

PLATINUM UNDERWRITERS HOLDINGS LTD
Form 10-Q
October 22, 2014

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-31341

Platinum Underwriters Holdings, Ltd.
(Exact name of registrant as specified in its charter)

Bermuda 98-0416483
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

Waterloo House
100 Pitts Bay Road
Pembroke, Bermuda HM 08
(Address of principal executive offices) (Zip Code)

(441) 295-7195

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

The registrant had 24,827,245 common shares, par value \$0.01 per share, outstanding as of October 16, 2014.

PLATINUM UNDERWRITERS HOLDINGS, LTD.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

Platinum Underwriters Holdings, Ltd. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

September 30, 2014 and December 31, 2013

(\$ in thousands, except share data)

	(Unaudited)	
	September 30, 2014	December 31, 2013
ASSETS		
Investments:		
Fixed maturity available-for-sale securities at fair value (amortized cost - \$1,717,878 and \$1,799,888, respectively)	\$ 1,818,856	\$ 1,857,870
Fixed maturity trading securities at fair value (amortized cost - \$91,671 and \$97,959, respectively)	95,155	103,395
Short-term investments	26,269	66,679
Total investments	1,940,280	2,027,944
Cash and cash equivalents	1,339,149	1,464,418
Accrued investment income	20,184	20,026
Reinsurance premiums receivable	135,113	138,454
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	2,491	1,057
Prepaid reinsurance premiums	6,495	1,032
Funds held by ceding companies	90,385	119,241
Deferred acquisition costs	32,641	31,103
Reinsurance deposit assets	82,397	79,303
Deferred tax assets	19,705	25,141
Other assets	17,319	16,166
Total assets	\$ 3,686,159	\$ 3,923,885
LIABILITIES AND SHAREHOLDERS' EQUITY		
<u>Liabilities</u>		
Unpaid losses and loss adjustment expenses	\$ 1,498,342	\$ 1,671,365
Unearned premiums	130,366	126,300
Debt obligations	250,000	250,000
Commissions payable	53,775	78,791
Other liabilities	57,028	50,722
Total liabilities	\$ 1,989,511	\$ 2,177,178
<u>Shareholders' Equity</u>		
Common shares, \$0.01 par value, 200,000,000 shares authorized, 24,827,245 and 28,142,977 shares issued and outstanding, respectively	\$ 248	\$ 281
Additional paid-in capital	-	10,711
Accumulated other comprehensive income	87,471	48,084
Retained earnings	1,608,929	1,687,631
Total shareholders' equity	\$ 1,696,648	\$ 1,746,707
Total liabilities and shareholders' equity	\$ 3,686,159	\$ 3,923,885

See accompanying notes to consolidated financial statements.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

(\$ in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue:				
Net premiums earned	\$129,463	\$135,360	\$380,561	\$405,146
Net investment income	17,523	17,758	52,860	54,110
Net realized gains (losses) on investments	3,109	(306)	1,998	24,698
Total other-than-temporary impairments	-	14	15	(600)
Portion of impairment losses recognized in other comprehensive income	-	(79)	(239)	(1,402)
Net impairment losses on investments	-	(65)	(224)	(2,002)
Other income (expense)	86	1,426	2,797	2,503
Total revenue	150,181	154,173	437,992	484,455
Expenses:				
Net losses and loss adjustment expenses	66,178	44,142	143,552	120,807
Net acquisition expenses	28,042	30,675	83,391	91,207
Operating expenses	18,607	20,672	58,324	59,695
Net foreign currency exchange losses (gains)	(102)	487	(255)	(592)
Interest expense	4,789	4,782	14,363	14,341
Total expenses	117,514	100,758	299,375	285,458
Income before income taxes	32,667	53,415	138,617	198,997
Income tax expense	3,542	15,130	9,577	24,342
Net income	\$29,125	\$38,285	\$129,040	\$174,655
<u>Earnings per common share:</u>				
Basic earnings per common share	\$1.13	\$1.34	\$4.83	\$5.71
Diluted earnings per common share	\$1.12	\$1.32	\$4.78	\$5.63
<u>Shareholder dividends:</u>				
Common shareholder dividends declared	\$2,024	\$2,260	\$6,345	\$7,181
Dividends declared per common share	\$0.08	\$0.08	\$0.24	\$0.24

