



A FAIRFAX Company

Annual Report 2011

reinsurance

specialty insurance

diverse platform

strong capitalization

global

local markets

solutions



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Odyssey Re Holdings Corp. is a leading worldwide underwriter of reinsurance and specialty insurance, with **total assets of \$10.6 billion and \$3.3 billion in shareholders' equity** as of December 31, 2011.

Odyssey Re Holdings Corp., headquartered in Stamford, Connecticut, operates globally under the banner OdysseyRe. Supported by \$3.0 billion of statutory policyholders' surplus, we **underwrite a wide range of property and casualty reinsurance and insurance products through our subsidiaries:** Odyssey Reinsurance Company, Odyssey Reinsurance Company Escritório de Representação no Brasil Ltda., Hudson Insurance Company, Hudson Specialty Insurance Company, Newline Underwriting Management Limited, OdysseyRe's managing agent at Lloyd's, Newline Asia Services Pte. Ltd., Newline Australia Insurance Pty Ltd and Newline Insurance Company Limited.

OdysseyRe is rated "A" (Excellent) by A.M. Best Company and "A-" (Strong) by Standard & Poor's.

Odyssey Re Holdings Corp. is a wholly-owned subsidiary of **Fairfax Financial Holdings Limited.** Fairfax is a financial services holding company, publicly traded on the Toronto Stock Exchange, under the symbol FFH, with total assets of \$33.4 billion and \$8.4 billion in shareholders' equity.

At a Glance

OdysseyRe conducts its business through four operating Divisions: Americas, EuroAsia, London Market and US Insurance. Each Division is managed by talented underwriters and staffed by skilled pricing actuaries, auditors, claims professionals and catastrophe modelers, all with the technical resources to assess and underwrite risk. We offer a broad range of products customized by experts with the capacity to listen, understand the need and design the appropriate solution for our business partners. Our diverse platform and strong capitalization provide a stable market to our business partners across all lines of business.

Odyssey Reinsurance Company	Newline Syndicate 1218 Newline Insurance Company Limited	Hudson Insurance Company Hudson Specialty Insurance Company
<p>Operates from offices in Stamford, New York City, Miami, Mexico City, Montreal, São Paulo, Toronto, London, Paris, Stockholm and Singapore, with a representative office in Tokyo</p>	<p>Operates primarily in London, from both Lloyd's and the LUC, an office in Manchester, with wholly-owned managing agents based in Singapore and Melbourne, Australia</p>	<p>Headquartered in New York City, with nine other principal offices throughout the US</p>
Product Offering	Product Offering	Product Offering
<p>Property Treaty (Assumed & Retro)</p> <p>Casualty Treaty</p> <p>Surety & Trade Credit</p> <p>Marine & Energy</p> <p>Aviation & Space</p> <p>Casualty Facultative (US only)</p> <p>Property Facultative (Latin America only)</p> <p>Agriculture (Latin America only)</p>	<p>International Casualty Insurance, including:</p> <p>Bankers Blanket Bond / Commercial Crime</p> <p>Professional Liability</p> <p>Directors & Officers Liability</p> <p>General Liability / Products Liability / Employers Liability</p> <p>Medical Professional Liability</p> <p>Motor Insurance</p>	<p>Healthcare (Hospitals and Physicians)</p> <p>Professional Liability and Environmental</p> <p>Management Liability (Public, Private and Non-Profit D&O)</p> <p>Crop</p> <p>Specialty Property (DIC California Quake, Commercial Property, Offshore Energy)</p> <p>Specialty Commercial Auto</p> <p>General Liability/Package</p> <p>Personal Umbrella</p> <p>Surety</p>

Financial Highlights

Odyssey Re Holdings Corp.

(dollars in millions)

	2011	2010	2009
Gross premiums written	\$ 2,420.7	\$ 2,167.3	\$ 2,195.0
Net premiums written	2,089.7	1,853.8	1,893.8
Net premiums earned	2,014.7	1,885.7	1,927.4
Net investment income	284.2	327.9	316.3
Net realized investment gains	65.8	170.3	189.1
(Loss) income before income taxes	(87.0)	431.4	494.4
Net (loss) income available to common shareholders	(67.7)	327.1	376.1
Total assets	10,616.5	11,114.6	10,785.1
Shareholders' equity, as reported	3,335.4	3,669.0	3,554.9
Shareholders' equity, pro forma	3,335.4	3,320.5 ^(a)	3,219.3 ^(a)
Return on average common equity	(2.1%)	9.2%	12.1%
Combined ratio	116.8%	98.6%	96.7%

^(a) Excludes Clearwater Insurance Company, which the Company transferred its ownership interest on January 1, 2011

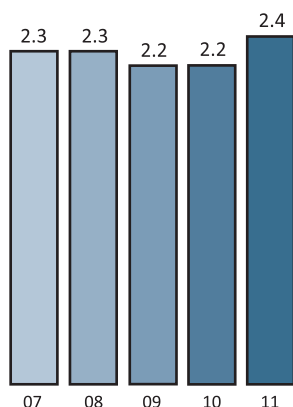
Gross Premiums Written by Division

(dollars in millions)

	2011	2010	2009
Americas	\$ 792.7	\$ 747.4	\$ 745.9
EuroAsia	607.4	538.6	559.2
London Market	360.4	339.0	342.9
US Insurance	660.2	542.3	547.0
Total Gross Premiums Written	\$ 2,420.7	\$ 2,167.3	\$ 2,195.0

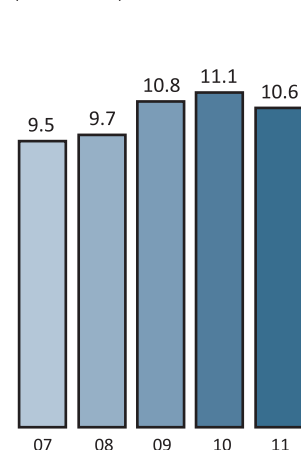
Gross Premiums Written

(\$ in billions)



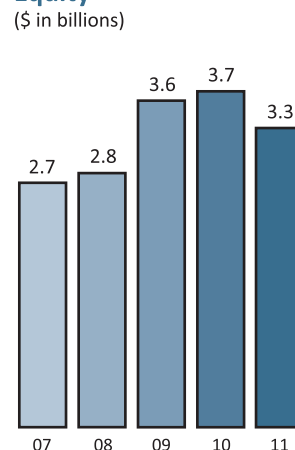
Total Assets

(\$ in billions)



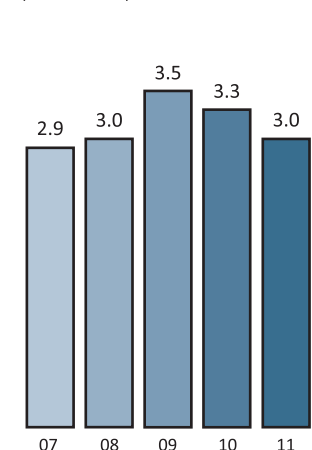
Shareholders' Equity

(\$ in billions)



Statutory Surplus

(\$ in billions)



Dear Friends, Business Partners and Colleagues



It is an honor and a privilege to issue my first Annual Report letter as CEO of OdysseyRe. They say timing is everything... what a year to take charge! If I could use a sporting analogy to characterize our results in 2011, I would say it was a noisy, action-packed contest that ended in a draw. And why is that...

despite a \$735 million net pre-tax cat bill, a combined ratio of 116.8%, (the second worst in our 15-year history) and below-average investment returns, OdysseyRe finished the year with slightly more capital than when we started. While we don't play the game unless we intend to win, and a draw is not an attractive outcome, under the circumstances, we will gladly take it. Fortunately in (re)insurance there are no penalty shootouts or sudden death overtimes. Seriously though, it is a testament to the diversity and resiliency of our business model that we absorbed so much pain and came out the other side with our dignity and our capital strength fully intact.

So why has this been such a challenging year? When it is all said and done, 2011 will go down as one of the most active cat periods on record, with total industry claims from natural peril events approaching \$110 billion. If that weren't enough, our industry continues to suffer from an intense and prolonged soft market that only now is starting to show signs of abating. It's difficult enough to make an underwriting profit in today's pricing environment in a normal cat year, but throw \$110 billion of largely un(der)modeled cat losses into the punch bowl, and that makes for an unpleasant cocktail.

Results notwithstanding, OdysseyRe has an enviable portfolio and position in the market that distinguishes us from our peers. In the pages that follow, we detail our business activity in 2011 by Division. Let me open, however, by providing a brief global overview.

For 2011, OdysseyRe produced a modest net loss of \$68 million after tax. Despite this, our GAAP equity rose roughly \$15 million from \$3.32 billion at year end 2010 to \$3.34 billion at year end 2011 due to unrealized appreciation in our investments.

OdysseyRe is a globally diversified underwriter of property and casualty reinsurance and specialty insurance operating through four divisions: Americas, EuroAsia, London Market and US Insurance. We conduct our reinsurance business through our flagship company Odyssey Reinsurance Company, headquartered in Stamford, Connecticut, where we underwrite a global reinsurance portfolio of \$1.53 billion through a branch and representative network of 12 offices located around the world.

The other side of the house, our specialty insurance business, operates through Hudson Insurance Group in the US and Newline Group internationally. Hudson is headquartered in New York City and operates through a network of ten offices throughout the US. Newline is based in London and transacts its business through a network of four offices. In 2011, the global premium generated by our insurance operations totaled just under \$900 million.

OdysseyRe has a diverse mix of business. We write business in more than 100 countries through 30 business units operating from offices located in 10 countries around the world. Fifteen of those business units are focused in the reinsurance sector, while the remaining fifteen are dedicated to insurance. Having a diversified portfolio is critical to our strategy. It fosters discipline, allowing us to take maximum advantage of market opportunities as they arise with the flexibility to shed underpriced business as conditions warrant.

Gross written premium for the full year totaled \$2.42 billion, an increase of 12% over the prior year, while net earned premiums grew 6.9% to \$2.01 billion. We saw premium growth across our network in every Division, with increases mainly focused in property treaty and in Hudson's US specialty insurance business.

As highlighted in last year's Annual Report, we began to selectively expand our property treaty writings in 2009 and this trend continued in 2011. Total property premium accounted for 46% of gross written premium in 2011, compared to 44% in 2010.

While OdysseyRe's property business continues to expand, our casualty portfolio, and in particular our US casualty reinsurance account, reduced further in 2011 as the margins offered for this business remain under pressure. Casualty writings represented 36% of the whole portfolio in 2011, down from 39% in 2010. It is worth noting that roughly 70% of our total casualty writings consist of insurance business underwritten by Hudson and Newline.

The rest of the portfolio – a mixture of motor, marine, aerospace, surety, trade credit and accident & health – was broadly stable and represents 18% of the portfolio overall.

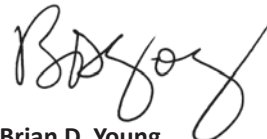
The mix of business between the US and International is split 52% / 48%. However, 61% of the reinsurance portfolio emanates from business outside the US while 74% of the insurance portfolio is written in the US.

As mentioned previously, our combined ratio for the full year ran to 116.8%. Cat losses contributed \$735 million (37 combined ratio points) to the result, significantly more than our pricing contemplated. Most of the catastrophe losses affecting our results emanated from Asia Pacific with events in Japan, Thailand and New Zealand accounting for \$561 million of the \$735 million total bill. The concentration of loss in this region masks an otherwise strong underlying performance across the Company. Over 90% of OdysseyRe's global net earned premium volume for the current year produced a solid combined ratio of 92.9%. Prior period reserves trended favorably for the fourth consecutive year and lowered our calendar year combined ratio by 2.6 loss ratio points overall.

It has been a difficult 12 months but we emerge as strong and committed as ever. Our balance sheet has demonstrated its resiliency and our capital base remains rock solid. OdysseyRe enters 2012 with a renewed risk appetite and a willingness to put our capital to use for the benefit of our clients.

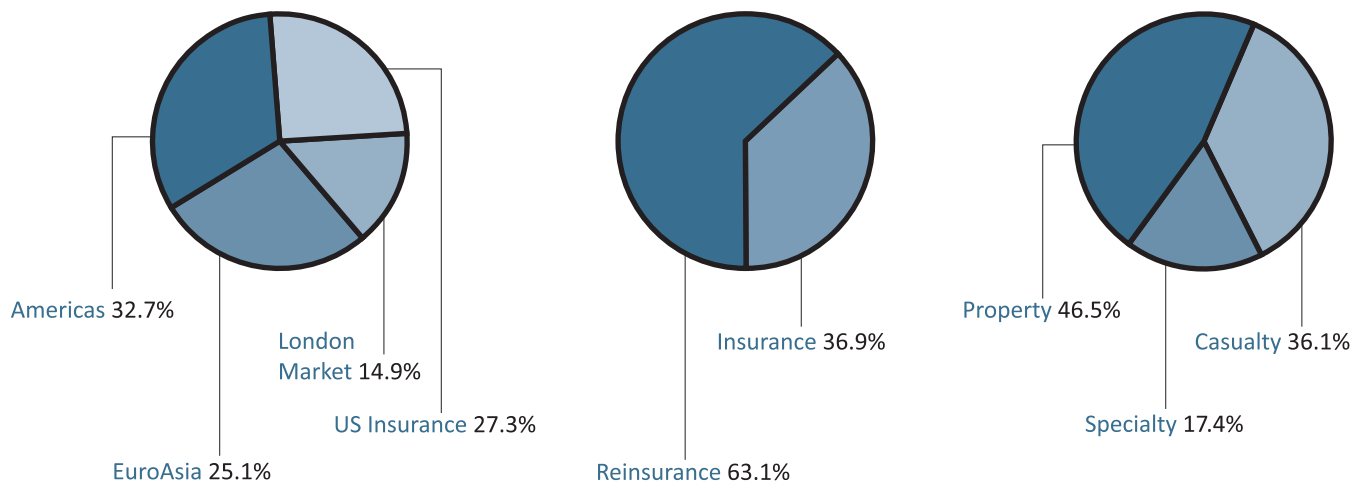
While the financial toll to the (re)insurance industry has been great, the loss to those directly affected by the series of devastating events last year has been profound. We at OdysseyRe wish to extend our heartfelt wishes for the speediest possible recovery for all those unfortunate enough to have been immediately impacted by the earthquakes, tsunami and flooding of the past year.

This letter would not be complete without thanking our parent company, Fairfax Financial Holdings Limited, for its unstinting commitment and support. Moreover, to all of our 750 employees, thank you for your hard work and dedication to making this Company the best it can be. Last, but certainly not least, thanks to all of our business partners whose loyalty, service and business makes our success possible.

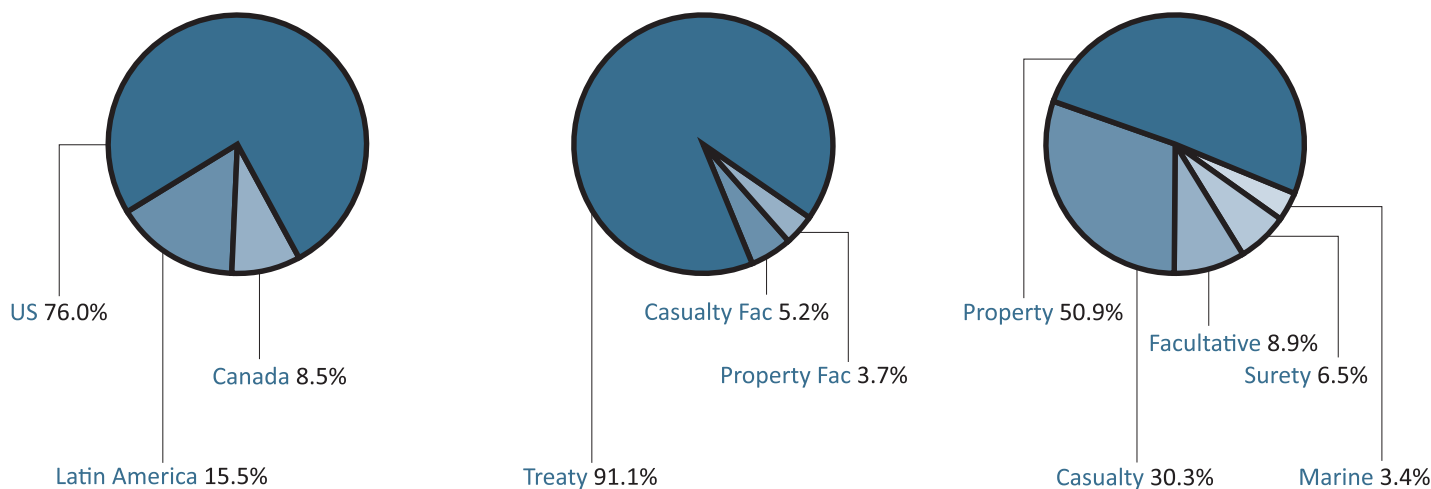


Brian D. Young
President & Chief Executive Officer

2011 Gross Premiums Written \$2.4 billion



Americas Division
2011 Gross Premiums Written \$792.7 million



The Americas Division

The Americas Division, led by Brian Quinn (North America) and Philippe Mallier (Latin America), underwrites reinsurance of property, casualty, surety, marine, aviation and agricultural business. With over 290 employees, we serve our business partners through a network of seven offices in the US, Canada and Latin America. We wrote \$792.7 million of gross premiums in 2011, with premiums totaling \$669.6 million in North America and \$123.1 million in Latin America.

In North America, we underwrite business from Stamford, Toronto and Montreal, with casualty facultative operations based in New York City. Gross premiums written in the US increased 7.3% over 2010 primarily due to growth in property treaty business, partially offset by the continued scaling back of casualty business as a result of unfavorable market conditions. Our Canadian operation increased its portfolio across most lines by 18.5% due to growth in new and existing business, including opportunities emanating from Quebec-based clients sourced through our recently opened Montreal office.

In Latin America, we underwrite treaty business from our Miami office with our facultative operations based in Mexico City. In early 2010, we established a local presence in Brazil by opening a representative office in São Paulo from which we continue to expand our Brazilian portfolio. Gross premiums were stable in

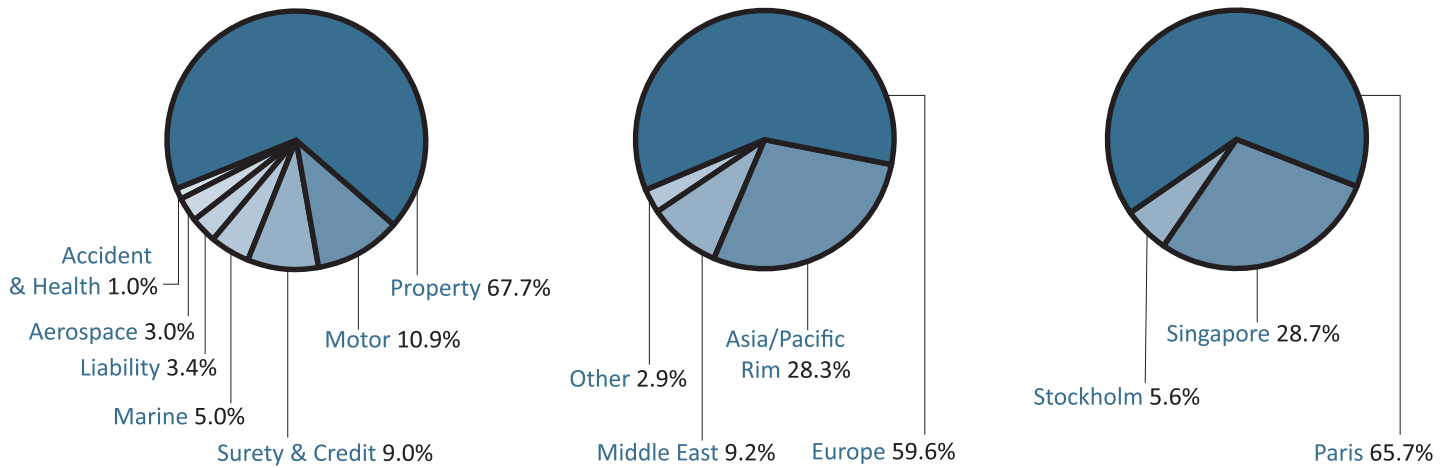
The Division's most valuable asset is its stable, experienced and proven underwriting team.

Latin America in 2011 despite the re-engineering of our portfolio from proportional and lower margin business to non-proportional and higher margin business.

The combined ratio in the Americas for the year was 91.9%, an improvement of 10.3 points compared to 2010. The continued shift in business mix from casualty to property and an increase in favorable prior year loss development were the principal drivers of this improvement.

The Division's most valuable asset is its stable, experienced and proven underwriting team. Our product line expertise, diverse appetite and multiple geographic platforms provide the ability to capitalize on underwriting opportunities throughout the Americas.

EuroAsia Division
2011 Gross Premiums Written \$607.4 million



The EuroAsia Division

The EuroAsia Division is headquartered in Paris, led by Lucien Pietropoli. Our Paris-based underwriting staff is comprised of three territory-focused treaty underwriting teams responsible for writing business within western and central Europe, the Middle East and Africa. We have an office in Stockholm to service the Nordic, Russian and Baltic markets, as well as a branch in Singapore, supported by a representative office in Japan, to underwrite reinsurance business emanating from the Asia-Pacific region.

We wrote \$607.4 million of gross premiums in 2011, an increase of 12.8% from the previous year. In Europe, where capacity and pricing remain stable, our Paris and Stockholm offices wrote \$433.4 million in gross premiums, an increase of 5.1% from the prior year. Premium writings from our Singapore office grew 37.9%, mainly due to expanded property writings in China, reinstatement premiums and higher property catastrophe rates in Japan following the Tōhoku earthquake. The combined ratio of 171.1% was driven higher by losses from an unprecedented string of natural catastrophes in Asia. Catastrophe losses accounted for 96.4 combined ratio points. Until 2011, the Division generated a consistent stream of underwriting profits since its inception. Needless to say, 2011 will go down in insurance history as being one of the costliest years on record for insured catastrophe losses.

The portfolio is well spread and geographically diverse; we write business in 64 countries with France being our largest market, accounting for 22.8% of business written. Though market conditions will continue to be challenging, our talented staff, underwriting discipline, prudent risk management and loyal business partners may help profitability return in the year ahead.

The portfolio is well spread and geographically diverse; we write business in 64 countries.

The London Market Division

The London Market Division, led by Carl Overy, operates through three underwriting platforms from our headquarters at the London Underwriting Centre: Newline Group, comprised of Newline Syndicate 1218 at Lloyd's and Newline Insurance Company Limited; and OdysseyRe's UK branch. The Newline Syndicate also operates service companies from Singapore and Melbourne, providing local market knowledge and expertise. Newline Insurance Company Limited operates a regional office in Manchester, England.

The Division underwrote \$360.4 million of gross premiums, an increase of 6.3% from 2010. The split of business is the same as in prior years, with two-thirds written as insurance by

Newline Group and the balance written as reinsurance by OdysseyRe. The combined ratio was 97.9%, compared to 87.7% for the prior year, with results reflecting 14.5 points of catastrophe losses from the Japan Tōhoku earthquake and the Thailand flooding.

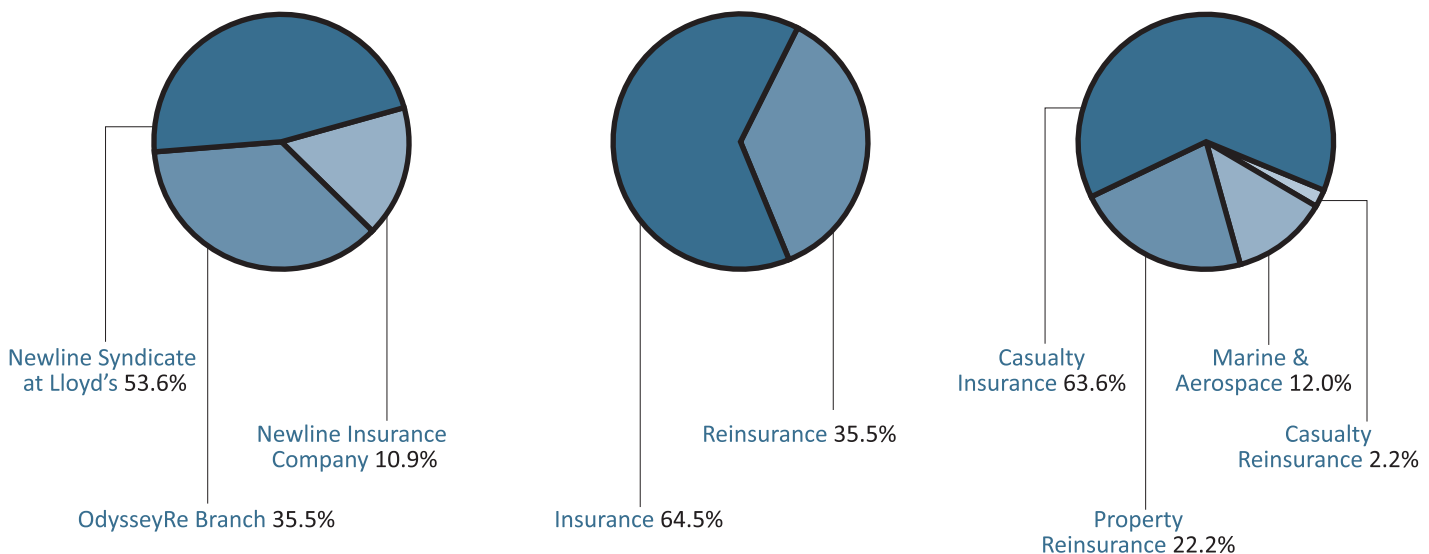
Newline Group operates through six business units offering a range of insurance products to non-US clients located in most regions and territories around the world. Newline's key insurance product lines are public and products liability, employers liability, professional liability, D&O, bankers blanket bond/commercial crime, medical malpractice and UK motor. All of these products are offered through both the Syndicate at Lloyd's and Newline Insurance with the exception of UK motor, which is only underwritten through Newline Insurance.

