

Financial Statements of

MONTANA RE LTD.

December 31, 2011 and 2010



MONTANA RE LTD.

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Independent Auditors' Report to the Shareholder

We have audited the accompanying financial statements of Montana Re Ltd. (the "Company"), which comprise the balance sheets as at December 31, 2011 and 2010, the related statements of income and retained earnings and cash flows for the year ended December 31, 2011 and the period from October 22, 2009 (date of incorporation) to December 31, 2010, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles and for such internal controls as management determines as necessary to enable the presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audits to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2011 and 2010, and its financial performance and its cash flows for the year ended December 31, 2011 and the period from October 22, 2009 (date of incorporation) to December 31, 2010 in conformity with U.S. generally accepted accounting principles.



Independent Auditors' Report to the Shareholder (continued)

Emphasis of Matter

Without qualifying our opinion, we draw attention to notes 2(b)(i) and 5 to the financial statements. As at December 31, 2011 and 2010, the financial statements include derivative financial instruments valued on a net basis at US\$5,667,500 and US\$(1,660,500), respectively, using the valuation method discussed in Note 2(b)(i) in the absence of readily ascertainable market values. However, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for these financial instruments existed or had another valuation method been adopted, and the differences could be material.

Furthermore, without qualifying our opinion, we draw attention to Note 6 to the financial statements. During the year ended December 31, 2011 both an Event Notice and Event Report were issued. The Event Report confirmed a principal reduction of US\$Nil.

KPMG

June 19, 2012

MONTANA RE LTD.

Balance Sheets

December 31, 2011 and 2010
(stated in United States dollars)

	Note	2011	2010
Assets			
Cash and cash equivalents	3	169,894	438,397
Collateralised loan	2(g),4	421,435,663	414,014,471
Derivative financial instruments	5	6,527,500	217,000
Reinsurance premiums receivable		22,183,695	20,471,124
Interest receivable		150,036	54,540
Prepaid expenses		175,915	352,765
Total assets		US\$ 450,642,703	435,548,297
Liabilities and shareholder's equity			
Liabilities			
Accounts payable and accrued expenses	10	196,289	277,194
Interest payable	6	3,395,452	2,176,000
Derivative financial instruments	5	860,000	1,877,500
Unearned premiums		19,081,257	18,858,079
Collateral margin payable	2(g),4	36,435,663	29,014,471
Provision for outstanding losses	2(d)	0	0
		59,968,661	52,203,244
Notes payable	6	385,000,000	385,000,000
Shareholder's equity			
Share capital	7	5,000	5,000
Retained earnings/(accumulated deficit)		5,669,042	(1,659,947)
		5,674,042	(1,654,947)
Total liabilities and shareholder's equity		US\$ 450,642,703	435,548,297

See accompanying notes to financial statements.

Approved on behalf of the Board of Directors on June 19, 2012

KEVIN POOLE

_____ Director

DENA THOMPSON

_____ Director

MONTANA RE LTD.

Statements of Income and Retained Earnings

Year ended December 31, 2011 and period from October 22, 2009
(date of incorporation) to December 31, 2010
(stated in United States dollars)

	Note	2011	2010
Underwriting income			
Reinsurance premiums assumed		48,274,749	47,228,844
Movement in unearned premiums		(223,178)	(18,858,079)
Net underwriting income		48,051,571	28,370,765
Investment income			
Interest income	8	1,339,126	656,739
		1,339,126	656,739
Net gain/(loss) on financial instruments			
Net gain/(loss) on embedded derivative financial instruments	5	7,328,000	(1,660,500)
		7,328,000	(1,660,500)
Expenses			
Interest expense	6	48,717,770	23,121,843
Initial offering costs	10	0	5,440,283
Administration expenses	9,10	671,938	464,825
		49,389,708	29,026,951
Net income/(loss) for year/period		7,328,989	(1,659,947)
Accumulated deficit at beginning of year/period		(1,659,947)	0
Retained earnings/(accumulated deficit) at end of year/period		US\$ 5,669,042	(1,659,947)

See accompanying notes to financial statements.

MONTANA RE LTD.

Statements of Cash Flows

Year ended December 31, 2011 and period from October 22, 2009
(date of incorporation) to December 31, 2010
(stated in United States dollars)

	2011	2010
Cash provided by/(applied in):		
Operating activities		
Net income/(loss) for period	7,328,989	(1,659,947)
Add/(deduct) items not affecting cash:		
Net movement in unrealised loss on embedded derivative financial instruments	(7,328,000)	1,660,500
Add/(deduct) net changes in non-cash operating balances:		
Collateralised loan	(7,421,192)	(414,014,471)
Reinsurance premiums receivable	(1,712,571)	(20,471,124)
Interest receivable	(95,496)	(54,540)
Prepaid expenses	176,850	(352,765)
Accounts payable and accrued expenses	(80,905)	277,194
Interest payable	1,219,452	2,176,000
Unearned premiums	223,178	18,858,079
Collateral margin payable	7,421,192	29,014,471
	(268,503)	(384,566,603)
Financing activities		
Proceeds from issue of notes payable	0	385,000,000
Issuance of share capital	0	5,000
	0	385,005,000
(Decrease)/increase in cash and cash equivalents during year/period	(268,503)	438,397
Cash and cash equivalents at beginning of year/period	438,397	0
Cash and cash equivalents at end of year/period	US\$ 169,894	438,397
Supplementary information on cash flows from operating activities		
Interest received	1,243,630	602,199
Interest paid	US\$ 47,498,318	20,945,843

See accompanying notes to financial statements.