See accompanying notes to consolidated financial statements.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

(\$ in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	\$29,125	\$38,285	\$129,040	\$174,655
Other comprehensive income (loss) on available-for-sale securities before reclassifications:				
Change in net unrealized gains and losses on securities with other-than-temporary impairments recorded	-	14	15	(600)
Change in net unrealized gains and losses on all other securities	(1,598)	(7,622)	46,708	(65,839)
Total change in net unrealized gains and losses	(1,598)	(7,608)	46,723	(66,439)
Reclassifications to net income on available-for-sale securities:				
Net realized gains on investments	(3,895)	-	(3,951)	(27,243)
Net impairment losses on investments	-	65	224	2,002
Total reclassifications to net income	(3,895)	65	(3,727)	(25,241)
Other comprehensive income (loss) before income taxes	(5,493)	(7,543)	42,996	(91,680)
Income tax (expense) benefit	1,613	566	(3,609)	11,380
Other comprehensive income (loss)	(3,880)	(6,977)	39,387	(80,300)
Comprehensive income	\$25,245	\$31,308	\$168,427	\$94,355

See accompanying notes to consolidated financial statements.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

For the Nine Months Ended September 30, 2014 and 2013

(\$ in thousands)

	2014	2013
<u>Common shares:</u>		
Balances at beginning of period	\$281	\$327
Issuance of common shares	3	6
Repurchase of common shares	(36)	(54)
Balances at end of period	248	279
<u>Additional paid-in capital:</u>		
Balances at beginning of period	10,711	209,897
Issuance of common shares	(2,823)	13,320
Amortization of share-based compensation	6,363	6,661
Repurchase of common shares	(14,251)	(229,878)
Balances at end of period	-	-
<u>Accumulated other comprehensive income:</u>		
Balances at beginning of period	48,084	137,690
Other comprehensive income (loss)	39,387	(80,300)
Balances at end of period	87,471	57,390
<u>Retained earnings:</u>		
Balances at beginning of period	1,687,631	1,546,620
Net income	129,040	174,655
Repurchase of common shares	(201,397)	(72,833)
Common share dividends	(6,345)	(7,181)
Balances at end of period	1,608,929	1,641,261
Total shareholders' equity	\$1,696,648	\$1,698,930

See accompanying notes to consolidated financial statements.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

For the Nine Months Ended September 30, 2014 and 2013

(\$ in thousands)

	2014	2013
<u>Operating Activities:</u>		
Net income	\$129,040	\$174,655
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net realized gains on investments	(1,998)	(24,698)
Net impairment losses on investments	224	2,002
Net foreign currency exchange gains	(255)	(592)
Amortization of share-based compensation	8,522	9,955
Other amortization and depreciation	7,735	6,533
Deferred income tax expense	1,827	8,167
Net fixed maturity trading securities activities	1,136	6,993
Changes in:		
Accrued investment income	(292)	557
Reinsurance premiums receivable	2,158	(5,672)
Funds held by ceding companies	27,766	(4,622)
Deferred acquisition costs	(1,656)	(4,257)
Reinsurance deposit assets	(3,094)	(27,486)
Net unpaid and paid losses and loss adjustment expenses	(163,679)	(193,807)
Net unearned premiums	(660)	13,887
Commissions payable	(24,723)	10,217
Other operating assets and liabilities	3,520	14,070
Net cash provided by (used in) operating activities	(14,429)	(14,098)
<u>Investing Activities:</u>		
Proceeds from sales of:		
Fixed maturity available-for-sale securities	70,906	203,571
Short-term investments	6,613	11,857
Proceeds from the maturities or paydowns of:		
Fixed maturity available-for-sale securities	93,476	155,246
Short-term investments	100,394	209,240
Acquisitions of:		
Fixed maturity available-for-sale securities	(90,026)	(291,006)
Short-term investments	(66,036)	(121,306)
Acquisitions of furniture, equipment and other assets	-	(6,188)
Net cash provided by (used in) investing activities	115,327	161,414
<u>Financing Activities:</u>		
Dividends paid to common shareholders	(6,345)	(7,181)
Repurchase of common shares	(215,684)	(302,765)
Proceeds from share-based compensation, including income tax benefits	565	15,385
Net cash provided by (used in) financing activities	(221,464)	(294,561)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(4,703)	(7,745)
Net increase (decrease) in cash and cash equivalents	(125,269)	(154,990)
Cash and cash equivalents at beginning of period	1,464,418	1,720,395

