehensive income.

### (i) Cash and cash equivalents

For purposes of the statements of cash flows the Company considers all time deposits with an original maturity of ninety days or less and money market funds which can be redeemed without penalty as equivalent to cash.

### (j) Provision for bad debts

The company reviews receivables on a quarterly basis. A bad debt provision is generally provided for any receivable based on estimated loss rate calculated by historical impairment experience. In addition the Company considers known and emerging credit events to determine if other provisions are necessary. The Company had provision for doubtful debts for the year ended 2011 of $497,141 (2010 - $190,571).

## 3. Cash and investments

**(a)** Cash and cash equivalents are held in various banks in each of the jurisdictions in which the Company operates. The Company's management evaluates the financial strength and stability of these institutions on a periodic basis.

The bankers of the Company's parent issued letters of credit in the amount of $76,171 (2010 - $457,577) in favor of US ceding companies. The Company's parent has pledged assets of a similar amount as security for these letters of credit.

Letters of credit were also established with a Bermuda bank in the amount of $2,229,173 (2010 - $842,732). Cash of a similar amount is pledged as security for these letters of credit.

In the normal course of business, cash and cash equivalents with a fair value of $3,405,964 as at December 31, 2011 (2010 - $4,641,877) have been deposited in trust for the benefit of a US ceding company. These funds are held in trust by a US based bank.

**(b)** The amortized cost and fair value of available-for-sale investments are as follows:

**3. Cash and investments (continued)**

| December 31, 2011 | Amortized cost | Unrealized gains | Unrealized losses less than 12 months | Unrealized losses greater than 12 months | Fair value |
|---|---|---|---|---|---|
| Debt securities issued by U.S. Treasuries | $140,219,151 | $ 1,643,734 | $ - | $ (11,761) | $ 141,851,124 |
| U.S. Agencies | 28,185,527 | 619,446 | - | (12,528) | 28,792,445 |
| Corporate debt securities U.S | 205,225,766 | 4,895,565 | (79,568) | (1,892,919) | 208,148,844 |
| Non-U.S | 176,154,819 | 3,482,989 | (18,228) | (140,518) | 179,479,062 |
| Non-U.S government and agencies | 67,801,978 | 1,159,796 | - | (6,417) | 68,955,357 |
| Structured Deposits | 21,050,288 | 3,354 | - | - | 21,053,642 |
| Short term investments | 65,489,997 | - | - | - | 65,489,997 |
| Catastrophe bonds | 14,000,000 | 399,800 | - | - | 14,399,800 |
| | $718,127,526 | $ 12,204,684 | $ (97,796) | $ (2,064,143) | $ 728,170,271 |

| December 31, 2010 | Amortized cost | Unrealized gains | Unrealized losses less than 12 months | Unrealized losses greater than 12 months | Fair value |
|---|---|---|---|---|---|
| Debt securities issued by U.S. Treasuries | $123,678,341 | $ 1,904,219 | $ (1,387,931) | $ - | $ 124,194,629 |
| U.S. Agencies | 14,330,305 | 493,476 | - | - | 14,823,781 |
| Corporate debt securities U.S | 297,097,908 | 8,103,330 | (889,044) | (29,241) | 304,282,953 |
| Non-U.S. | 142,882,161 | 3,272,257 | (313,781) | (121,854) | 145,718,783 |
| Non U.S. government and government agency | 25,490,974 | 742,267 | - | - | 26,233,241 |
| Structured deposits | 10,000,000 | 1,983 | - | - | 10,001,983 |
| Catastrophe bonds | 27,676,200 | 520,050 | - | (282,380) | 27,913,870 |
| | $641,155,889 | $ 15,037,582 | $ (2,590,756) | $ (433,475) | $ 653,169,240 |

Deferred tax of $163,107 (2010 - $180,685) is excluded from the above tables.

As at December 31, 2011 there is an investment of $21m in HSBC Specialist Funds – Short Duration Fixed Income Fund (SDFI) classified within structured deposits. The SDFI invests primarily in Government Agencies and Corporate Bonds. Moodys credit rating on the fund is Aa. All securities in the fund will have a minimum long term rating inclusive of A/A3 or higher.

Short term investments comprise fixed deposits with a maturity of less than 3 months which do not have a credit rating attached.