MONTANA RE LTD.

Notes to Financial Statements

December 31, 2011 and 2010
(stated in United States dollars)

1. Incorporation and background information

Montana Re Ltd. (the “Company”) was incorporated under the Companies Law of the Cayman Islands on October 22, 2009 and has been issued a Restricted Class “B” Insurance Licence under Section 4 of the Cayman Islands Insurance Law.

The Company was formed for the sole purpose of offering Notes under a Principal-at-Risk Variable Rate Note Program (“Program”) to provide Flagstone Reassurance Suisse, S.A. (“Ceding Reinsurer”) with a program for obtaining multi-year insurance coverage for certain Covered Events within specified Covered Areas as defined by separate Reinsurance Agreements with respect to each Class within a Series of Notes entered into by both parties. Specifically, the Reinsurance Agreements provide for coverage against losses as confirmed by Property Claim Services (“PCS”) as a Catastrophe that occur within the Covered Area (“Covered Events”). The Reinsurance Agreements require payments to the Ceding Reinsurer following the occurrence of certain Covered Events in excess of the separate Attachment Levels up to the Exhaustion Levels as specified in the Reinsurance Agreements from the peril of hurricanes, earthquakes, typhoons and windstorms. On November 30, 2009 (“Initial Issuance Date”), the Company issued the following notes:

- US\$100,000,000 Series 2009-1, Class A Principal-at-Risk Variable Rate Notes due December 7, 2012 (“Class A Notes”), which are exposed to Hurricanes affecting the Class A Covered Area on a per occurrence basis during the Class A Risk Period.
- US\$75,000,000 Series 2009-1, Class B Principal-at-Risk Variable Rate Notes due December 7, 2012 (“Class B Notes”), which are exposed to Hurricanes and Earthquakes affecting the Class B Covered Area on a per occurrence basis during the Class B Risk Period.

Subsequent to the initial issuance date, on December 22, 2010, the Company issued the following additional notes:

- US\$70,000,000 Series 2010-1, Class C Principal-at-Risk Variable Rate Notes due January 8, 2014 (“Class C Notes”), which are exposed to U.S. Hurricane Events and U.S. Earthquake Events affecting the Class C Covered Area on a per occurrence basis during the Class C Risk Period.
 - US\$80,000,000 Series 2010-1, Class D Principal-at-Risk Variable Rate Notes due January 8, 2014 (“Class D Notes”), which are exposed to U.S. Hurricane Events, U.S. Earthquake Events and Cayman Islands Hurricane Events affecting the Class D Covered Area on a per occurrence basis during the Class D Risk Period.
 - US\$60,000,000 Series 2010-1, Class E Principal-at-Risk Variable Rate Notes due January 8, 2014 (“Class E Notes”), which are exposed to second and/or subsequent events on an aggregate basis of any of U.S. Hurricane Events, U.S. Earthquake Events, Japan Earthquake Events, Typhoon Events and Europe Windstorm Events affecting the Class E Covered Area during a Class E Annual Risk Period.
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MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

1. Incorporation and background information (continued)

The Company may from time to time issue additional Notes pursuant to the Program, containing such terms and conditions as specified in an Offering Circular Supplement applicable thereto.

At the inception of the Reinsurance Agreements associated with the Series 2009-1 Notes, the Company reinsured 66.89% of US\$149,500,000 of the Event Index Value relating to a Covered Event in excess of the Initial Attachment Level of US\$491,000,000 up to the Initial Exhaustion Level of US\$640,500,000 for the Class A Notes, and the Company reinsured 50.34% of US\$149,000,000 of the Event Index Value relating to a Covered Event in excess of the Initial Attachment Level of US\$342,000,000 up to the Initial Exhaustion Level of US\$491,000,000 for the Class B Notes. In accordance with the Calculation Agent Agreement dated November 30, 2009, a reset of the Attachment and Exhaustion Levels (based on updated exposure data) associated with the Series 2009-1 Notes is to become effective on November 23 of each year, commencing on November 23, 2010 and ending on November 23, 2011. On November 4, 2010, the Company received a Reset Report for the 2009-1 Notes. For the Class A Notes, the Updated Insurance Percentage was reset at 67.11%, the Updated Attachment Level was reset at US\$492,000,000 and the Updated Exhaustion Level was reset at US\$641,000,000. For the Class B notes, the Updated Insurance Percentage was reset at 53.19%, the Updated Attachment Level was reset at US\$341,000,000 and the Updated Exhaustion Level was reset at US\$482,000,000.

On November 11, 2011, the Company received a Reset Report for the 2009-1 Notes. For the Class A Notes, the Updated Insurance Percentage was reset at 86.21%, the Updated Attachment Level was reset at US\$387,000,000 and the Updated Exhaustion Level was reset at US\$503,000,000. For the Class B Notes, the Updated Insurance Percentage was reset at 57.25%, the Updated Attachment Level was reset at US\$306,000,000 and the Updated Exhaustion Level was reset at US\$437,000,000. The risk period associated with the Series 2009-1 Notes is from December 1, 2009 to November 30, 2012, although it may be extended by up to 18 months for the Class A Notes and 24 months for the Class B Notes by the Ceding Reinsurer following one or more Extension Events.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