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Cash and cash equivalents at end of period	\$1,339,149	\$1,565,405
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Supplemental disclosures of cash flow information:

Income taxes paid, net of refunds	\$4,718	\$15,293
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Interest paid	\$9,375	\$9,375
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See accompanying notes to consolidated financial statements.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation and Consolidation

Platinum Underwriters Holdings, Ltd. (“Platinum Holdings”) is a holding company domiciled in Bermuda. Through our reinsurance subsidiaries, we provide property and marine, casualty and finite risk reinsurance coverages, through reinsurance brokers, to a diverse clientele of insurers and select reinsurers on a worldwide basis.

Platinum Holdings and its consolidated subsidiaries (collectively, the “Company”) include Platinum Holdings, Platinum Underwriters Bermuda, Ltd. (“Platinum Bermuda”), Platinum Underwriters Reinsurance, Inc. (“Platinum US”), Platinum Regency Holdings (“Platinum Regency”), Platinum Underwriters Finance, Inc. (“Platinum Finance”) and Platinum Administrative Services, Inc. The terms “we”, “us”, and “our” refer to the Company, unless the context otherwise indicates.

We operate through our licensed reinsurance subsidiaries, Platinum Bermuda, a Bermuda reinsurance company, and Platinum US, a U.S. reinsurance company. Platinum Regency is an intermediate holding company based in Ireland and a wholly owned subsidiary of Platinum Holdings. Platinum Finance is an intermediate holding company based in the U.S. and a wholly owned subsidiary of Platinum Regency. Platinum Bermuda is a wholly owned subsidiary of Platinum Holdings and Platinum US is a wholly owned subsidiary of Platinum Finance. Platinum Administrative Services, Inc. is a wholly owned subsidiary of Platinum Finance that provides administrative support services to the Company.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information. Accordingly, they do not include all the information and footnotes required by U.S. GAAP for complete financial statements. All material inter-company transactions and accounts have been eliminated in preparing these consolidated financial statements. The consolidated financial statements as of September 30, 2014 and for the three and nine months ended September 30, 2014 and 2013 are unaudited and include all adjustments consisting of normal recurring items that management considers necessary for a fair presentation under U.S. GAAP. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2013.

The preparation of financial statements requires us 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 may differ materially from these estimates. The major estimates used in the preparation of the Company's consolidated financial statements, and therefore considered to be critical accounting estimates, include, but are not limited to, premiums written and earned, unpaid losses and loss adjustment expenses (“LAE”), valuation of investments and income taxes. In addition, estimates are used in our risk transfer analysis for assumed and ceded reinsurance transactions. Results of changes in estimates are reflected in results of operations in the period in which the change is made. The results of operations for any interim period are not necessarily indicative of results for the full year.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

2. Investments

Fixed Maturity Available-for-sale Securities

Our fixed maturity available-for-sale securities are U.S. dollar denominated securities. The following table sets forth our fixed maturity available-for-sale securities as of September 30, 2014 and December 31, 2013 (\$ in thousands):

