Flagstone Reinsurance Holdings Ltd
Form 10-Q
August 04, 2009

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

Form 10-Q

þ Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2009

OR

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

Commission file number 001-33364

Flagstone Reinsurance Holdings Limited
(Exact Name of Registrant as Specified in Its Charter)

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

Crawford House
23 Church Street
Hamilton HM 11
Bermuda
(Address of Principal Executive Offices)

(441) 278-4300
(Registrant's telephone number, including area code)

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

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

Securities registered pursuant to Section 12(g) of the Act:

None

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

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

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

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

As of July 31, 2009 the Registrant had 84,864,844 common voting shares outstanding, with a par value of $0.01 per share.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FLAGSTONE REINSURANCE HOLDINGS LIMITED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Expressed in thousands of U.S. dollars, except share data)

	As at June 30, 2009 (Unaudited)	As at December 31, 2008
ASSETS		
Investments:		
Fixed maturities, at fair value (Amortized cost: 2009 - $1,062,445 ; 2008 - $787,792)	$ 1,077,479	$ 784,355
Short term investments, at fair value (Amortized cost: 2009 - $222,882; 2008 - $30,491)	229,837	30,413
Equity investments, at fair value (Cost: 2009 - $10,802; 2008 - $16,266)	3,400	5,313
Other investments	53,534	54,655
Total Investments	1,364,250	874,736
Cash and cash equivalents	378,232	783,705
Restricted cash	79,561	42,403
Premium balances receivable	453,668	218,287
Unearned premiums ceded	85,563	31,119
Reinsurance recoverable	16,810	16,422
Accrued interest receivable	9,554	7,226
Receivable for investments sold	11,114	9,634
Deferred acquisition costs	70,484	44,601
Funds withheld	18,676	14,433
Goodwill	16,541	17,141
Intangible assets	36,850	32,873
Other assets	113,095	123,390
Total Assets	$ 2,654,398	$ 2,215,970
LIABILITIES		
Loss and loss adjustment expense reserves	$ 453,490	$ 411,565
Unearned premiums	522,681	270,891
Insurance and reinsurance balances payable	46,214	31,123
Payable for investments purchased	16,249	7,776
Long term debt	251,987	252,575
Other liabilities	57,220	58,577
Total Liabilities	1,347,841	1,032,507
EQUITY		
Common voting shares, 150,000,000 authorized, $0.01 par value, issued and outstanding	849	848

(2009 - 84,864,844; 2008 - 84,801,732)				
Additional paid-in capital		904,228		897,344
Accumulated other comprehensive loss		(2,902)		(8,271)
Retained earnings		192,604		96,092
Total Flagstone Shareholders' Equity		1,094,779		986,013
Noncontrolling Interest in Subsidiaries		211,778		197,450
Total Equity		1,306,557		1,183,463
Total Liabilities and Equity	$	2,654,398	$	2,215,970

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

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FLAGSTONE REINSURANCE HOLDINGS LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(Expressed in thousands of U.S. dollars, except share and per share data)

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
REVENUES				
Gross premiums written	$ 328,709	$ 271,178	$ 690,194	$ 513,424
Premiums ceded	(59,742)	(38,435)	(135,411)	(54,449)
Net premiums written	268,967	232,743	554,783	458,975
Change in net unearned premiums	(81,991)	(90,976)	(194,972)	(181,951)
Net premiums earned	186,976	141,767	359,811	277,024
Net investment income	10,646	13,279	8,893	31,975
Net realized and unrealized gains (losses) - investments	7,082	(9,339)	5,183	(21,751)
Net realized and unrealized gains (losses) - other	2,470	11,132	9,900	(1,105)
Other income	2,333	2,127	7,502	3,851
Total revenues	209,507	158,966	391,289	289,994
EXPENSES				
Loss and loss adjustment expenses	57,641	56,298	134,235	96,065
Acquisition costs	36,203	27,210	64,240	51,375
General and administrative expenses	34,578	24,214	68,878	50,763
Interest expense	3,119	4,609	6,676	9,949
Net foreign exchange (gains) losses	(362)	1,630	735	(5,069)
Total expenses	131,179	113,961	274,764	203,083
Income before income taxes and interest in earnings of equity investments	78,328	45,005	116,525	86,911
Provision for income tax	(250)	(442)	456	(1,307)
Interest in loss of equity investments	(300)	-	(678)	-
Net income	77,778	44,563	116,303	85,604
Less: Income attributable to noncontrolling interest	(9,964)	(2,615)	(12,746)	(10,796)
NET INCOME ATTRIBUTABLE TO FLAGSTONE	$ 67,814	$ 41,948	$ 103,557	$ 74,808
Net income	$ 77,778	$ 44,563	$ 116,303	$ 85,604
Change in currency translation adjustment	5,399	(2,766)	7,266	(4,186)
Change in defined benefit pension plan obligation	(145)	27	(321)	(522)
Comprehensive income	83,032	41,824	123,248	80,896
Less: Comprehensive income attributable to noncontrolling interest	(11,743)	(2,615)	(14,322)	(10,796)
COMPREHENSIVE INCOME ATTRIBUTABLE TO FLAGSTONE	$ 71,289	$ 39,209	$ 108,926	$ 70,100
Weighted average common shares outstanding—Basic	85,070,001	85,470,205	85,070,001	85,470,043