1. Incorporation and background information (continued)

At the inception of the Reinsurance Agreements associated with the Series 2010-1 Notes, the Company reinsured 55.05% of US\$127,146,910 of the Event Index Value relating to a Covered Event in excess of the Initial Attachment Level of US\$342,000,000 up to the Initial Exhaustion Level of US\$469,146,910, for the Class C Notes, the Company reinsured 61.54% of US\$130,000,000 of the Event Index Value relating to a Covered Event in excess of the Initial Attachment Level of US\$212,000,000 up to the Initial Exhaustion Level of US\$342,000,000 for the Class D Notes, and the Company reinsured 60.00% of US\$100,000,000 of the Event Index Value relating to a Covered Event in excess of the Initial Attachment Level of US\$100,000,000 up to the Initial Exhaustion Level of US\$200,000,000 for the Class E Notes. In accordance with the Calculation Agent Agreement dated December 22, 2010, a reset of the Attachment and Exhaustion Levels (based on updated exposure data) associated with the Series 2010-1 Notes is to become effective on January 1 of each year, commencing on January 1, 2012 and ending on January 1, 2013.

On November 11, 2011, the Company received a Reset Report for the 2010-1 Notes. For the Class C Notes, the Updated Attachment Level was reset at US\$305,000,000 and the Updated Exhaustion Level was reset at US\$418,000,000. For the Class D Notes, the Updated Attachment Level was reset at US\$224,000,000 and the Updated Exhaustion Level was reset at US\$359,000,000. For the Class E Notes, the Updated Attachment Level remained at US\$100,000,000 and the Updated Exhaustion Level was reset at US\$194,000,000. The risk period associated with the Series 2010-1 Notes is from January 1, 2011 to December 31, 2013, although it may be extended by up to 6 months by the Ceding Reinsurer following one or more Extension Events.

The aggregate amount of payments to be made by the Company to the Ceding Insurer under the Reinsurance Agreements is limited at all times to be original principal amount of the Notes issued and outstanding.

At December 31, 2011 the Class A Notes and Class B Notes (together "Series 2009-1 Notes") and the Class C Notes, Class D Notes and Class E Notes (together "Series 2010-1 Notes") were issued and remained outstanding. The Company utilised the proceeds from the issue of the Notes to secure its obligations to the Ceding Reinsurer under the Reinsurance Agreements. The proceeds were used to purchase certain Permitted Investments (note 4). The Notes are secured pursuant to a Indenture Agreement (the "Indenture Agreement") between the Company and Deutsche Bank Trust Company Americas (the "Indenture Trustee"), as Trustee for the holders of the Notes.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

1. Incorporation and background information (continued)

The amount of the principal and coupon that holders of the Notes outstanding at December 31, 2011 shall receive on the maturity date (throughout the life of the Notes) depends in part on whether a loss event occurs. The Notes are not principal protected. The Noteholders may lose, in part or in whole, amounts invested in the Notes as a result of a loss event occurring. As further described in note 2(d) and 6, the potential reduction/elimination of interest payments on the Notes and principal value of the Notes may not necessarily bear a direct correlation to the actual specific losses incurred by the Ceding Reinsurer as a result of a loss event taking place. As such, the Notes are deemed to comprise a host debt financial instrument and an embedded derivative to be accounted for as described in note 2(e).

At December 31, 2011 and 2010, the Company had no employees. The registered office of the Company is located at Uglan House, P.O. Box 309, Grand Cayman, Cayman Islands, KY1-1104. The functional currency of the Company is the United States dollar and not the local currency of the Cayman Islands reflecting the fact that all of the Company's assets and liabilities are denominated in United States dollars. The financial statements are presented in United States dollars.

2. Significant accounting policies

These financial statements are prepared in conformity with U.S. generally accepted accounting principles ("US GAAP").

The significant accounting policies adopted by the Company are as follows:

(a) Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the year. Actual results could differ from those estimates.

(b) Fair value measurements

In accordance with the authoritative guidance on fair value measurements and disclosures under US GAAP, the Company discloses the fair value of its derivative financial instruments in a hierarchy that prioritizes the inputs to valuation techniques used to measure the fair value. The fair value of a financial asset or liability is defined using an "exit price" definition. It is the amount that would be received to sell the asset or the amount that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The hierarchy gives the highest priority to valuations based upon unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to valuations based upon unobservable inputs that are significant to the valuation (Level 3 measurements).

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

2. Significant accounting policies (continued)

(b) Fair value measurements (continued)

The guidance establishes three levels of the fair value hierarchy as follows:

- Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market.
- Level 3: Valuation is based upon valuation techniques that use significant inputs that are unobservable or are generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the company's own assumptions about the assumptions market participants would use in pricing the assets or liabilities.

(i) Valuation techniques

Embedded derivatives

As further described in note 2(e) and 6, the potential reduction/elimination of interest and principal repayment on the Notes may not necessarily bear a direct correlation to the actual specific losses incurred by the Ceding Insurer as a result of Covered Events taking place. As such, the Notes are deemed to comprise a host debt financial instrument and an embedded derivative.