	Amortized Cost	Included in Accumulated Other Comprehensive Income		Fair Value	Non-credit portion of OTTI ⁽¹⁾
		Gross Unrealized Gains	Gross Unrealized Losses		
<u>September 30, 2014:</u>					
U.S. Government	\$49,409	\$165	\$ -	\$49,574	\$ -
U.S. Government agencies	78,611	1,300	47	79,864	-
Municipal bonds	1,153,360	84,639	873	1,237,126	-
Non-U.S. governments	24,997	111	-	25,108	-
Corporate bonds	205,794	8,766	1,341	213,219	-
Commercial mortgage-backed securities	60,106	3,821	192	63,735	-
Residential mortgage-backed securities	129,425	1,936	419	130,942	175
Asset-backed securities	16,176	3,137	25	19,288	-
Total fixed maturity available-for-sale securities	\$1,717,878	\$103,875	\$ 2,897	\$1,818,856	\$ 175
<u>December 31, 2013:</u>					
U.S. Government	\$4,561	\$204	\$ -	\$4,765	\$ -
U.S. Government agencies	51,847	-	725	51,122	-
Municipal bonds	1,220,869	54,333	5,955	1,269,247	-
Non-U.S. governments	39,973	541	-	40,514	-
Corporate bonds	224,095	6,704	3,564	227,235	-
Commercial mortgage-backed securities	72,641	4,982	132	77,491	-
Residential mortgage-backed securities	169,699	1,335	1,069	169,965	331
Asset-backed securities	16,203	1,657	329	17,531	305
Total fixed maturity available-for-sale securities	\$1,799,888	\$69,756	\$ 11,774	\$1,857,870	\$ 636

The non-credit portion of other than temporary impairments ("OTTI") represents the amount of unrealized losses on (1) impaired securities that were not recorded in the consolidated statements of operations as of the reporting date.

These unrealized losses are included in gross unrealized losses as of September 30, 2014 and December 31, 2013.

Fixed Maturity Trading Securities

Our fixed maturity trading securities are non-U.S. dollar denominated securities that, along with our non-U.S. dollar short-term trading investments and non-U.S. dollar cash and cash equivalents, are generally held for the purposes of hedging our net non-U.S. dollar denominated reinsurance liabilities. These investments were all non-U.S. governments and the fair value was \$95.2 million and \$103.4 million as of September 30, 2014 and December 31,

2013, respectively.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Maturities

The following table sets forth the amortized cost and fair value of our fixed maturity available-for-sale and trading securities by stated maturity as of September 30, 2014 (\$ in thousands):

	Amortized	
	Cost	Fair Value
Due in one year or less	\$173,778	\$175,895
Due from one to five years	431,638	452,325
Due from five to ten years	610,477	642,058
Due in ten or more years	387,949	429,768
Mortgage-backed and asset-backed securities	205,707	213,965
Total	\$1,809,549	\$1,914,011

The actual maturities of our fixed maturity available-for-sale and trading securities could differ from stated maturities due to call or prepayment provisions.

Short-term Investments

We account for short-term investments as trading in accordance with the fair value option and include them in investing activities on the statements of cash flows. These investments were all non-U.S. governments and the fair value was \$26.3 million and \$66.7 million as of September 30, 2014 and December 31, 2013, respectively.

Other-Than-Temporary Impairments

We analyze the creditworthiness of our available-for-sale securities by reviewing various performance metrics of the issuer. We determined that none of our government bonds, government agencies, municipal bonds, corporate bonds or commercial mortgage-backed securities ("CMBS") were other-than-temporarily impaired for the three and nine months ended September 30, 2014 and 2013.

The following table sets forth the net impairment losses on investments for the three and nine months ended September 30, 2014 and 2013 (\$ in thousands):

	Three		Nine Months	
	Months	Months	Months	Months
	Ended	Ended	Ended	Ended
	September	September	September	September
	30,	30,	30,	30,
	2014	2013	2014	2013
Non-agency residential mortgage-backed securities	\$ -	\$ 28	\$ 223	\$ 1,439
Sub-prime asset-backed securities	-	37	1	563
Net impairment losses on investments	\$ -	\$ 65	\$ 224	\$ 2,002

Residential mortgage-backed securities ("RMBS") include U.S. Government agency RMBS and non-agency RMBS. Asset-backed securities ("ABS") include securities with underlying sub-prime mortgages as collateral. We determined

that none of our U.S. Government agency RMBS were other-than-temporarily impaired for the three and nine months ended September 30, 2014 and 2013. We analyze our non-agency RMBS and sub-prime ABS on a periodic basis using default loss models based on the performance of the underlying loans. Performance metrics include delinquencies, defaults, foreclosures, prepayment speeds and cumulative losses incurred. The expected losses for a mortgage pool are compared with the current level of credit support, which generally represents the point at which our security would experience losses. We evaluate projected cash flows as well as other factors in order to determine if a credit impairment has occurred. As of September 30, 2014, the single largest unrealized loss within our RMBS portfolio was \$0.2 million related to a non-agency RMBS security with an amortized cost of \$0.3 million. As of September 30, 2014, securities in our sub-prime ABS portfolio are all in an unrealized gain position.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