OdysseyRe's London branch underwrites property, casualty, motor, marine, aerospace and accident & health reinsurance worldwide. The business is predominantly excess of loss and has a catastrophe-oriented focus. All of OdysseyRe's retrocessional underwriting is centralized in London, where we are a lead provider of property catastrophe retro coverage.

The London Market Division continues to produce underwriting profits by managing the business cycle through underwriting discipline.

The London Market Division continues to produce underwriting profits by managing the business cycle through underwriting discipline.

London Market Division 2011 Gross Premiums Written \$360.4 million



The US Insurance Division

The US Insurance Division is run by Chris Gallagher, Chief Executive Officer and Chris Suarez, Chief Underwriting Officer, headquartered in New York City, and operates out of nine additional offices located throughout the US, with over 250 employees. We offer a wide range of property and casualty insurance products underwritten by industry or product specialists on both an individual risk and program basis through nine specialized business units. These units include: healthcare; non-medical professional liability; specialty commercial auto; tribal; general liability/package; financial products; specialty property; surety and crop.

In 2011, we wrote \$660.2 million of gross premiums, an increase of 21.7% over 2010. This was primarily due to premium growth across all lines of business, but most notably in our crop segment. The combined ratio for 2011 was 101.2% compared to 90.3% for the prior year mainly due to the severe drought in Texas causing higher than expected claim activity for the multi-peril crop insurance product.

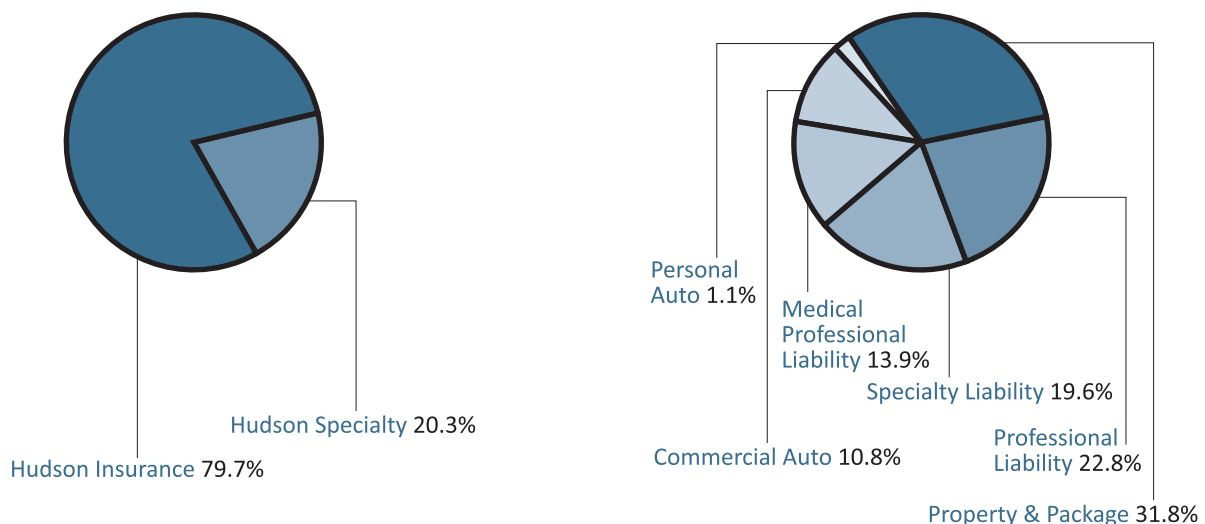
The Division trades under the name of Hudson Insurance Group (Hudson) and writes business in two principal companies: Hudson Insurance Company and Hudson Specialty Insurance Company. Hudson Insurance is licensed as an admitted carrier in all states and Hudson Specialty is approved nationwide

as a non-admitted E&S carrier. Over the last several years, we have broadened our direct underwriting capabilities while at the same time expanding in the market served by program administrators. Changing underwriting opportunities has led to a significant shift in our premium mix, with Hudson representing 27% of OdysseyRe's global gross premiums in 2011 compared to 2% in 2001.

We have broadened our direct underwriting capabilities while at the same time expanding in the market served by program administrators.

On a targeted basis, Hudson continues to invest heavily in technology and new staff to expand our underwriting platforms in-house in those areas where we see an enhanced opportunity and significant growth potential. We remain firmly committed to our prudent expansion efforts.

US Insurance Division 2011 Gross Premiums Written \$660.2 million



Board of Directors

Odyssey Re Holdings Corp.

V. Prem Watsa
*Chairman of the Board
Chairman and Chief Executive Officer,*
Fairfax Financial Holdings Limited,
a financial services holding company

Andrew A. Barnard
*Vice Chairman of the Board
President and Chief Operating Officer,*
Fairfax Insurance Group

James F. Dowd
*Vice Chairman of the Board
President and Chief Executive Officer,*
Fairfax Inc. (Retired)
Independent Business Consultant and
Corporate Director

Brian D. Young
President and Chief Executive Officer,
Odyssey Re Holdings Corp.

Anthony F. Griffiths ⁽¹⁾ ⁽²⁾
*Independent Business Consultant
and Corporate Director*

Alan D. Horn ⁽²⁾
Chairman, Rogers Communications Inc.

Brandon W. Sweitzer ⁽¹⁾ ⁽²⁾
*Senior Fellow of the Chamber
of Commerce of the United States*

⁽¹⁾ Compensation Committee

⁽²⁾ Audit Committee

Officers

Odyssey Re Holdings Corp.

Brian D. Young
*President and
Chief Executive Officer*

Michael G. Wacek
Executive Vice President

Jan Christiansen
*Executive Vice President and
Chief Financial Officer*

Peter H. Lovell
*Senior Vice President,
General Counsel and
Corporate Secretary*

Senior Officers of the Company

Elise M. Ahearn
Bernard Assens
Neil P. Beaton
Robert S. Bennett
Lawrence C. Berger
Lawrence J. Boyle
Thomas C. Bredahl
Mauro Wassilewsky Caetano
Hugo A. Cardona
Alane R. Carey
Jérémie Caujole
Francis D. Cerasoli
Jaime Chaves
Andrew K. Chu
Thierry Clarenc
Mary M. Coca
Richard F. Coerver
Patrice M. Conboy
James A. Crowe
James J. Danbrowney
Dina G. Daskalakis
Christophe Deléris-Fanien
Matthew J. Deneen
Isabelle Dubots-Lafitte
Gerard A. Dugan
Neil D. Duncan
Nicholas P. Esposito
Philip A. Evensen
Paul T. Everett
Roy Fenn
Philip T. Foley
Christopher L. Gallagher
John E. Gavigan
Patrick E. Gentile
Michael P. Gleeson
Joseph A. Guardo
Robert P. Hands
Michael Hanns
Martin S. J. Hawkins
James J. Hooghuis
Sonny Kapur

Robert B. Kastner
Margaret M. Killeen
Kimber J. Lantry
Hervé Leduc
Gaël Le Païh
Eugene R. Lock
Gary P. Maile
Philippe E. Mallier
Olivier Massot
Pär Mattsson
J. Richard F. Micklem
Sean C. Moffat
Lambert Morvan
Carl A. Overy
Kent A. Petersen
Kaz W. Pienkawa
Lucien Pietropoli
Stephen L. Porcelli
Brian D. Quinn
Darryl M. Razzaia
Patricia C. Robinson
André-François Rocque
Andrew W. Rogers
Roger M. Rossiter
Craig D. Rowsell
Jeffrey M. Rubin
James B. Salvesen
Elizabeth A. Sander
Gustavo A. Scheffler
Susan C. Schoenberger
Anthony J. Slowski
Christopher T. Suarez
Emily Tay
Guy Tippet
Tadashi Urata
Stephen J. Van de Graaf
John F. Verbich
Patricia L. Wasoka
J. Ceri Welch
Mark A. Welshons
William F. Wetherall
Jean M. Willig

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2011 Financial Report



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Odyssey Re Holdings Corp.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, comprehensive income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Odyssey Re Holdings Corp. and its subsidiaries at December 31, 2011 and December 31, 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

New York, New York
March 9, 2012

ODYSSEY RE HOLDINGS CORP.
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2011	2010
	(In thousands, except share and per share amounts)	
ASSETS		
Investments and cash:		
Fixed income securities, available for sale, at fair value (amortized cost \$3,005,623 and \$4,595,904, respectively)	\$ 3,514,527	\$ 4,675,782
Fixed income securities, held for trading, at fair value (amortized cost \$805,137 and \$309,454, respectively)	790,111	364,489
Redeemable preferred stock, at fair value (cost \$54 and \$54, respectively)	54	54
Convertible preferred stocks, held for trading, at fair value (cost \$220,543 and \$214,543, respectively).....	219,530	214,144
Equity securities:		
Common stocks, available for sale, at fair value (cost \$720,950 and \$1,093,015, respectively)	694,144	1,463,600
Common stocks, held for trading, at fair value (cost \$197,676)	155,974	-
Common stocks, at equity	135,132	226,551
Short-term investments, held for trading, at fair value (amortized cost \$1,965,497 and \$250,253, respectively).....	1,965,504	250,253
Cash and cash equivalents	390,283	1,058,034
Cash and cash equivalents held as collateral	101,067	31,075
Other invested assets	460,566	620,165
Total investments and cash	8,426,892	8,904,147
Accrued investment income	63,538	78,312
Premiums receivable	557,590	424,893
Reinsurance recoverable on paid losses	80,498	49,528
Reinsurance recoverable on unpaid losses	767,651	952,455
Prepaid reinsurance premiums	120,940	111,280
Funds held by reinsureds	143,540	155,851
Deferred acquisition costs	137,255	119,578
Federal and foreign income taxes receivable	231,524	225,011
Other assets	87,047	93,589
Total assets	\$ 10,616,475	\$ 11,114,644
LIABILITIES		
Unpaid losses and loss adjustment expenses	\$ 5,517,600	\$ 5,809,665
Unearned premiums	739,484	662,787
Reinsurance balances payable	163,083	167,247
Funds held under reinsurance contracts	28,963	42,317
Debt obligations	446,046	487,148
Other liabilities	385,855	276,447
Total liabilities	7,281,031	7,445,611
Commitments and Contingencies (Note 14)		
SHAREHOLDERS' EQUITY		
Non-controlling interest.....	29,299	-
Preferred shares, \$0.01 par value; 1,200,000 shares authorized; 253,599 Series A shares issued and outstanding; 70,000 Series B shares issued and outstanding.....	3	3
Common shares, \$10.00 par value; 60,000 shares authorized; 51,224 and 56,605 shares issued and outstanding, respectively.....	513	567
Additional paid-in capital	417,647	456,049
Accumulated other comprehensive income, net of deferred income taxes	381,270	391,485
Retained earnings	2,506,712	2,820,929
Total shareholders' equity	3,335,444	3,669,033
Total liabilities and shareholders' equity	\$ 10,616,475	\$ 11,114,644

See accompanying notes to consolidated financial statements.

ODYSSEY RE HOLDINGS CORP.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
REVENUES			
Gross premiums written	\$ 2,420,744	\$ 2,167,338	\$ 2,195,035
Ceded premiums written	331,019	313,540	301,222
Net premiums written	2,089,725	1,853,798	1,893,813
(Increase) decrease in net unearned premiums	(75,020)	31,916	33,599
Net premiums earned	2,014,705	1,885,714	1,927,412
Net investment income	284,161	327,875	316,329
Net realized investment gains (losses):			
Net realized investment gains	261,553	190,657	316,101
Other-than-temporary impairment losses	(195,781)	(20,308)	(127,013)
Total net realized investment gains	65,772	170,349	189,088
 Total revenues	 2,364,638	 2,383,938	 2,432,829
EXPENSES			
Losses and loss adjustment expenses	1,812,342	1,317,053	1,301,996
Acquisition costs	350,666	347,120	375,259
Other underwriting expenses	190,866	194,328	185,688
Other expense, net	62,734	63,591	44,416
Interest expense	28,924	30,464	31,040
Loss on early extinguishment of debt.....	6,121	-	-
Total expenses	2,451,653	1,952,556	1,938,399
 (Loss) income before income taxes	 (87,015)	 431,382	 494,430
Federal and foreign income tax (benefit) provision:			
Current	84,941	115,235	153,250
Deferred	(105,993)	(17,128)	(32,156)
Total federal and foreign income tax (benefit) provision	(21,052)	98,107	121,094
 Net (loss) income	 (65,963)	 333,275	 373,336
Preferred dividends.....	(1,786)	(3,966)	(5,233)
Loss on redemption of Series A and Series B preferred shares.....	-	(2,183)	-
Gain on purchase of Series B preferred shares.....	-	5	7,997
 NET (LOSS) INCOME AVAILABLE TO COMMON SHAREHOLDERS	 \$ (67,749)	 \$ 327,131	 \$ 376,100
COMPREHENSIVE INCOME			
Net (loss) income	\$ (65,963)	\$ 333,275	\$ 373,336
Other comprehensive income (loss), net of tax	74,207	(153,984)	463,473
Comprehensive income	\$ 8,244	\$ 179,291	\$ 836,809

See accompanying notes to consolidated financial statements.

ODYSSEY RE HOLDINGS CORP.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Years Ended December 31,		
	2011	2010	2009
	(In thousands, except share amounts)		
NON-CONTROLLING INTEREST			
Balance, beginning of year	\$ -	\$ -	\$ -
Clearwater ownership of preferred shares of subsidiaries.....	29,299	-	-
Balance, end of year	<u>29,299</u>	<u>-</u>	<u>-</u>
PREFERRED SHARES (par value)			
Balance, beginning of year	3	32	39
Series A and Series B preferred shares redemption.....	-	(28)	-
Series B preferred shares purchased	-	(1)	(7)
Balance, end of year	<u>3</u>	<u>3</u>	<u>32</u>
COMMON SHARES (par value)			
Balance, beginning of year	567	567	603
Common shares repurchased and retired	-	-	(18)
Common shares cancelled due to Merger (see Note 1)	-	-	(18)
Common shares capital redemptions - Clearwater transfer.....	(59)	-	-
Common shares capital contributions.....	5	-	-
Balance, end of year	<u>513</u>	<u>567</u>	<u>567</u>
ADDITIONAL PAID-IN CAPITAL			
Balance, beginning of year	456,049	515,066	614,203
Common shares capital redemptions - Clearwater transfer.....	(46,877)	-	-
Capital contribution.....	13,673	20,506	-
Series A and Series B preferred shares redemption.....	-	(68,437)	-
Common shares repurchased and retired	-	-	(73,745)
Series B preferred shares purchased	-	(822)	(17,173)
Net change due to stock option exercises and restricted share awards	(5,198)	(10,264)	(13,105)
Net effect of share-based compensation	-	-	4,701
Common shares issued	-	-	167
Common shares cancelled due to Merger (see Note 1)	-	-	18
Balance, end of year	<u>417,647</u>	<u>456,049</u>	<u>515,066</u>
TREASURY SHARES (at cost)			
Balance, beginning of year	-	-	(795)
Purchases of treasury shares	-	-	(18,001)
Reissuance of treasury shares	-	-	17,606
Cancellation of treasury shares due to Merger (see Note 1)	-	-	1,190
Balance, end of year	<u>-</u>	<u>-</u>	<u>-</u>
ACCUMULATED OTHER COMPREHENSIVE INCOME			
NET OF DEFERRED INCOME TAXES			
Balance, beginning of year	391,485	545,469	81,996
Clearwater transfer - unrealized appreciation of securities.....	(83,705)	-	-
Clearwater - foreign currency translation adjustment.....	(717)	-	-
Unrealized net appreciation (depreciation) on securities, net of reclassification adjustments	63,356	(205,872)	462,483
Foreign currency translation adjustments	16,328	51,415	2,768
Benefit plan liabilities	(5,477)	473	(1,778)
Balance, end of year	<u>381,270</u>	<u>391,485</u>	<u>545,469</u>
RETAINED EARNINGS			
Balance, beginning of year	2,820,929	2,493,798	2,131,051
Clearwater transfer.....	(246,468)	-	-
Net (loss) income	(65,963)	333,275	373,336
Loss on redemption of Series A and Series B preferred shares.....	-	(2,183)	-
Gain on purchase of Series B preferred shares	-	5	7,997
Dividends to preferred shareholders	(1,786)	(3,966)	(5,233)
Dividends to common shareholders	-	-	(13,353)
Balance, end of year	<u>2,506,712</u>	<u>2,820,929</u>	<u>2,493,798</u>
TOTAL SHAREHOLDERS' EQUITY	<u>\$ 3,335,444</u>	<u>\$ 3,669,033</u>	<u>\$ 3,554,932</u>
COMMON SHARES OUTSTANDING			
Balance, beginning of year	56,605	56,604,650	60,242,949
Reverse share split of 1 share per 1,000 shares of common stock.....	-	(56,548,045)	-
Shares cancelled due to Merger (see Note 1)	-	-	(1,847,272)
Repurchased and retired	(5,921)	-	(1,789,100)
Net treasury shares acquired	-	-	(10,927)
Shares issued	540	-	9,000
Balance, end of year	<u>51,224</u>	<u>56,605</u>	<u>56,604,650</u>

See accompanying notes to consolidated financial statements.

ODYSSEY RE HOLDINGS CORP.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2011	2010	2009
	(In thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net (loss) income	\$ (65,963)	\$ 333,275	\$ 373,336
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
(Increase) decrease in premiums receivable and funds held, net	(188,999)	32,325	66,698
Increase (decrease) in unearned premiums and prepaid reinsurance premiums, net	73,067	(16,945)	(33,399)
Increase in unpaid losses and loss adjustment expenses, net	455,297	264,795	43,246
Increase in current and deferred federal and foreign income taxes, net	(59,142)	(85,745)	(234,724)
(Increase) decrease in deferred acquisition costs	(18,793)	6,412	13,612
Change in other assets and liabilities, net	116,106	(103,746)	(55,692)
Net realized investment gains	(65,772)	(170,349)	(189,088)
Loss on early extinguishment of debt.....	6,121	-	-
Bond discount amortization, net	(40,689)	(21,041)	(13,319)
Amortization of compensation plans	5,543	24,649	26,226
Net cash provided by (used in) operating activities	<u>216,776</u>	<u>263,630</u>	<u>(3,104)</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Maturities of fixed income securities, available for sale	11,254	13,983	206,909
Sales of fixed income securities, available for sale	1,799,224	2,061,693	446,906
Purchases of fixed income securities, available for sale	(635,012)	(2,385,615)	(1,134,974)
Sales of equity securities	654,588	1,057,905	597,640
Purchases of equity securities	(56,129)	(231,653)	(623,844)
Net settlements of other invested assets	303,816	(210,846)	29,366
Purchases of other invested assets	(202,250)	(451,019)	(29,828)
Net change in cash and cash equivalents held as collateral	(72,115)	25,645	30,407
Sales of trading securities	1,903,791	814,793	247,669
Purchases of trading securities	(4,451,808)	(757,807)	(622,721)
Net change in short-term investments	-	43,079	1,096,288
Acquisition of subsidiary and net assets of a business, net of cash acquired	-	-	(3,357)
Net cash (used in) provided by investing activities	<u>(744,641)</u>	<u>(19,842)</u>	<u>240,461</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Redemption of Series A and Series B preferred shares.....	-	(70,648)	-
Capital contribution.....	13,679	20,506	-
Purchase of restricted shares.....	(10,806)	(13,168)	-
Dividends paid to preferred shareholders	(1,786)	(5,096)	(5,882)
Debt modification costs.....	-	(2,735)	-
Purchase of Series B preferred shares	-	(816)	(9,183)
Common shares repurchased and retired	-	-	(72,573)
Purchase of treasury shares	-	-	(18,001)
Dividends paid to common shareholders	-	-	(13,353)
Proceeds from exercise of stock options	-	-	851
Excess tax benefit from compensation plans	-	-	3,816
Early extinguishment of debt obligations.....	(47,849)	-	-
Repurchase of common shares through transfer of ownership of subsidiary.....	(80,953)	-	-
Net cash used in financing activities	<u>(127,715)</u>	<u>(71,957)</u>	<u>(114,325)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>(12,171)</u>	<u>(55,241)</u>	<u>62,665</u>
(Decrease) increase in cash and cash equivalents	(667,751)	116,590	185,697
Cash and cash equivalents, beginning of year	1,058,034	941,444	755,747
Cash and cash equivalents, end of year	<u>\$ 390,283</u>	<u>\$ 1,058,034</u>	<u>\$ 941,444</u>
Supplemental disclosures of cash flow information:			
Interest paid	\$ 28,188	\$ 29,527	\$ 30,555
Income taxes paid	\$ 51,299	\$ 179,482	\$ 355,943
Non-cash activity (see Note 1):			
Repurchase of common shares through transfer of ownership of subsidiary.....	\$ (267,574)	\$ -	\$ -

See accompanying notes to consolidated financial statements.

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization

Odyssey Re Holdings Corp., a Delaware corporation (together with its subsidiaries, the “Company” or “OdysseyRe”), is an underwriter of reinsurance, providing a full range of property and casualty products on a worldwide basis, and an underwriter of specialty insurance, primarily in the United States and through the Lloyd’s of London marketplace. Odyssey Re Holdings Corp. owns all of the common shares of Odyssey Reinsurance Company (“ORC”), formerly known as Odyssey America Reinsurance Corporation, its principal operating subsidiary, which is domiciled in the state of Connecticut. ORC directly or indirectly owns all of the common shares of the following subsidiaries: Hudson Insurance Company (“Hudson”); Hudson Specialty Insurance Company (“Hudson Specialty”); Newline Holdings U.K. Limited, Newline Underwriting Management Limited, which manages Newline Syndicate (1218), a member of Lloyd’s of London, Newline Insurance Company Limited (“NICL”), Newline Corporate Name Limited (“NCNL”), which provides capital for and receives the distributed earnings from Newline Syndicate (1218) (collectively, “Newline”); Clearwater Select Insurance Company (“Clearwater Select”); and Napa River Insurance Services, Inc. Fairfax Financial Holdings Limited (“Fairfax”), a publicly traded financial services holding company based in Canada, owns 100.0% of the common shares of OdysseyRe.

On February 18, 2011, the Secretary of State of Connecticut approved the filing by Odyssey America Reinsurance Corporation of an amended and restated certificate of incorporation, reflecting the change in the company’s name to Odyssey Reinsurance Company.

On January 1, 2011, with the approval of the Departments of Insurance of the states of Connecticut and Delaware, the regulatory authorities for ORC and Clearwater Insurance Company (“Clearwater”), respectively, the Company transferred ownership of Clearwater to TIG Insurance Group, Inc. (“TIG”), which is a Fairfax subsidiary and a shareholder of the Company, in exchange for 5,921 common shares of the Company held by TIG. Prior to the transaction, Clearwater distributed to ORC, by means of a dividend, its then ownership interest in the common stock of Hudson and Clearwater Select. ORC then distributed all of the issued and outstanding shares of common stock of Clearwater to the Company, by means of a dividend with a value of \$0.38 billion. The transaction was reflected by the Company as a nonreciprocal transfer between the Company and TIG, whereby the total assets of \$1.12 billion and total liabilities of \$0.77 billion of Clearwater were removed from the consolidated balance sheet of the Company effective January 1, 2011, offset by a reduction in the Company’s shareholders’ equity of \$0.35 billion. There was no gain or loss recognized as a result of the transfer of ownership of Clearwater. The number of common shares re-acquired by the Company from TIG, which were subsequently retired, was based upon the estimated fair values of Clearwater and OdysseyRe as of September 30, 2010, which had not changed appreciably as of December 31, 2010. The balance sheet of Clearwater that was transferred to TIG as of January 1, 2011 included preferred shares of Hudson and Clearwater Select with an aggregate value of \$29.3 million (see Note 19).

On September 18, 2009, Fairfax and OdysseyRe announced that they had entered into an agreement and plan of merger (the “Merger Agreement”) pursuant to which Fairfax would promptly commence a tender offer to acquire all of the outstanding shares of common stock of OdysseyRe that Fairfax and its subsidiaries did not then own, for \$65.00 in cash per share, representing total cash consideration of approximately \$1.1 billion. Pursuant to the Merger Agreement, on September 23, 2009, Fairfax commenced the tender offer (the “Offer”). The Board of Directors of OdysseyRe, following the unanimous recommendation of a special committee comprised solely of independent directors which had been formed to review and consider any Fairfax proposal, recommended that OdysseyRe’s minority stockholders tender their shares to the Offer and vote or consent to approve and adopt the Merger Agreement if it were to be submitted for their approval and adoption.

Pursuant to the Offer, which expired on October 21, 2009 at 12:00 midnight, New York City time, Fairfax acquired a total of approximately 14.3 million shares of common stock of OdysseyRe (the “Tendered Shares”). The Tendered Shares, combined with the shares previously owned by Fairfax and its subsidiaries, represented approximately 97.1% of the 58,451,922 shares of common stock of OdysseyRe then outstanding. Following the purchase of the Tendered Shares, Fairfax caused a short-form merger pursuant to which Fairfax Investments USA Corp., a newly-formed, wholly-owned subsidiary of Fairfax, merged with and into OdysseyRe (the “Merger”).