The embedded derivatives within the Notes are measured as a freestanding derivative financial instrument separate from the host contracts. The fair values of the embedded derivatives have been estimated by management at a value implied from indicative pricing of the Notes in a relative illiquid secondary market at the balance sheet date. The embedded derivatives have been included in Level 3 of the fair value hierarchy.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

2. Significant accounting policies (continued)

(b) Fair value measurements (continued)

(ii) Fair value classifications

The following table presents the financial instruments measured at fair value carried on the balance sheet by caption and by level within the fair value hierarchy as of December 31, 2011 and 2010:

2011	Total	Level 1	Level 2	Level 3
Assets:				
Embedded derivatives	6,527,500	0	0	6,527,500
Liabilities:				
Embedded derivatives	(860,000)	0	0	(860,000)
US\$	5,667,500	0	0	5,667,500

2010	Total	Level 1	Level 2	Level 3
Assets:				
Embedded derivatives	217,000	0	0	217,000
Liabilities:				
Embedded derivatives	(1,877,500)	0	0	(1,877,500)
US\$	(1,660,500)	0	0	(1,660,500)

The following table includes a roll forward of the amounts classified within Level 3 of the fair value hierarchy for the year ended December 31, 2011 and period from October 22, 2009 (date of incorporation) to December 31, 2010.

	Balance at December 31, 2010	Net Purchases and Sales	Included in Net gain/(loss)	Gains/ (Losses) included in AOCI	Balance at December 31, 2011
Embedded derivatives	(1,660,500)	0	7,328,000	0	5,667,500
US\$	(1,660,500)	0	7,328,000	0	5,667,500

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

2. Significant accounting policies (continued)

(b) Fair value measurements (continued)

(ii) Fair value classifications (continued)

	Balance at beginning of period	Net Purchases and Sales	Included in Net gain/(loss)	Gains/ (Losses) included in AOCI	Balance at December 31, 2010
2010					
Embedded derivatives	0	0	(1,660,500)	0	(1,660,500)
US\$	0	0	(1,660,500)	0	(1,660,500)

The movement in unrealised gain on the derivatives for the period ended December 31, 2011 is included in the statements of income and retained earnings.

(c) Reinsurance premiums assumed and unearned premiums

Premiums paid by the Ceding Reinsurer to the Company in accordance with the terms of the Reinsurance Agreements are recorded on the accrual basis. Reinsurance Premium, being equal to 9.75% per annum for Class A Notes, 13.25% per annum for Class B Notes, 11.90% per annum for Class C Notes, 16.40% per annum for Class D Notes and 9.50% per annum for Class E Notes are recognized as income on a pro-rata basis over the term of each Risk Period. Reinsurance premiums comprise amounts sufficient to reimburse the Company for the Interest Spread, expenses incurred in connection with the original issuance of the Notes (“Initial Premium”) and certain annual expenses (“Additional Premium”), all of which are defined in the relevant transaction documents. Additional Premium is recognized as income over the period. Any portion of the reinsurance premiums relating to periods after the balance sheet date are deferred and included in unearned premiums in the balance sheet. Initial Payment received on execution of the Reinsurance Agreement is recognized as income on the date of execution of the Reinsurance Agreement.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

2. Significant accounting policies (continued)

(d) Provision for outstanding losses

The Company will record as a provision for outstanding losses, amounts equivalent to the amount calculated by the Calculation Agent in terms of the procedures set forth in the Calculation Agent Agreement. The Company will record an expense for losses once it is notified of an Event Payment. No claims with respect to an Event shall be made upon the Company and the Company has no liability for any losses with respect to an Event. Unless and until the Company has received an Event Report stating that such Event has occurred and stating the Event Payment if any, payable to the Ceding Insurer subject to the Aggregate Limit. Subsequent to the filing of a proof of loss claim by the Ceding Insurer following the Commutation Date associated with an event, the Ceding Insurer will be required to reimburse the Company for amounts initially received by them in excess of the final determined incurred losses of the Ceding Insurer. The Noteholders will not have any recourse to any amount paid by the Ceding Insurer to the Company following such settlement. There will instead be on automatic reinstatement of coverage as referred to in note 1. At December 31, 2011 the Company had not been notified of an Event in the form of an Event Report and as such, no provision for outstanding losses has been recorded.

(e) Notes payable/embedded derivatives

The Notes payable comprise a host debt financial instrument and an embedded derivative transaction as the payment of principal and interest could be adversely impacted by a Covered Event as described in note 1. The cash flows relating to payment of interest and repayment of principal are exposed to variation based on a geological occurrence (“the underlying”) that creates cash flow implications for the Noteholder not necessarily specific to the losses incurred by the Ceding Reinsurer. The Company’s exposure to this underlying forms the basis of the embedded derivatives. In accordance with relevant accounting standards, the debt instrument and embedded derivative component of this financial instrument are separated and valued independently.

The host debt instrument component of the Notes is carried at amortised cost until such time as a principal reduction is required in accordance with the terms and conditions of the Notes.

Embedded derivatives are classified as financial instruments held for trading. Both realised and unrealised gains and losses arising from a change in fair value of the embedded derivatives are recognised in the statements of income and retained earnings.

(f) Initial offering costs

Expenses incurred in connection with the issuance of the Notes and execution of the Reinsurance Agreements have been expensed and included in the statements of income and retained earnings on the date of the offering.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