The following table sets forth a summary of the cumulative credit losses recognized on our fixed maturity available-for-sale securities for the three and nine months ended September 30, 2014 and 2013 (\$ in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Balance, beginning of period	\$28,134	\$35,762	\$31,603	\$40,219
Credit losses on securities previously impaired	-	65	224	2,002
Reduction for paydowns and securities sold	(870)	(2,956)	(4,001)	(9,094)
Reduction for increases in cash flows expected to be collected	(311)	(195)	(873)	(451)
Balance, end of period	\$26,953	\$32,676	\$26,953	\$32,676

For the three and nine months ended September 30, 2014, total cumulative credit losses decreased primarily due to principal paydowns. As of September 30, 2014, total cumulative credit losses were related to CMBS, non-agency RMBS and sub-prime ABS. The cumulative credit loss we recorded on CMBS of \$0.1 million was on one security issued in 2007. As of September 30, 2014, 1.1% of the mortgages backing this security were 90 days or more past due and 3.2% of the mortgages had incurred cumulative losses. The cumulative credit losses we recorded on non-agency RMBS and sub-prime ABS of \$26.9 million were on sixteen securities issued from 2004 to 2007. As of September 30, 2014, 16.2% of the mortgages backing these securities were 90 days or more past due and 9.3% of the mortgages had incurred cumulative losses. For these securities, the expected losses for the underlying mortgages were greater than the remaining average credit support of 3.0%.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Gross Unrealized Losses

The following table sets forth our gross unrealized losses on securities classified as fixed maturity available-for-sale aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of September 30, 2014 and December 31, 2013 (\$ in thousands):

	September 30, 2014		December 31, 2013	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
<u>Less than twelve months:</u>				
U.S. Government agencies	\$4,768	\$ 47	\$41,122	\$ 725
Municipal bonds	4,600	18	247,873	5,955
Corporate bonds	21,552	276	90,789	3,486
Commercial mortgage-backed securities	591	1	2,938	1
Residential mortgage-backed securities	58,043	43	35,910	172
Asset-backed securities	13,575	25	13,576	24
Total	\$103,129	\$ 410	\$432,208	\$ 10,363
<u>Twelve months or more:</u>				
U.S. Government agencies	\$-	\$ -	\$-	\$ -
Municipal bonds	53,833	855	-	-
Corporate bonds	14,460	1,065	920	78
Commercial mortgage-backed securities	4,562	191	4,624	131
Residential mortgage-backed securities	6,906	376	10,587	897
Asset-backed securities	-	-	699	305
Total	\$79,761	\$ 2,487	\$16,830	\$ 1,411
<u>Total unrealized losses:</u>				
U.S. Government agencies	\$4,768	\$ 47	\$41,122	\$ 725
Municipal bonds	58,433	873	247,873	5,955
Corporate bonds	36,012	1,341	91,709	3,564
Commercial mortgage-backed securities	5,153	192	7,562	132
Residential mortgage-backed securities	64,949	419	46,497	1,069
Asset-backed securities	13,575	25	14,275	329
Total	\$182,890	\$ 2,897	\$449,038	\$ 11,774

We believe that the gross unrealized losses in our fixed maturity available-for-sale securities portfolio of \$2.9 million represent temporary declines in fair value. We believe that the unrealized losses are not necessarily predictive of ultimate performance and that the provisions we have made for net impairment losses are adequate. However, economic conditions may deteriorate more than expected and may adversely affect the expected cash flows of our securities, which in turn may lead to impairment losses being recorded in future periods. Conversely, economic conditions may improve more than expected and favorably increase the expected cash flows of our impaired securities, which would be earned through net investment income over the remaining life of the security.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Net Investment Income

The following table sets forth our net investment income for the three and nine months ended September 30, 2014 and 2013 (\$ in thousands):

