Flagstone Reinsurance Holdings Ltd
Form 10-Q
November 03, 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 September 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 | 98-0481623 |
| (State or Other Jurisdiction of Incorporation or Organization) | (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 November 2, 2009 the Registrant had 82,864,844 common voting shares outstanding, net of treasury shares, 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 September 30, 2009 (Unaudited) | As at December 31, 2008 |
|---|---|---|
| ASSETS | | |
| Investments: | | |
| Fixed maturities, at fair value (Amortized cost: 2009 - $1,212,502 ; 2008 - $787,792) | $ 1,250,939 | $ 784,355 |
| Short term investments, at fair value (Amortized cost: 2009 - $197,594; 2008 - $30,491) | 202,711 | 30,413 |
| Equity investments, at fair value (Cost: 2009 - $29,953; 2008 - $16,266) | 21,796 | 5,313 |
| Other investments | 27,960 | 54,655 |
| Total Investments | 1,503,406 | 874,736 |
| Cash and cash equivalents | 334,730 | 783,705 |
| Restricted cash | 52,370 | 42,403 |
| Premium balances receivable | 376,584 | 218,287 |
| Unearned premiums ceded | 80,907 | 31,119 |
| Reinsurance recoverable | 15,996 | 16,422 |
| Accrued interest receivable | 9,318 | 7,226 |
| Receivable for investments sold | 27,410 | 9,634 |
| Deferred acquisition costs | 67,088 | 44,601 |
| Funds withheld | 21,890 | 14,433 |
| Goodwill | 16,496 | 17,141 |
| Intangible assets | 35,666 | 32,873 |
| Other assets | 102,006 | 123,390 |
| Total Assets | $ 2,643,867 | $ 2,215,970 |
| | | |
| LIABILITIES | | |
| Loss and loss adjustment expense reserves | $ 471,954 | $ 411,565 |
| Unearned premiums | 459,087 | 270,891 |
| Insurance and reinsurance balances payable | 65,974 | 31,123 |
| Payable for investments purchased | 37,944 | 7,776 |
| Long term debt | 252,774 | 252,575 |
| Other liabilities | 60,173 | 58,577 |
| Total Liabilities | 1,347,906 | 1,032,507 |
| | | |
| EQUITY | | |
| Common voting shares, 300,000,000 authorized, $0.01 par value, issued and outstanding | 849 | 848 |