2. Significant accounting policies (continued)

(g) Collateralised loan, collateral margin payable and interest income

The Company (the “Buyer”) has entered into triparty repurchase agreements with Goldman Sachs International (“GSI”) and BNP Paribas (“BNP”) (the “Sellers”), Bank of New York Mellon (the “Custodian”) and Bank of New York Mellon for the Series 2009-1 Notes and Euroclear Bank S.A./N.V. for the Series 2010-1 Notes (the “Triparty Agents”). The cash received upon the issuance of the Series 2009-1 and 2010-1 notes are transferred to the Sellers in return for securities, which are to be held as collateral until the redemption or termination date of the repurchase agreements. The collateral is maintained by an independent agent, and the securities cannot be sold or re-pledged without the prior consent of the Sellers. The constraints on the Company’s ability to sell or re-pledge the securities forms the basis of the collateralised loan. The collateralised loan is subject to margin adjustments which are based upon increases and decreases in the credit ratings from recognised agencies of both the Sellers and the Eligible Securities. The collateralised loan is recorded on the balance sheet at the fair value of the underlying securities transferred to the indenture trustee, adjusted to reflect the margin requirements of the repurchase agreements. The collateralised loan bears an interest rate of three month LIBOR on the original cash amount transferred to the Sellers which is recorded as interest income in the statement of loss and accumulated deficit. The Company records a collateral margin payable on the balance sheet which represents the difference in the fair value of the underlying securities held as collateral and the amount originally transferred to the Sellers in the form of cash.

(h) Cash and cash equivalents

For the purposes of the statements of cash flows, cash and cash equivalents include current accounts and other highly liquid assets with original maturities of three months or less.

(i) Comprehensive income

The Company has no comprehensive income other than net income disclosed in the statements of income and retained earnings. Therefore a separate statement of comprehensive income has not been prepared.

(j) Interest income/expense

Interest income and expense are recognised in the statements of income and retained earnings on an accrual basis.

(k) Expenses

All expenses are recognised in the statements of income and retained earnings on an accrual basis.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

2. Significant accounting policies (continued)

(l) Taxation

There is presently no taxation imposed on income or premiums by the Government of the Cayman Islands. If any form of taxation were to be enacted, the Company has been granted an exemption therefrom until the year 2029. Consequently there is no provision for taxation in these financial statements.

The Company is required to determine whether a tax position of the Company is more likely than not to be sustained upon examination by the applicable taxing authority based on the technical merits of the position. The Company has evaluated its tax position and does not consider itself to be engaged in trade or business in any jurisdiction other than the Cayman Islands and therefore is not subject to income taxes. If the Company should be considered to be engaged in a trade or business in a jurisdiction outside of the Cayman Islands, it could be subject to income taxes.

Management does not believe there are any tax positions taken by the Company that are subject to uncertainty and as a result, no provisions have been made in these financial statements.

(m) Recently Issued Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (“FASB”) issued ASU 2011-04 “*Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and International Financial Reporting Standards (“IFRS”)*”, ASU 2011-04 includes common requirements for measurement of and disclosure about fair value between US GAAP and IFRS. ASU 2011-04 will require reporting entities to disclose the following information for fair value measurements categorized within Level 3 of the fair value hierarchy: quantitative information about the unobservable inputs used in the fair value measurement, the valuation processes used by the reporting entity. The new and revised disclosures are effective for interim and annual reporting periods beginning after December 15, 2011. The adoption of ASU 2011-04 will not have any impact on the Company’s financial position or results of operation.

In December 2011, the FASB issued ASU 2011-11, “*Disclosures about Offsetting Assets and Liabilities*”. ASU 2011-11 requires entities to disclose both gross and net information about financial instruments and derivative instruments that are either (i) offset in the balance sheet, or, (ii) subject to an enforceable master netting arrangement or similar arrangement, irrespective of whether they are offset in the balance sheet. In addition, ASU 2011-11 requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. The requirements of ASU 2011-11 are effective for interim and annual reporting periods beginning on or after January 1, 2013. The adoption of ASU 2011-11 will not have any impact on the Company’s financial Position or results of operations, as ASU 2011-11 only effects disclosures about offsetting.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

3. Cash and cash equivalents

	2011	2010
Current account	169,790	438,292
Note payment account	104	105
	US\$ 169,894	438,397

4. Collateralised loan

During the period ended December 31, 2010, GSI and BNP entered into a Global Master Repurchase Agreement (“GMRA”) in November 30, 2009 and December 22, 2010 in association with the Series 2009-1 and 2010-1 Notes respectively. Under the terms of the GMRA between the Company and GSI, US\$175,000,000 in proceeds from the issue of the Series 2009-1 Notes were assigned to the Triparty Agent in return for securities transferred from GSI to serve as collateral for the effective borrowing of the proceeds from the Notes issued. The collateral will be repurchased by GSI and the proceeds together with margin amounts if applicable will be returned to the Company in the amount equivalent to the original amount of the cash placed, should there be a loss event during the risk period or upon maturity of the Series 2009-1 Notes.

Similarly, under the terms of the GMRA between the Company and BNP, US\$210,000,000 in proceeds from the issue of the Series 2010-1 Notes were assigned to the Triparty Agent in return for securities transferred from BNP to serve as collateral for the effective borrowing of the proceeds from the Note issues. The collateral will be repurchased by BNP and the proceeds together with margin amounts if applicable, will be returned to the Company in the amount equivalent to the original amount of the cash placed, should there be a loss event during the risk period or upon maturity of the Series 2010-1 Notes.

The primary purpose of each Repurchase Agreement is to provide a means of investing the proceeds of the issue of the respective Class of Notes to generate a LIBOR-linked return which is collateralized by assets (i) which are comprised of Eligible Securities; and (ii) the aggregate value of which is maintained through daily margining conducted by the Triparty Agents on each Business Day, in each case subject to the limitations described below.

The collateralised loan represents the fair value of the original note proceeds which has been collateralised by GSI and BNP securities, and additional collateral margin required under the terms of the Repurchase Agreements. The collateral margin requirement is based upon the credit ratings from recognised agencies of both the Sellers and the Eligible Securities. Upon a down grade or upgrade in the credit ratings of the Sellers or the Eligible Securities, the collateral margin requirement is adjusted accordingly.