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Merger was effected on October 28, 2009 pursuant to Section 253 of the General Corporation Law of the State of Delaware (the “DGCL”) by the execution and filing of a Certificate of Ownership and Merger with the Secretary of State of the State of Delaware. As a result of the Merger, all of the remaining shares of OdysseyRe’s common stock held by the remaining minority shareholders of OdysseyRe (the “Remaining Shares”) were cancelled and, subject to appraisal rights under Delaware law, converted into the right to receive \$65.00 per share in cash, without interest, and subject to any applicable withholding of taxes. As a result of the Merger, Fairfax and its subsidiaries became the owner of 100% of the outstanding shares of the Company’s common stock. The Company subsequently withdrew its shares of common stock from listing on the New York Stock Exchange and terminated registration of these shares under the Securities Exchange Act of 1934. All common shares remaining in treasury following the Merger were cancelled.

On May 20, 2010, Fairfax announced that it had completed the acquisition of all of the outstanding shares of Zenith National Insurance Corp.’s (“Zenith”) common stock that it did not currently own. With Fairfax’s completion of the Zenith acquisition, the Company has determined that it is appropriate to change the classification of its 6.3% ownership in Zenith from a common stock at fair value to a common stock at equity. As a result of this change, the Company has retrospectively adjusted its consolidated financial statements to reflect its ownership of Zenith as if the equity method of accounting had been utilized since the date of the original purchase, as required by accounting principles general accepted in the United States of America, (“GAAP”). This change in accounting principle resulted in the following adjustments to the respective captions of the Company’s previously reported 2009 consolidated statement of operations and comprehensive income:

	Previously Reported	Adjustment	As Adjusted
For the Year Ended December 31, 2009:			
Consolidated Statement of Operations and Comprehensive Income:			
Net investment income	\$ 317,894	\$ (1,565)	\$ 316,329
Net realized investment gains	312,964	3,137	316,101
Federal and foreign income tax (benefit) provision - deferred	(32,706)	550	(32,156)
Net income	372,314	1,022	373,336
Net income available to common shareholders	375,078	1,022	376,100

2. Summary of Significant Accounting Policies

(a) *Basis of Presentation.* The accompanying consolidated financial statements have been prepared in accordance with GAAP. The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions have been eliminated.

The preparation of consolidated financial statements in conformity with GAAP requires the Company to make estimates and assumptions, which could differ materially from actual results that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The Company considers its accounting policies that are most dependent on the application of estimates and assumptions, as critical accounting estimates, which are defined as estimates that are both important to the portrayal of the Company’s financial condition and results of operations, and require the Company to exercise significant judgment. These estimates, by necessity, are based on assumptions about numerous factors.

The Company reviews its critical accounting estimates and assumptions on a quarterly basis. These reviews include the estimate of reinsurance premiums and premium related amounts, establishing deferred acquisition costs, goodwill and intangible impairment evaluations, an evaluation of the adequacy of reserves for unpaid losses and loss adjustment expenses, review of its reinsurance and retrocession agreements, estimates related to income taxes, including an analysis of the recoverability of deferred income tax assets and an evaluation of its investment portfolio, including a review for other-than-temporary declines in estimated fair value.

(b) *Investments.* The majority of the Company’s investments in fixed income securities and common stocks are categorized as “available for sale” and are recorded at their estimated fair value based on quoted market prices. Certain investments, including fixed income securities that contain embedded derivatives, are reflected as trading securities (see

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 4). Most investments in common stocks of affiliates are carried at the Company's proportionate share of the equity of those affiliates. Short-term investments, which are classified as "held for trading", which have a maturity of one year or less from the date of purchase, are carried at fair value. The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Investments in limited partnerships and investment funds have been reported in other invested assets. Other invested assets also include trust accounts relating to the Company's benefit plans and derivative securities, all of which are carried at fair value. The Company routinely evaluates the carrying value of its investments in common stocks of affiliates and in partnerships and investment funds. In the case of limited partnerships and investment funds, the carrying value is generally established on the basis of the net valuation criteria as determined by the managers of the investments. Such valuations could differ significantly from the values that would have been available had markets existed for the securities. Investment transactions are recorded on their trade date, with balances pending settlement reflected in the consolidated balance sheets as a component of other assets or other liabilities.

Investment income, which is reported net of applicable investment expenses, is recorded as earned. Realized investment gains or losses are determined on the basis of average cost. The Company records, in investment income, its proportionate share of income or loss, including realized gains or losses, for those securities for which the equity method of accounting is utilized, which include most common stocks of affiliates, limited partnerships and investment funds. Due to the timing of when financial information is reported by equity investees and received by the Company, including limited partnerships and investment funds, results attributable to these investments are generally reported by the Company on a one month or one quarter lag. Unrealized appreciation and depreciation related to trading securities is recorded as realized investment gains or losses in the consolidated statements of operations.

The net amount of unrealized appreciation or depreciation on the Company's available for sale investments, net of applicable deferred income taxes, is reflected in shareholders' equity in accumulated other comprehensive income. A decline in the fair value of an available for sale investment below its cost or amortized cost that is deemed other-than-temporary is recorded as a realized investment loss in the consolidated statements of operations, resulting in a new cost or amortized cost basis for the investment. Other-than-temporary declines in the carrying values of investments recorded in accordance with the equity method of accounting are recorded in net investment income in the consolidated statements of operations.

(c) *Premium Revenue Recognition.* Reinsurance assumed premiums written and related costs are based upon reports received from ceding companies. Where reinsurance assumed premiums written have not been reported by the ceding company, they are estimated, at the individual contract level, based on historical patterns and experience from the ceding company and judgments of the Company. Subsequent adjustments to premiums written, based on actual results or revised estimates from the ceding company, are recorded in the period in which they become known. Reinsurance assumed premiums written related to proportional treaty business are established on a basis that is consistent with the coverage periods under the terms of the underlying insurance contracts. Reinsurance assumed premiums written related to excess of loss and facultative reinsurance business are recorded over the coverage term of the contracts, which is generally one year. Unearned premium reserves are established for the portion of reinsurance assumed premiums written to be recognized over the remaining contract period. Unearned premium reserves related to proportional treaty contracts are computed based on reports received from ceding companies, which show premiums written but not yet earned. Premium adjustments made over the life of the contract are recognized as earned premiums based on the applicable contract period to which they apply. Insurance premiums are earned on a pro rata basis over the policy period, which is generally one year. A reserve for uncollectible premiums is established when deemed necessary.

The cost of reinsurance purchased by the Company (reinsurance premiums ceded) is reported as prepaid reinsurance premiums and amortized over the contract period in proportion to the amount of insurance protection provided. The ultimate amount of premiums, including adjustments, is recognized as premiums ceded, and amortized over the applicable contract period to which they apply. Reserves are established for the unexpired portion of premiums ceded and recorded as an asset in prepaid reinsurance premiums. Premiums earned are reported net of reinsurance ceded premiums earned in the consolidated statements of operations. Amounts paid by the Company for retroactive reinsurance that meets the conditions for reinsurance accounting are reported as reinsurance receivables to the extent those amounts do not exceed the associated liabilities. If the liabilities exceed the amounts paid, reinsurance receivables are increased to reflect the difference, and the

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

resulting gain is deferred and amortized over the estimated settlement period. If the amounts paid for retroactive reinsurance exceed the liabilities, the Company will increase the related liabilities or reduce the reinsurance receivable, or both, at the time the reinsurance contract is effective, and the excess is charged to net income. Changes in the estimated amount of liabilities relating to the underlying reinsured contracts are recognized in net income in the period of the change.

Assumed and ceded reinstatement premiums represent additional premiums related to reinsurance coverages, principally catastrophe excess of loss contracts, which are paid when the incurred loss limits have been utilized under the reinsurance contract and such limits are reinstated. Premiums written and earned premiums related to a loss event are estimated and accrued as earned. The accrual is adjusted based upon any change to the ultimate losses incurred under the contract.

(d) *Deferred Acquisition Costs.* Acquisition costs, which are reported net of acquisition costs ceded, consist of commissions and brokerage expenses incurred on insurance and reinsurance business written, and are deferred and amortized over the period in which the related premiums are earned, which is generally one year. Commission adjustments are accrued based on changes in premiums and losses recorded by the Company in the period in which they become known. Deferred acquisition costs are limited to their estimated realizable value based on the related unearned premium, which considers anticipated losses and loss adjustment expenses and estimated remaining costs of servicing the business, all based on historical experience. The realizable value of the Company's deferred acquisition costs is determined without consideration of investment income.

(e) *Goodwill and Intangible Assets.* The Company accounts for goodwill and intangible assets as permitted or required by GAAP. A purchase price paid that is in excess of net assets arising from a business combination is recorded as an asset ("goodwill") and is not amortized. Intangible assets with a finite life are amortized over the estimated useful life of the asset. Intangible assets with an indefinite useful life are not amortized. Goodwill and intangible assets are analyzed for impairment on an annual basis or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. If the goodwill or intangible asset is impaired, it is written down to its realizable value with a corresponding expense reflected in the consolidated statements of operations. The Company has determined that its goodwill and intangible assets are not impaired as of December 31, 2011 and 2010.

The following table reflects the carrying amount of goodwill, intangible assets with an indefinite life and intangible assets with a finite life as of December 31, 2011 and 2010 (in thousands):

	Intangible Assets			
	Goodwill	Indefinite	Finite	Total
		Life	Life	
Balance, January 1, 2010.....	\$ 36,734	\$ 5,813	\$ 8,498	\$ 51,045
Amortization during 2010	-	-	(2,047)	(2,047)
Balance, December 31, 2010	36,734	5,813	6,451	48,998
Amortization during 2011.....	-	-	(1,858)	(1,858)
Balance, December 31, 2011.....	<u>\$ 36,734</u>	<u>\$ 5,813</u>	<u>\$ 4,593</u>	<u>\$ 47,140</u>

The Company amortized \$2.6 million for the year ended December 31, 2009, related to its intangible assets with a finite life. The Company did not incur any impairment of its goodwill or intangible assets during 2011, 2010 or 2009.

The following table provides the estimated amortization expense related to intangible assets for the succeeding five years (in thousands):

	Years Ended December 31,				
	2012	2013	2014	2015	2016
Amortization of intangible assets	\$ 1,698	\$ 1,312	\$ 459	\$ 343	\$ 298

(f) *Unpaid losses and loss adjustment expenses.* The reserves for losses and loss adjustment expenses are estimates of amounts needed to pay reported and unreported claims and related loss adjustment expenses. The estimates are based on

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

assumptions related to the ultimate cost to settle such claims. The inherent uncertainties of estimating reserves are greater for reinsurers than for primary insurers, due to the diversity of development patterns among different types of reinsurance contracts and the necessary reliance on ceding companies for information regarding reported claims. As a result, there can be no assurance that the ultimate liability will not exceed amounts reserved, with a resulting adverse effect on the Company.

The reserve for unpaid losses and loss adjustment expenses is based on the Company's evaluations of reported claims and individual case estimates received from ceding companies for reinsurance business or the estimates advised by the Company's claims adjusters for insurance business. The Company utilizes generally accepted actuarial methodologies to determine reserves for losses and loss adjustment expenses on the basis of historical experience and other estimates. The reserves are reviewed continually during the year and changes in estimates in losses and loss adjustment expenses are reflected as an expense in the consolidated statements of operations in the period the adjustment is made. Reinsurance recoverables on unpaid losses and loss adjustment expenses are reported as assets. A reserve for uncollectible reinsurance recoverables is established based on an evaluation of each reinsurer or retrocessionaire and historical experience. The Company uses tabular reserving for workers' compensation indemnity loss reserves, which are considered to be fixed and determinable, and discounts such reserves using an interest rate of 3.5%. Workers' compensation indemnity loss reserves have been discounted using the Life Table for Total Population: United States, 2004.

(g) *Deposit Assets and Liabilities.* The Company may enter into assumed and ceded reinsurance contracts that contain certain loss limiting provisions and, as a result, do not meet the risk transfer provisions of GAAP accounting standards. These contracts are accounted for using the deposit accounting method in accordance with GAAP. Under the deposit method of accounting, revenues and expenses from reinsurance contracts are not recognized as written premium and incurred losses. Instead, the profits or losses from these contracts are recognized net, as other income or expense over the contract or contractual settlement periods. In accordance with this accounting standard, these contracts are deemed as either transferring only significant timing risk or only significant underwriting risk or transferring neither significant timing, nor underwriting risk.

For such contracts, the Company initially records the amount of consideration paid as a deposit asset or received as a deposit liability. Revenue or expense is recognized over the term of the contract, with any deferred amount recorded as a component of assets or liabilities until such time it is earned. The ultimate asset or liability under these contracts is estimated, and the asset or liability initially established, which represents consideration received, is increased or decreased over the term of the contract. The change during the period is recorded in the Company's consolidated statements of operations, with increases and decreases in the ultimate asset or liability shown in other expense, net. As of December 31, 2011 and 2010, the Company had reflected in other assets \$8.1 million and \$7.9 million, respectively, and in other liabilities \$1.9 million and \$1.8 million, respectively, related to deposit contracts. In cases where cedants retain the consideration on a funds held basis, the Company records those assets in other assets, and records the related investment income on the assets in the Company's consolidated statements of operations as investment income.

(h) *Income Taxes.* The Company records deferred income taxes to provide for the net tax effect of temporary differences between the carrying values of assets and liabilities in the Company's consolidated financial statements and their tax bases. Such differences relate principally to deferred acquisition costs, unearned premiums, unpaid losses and loss adjustment expenses, investments and tax credits. Deferred tax assets are reduced by a valuation allowance when the Company believes it is more likely than not that all or a portion of deferred taxes will not be realized. As of December 31, 2011 and 2010, a valuation allowance was not required.

During the third quarter of 2006, Fairfax reduced its ownership of the Company to below 80%, and as a result, the Company was deconsolidated from the United States tax group of Fairfax. Accordingly, the Company filed separate company tax returns for the period August 2, 2006 to October 20, 2009. As a result of the Merger, effective October 21, 2009, the Company rejoined the United States tax group of Fairfax. The Merger had no effect on the Company's tax position (see Note 13). The Company has elected to recognize accrued interest and penalties associated with uncertain tax positions as part of the income tax provision. As of December 31, 2011 and 2010, the Company has not recorded any interest or penalties.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(i) *Derivatives.* The Company utilizes derivative instruments to manage against potential adverse changes in the value of its assets and liabilities. Derivatives include credit default swaps, call options and warrants, total return swaps, interest rate swaps, forward currency contracts, CPI-linked derivative contracts and other equity and credit derivatives. In addition, the Company holds options on certain securities within its fixed income portfolio, which allows the Company to extend the maturity date on fixed income securities or convert fixed income securities to equity securities. The Company categorizes these investments as trading securities, and changes in fair value are recorded as realized investment gains or losses in the consolidated statements of operations. All derivative instruments are recognized as either assets or liabilities on the consolidated balance sheet and are measured at their fair value. Gains or losses from changes in the derivative values are reported based on how the derivative is used and whether it qualifies for hedge accounting. As the Company's derivative instruments do not qualify for hedge accounting, changes in fair value are included in realized investment gains and losses in the consolidated statements of operations. Margin balances required by counterparties in support of derivative positions are included in fixed income securities, available for sale.

(j) *Operating Segments.* The Company has four operating segments that reflect the manner in which management monitors and evaluates the Company's financial performance. The Company's four segments are as follows: Americas, EuroAsia, London Market and U.S. Insurance (see Note 12).

(k) *Foreign Currency.* Foreign currency transaction gains or losses resulting from a change in exchange rates between the currency, in which a transaction is denominated, or the original currency, and the functional currency are reflected in the consolidated statements of operations in the period in which they occur. The Company translates the financial statements of its foreign subsidiaries and branches that have functional currencies other than the U.S. dollar, into U.S. dollars by translating balance sheet accounts at the balance sheet date exchange rate and income statement accounts at the average exchange rate for the year. Translation gains or losses are recorded, net of deferred income taxes, as a component of accumulated other comprehensive income. As of January 1, 2011, certain branch investment units changed their reporting functional currencies from United States dollars to Canadian dollars, British pounds and the Euro.

The following table presents the foreign exchange effect, net of tax, on certain line items in the Company's financial statements for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Statement of operations:			
Net investment income (loss).....	\$ 1,022	\$ (442)	\$ 1,771
Net realized investment (losses) gains	(2,868)	(78,877)	7,449
Other expense, net	<u>(47,737)</u>	<u>(30,208)</u>	<u>(4,233)</u>
(Loss) income before income taxes	(49,583)	(109,527)	4,987
Total federal and foreign income tax (benefit) provision	<u>(17,357)</u>	<u>(38,334)</u>	<u>1,745</u>
Net (loss) income	(32,226)	(71,193)	3,242
Other comprehensive income, net of tax	<u>16,328</u>	<u>51,415</u>	<u>2,768</u>
Total effect on comprehensive income and shareholders' equity	<u>\$ (15,898)</u>	<u>\$ (19,778)</u>	<u>\$ 6,010</u>

(l) *Stock-Based Compensation Plans.* The Company accounts for awards to employees in the common stock of Fairfax, and, prior to the Merger, for awards in its own common shares to employees, in accordance with Accounting Standards Codification ("ASC") 718, "Share-Based Payment." Following the Merger, the Company established the Restricted Share and Equity Value Plan (the "Plan"). Under the terms of the Plan, each restricted equity value right ("REVRs") will have a value (the "REVR Value") equal to the total shareholders' equity of the Company attributable to the common equity as of the last day of the most recently completed quarter of the Company for which Fairfax has publicly released its earnings report, or in the event that Fairfax does not intend to publicly release an earnings report, for which financial statements that report the Company's book value are available, as adjusted for dividends, capital contributions or other extraordinary events (in each case, as determined by the Board of Directors of the Company or the Compensation Committee thereof, in its sole discretion), divided by 58,443,149 (which was the number of Company common shares outstanding as of September 30, 2009). Upon vesting of a REVR, participants receive a single sum cash payment equal to

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the REVR Value as of the applicable vesting date, less any applicable withholding of taxes. The Company accounts for the Plan as a liability plan in accordance with ASC 718.

(m) *Payments.* Payments of claims by the Company, as reinsurer, to a broker on behalf of a reinsured company are recorded on the Company's books as a paid loss at the time the cash is disbursed. The payment is treated as a paid claim to the reinsured. Premiums due to the Company from the reinsured are recorded as receivables from the reinsured until the cash is received by the Company, either directly from the reinsured or from the broker.

(n) *Funds Held Balances.* Funds held under reinsurance contracts is an account used to record a liability, in accordance with the contractual terms, arising from the Company's receipt of a deposit from a reinsurer or the withholding of a portion of the premiums due, as a guarantee that a reinsurer will meet its loss and other obligations. Interest generally accrues on withheld funds in accordance with contract terms. Funds held by reinsured is an account used to record an asset resulting from the ceding company, in accordance with the contractual terms, withholding a portion of the premium due the Company as a guarantee that the Company will meet its loss and other obligations.

(o) *Fixed Assets.* Fixed assets, with a net book value of \$17.7 million and \$14.1 million as of December 31, 2011 and 2010, respectively, are included in other assets. Property and equipment are recorded at cost. Depreciation and amortization are generally computed on a straight-line basis over the following estimated useful lives:

Leasehold improvements	10 years or term of lease, if shorter
Electronic data processing equipment and furniture	5 years
Personal computers and software	3 years

Depreciation and amortization expense for the years ended December 31, 2011, 2010 and 2009 was \$5.4 million, \$4.6 million and \$4.6 million, respectively.

(p) *Contingent Liabilities.* Amounts are accrued for the resolution of claims that have either been asserted or are deemed probable of assertion if, in the opinion of the Company, it is both probable that a liability has been incurred and the amount of the liability can be reasonably estimated. In many cases, it is not possible to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until years after the contingency arises, in which case, no accrual is made until that time. For the years ended December 31, 2011 and 2010, no contingent liabilities have been recorded (see Note 14).

3. Recent Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") is the organization whose primary responsibility is to develop GAAP. In October 2010, the FASB issued Accounting Standards Update No. 2010-26, "Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts" ("Update No. 2010-26"), which provides clarification for the definition of capitalizable deferred acquisition costs, to the codified pronouncements constituting GAAP. Update No. 2010-26 is required to be adopted by the Company effective January 1, 2012. As the Company's existing policy with respect to the deferral of acquisition costs is consistent with the clarified guidance, there is no expected impact to the Company's financial statements from the adoption of Update No. 2010-26.

4. Fair Value Measurements

The Company accounts for a significant portion of its financial instruments at fair value as permitted or required by GAAP.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Fair Value Hierarchy

The assets and liabilities recorded at fair value in the consolidated balance sheets are measured and classified in a three level hierarchy for disclosure purposes based on the observability of inputs available in the marketplace used to measure fair values. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. Gains and losses for assets and liabilities categorized within the Level 3 table below, therefore, may include changes in fair value that are attributable to both observable inputs (Levels 1 and 2) and unobservable inputs (Level 3). Financial assets and liabilities recorded in the consolidated balance sheets are categorized based on the inputs to the valuation techniques as follows:

Level 1: Level 1 financial instruments are financial assets and liabilities for which the values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Company has the ability to access. Market price data generally is obtained from exchange markets. The Company does not adjust the quoted price for such instruments. The majority of the Company's Level 1 investments are common stocks that are actively traded in a public market and short-term investments and cash equivalents, for which the cost basis approximates fair value.

Level 2: Level 2 financial instruments are financial assets and liabilities for which the values are based on quoted prices in markets that are not active, or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

- a) Quoted prices for similar assets or liabilities in active markets;
- b) Quoted prices for identical or similar assets or liabilities in non-active markets;
- c) Pricing models, the inputs for which are observable for substantially the full term of the asset or liability; and
- d) Pricing models, the inputs for which are derived principally from, or corroborated by, observable market data through correlation or other means, for substantially the full term of the asset or liability.

Assets and liabilities measured at fair value on a recurring basis and classified as Level 2 include government, corporate and municipal fixed income securities, which are priced using publicly traded over-the-counter prices and broker-dealer quotes. Observable inputs such as benchmark yields, reported trades, broker-dealer quotes, issuer spreads and bids are available for these investments. For determining the fair value of credit default swaps, which are classified as Level 2, the Company utilizes broker-dealer quotes that include observable credit spreads. For determining the fair value of warrants, which are also classified as Level 2, the Company utilizes broker-dealer quotes. Also included in Level 2 are inactively traded convertible corporate debentures that are valued using a pricing model that includes observable inputs such as credit spreads and discount rates in the calculation.

Level 3: Level 3 financial instruments are financial assets and liabilities for which the values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These measurements include circumstances in which there is little, if any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Therefore, these inputs reflect the Company's own assumptions about the methodology and valuation techniques that a market participant would use in pricing the asset or liability.

During the year ended December 31, 2011, no securities were transferred into or out of Level 3. During the fourth quarter ended December 31, 2010, the Company transferred \$165.0 million of Level 2 investments to Level 3 after determining that the inflation volatility input used in the valuation of its CPI-linked derivative contracts had ceased to be observable as these contracts were out-of-the money and their average term to maturity no longer corresponded with the term of more actively traded 10-year contracts.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company uses valuation techniques to establish the fair value of Level 3 investments. During the years ended December 31, 2011 and 2010, the Company purchased \$126.0 million and \$238.5 million, respectively, of investments that are classified as Level 3. As of December 31, 2011 and 2010, respectively, the Company held \$208.2 million and \$423.8 million of investments that are classified as Level 3. These Level 3 investments include an unsecured loan to Fairfax Inc., a subsidiary of Fairfax, which is reflected in other invested assets on the consolidated balance sheets and valued based on the callable value of the loan. Level 3 investments also include certain limited partnerships, also classified as other invested assets on the consolidated balance sheets based on the net asset values received from the general partners. Generally, these limited partnerships invest in securities that trade in active markets and as a result, their net asset values reflect their fair values. The Company classifies such investments as Level 3 within the fair value hierarchy when the Company is required to provide the general partner with more than three months notice prior to liquidation or redemption of the partnership interest. Level 3 investments also include CPI-linked derivative contracts and preferred stock.

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities. Reclassifications impacting Level 3 of the fair value hierarchy are generally reported as transfers in or out of the Level 3 category as of the beginning of the period in which the reclassifications occur. The Company has determined, after carefully considering the impact of recent economic conditions and liquidity in the credit markets on the Company's portfolio, that it should not re-classify any of its investments from Level 1 or Level 2 to Level 3 in 2011. There were no transfers of securities between Level 1 and Level 2 in 2011 or 2010.