| | | | | |
|---|---|---|---|---|
| (2009 - 84,864,844; 2008 - 84,801,732) | | | | |
| Common shares held in treasury, at cost (2009 - 2,000,000; 2008 - nil) | | (20) | | - |
| Additional paid-in capital | | 887,829 | | 897,344 |
| Accumulated other comprehensive loss | | (7,332) | | (8,271) |
| Retained earnings | | 256,289 | | 96,092 |
| Total Flagstone Shareholders' Equity | | 1,137,615 | | 986,013 |
| Noncontrolling Interest in Subsidiaries | | 158,346 | | 197,450 |
| Total Equity | | 1,295,961 | | 1,183,463 |
| Total Liabilities and Equity | $ | 2,643,867 | $ | 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 September 30, 2009 | For the Three Months Ended September 30, 2008 | For the Nine Months Ended September 30, 2009 | For the Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| REVENUES | | | | |
| Gross premiums written | $ 174,590 | $ 173,219 | $ 864,784 | $ 686,643 |
| Premiums ceded | (39,781) | (21,984) | (175,192) | (76,433) |
| Net premiums written | 134,809 | 151,235 | 689,592 | 610,210 |
| Change in net unearned premiums | 60,708 | 37,406 | (134,264) | (144,545) |
| Net premiums earned | 195,517 | 188,641 | 555,328 | 465,665 |
| Net investment income | 10,779 | 16,056 | 19,672 | 48,031 |
| Net realized and unrealized gains (losses) - investments | 21,286 | (138,677) | 26,469 | (160,428) |
| Net realized and unrealized gains (losses) - other | 1,373 | (1,039) | 11,273 | (2,144) |
| Other income | 4,269 | 1,418 | 11,771 | 5,269 |
| Total revenues | 233,224 | 66,399 | 624,513 | 356,393 |
| | | | | |
| EXPENSES | | | | |
| Loss and loss adjustment expenses | 80,175 | 199,768 | 214,410 | 295,833 |
| Acquisition costs | 35,224 | 27,452 | 99,464 | 78,827 |
| General and administrative expenses | 35,266 | 16,271 | 104,144 | 67,034 |
| Interest expense | 2,814 | 3,722 | 9,490 | 13,671 |
| Net foreign exchange losses | 2,390 | 8,331 | 3,125 | 3,262 |
| Total expenses | 155,869 | 255,544 | 430,633 | 458,627 |
| Income (loss) before income taxes and interest in earnings of equity investments | 77,355 | (189,145) | 193,880 | (102,234) |
| Provision for income tax | (532) | (585) | (76) | (1,892) |
| Interest in loss of equity investments | (370) | (475) | (1,048) | (475) |
| Net income (loss) | 76,453 | (190,205) | 192,756 | (104,601) |
| Less: (Income) loss attributable to noncontrolling interest | (9,323) | 3,657 | (22,069) | (7,139) |
| NET INCOME (LOSS) ATTRIBUTABLE TO FLAGSTONE | $ 67,130 | $ (186,548) | $ 170,687 | $ (111,740) |
| | | | | |
| Net income (loss) | $ 76,453 | $ (190,205) | $ 192,756 | $ (104,601) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Change in currency translation adjustment | | (4,656) | | 5,833 | | 2,610 | | 1,130 |
| Change in defined benefit pension plan obligation | | 480 | | 57 | | 159 | | (465) |
| Comprehensive income (loss) | | 72,277 | | (184,315) | | 195,525 | | (103,936) |
| Less: Comprehensive (income) loss attributable to noncontrolling interest | | (9,577) | | 3,657 | | (23,899) | | (7,139) |
| COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO FLAGSTONE | $ | 62,700 | $ | (180,658) | $ | 171,626 | $ | (111,075) |
| | | | | | | | | |
| Weighted average common shares outstanding—Basic | | 84,004,784 | | 85,499,283 | | 84,711,027 | | 85,479,861 |
| Weighted average common shares outstanding—Diluted | | 84,176,602 | | 85,499,283 | | 84,909,340 | | 85,479,861 |
| Net income (loss) attributable to Flagstone per common share—Basic | $ | 0.80 | $ | (2.18) | $ | 2.01 | $ | (1.31) |
| Net income (loss) attributable to Flagstone per common share—Diluted | $ | 0.80 | $ | (2.18) | $ | 2.01 | $ | (1.31) |
| Dividends declared per common share | $ | 0.04 | $ | 0.04 | $ | 0.12 | $ | 0.12 |

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)

| | | | | Flagstone Shareholders' Equity | | | |
|---|---|---|---|---|---|---|---|
| For the nine month period ended September 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 |
| | | | | | | | |
| Repurchase of preferred shares | (63,117 ) | | | | | | (63,117 ) |
| Comprehensive income: | | | | | | | |
| Net income | 192,756 | 192,756 | 170,687 | | | | 22,069 |
| Other comprehensive income: | | | | | | | |
| Change in currency translation adjustment | 2,610 | 2,610 | | 780 | | | 1,830 |
| Defined benefit pension plan obligation | 159 | 159 | | 159 | | | |
| | 2,769 | 2,769 | | | | | |
| Comprehensive income | 195,525 | $ 195,525 | | | | | |
| Stock based compensation | 10,399 | | | | | 10,399 | |
| Subsidiary stock based compensation | 14 | | | | | | 14 |
| Subsidiary stock issuance | - | | | | | (184 ) | 184 |
| Purchase of noncontrolling interest | (84 ) | | | | | | (84 ) |
| Issue of shares, net | 1 | | | | 1 | | |
| Shares repurchased and held in treasury | (19,750 ) | | | | (20 ) | (19,730 ) | |
| Dividends declared | (10,490 ) | | (10,490 ) | | | | |
| Ending balance | $ 1,295,961 | | $ 256,289 | $ (7,332 ) | $ 829 | $ 887,829 | $ 158,346 |