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Notes to Financial Statements (continued)

December 31, 2011 and 2010
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4. Collateralised loan (continued)

In respect of an Eligible Security for the Series 2009-1 Notes, the percentage (“2009-1 Adjustment Percentage”) equal to the percentages set out in Column I of the following table as are applicable to the Eligible Security and for the avoidance of doubt, if more than one criterion below applies to any one asset, the relevant percentage shall be the aggregate of those applicable; provided, that if GSI is downgraded below BBB+ by S&P and below Baa1 by Moody’s, the percentages set forth in Column II shall be applicable.

	Column I	Column II
Cash	100%	100%
U.S. Treasury Securities (including TIPS and STRIPS)	101%	101%
U.S. Agency Debentures	102%	102%
Non-U.S. Sovereign Debt (AA- and above)	103%	108%
Non-U.S. Sovereign Debt (A- and A+)	105%	110%
Corporate Debt (AA- and above)	113%	118%
Corporate Debt (BBB to A+)	115%	120%

In respect of an Eligible Security for the Series 2010-1 Notes, the adjustment percentage (“2010-1 Adjustment Percentage”) equal to the percentages outlined below are applicable to the Eligible Security and for the avoidance of doubt, if more than one criterion below applies to any one asset, the relevant percentage shall be the aggregate of those applicable.

(i) a percentage (the “Base Adjustment Percentage”) that at any time depends upon the Repurchase Counterparty Rating at such date, as follows:

- “AA-” and above: 100%
- Below “AA-” and above “A-”: 105%
- “A-”: 107%
- Below “A-”: 120%

(ii) such incremental percentages set out below as are applicable to the relevant Eligible Security and for the avoidance of doubt, if more than one criterion below applies to any one asset, the relevant percentage will be the aggregate of those applicable:

- Sovereign Debt rated “AA-/Aa3” or above: 1%
 - Sovereign Debt rated below “AA-/Aa3”: 4%
 - Corporate Debt: 8%
 - On any date, if the relevant debt security has as of the preceding Business Day, a remaining term to maturity of more than five (5) years: 1%
 - Quotation age (as determined by the Triparty Agent) more than three (3) Business Days old: 3%
-

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Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

4. Collateralised loan (continued)

For avoidance of doubt, for clause (ii), “AA-/ Aa3” refers to a rating of at least “AA-” by S&P or “Aa3” by Moody’s and, to the extent rated by both S&P and Moody’s, a rating of least “AA-” by S&P and at least “Aa3” by Moody’s.

The Company records a collateral margin payable on the balance sheet which represents the difference in the fair value of the underlying securities held as collateral and the amount originally transferred to the Sellers via the Repurchase Agreements.

The underlying securities held as collateral as at December 31, 2011 include U.S. and foreign corporate debt securities.

	Fair value of collateralisation	Collateral margin payable	Net receivable*
Class A Notes	111,068,902	(11,068,902)	100,000,000
Class B Notes	81,538,131	(6,538,131)	75,000,000
Class C Notes	76,266,037	(6,266,037)	70,000,000
Class D Notes	87,398,378	(7,398,378)	80,000,000
Class E Notes	65,164,215	(5,164,215)	60,000,000
	US\$ 421,435,663	(36,435,663)	385,000,000

* At maturity or in the case of a loss event this is the net amount recoverable via the Repurchase Agreements, to then be paid to the Noteholders and/or Ceding Reinsurer.

5. Derivative financial instruments

As described in notes 1, 2(e) and 6, the Company issued Notes. The Notes represent hybrid instruments which are separated into host debt instruments recorded as financial liabilities in the balance sheet and embedded derivatives recorded as financial assets and/or liabilities in the balance sheet. At December 31, 2011, the value of the derivative embedded in the Class A Notes and Class B Notes is estimated to be US\$(282,500) (2010: US\$(1,877,500)) and the derivative embedded in the Class C Notes, Class D Notes and Class E Notes is estimated to be US\$5,950,000 (2010: US\$217,000).

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

5. Derivative financial instruments (continued)

Volume of derivative activities

At December 31, 2011, the volume of the Company's derivative activities not accounted for as hedging instruments, based on their notional amounts and number of contracts, categorized by primary underlying risk, are as follows:

		Notional amounts	Number of contracts
Catastrophe risk			
Embedded derivatives	US\$	385,000,000	5

Impact of derivatives on the balance sheets and statements of income and retained earnings

The following table identifies the fair value of derivative contracts not accounted for as hedging instruments included in the balance sheet as derivative contracts, categorized by primary underlying risk, at December 31, 2011. Balances are presented on a gross basis.

		Derivative assets	Derivative liabilities	Amount of gain/ (loss)
Catastrophe risk*				
Embedded derivatives	US\$	6,527,500	(860,000)	7,328,000

* Catastrophe risk is the risk of an occurrence of a Covered Event resulting in a reduction of the principal amount of the Notes outstanding. As the embedded derivatives have been bifurcated from their host contracts (being the principal amount of the Notes outstanding), the valuation of the embedded derivatives contain an element of both catastrophe risk and credit risk relating to the Company's ability to repay the Notes. Management have determined that it is impracticable to separate the credit risk from the catastrophe risk and furthermore are of the opinion that it will not influence the users of these financial statements.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

5. Derivative financial instruments (continued)

Impact of derivatives on the balance sheets and statements of income and retained earnings (continued)

The following table presents net gain and loss amounts included in the statements of income and retained earnings (as identified above) categorised by the nature of the transaction, for the year ended December 31, 2011 and the period from October 22, 2009 (date of incorporation) to December 31, 2010.