Weighted average common shares outstanding—Diluted	85,162,981	85,638,506	85,253,230	85,714,196
Net income attributable to Flagstone per common share—Basic	$ 0.80	$ 0.49	$ 1.22	$ 0.88
Net income attributable to Flagstone per common share—Diluted	$ 0.80	$ 0.49	$ 1.21	$ 0.87
Dividends declared per common share	$ 0.04	$ 0.04	$ 0.08	$ 0.08

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

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FLAGSTONE REINSURANCE HOLDINGS LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
(Expressed in thousands of U.S. dollars, except share data)

For the six month period ended June 30, 2009	Total equity	Comprehensive income	Retained earnings	Accumulated other comprehensive loss	Common voting shares	Additional paid-in capital	Noncontrolling interest in subsidiaries
Beginning balance	$ 1,183,463	$ -	$ 96,092	$ (8,271)	$ 848	$ 897,344	$ 197,450
Comprehensive income:							
Net income	116,303	116,303	103,557				12,746
Other comprehensive income:							
Change in currency translation adjustment	7,266	7,266		5,690			1,576
Defined benefit pension plan obligation	(321)	(321)		(321)			
	6,945	6,945					
Comprehensive income	123,248	$ 123,248					
Stock based compensation	7,068					7,068	
Subsidiary stock based compensation	(94)						(94)
Subsidiary stock issuance	-					(184)	184
Purchase of noncontrolling interest	(84)						(84)
Issue of shares, net	1				1		
Dividends declared	(7,045)		(7,045)				
Ending balance	$ 1,306,557		$ 192,604	$ (2,902)	$ 849	$ 904,228	$ 211,778

For the six month period ended June 30, 2008	Total equity	Comprehensive income	Retained earnings	Accumulated other comprehensive income	Common voting shares	Additional paid-in capital	Noncontrolling interest in subsidiaries
Beginning balance	$ 1,395,263	$ -	$ 296,890	$ 7,426	$ 853	$ 905,316	$ 184,778
Repurchase of preferred shares	(6,639)						(6,639)
Acquisition of subsidiaries	7,416						7,416
Comprehensive income:							
Net income	85,604	85,604	74,808				10,796

Other comprehensive income:							
Change in currency translation adjustment	(4,186)	(4,186)		(4,186)			
Defined benefit pension plan obligation	(522)	(522)		(522)			
	(4,708)	(4,708)					
Comprehensive income	80,896	$ 80,896					
Stock based compensation	7,012					7,012	
Subsidiary stock based compensation	(337)						(337)
Issue of shares, net	(364)					(364)	
Dividends declared	(7,049)		(7,049)				
Other	(91)						(91)
Ending balance	$ 1,476,107		$ 364,649	$ 2,718	$ 853	$ 911,964	$ 195,923

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

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FLAGSTONE REINSURANCE HOLDINGS LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Expressed in thousands of U.S. dollars)