| | | | | Flagstone Shareholders' Equity | | | |
|---|---|---|---|---|---|---|---|
| For the nine month period ended | Total equity | Comprehensive income | Retained earnings | Accumulated other | Common | Additional | Noncontrolling interest in |

| September 30, 2008 | | | | comprehensive income | voting shares | paid-in capital | 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 | (104,601 ) | (104,601 ) | (111,740 ) | | | | 7,139 |
| Other comprehensive income: | | | | | | | |
| Change in currency translation adjustment | 1,130 | 1,130 | | 1,647 | | | (517 ) |
| Defined benefit pension plan obligation | (465 ) | (465 ) | | (465 ) | | | |
| | 665 | 665 | | | | | |
| Comprehensive income | (103,936 ) | $ (103,936 ) | | | | | |
| Stock based compensation | (4,906 ) | | | | | (4,906 ) | |
| Subsidiary stock based compensation | (201 ) | | | | | | (201 ) |
| Subsidiary stock issuance | - | | | | | (126 ) | 126 |
| Issue of shares, net | (364 ) | | | | | (364 ) | |
| Dividends declared | (10,112 ) | | (10,112 ) | | | | |
| Other | (91 ) | | | | | | (91 ) |
| Ending balance | $ 1,276,430 | | $ 175,038 | $ 8,608 | $ 853 | $ 899,920 | $ 192,011 |

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 Nine Months Ended September 30, 2009 | September 30, 2008 |
|---|---|---|
| Cash flows provided by (used in) operating activities: | | |
| Net income (loss) | $ 192,756 | $ (104,601) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Net realized and unrealized (gains) losses | (37,742) | 162,572 |
| Net unrealized foreign exchange gains | 1,191 | - |
| Depreciation expense | 5,204 | 3,515 |
| Share based compensation expense (recovery) | 10,048 | (4,780) |
| Interest in loss of equity investments | 1,048 | 475 |
| Accretion/amortization on fixed maturities | 3,039 | (16,524) |
| Changes in assets and liabilities, excluding net assets acquired: | | |
| Reinsurance premium receivable | (157,581) | (139,756) |
| Unearned premiums ceded | (49,241) | (29,610) |
| Deferred acquisition costs | (21,802) | (22,619) |
| Funds withheld | (7,280) | (5,208) |
| Loss and loss adjustment expense reserves | 50,666 | 212,087 |
| Unearned premiums | 182,819 | 179,650 |
| Insurance and reinsurance balances payable | 38,855 | 21,560 |
| Reinsurance recoverable | 1,960 | (11,652) |
| Other changes in assets and liabilities, net | 46,219 | 3,944 |
| Net cash provided by operating activities | 260,159 | 249,053 |
| | | |
| Cash flows (used in) provided by investing activities: | | |
| Net cash (paid) received in (disposal) acquisition of subsidiaries | (1,732) | 4,855 |
| Purchases of fixed income securities | (1,940,588) | (885,082) |
| Sales and maturities of fixed income securities | 1,352,715 | 1,245,168 |
| Purchases of equity securities | (2,006) | (120,950) |
| Sales of equity securities | 7,623 | 81,122 |
| Purchases of other investments | (8,446) | (492,260) |
| Sales of other investments | 9,998 | 246,316 |
| Purchases of fixed assets | (10,726) | (21,063) |
| Sales of fixed asset | 145 | - |
| Change in restricted cash | (9,967) | (3,179) |
| Net cash (used in) provided by investing activities | (602,984) | 54,927 |
| | | |
| Cash flows (used in) provided by financing activities: | | |
| Issue of common shares, net of issuance costs paid | - | (491) |
| Shares repurchased and held in treasury | (19,750) | - |
| Contribution (distribution) of noncontrolling interest | 197 | (166) |
| Repurchase of noncontrolling interest | (63,117) | (8,652) |