**3. Cash and investments (continued)**

Unrealized losses on investments held at December 31, 2011 and 2010 comprise an accumulation of relatively small unrealized losses on a security by security basis caused by general interest rate movements rather than credit events. During 2011 management identified another than temporary impairment in relation to one security and recorded an unrealized loss of $0.7m in the income statement in relation to this decline in value. The security has been disposed of following the year-end. There are no amounts in respect of declines in the value of individual securities considered to be other than temporary included in gross unrealized losses on fixed maturity investments for the years ended December 31, 2011 and 2010.

By fair value the company securities are investment grade rated as follows:

| Rating | Fair value | % |
|---|---|---|
| AAA | $ 370,869,469 | 50.9% |
| AA | 182,594,966 | 25.1% |
| A | 77,303,663 | 10.6% |
| BBB | 17,512,376 | 2.4% |
| BB | 8,135,500 | 1.1% |
| B | 6,264,300 | 0.9% |
| NR | 65,489,997 | 9.0% |
| | $ 728,170,271 | 100.0% |

**(c)** For investments in marketable securities held on December 31, 2011 the maturity distribution is as follows:

| | Amortized cost | Fair value |
|---|---|---|
| Within one year | $ 186,949,479 | $ 188,272,603 |
| From one to five years | 462,541,565 | 469,760,794 |
| From five to ten years | 68,636,482 | 70,136,874 |
| | $ 718,127,526 | $ 728,170,271 |

**(d)** During the year, proceeds from the sale of investments amounted to $667,416,707 (2010 - $472,446,993) and proceeds from maturities of investments amounted to $122,336,195 (2010 - $83,172,853). The Company realized gains of $9,522,735(2010 - $6,076,163) and losses of $3,109,719 (2010 - $741,313) on those sales and maturities.

**(e)** With the exception of catastrophe bonds, the investments held at December 31, 2011 have all been assigned a credit rating of BBB- or better by Standard & Poor's. In accordance with the Company's investment guidelines, with the exception of US government and government agency securities, no more than 10% of the investment portfolio may be invested in any one issuer. The largest holding, excluding holdings issued by the US Government and its agencies, represents 9.9% (2010 - 3.5%) of the total investment portfolio.

**3. Cash and investments (continued)**

At December 31, 2011, the Company held investments in catastrophe bonds with a fair value of $14,399,800 (2010 - $27,913,870) comprising five (2010 - eleven) catastrophe bonds with Standard & Poor's ratings ranging from B+ to BB+ and maturities ranging from 2012 to 2013. The issuers of these securities have used the proceeds raised to collateralize certain catastrophe reinsurance obligations primarily, U.S. windstorm and Japanese typhoon risk. Investments in these bonds are specifically chosen to complement the Company's overall underwriting risk profile. The investment in these securities is therefore at risk of loss, in whole or in part, if a covered catastrophe occurs.

**(f)** Net investment income comprises the following:

| | 2011 | 2010 |
|---|---|---|
| Interest income on debt securities | $ 21,769,958 | $ 22,038,588 |
| Interest income on cash and cash equivalents | 1,287,255 | 849,316 |
| Amortization | (3,519,038) | (2,099,852) |
| Investment expenses | (879,772) | (983,265) |
| Other than temporary impairment | (732,351) | – |
| | $ 17,926,052 | $ 19,804,787 |

**4. Fair value of financial instruments**

FASB ASC 820, Fair Value Measurements and Disclosures ("FASB ASC 820"), clarifies the definition of fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FASB ASC 820 clarifies that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets and the lowest priority being unobservable data. Further, FASB ASC 820 requires tabular disclosures of the fair value measurements by level within the fair value hierarchy. The Company adopted FASB ASC 820 effective January 1, 2008. The adoption did not have a significant impact on the Company's financial position or results of operations, but resulted in additional disclosures in the consolidated financial statements.

The following are the levels within the fair value hierarchy:

- Level 1 - Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these instruments does not entail a significant degree of judgment.

- Level 2 - Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals, broker quotes and certain pricing indices.

- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement. These measurements include circumstances where there is little, if any, market activity for the asset or liability. In these cases, significant management assumptions can be used to establish management's best estimate of the assumptions used by other market participants in determining the fair value of the asset or liability.

**4. Fair value of financial instruments (continued)**

There have been no material changes in the Company's valuation techniques since the adoption of FAS ASC 820.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement of the asset or liability. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the asset or liability.