The Company is responsible for determining the fair value of its investment portfolio by utilizing market driven fair value measurements obtained from active markets where available, by considering other observable and unobservable inputs and by employing valuation techniques that make use of current market data. For the majority of the Company's investment portfolio, the Company uses quoted prices and other information from independent pricing sources to determine fair values.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables present the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 and 2010 (in thousands):

	Asset / Liability Measured at Fair Value December 31, 2011	Fair Value Measurements as of December 31, 2011		
		Quoted Prices in Active Markets for Identical Assets / Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fixed income securities, available for sale:				
United States government, government agencies and authorities	\$ 468,811	\$ -	\$ 468,811	\$ -
States, municipalities and political subdivisions	2,491,914	-	2,491,914	-
Foreign governments	352,165	-	352,165	-
Corporate	201,637	25,252	176,385	-
Total fixed income securities, available for sale	3,514,527	25,252	3,489,275	-
Fixed income securities, held as trading securities:				
United States government, government agencies and authorities	65,652	-	65,652	-
States, municipalities and political subdivisions	203,275	-	203,275	-
Foreign governments	344,774	-	344,774	-
Corporate	176,410	-	176,410	-
Total fixed income securities, held as trading securities	790,111	-	790,111	-
Redeemable preferred stock, available for sale	54	-	54	-
Convertible preferred stocks, held as trading securities	219,530	-	213,530	6,000
Common stocks, available for sale	694,144	680,516	13,628	-
Common stocks, held for trading	155,974	155,974	-	-
Short-term investments, held as trading securities	1,965,504	1,961,419	4,085	-
Cash equivalents	156,041	129,571	26,470	-
Derivatives	132,024	-	45,062	86,962
Other investments	143,266	-	28,033	115,233
Total assets measured at fair value	\$ 7,771,175	\$ 2,952,732	\$ 4,610,248	\$ 208,195
Derivative liabilities	\$ 81,855	\$ -	\$ 81,855	\$ -

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

	Asset / Liability Measured at Fair Value December 31, 2010	Fair Value Measurements as of December 31, 2010		
		Quoted Prices in Active Markets for Identical Assets / Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fixed income securities, available for sale:				
United States government, government agencies and authorities	\$ 917,645	\$ -	\$ 917,645	\$ -
States, municipalities and political subdivisions	2,784,337	-	2,784,337	-
Foreign governments	725,852	-	725,852	-
Corporate	247,948	-	247,948	-
Total fixed income securities, available for sale	4,675,782	-	4,675,782	-
Fixed income securities, held as trading securities:				
Foreign governments	110,173	-	110,173	-
Corporate	254,316	-	254,316	-
Total fixed income securities, held as trading securities	364,489	-	364,489	-
Redeemable preferred stock, available for sale	54	-	54	-
Convertible preferred stocks, held as trading securities	214,144	-	214,144	-
Common stocks, available for sale	1,463,600	1,438,361	25,239	-
Short-term investments, held as trading securities	250,253	247,200	3,053	-
Cash equivalents	804,934	804,934	-	-
Derivatives	185,397	-	18,358	167,039
Other investments	268,696	-	11,980	256,716
Total assets measured at fair value	\$ 8,227,349	\$ 2,490,495	\$ 5,313,099	\$ 423,755
Derivative liabilities	\$ 99,846	\$ -	\$ 99,846	\$ -

The following table provides a summary of changes in the fair value of Level 3 financial assets for the years ended December 31, 2011 and 2010 (in thousands):

	Fixed Income Securities	Other Invested Assets	Equity Securities
Balance, January 1, 2010.....	\$ 14,246	\$ 33,298	\$ -
Total realized investment gains (losses) included in net income	16,532	(4,631)	-
Purchases	8,408	230,072	-
Settlements	(39,186)	-	-
Transfers from Level 2 to Level 3	-	165,016	-
Balance, December 31, 2010.....	-	423,755	-
Total realized investment losses included in net income	-	(124,658)	-
Purchases	-	119,969	6,000
Settlements	-	(216,871)	-
Balance, December 31, 2011.....	\$ -	\$ 202,195	\$ 6,000

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables present realized investment (losses) gains included in net income related to Level 3 assets for the years ended December 31, 2011 and 2010 (in thousands):

	Year Ended December 31,		
	2011	2010	2010
	Other Invested Assets	Other Invested Assets	Fixed Income Securities
Realized investment (losses) gains related to securities sold	\$ (21,442)	\$ -	\$ 16,532
Realized investment losses related to securities held	(103,216)	(4,631)	-
Total net realized investment (losses) gains relating to Level 3 assets.....	<u>\$ (124,658)</u>	<u>\$ (4,631)</u>	<u>\$ 16,532</u>

Fair Value Option

The fair value option (“FVO”) available under GAAP allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities. Changes in the fair value of assets and liabilities for which the election is made will be recognized in net income as they occur. The FVO election is permitted on an instrument-by-instrument basis at initial recognition of an asset or liability or upon the occurrence of an event that gives rise to a new basis of accounting for that instrument.

The Company elected the FVO for its investment in Advent Capital (Holdings) PLC (“Advent”). Fairfax and its subsidiaries own 100.0% of Advent’s common stock, of which the Company holds 18.3%. To determine the fair value of Advent, the Company evaluates observable price-to-book multiples of peer companies and applies such to Advent’s most recently available book value per share. As of December 31, 2011, Advent is recorded at fair value of \$29.6 million in other invested assets, with related changes in fair value recognized as a realized investment gain or loss in the period in which they occur. The change in Advent’s fair value resulted in the recognition of a realized investment gain of \$2.7 million for the year ended December 31, 2011, a realized investment loss of \$6.0 million for the year ended December 31, 2010 and a realized investment gain of \$6.2 million for the year ended December 31, 2009. Advent’s value as of December 31, 2011, calculated in accordance with the equity method of accounting, would have been \$34.4 million.

On June 7 and November 1, 2011, respectively, the Company purchased Class G and Class A common shares of HWIC Asia Fund (“HWIC Asia”). At the time of purchase the Company elected the FVO for these investments. HWIC Asia is a multi-class investment company which provides a Net Asset Value (“NAV”) on a monthly basis. HWIC Asia is 100.0% owned by Fairfax, of which the Company owns 7.0%. As of December 31, 2011, the HWIC Asia Class G and Class A common shares are recorded at fair value of \$9.6 million and \$6.9 million, respectively, in other invested assets. The change in the fair value of the HWIC Asia Class G and Class A common shares resulted in the recognition of realized investment losses of \$0.6 million and \$3.1 million, respectively, for the year ended December 31, 2011.

As of December 31, 2011, the Company has not elected the FVO for any of its liabilities.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

5. Investments and Cash

A summary of the Company's available for sale investment portfolio as of December 31, 2011 and 2010, is as follows (in thousands):

<u>2011</u>	<u>Cost or Amortized Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Fair Value</u>
Fixed income securities, available for sale:				
United States government, government agencies and authorities	\$ 358,656	\$ 110,155	\$ -	\$ 468,811
States, municipalities and political subdivisions	2,155,608	336,306	-	2,491,914
Foreign governments	308,229	43,938	2	352,165
Corporate	183,130	18,508	1	201,637
Total fixed income securities, available for sale	3,005,623	508,907	3	3,514,527
Redeemable preferred stock, at fair value	54	-	-	54
Common stocks, at fair value	720,950	94,346	121,152	694,144
Total	<u>\$ 3,726,627</u>	<u>\$ 603,253</u>	<u>\$ 121,155</u>	<u>\$ 4,208,725</u>
<u>2010</u>	<u>Cost or Amortized Cost</u>	<u>Gross Unrealized Appreciation</u>	<u>Gross Unrealized Depreciation</u>	<u>Fair Value</u>
Fixed income securities, available for sale:				
United States government, government agencies and authorities	\$ 958,733	\$ 13,150	\$ 54,236	\$ 917,647
States, municipalities and political subdivisions	2,668,208	155,500	39,374	2,784,334
Foreign governments	739,467	17,921	31,536	725,852
Corporate	229,496	28,144	9,691	247,949
Total fixed income securities, available for sale	4,595,904	214,715	134,837	4,675,782
Redeemable preferred stock, at fair value	54	-	-	54
Common stocks, at fair value	1,093,015	374,984	4,399	1,463,600
Total	<u>\$ 5,688,973</u>	<u>\$ 589,699</u>	<u>\$ 139,236</u>	<u>\$ 6,139,436</u>

Common stocks accounted for under the equity method of accounting were carried at \$135.1 million and \$226.6 million as of December 31, 2011 and 2010, respectively. Common stocks at equity had gross unrealized appreciation of \$0.7 million and \$40.9 million as of December 31, 2011 and 2010, respectively. Common stocks at equity had gross unrealized depreciation of \$5.8 million as of December 31, 2011. Other invested assets were carried at \$460.6 million and \$620.2 million as of December 31, 2011 and 2010, respectively, reflecting no gross unrealized appreciation or depreciation.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A summary of the Company's held for trading portfolio as of December 31, 2011 and 2010 is as follows (in thousands):

	<u>2011</u> <u>Fair Value</u>	<u>2010</u> <u>Fair Value</u>
Fixed income securities, held for trading:		
United States government, government agencies and authorities	\$ 65,652	\$ -
States, municipalities and political subdivisions	203,275	-
Foreign governments	344,774	110,173
All other corporate	176,410	254,316
Total fixed income securities, held for trading.....	<u>790,111</u>	<u>364,489</u>
Convertible preferred stock, at fair value.....	219,530	214,144
Common stocks, at fair value.....	155,974	-
Short-term investments.....	1,965,504	250,253
Cash and cash equivalents	390,283	1,058,034
Cash collateral for borrowed securities	101,067	31,075
Total	<u>\$ 3,622,469</u>	<u>\$ 1,917,995</u>

(a) Fixed Income Maturity Schedule

The amortized cost and fair value of fixed income securities as of December 31, 2011, by contractual maturity, are shown below (in thousands).

	At December 31, 2011					
	Available for Sale			Held for Trading		
	Cost or Amortized Cost	Fair Value	% of Total Fair Value	Cost or Amortized Cost	Fair Value	% of Total Fair Value
Due in one year or less	\$ 62,698	\$ 63,123	1.8 %	\$ 66,592	\$ 65,964	8.3 %
Due after one year through five years	100,210	105,474	3.0	171,867	151,573	19.2
Due after five years through ten years	77,025	88,520	2.5	176,030	173,917	22.0
Due after ten years	2,765,690	3,257,410	92.7	390,648	398,657	50.5
Total fixed income securities	<u>\$ 3,005,623</u>	<u>\$ 3,514,527</u>	<u>100.0 %</u>	<u>\$ 805,137</u>	<u>\$ 790,111</u>	<u>100.0 %</u>

Actual maturities may differ from the contractual maturities shown in the table above due to the existence of call or put options. In the case of securities containing call options, the actual maturity will be the same as the contractual maturity if the issuer elects not to exercise its call option. Total securities subject to a call option represent approximately 47.6% of the total fair value. In the case of securities containing put options, the actual maturity will be the same as the contractual maturity if the Company elects not to exercise its put option. Total securities containing the put option represent approximately 2.0% of the total fair value.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(b) Net Investment Income and Realized Investment Gains (Losses)

The following table sets forth the components of net investment income for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Interest on fixed income securities	\$ 289,364	\$ 291,189	\$ 253,100
Dividends on preferred stocks	16,641	6,976	-
Dividends on common stocks, at fair value	20,255	31,884	50,387
Net income of common stocks, at equity	4,988	13,823	9,804
Interest on cash and short-term investments	4,655	7,914	8,818
Other invested assets	<u>30,644</u>	<u>35,310</u>	<u>22,688</u>
Gross investment income	366,547	387,096	344,797
Less: investment expenses	79,432	56,026	24,817
Less: interest on funds held under reinsurance contracts	2,954	3,195	3,651
Net investment income	<u>\$ 284,161</u>	<u>\$ 327,875</u>	<u>\$ 316,329</u>

The following table summarizes the Company's net realized investment gains for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Available for sale.....	\$ 207,184	\$ 379,983	\$ 99,117
Held for trading.....	(141,412)	(209,634)	89,971
Total net realized investment gains.....	<u>\$ 65,772</u>	<u>\$ 170,349</u>	<u>\$ 189,088</u>

The following table sets forth the components of net realized investment gains and losses on the Company's available for sale securities for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Fixed income securities:			
Realized investment gains.....	\$ 203,270	\$ 254,876	\$ 114,973
Realized investment losses	205,238	108,291	26,253
Net realized investment (losses) gains	<u>(1,968)</u>	<u>146,585</u>	<u>88,720</u>
Preferred stock:			
Realized investment gains	-	1,548	-
Realized investment losses	-	-	394
Net realized investment gains (losses)	<u>-</u>	<u>1,548</u>	<u>(394)</u>
Equity securities:			
Realized investment gains	225,228	258,039	140,053
Realized investment losses	16,076	26,189	129,262
Net realized investment gains.....	<u>209,152</u>	<u>231,850</u>	<u>10,791</u>
Total available for sale realized investment gains:			
Realized investment gains	428,498	514,463	255,026
Realized investment losses	221,314	134,480	155,909
Net realized investment gains	<u>\$ 207,184</u>	<u>\$ 379,983</u>	<u>\$ 99,117</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The net realized investment gains or losses on disposal in the table below represent the total gains or losses from the purchase dates of the investments and have been reported in net realized investment gains in the consolidated statements of operations. The change in fair value presented below consists of two components: (i) the reversal of the gain or loss recognized in previous years on securities sold and (ii) the change in fair value resulting from mark-to-market adjustments on contracts still outstanding. The following table sets forth the total net realized investment gains and losses on held for trading securities for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Fixed income securities:			
Net realized investment gains (losses) on disposal.....	\$ 37,809	\$ (25,164)	\$ 35,185
Change in fair value.....	(122,895)	124,571	94,731
Net realized investment (losses) gains	<u>(85,086)</u>	<u>99,407</u>	<u>129,916</u>
Preferred stock:			
Change in fair value.....	(614)	(7,869)	7,470
Net realized investment (losses) gains	<u>(614)</u>	<u>(7,869)</u>	<u>7,470</u>
Equity securities:			
Net realized investment gains on disposal.....	3,025	-	-
Change in fair value.....	(41,702)	-	-
Net realized investment losses.....	<u>(38,677)</u>	<u>-</u>	<u>-</u>
Derivative securities:			
Net realized investment gains (losses) on disposal.....	46,136	(251,764)	5,286
Change in fair value.....	(53,157)	(28,245)	(123,914)
Net realized investment losses.....	<u>(7,021)</u>	<u>(280,009)</u>	<u>(118,628)</u>
Other securities:			
Net realized investment (losses) gains on disposal.....	(174)	(12,106)	67,782
Change in fair value.....	(9,840)	(9,057)	3,431
Net realized investment (losses) gains.....	<u>(10,014)</u>	<u>(21,163)</u>	<u>71,213</u>
Total held for trading realized investment gains:			
Net realized investment gains (losses) on disposal	86,796	(289,034)	108,253
Change in fair value.....	(228,208)	79,400	(18,282)
Net realized investment (losses) gains.....	<u>\$ (141,412)</u>	<u>\$ (209,634)</u>	<u>\$ 89,971</u>

Included in net realized investment gains for the years ended December 31, 2011, 2010 and 2009 are \$195.8 million, \$20.3 million and \$127.0 million, respectively, related to realized investment losses on the other-than-temporary impairment of investments, as follows (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Fixed income securities	\$ 188,780	\$ 2,911	\$ 3,361
Preferred stock	-	-	216
Equity securities	7,001	17,397	123,436
Total other-than-temporary impairments	<u>\$ 195,781</u>	<u>\$ 20,308</u>	<u>\$ 127,013</u>

For those fixed income securities that were determined to be other-than-temporarily impaired, the Company determined that such impairments were related to credit, requiring the recognition of an impairment charge to income, and

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not related to other factors (e.g., interest rates and market conditions), which would have required charges to other comprehensive income.

(c) Unrealized Appreciation (Depreciation)

The following table sets forth the changes in unrealized net appreciation (depreciation) of investments, and the related tax effect, reflected in accumulated other comprehensive income for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Fixed income securities	\$ 468,311	\$ (322,946)	\$ 237,773
Redeemable preferred stock	-	-	395
Equity securities	(370,586)	(12,211)	473,336
Short-term investments	-	-	6
Other invested assets	(7)	-	-
Increase (decrease) in unrealized net appreciation (depreciation) of investments	97,718	(335,157)	711,510
Deferred income tax (expense) benefit.....	(34,362)	129,285	(249,027)
Change in net unrealized appreciation (depreciation) of investments included in other comprehensive income.....	<u>\$ 63,356</u>	<u>\$ (205,872)</u>	<u>\$ 462,483</u>

The Company reviews, on a quarterly basis, its investment portfolio for declines in value, and specifically considers securities with fair values that have declined to less than 80% of their cost or amortized cost at the time of review. Declines in the fair value of investments which are determined to be temporary are recorded as unrealized depreciation, net of tax, in accumulated other comprehensive income. If the Company determines that a decline relating to credit issues is “other-than-temporary,” the cost or amortized cost of the investment will be written down to the fair value, and a realized loss will be recorded in the Company’s consolidated statements of operations. If the Company determines that a decline related to other factors (e.g., interest rates or market conditions) is “other-than-temporary,” the cost or amortized cost of the investment will be written down to the fair value within other comprehensive income.

In assessing the value of the Company’s debt and equity securities held as investments, and possible impairments of such securities, the Company reviews (i) the issuer’s current financial position and disclosures related thereto, (ii) general and specific market and industry developments, (iii) the timely payment by the issuer of its principal, interest and other obligations, (iv) the outlook and expected financial performance of the issuer, (v) current and historical valuation parameters for the issuer and similar companies, (vi) relevant forecasts, analyses and recommendations by research analysts, rating agencies and investment advisors, and (vii) other information the Company may consider relevant. Generally, a change in the market or interest rate environment would not, of itself, result in an impairment of an investment. In addition, the Company considers its ability and intent to hold the security to recovery when evaluating possible impairments.

The facts and circumstances involved in making a decision regarding an other-than-temporary impairment are those that exist at that time. Should the facts and circumstances change such that an other-than-temporary impairment is considered appropriate, the Company will recognize the impairment by reducing the cost, amortized cost or carrying value of the investment to its fair value, and recording the loss in its consolidated statements of operations. Upon the disposition of a security where an other-than-temporary impairment has been taken, the Company will record a gain or loss based on the adjusted cost or carrying value of the investment.

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The following tables reflect the fair value and gross unrealized depreciation of the Company's fixed income securities, and common stocks, at fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized depreciation position, as of December 31, 2011 and 2010 (in thousands):

	Duration of Unrealized Loss								
	Less than 12 Months			Greater than 12 Months			Total		
	Fair Value	Gross Unrealized Depreciation	Number of Securities	Fair Value	Gross Unrealized Depreciation	Number of Securities	Fair Value	Gross Unrealized Depreciation	Number of Securities
December 31, 2011									
Fixed income securities									
non-investment grade,									
Foreign governments.....	\$ 5,923	\$ (1)	1	\$ 13,144	\$ (1)	1	\$ 19,067	\$ (2)	2
Corporate.....	5,753	(1)	1	-	-	-	5,753	(1)	1
Total fixed income securities.....	11,676	(2)	2	13,144	(1)	1	24,820	(3)	3
Common stocks, at fair value....	261,884	(121,152)	9	-	-	-	261,884	(121,152)	9
Total temporarily impaired securities.....	<u>\$ 273,560</u>	<u>\$ (121,154)</u>	<u>11</u>	<u>\$ 13,144</u>	<u>\$ (1)</u>	<u>1</u>	<u>\$ 286,704</u>	<u>\$ (121,155)</u>	<u>12</u>

	Duration of Unrealized Loss								
	Less than 12 Months			Greater than 12 Months			Total		
	Fair Value	Gross Unrealized Depreciation	Number of Securities	Fair Value	Gross Unrealized Depreciation	Number of Securities	Fair Value	Gross Unrealized Depreciation	Number of Securities
December 31, 2010									
Fixed income securities									
investment grade:									
United States government, government agencies and authorities.....	\$ 535,462	\$ (52,667)	8	\$ 9,271	\$ (1,569)	1	\$ 544,733	\$ (54,236)	9
States, municipalities and political subdivisions.....	562,147	(37,188)	31	17,526	(2,185)	1	579,673	(39,373)	32
Foreign governments.....	259,392	(10,133)	7	-	-	-	259,392	(10,133)	7
Total investment grade.....	<u>1,357,001</u>	<u>(99,988)</u>	<u>46</u>	<u>26,797</u>	<u>(3,754)</u>	<u>2</u>	<u>1,383,798</u>	<u>(103,742)</u>	<u>48</u>
non-investment grade,									
Foreign governments.....	204,380	(21,403)	5	-	-	-	204,380	(21,403)	5
Corporate.....	3	(4)	2	24,089	(9,688)	1	24,092	(9,692)	3
Total non-investment grade....	<u>204,383</u>	<u>(21,407)</u>	<u>7</u>	<u>24,089</u>	<u>(9,688)</u>	<u>1</u>	<u>228,472</u>	<u>(31,095)</u>	<u>8</u>
Total fixed income securities.....	1,561,384	(121,395)	53	50,886	(13,442)	3	1,612,270	(134,837)	56
Common stocks, at fair value.....	245,372	(3,983)	4	6,561	(416)	2	251,933	(4,399)	6
Total temporarily impaired securities.....	<u>\$ 1,806,756</u>	<u>\$ (125,378)</u>	<u>57</u>	<u>\$ 57,447</u>	<u>\$ (13,858)</u>	<u>5</u>	<u>\$ 1,864,203</u>	<u>\$ (139,236)</u>	<u>62</u>

The Company believes the gross unrealized depreciation is temporary in nature and we have not recorded a realized investment loss related to these securities. Given the size of our investment portfolio and capital position, the Company believes it is likely that it will not be required to sell or liquidate these securities before the fair value recovers the gross unrealized depreciation.

(d) Common Stocks, at Equity

Common stocks, at equity, totaled \$135.1 million as of December 31, 2011 and \$226.6 million as of December 31, 2010. The following table sets forth the components of common stocks, at equity, as of December 31, 2011 and 2010 (in thousands):

	2011	2010
Fairfax Asia Limited	\$ 86,878	\$ 100,347
TRG Holdings Corporation	-	74,336
Zenith National Insurance Corp.	48,227	51,841
Other	27	27
Total common stocks, at equity	<u>\$ 135,132</u>	<u>\$ 226,551</u>

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On January 1, 2011, TRG Holdings Corporation was transferred to TIG Insurance Group, Inc. as part of the Clearwater transfer. For common stocks, at equity, as of December 31, 2011, the relative ownership held by the Company was 17.4% (economic) for Fairfax Asia Limited (which is 100% owned by Fairfax) and 6.2% (economic) for Zenith (which is 100% owned by Fairfax).

(e) Other Invested Assets

Other invested assets totaled \$460.6 million as of December 31, 2011, compared to \$620.2 million as of December 31, 2010. The following table shows the components of other invested assets as of December 31, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Hedge funds, at equity	\$ 160,394	\$ 132,625
Private equity partnerships, at equity	18,151	26,717
Private equity partnerships, at fair value	81,097	29,803
Derivatives, at fair value	132,025	185,397
Benefit plan funds, at fair value	11,515	11,980
Advent Capital (Holdings) PLC	29,610	26,913
HWIC Asia Fund Class A.....	6,886	-
HWIC Asia Fund Class G.....	9,632	-
Unsecured loan with Fairfax	4,526	200,000
O.R.E Holdings Limited	6,730	6,730
Total other invested assets	<u>\$ 460,566</u>	<u>\$ 620,165</u>

The Company's hedge fund and private equity partnership investments may be subject to restrictions on redemptions or sales, which are determined by the governing documents thereof, and limit the Company's ability to liquidate these investments in the short term. Due to a time lag in reporting by a majority of hedge fund and private equity fund managers, valuations for these investments are reported by OdysseyRe on a one month or one quarter lag. For the years ended December 31, 2011, 2010 and 2009, the Company recognized net investment income of \$3.3 million, \$14.5 million and \$17.9 million, respectively, from its hedge funds and private equity investments. For the years ended December 31, 2011, 2010 and 2009, the Company recognized net realized investment losses of \$3.8 million, \$0.6 million and \$0.3 million, respectively, from its private equity investments that are held as trading securities. With respect to the Company's \$99.2 million in investments in private equity partnerships, the Company has commitments that may require additional funding of up to \$224.3 million. As of December 31, 2011, other invested assets include \$6.7 million related to the Company's investment in O.R.E Holdings Limited, which is net of other-than-temporary write-downs of \$9.9 million.

As of December 31, 2011, the Company held one collateral loan which constituted a financial instrument without a quoted price, or a "non-traded investment." This collateral loan was fully impaired during 2005. The Company periodically evaluates the carrying values of non-traded investments by reviewing the borrowers' current financial position and the timeliness of their interest and principal payments.

On October 14, 2011, the Company entered into a direct participation agreement pursuant to which the Company purchased collateral loans at a cost of \$154.9 million. The collateral loans were sold as of December 22, 2011 after the Company collected \$0.7 million in interest income.