	For the Six Months Ended June 30, 2009	June 30, 2008
Cash flows provided by (used in) operating activities:		
Net income	$ 116,303	$ 85,604
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized and unrealized (gains) losses	(15,083)	22,856
Net unrealized foreign exchange gains	(2,430)	-
Depreciation expense	3,347	2,214
Share based compensation expense	6,832	6,788
Interest in earnings of equity investments	678	-
Accretion/amortization on fixed maturities	5,683	(9,736)
Changes in assets and liabilities, excluding net assets acquired:		
Reinsurance premium receivable	(236,036)	(175,080)
Unearned premiums ceded	(54,158)	(24,728)
Deferred acquisition costs	(25,729)	(20,439)
Funds withheld	(4,195)	(3,386)
Loss and loss adjustment expense reserves	38,663	47,063
Unearned premiums	249,819	210,635
Insurance and reinsurance balances payable	19,218	21,478
Resinsurance recoverable	623	-
Other changes in assets and liabilities, net	25,570	4,883
Net cash provided by operating activities	129,105	168,152
Cash flows (used in) provided by investing activities:		
Net cash (paid) received in (disposal) acquisition of subsidiaries	(1,731)	4,729
Purchases of fixed income securities	(1,423,515)	(936,439)
Sales and maturities of fixed income securities	963,914	1,230,546
Purchases of equity securities	(2,006)	(39,974)
Sales of equity securities	4,359	-
Purchases of other investments	(4,114)	(330,203)
Sales of other investments	(3,628)	144,675
Purchases of fixed assets	(7,456)	(10,786)
Sale of fixed asset	145	-
Change in restricted cash	(37,158)	(1,006)
Net cash (used in) provided by investing activities	(511,190)	61,542
Cash flows (used in) provided by financing activities:		
Issue of common shares, net of issuance costs paid	-	(364)
Contribution of minority interest	-	(429)
Repurchase of minority interest	-	(8,652)
Dividend paid on common shares	(6,786)	(6,825)
Repayment of long term debt	(15,038)	(9,195)
Other	414	(4,003)

Net cash used in financing activities		(21,410)		(29,468)
Effect of foreign exchange rate on cash		(1,978)		(998)
(Decrease) increase in cash and cash equivalents		(405,473)		199,228
Cash and cash equivalents - beginning of year		783,705		362,622
Cash and cash equivalents - end of period	$	378,232	$	561,850
Supplemental cash flow information:				
Receivable for investments sold	$	11,114	$	2,942
Payable for investments purchased	$	16,249	$	6,162
Interest paid	$	6,681	$	10,679

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

FLAGSTONE REINSURANCE HOLDINGS LIMITED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for ratios, share and per share amounts)

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1. Basis of Presentation and Consolidation

These unaudited condensed consolidated financial statements include the accounts of Flagstone Reinsurance Holdings Limited (the "Company") and its wholly owned subsidiaries, including Flagstone Réassurance Suisse SA ("Flagstone Suisse") and have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries, including those that meet the consolidation requirements of variable interest entities ("VIEs"). The Company assesses the consolidation of VIEs based on whether the Company is the primary beneficiary of the entity in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46, as revised, "Consolidation of Variable Interest Entities - an interpretation of ARB No. 51" ("FIN 46(R)"). Entities in which the Company has an ownership of more than 20% and less than 50% of the voting shares are accounted for using the equity method. All inter-company accounts and transactions have been eliminated on consolidation.

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

In the opinion of management, these unaudited condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position and results of operations as at the end of and for the periods presented. The results of operations and cash flows for any interim period will not necessarily be indicative of the results of operations and cash flows for the full fiscal year or subsequent quarters. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission (the "SEC") on March 13, 2009.

These interim financial statements separately present restricted cash and reinsurance recoverable. In the prior period these amounts were included with cash and cash equivalents and other assets. This presentation of prior period amounts have been reclassified consistent with the current period presentation of separately presenting restricted cash and reinsurance recoverable. This presentation change has no effect on net income or loss attributable to Flagstone.

2. New Accounting Pronouncements

Adoption of new accounting pronouncements

On April 1, 2009, the Company adopted the provisions of the FASB Statement No. 165, "Subsequent Events" ("SFAS 165"), which requires the disclosure of the date after the balance sheet date but before financial statements are issued or available to be issued through which an entity has evaluated subsequent events and the basis for that date, that is, whether the date represents the date the financial statements were issued or were available to be issued. SFAS 165 also alerts all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. We evaluated subsequent events to August 4, 2009 and there are no subsequent events to note.

On April 1, 2009, the Company adopted the provisions of the three FASB staff positions ("FSP") intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities: FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP FAS 157-4"), FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments" ("FSP FAS 107-1 and APB 28-1") and FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP FAS 115-2 and FSP FAS 124-2").

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FSP FAS 157-4 provides guidelines for making fair value measurements more consistent with the principles presented in FASB Statement No. 157, “Fair Value Measurements” (“SFAS 157”). FSP FAS 157-4 relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms what SFAS 157 states is the objective of fair value measurement—to reflect how much an asset would be sold for in an orderly transaction (as opposed to a distressed or forced transaction) at the date of the financial statements under current market conditions. Specifically, it reaffirms the need to use judgment to ascertain if a formerly active market has become inactive and in determining fair values when markets have become inactive.