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

Included in Level 2 are US government agencies, non-US government, corporate investments, catastrophe bonds and structured deposits. For all assets classified as Level 2, the market approach is utilized. The significant inputs used to determine the fair value of those assets classified as Level 2 are as follows:

- U.S government agency securities consist of securities issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other agencies. The fair values of these securities are determined using the spread above the risk-free yield curve and reported trades. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

- Non-U.S. government securities consist of bonds issued by non-U.S. governments and agencies along with supranational organizations. The significant inputs include the spread above the risk-free yield curve, reported trades and broker/ dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

- Corporate securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker/ dealer quotes, benchmark yields, and industry and market indicators. These are considered observable market inputs and, therefore, the fair value of these securities are classified within Level 2.

- Catastrophe bonds are recorded at fair value based on dealer quotes and trade prices. These inputs are observable and, therefore, the investments in catastrophe bonds are classified within Level 2.

- Structured deposits are recorded at fair value based on quoted indexes that are observable, and, therefore, the investments in structured deposits are classified within Level 2.

**4. Fair value of financial instruments (continued)**

| | Fair value measurements as at December 31, 2011 | | | |
|---|---|---|---|---|
| At December 31, 2011 | Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Debt securities issued by | | | | |
| U.S. Treasury | $ 141,851,125 | $ 141,851,125 | $ - | $ - |
| U.S. Agencies | 28,792,445 | - | 28,792,445 | - |
| Corporate debt securities | | | | |
| U.S. | 208,148,843 | - | 208,148,843 | - |
| Non-U.S. | 179,479,062 | - | 179,479,062 | - |
| Non-U.S. government and agencies | 68,955,357 | - | 68,955,357 | - |
| Structured deposit | 21,053,642 | - | 21,053,642 | - |
| Short term investments | 65,489,997 | 65,489,997 | - | - |
| Catastrophe bonds | 14,399,800 | - | 14,399,800 | - |
| | $ 728,170,271 | $ 207,341,122 | $520,829,149 | $ - |

| | Fair value measurements as at December 31, 2010 | | | |
|---|---|---|---|---|
| At December 31, 2010 | Total | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| Debt securities issued by | | | | |
| U.S. Treasury | $ 124,194,629 | $ 124,194,629 | $ - | $ - |
| U.S. Agencies | 14,823,781 | - | 14,823,781 | - |
| Corporate debt securities | | | | |
| U.S. | 304,282,953 | - | 304,282,953 | - |
| Non-U.S. | 145,718,783 | - | 145,718,783 | - |
| Non-U.S. government and agencies | 26,233,241 | - | 26,233,241 | - |
| Structured deposit | 10,001,983 | - | 10,001,983 | - |
| Catastrophe bonds | 27,913,870 | - | 27,913,870 | - |
| | $ 653,169,240 | $ 124,194,629 | $528,974,611 | $ - |

## 4. Fair value of financial instruments (continued)

The fair value of other assets and liabilities, consisting of accrued interest receivable, reinsurance balances receivable, funds withheld, reinsurance balances payable, accounts payable and accrued expenses approximates their carrying value due to their relative short term nature.

The estimates of fair value of other assets and liabilities are subjective in nature and are not necessarily indicative of the amounts that the Company would actually realize in a current market exchange. However, any differences would not be expected to be material. Certain instruments such as deferred acquisition expenses, prepaid expenses, outstanding losses and loss expenses, unearned premiums and unearned ceded premiums are excluded from fair value disclosure. Thus the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

## 5. Reinsurance

Reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of the reinsurer to honor its obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectable. The Company regularly evaluates the financial condition of its reinsurers. At December 31, 2011 $63.0m and (2010-$nil) in recoveries are due from the Company's reinsurer. Ceded reinsurance has been placed with the parent company, Mitsui Sumitomo Insurance Company Limited with a credit rating of AA- (2010 -AA) from Standard & Poor's and six other reinsurers with credit ratings of between A+ and A-.