	2011	2010
Net gain/(loss) on embedded derivative financial instruments:		
Net movement in unrealised gain/(loss)	7,328,000	(1,660,500)
	US\$ 7,328,000	(1,660,500)

6. Notes payable

On November 30, 2009 the Company issued US\$100,000,000 Class A Notes and US\$75,000,000 Class B Notes, which are due on December 7, 2012. On December 22, 2010 the Company issued US\$70,000,000 Class C Notes, US\$80,000,000 Class D Notes and US\$60,000,000 Class E Notes, which are due on January 8, 2014.

The Company's obligation to pay the original principal amount of the Notes will be reduced by an amount equal to the amount of any payment by the Company to the Ceding Reinsurer or any amount owed to the Ceding Reinsurer under the Reinsurance Agreement subsequent to the occurrence of a Covered Event and loss calculation of the Ceding Reinsurer based on the amount calculated by the Calculation Agent. As described in notes 1 and 2(e), circumstances may arise whereby the Ceding Reinsurer is required to reimburse the Company for funds previously received in excess of the Ceding Reinsurer's specific incurred losses. Noteholders will not have any recourse to these excess funds.

Interest on the Series 2009-1 Notes is payable quarterly in arrears, commencing March 8, 2010 at a rate of three-month LIBOR plus 9.75% per annum for the Class A Notes and three-month LIBOR plus 13.25% per annum for the Class B Notes. Interest on the Series 2010-1 Notes is payable quarterly in arrears, commencing March 7, 2011 at a rate of three-month LIBOR plus 11.90% per annum for the Class C Notes, three-month LIBOR plus 16.40% per annum for the Class D Notes, and three-month LIBOR plus 9.50% per annum for the Class E Notes.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

6. Notes payable (continued)

On March 25, 2011, the Company received an Event Notice from the Ceding Reinsurer which has been issued in reference to the Reinsurance Agreement, applicable to the Class E notes dated as of December 22, 2010, between the Ceding Reinsurer and the Company. Pursuant to section 3(a)(i) of the Calculation Agent Agreement, the Ceding Reinsurer instructed the Calculation Agent to determine whether or not the Japanese Earthquake on or about March 11, 2011 constitutes a covered event with respect to the Class E notes and to provide the Event Index Value, the Event Calculation Amount, the Class E Aggregate Payment Amount, the Loss Payment Amount, the Period Loss Payment Amount, the amount of any Principal Reduction and the resulting Outstanding Principal Amount for the Class E notes.

On May 31, 2011 the Calculation Agent reported via an Event Report that a Covered Event has occurred for the Class E Notes. In addition, the Event Report confirmed an Event Index Value equal to US\$322,245,205, Event Calculation Amount equal to US\$100,000,000, Class E Aggregate Payment Amount equal to US\$Nil, Loss Payment Amount equal to US\$Nil, Period Loss Payment equal to US\$Nil, Principal Reduction equal to US\$Nil and the resulting Outstanding Principal Amount for the Class E Notes equal to US\$60,000,000.

As indicated in note 1, the Notes are secured pursuant to an Indenture Agreement.

Under the respective Deed of Charge, the Issuer will, for each Class of Series 2009-1 Notes, charge and/or assign by way of security to the Indenture Trustee for the benefit of the Repurchase Counterparty, the Ceding Reinsurer and the Holders of such Class of Notes (the "Beneficiaries") as security for the payment of amounts to the Repurchase Counterparty under the related Repurchase Agreement, the payment of amounts to the Ceding Reinsurer under the related Reinsurance Agreement and the payment of the principal amount of, and interest on, such Class of Notes (the "Payment Obligations"), all the Issuer's right, title, interest and benefit in, to and under: (i) the respective Reinsurance Agreement, including the right to receive all payments due and payable from the Ceding Reinsurer thereunder; (ii) the respective Repurchase Agreement; and (iii) the Collateral Account relating to such Class of Notes and all proceeds therein. In addition to the Class Collateral, (i) under the Indenture, the Issuer will assign and pledge to the Indenture Trustee for the benefit of Series 2009-1 Noteholders all of the Issuer's right, benefit and interest, in, to and under: (A) with respect to the Program, the Administration Agreement and the PCS License Agreement; and (B) with respect to the Series 2009-1 Notes, the Calculation Agent Agreement and the Escrow Agreement and (ii) under the respective Deed of Charge, the Issuer will charge and/or assign by way of security for the Indenture Trustee for the benefit of Holders of a Class of Series 2009-1 Notes all of the Issuer's right, title, interest and benefit in, to and under the respective Collateral Payment Account ("Additional Collateral" and together with Class Collateral, "Collateral"). The Indenture Trustee shall act on behalf of the Issuer with respect to exercising the Issuer's rights under (i) above only at the direction of the applicable Noteholders. There is expressly excluded from the Collateral for each Class of Series 2009-1 Notes any interest of the Issuer in (i) the respective Expense Account, (ii) amounts representing the Issuer's ordinary share capital, (iii) the amount of \$1,500 paid on each Issuance Date and (iv) and any Income on Repurchase Assets.