FSP FAS 107-1 and APB 28-1 enhance consistency in financial reporting by increasing the frequency of fair value disclosures. The guidance relates to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet at fair value. Prior to issuing this FSP, fair values for these assets and liabilities were only disclosed once a year. The FSP now requires these disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value.

FSP FAS 115-2 and FSP FAS 124-2 provide additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. The guidance is intended to bring greater consistency to the timing of impairment recognition, and provide greater clarity to investors about the credit and noncredit components of impaired debt securities that are not expected to be sold. The measure of impairment in comprehensive income remains fair value. The FSP also requires increased and more timely disclosures sought by investors regarding expected cash flows, credit losses, and an aging of securities with unrealized losses.

The effect of adopting these FSPs was immaterial to our financial statements.

On January 1, 2009, the Company adopted the provisions of the FASB Statement No. 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51” (“SFAS 160”). SFAS 160 requires all entities to report noncontrolling interests in subsidiaries (formerly known as minority interests) as a separate component of equity in the consolidated balance sheets, to clearly identify consolidated net income attributable to the parent and to the noncontrolling interest on the face of the consolidated statement of operations, and to provide sufficient disclosure that clearly identifies and distinguishes between the interest of the parent and the interests of noncontrolling owners. SFAS 160 also establishes accounting and reporting standards for changes in a parent’s ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. Upon adoption of SFAS 160, we recharacterized our minority interest as a noncontrolling interest and classified it as a component of shareholders’ equity in our consolidated financial statements

On January 1, 2009, the Company adopted the provisions of FASB Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133" (“SFAS 161”). The provisions of SFAS 161 amend and expand the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosures about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133 “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”) and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. The effect of adopting SFAS 161 was immaterial to our financial statements.

New accounting pronouncements issued during 2009 impacting the Company are as follows:

On June 12, 2009, the FASB issued SFAS No. 166, “Accounting for Transfers of Financial Assets,” (“SFAS No. 166”). SFAS No. 166 requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor’s beneficial interest) and liabilities incurred as a result of financial assets accounted for as a sale. It is a revision to FASB Statement No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” and requires more information about transfers of financial assets, including securitization transactions, and where entities have continuing exposure to the risks related to transferred financial assets. SFAS No. 166 is effective on a prospective basis in fiscal years beginning on or after November 15, 2009 and interim periods within those fiscal years, and will be adopted by the Company in the first quarter of fiscal year 2010. The Company is assessing the potential impact, if any, of the adoption of SFAS No. 166 on its consolidated results of operations and financial condition.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for ratios, share and per share amounts)

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On June 12, 2009, the FASB issued SFAS No. 167, "Amendments to FASB Interpretation No. 46(R)," ("SFAS No. 167"). SFAS No. 167 amends FASB Statement No. 46 (revised December 2003), "Consolidation of Variable Interest Entities," to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. It determines whether a reporting entity is required to consolidate another entity based on, among other things, the other entity's purpose and design and the reporting entity's ability to direct the activities of the other entity that most significantly impacts the other entity's economic performance. SFAS No. 167 is effective on a prospective basis in fiscal years beginning on or after November 15, 2009 and interim periods within those fiscal years, and will be adopted by the Company in the first quarter of fiscal year 2010. The Company is assessing the potential impact, if any, of the adoption of SFAS No. 167 on its consolidated results of operations and financial condition.

In June, 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles," (Codification) ("SFAS No. 168"). SFAS No. 168 is a replacement to SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles," which became effective on November 13, 2008 and identified the sources of accounting principles and the framework for selecting the principles used in preparing the financial statements in conformity with U.S. GAAP. It also arranged these sources of U.S. GAAP in a hierarchy for users to apply. SFAS No. 168 will become the source of authoritative U.S. GAAP recognized by the FASB to be applied to nongovernmental entities in the preparation of financial statements. The Codification will carry the same level of authority and effectively supersede SFAS No. 162. The U.S. GAAP hierarchy will be modified to include two levels of U.S. GAAP: authoritative and non-authoritative. SFAS No. 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009, and will be adopted by the Company in the third quarter of fiscal year 2009. The Company is assessing the potential impact, if any, of the adoption of SFAS No. 168 on its consolidated results of operations and financial condition.