## 6. Capital assets

Capital assets consist of the following:

| | 2011 | | | 2010 |
|---|---|---|---|---|
| | Cost | Accumulated depreciation | Net book value | Net book value |
| Furniture and fixtures | $ 2,902,290 | $ 1,725,311 | $ 1,176,979 | $ 1,145,325 |
| Motor vehicles | 200,837 | 76,640 | 124,197 | 121,325 |
| Computers | 6,907,440 | 5,682,072 | 1,225,368 | 2,255,591 |
| | $ 10,010,567 | $ 7,484,023 | $ 2,526,544 | $ 3,522,241 |

**7. Outstanding losses and loss expenses**

The summary of changes in outstanding losses and loss expenses at December 31, 2011 and 2010 are as follows:

| | 2011 | 2010 |
|---|---|---|
| Gross balance at the beginning of the year | $ 180,901,314 | $ 144,793,548 |
| Less: outstanding losses recoverable from reinsurers | (18,263,391) | (8,617,853) |
| Balance at beginning of year | 162,637,923 | 136,175,695 |
| Incurred related to: | | |
| Current year | 217,208,254 | 51,326,936 |
| Prior years | 25,445,106 | 52,311,608 |
| Foreign exchange (gain) loss on outstanding losses and loss expenses | (4,663,102) | 1,712,433 |
| Total loss and loss expenses incurred | 237,990,258 | 105,350,977 |
| Paid related to: | | |
| Current year | 9,601,976 | 2,048,818 |
| Prior years | 64,036,114 | 83,907,920 |
| Total paid losses | 73,638,090 | 85,956,738 |
| Foreign exchange loss on translation of outstanding loss expenses | 3,958,720 | 7,067,989 |
| Net balance at end of year | 314,805,505 | 162,637,923 |
| Plus outstanding losses recoverable from reinsurers | 63,792,907 | 18,263,391 |
| Balance at end of year | $ 378,598,412 | $ 180,901,314 |

The total net incurred losses for 2011 included $188.3m (2010 - $13.1m) in respect of large losses (losses exceeding $0.03m) reported during the year. Of these $7.8m related to Ireland (2010 - $4.2m), $79.0m to Singapore (2010 - $7.0m), $5.1m to Labuan (2010 - $1.9m) and to Bermuda $96.6m (2010- $Nil).

During the year the Company reinsured forty percent of its proportional property business to Mitsui Sumitomo Insurance Company Limited leading to a decrease in net incurred losses for the year.

During 2011 the Company also incurred losses of $84.0m net of recoveries from the catastrophe excess of loss protection in relation to the severe flooding in Thailand during September and October 2011. The flooding mainly affected the industrial parks of Northern and Central Thailand. The Company's exposure in Thailand is through both direct insurers having concentration of risks in industrial parks, as well as other direct insurers whose risks are spread throughout Thailand. Other losses incurred

**7. Outstanding losses and loss expenses (continued)**

include $56.1m and $23.4m in respect of New Zealand Earthquake Lyttleton and Sumner respectively, $4.5m for Alabama Tornadoes, $2.7m for Tennessee Wind/Hail and $1.0m for Danish Floods.

Prior year incurred has had an adverse movement in 2011, as a result of MS RE's vast majority of business in proportional treaties, it is expected that previous years will account for a significant portion of incurred losses every year for the large number of older underwriting years running off. This is particularly true of longer tail business such as engineering.

Reserves are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments could require a material change in the amount estimated. The reserves are subject to an annual actuarial review by independent actuaries.

**8. Related party transactions**

Premiums assumed from the parent or affiliates amounted to $9,785,209 (2010 - $9,622,211), and were undertaken on normal commercial rates. Other balance sheet and income statement items associated with these policies include the following:

| | 2011 | 2010 |
|---|---|---|
| **Assets** | | |
| Reinsurance balances receivable | $ 1,271,084 | $ 1,163,108 |
| Prepaid expenses | 8,935 | 507,766 |
| Funds withheld | 316,420 | 334,744 |
| Reinsurers' share of outstanding losses | 41,923,240 | – |
| Reinsurers' share of unearned premium | 9,343,360 | – |
| **Liabilities** | | |
| Outstanding losses and loss expenses | 3,211,218 | 411,302 |
| Unearned premiums | 549,446 | 828,836 |
| Accrued expenses | 158,611 | 355,300 |
| **Expenses** | | |
| Net claims paid | 5,086,516 | 1,503,443 |
| Losses and loss expenses incurred | 26,116 | 23,938 |
| Reinsurers' share of net written premium | 18,040,652 | 11,752,796 |
| **Income** | | |
| Net Premium Written | 10,028,390 | 9,622,211 |
| Reinsurers share of claims paid | 11,892,038 | 1,469,199 |
| Other Income | 55,955 | - |

In prior years, the Company had entered into a retrocession agreement with its parent company, whereby the Company ceded to its parent a portion of certain high layer property and fire catastrophe risks. During 2011, the Company resumed the retrocession agreement for fire non proportional risks.