(f) Derivative Investments

The Company has utilized credit default swaps, call options and warrants, total return swaps, interest rate options, forward currency contracts, futures contracts and CPI-linked derivative contracts to manage against adverse changes in the values of assets and liabilities. These products are typically not linked to specific assets or liabilities on the consolidated balance sheets or a forecasted transaction and, therefore, do not qualify for hedge accounting. The following tables set forth

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the Company's derivative positions, which are included in other invested assets or other liabilities in the consolidated balance sheets, as of December 31, 2011, and December 31, 2010, respectively (in thousands):

As of December 31, 2011				
	Exposure/ Notional Amount	Cost	Fair Value Asset	Fair Value Liability
	Amount		Asset	Liability
CPI-linked derivative contracts.....	\$ 19,024,800	\$ 169,352	\$ 86,962	\$ -
Short total return swaps.....	2,160,169	-	19,120	34,728
Long total return swaps.....	724,063	-	-	35,901
Forward currency contracts	469,867	-	5,553	6,191
Credit default swaps.....	445,934	5,693	7,201	-
Warrants	156,365	5,682	13,189	-
Interest rate swaps	140,000	-	-	5,036

As of December 31, 2010				
	Exposure/ Notional Amount	Cost	Fair Value Asset	Fair Value Liability
	Amount		Asset	Liability
CPI-linked derivative contracts.....	\$ 17,363,108	\$ 147,351	\$ 167,039	\$ -
Short total return swaps.....	2,276,230	-	336	67,183
Long total return swaps.....	633,512	-	-	2,208
Forward currency contracts	566,246	-	-	25,060
Credit default swaps	459,171	5,693	8,449	-
Warrants	165,671	9,984	9,573	-
Interest rate swaps	140,000	-	-	5,396

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The following tables summarize the effect of the hedging instruments and related hedged items on the Company's financial position, results of operations and cash flows as of and for the years ended December 31, 2011 and 2010 (in thousands):

	As of and for the Year Ended December 31, 2011					
	Exposure / Notional Value	Carrying Value	Effect on Pre-tax:			Net Cash Flow from Disposals
			Other Comprehensive Income	Net Realized Investment Gains	Net Equity	
Equity risk exposures:						
Preferred stocks	\$ 219,584	\$ 219,584	\$ -	\$ (614)	\$ (614)	\$ -
Common stocks, at fair value	850,118	850,118	(357,649)	170,475	(187,174)	198,982
Other.....	724,063	(35,901)	-	(55,320)	(55,320)	(21,628)
Total equity exposure	<u>\$ 1,793,765</u>	<u>\$ 1,033,801</u>	<u>(357,649)</u>	<u>114,541</u>	<u>(243,108)</u>	<u>177,354</u>
Hedging instruments:						
Other invested assets:						
Total return swaps	\$ 2,160,169	\$ (15,608)	-	151,184	151,184	99,945
Total equity hedging instruments	<u>\$ 2,160,169</u>	<u>\$ (15,608)</u>	<u>-</u>	<u>151,184</u>	<u>151,184</u>	<u>99,945</u>
Net equity impact			<u>\$ (357,649)</u>	<u>\$ 265,725</u>	<u>\$ (91,924)</u>	<u>\$ 277,299</u>
Credit risk exposures:						
Fixed income securities	\$ 4,304,638	\$ 4,304,638	\$ 468,311	\$ (87,054)	\$ 381,257	\$ 235,748
Derivatives - other invested assets	19,181,165	100,151	-	(114,738)	(114,738)	(20,501)
Cash, cash equivalents and short-term investments	2,456,854	2,456,854	-	(6,905)	(6,905)	(6,905)
Premiums receivable	557,590	557,590	-	6,022	6,022	6,022
Reinsurance recoverable	1,112,629	1,112,629	-	25,079	25,079	-
Total credit risk exposure	<u>\$ 27,612,876</u>	<u>\$ 8,531,862</u>	<u>468,311</u>	<u>(177,596)</u>	<u>290,715</u>	<u>214,364</u>
Hedging instruments:						
Other invested assets:						
Credit default swaps:						
Banking	\$ 207,703	\$ 3,345	-	(103)	(103)	-
Insurance	238,231	3,856	-	(1,145)	(1,145)	-
Total credit default swaps	<u>\$ 445,934</u>	<u>\$ 7,201</u>	<u>-</u>	<u>(1,248)</u>	<u>(1,248)</u>	<u>-</u>
Net equity impact			<u>\$ 468,311</u>	<u>\$ (178,844)</u>	<u>\$ 289,467</u>	<u>\$ 214,364</u>

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	As of and for the Year Ended December 31, 2010					
	Exposure / Notional Value	Carrying Value	Effect on Pre-tax:			Net Cash Flow from Disposals
			Other Comprehensive Income	Net Realized Investment Gains	Net Equity	
Equity risk exposures:						
Preferred stocks	\$ 214,198	\$ 214,198	\$ -	\$ (6,321)	\$ (6,321)	\$ 1,288
Common stocks, at fair value	1,463,600	1,463,600	(18,113)	232,992	214,879	242,210
Other.....	633,512	(2,208)	-	61,152	61,152	63,360
Total equity exposure	<u>\$ 2,311,310</u>	<u>\$ 1,675,590</u>	<u>(18,113)</u>	<u>287,823</u>	<u>269,710</u>	<u>306,858</u>
Hedging instruments:						
Other invested assets:						
Total return swaps	\$ 2,276,230	\$ (66,847)	-	(327,859)	(327,859)	(257,881)
Total equity hedging instruments	<u>\$ 2,276,230</u>	<u>\$ (66,847)</u>	<u>-</u>	<u>(327,859)</u>	<u>(327,859)</u>	<u>(257,881)</u>
Net equity impact			<u>\$ (18,113)</u>	<u>\$ (40,036)</u>	<u>\$ (58,149)</u>	<u>\$ 48,977</u>
Credit risk exposures:						
Fixed income securities	\$ 5,040,271	\$ 5,040,271	\$ (322,946)	\$ 245,992	\$ (76,954)	\$ 120,774
Derivatives - other invested assets	17,528,779	176,613	-	21,890	21,890	141
Cash, cash equivalents and short-term investments	1,339,361	1,339,361	-	(13,866)	(13,866)	(13,866)
Premiums receivable	424,893	424,893	-	313	313	313
Reinsurance recoverable	1,269,114	1,269,114	-	(697)	(697)	-
Total credit risk exposure	<u>\$ 25,602,418</u>	<u>\$ 8,250,252</u>	<u>(322,946)</u>	<u>253,632</u>	<u>(69,314)</u>	<u>107,362</u>
Hedging instruments:						
Other invested assets:						
Credit default swaps:						
Banking	\$ 214,647	\$ 3,449	-	351	351	(1,868)
Insurance	244,524	5,000	-	(1,888)	(1,888)	(13,022)
Total credit default swaps	<u>\$ 459,171</u>	<u>\$ 8,449</u>	<u>-</u>	<u>(1,537)</u>	<u>(1,537)</u>	<u>(14,890)</u>
Net equity impact			<u>\$ (322,946)</u>	<u>\$ 252,095</u>	<u>\$ (70,851)</u>	<u>\$ 92,472</u>

In the normal course of affecting its economic hedging strategy with respect to credit risk and equity risk, the Company expects that there may be periods where the notional value of the hedging instrument may exceed or be less than the exposure item being hedged. This situation may arise when management compensates for imperfect correlations between the hedging item and the hedge, due to the timing of opportunities related to the Company's ability to exit and enter hedged or hedging items at attractive prices or when management desires to only partially hedge an exposure.

As an economic hedge against the potential adverse impact on the Company of decreasing price levels in the economy, the Company has purchased derivative contracts referenced to consumer price indices ("CPI") in the geographic regions in which the Company operates. These contracts have a remaining average life of 8.6 years and 9.3 years as of December 31, 2011 and 2010, respectively. As the remaining life of a contract declines, the fair value of the contract (excluding the impact of CPI changes) will generally decline. The initial premium paid for the contracts is recorded as a derivative asset and subsequently adjusted for changes in the unrealized fair value of the contracts at each balance sheet date. Changes in the unrealized fair value of the contracts are recorded as realized gains or losses on investments in the Company's consolidated statements of operations and comprehensive income with a corresponding adjustment to the carrying value of the derivative asset. In the event of a sale, expiration or early settlement of one of the Company's CPI-linked derivative contracts, the Company would receive the fair value of that contract on the date of the transaction. The Company's maximum potential cash loss is limited to the premiums paid to enter into the derivative contracts. Pursuant to the agreements governing the CPI-linked derivatives, counterparties to these transactions are contractually required to periodically deposit eligible collateral for the benefit of the Company in support of the then-current fair value of the derivative contracts. As of December 31, 2011, the fair value of this collateral was \$53.5 million.

The Company holds significant investments in equities and equity-related securities, which the Company believes will significantly appreciate in value over time. The market values and the liquidity of these investments are volatile and may vary significantly either up or down in short periods. Their ultimate value, therefore, will only be known over the long term. As a result of volatility in the equity markets and the uncertainty caused by credit concerns related to the sovereign debt of certain countries in the European Union, the Company determined to increase the level of protection of its equity

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and equity-related holdings against a potential decline in equity markets by way of additional short positions effected through equity index total return swaps. As a result, beginning in September 2009 and continuing through 2011, the Company re-initiated U.S. equity index total return swap contracts, which had an aggregate notional value of \$2.0 billion as of December 31, 2011, to protect against potential future broad market downturns. The collateral requirement related to entering the total return swaps was \$257.1 million as of December 31, 2011. These total return swap transactions terminate during the second and third quarter of 2012. The equity index total return swaps are recorded at fair value in other invested assets or other liabilities based on a positive or negative value as of December 31, 2011 and 2010, respectively, with the related changes in the fair values recorded as realized investment gains or losses in the consolidated statements of operations and comprehensive income in the period in which they occur.

The Company holds long position common stock total return swaps, with a total notional value of \$724.1 million, as replications of investments in publicly-listed common stocks. The collateral requirement related to these swaps, which terminate in the third and fourth quarter of 2012, was \$56.5 million as of December 31, 2011. The common stock total return swaps, which are carried at fair value, were in a loss position as of December 31, 2011 and 2010, and are recorded in other liabilities. Changes in the fair value of common stock total return swaps are recorded as realized investment gains or losses in the consolidated statements of operations and comprehensive income in the period in which they occur.

During 2011, the Company purchased short position common stock total return swaps, with a notional value of \$162.5 million. The collateral requirement related to these swaps, which terminate in the first quarter of 2012, was \$8.5 million as of December 31, 2011. The common stock total return swaps are recorded at fair value in other invested assets as of December 31, 2011. Changes in the fair value are recorded as realized investment gains or losses in the consolidated statements of operations and comprehensive income in the period in which they occur. Pursuant to the agreements governing the total return swap contracts, counterparties to these transactions are contractually required to periodically deposit eligible collateral for the benefit of the Company in support of the then-current fair value of the derivative contracts. As of December 31, 2011, the fair value of this collateral was \$21.9 million.

The Company has entered into forward currency contracts to manage its foreign currency exchange rate risk on a macro basis. Under a forward currency contract, the Company and the counterparty are obligated to purchase or sell an underlying currency at a specified price and time. The collateral requirement related to the forward currency contracts was \$4.7 million as of December 31, 2011. Forward currency contracts are recorded at fair value in other invested assets or other liabilities based on a positive or negative value as of December 31, 2011 and 2010, with the related changes in fair value recognized as realized investment gains or losses in the consolidated statements of operations and comprehensive income in the period in which they occur. As a result of the appreciation in the fair value of the forward contracts, counterparties to these transactions are required to place government securities as collateral, pursuant to the forward contract agreements. The fair value of the collateral as of December 31, 2011 was \$0.5 million.

The Company holds credit default swaps, referenced to certain issuers in the banking and insurance sectors of the financial services industry worldwide, that serve as an economic hedge against declines in the fair value of investments and other corporate assets resulting from systemic financial and credit risk. Under a credit default swap, as the buyer, the Company agrees to pay to a specific counterparty, at specified periods, fixed premium amounts based on an agreed notional principal amount in exchange for protection against default by the issuers of specified referenced debt securities. The credit events, as defined by the respective credit default swap contracts, establishing the rights to recover amounts from the counterparties are comprised of ISDA-standard credit events, which are: bankruptcy, obligation acceleration, obligation default, failure to pay, repudiation/moratorium and restructuring. As of December 31, 2011, all credit default swap contracts held by the Company have been purchased from and entered into with either Citibank, N.A., Deutsche Bank AG or Barclays Bank PLC as the counterparty, with positions on certain covered risks with more than one of these counterparties. The Company obtains market-derived fair values for its credit default swaps from third-party providers, principally broker-dealers. The Company assesses the reasonableness of the fair values obtained from these providers by comparison to models validated by qualified personnel, by reference to movements in credit spreads and by comparing the fair values to recent transaction prices for similar credit default swaps, where available.

The initial premium paid for each credit default swap contract is recorded as a derivative asset and is subsequently adjusted for changes in the unrealized fair value of the contract at each balance sheet date. As these contracts do not qualify

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for hedge accounting, changes in the unrealized fair value of the contract are recorded as net realized investment gains or losses in the Company's consolidated statements of operations and comprehensive income. Sales of credit default swap contracts required the Company to reverse through net realized investment gains previously recorded unrealized fair value changes since the inception of the contract, and to record the actual amount based upon the final cash settlement. Derivative assets are reported gross, on a contract-by-contract basis, at fair value in other invested assets in the consolidated balance sheets. The sale, expiration or early settlement of a credit default swap will not result in a cash payment owed by the Company; rather, such an event can only result in a cash payment by a third party purchaser of the contract, or the counterparty, to the Company. Accordingly, there is no opportunity for netting of amounts owed in settlement. Cash receipts at the date of sale of the credit default swaps are recorded as cash flows from investing activities arising from net sales of assets and liabilities classified as held for trading.

The fair values of credit default swaps may be subject to significant volatility, given potential differences in the perceived risk of default of the underlying issuers, movements in credit spreads and the length of time to the contracts' maturities. The fair value of the credit default swaps may vary dramatically either up or down in short periods, and their ultimate value may therefore only be known upon their disposition. Credit default swap transactions generally settle in cash. As a result of the appreciation in the fair value of the credit default swaps, counterparties to these transactions are required to place government securities as collateral, pursuant to the swap agreements. The fair value of the collateral as of December 31, 2011 was \$2.8 million. As the Company funds all of its obligations relating to these contracts upon initiation of the transaction, there are no requirements in these contracts for the Company to provide collateral.

The fair value of the credit default swaps portfolio was \$7.2 million as of December 31, 2011, compared to \$8.4 million as of December 31, 2010. The credit default swaps portfolio has an average term to expiration of 1.4 years as of December 31, 2011, a decrease from 2.4 years as of December 31, 2010.

The Company has investments in warrants, which are contracts that grant the holder the right, but not the obligation, to purchase an underlying financial instrument at a given price and time or at a series of prices and times. Warrants, which are included in other invested assets as of December 31, 2011 and 2010, are recorded at fair value, with the related changes in fair value recognized as realized investment gains or losses in the consolidated statements of operations in the period in which they occur.

The Company has entered into interest rate swaps to protect it from adverse movements in interest rates. Under its current interest rate swap contracts, the Company receives a floating interest rate and pays a fixed interest rate based on the notional amounts in the contracts. Interest rate swaps are recorded at fair value in other liabilities as of December 31, 2011 and 2010, with the related changes in fair value recognized as realized investment gains or losses in the consolidated statements of operations in the period in which they occur.

Counterparties to the derivative instruments expose the Company to credit risk in the event of non-performance. The Company believes this risk is low, given the diversification among various highly rated counterparties. The credit risk exposure is reflected in the fair value of the derivative instruments.

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The net realized investment gains or losses on disposal in the table below represent the total gains or losses from the purchase dates of the investments and have been reported in net realized investment gains in the consolidated statements of operations. The change in fair value presented below consists of two components: (i) the reversal of the gain or loss recognized in previous years on securities sold and (ii) the change in fair value resulting from mark-to-market adjustments on contracts still outstanding. The following table sets forth the total net realized investment gains and losses on derivatives for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
CPI-linked derivative contracts:			
Net realized investment losses on disposal.....	\$ (21,442)	\$ -	\$ -
Change in fair value	<u>(102,080)</u>	<u>19,643</u>	<u>46</u>
Net realized investment (losses) gains	<u>(123,522)</u>	<u>19,643</u>	<u>46</u>
Short total return swaps:			
Net realized investment gains (losses) on disposal	99,945	(257,881)	(33,724)
Change in fair value	<u>51,239</u>	<u>(69,979)</u>	<u>3,132</u>
Net realized investment gains (losses).....	<u>151,184</u>	<u>(327,860)</u>	<u>(30,592)</u>
Long total return swaps:			
Net realized investment (losses) gains on disposal	(21,628)	63,360	-
Change in fair value	<u>(33,692)</u>	<u>(2,208)</u>	<u>-</u>
Net realized investment (losses) gains.....	<u>(55,320)</u>	<u>61,152</u>	<u>-</u>
Forward currency contracts:			
Net realized investment (losses) gains on disposal	(8,573)	(39,435)	7,592
Change in fair value	<u>24,421</u>	<u>14,191</u>	<u>(67,475)</u>
Net realized investment gains (losses)	<u>15,848</u>	<u>(25,244)</u>	<u>(59,883)</u>
Credit default swaps:			
Net realized investment (losses) gains on disposal	-	(14,890)	33,960
Change in fair value	<u>(1,248)</u>	<u>13,353</u>	<u>(62,666)</u>
Net realized investment losses.....	<u>(1,248)</u>	<u>(1,537)</u>	<u>(28,706)</u>
Warrants:			
Net realized investment gains (losses) on disposal	941	141	(237)
Change in fair value	<u>7,843</u>	<u>2,106</u>	<u>3,059</u>
Net realized investment gains.....	<u>8,784</u>	<u>2,247</u>	<u>2,822</u>
Interest rate swaps:			
Net realized investment losses on disposal	(3,107)	(3,058)	(2,030)
Change in fair value	<u>360</u>	<u>(5,352)</u>	<u>(10)</u>
Net realized investment losses	<u>(2,747)</u>	<u>(8,410)</u>	<u>(2,040)</u>

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	<u>2011</u>	<u>2010</u>	<u>2009</u>
Futures contracts:			
Net realized investment losses on disposal	-	-	(275)
Net realized investment losses	-	-	(275)
Total derivatives:			
Net realized investment gains (losses) on disposal	46,136	(251,764)	5,286
Change in fair value	(53,157)	(28,245)	(123,914)
Net realized investment losses.....	<u>\$ (7,021)</u>	<u>\$ (280,009)</u>	<u>\$ (118,628)</u>

(g) Assets on Deposit

The Company is required to maintain assets on deposit with various regulatory authorities to support its insurance and reinsurance operations. These requirements are generally promulgated in the statutes and regulations of the individual jurisdictions. The assets on deposit are available to settle insurance and reinsurance liabilities. The Company utilizes trust funds in certain transactions where the trust funds are set up for the benefit of the ceding companies and generally take the place of letter of credit requirements. As of December 31, 2011, restricted assets supporting these deposits and trust fund requirements totaled \$1.4 billion, as depicted in the following table (in thousands):

	As of December 31, 2011		
	Restricted Assets Relating to:		
	U.S. Regulatory Requirements	Foreign Regulatory Requirements	Total
Fixed income securities	\$ 557,487	\$ 575,751	\$ 1,133,238
Cash, cash equivalents and short-term investments	6,277	254,573	260,850
Total	<u>\$ 563,764</u>	<u>\$ 830,324</u>	<u>\$ 1,394,088</u>

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6. Accumulated Other Comprehensive Income

The following table shows the components of the change in accumulated other comprehensive income, net of deferred income taxes, for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Beginning balance of unrealized net appreciation on securities	\$ 331,352	\$ 537,224	\$ 74,741
Clearwater transfer.....	(83,705)	-	-
Adjusted beginning balance.....	247,647	537,224	74,741
Ending balance of unrealized net appreciation on securities	311,003	331,352	537,224
Current period change in unrealized net appreciation (depreciation) on securities	63,356	(205,872)	462,483
Beginning balance of foreign currency translation adjustments	64,899	13,484	10,716
Clearwater transfer.....	(717)	-	-
Adjusted beginning balance.....	64,182	13,484	10,716
Ending balance of foreign currency translation adjustments	80,510	64,899	13,484
Current period change in foreign currency translation adjustments	16,328	51,415	2,768
Beginning balance of benefit plan liabilities	(4,766)	(5,239)	(3,461)
Ending balance of benefit plan liabilities	(10,243)	(4,766)	(5,239)
Current period change in benefit plan liabilities	(5,477)	473	(1,778)
Other comprehensive income (loss)	<u>\$ 74,207</u>	<u>\$ (153,984)</u>	<u>\$ 463,473</u>
Beginning balance of accumulated other comprehensive income	\$ 391,485	\$ 545,469	\$ 81,996
Other comprehensive income (loss)	74,207	(153,984)	463,473
Clearwater transfer.....	(84,422)	-	-
Change in accumulated other comprehensive (loss) income	(10,215)	(153,984)	463,473
Ending balance of accumulated other comprehensive income	<u>\$ 381,270</u>	<u>\$ 391,485</u>	<u>\$ 545,469</u>

The following table shows the components of accumulated other comprehensive income (loss), and the related deferred income taxes on each component, as of December 31, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Gross:		
Unrealized appreciation on securities	\$ 478,094	\$ 491,338
Foreign currency translation adjustments	123,927	99,844
Benefit plan liabilities	(15,759)	(7,334)
Total accumulated other comprehensive income, gross of deferred income taxes.....	<u>\$ 586,262</u>	<u>\$ 583,848</u>
Deferred taxes:		
Unrealized appreciation on securities	\$ (167,091)	\$ (159,986)
Foreign currency translation adjustments	(43,417)	(34,945)
Benefit plan liabilities	5,516	2,568
Total deferred taxes on accumulated other comprehensive income.....	<u>\$ (204,992)</u>	<u>\$ (192,363)</u>

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The components of comprehensive income for the years ended December 31, 2011, 2010 and 2009 are shown in the following table (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net (loss) income	\$ (65,963)	\$ 333,275	\$ 373,336
Other comprehensive income (loss), before tax:			
Unrealized net appreciation on securities arising during the period	316,153	101,155	836,090
Reclassification adjustment for realized investment			
gains included in net income	(218,435)	(436,312)	(124,578)
Foreign currency translation adjustments	25,122	79,100	4,258
Benefit plan liabilities	<u>(8,425)</u>	<u>727</u>	<u>(2,735)</u>
Other comprehensive income (loss), before tax	<u>114,415</u>	<u>(255,330)</u>	<u>713,035</u>
Tax (provision) benefit:			
Unrealized net appreciation on securities arising during the period	(110,814)	(23,424)	(292,631)
Reclassification adjustment for realized investment			
gains included in net income	76,452	152,709	43,602
Foreign currency translation adjustments	(8,794)	(27,685)	(1,490)
Benefit plan liabilities	<u>2,948</u>	<u>(254)</u>	<u>957</u>
Total tax (provision) benefit	<u>(40,208)</u>	<u>101,346</u>	<u>(249,562)</u>
Other comprehensive income (loss), net of tax	<u>74,207</u>	<u>(153,984)</u>	<u>463,473</u>
Comprehensive income	<u>\$ 8,244</u>	<u>\$ 179,291</u>	<u>\$ 836,809</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

7. Unpaid Losses and Loss Adjustment Expenses

The following table sets forth the activity in the liability for unpaid losses and loss adjustment expenses for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Gross unpaid losses and loss adjustment expenses, beginning of year	\$ 5,809,665	\$ 5,507,766	\$ 5,250,484
Less: Ceded unpaid losses and loss adjustment expenses, beginning of year	<u>952,455</u>	<u>841,486</u>	<u>690,171</u>
Net unpaid losses and loss adjustment expenses, beginning of year	<u>4,857,210</u>	<u>4,666,280</u>	<u>4,560,313</u>
Add: Net incurred losses and loss adjustment expenses related to:			
Current year	1,863,733	1,320,651	1,313,319
Prior years	<u>(51,391)</u>	<u>(3,598)</u>	<u>(11,323)</u>
Total net incurred losses and loss adjustment expenses	<u>1,812,342</u>	<u>1,317,053</u>	<u>1,301,996</u>
Less: Net paid losses and loss adjustment expenses related to:			
Current year	438,955	184,373	230,610
Prior years	<u>958,379</u>	<u>988,205</u>	<u>1,024,182</u>
Total net paid losses and loss adjustment expenses	<u>1,397,334</u>	<u>1,172,578</u>	<u>1,254,792</u>
Disposition of Clearwater's net unpaid losses and loss adjustment expenses.....	<u>(484,230)</u>	<u>-</u>	<u>-</u>
Effects of exchange rate changes	<u>(38,039)</u>	<u>46,455</u>	<u>58,763</u>
Net unpaid losses and loss adjustment expenses, end of year	4,749,949	4,857,210	4,666,280
Add: Ceded unpaid losses and loss adjustment expenses, end of year	<u>767,651</u>	<u>952,455</u>	<u>841,486</u>
Gross unpaid losses and loss adjustment expenses, end of year	<u>\$ 5,517,600</u>	<u>\$ 5,809,665</u>	<u>\$ 5,507,766</u>

Estimates of reserves for unpaid losses and loss adjustment expenses, with respect to loss events that have occurred on or before the balance sheet date, are contingent on many assumptions that may or may not occur in the future. These assumptions include loss estimates attributable to a variety of loss events, including earthquakes, hurricanes, windstorms and floods. The eventual outcome of these loss events may be different from the assumptions underlying the Company's reserve estimates. When the business environment and loss trends diverge from expected trends, the Company may have to adjust its reserves accordingly, potentially resulting in adverse or favorable effects to the Company's financial results. The Company believes that the recorded estimate represents the best estimate of unpaid losses and loss adjustment expenses based on the information available as of December 31, 2011. The estimate is reviewed on a quarterly basis and the ultimate liability may be greater or less than the amounts provided, for which any adjustments will be reflected in the periods in which they become known.

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As of January 1, 2011, Clearwater was transferred to TIG. Unpaid losses and loss adjustment expenses transferred as part of this transaction were \$484.2 million.