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Fixed maturity securities	\$16,723	\$16,815	\$50,694	\$51,428
Short-term investments and cash and cash equivalents	718	1,123	2,220	3,346
Funds held by ceding companies	945	722	2,726	2,375
Subtotal	18,386	18,660	55,640	57,149
Investment expenses	(863)	(902)	(2,780)	(3,039)
Net investment income	\$17,523	\$17,758	\$52,860	\$54,110

Net Realized Gains (Losses) on Investments

The following table sets forth our net realized gains (losses) on investments for the three and nine months ended September 30, 2014 and 2013 (\$ in thousands):

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Gross realized gains on the sale of investments	\$3,895	\$-	\$3,951	\$27,258
Gross realized losses on the sale of investments	-	-	-	(15)
Net realized gains on the sale of investments	3,895	-	3,951	27,243
Fair value adjustments on trading securities	(786)	(306)	(1,953)	(2,545)
Net realized gains (losses) on investments	\$3,109	\$(306)	\$1,998	\$24,698

3. Fair Value Measurements

The accounting guidance related to fair value measurements addresses the recognition and disclosure of fair value measurements where those measurements are either required or permitted by the guidance. The fair values of our financial assets and liabilities addressed by this guidance are determined primarily through the use of observable inputs. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability based on market data obtained from external independent sources. Unobservable inputs reflect management's assumptions about what market participants' assumptions would be in pricing the asset or liability based on the best information available. We classify our financial assets and liabilities in the fair value hierarchy based on the lowest level input that is significant to the fair value measurement. This classification requires judgment in assessing the market and pricing methodologies for a particular security. The fair value hierarchy is comprised of the following three levels:

Level 1: Valuations are based on unadjusted quoted prices in active markets for identical financial assets or liabilities;

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Level 2: Valuations are based on prices obtained from index providers, independent pricing vendors or broker-dealers using observable inputs for financial assets and liabilities; and

Level 3: Valuations are based on unobservable inputs for assets and liabilities where there is little or no market activity. Unadjusted third party pricing sources or management's assumptions and internal valuation models may be used to determine the fair value of financial assets or liabilities.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Level 1, 2 and 3 Financial Assets Carried at Fair Value

The fair values of our fixed maturity securities, short-term investments and cash and cash equivalents are based on prices primarily obtained from index providers, pricing vendors or broker-dealers using observable inputs. The fair value measurements of all of our securities were based on unadjusted prices provided by third party pricing sources. We validate the prices we obtain from third party pricing sources by performing price comparisons against multiple pricing sources, if available, periodically back-testing sales to the previously reported fair value, performing an in-depth review of specific securities when evaluating stale prices and large price movements, as well as performing other validation procedures. We also continuously monitor market data that relates to our investment portfolio and review pricing documentation that describes the methodologies used by various pricing sources. If we determine that a price appears unreasonable, we investigate and assess whether the price should be adjusted. The fair value measurements of our reinsurance deposit assets were based upon our internal valuation model, which utilizes certain characteristics of both the market and income valuation approaches. Our fixed maturity securities, short-term investments, cash and cash equivalents and reinsurance deposit assets are classified in the fair value hierarchy as follows:

U.S. Government

Level 1 - The fair values of U.S. Government securities were based on quoted prices in active markets for identical assets.

U.S. Government agencies

Level 2 - The fair values of U.S. Government agencies were based on observable inputs that may include the spread above the risk-free yield curve, reported trades and broker-dealer quotes.

Municipal bonds

Level 2 - The fair values of municipal bonds were determined based on observable inputs that may include the spread above the risk-free yield curve, reported trades, broker-dealer quotes, benchmark securities, bids, credit risks and economic indicators.

Non-U.S. governments

Level 1 or 2 - The fair values of non-U.S. government securities classified as Level 1 were based on quoted prices in active markets for identical assets. Non-U.S. government securities classified as Level 2 were based on observable inputs that may include the spread above the risk-free yield curve, reported trades and broker-dealer quotes. Our non-U.S. government bond portfolio consisted of securities issued primarily by governments, provinces, agencies and supranationals.

Corporate bonds

Level 2 - The fair values of corporate bonds were determined based on observable inputs that may include the spread above the risk-free yield curve, reported trades, broker-dealer quotes, benchmark securities, bids, credit risks and industry and economic indicators.