The Company has appointed a company related through common control as an investment manager. The Company pays fees for investment management services based on the month end market value of the total investment portfolio. The fees are based on normal commercial terms and are included in investment expenses. The fees incurred for the above services were $529,097 (2010 - $521,182) for the year.

**8. Related party transactions (continued)**

At December 31, 2011 fees of $135,559 (2010 - $136,380) are included in accounts payable and accrued expenses.

**9. Taxation**

Total income taxes for the years ended December 31, 2011 and 2010 were allocated as follows:

| | 2011 | 2010 |
|---|---|---|
| Income taxes from continuing operations | $ (2,272,292) | $ 1,136,153 |
| Shareholder's equity, for unrealized gains and losses recognized for financial statements purposes | 163,106 | 180,685 |
| | $ (2,109,186) | $ 1,316,838 |

Income tax expense attributable to continuing operations for the years ended December 31, 2011 and 2010 consists of:

| | 2011 | 2010 |
|---|---|---|
| Current expense | $ 23,441 | $ 409,845 |
| Deferred benefit | (2,295,733) | 726,308 |
| | $ (2,272,292) | $ 1,136,153 |

A reconciliation setting forth the differences between the effective tax rate of the Company and the Irish statutory tax rate is as follows:

| | 2011 | 2010 |
|---|---|---|
| Expected tax rate | 0.00% | 0.00% |
| Effective tax from non-Bermuda operations | 2.94% | 1.48% |
| Actual tax rate | 2.94% | 1.48% |

The tax effects of temporary differences that give rise to significant portions of the deferred tax provision are as follows:

| | 2011 | 2010 |
|---|---|---|
| Deferred tax asset: | | |
| Unutilized losses carried forward and capital allowances | $ 2,443,879 | $ 314,088 |
| Gross deferred tax asset | 2,443,879 | 314,088 |
| Less valuation allowance | - | - |
| Deferred tax asset | $ 2,443,879 | $ 314,088 |

## 9. Taxation (continued)

| | 2011 | 2010 |
|---|---|---|
| Deferred tax liability:<br>Unrealized gain on fixed interest securities available for sale | $ 163,108 | $ 180,685 |
| Deferred tax liability | 163,108 | 180,685 |
| Net deferred tax asset | $ 2,280,771 | $ 133,403 |

There is a total deferred tax asset of $7,899,690 at 31 December 2011, arising in respect of tax adjusted trading losses, fixed asset timing differences and excess foreign tax credits carried forward from earlier periods. On the basis that it is prudent to recognise only 30% of the deferred tax assets at present, the closing deferred tax asset for accounts purposes is reduced to $2,639,907. There is therefore, an unrecognised deferred tax asset of €5,529,784 at year end.

Under current Bermuda law the Company is not required to pay any taxes in Bermuda on either income or capital gains. The Company has received an undertaking from the Minister of Finance in Bermuda that in the event of any such taxes being imposed the Company will be exempted from taxation until the year 2016.

The Company has adopted FASB ASC 740 which provides detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in a Company's consolidated financial statements. FASB ASC 740 has no impact on the Company's operating results or financial condition for the years ended December 31, 2011 and 2010.

MSRe is subject to Irish tax, in the branches in Malaysia and Singapore corporation tax is provided on taxable profits at the current tax rate applicable to the Company's activities. Double Taxation agreements exist between Ireland and Malaysia and Ireland and Singapore, corporation tax borne in Malaysia and Singapore can be utilized against tax payable in Ireland.

## 10. Commitments

MS Frontier Reinsurance Limited has entered into an agreement to lease office space in Bermuda for $64,132 per month for five (5) years beginning November 1, 2010.

Mitsui Sumitomo Reinsurance Limited has office space leased in Singapore, Labuan, Kuala Lumpur and Dublin for a total of $77,200 per month (lease commitments ending on October 31, 2012; July 31, 2013; September 30, 2012 and July 31, 2013 respectively).