Net incurred losses and loss adjustment expenses related to the current year were \$1,863.7 million, \$1,320.7 million and \$1,313.3 million for the years ended December 31, 2011, 2010 and 2009, respectively. The increase in incurred losses and loss adjustment expenses for the years ended December 31, 2011 and 2010 were principally due to increases in property catastrophe losses. For the years ended December 31, 2011, 2010 and 2009, current year catastrophe events were \$762.5 million, \$222.2 million and \$131.1 million, respectively. For the year ended December 31, 2011, current year property catastrophe losses included \$398.4 million related to the Japan earthquake, \$155.1 million related to the Thailand flood, \$25.9 million related to the February 2011 New Zealand earthquake and \$18.2 million related to Hurricane Irene. For the year ended December 31, 2010, current year property catastrophe losses included \$83.3 million related to the Chile earthquake, \$16.8 million related to Windstorm Xynthia and \$16.0 million related to the September 2010 New Zealand earthquake. For the year ended December 31, 2009, current year property catastrophe losses included \$53.5 million related to Windstorm Klaus, \$16.2 million related to Windstorm Wolfgang and \$10.4 million related to the floods in Turkey.

Net incurred losses and loss adjustment expenses related to prior years decreased \$51.4 million, \$3.6 million and \$11.3 million for the years ended December 31, 2011, 2010 and 2009, respectively. The decrease in prior years' incurred losses and loss adjustment expenses for the year ended December 31, 2011 was attributable to decreased loss estimates due to loss emergence lower than expectations in the year in each of the Company's four divisions: the Americas, EuroAsia, London Market and U.S. Insurance. The decrease in prior years' incurred losses and loss adjustment expenses for the year ended December 31, 2010 was attributable to reduced loss estimates due to loss emergence lower than expectations in the year on business written in the EuroAsia, London Market and U.S. Insurance divisions, partially offset by increased loss estimates in the Americas division. The decrease in prior years' incurred losses and loss adjustment expenses for the year ended December 31, 2009 was attributable to reduced loss estimates due to loss emergence lower than expectations in the year on business written in the EuroAsia, London Market and U.S. Insurance divisions, partially offset by increased loss estimates in the Americas division.

Net paid losses and loss adjustment expenses related to the current year were \$439.0 million, \$184.4 million and \$230.6 million for the years ended December 31, 2011, 2010 and 2009, respectively. The increase in paid losses and loss adjustment expenses for the year ended December 31, 2011 was principally due to an increase in property catastrophe losses. For the year ended December 31, 2011, paid losses and loss adjustment expenses related to current year catastrophe events were \$227.3 million compared to \$48.9 million for the year ended December 31, 2010.

The effects of exchange rate changes on net unpaid losses and loss adjustment expenses resulted in a decrease of \$38.0 million for the year ended December 31, 2011 and increases of \$46.5 million and \$58.8 million for the years ended December 31, 2010 and 2009, respectively. The effects of exchange rate changes were attributable to changes in foreign currency exchange rates for unpaid losses and loss adjustment expenses in the Americas, EuroAsia and London Market divisions.

Ceded unpaid losses and loss adjustment expenses were \$767.7 million, \$952.5 million and \$841.5 million as of December 31, 2011, 2010 and 2009, respectively. The decrease in ceded unpaid losses and loss adjustment expenses for the year ended December 31, 2011 was principally attributable to a \$264.6 million decrease in unpaid reinsurance recoverables related to the transfer of ownership of Clearwater Insurance Company on January 1, 2011. The increase in ceded unpaid losses and loss adjustment expenses for the year ended December 31, 2010 was principally attributable to a \$72.4 million increase in unpaid reinsurance recoverables related to non-catastrophe exposure, principally in the London Market and U.S. Insurance divisions.

The Company uses tabular reserving for workers' compensation indemnity loss reserves, which are considered to be fixed and determinable, and discounts such reserves using an interest rate of 3.5%. Workers' compensation indemnity loss reserves have been discounted using the Life Table for Total Population: United States, 2004. Reserves reported at the discounted value were \$80.2 million and \$116.5 million as of December 31, 2011 and 2010, respectively. The amount of case reserve discount was \$39.1 million and \$54.0 million as of December 31, 2011 and 2010, respectively. The amount of

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incurred but not reported reserve discount was \$15.0 million and \$20.9 million as of December 31, 2011 and 2010, respectively.

8. Asbestos and Environmental Losses and Loss Adjustment Expenses

As a result of the transfer of ownership of Clearwater to TIG on January 1, 2011, the Company is no longer materially exposed to asbestos and/or environmental claims and accordingly no longer establishes a specific reserve for such exposures.

The Company's reserves for asbestos and environmental-related liabilities displayed below are related to business written by Clearwater prior to 1986. As of December 31, 2011, the Company has no specific reserve for asbestos and environmental unpaid losses and loss adjustment expenses. The Company's asbestos and environmental reserve development, gross and net of reinsurance, for the years ended December 31, 2010 and 2009 is set forth in the table below (in thousands):

	2010	2009
Asbestos		
Gross unpaid losses and loss adjustment expenses, beginning of year	\$ 386,735	\$ 360,733
Add: Gross incurred losses and loss adjustment expenses	73,800	69,384
Less: Gross calendar year paid losses and loss adjustment expenses	51,136	43,382
Gross unpaid losses and loss adjustment expenses, end of year	\$ 409,399	\$ 386,735
Net unpaid losses and loss adjustment expenses, beginning of year	\$ 241,572	\$ 230,486
Add: Net incurred losses and loss adjustment expenses	44,400	39,959
Less: Net calendar year paid losses and loss adjustment expenses	34,191	28,873
Net unpaid losses and loss adjustment expenses, end of year	\$ 251,781	\$ 241,572
Environmental		
Gross unpaid losses and loss adjustment expenses, beginning of year	\$ 27,142	\$ 34,242
Add: Gross incurred losses and loss adjustment expenses	10,653	863
Less: Gross calendar year paid losses and loss adjustment expenses	4,179	7,963
Gross unpaid losses and loss adjustment expenses, end of year	\$ 33,616	\$ 27,142
Net unpaid losses and loss adjustment expenses, beginning of year	\$ 23,885	\$ 29,819
Add: Net incurred losses and loss adjustment expenses	8,842	578
Less: Net calendar year paid losses and loss adjustment expenses	3,784	6,512
Net unpaid losses and loss adjustment expenses, end of year	\$ 28,943	\$ 23,885

Net incurred losses and loss adjustment expenses for asbestos claims increased \$44.4 million and \$40.0 million for the years ended December 31, 2010 and 2009, respectively. The increases in net incurred losses and loss adjustment expenses were principally attributable to the annual reviews of claim activity and loss emergence trend information obtained in the calendar periods from ceding companies and other industry sources. Upon consideration of this new loss emergence information received in 2010 and 2009, the Company revised its loss development assumptions used in its asbestos loss reserving analyses, which had the effect of increasing the asbestos loss estimates for these calendar periods.

Net incurred losses and loss adjustment expenses for environmental claims increased \$8.8 million and \$0.6 million for the years ended December 31, 2010 and 2009, respectively. The increases in net incurred losses and loss adjustment expenses for the years ended December 31, 2010 and 2009 were principally attributable to the annual reviews of claim activity and loss emergence trend information obtained in the calendar year from ceding companies.

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9. Reinsurance and Retrocessions

The Company utilizes reinsurance and retrocessional agreements to reduce and spread the risk of loss on its insurance and reinsurance business and to limit exposure to multiple claims arising from a single occurrence. The Company is subject to accumulation risk with respect to catastrophic events involving multiple treaties, facultative certificates and insurance policies. To protect against these risks, the Company purchases catastrophe excess of loss protection. The retention, the level of capacity purchased, the geographical scope of the coverage and the costs vary from year to year. In 2011, the Company purchased catastrophe excess of loss protection for certain non-U.S. exposures as well as various additional specific protections for its facultative property account in Latin America. Additionally, the Company purchases specific protections related to the insurance business underwritten by its London Market and U.S. Insurance divisions.

There is a credit risk with respect to reinsurance, which would result in the Company recording a charge to earnings in the event that such reinsuring companies are unable, at some later date, to meet their obligations under the reinsurance agreements in force. Reinsurance recoverables are recorded as assets and a reserve for uncollectible reinsurance recoverables is established based on the Company's evaluation of each reinsurer's or retrocessionaire's ability to meet its obligations under the agreements. Premiums written and earned are stated net of reinsurance ceded in the consolidated statements of operations. Direct, reinsurance assumed, reinsurance ceded and net amounts for the years ended December 31, 2011, 2010 and 2009 follow (in thousands):

	Year Ended December 31,		
	2011	2010	2009
Premiums Written			
Direct	\$ 892,801	\$ 758,094	\$ 780,467
Add: assumed	1,527,943	1,409,244	1,414,568
Less: ceded	331,019	313,540	301,222
Net	<u>\$ 2,089,725</u>	<u>\$ 1,853,798</u>	<u>\$ 1,893,813</u>
Premiums Earned			
Direct	\$ 854,934	\$ 789,749	\$ 741,074
Add: assumed	1,480,403	1,411,227	1,472,116
Less: ceded	320,632	315,262	285,778
Net	<u>\$ 2,014,705</u>	<u>\$ 1,885,714</u>	<u>\$ 1,927,412</u>

The total amount of reinsurance recoverable on paid and unpaid losses as of December 31, 2011 and 2010 was \$0.8 billion and \$1.0 billion, respectively. The reserve for uncollectible reinsurance recoverable, which decreased on January 1, 2011 as a result of the transfer of Clearwater, was \$17.5 million and \$42.5 million, as of December 31, 2011 and 2010, respectively, and has been netted against reinsurance recoverables on loss payments in the consolidated balance sheets. The Company has also established a reserve for potentially uncollectible assumed reinsurance balances of \$11.2 million and \$5.2 million as of December 31, 2011 and 2010, respectively, which has been netted against premiums receivable.

In accordance with the terms of certain of its reinsurance agreements, the Company has recorded interest expense associated with its ceded reinsurance agreements of \$3.0 million, \$3.2 million and \$3.7 million for the years ended December 31, 2011, 2010 and 2009, respectively.

10. Reinsurance Recoverables

The Company's ten largest reinsurers represent 69.4% of its total reinsurance recoverables as of December 31, 2011. Amounts due from all other reinsurers are diversified, with no other individual reinsurer representing more than \$25.4 million, or 3.0%, of reinsurance recoverables as of December 31, 2011, and the average balance is less than \$5.2 million. The Company held total collateral of \$141.9 million as of December 31, 2011, representing 16.7% of total reinsurance

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recoverables. The following table shows the total amount that is recoverable from each of the Company's ten largest reinsurers for paid and unpaid losses as of December 31, 2011, the amount of collateral held, and each reinsurer's A.M. Best rating (in thousands):

<u>Reinsurer</u>	<u>Reinsurance Recoverable</u>	<u>% of Total</u>	<u>Collateral</u>	<u>A.M. Best Rating</u>
Lloyd's.....	\$ 160,180	19.0 %	\$ -	A
Federal Crop Ins Corporation.....	114,017	13.4	-	NR
Alterra Bermuda Ltd.....	57,272	6.8	15,413	A
Everest Re (Bermuda) Ltd.....	49,468	5.8	-	A+
Ullico Casualty Company.....	47,640	5.6	47,640	B+
Brit Insurance Ltd.....	38,370	4.5	-	A
Munich Reinsurance America.....	33,933	4.0	-	A+
Swiss Re America Corporation.....	32,513	3.8	29,603	A+
Platinum Underwriters Bermuda Ltd.....	28,433	3.4	-	A
Transatlantic Re.....	26,621	3.1	-	A
Sub-total.....	<u>588,447</u>	<u>69.4</u>	<u>92,656</u>	
All other.....	259,702	30.6	49,214	
Total.....	<u>\$ 848,149</u>	<u>100.0 %</u>	<u>\$ 141,870</u>	

Reinsurance recoverables, which decreased on January 1, 2011 as a result of the transfer of Clearwater, were \$1,002.0 million and collateral was \$227.1 million, or 22.7% of the reinsurance recoverable balance, as of December 31, 2010.

Several individual reinsurers are part of the same corporate group. The following table shows the five largest aggregate amounts that are recoverable from all individual entities that form part of the same corporate group as of December 31, 2011 and the amount of collateral held from each group (in thousands):

<u>Reinsurer</u>	<u>Reinsurance Recoverable</u>	<u>% of Total</u>	<u>Collateral</u>
Lloyd's of London.....	\$ 160,180	19.0 %	\$ -
Federal Crop Ins Corp.....	114,017	13.4	-
Alterra Holdings.....	72,435	8.5	15,413
Everest Re.....	50,255	5.9	-
Munich Re.....	48,123	5.7	-
Sub-total.....	<u>445,010</u>	<u>52.5</u>	<u>15,413</u>
All other.....	403,139	47.5	126,457
Total.....	<u>\$ 848,149</u>	<u>100.0 %</u>	<u>\$ 141,870</u>

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The Company is the beneficiary of letters of credit, cash and other forms of collateral to secure certain amounts due from its reinsurers. The total amount of collateral held by the Company as of December 31, 2011 is \$141.9 million, which represents 16.7% of the total amount of reinsurance recoverables, comprised of the following forms of collateral (in thousands):

<u>Form of Collateral</u>	<u>Collateral</u>	<u>% of Recoverables</u>
Letters of credit	\$ 34,851	4.1 %
Funds withheld from reinsurers	26,053	3.1
Trust agreements	80,966	9.5
Total	<u>\$ 141,870</u>	<u>16.7 %</u>

Each reinsurance contract between the Company and the reinsurer describes the losses which are covered under the contract and terms upon which payments are to be made. The Company generally has the ability to utilize collateral to settle unpaid balances due under its reinsurance contracts when it determines that the reinsurer has not met its contractual obligations. Letters of credit are for the sole benefit of the Company to support the obligations of the reinsurer, providing the Company with the unconditional ability, in its sole discretion, to draw upon the letters of credit in support of any unpaid amounts due under the relevant contracts. Cash and investments supporting funds withheld from reinsurers are included in the Company's invested assets. Funds withheld from reinsurers are typically used to automatically offset payments due to the Company in accordance with the terms of the relevant reinsurance contracts. Amounts held under trust agreements are typically comprised of cash and investment grade fixed income securities and are not included in the Company's invested assets. The ability of the Company to draw upon funds held under trust agreements to satisfy any unpaid amounts due under the relevant reinsurance contracts is typically unconditional and at the sole discretion of the Company.

11. Debt Obligations, Common Shares and Preferred Shares

Debt Obligations

The components of the Company's debt obligations as of December 31, 2011 and 2010 were as follows (in thousands):

	<u>December 31, 2011</u>	<u>December 31, 2010</u>
7.65% Senior Notes due 2013	\$ 181,929	\$ 223,294
6.875% Senior Notes due 2015	124,117	123,854
Series A Floating Rate Senior Debentures due 2021	50,000	50,000
Series B Floating Rate Senior Debentures due 2016	50,000	50,000
Series C Floating Rate Senior Debentures due 2021	40,000	40,000
Total debt obligations	<u>\$ 446,046</u>	<u>\$ 487,148</u>

On November 28, 2006, the Company completed the private sale of \$40.0 million aggregate principal amount of floating rate senior debentures, Series C, due December 15, 2021 (the "Series C Notes"). Interest on the Series C Notes accrues at a rate per annum equal to the three-month London Interbank Offer Rate ("LIBOR"), reset quarterly, plus 2.50%, and is payable quarterly in arrears on March 15, June 15, September 15 and December 15 of each year. The Company has the option to redeem the Series C Notes at par, plus accrued and unpaid interest, in whole or in part on any interest payment date on or after December 15, 2011. For the years ended December 31, 2011 and 2010, the average annual interest rate on the Series C Notes was 2.81% and 2.84%, respectively.

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On February 22, 2006, the Company issued \$100.0 million aggregate principal amount of floating rate senior debentures, pursuant to a private placement. The net proceeds from the offering, after fees and expenses, were \$99.3 million. The debentures were sold in two tranches: \$50.0 million of Series A, due March 15, 2021 (the “Series A Notes”), and \$50.0 million of Series B, due March 15, 2016 (the “Series B Notes”). Interest on each series of debentures is due quarterly in arrears on March 15, June 15, September 15 and December 15 of each year. The interest rate on each series of debentures is equal to the three-month LIBOR, reset quarterly, plus 2.20%. The Series A Notes are callable by the Company on any interest payment date on or after March 15, 2011 at their par value, plus accrued and unpaid interest, and the Series B Notes are callable by the Company on any interest payment date on or after March 15, 2009 at their par value, plus accrued and unpaid interest. For the years ended December 31, 2011 and 2010, the average annual interest rate on each series of notes was 2.51% and 2.54%, respectively.

During the second quarter of 2005, the Company issued \$125.0 million aggregate principal amount of senior notes due May 1, 2015. The issue was sold at a discount of \$0.8 million, which is being amortized over the life of the notes. Interest accrues on the senior notes at a fixed rate of 6.875% per annum, which is due semi-annually on May 1 and November 1.

During the fourth quarter of 2003, the Company issued \$225.0 million aggregate principal amount of senior notes due November 1, 2013 (the “2013 Notes”). The issue was sold at a discount of \$0.4 million, which is being amortized over the life of the notes. Interest accrues on the senior notes at a fixed rate of 7.65% per annum, which is due semi-annually on May 1 and November 1.

During the second quarter of 2011, the Company recognized a \$6.1 million loss on the extinguishment of long term debt. The \$6.1 million loss was on the early extinguishment of a portion of the Company’s 2013 Notes. On June 6, 2011, the Company received proceeds from Fairfax in the amount of \$47.8 million to reduce the principal amount of the 2013 Notes by \$42.2 million. A portion of the proceeds was also used to write-off the pro-rata portion of the unamortized issuance and discount costs of \$0.5 million.

As of December 31, 2011, the aggregate maturities of the Company’s debt obligations, at face value, were as follows (in thousands):

<u>Year</u>	<u>December 31,</u> <u>2011</u>
2013.....	\$ 182,827
2015.....	125,000
2016.....	50,000
2021.....	90,000
Total	<u>\$ 447,827</u>

As of December 31, 2011 and 2010, the amortized cost of the Company’s debt obligations was \$446.0 million and \$487.1 million respectively, as reflected in the respective consolidated balance sheets. As of December 31, 2011 and 2010, the estimated fair value of the Company’s debt obligations was \$455.5 million and \$515.9 million, respectively. The estimated fair value is based on quoted market prices of the Company’s debt, where available, and for debt similar to the Company’s, and discounted cash flow calculations.

On July 13, 2007, the Company entered into a \$200.0 million credit facility (the “Credit Agreement”) with Wachovia Bank National Association (“Wachovia”), KeyBank National Association and a syndicate of lenders. The original Credit Agreement provided for a five-year credit facility of \$200.0 million, \$100.0 million of which was available for direct, unsecured borrowings by the Company, and all of which was available for the issuance of secured letters of credit to support the Company’s insurance and reinsurance business. As of June 17, 2009, the Credit Agreement was amended to explicitly permit the Company to pledge collateral to secure its obligations under swap agreements, subject to certain financial limitations, in the event that such collateral is required by the counterparty or counterparties. As of February 24, 2010, the Credit Agreement was amended (i) to reduce the size of the facility to \$100.0 million, removing the unsecured \$100.0 million tranche, (ii) to remove the previous limitation on dividends and other “restricted payments” that the

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Company may pay to its shareholders and (iii) amend certain of the covenants and default provisions, the minimum ratings requirement, and the pricing of the credit facility.

The amended Credit Agreement contains an option that permits the Company to request an increase in the aggregate amount of the facility by an amount up to \$50.0 million, to a maximum facility size of \$150.0 million. Following such a request, each lender has the right, but not the obligation, to commit to all or a portion of the proposed increase. As of December 31, 2011 and 2010, there was \$34.3 million and \$33.8 million, respectively, outstanding under the Credit Agreement, all of which was in support of secured letters of credit.

In December 2008, the Company entered into interest rate swaps, with an aggregate notional value of \$140.0 million, to protect it from adverse movements in interest rates. Under these swap contracts, the Company receives a floating interest rate of three-month LIBOR and pays a fixed interest rate of 2.49% on the \$140.0 million notional value of the contracts, for a five-year period ending in December 2013.

Common Shares

On December 21, 2010, the Company filed a certificate of amendment to its amended and restated certificate of incorporation with the State of Delaware. The certificate of amendment, which was approved by the Company's shareholders and Board of Directors, reduced the number of authorized shares of capital stock of the Company to 1,260,000 shares, consisting of 60,000 shares of common stock, par value \$10.00 per share, and 1,200,000 shares of preferred stock, par value \$0.01 per share. Prior to the filing of the certificate of amendment, the Company's authorized capital stock consisted of 700,000,000 shares (500,000,000 shares of common stock, par value \$0.01 per share, and 200,000,000 shares of preferred stock, par value \$0.01 per share). Upon the effectiveness of the certificate of amendment, the Company effected a 1 for 1,000 share reverse stock split of its common shares, such that each 1,000 shares of the Company's old common stock, par value \$0.01 per share, automatically were combined and reclassified into one (1) share of the Company's new common stock, par value \$10.00 per share.

On January 1, 2011, the Company transferred ownership of Clearwater to TIG, in exchange for 5,921 common shares of the Company held by TIG. The 5,921 common shares reacquired by the Company from TIG were subsequently retired (see Note 1).

The Company's Board of Directors authorized a share repurchase program whereby the Company was authorized to repurchase shares of its then publicly held common stock on the open market from time to time through December 31, 2009, up to an aggregate repurchase price of \$600.0 million. Shares repurchased under the program were retired. During the year ended December 31, 2009, the Company repurchased and retired 1,789,100 shares of its common stock, at a cost of \$72.6 million, an average repurchase price of \$40.56 per share. From the inception of the program through October 21, 2009, the Company repurchased and retired 13,906,845 shares of its common stock at a total cost of \$518.4 million.

The Company did not declare or pay any common stock dividends during the years ended December 31, 2011 and 2010. In each of the first three quarters of 2009, the Company paid a dividend of \$0.075 per common share, resulting in an aggregate annual dividend of \$0.225 per common share, totaling \$13.4 million. The dividends were paid on March 31, 2009, June 30, 2009 and September 30, 2009. No common stock dividend was declared or paid during the fourth quarter of 2009.

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Preferred Shares

The Company's 8.125% Series A preferred shares (253,599 shares outstanding) have a liquidation preference of \$25.00 per share and are redeemable at \$25.00 per share at the Company's option, in whole, or in part from time to time, on or after October 20, 2010. Dividends on the Company's floating rate Series B preferred shares (70,000 shares outstanding) are payable at an annual rate equal to 3.25% above the three-month LIBOR on the applicable quarterly determination date. The Series B preferred shares have a liquidation preference of \$25.00 per share and are redeemable at the Company's option, in whole or in part from time to time, at the redemption prices below (in thousands, except per share amounts):

<u>Period</u>	<u>Redemption Price</u>	
	<u>Per Share</u>	<u>In Aggregate</u>
October 20, 2010 through October 19, 2011	\$ 25.375	\$ 1,776
October 20, 2011 through October 19, 2012	25.250	1,768
October 20, 2012 through October 19, 2013	25.125	1,759
October 20, 2013 and thereafter	25.000	1,750

On October 20, 2010, the Company redeemed for cash all of the issued and outstanding shares of its Series A and Series B preferred stock not owned by affiliates, at a per share redemption price of \$25.00 and \$25.375, respectively. The total redemption cost of the Series A and Series B preferred shares for the year ended December 31, 2010 was \$43.6 million and \$27.0 million, respectively. As a result of the redemption of the Series A and B preferred shares, the Company recorded a loss of \$2.2 million during 2010, which amount was reflected in the Company's retained earnings and included in net income available to common shareholders.

Dividends on each series of preferred shares are deferrable on a non-cumulative basis, provided that no dividends or other distributions have been declared or paid or set apart for payment on any other class or series of the Company's capital shares ranking junior to or equal with the preferred shares. Dividends on Series A and Series B preferred shares will each be payable when, as and if declared by the Company's Board of Directors, quarterly in arrears on the 20th day of January, April, July, and October of each year. Deferred dividends on either series will not accrue interest prior to the date of redemption. On December 12, 2011, the Company's Board of Directors declared quarterly dividends of \$0.5078125 per share on the Company's 8.125% Series A preferred shares and \$0.2211912 per share on the Company's floating rate Series B preferred shares. The total dividends of \$0.3 million were paid on January 20, 2012 to Series A and Series B preferred shareholders of record on December 31, 2011.

During the years ended December 31, 2010 and 2009, ORC purchased 33,700 and, 704,737 shares, respectively, of the Company's Series B preferred shares, with a liquidation preference of \$0.8 million, and \$17.2 million, respectively, with a purchase price of \$0.8 million, and \$9.2 million, respectively. As a result of the purchase of the Series B preferred shares, the Company recorded gain of less than \$0.1 million for the year ended December 31, 2010 and \$8.0 million for the year ended December 31, 2009, which amount was reflected in the Company's retained earnings and included in net income available to common shareholders.

As of December 31, 2011, a subsidiary of Fairfax owned 253,599 shares and 70,000 shares of the Company's Series A and Series B preferred stock, respectively, and ORC owned 866,437 shares of the Company's Series B preferred stock. The shares owned by ORC have been eliminated in these consolidated financial statements.