| | | |
|---|---|---|
| Dividend paid on common shares | (10,100) | (10,239) |
| Repayment of long term debt | (15,042) | (9,840) |
| Other | 621 | (3,406) |
| Net cash used in financing activities | (107,191) | (32,794) |
| | | |
| Effect of foreign exchange rate on cash | 1,041 | 185 |
| | | |
| (Decrease) increase in cash and cash equivalents | (448,975) | 271,371 |
| Cash and cash equivalents - beginning of year | 783,705 | 362,622 |
| Cash and cash equivalents - end of period | $ 334,730 | $ 633,993 |
| | | |
| Supplemental cash flow information: | | |
| Receivable for investments sold | $ 27,410 | $ 31,749 |
| Payable for investments purchased | $ 37,944 | $ 4,944 |
| Interest paid | $ 9,338 | $ 13,486 |

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 ("Flagstone" or 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. References in this Form 10-Q to "dollars" or "$" are to the lawful currency of the United States of America, unless the context otherwise requires. All amounts in the following tables are expressed in thousands of U.S. dollars, except share amounts, per share amounts and percentages. 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 Accounting Standards Codification ("FASB ASC") Topic 810, "Consolidation". 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. 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. This presentation change has no effect on net income or loss attributable to Flagstone.

2. New Accounting Pronouncements

Adoption of new accounting pronouncements

On September 15, 2009, the Company adopted FASB ASC Topic 105, "Generally Accepted Accounting Principles" ("ASC 105" or "The Codification"). ASC 105 is a replacement to FASB Statement No. 162, "The Hierarchy of Generally Accepted Accounting Principles," ("SFAS 162") which became effective on November 13, 2008, and identified the sources of accounting principles and the framework for selecting the principles used in preparing financial statements in conformity with U.S. GAAP. It also arranged these sources of U.S. GAAP in a hierarchy for users to apply. ASC 105 provides for a single source of authoritative U.S. GAAP recognized by the FASB to be applied to nongovernmental entities in the preparation of financial statements. The Codification carries the same level of authority and supersedes SFAS 162 and all other accounting and reporting standards. The U.S. GAAP hierarchy has been modified to include two levels of U.S. GAAP: authoritative and non-authoritative.

On April 1, 2009, the Company adopted the provisions of the FASB ASC Topic 855, "Subsequent Events" ("ASC 855"), 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. ASC 855 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.

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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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On April 1, 2009, the Company adopted the provisions of the FASB ASC 820-10-35, “Fair Value Measurements and Disclosures- Overall -Subsequent Measurement” (“ASC 820-10-35”), ASC 825-10-50, “Financial Instruments – Overall – Disclosure”(“ASC 825-10-50”), and ASC 320-10-35, “Investments – Debt and Equity Securities – Overall – Subsequent Measurement” (“ASC 320-10-35”) intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities.

ASC 820-10-35 relates to determining fair values when there is no active market or where the price inputs being used represent distressed sales. It reaffirms what the objective of fair value measurement is 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. The adoption of ASC 820-10-35 did not have a material impact on the Company's consolidated shareholders’ equity or net income.

ASC 825-10-50 enhances 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 standard, fair values for these assets and liabilities were only disclosed once a year. ASC 825-10-50 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.

ASC 320-10-35 provides 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 at fair value. ASC 320-10-35 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 adoption of ASC 825-10-50 and ASC 320-10-35 as of April 1, 2009, only required new disclosures to be made and did not have an impact on the Company’s consolidated shareholders’ equity or net income.

On January 1, 2009, the Company adopted the provisions of ASC Topic 810, “Consolidation” (“ASC 810”). ASC 810 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. ASC 810 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 ASC 810, 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 ASC Topic 815, "Derivatives and Hedging" ("ASC 815"). The provisions of ASC 815 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 ASC 815 and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Adopting ASC 815 did not have an impact on the Company's consolidated shareholders' equity or net income as it required only new disclosures to be made.

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

On June 12, 2009, the FASB issued FASB Statement No. 166, "Accounting for Transfers of Financial Assets," ("SFAS 166"). SFAS 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 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 166 on its consolidated results of operations and financial condition.