As part of the reinsurance business of MSRe, the Singapore branch is required to hold assets of $20,480,502 within insurance funds held on deposit in Singapore. Any surplus assets may only be released from Singaporean jurisdiction once the solvency requirements of Singapore Law have been met. The Company has entered into a counter indemnity with a bank in relation to the Singapore branch.

## 11. Share capital and contributed surplus

The Company's share capital comprises 350,000,000 authorized and 294,588,584 issued and fully paid shares of $1 par value each.

**11. Share capital and contributed surplus (continued)**

On November 13, 2006 a cash contribution of $100,000,000 was made to the contributed surplus of the Company by its parent, Mitsui Sumitomo Insurance Company Ltd. A further cash contribution of $50,000,000 was made to the contributed surplus of the Company on November 17, 2011 by the parent company Mitsui Sumitomo Insurance Company.

During 2010 the Company increased its authorized share capital from $200,000,000 to $350,000,000. The Company issued 94,588,584 shares of $1 each par value to its parent. Mitsui Sumitomo Insurance Limited contributed $94,588,584 in the form of the fair value of the net assets of MS Re.

**12. Statutory requirements**

**Bermuda**

MS Frontier Reinsurance Limited is required by its licence to maintain capital and surplus greater than a minimum statutory amount determined as the greater of a percentage of outstanding losses or a given fraction of net written premiums. At December 31, 2011 MS Frontier Reinsurance Limited is required to maintain a minimum statutory capital and surplus of $16,116,607. Actual statutory capital and surplus is $664,411,273.

Actual statutory capital and surplus, as determined using statutory accounting principles, is as follows:

| | |
|---|---|
| Total shareholder's equity | $ 669,391,527 |
| Less non-admitted assets: | |
| Deferred acquisition expenses | (2,135,763) |
| Prepaid expenses | (1,996,467) |
| Capital assets | (848,024) |
| Statutory capital and surplus | $ 664,411,273 |

MS Frontier Reinsurance Limited is also required to maintain a minimum liquidity ratio whereby the value of its relevant assets are not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and cash equivalents, investments, accrued interest receivable, reinsurance balances receivable and funds withheld.

Certain categories of assets do not qualify as relevant assets under the statute. The relevant liabilities are total general business insurance reserves and total other liabilities, less sundry liabilities.

At December 31, 2011 MS Frontier Reinsurance Limited was required to maintain relevant assets of $95,687,483. At that date relevant assets were $629,277,496 and the minimum liquidity ratio was therefore met.

MS Frontier Reinsurance Limited is subject to enhanced capital requirements in addition to minimum levels of solvency and liquidity under the Bermuda Insurance Act, 1978 and related regulations. The enhanced capital requirement ("ECR") is determined by reference to a standardized statutory risk-based capital model used to measure the risk associated with the Company's assets, liabilities and premiums. If a company fails to maintain or meet the ECR, various degrees of regulatory action may be taken. The principal difference between statutory capital and surplus and shareholders' equity presented in accordance with U.S. GAAP is deferred acquisition costs, which are non-admitted assets for statutory purposes. As of December 31, 2011, MS Frontier Reinsurance Limited met the ECR.

**12. Statutory requirements (continued)**

**Ireland**

Mitsui Sumitomo Reinsurance Limited is an authorized reinsurance undertaking in Ireland and is required to maintain in respect of the whole of its business an adequate available solvency margin that is at all times at least equal to that required by the regulations. The available solvency margin must consist of its assets, free of all foreseeable liabilities less any intangible items.

The amount of available solvency margin must be based on, the undertakings paid up share capital, the undertakings statutory and free reserves that do not correspond to underwriting liabilities, and the undertakings profit and loss brought forward.

The amount of solvency margin for an authorized reinsurance undertaking is to be the higher of:

a) Minimum Guarantee Fund equal to $4.1m for all reinsurance undertakings, or

b) The total Required Solvency Margin determined on the higher of Premium or Claims basis.

As at 31st December 2011 Mitsui Sumitomo Reinsurance's Available Solvency Margin is $82.8m (2010 - $106.5m), its Required Solvency Margin is $27.3m (2010 - $27.9m) and its Solvency Cover is 304% (2010 - 382%).

**13. Subsequent events**

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date of December 31, 2011 through May 7, 2012, the date the consolidated financial statements were authorized for issuance by the Board of Directors. On April 25, 2012 the Company received a capital injection of $100,000,000 from its parent, Mitsui Sumitomo Insurance Limited to be utilized in the expansion of its business. There were no further significant subsequent events.