12. Segment Reporting

The Company's operations are managed through four operating divisions: Americas, EuroAsia, London Market and U.S. Insurance. The Americas division is comprised of the Company's reinsurance operations in the United States, Canada and Latin America, and writes property and casualty reinsurance business on a treaty and facultative basis. The EuroAsia division writes treaty reinsurance business. The London Market division operates through three distribution channels: Newline Syndicate (1218) at Lloyd's and NACL, which focus on casualty insurance, and the London branch of ORC, which

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focuses on worldwide property and casualty reinsurance. The U.S. Insurance division writes specialty insurance lines and classes of business, such as medical professional liability, professional liability, crop and commercial automobile.

The financial results of these divisions for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

Year Ended December 31, 2011	Americas	EuroAsia	London Market	U.S. Insurance	Total
Gross premiums written	\$ 792,715	\$ 607,402	\$ 360,374	\$ 660,253	\$ 2,420,744
Net premiums written	783,206	585,950	304,147	416,422	2,089,725
Net premiums earned	\$ 754,428	\$ 565,730	\$ 301,519	\$ 393,028	\$ 2,014,705
Losses and loss adjustment expenses	462,014	829,806	220,591	299,931	1,812,342
Acquisition costs and other underwriting expenses	230,998	138,141	74,512	97,881	541,532
Total underwriting deductions	693,012	967,947	295,103	397,812	2,353,874
Underwriting income (loss)	\$ 61,416	\$ (402,217)	\$ 6,416	\$ (4,784)	(339,169)
Net investment income					284,161
Net realized investment gains					65,772
Other expense, net					(62,734)
Interest expense					(28,924)
Loss on early extinguishment of debt					(6,121)
Loss before income taxes					\$ (87,015)
Underwriting ratios:					
Losses and loss adjustment expenses	61.2 %	146.7 %	73.2 %	76.3 %	90.0 %
Acquisition costs and other underwriting expenses	30.7	24.4	24.7	24.9	26.8
Combined ratio	91.9 %	171.1 %	97.9 %	101.2 %	116.8 %

Year Ended December 31, 2010	Americas	EuroAsia	London Market	U.S. Insurance	Total
Gross premiums written	\$ 747,382	\$ 538,614	\$ 339,039	\$ 542,303	\$ 2,167,338
Net premiums written	724,840	518,869	288,188	321,901	1,853,798
Net premiums earned	\$ 726,978	\$ 520,282	\$ 292,952	\$ 345,502	\$ 1,885,714
Losses and loss adjustment expenses	581,057	348,084	178,991	208,921	1,317,053
Acquisition costs and other underwriting expenses	228,713	131,819	78,033	102,883	541,448
Total underwriting deductions	809,770	479,903	257,024	311,804	1,858,501
Underwriting (loss) income	\$ (82,792)	\$ 40,379	\$ 35,928	\$ 33,698	27,213
Net investment income					327,875
Net realized investment gains					170,349
Other expense, net					(63,591)
Interest expense					(30,464)
Income before income taxes					\$ 431,382
Underwriting ratios:					
Losses and loss adjustment expenses	79.9 %	66.9 %	61.1 %	60.5 %	69.8 %
Acquisition costs and other underwriting expenses	31.5	25.3	26.6	29.8	28.8
Combined ratio	111.4 %	92.2 %	87.7 %	90.3 %	98.6 %

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

<u>Year Ended December 31, 2009</u>	<u>Americas</u>	<u>EuroAsia</u>	<u>London Market</u>	<u>U.S. Insurance</u>	<u>Total</u>
Gross premiums written	\$ 745,936	\$ 559,165	\$ 342,925	\$ 547,009	\$ 2,195,035
Net premiums written	731,228	532,981	254,462	375,142	1,893,813
Net premiums earned	<u>\$ 775,000</u>	<u>\$ 542,777</u>	<u>\$ 251,596</u>	<u>\$ 358,039</u>	<u>\$ 1,927,412</u>
Losses and loss adjustment expenses	548,686	392,709	140,807	219,794	1,301,996
Acquisition costs and other underwriting expenses	<u>245,903</u>	<u>135,777</u>	<u>71,590</u>	<u>107,677</u>	<u>560,947</u>
Total underwriting deductions	794,589	528,486	212,397	327,471	1,862,943
Underwriting (loss) income	<u>\$ (19,589)</u>	<u>\$ 14,291</u>	<u>\$ 39,199</u>	<u>\$ 30,568</u>	64,469
Net investment income					316,329
Net realized investment gains					189,088
Other expense, net					(44,416)
Interest expense					(31,040)
Income before income taxes					<u>\$ 494,430</u>
Underwriting ratios:					
Losses and loss adjustment expenses	70.8 %	72.4 %	56.0 %	61.4 %	67.6 %
Acquisition costs and other underwriting expenses	<u>31.7</u>	<u>25.0</u>	<u>28.4</u>	<u>30.1</u>	<u>29.1</u>
Combined ratio	<u>102.5 %</u>	<u>97.4 %</u>	<u>84.4 %</u>	<u>91.5 %</u>	<u>96.7 %</u>

Gross Premiums Written by Major Unit/Division
(in thousands)

	<u>Years Ended December 31,</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
United States	\$ 601,976	\$ 561,048	\$ 561,773
Latin America	123,144	129,280	146,163
Canada	<u>67,595</u>	<u>57,054</u>	<u>38,000</u>
Total Americas	792,715	747,382	745,936
EuroAsia	607,402	538,614	559,165
London Market	360,374	339,039	342,925
U.S. Insurance	660,253	542,303	547,009
Total gross premiums written	<u>\$ 2,420,744</u>	<u>\$ 2,167,338</u>	<u>\$ 2,195,035</u>

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Gross Premiums Written by Type of Business/Business Unit
(in thousands)

	Years Ended December 31,		
	2011	2010	2009
Americas			
Property excess of loss	\$ 272,367	\$ 210,332	\$ 157,690
Property proportional	133,069	128,717	97,925
Property facultative	29,232	22,285	21,810
Subtotal property	434,668	361,334	277,425
Casualty excess of loss	159,976	173,546	203,448
Casualty proportional	55,356	89,385	134,389
Casualty facultative	41,527	49,400	57,131
Subtotal casualty	256,859	312,331	394,968
Marine and aerospace	26,860	21,275	23,865
Surety and credit	51,824	52,442	49,678
Other lines	22,504	-	-
Total Americas	792,715	747,382	745,936
EuroAsia			
Property excess of loss	232,237	192,871	193,428
Property proportional	183,728	175,018	183,388
Property facultative	35	(4)	14
Subtotal property	416,000	367,885	376,830
Casualty excess of loss	62,764	60,376	67,604
Casualty proportional	25,927	26,598	28,061
Subtotal casualty	88,691	86,974	95,665
Marine and aerospace	48,192	39,327	44,285
Surety and credit	54,519	44,428	42,385
Total EuroAsia	607,402	538,614	559,165
London Market			
Property excess of loss	79,009	76,412	63,813
Property proportional	905	907	867
Subtotal property	79,914	77,319	64,680
Casualty excess of loss	8,146	5,908	5,321
Casualty proportional	(87)	661	3,550
Subtotal casualty	8,059	6,569	8,871
Marine and aerospace	39,853	39,360	35,916
Total reinsurance	127,826	123,248	109,467
Liability lines	229,101	209,536	227,844
Other	3,447	6,255	5,614
Total insurance	232,548	215,791	233,458
Total London Market	360,374	339,039	342,925

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Gross Premiums Written by Type of Business/Business Unit
(in thousands)

	Years Ended December 31,		
	2011	2010	2009
U.S. Insurance			
Property and package	210,339	158,779	135,047
Professional liability	150,316	121,438	119,918
Specialty liability	129,545	110,044	113,938
Medical professional liability	91,691	88,560	96,957
Commercial automobile	71,188	55,519	65,594
Personal automobile	7,174	7,963	15,555
Total U.S. Insurance	<u>660,253</u>	<u>542,303</u>	<u>547,009</u>
Total gross premiums written	<u>\$ 2,420,744</u>	<u>\$ 2,167,338</u>	<u>\$ 2,195,035</u>

The Company does not maintain separate balance sheet data for each of its operating segments. Accordingly, the Company does not review and evaluate the financial results of its operating segments based upon balance sheet data.

13. Federal and Foreign Income Taxes

The components of the federal and foreign income tax provision (benefit) included in the consolidated statements of operations for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

	2011	2010	2009
Current:			
United States	\$ 17,509	\$ 31,870	\$ 77,775
Foreign	67,432	83,365	75,475
Total current income tax provision	<u>84,941</u>	<u>115,235</u>	<u>153,250</u>
Deferred:			
United States	(104,650)	(18,301)	(1,232)
Foreign	(1,343)	1,173	(30,924)
Total deferred income tax benefit	<u>(105,993)</u>	<u>(17,128)</u>	<u>(32,156)</u>
Total federal and foreign income tax (benefit) provision	<u>\$ (21,052)</u>	<u>\$ 98,107</u>	<u>\$ 121,094</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Deferred federal and foreign income taxes reflect the tax impact of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. Components of federal and foreign income tax assets and liabilities as of December 31, 2011 and 2010 are as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Unpaid losses and loss adjustment expenses	\$ 154,362	\$ 157,835
Unearned premiums	39,226	34,593
Reserve for potentially uncollectible balances	6,061	12,238
Pension and benefit accruals	15,000	11,790
Investments	206,326	121,381
Alternative minimum tax credit	10,064	2,383
Foreign tax credit	115,843	118,889
Other	387	4,072
Total deferred tax assets	<u>547,269</u>	<u>463,181</u>
Deferred acquisition costs	44,226	39,015
Foreign deferred items	35,028	36,371
Subsidiary net operating loss	33,604	-
Total deferred tax liabilities	<u>112,858</u>	<u>75,386</u>
Net deferred tax assets	434,411	387,795
Deferred income taxes on accumulated other comprehensive income	<u>(204,990)</u>	<u>(192,365)</u>
Deferred federal and foreign income tax asset	229,421	195,430
Current federal and foreign income tax asset	2,103	29,581
Federal and foreign income taxes receivable	<u>\$ 231,524</u>	<u>\$ 225,011</u>

The following table reconciles federal and foreign income taxes at the statutory federal income tax rate to the Company's tax provision and effective tax rate for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>		<u>2010</u>		<u>2009</u>	
	<u>Amount</u>	<u>% of Pre-tax Income</u>	<u>Amount</u>	<u>% of Pre-tax Income</u>	<u>Amount</u>	<u>% of Pre-tax Income</u>
(Loss) income before income taxes	<u>\$ (87,015)</u>		<u>\$ 431,382</u>		<u>\$ 494,430</u>	
Income tax (benefit) provision computed at the U.S. statutory tax rate on (loss) income	\$ (30,455)	35.0 %	\$ 150,984	35.0 %	\$ 173,051	35.0 %
(Decrease) increase in income taxes resulting from:						
Dividend received deduction	(3,673)	4.2	(6,036)	(1.4)	(8,622)	(1.7)
Tax-exempt income	(29,402)	33.8	(37,649)	(8.7)	(38,010)	(7.7)
Foreign tax expense	41,394	(47.6)	-	-	-	-
Other, net	<u>1,084</u>	<u>(1.2)</u>	<u>(9,192)</u>	<u>(2.2)</u>	<u>(5,325)</u>	<u>(1.1)</u>
Total federal and foreign income tax provision	<u>\$ (21,052)</u>	<u>24.2 %</u>	<u>\$ 98,107</u>	<u>22.7 %</u>	<u>\$ 121,094</u>	<u>24.5 %</u>

Domestic pre-tax income was \$286.5 million, \$298.0 million and \$289.5 million for the years ended December 31, 2011, 2010 and 2009, respectively. Foreign pre-tax (loss) income was \$(373.5) million, \$133.4 million and \$204.9 million for the years ended December 31, 2011, 2010 and 2009, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company has elected to expense foreign taxes in its federal tax return for the year ended December 31, 2011. For the years ended December 31, 2010 and December 31, 2009, the Company elected to credit foreign taxes. The Company's foreign tax expense for the year ended December 31, 2011 is net of an \$11.1 million benefit generated by the application of the United Kingdom group relief regime.

During the third quarter of 2006, Fairfax reduced its ownership of the Company to below 80%, and as a result, the Company was deconsolidated from the United States tax group of Fairfax. Accordingly, the Company filed separate company tax returns for the period August 2, 2006 to October 20, 2009. As a result of the Merger (see Note 1), effective October 21, 2009, the Company rejoined the United States tax group of Fairfax. The Merger had no effect on the Company's tax position. The Company paid federal and foreign income taxes of \$51.3 million, \$179.5 million and \$355.9 million for the years ended December 31, 2011, 2010 and 2009, respectively. As of December 31, 2011, the Company had a current tax receivable of \$2.1 million, which reflects \$5.3 million receivable from Fairfax and a net payable of \$3.2 million to various foreign governments. As of December 31, 2010, the Company had a current tax receivable of \$29.6 million, which reflects \$53.5 million receivable from Fairfax and a net payable of \$23.9 million to the U.S. federal government and various foreign governments.

The Company files income tax returns with various federal, state and foreign jurisdictions. The Company's U.S. federal income tax returns for 2009 through 2010 remain open for examination. The Internal Revenue Service completed their audit of the Company's 2007 through 2008 tax returns in 2011 and will commence their audit of the Company's 2009 and 2010 tax returns during 2012. There were no material adjustments proposed under the recently completed audit cycle. Income tax returns filed with various state and foreign jurisdictions remain open to examination in accordance with individual statutes.

The Company has elected to recognize accrued interest and penalties associated with uncertain tax positions as part of the income tax provision. The Company does not have any material unrecognized tax benefits and, accordingly, has not recognized any accrued interest or penalties associated with uncertain tax positions.

14. Commitments and Contingencies

(a) Contingencies

Plumbers & Pipefitters Union v. Fairfax Financial Holdings Limited, Odyssey Re Holdings Corp., et al. This securities class action was filed on July 25, 2011 as a replacement of the *Parks* suit (dismissed on May 24, 2011) in an effort to cure the jurisdictional problems that led to the *Parks* dismissal. As with *Parks*, the matter was filed in the U.S. District Court, Southern District of New York. Several of Fairfax's officers and directors, including some who are current or former directors of the Company, were also named as defendants in the suit. The suit, which purports to be filed on behalf of purchasers of Fairfax's securities between and including May 21, 2003 and March 22, 2006, alleges that Fairfax and the Company violated federal securities laws by making material misstatements or failing to disclose certain material information. A Motion to Dismiss all claims was filed in December of 2011, and plaintiff's response is due in February of 2012. OdysseyRe denies the allegations of the complaint and intends to continue to vigorously defend against these claims.

Fairfax Financial Holdings Limited v. S.A.C. Capital Mgt., et al. – This suit was filed by Fairfax in July 2006 in the Superior Court, Morris County, New Jersey, seeking damages from a number of defendants who, the complaint alleges, participated in a stock market manipulation scheme involving Fairfax shares. The complaint was subsequently amended to add additional allegations and two defendants. The Company was not originally a party to the suit. On January 25, 2008, two named defendants filed an answer and amended counterclaim, seeking unspecified damages, and naming OdysseyRe as a third party defendant. Defendants alleged, among other things, that the Company engaged in a fraudulent tax scheme as part of a broad conspiracy by Fairfax to retaliate against short sellers of Fairfax securities. As a result of motion practice during the course of 2008, on September 8, 2008, the defendants filed an amended counterclaim and third-party complaint that again named the Company and certain directors as defendants. In July 2011, the third-party claims against the Company were voluntarily dismissed without prejudice by those defendants, and no claims remain against the Company.

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The Company participates in Lloyd's through its 100% ownership of Newline Syndicate (1218), for which the Company provides 100% of the capacity. The results of Newline Syndicate (1218) are consolidated in the financial statements of the Company. In support of Newline Syndicate (1218)'s capacity at Lloyd's, the Company has pledged securities and cash with a fair value of \$316.7 million as of December 31, 2011 in a deposit trust account in favor of the Society and Council of Lloyd's. The securities may be substituted with other securities at the discretion of the Company, subject to approval by Lloyd's. The securities are carried at fair value and are included in investments and cash in the Company's consolidated balance sheets. Interest earned on the securities is included in investment income. The pledge of assets in support of Newline Syndicate (1218) provides the Company with the ability to participate in writing business through Lloyd's, which remains an important part of the Company's business. The pledged assets effectively secure the contingent obligations of Newline Syndicate (1218) should it not meet its obligations. The Company's contingent liability to the Society and Council of Lloyd's is limited to the aggregate amount of the pledged assets. The Company has the ability to remove funds at Lloyd's annually, subject to certain minimum amounts required to support outstanding liabilities as determined under risk-based capital models and approved by Lloyd's. The funds used to support outstanding liabilities are adjusted annually and the obligations of the Company to support these liabilities will continue until they are settled or the liabilities are reinsured by a third party approved by Lloyd's. The Company expects to continue to actively operate Newline Syndicate (1218) and support its requirements at Lloyd's. The Company believes that Newline Syndicate (1218) maintains sufficient liquidity and financial resources to support its ultimate liabilities and the Company does not anticipate that the pledged assets will be utilized.

As of July 14, 2000, ORC agreed to guarantee the performance of all the insurance and reinsurance contract obligations, whether incurred before or after the agreement, of Compagnie Transcontinentale de Réassurance ("CTR"), a subsidiary of Fairfax, in the event CTR became insolvent and CTR was not otherwise indemnified under its guarantee agreement with a Fairfax affiliate. The guarantee, which was entered into while ORC and CTR were each 100% owned by Fairfax, was provided by ORC to facilitate the transfer of renewal rights to CTR's business, together with certain CTR employees, to ORC in 2000 in order to further expand the Company's international reinsurance business. The guarantee was terminated effective December 31, 2001. There were no amounts received from CTR under the guarantee, and the Company did not provide any direct consideration for the renewal rights to the business of CTR. CTR was dissolved and its assets and liabilities were assumed by subsidiaries of Fairfax that have the responsibility for the run-off of its liabilities. Although CTR's liabilities were assumed by Fairfax subsidiaries, the guarantee only pertains to those liabilities attaching to the policies written by CTR. Fairfax has agreed to indemnify ORC for all its obligations incurred under its guarantee. The Company's potential exposure in connection with this agreement stems from CTR's remaining gross reserves, which are estimated to be \$76.8 million as of December 31, 2011. The Company believes that the financial resources of the Fairfax subsidiaries that have assumed CTR's liabilities provide adequate protection to satisfy the obligations that are subject to this guarantee. The Company does not expect to make payments under this guarantee and does not consider its potential exposure under this guarantee to be material to its consolidated financial position.

ORC agreed, as of April 1, 2002, to guarantee the payment of all of the insurance contract obligations (the "Subject Contracts"), whether incurred before or after the agreement, of Falcon Insurance Company (Hong Kong) Limited ("Falcon"), a subsidiary of Fairfax Asia Limited ("Fairfax Asia"), in the event Falcon becomes insolvent. Fairfax Asia is 100% owned by Fairfax, which includes a 26.2% economic interest owned by the Company. The guarantee by ORC was made to assist Falcon in writing business through access to ORC's financial strength ratings and capital resources. ORC is paid a fee for this guarantee of one quarter of one percent of all gross premiums earned associated with the Subject Contracts on a quarterly basis. For the years ended December 31, 2011, 2010 and 2009, Falcon paid \$0.1 million, \$0.2 million and \$0.3 million, respectively, to ORC in connection with this guarantee. ORC's potential exposure in connection with this agreement is estimated to be \$84.9 million, based on Falcon's loss reserves at December 31, 2011. Falcon's shareholders' equity on a U.S. GAAP basis is estimated to be \$57.8 million as of December 31, 2011. Fairfax has agreed to indemnify ORC for any obligation under this guarantee. The Company believes that the financial resources of Falcon provide adequate protection to support its liabilities in the ordinary course of business. The Company anticipates that Falcon will meet all of its obligations in the normal course of business and does not expect to make any payments under this guarantee. The Company does not consider its potential exposure under this guarantee to be material to its consolidated financial position.

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During 2004, ORE entered into a joint venture agreement relating to the purchase by ORE of 45% of Cheran Enterprises Private Limited (“CEPL”). CEPL is a corporation domiciled in India, that was organized to engage in the purchase, development and sale of commercial real estate properties. The joint venture agreement governing CEPL contains a provision whereby the Company could have been called upon to provide a guarantee of a credit facility, if such a facility had been established by CEPL, in an amount up to \$65.0 million for the funding of proposed developments. The credit facility was never established, and the requisite conditions for any future provision of the guarantee no longer exist. ORE’s joint venture partner (“Partner”) claimed that the guarantee should be available and pursued legal actions against the Company and ORE. The Company and ORE found this claim without merit and vigorously defended the legal actions, while also bringing an action to recover the invested funds that had been illegally diverted by Partner. On August 13, 2008, the Company Law Board in Chennai, India ruled in ORE’s favor and directed CEPL to return to ORE the full amount of its investment, plus 8% interest, within the one-year period commencing November 1, 2008, or, in the event that such amount was not paid, to convey to ORE a portion of the real property owned by CEPL’s subsidiary, Vasantha Mills Limited (“VML”). Partner appealed this ruling and it was affirmed by the High Court in August 2011. As of December 31, 2011, no payment on the award has been made to ORE, and the Company had written down the value of its investment in ORE by \$9.9 million. Because no payment of the award has yet been received and the transfer to ORE of the VML property remains in issue, despite ORE’s vigorous pursuit of this objective, the Company has taken no steps to reverse the write-downs that have been taken to date.

The Company and its subsidiaries are involved from time to time in ordinary litigation and arbitration proceedings as part of the Company’s business operations. In the Company’s opinion, the outcome of these suits, individually or collectively, is not likely to result in judgments that would be material to the financial condition or results of operations of the Company.

(b) *Commitments*

The Company and its subsidiaries lease office space and furniture and equipment under long-term operating leases expiring through the year 2022. Minimum annual rentals follow (in thousands):

	Amount
2011.....	\$ 9,182
2012.....	7,721
2013.....	7,654
2014.....	7,509
2015.....	5,544
2016 and thereafter	28,470
Total	\$ 66,080

The amounts above are reduced by an aggregate minimum rental recovery of \$0.2 million resulting from the sublease of space to other companies.

Rental expense, before sublease income under these operating leases, was \$11.2 million, \$11.5 million and \$11.4 million for the years ended December 31, 2011, 2010 and 2009, respectively. The Company recovered pre-tax amounts of \$0.1 million for each of the years ended December 31, 2011, 2010 and 2009, from subleases.

15. Statutory Information and Dividend Restrictions

ORC, the Company’s principal operating subsidiary, is subject to state regulatory restrictions that limit the maximum amount of dividends payable. In any 12-month period, ORC may pay dividends equal to the greater of (i) 10% of statutory capital and surplus as of the prior year end or (ii) net income for such prior year, without prior approval of the Insurance Commissioner of the State of Connecticut (the “Connecticut Commissioner”). The maximum amount of dividends which ORC may pay in 2012, without such prior approval is \$302.5 million, based on ORC’s separate company statutory financial

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

statements. Connecticut law further provides that (i) ORC must report to the Connecticut Commissioner, for informational purposes, all dividends and other distributions within five business days after the declaration thereof and at least ten days prior to payment and (ii) ORC may not pay any dividend or distribution in excess of its earned surplus, defined as the insurer's "unassigned funds surplus" reduced by 25% of unrealized appreciation in value or revaluation of assets or unrealized profits on investments, as reflected in its most recent statutory annual statement on file with the Connecticut Commissioner, without the Connecticut Commissioner's approval. ORC did not declare any dividends to the Company during the year ended December 31, 2011. ORC declared dividends of \$512.0 million, of which \$225.0 million was paid, during the year ended December 31, 2010. ORC paid the balance of \$287.0 million in the form of a dividend of all of the common stock of Clearwater to the Company on January 1, 2011. ORC paid dividends to the Company of \$200.0 million during the year ended December 31, 2009.

The following is the consolidated statutory basis net (loss) income and policyholders' surplus of ORC and its subsidiaries, for each of the years ended and as of December 31, 2011, 2010 and 2009 (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net (loss) income	\$ (26,707)	\$ 338,205	\$ 374,884
Policyholders' surplus	3,054,109	3,320,141	3,512,819

16. Related Party Transactions

The Company has entered into various reinsurance arrangements with Fairfax and its affiliates. The approximate amounts included in or deducted from income, expense, assets and liabilities in the accompanying consolidated financial statements, with respect to reinsurance assumed and ceded from and to affiliates, as of and for the years ended December 31, 2011, 2010 and 2009, follow (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assumed:			
Premiums written	\$ 15,114	\$ 13,029	\$ 14,434
Premiums earned	15,243	15,337	15,956
Losses and loss adjustment expenses	37,176	16,016	15,868
Acquisition costs	4,214	3,697	3,989
Reinsurance payable on paid losses	5,894	1,333	(86)
Reinsurance balances receivable	3,091	257	1,441
Unpaid losses and loss adjustment expenses	141,959	123,283	131,446
Unearned premiums	6,620	4,181	6,489
Ceded:			
Premiums written	\$ 2,332	\$ (23)	\$ 39
Premiums earned	1,569	(23)	39
Losses and loss adjustment expenses	(566)	7,256	(882)
Acquisition costs	207	-	(8)
Ceded reinsurance balances payable	34	202	333
Reinsurance recoverables on paid losses	(578)	(249)	(192)
Reinsurance recoverables on unpaid losses	1,990	13,949	9,318
Unearned premiums	739	-	-

Written premiums assumed from Fairfax's affiliates in 2011 represent less than 0.6% of OdysseyRe's total gross premiums written for the year ended December 31, 2011. The largest amounts of related party assumed business in 2011 were received from Commonwealth Insurance Company and Northbridge Financial Corp.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's subsidiaries have entered into investment management agreements with Fairfax and its wholly-owned subsidiary, Hamblin Watsa Investment Counsel Ltd. These agreements provide for an annual base fee of 0.20% (20 basis points), calculated and paid quarterly based upon the subsidiary's average invested assets for the preceding three months. The agreements also include incentive fees of 0.10% (10 basis points), which are payable if realized gains exceed 1% of the average investment portfolio in any given year, subject to cumulative realized gains on investments exceeding 1% of the average investment portfolio. Additional incentive fees are paid based upon the performance of the subsidiary's equity portfolio equal to 10% of the return on equities (subject to an annual maximum) in excess of the Standard & Poor's 500 index plus 200 basis points, provided that the equity portfolio has achieved such excess on a cumulative basis. If the performance of the equity portfolio does not equal or exceed this benchmark in a given year, the annual base fee, on the equity portion of the portfolio, is reduced to 0.18% (18 basis points). The aggregate annual investment management fee payable by each subsidiary, including incentive fees, is capped at 0.40% (40 basis points) of its investment portfolio, with any excess amounts carried into the following year. These agreements may be terminated by either party on 30 days' notice. For the years ended December 31, 2011, 2010 and 2009, total fees, including incentive fees, of \$27.9 million, \$28.5 million and \$28.8 million, respectively, are included in the consolidated statements of operations.