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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On June 12, 2009, the FASB issued FASB Statement 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 impact 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 August 2009, the FASB issued Accounting Standards Update No. 2009-05, “Measuring Liabilities at Fair Value” (“ASU 2009-05”). This update provides amendments to ASC Topic 820, “Fair Value Measurements and Disclosures” for the fair value measurement of liabilities when a quoted price in an active market is not available. ASU 2009-05 is effective for the first interim or annual reporting period beginning after the ASU’s issuance, and will be adopted by the Company in the fourth quarter of fiscal year 2009. The Company is assessing the potential impact, if any, of the adoption of ASU 2009-05 on its consolidated results of operations and financial condition.

In September 2009, the FASB issued Accounting Standards Update No. 2009-12, “Measuring Fair Value of Certain Investments” (“ASU 2009-12”). This update provides further amendments to ASC Topic 820, “Fair Value Measurements and Disclosures” to offer investors a practical expedient for measuring the fair value of investments in certain entities that calculate net asset value per share (“NAV”). Specifically, measurement using NAV is reasonable for investments within the scope of ASU 2009-12. The ASU 2009-12 is effective for the first interim or annual reporting period beginning after the ASU’s issuance, and will be adopted by the Company in the fourth quarter of fiscal year 2009. The Company is assessing the potential impact, if any, of the adoption of ASU 2009-12 on its consolidated results of operations and financial condition.

3. Investments

Fair value disclosure

In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, the Company determined that its investments in U.S. government treasury securities, listed equity securities and exchange traded funds 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, and asset-backed securities 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. 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 fair value of the investment funds is determined 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. Additionally, there are two mortgage-backed securities that were 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.

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

| | Fair Value Measurement at September 30, 2009, using: | | | |
|---|---|---|---|---|
| Description | Fair Value Measurements | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Other Unobservable Inputs (Level 3) |
| U.S. government and agency securities | $504,142 | $455,891 | $48,251 | $ - |
| U.S. states and political subdivisions | 1,968 | - | 1,968 | - |
| Non U.S. government and government agencies | 112,171 | - | 112,171 | - |
| Corporates | 488,779 | - | 488,779 | - |
| Mortgage-backed securities | 106,632 | - | 105,647 | 985 |
| Asset-backed securities | 37,247 | - | 37,247 | - |
| | 1,250,939 | 455,891 | 794,063 | 985 |
| Equity investments | 21,796 | 21,796 | - | - |
| Short term investments | 202,711 | 47,380 | 155,331 | - |
| | 1,475,446 | 525,067 | 949,394 | 985 |
| Other Investments | | | | |
| Investment funds | 5,113 | - | - | 5,113 |
| Catastrophe bonds | 18,220 | - | - | 18,220 |
| | 23,333 | - | - | 23,333 |
| | | | | |
| Totals | $1,498,779 | $525,067 | $949,394 | $ 24,318 |

For reconciliation purposes, the table above does not include an equity investment of $4.6 million in which the Company is deemed to have a significant influence and is accounted for under the equity method and as such, is not accounted for at fair value under the FASB ASC guidance for financial instruments.

For the Level 3 items still held as of September 30, 2009, the total change in fair value for the three month and nine months ended September 30, 2009 is $0.3 million and $(3.7) million respectively. There were no transfers in or out of level three during these periods.

| | Fair Value Measurement at December 31, 2008, using: | | | |
|---|---|---|---|---|
| Description | Fair Value Measurements | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Other Unobservable Inputs (Level 3) |

| | | | | |
|---|---|---|---|---|
| U.S. government and agency securities | $ 486,842 | $ 447,226 | $ 39,616 | $ - |
| U.S. states and political subdivisions | - | - | - | - |
| Non U.S. government and government agencies | 15,206 | - | 15,206 | - |
| Corporates | 140,423 | - | 140,423 | - |
| Mortgage-backed securities | 112,074 | - | 111,148 | 926 |
| Asset-backed securities | 29,810 | - | 29,810 | - |
| | 784,355 | 447,226 | 336,203 | 926 |
| Equity investments | 5,313 | 5,313 | - | - |
| Short term investments | 30,413 | 30,413 | - | - |
| | 820,081 | 482,952 | 336,203 | 926 |
| Other Investments | | | | |
| Investment funds | 9,805 | - | 647 | 9,158 |