# Corporate Information

**MS Frontier Reinsurance Limited Board of Directors as at April 1, 2012**

Keiichi Nakajima
Gary P. Devery
Peter Keane
Tamaki Kawate
Hisatoshi Saito
Yoshikazu Koike
D. Bradfield Adderley
Nicholas M. Frost

**External Auditors**

**KPMG**
Crown House
4 Par-La-Ville Road
Hamilton HM08
Bermuda
Tel +1 441 295 5063
Fax +1 441 295 9132
www.kpmg.bm

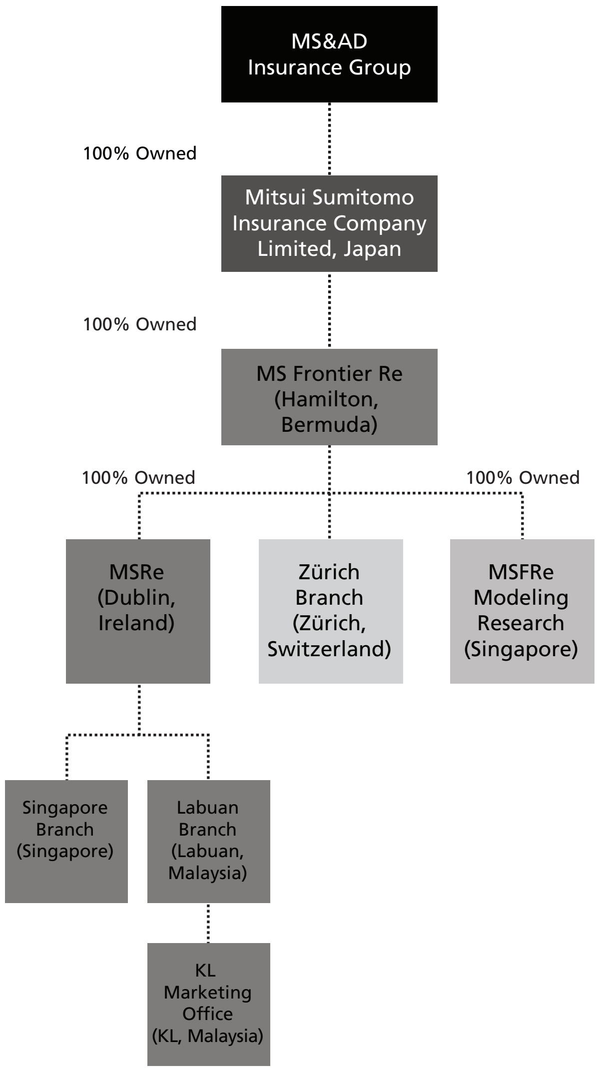
**Law Firm**
**Appleby**
Canon's Court
22 Victoria Street
Hamilton HM EX
Bermuda
Tel +1 441 295 2244
Fax +1 441 292 8666
www.applebyglobal.com

**MS&AD Insurance Group Holdings, Inc.**
Yaesu First Financial Bldg, 3-7, Yaesu 1-chome
Chuo-ku, Tokyo,
103-0028, Japan
Tel +81 3 6202 5269
www.ms-ad-hd.com

**Shareholders Meeting**

The next Annual General Meeting will be held on July 20, 2012 at the company's main office.

**Structure of MS Frontier Re Group**



**MS Frontier Reinsurance Limited, Bermuda**

**Office Address**
8th Floor
141 Front Street
Hamilton HM19, Bermuda
Tel +1 441 295 5795
Fax +1 441 295 8384

**www.msfrontier.bm**

**Mitsui Sumitomo Reinsurance Limited, Ireland**

**Office Address**
4 Exchange Place
Customs House Docks
I.F.S.C. Dublin 1, Ireland
Tel + 353 (1) 612 6120
Fax + 353 (1) 612 6121

**www.msre.ie**

**MS Frontier Re Modeling Research Pte Ltd. Singapore Office**

**Office Address**
16 Raffles Quay #40-01
Hong Leong Building
Singapore 048581
Tel +65 6508 9280
Fax +65 6220 3018

**MS Frontier Reinsurance Limited, Switzerland Branch Office**

**Office Address**
Lavaterstrasse 66
CH 8002 Zürich,
Switzerland
Tel +41 44 204 20 80
Fax +41 43 344 91 77