3. Investments

Fair value disclosure

In accordance with SFAS 157, the Company determined that its investments in U.S. government treasury securities and listed equity securities are stated at Level 1 fair value as determined by the quoted market price of these securities, as provided either by independent pricing services or exchange market prices. Investments in U.S government agency securities, corporate bonds, mortgage-backed securities, asset-backed securities, and exchange traded funds are stated at Level 2 fair value derived from broker quotes based on inputs that are observable for the asset, either directly or indirectly, such as yield curves and transactional history. There are two mortgage-backed securities that are classified as Level 3 due to the limited availability of the pricing sources which may be indicative of a less active market. Their fair value is determined using broker quotes. The Company has reviewed its Level 3 investments, and the valuation methods are as follows: Catastrophe bonds are stated at fair value as determined by reference to broker indications. Those indications are based on current market conditions, including liquidity and transactional history, recent issue price of similar catastrophe bonds and seasonality of the underlying risks. The investment funds are valued by the investment fund managers using the valuations and financial statements provided by the general partners of the funds on a quarterly basis. These valuations are then adjusted by the investment fund managers for cash flows since the most recent valuation. The valuation methodology used for the investment funds is consistent with the methodology that is generally employed in the investment industry.

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FLAGSTONE REINSURANCE HOLDINGS LIMITED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for ratios, share and per share amounts)

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As at June 30, 2009 and December 31, 2008, the Company's investments are allocated between levels as follows:

	Fair Value Measurement at June 30, 2009, using:			
	Fair Value Measurements	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Description				
U.S. government and agency securities	$ 435,766	$ 392,688	$ 43,078	$ -
U.S. states and political subdivisions	369	-	369	-
Non U.S. government and government agencies	99,846	-	99,846	-
Corporates	426,041	-	426,041	-
Mortgage-backed securities	95,096	-	94,133	963
Asset-backed securities	20,361	-	20,361	-
Equity investments	3,400	3,400	-	-
Short term investments	229,837	85,438	144,399	-
	1,310,716	481,526	828,227	963
Other Investments				
Investment funds	5,316	-	-	5,316
Catastrophe bonds	43,221	-	-	43,221
	48,537	-	-	48,537
Totals	$ 1,359,253	$ 481,526	$ 828,227	$ 49,500

For reconciliation purposes, the table above does not include an equity investment of $5.0 million in which the Company is deemed to have a significant influence and which is accounted for under the equity method and as such, is not accounted for at fair value under SFAS 159,"The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" ("SFAS 159").

For the Level 3 items still held as of June 30, 2009, the total change in fair value for the three month and six months ended June 30, 2009 is $(2.5) million and $(3.8) million respectively.

	Fair Value Measurement at December 31, 2008, using:			
	Fair Value Measurements	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Description				
Fixed maturity investments	$ 784,355	$ 447,226	$ 336,203	$ 926
Short term investments	30,413	30,413	-	-

Equity investments	5,313	5,313	-	-
	820,081	482,952	336,203	926
Other Investments				
Investment funds	9,805	-	647	9,158
Catastrophe bonds	39,174	-	-	39,174
	48,979	-	647	48,332
Totals	$ 869,060	$ 482,952	$ 336,850	$ 49,258

For reconciliation purposes, the table above does not include an equity investment of $5.7 million in which the Company is deemed to have a significant influence and which is accounted for under the equity method and as such, is not accounted for at fair value under SFAS 159.

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FLAGSTONE REINSURANCE HOLDINGS LIMITED
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in tables expressed in thousands of U.S. dollars, except for ratios, share and per share amounts)
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The reconciliation of the fair value for the Level 3 investments as at June 30, 2009, including net purchases and sales and change in unrealized gains, is set out below:

	For the Six Months Ended June 30, 2009			
	Mortgage - backed securities	Investment funds	Catastrophe bonds	Total
Fair value, December 31, 2008	$ 926	$ 9,158	$ 39,174	$ 49,258
Total unrealized losses included in earnings	75	(1,418)	83	(1,260)
Net purchases and sales	(47)	101	-	54
Total investment income included in earning	4	-	(82)	(78)
Fair value, March 31, 2009	958	7,841	39,175	47,974
Total unrealized losses included in earnings	70	(2,664)	54	(2,540)
Net purchases and sales	(71)	139	3,925	3,993
Total investment income included in earning	6	-	67	73
Fair value, June 30, 2009	$ 963	$ 5,316	$ 43,221	$ 49,500

Pledged assets

As at June 30, 2009 and December 31, 2008, approximately $79.6 million and $42.4 million, respectively, of cash and cash equivalents and approximately $407.0 million and $327.2 million, respectively, of fixed maturity securities were deposited or pledged in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions and insurance laws.