Commercial mortgage-backed securities

Level 2 or 3 - The fair values of CMBS classified as Level 2 were determined based on observable inputs that may include the spread above the risk-free yield curve, reported trades, broker-dealer quotes, bids, security cash flows and structures, delinquencies, loss severities and default rates. CMBS classified as Level 3 used unobservable inputs that may include the probability of default and loss severity in the event of default.

Residential mortgage-backed securities

Level 2 or 3 - Our RMBS portfolio was comprised of securities issued by U.S. Government agencies and by non-agency institutions. The fair values of RMBS classified as Level 2 were determined based on observable inputs that may include the spread above the risk-free yield curve, reported trades, broker-dealer quotes, bids, loan level information, security cash flows and structures, prepayment speeds, delinquencies, loss severities and default rates. Non-agency RMBS classified as Level 3 used unobservable inputs that may include the probability of default, loss severity in the event of default and prepayment speeds.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Asset-backed securities

Level 2 or 3 - The fair values of ABS classified as Level 2 were determined based on observable inputs that may include the spread above the risk-free yield curve, reported trades, broker-dealer quotes, bids, security cash flows and structures, type of collateral, prepayment speeds, delinquencies, loss severities and default rates. Sub-prime ABS classified as Level 3 used unobservable inputs that may include the probability of default, loss severity in the event of default and prepayment speeds.

Short-term investments

Level 1 or 2 - The fair values of short-term investments classified as Level 1 were based on quoted prices in active markets for identical assets. The fair values of short-term investments classified as Level 2 were determined based on observable inputs that may include the risk-free yield curve, reported trades and broker-dealer quotes.

Cash and cash equivalents

Level 1 or 2 - The fair values of cash and cash equivalents classified as Level 1 were determined based on quoted prices in active markets for identical assets. The fair values of cash and cash equivalents classified as Level 2 were determined based on observable inputs that may include the risk-free yield curve, reported trades and broker-dealer quotes. Cash and cash equivalents include demand deposits, time deposits, money market instruments and both U.S. Government and non-U.S. government obligations.

Reinsurance deposit assets

Level 3 - The fair values of our reinsurance deposit assets were determined by management primarily using unobservable inputs through the application of our own assumptions and internal valuation model. See further discussion on reinsurance deposit assets below.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Fair Value Levels

The following table presents the fair value hierarchy for those financial assets measured at fair value on a recurring basis by the Company as of September 30, 2014 and December 31, 2013 (\$ in thousands):

	Total	Fair Value Measurement Using:		
		Level 1	Level 2	Level 3
<u>September 30, 2014:</u>				
Investments:				
U.S. Government	\$49,574	\$49,574	\$-	\$-
U.S. Government agencies	79,864	-	79,864	-
Municipal bonds	1,237,126	-	1,237,126	-
Non-U.S. governments	120,263	52,280	67,983	-
Corporate bonds	213,219	-	213,219	-
Commercial mortgage-backed securities	63,735	-	61,782	1,953
Residential mortgage-backed securities	130,942	-	130,555	387
Asset-backed securities	19,288	-	15,577	3,711
Short -term investments	26,269	-	26,269	-
Total investments	1,940,280	101,854	1,832,375	6,051
Cash and cash equivalents	1,339,149	1,327,017	12,132	-
Reinsurance deposit assets	82,397	-	-	82,397
Total	\$3,361,826	\$1,428,871	\$1,844,507	\$88,448

December 31, 2013:

Investments:				
U.S. Government	\$4,765	\$4,765	\$-	\$-
U.S. Government agencies	51,122	-	51,122	-
Municipal bonds	1,269,247	-	1,269,247	-
Non-U.S. governments	143,909	54,980	88,929	-
Corporate bonds	227,235	-	227,235	-
Commercial mortgage-backed securities	77,491	-	77,491	-
Residential mortgage-backed securities	169,965	-	169,372	593
Asset-backed securities	17,531	-	15,304	2,227
Short -term investments	66,679	8,933	57,746	-
Total investments	2,027,944	68,678	1,956,446	2,820
Cash and cash equivalents	1,464,418	1,464,418	-	-
Reinsurance deposit assets	79,303	-	-	79,303
Total	\$3,571,665	\$1,533,096	\$1,956,446	\$82,123

Cash and cash equivalents included demand deposits and time deposits totaling \$192.8 million as of September 30, 2014 and totaling \$120.7 million as of December 31, 2013.