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
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6. Notes payable (continued)

Under each Deed of Charge, the Issuer will charge and/or assign by way of security to the Indenture Trustee for the benefit of the Indenture Trustee and Paying Agent, the Repurchase Counterparty, the Ceding Reinsurer and the Holders of the respective Class within the Series 2010-1 Notes (the Beneficiaries”), as security for the payment of amounts to (i) the Indenture Trustee and Paying Agent in connection with such Class under the Indenture, (ii) the Repurchase Counterparty under the related Repurchase Agreement, (iii) the payment of amounts to the Ceding Reinsurer under the related Reinsurance Agreement and (iv) the payment of the principal amount of, and interest on, such Class of Notes (the “Payment Obligations”), all the Issuer’s right, title, interest and benefit in, to and under: (x) the respective Reinsurance Agreement, including the right to receive all payments due and payable from the Ceding Reinsurer thereunder; (y) the respective Repurchase Agreement; and (z) the Collateral Account relating to such Class of Notes and all proceeds therein (collectively (x)-(z), “Class Collateral”); provided that (A) the charge and/or assignment of the property referred to in clause (x) above shall be for the exclusive benefit of the Holders of such Class of Notes and (B) the charge and/or assignment of the property referred to in clause (y) above shall for the exclusive benefit of the Ceding Reinsurer and the Holders of such Class of Notes. In addition to the Class Collateral, (i) under the Indenture, the Issuer will assign and pledge to the Indenture Trustee for the benefit of Series 2010-1 Noteholders all of the Issuer’s right, benefit and interest, in, to and under: (A) with respect to the Program, the Administration Agreement; and (B) with respect to the Series 2010-1 Notes, the Calculation Agent Agreement and the Escrow Agreement and (ii) under the respective Deed of Charge, the Issuer will charge and/or assign by way of security for the Indenture Trustee for the benefit of Holders of such Class of Notes all of the Issuer’s right, title, interest and benefit in, to and under the respective Collateral Payment Account (“Additional Collateral” and together with Class Collateral, “Collateral”). The Indenture Trustee will act on behalf of the Issuer with respect to exercising the Issuer’s rights under clause (i) above only at the direction of the applicable Noteholders. There is expressly excluded from the Collateral for each Class within the Series 2010-1 Notes any interest of the Issuer in (i) the Expense Accounts, (ii) amounts representing the Issuer’s ordinary share capital, (iii) the amount of \$1,500 paid on each Issuance Date, (iv) any Income on Repurchase Assets and (v) the Excess Accounts.

Notwithstanding the foregoing, neither the Indenture Trustee nor any Noteholder will have the right to enforce or otherwise realise upon the Indenture Trustee’s security interest in the rights of the Company with respect to the Collateral until all of the Company’s obligations under the respective Reinsurance Agreement (including, without limitation, its potential liability for claims to be paid thereunder) have been satisfied or terminated in accordance with the terms thereof. Accordingly the Noteholders, respectively, bear the risk of losses sustained by the Company.

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Notes to Financial Statements (continued)

December 31, 2011 and 2010
(stated in United States dollars)

7. Share capital

		2011	2010
Authorised:			
5,000 shares of par value US\$1 each	US\$	5,000	5,000
Alloted, called up and fully paid:			
5,000 shares	US\$	5,000	5,000

The allotted share capital is held by HSBC Bank (Cayman) Limited (“HSBC”) as Trustee under the terms of the Declaration of Trust between HSBC and the Company.

8. Investment income

		2011	2010
Interest income	US\$	1,339,126	656,739

Interest is earned on the collateralised loans via the triparty repurchase agreements at a rate of 3 month LIBOR for the Class A and B notes and 3 month LIBOR plus 0.05% for the Class C, D and E notes.

9. Administration expenses

	Note	2011	2010
Calculation agent fees		205,000	97,397
PCS Licence fees		156,216	169,912
Trustee fees		116,500	47,616
Management fees	10	76,500	81,164
Rating Agency fees		40,000	3,288
Professional fees		32,025	34,657
Government fees		12,966	12,966
Miscellaneous expenses		32,731	17,825
	US\$	671,938	464,825

MONTANA RE LTD.

Notes to Financial Statements (continued)

December 31, 2011 and 2010
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10. Balances and transactions with related parties

Prior to June 1, 2011 the following balances and transactions are a result of management and administration services provided by an entity that was related to the Company via ownership of the Company's ordinary shares and common directors. Subsequent to the dates the following balances and transactions are a result of management and administration services provided by an entity related to the Company by virtue of common directorships:

	2011	2010
Balance sheets		
Accounts payable and accrued expenses for management fees	5,000	5,411
Statements of income retained earnings		
Initial offering costs	0	55,000
Management fees	US\$ 76,500	81,164

11. Financial instruments

Credit risk

Credit risk is the risk of counterparty default. Financial assets which potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, interest receivable, collateralised loan, and reinsurance premiums receivable under the Reinsurance Agreements. Credit risk is limited due to the Company's cash and interest receivable, which are US\$ denominated, being with a high credit quality financial institution. The Company manages any exposure to credit risk on its collateralised loan from the Repurchase Counterparties by dealing only with counterparties with good ratings and via the over-collateralisation terms and conditions within the triparty repurchase agreements. The Company manages any exposure to credit risk on its reinsurance premiums receivable from the Ceding Reinsurer by dealing only with insurers with good ratings.

12. Subsequent events

In preparing these financial statements, the Company has evaluated and disclosed all material subsequent events up to June 19, 2012, which is the date that the financial statements were available to be issued.