4. Derivatives

The Company accounts for its derivative instruments using SFAS No. 133 which requires an entity to recognize all derivative instruments as either assets or liabilities in the balance sheet and measure those instruments at fair value, with the fair value recorded in other assets or liabilities. The accounting for realized and unrealized gains and losses associated with changes in the fair value of derivatives depends on its hedge designation and whether the hedge is highly effective in achieving offsetting changes in the fair value of the asset or liability being hedged. The realized and unrealized gains and losses on derivatives not designated as hedging instruments are included in net realized and unrealized gains and losses in the consolidated financial statements. Gains and losses associated with changes in fair value of the designated hedge instruments are recorded with the gains and losses on the hedged items, to the extent that the hedge is effective.

The details of the derivatives held by the Company as of June 30, 2009 and December 31, 2008 are as follows:

As at June 30, 2009							
Asset Derivatives			Liability Derivatives			Total Derivatives	
Balance Sheet Location	Derivative Exposure	Fair Value	Balance Sheet Location	Derivative Exposure	Fair Value	Derivative Exposure	Net Fair Value

Derivatives designated as hedging instruments								
Foreign currency forward contracts (1)	Other Assets	$ 117,763	$ 162	Other Liabilities	$ 17,295	$ 444	$ 135,058	$ (282)
			162			444		(282)
Derivatives not designated as hedging instruments								
Futures contracts	Other Assets	$ -	$ -	Other Liabilities	$ 48,351	$ 1,133	$ 48,351	$ (1,133)
Total return swaps	Other Assets	40,000	515	Other Liabilities	5,000	201	45,000	314
Currency swaps	Other Assets	-	-	Other Liabilities	18,237	154	18,237	(154)
Foreign currency forward contracts	Other Assets	97,314	5,170	Other Liabilities	431,573	15,541	528,887	(10,371)
Mortgage backed securities TBA	Other Assets	39,958	353	Other Liabilities	5,037	6	44,995	347
Other reinsurance derivatives	Other Assets	-	-	Other Liabilities	-	847	-	(847)
			6,038			17,882		(11,844)
Total Derivatives			$ 6,200			$ 18,326		$ (12,126)

FLAGSTONE REINSURANCE HOLDINGS LIMITED
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(Amounts in tables expressed in thousands of U.S. dollars, except for ratios, share and per share amounts)

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	As at December 31, 2008							
	Asset Derivatives			Liability Derivatives			Total Derivatives	
	Balance Sheet Location	Derivative Exposure	Fair Value	Balance Sheet Location	Derivative Exposure	Fair Value	Derivative Exposure	Net Fair Value
Derivatives designated as hedging instruments								
Forward currency forward contracts (1)	Other Assets	$ 43,327	$ 1,419	Other Liabilities	$ 294,385	$ 7,103	$ 337,712	$ (5,684)
			1,419			7,103		(5,684)
Derivatives not designated as hedging instruments								
Futures contracts	Other Assets	$ 40,530	$ 333	Other Liabilities	$ 21,356	$ 190	$ 61,886	$ 143
Total return swaps	Other Assets	58,395	5,564	Other Liabilities	12,473	1,852	70,868	3,712
Currency swaps	Other Assets	-	-	Other Liabilities	18,071	315	18,071	(315)
Foreign currency forward contracts	Other Assets	54,768	1,493	Other Liabilities	60,924	5,317	115,692	(3,824)
Mortgage backed securities TBA	Other Assets	63,937	648	Other Liabilities	-	-	63,937	648
Other reinsurance derivatives	Other Assets	-	-	Other Liabilities	-	541	-	(541)
			8,038			8,215		(177)
Total Derivatives			$ 9,457			$ 15,318		$ (5,861)

(1) Recognized as a foreign currency hedge under SFAS 133.

Designated

	Amount of Gain or (Loss) on Derivatives Recognized in	
	Comprehensive Income (Loss)	Net Income
Derivatives Designated as Hedging Instruments	(Effective Portion)	(Ineffective Portion)

For the Three Months Ended			For the Three Months Ended
June 30, 2009	June 30, 2008	Location	June 30, 2009