Transfers of assets into or out of levels are recorded at their fair values as of the end of each reporting period, consistent with the date of the determination of fair value. There were no transfers between Levels 1 and 2 for the three and nine months ended September 30, 2014 and 2013. The transfers into and out of Level 3 were based on the level of evidence available to corroborate significant observable inputs with market observable information.

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

Changes in Level 3 Financial Assets

The following table reconciles the beginning and ending balance for our Level 3 financial assets measured at fair value on a recurring basis for the three and nine months ended September 30, 2014 and 2013 (\$ in thousands):

	Three Months Ended September 30, 2014				
	Commercial mortgage securities	Residential mortgage- backed securities	Asset-backed securities	Reinsurance deposit assets	Total
Balance, beginning of period	\$-	\$ 5,099	\$ 1,093	\$ 82,164	\$88,356
Sales, maturities and paydowns	-	(644)	-	-	(644)
Total increase (decrease) in fair value included in net income	-	-	-	233	233
Total net unrealized gains (losses) included in other comprehensive income (loss)	-	532	907	-	1,439
Transfers into Level 3	1,953	-	2,792	-	4,745
Transfers out of Level 3	-	(4,600)	(1,081)	-	(5,681)
Balance, end of period	\$1,953	\$ 387	\$ 3,711	\$ 82,397	\$88,448
Total increase (decrease) in fair value of the financial assets included in earnings for the period	\$-	\$ -	\$ -	\$ 233	\$233

	Three Months Ended September 30, 2013				
	Commercial mortgage securities	Residential mortgage- backed securities	Asset-backed securities	Reinsurance deposit assets	Total
Balance, beginning of period	\$-	\$ 4,520	\$ 1,257	\$ 76,948	\$82,725
Sales, maturities and paydowns	-	(269)	-	-	(269)
Total increase (decrease) in fair value included in net income	-	-	-	1,231	1,231
Total net unrealized gains (losses) included in other comprehensive income (loss)	-	329	(75)	-	254
Transfers into Level 3	-	-	1,378	-	1,378
Transfers out of Level 3	-	(4,065)	-	-	(4,065)
Balance, end of period	\$-	\$ 515	\$ 2,560	\$ 78,179	\$81,254
Total increase (decrease) in fair value of the financial assets included in earnings for the period	\$-	\$ -	\$ -	\$ 1,231	\$1,231

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Platinum Underwriters Holdings, Ltd. and Subsidiaries

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended September 30, 2014 and 2013

	Nine Months Ended September 30, 2014				
	Commercial mortgage-backed securities	Residential mortgage-backed securities	Asset-backed securities	Reinsurance deposit assets	Total
Balance, beginning of period	\$-	\$ 593	\$ 2,227	\$ 79,303	\$82,123
Sales, maturities and paydowns	-	(3,076)	-	-	(3,076)
Total increase (decrease) in fair value included in net income	-	-	-	3,094	3,094
Total net unrealized gains (losses) included in other comprehensive income (loss)	103	2,766	1,945	-	4,814
Transfers into Level 3	3,768	4,704	3,630	-	12,102
Transfers out of Level 3	(1,918)	(4,600)	(4,091)	-	(10,609)
Balance, end of period	\$1,953	\$ 387	\$ 3,711	\$ 82,397	\$88,448
Total increase (decrease) in fair value of the financial assets included in earnings for the period	\$-	\$ -	\$ -	\$ 3,094	\$3,094

	Nine Months Ended September 30, 2013				
	Commercial mortgage-backed securities	Residential mortgage-backed securities	Asset-backed securities	Reinsurance deposit assets	Total
Balance, beginning of period	\$524	\$ 5,374	\$ 1,036	\$ 50,693	\$57,627
Purchases	-	-	-	25,000	25,000
Sales, maturities and paydowns	-	-	-	-	-