Included in other expense, net for the years ended December 31, 2011, 2010 and 2009, are incurred charitable contributions of \$1.1 million, \$4.2 million and \$5.0 million, respectively, made to the OdysseyRe Foundation, a not-for-profit entity through which the Company provides funding to charitable organizations active in the communities in which the Company operates.

Due to expense sharing and investment management agreements with Fairfax and its affiliates, the Company has accrued, on its consolidated balance sheet, amounts receivable from affiliates of \$1.9 million and \$3.9 million as of December 31, 2011 and 2010, respectively, and amounts payable to affiliates of \$0.7 million and \$11.4 million as of December 31, 2011 and 2010, respectively.

Effective May 1, 2010, the Company and Fairfax (US) Inc. (a wholly-owned subsidiary of Fairfax formerly known as Fairfax Inc., and the direct and indirect holder of 100% of the common shares of the Company ("Fairfax US")) entered into a \$300.0 million two-way revolving credit facility, under which either party may borrow up to \$300.0 million from the other party. On April 1, 2011, the facility amount was raised to \$350.0 million. Loans under the facility are unsecured and bear interest at a rate of 7.5% per annum, payable quarterly, and the principal amount is payable on demand. Either party may terminate the facility at any time upon demand, at which time all outstanding principal and unpaid interest shall become due. On May 3, 2010, the Company loaned \$200.0 million to Fairfax US under the facility. During 2011, Fairfax US repaid \$195.5 million to the Company, resulting in a balance of \$4.5 million as of December 31, 2011.

During the years ended December 31, 2011 and 2010, the Company received \$16.1 million and \$6.8 million, respectively, of interest from Fairfax US related to these loans. As of December 31, 2011 and 2010, the Company accrued interest receivable of \$0.1 million and \$3.2 million, respectively, due from Fairfax US, which is included in accrued investment income on the balance sheets.

In the ordinary course of the Company's investment activities, the Company makes investments in investment funds, limited partnerships and other investment vehicles in which Fairfax or its affiliates may also be investors.

17. Employee Benefits

The Company provides its employees with benefits through various plans as described below. Effective August 1, 2011, the Company implemented modifications to the qualified defined benefit pension plan, the non-qualified excess benefit plans, the qualified deferred compensation plan, the non-qualified deferred compensation plan, and the postretirement benefit plan. The changes to these plans did not affect eligibility for, or benefit levels provided to, employees hired prior to August 1, 2011. However, employees hired on or after August 1, 2011 are not eligible to participate in the qualified defined benefit pension plan, the non-qualified excess benefit plans, or the post-retirement benefit plan. Such employees are eligible for enhanced benefits under the qualified deferred compensation plan and, if applicable, the non-qualified deferred compensation plan, as described below under "Other Plans."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company measures the assets and liabilities of its employee benefit plans as of the date of the Company's financial statements, as required by GAAP.

Defined Benefit Pension Plan

The Company maintains a qualified, non-contributory, defined benefit pension plan ("Plan") covering substantially all employees hired prior to August 1, 2011, who have reached age twenty-one and who have completed one year of service. Employer contributions to the Plan are in accordance with the minimum funding requirements of the Employee Retirement Income Security Act of 1974, as amended.

The amortization period for unrecognized pension costs and credits, including prior service costs, if any, and actuarial gains and losses, is based on the remaining service period for those employees expected to receive pension benefits. Actuarial gains and losses result when actual experience differs from that assumed or when actuarial assumptions are changed.

The following tables set forth the Plan's unfunded status and accrued pension cost recognized in the Company's consolidated financial statements as of December 31, 2011 and 2010 (in thousands):

	2011	2010
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 76,346	\$ 66,738
Service cost	6,632	5,898
Interest cost	4,493	3,925
Actuarial loss.....	8,548	1,453
Benefits paid	(928)	(1,668)
Effect of curtailment.....	(53)	-
Benefit obligation at end of year	95,038	76,346
Change in Plan assets:		
Fair value of Plan assets at beginning of year	66,949	57,276
Actual return on Plan assets	6,574	7,630
Actual contributions during the year	4,000	3,711
Benefits paid	(928)	(1,668)
Fair value of Plan assets at end of year	76,595	66,949
Unfunded status and accrued pension cost	\$ (18,443)	\$ (9,397)

The net amount recognized in the consolidated balance sheets related to the accrued pension cost of \$18.4 million and \$9.4 million, as of December 31, 2011 and 2010, respectively, is included in other liabilities. The net amount of accumulated other comprehensive loss (income) recognized is \$3.3 million and \$(2.5) million, before taxes, as of December 31, 2011 and 2010, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

As of December 31, 2011 and 2010, the fair value and percentage of fair value of the total Plan assets are as follows (in thousands):

	As of December 31,			
	2011		2010	
Equity securities	\$ 40,506	52.9 %	\$ 37,853	56.5 %
Fixed income securities	20,237	26.4	14,507	21.7
Pooled investment hedge fund	8,777	11.5	8,028	12.0
Money market	7,075	9.2	6,561	9.8
Fair value of Plan assets	\$ 76,595	100.0 %	\$ 66,949	100.0 %

The Plan seeks to maximize the economic value of its investments, by applying a long-term, value-oriented approach to optimize the total investment returns of the Plan's invested assets. Assets are transferred and allocated among various investment vehicles, when appropriate. The long-term rate of return assumption is based on this flexibility to adjust to market conditions. The actual return on assets has historically been in line with the Company's assumptions of expected returns. During 2011, the Company contributed \$4.0 million to the Plan. The Company currently expects to make a contribution to the Plan in 2012 of \$5.0 million.

The Company accounts for its Plan assets at fair value as required by GAAP. The Company has categorized its Plan assets, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The Company uses the three-level hierarchy approach that is described in Note 4.

For determining the fair value of the Company's Level 1 Plan assets, quoted market prices are used. The majority of these Plan assets are common stocks that are actively traded in a public market. The Plan's money market account, for which the cost basis approximates fair value, is also classified as a Level 1 investment.

The Company's Level 2 Plan assets, the majority of which are in government, corporate and municipal fixed income securities, are priced using publicly traded over-the-counter prices and broker-dealer quotes. Observable inputs such as benchmark yields, reported trades, broker-dealer quotes, issuer spreads and bids are available for these investments.

The Company's Level 3 Plan assets are valued by a third party, providing a net asset value, by using valuation techniques that include unobservable inputs. Generally, hedge funds invest in securities that trade in active markets, and as a result, their net asset values reflect their fair values. During the year ended December 31, 2011, the Company's investments that are classified as Level 3 had a fair value of \$8.8 million. During the year ended December 31, 2010, there was no activity for the investments that are classified as Level 3, other than the change in market value of \$0.8 million. As of December 31, 2010, the Company had investments that were classified as Level 3, which had a fair value of \$8.0 million, with no other activity except for a change in market value of \$1.4 million.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables present the fair value hierarchy for those Plan assets measured at fair value on a recurring basis as of December 31, 2011 (in thousands):

	Assets Measured at Fair Value December 31, 2011	Fair Value Measurements as of December 31, 2011		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 40,506	\$ 40,506	\$ -	\$ -
Fixed income securities	20,237	-	20,237	-
Pooled investment hedge fund	8,777	-	-	8,777
Money market	7,075	7,075	-	-
Total Plan assets measured at fair value	<u>\$ 76,595</u>	<u>\$ 47,581</u>	<u>\$ 20,237</u>	<u>\$ 8,777</u>

	Assets Measured at Fair Value December 31, 2010	Fair Value Measurements as of December 31, 2010		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Equity securities	\$ 37,853	\$ 37,853	\$ -	\$ -
Fixed income securities	14,507	-	14,507	-
Pooled investment hedge fund	8,028	-	-	8,028
Money market	6,561	6,561	-	-
Total Plan assets measured at fair value	<u>\$ 66,949</u>	<u>\$ 44,414</u>	<u>\$ 14,507</u>	<u>\$ 8,028</u>

The weighted average assumptions used to calculate the benefit obligation as of December 31, 2011 and 2010 are as follows:

	2011	2010
Discount rate	5.00 %	6.00 %
Rate of compensation increase	3.66 %	5.69 %

The discount rate represents the Company's estimate of the interest rate at which the Plan's benefits could be effectively settled. The discount rates are used in the measurement of the expected and accumulated postretirement benefit obligations and the service and interest cost components of net periodic postretirement benefit cost.

Net periodic benefit cost included in the Company's consolidated statements of operations for the years ended December 31, 2011, 2010 and 2009 is comprised of the following components (in thousands):

	2011	2010	2009
Net Periodic Benefit Cost:			
Service cost	\$ 6,632	\$ 5,898	\$ 5,121
Interest cost	4,493	3,925	3,432
Return on Plan assets	(4,019)	(3,444)	(2,188)
Net amortization and deferral	95	63	55
Net periodic benefit cost	<u>\$ 7,201</u>	<u>\$ 6,442</u>	<u>\$ 6,420</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The weighted average assumptions used to calculate the net periodic benefit cost for the years ended December 31, 2011, 2010 and 2009 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Discount rate	6.00 %	6.00 %	6.00 %
Rate of compensation increase	5.69 %	5.62 %	5.75 %
Expected long term rate of return on Plan assets	6.00 %	6.00 %	5.25 %

The accumulated benefit obligation for the Plan is \$79.0 million and \$57.7 million as of the December 31, 2011 and 2010 measurement dates, respectively.

The Plan's expected future benefit payments are shown below (in thousands):

<u>Year</u>	<u>Amount</u>
2012.....	\$ 2,950
2013.....	3,920
2014.....	3,860
2015.....	5,070
2016.....	5,110
2017 - 2021	39,910

The Company estimates that it will record a \$7.4 million expense related to the net periodic benefit cost during the year ended December 31, 2012. The Company does not expect any refunds of Plan assets during the year ended December 31, 2012.

Excess Benefit Plans

The Company maintains two non-qualified excess benefit plans ("Excess Plans") that provide more highly compensated officers and employees, hired prior to August 1, 2011, with defined retirement benefits in excess of qualified plan limits imposed by federal tax law. The following tables set forth the combined amounts recognized for the Excess Plans in the Company's consolidated financial statements as of December 31, 2011 and 2010 (in thousands):

	<u>2011</u>	<u>2010</u>
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 16,714	\$ 15,776
Service cost	873	719
Interest cost	975	914
Actuarial (gain) loss	(644)	714
Benefits paid	(768)	(1,409)
Benefit obligation at end of year	<u>17,150</u>	<u>16,714</u>
Change in Excess Plans' assets:		
Fair value of Excess Plans' assets at beginning of year	-	-
Actual contributions during the year	768	1,409
Benefits paid	(768)	(1,409)
Fair value of Excess Plans' assets at end of year	-	-
Unfunded status and accrued pension cost	<u>\$ (17,150)</u>	<u>\$ (16,714)</u>

The net amount recognized in the consolidated balance sheets related to the accrued pension cost of \$17.1 million and \$16.7 million, as of December 31, 2011 and 2010, respectively, is included in other liabilities. The net amount of

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

accumulated other comprehensive loss recognized is \$2.0 million and \$2.7 million, before taxes, as of December 31, 2011 and 2010, respectively.

The weighted average assumptions used to calculate the benefit obligation as of December 31, 2011 and 2010 are as follows:

	<u>2011</u>	<u>2010</u>
Discount rate	5.00 %	6.00 %
Rate of compensation increase	3.66 %	5.69 %

The discount rate represents the Company's estimate of the interest rate at which the Excess Plans' benefits could be effectively settled. The discount rates are used in the measurement of the expected and accumulated post retirement benefit obligations and the service and interest cost components of net periodic post retirement benefit cost.

Net periodic benefit cost included in the Company's consolidated statements of operations for the years ended December 31, 2011, 2010 and 2009 is comprised of the following components (in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net Periodic Benefit Cost:			
Service cost	\$ 873	\$ 719	\$ 733
Interest cost	975	914	950
Recognized net actuarial loss	133	110	126
Recognized prior service cost	(37)	(37)	(37)
Net periodic benefit cost	<u>\$ 1,944</u>	<u>\$ 1,706</u>	<u>\$ 1,772</u>

The weighted average assumptions used to calculate the net periodic benefit cost for the years ended December 31, 2011, 2010 and 2009 are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Discount rate	6.00 %	6.00 %	6.00 %
Rate of compensation increase	5.69 %	5.62 %	5.75 %

The accumulated benefit obligation for the Excess Plans is \$13.4 million and \$11.3 million as of December 31, 2011 and 2010, respectively.

The Excess Plans' expected benefit payments are shown below (in thousands):

<u>Year</u>	<u>Amount</u>
2012.....	\$ 1,050
2013.....	1,060
2014.....	1,090
2015.....	1,090
2016.....	1,630
2017 - 2021.....	12,660

A trust fund, which was established related to the Excess Plans, is included in other invested assets, and had a fair value of \$2.6 million and \$3.0 million as of December 31, 2011 and 2010, respectively. Plan benefits are paid by the Company as they are incurred by the participants, accordingly, there are no assets held directly by the Excess Plans.

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company expects to contribute \$1.1 million to the Excess Plans during the year ended December 31, 2012, which represents the amount necessary to fund the 2012 expected benefit payments.

The Company estimates that it will record a \$1.7 million expense related to the net periodic benefit cost during the year ended December 31, 2012.

Postretirement Benefit Plan

The Company provides certain health care and life insurance (“postretirement”) benefits for retired employees. Substantially all employees, hired prior to August 1, 2011, may become eligible for these benefits if they reach retirement age while working for the Company. The Company’s cost for providing postretirement benefits other than pensions is accounted for in accordance with ASC 715, “Compensation – Retirement Benefits.” The following tables set forth the amounts recognized for the postretirement benefit plan in the Company’s consolidated financial statements as of December 31, 2011 and 2010 (in thousands):

	2011	2010
Change in projected benefit obligation:		
Benefit obligation at beginning of year	\$ 30,047	\$ 24,471
Service cost	3,338	2,946
Interest cost	1,606	1,394
Actuarial loss.....	3,730	1,681
Benefits paid	(626)	(517)
Other	87	72
Benefit obligation at end of year	38,182	30,047
Unfunded status and accrued prepaid pension cost	\$ (38,182)	\$ (30,047)

The net amount recognized in the consolidated balance sheets related to the accrued benefit cost of \$38.2 million and \$30.0 million, as of December 31, 2011 and 2010, respectively, is included in other liabilities. The net amount of accumulated other comprehensive loss, before taxes, recognized is \$10.5 million and \$7.2 million as of December 31, 2011 and 2010, respectively.

The weighted average assumptions used to calculate the benefit obligation as of December 31, 2011 and 2010 are as follows:

	2011	2010
Discount rate	4.36 %	5.39 %
Rate of compensation increase	4.00 %	4.00 %

The discount rate represents the Company’s estimate of the interest rate at which the postretirement benefit plan benefits could be effectively settled. The discount rates are used in the measurement of the expected and accumulated post retirement benefit obligations and the service and interest cost components of net periodic post retirement benefit cost.

Net periodic benefit cost included in the Company’s consolidated statements of operations for the years ended December 31, 2011, 2010 and 2009 is comprised of the following components (in thousands):

	2011	2010	2009
Net Periodic Benefit Cost:			
Service cost	\$ 3,338	\$ 2,946	\$ 1,743
Interest cost	1,606	1,394	1,052
Net amortization and deferral.....	409	252	(131)
Net periodic benefit cost	\$ 5,353	\$ 4,592	\$ 2,664

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The weighted average assumptions used to calculate the net periodic benefit cost for the years ended December 31, 2011, 2010 and 2009 are as follows:

	2011	2010	2009
Discount rate	5.39 %	5.75 %	7.34 %
Rate of compensation increase	4.00 %	4.00 %	4.00 %

The accumulated benefit obligation for the postretirement plan was \$38.2 million and \$30.0 million as of December 31, 2011 and 2010, respectively.

The postretirement plan's expected benefit payments are shown below (in thousands):

Year	Amount
2012.....	\$ 568
2013.....	706
2014.....	837
2015.....	1,019
2016.....	1,240
2017 - 2021.....	10,264

The annual assumed rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) is assumed to be 7.68% in 2011, decreasing to 4.50% in 2027 and remaining constant thereafter. The health care cost trend rate assumption has a significant effect on the amounts reported. For example, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation by \$7.0 million (18.2% of the benefit obligation as of December 31, 2011) and the service and interest cost components of net periodic postretirement benefit costs by \$1.0 million for 2011. Decreasing the assumed health care cost trend rates by one percentage point in each year would decrease the accumulated postretirement benefit obligation and the service and interest cost components of net periodic postretirement benefit cost for 2011 by \$5.6 million and \$0.8 million, respectively.

The Company estimates that it will record \$6.6 million in benefit costs relating to this plan during the year ended December 31, 2012.

Other Plans

The Company also maintains a defined contribution profit sharing plan for all eligible employees. Each year, the Board of Directors may authorize payment of an amount equal to a percentage of each participant's basic annual earnings based on the experience of the Company for that year. These amounts are credited to the employee's account maintained by a third party, which has contracted to provide benefits under the plan. No contributions were authorized in 2011, 2010 and 2009.

The Company maintains a qualified deferred compensation plan pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended. Employees may contribute up to 50% of base salary on a pre-tax basis, subject to annual maximum contributions set by law (\$16,500 in 2011). The Company contributes an amount equal to 100% of each employee's pre-tax contribution up to certain limits. The maximum matching contribution is 4.0% of annual base salary, with certain government-mandated restrictions on contributions to highly compensated employees. The Company also maintains a non-qualified deferred compensation plan to allow for contributions in excess of qualified plan limitations. The Company's contributions to these plans of \$2.0 million in 2011, \$2.3 million in 2010 and \$2.0 million in 2009, are included in other underwriting expenses in the consolidated statements of operations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Beginning in 2012, employees hired after July 31, 2011 will receive an annual Company contribution of 6%, 7%, or 8% of base salary earned for the year, depending on an employee's length of service, to the qualified deferred compensation plan and, if applicable, to the non-qualified deferred compensation plan, in lieu of their participation in the defined benefit plan.

18. Restricted Equity Value Rights and Stock-Based Compensation Plans

The Company had previously established three stock-based compensation plans (the "Stock-Based Compensation Plans"): the Odyssey Re Holdings Corp. 2002 Stock Incentive Plan (the "2002 Option Plan"), the Odyssey Re Holdings Corp. Stock Option Plan (the "2001 Option Plan") and the Odyssey Re Holdings Corp. Restricted Share Plan (the "Restricted Share Plan"). The Stock-Based Compensation Plans generally provided officers, key employees and directors who were employed by or provided services to the Company, with stock options and/or restricted share awards. As a result of the Merger (see Note 1), the Stock-Based Compensation Plans were amended to allow for the conversion, substitution and issuance of restricted equity value rights ("REVRs"). Specifically, the Restricted Share Plan was amended and restated, as of October 28, 2009, as the "Odyssey Re Holdings Corp. Restricted Share and Equity Value Plan" (the "REVR Plan").

REVR Plan

In connection with the Merger, each unvested restricted share under the Restricted Share Plan (a "Restricted Share") was cancelled and converted into a right to acquire \$65.00 in cash, without interest (a "Restricted Cash Unit"), subject to the same vesting, transfer and other restrictions that applied to the Restricted Shares. Following the amendment and restatement of the REVR Plan, certain holders of Restricted Cash Units elected to convert each of their Restricted Cash Units into 1.2524 REVRs, which REVRs are subject to the same vesting, transfer and other restrictions that applied to the Restricted Cash Units.

In connection with the Merger, the common shares underlying each unvested option granted under the 2001 Option Plan and 2002 Option Plan were substituted with 1.2524 REVRs. Each unvested option became exercisable for REVRs, subject to the same terms and conditions, including the vesting schedule, as applicable to such option prior to the substitution.

Under the terms of the REVR Plan, each REVR has a value (the "REVR Value") equal to the most recently reported common shareholders' equity of the Company, as adjusted in accordance with the REVR Plan, divided by 58,443,149, which was the number of Company common shares outstanding as of September 30, 2009. Upon vesting of a REVR, a participant will receive a single sum cash payment equal to the REVR value as of the applicable vesting date, less any applicable withholding of taxes. The REVRs will be subject to the terms and conditions of the REVR Plan, including vesting and termination of employment provisions, and will not be paid until a participant satisfies the applicable vesting requirements.

The following table summarizes activity for the Restricted Cash Units and REVR Plan for the year ended December 31, 2011:

	Restricted Cash Units	REVRs
Outstanding as of December 31, 2010.....	12,393	632,895
Granted.....	-	2,189
Vested.....	(9,708)	(290,499)
Forfeited.....	-	(7,921)
Outstanding as of December 31, 2011.....	<u>2,685</u>	<u>336,664</u>

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

As of December 31, 2011 and 2010, the Company recorded a liability of \$13.6 million and \$20.1 million for the REVRs and Restricted Cash Units, respectively. For year ended December 31, 2011, the Company recognized an expense related to the REVRs and Restricted Cash Units of \$11.9 million. For the period from October 21, 2009, the effective date of issuance of the Restricted Cash Units and REVRs, through December 31, 2009, the Company recognized an expense related to the REVRs and Restricted Cash Units of \$15.0 million. The total tax benefit relating to the REVRs and Restricted Cash Units recognized for the years ended December 31, 2011 and 2010 was \$4.2 million and \$8.6 million, respectively.

Fairfax Restricted Share Plan and Share Option Plan

In 1999, Fairfax established the Fairfax Financial 1999 Restricted Share Plan (the “Fairfax Restricted Share Plan”) and the Share Option Plan (the “Option Plan”), and collectively, (the “Plans”), in which the Company was allowed to participate. The Plans generally provided officers, key employees and directors who were employed by or provided services to the Company with awards of restricted shares or stock options (with a grant price of zero) of Fairfax common stock (collectively, “Restricted Share Awards”). The Restricted Share Awards generally vest over a period of three to seven years. The Company had 65,036 Restricted Share Awards outstanding as of December 31, 2011.

In accordance with GAAP, the fair value of the Restricted Share Awards is estimated on the date of grant based on the market price of Fairfax’s stock and is amortized to compensation expense on a straight-line basis over the related vesting periods. The Company purchases Fairfax common stock on the open market following the grant of a Restricted Share Award and reflects such purchase as a reduction in the Company’s additional paid-in capital. As of December 31, 2011, there was \$15.5 million of unrecognized compensation cost related to unvested Restricted Share Awards granted from the Plans that was netted against additional paid-in capital, which is expected to be recognized over a remaining weighted-average vesting period of 3.3 years. The total fair value of the Restricted Share Awards granted during 2011 and 2010 was \$10.8 million and \$13.5 million, respectively. No Restricted Share Awards were granted in 2009 or 2008. As of December 31, 2011, the aggregate fair value of the Restricted Share Awards outstanding was \$24.3 million. For the year ended December 31, 2011 and 2010, the Company recognized expense related to the Fairfax Restricted Share Plan of \$4.4 million and \$1.3 million, respectively. There was no expense recognized for the year ended December 31, 2009 or for the year ended December 31, 2008, as all then outstanding awards have been fully amortized.

The following table summarizes activity for the Fairfax Restricted Share Plan and the Option Plan for the year ended December 31, 2011:

	Shares / Options	Weighted- Average Value at Grant Date
Restricted share awards outstanding as of December 31, 2010.....	35,180	\$ 384.81
Granted.....	30,215	357.63
Vested.....	(111)	351.47
Forfeited.....	(248)	351.47
Restricted share awards outstanding as of December 31, 2011.....	65,036	\$ 372.37
Vested and exercisable as of December 31, 2011.....	176	\$ 170.00

Employee Share Purchase Plans

In 2010, the Company established the Odyssey Re Holdings Corp. (Non-Qualified) 2010 Employee Share Purchase Plan (the “2010 ESPP”). Under the terms of the 2010 ESPP, eligible employees are given the election to purchase Fairfax common shares in an amount up to 10% of their annual base salary. The Company purchases, on the employee’s behalf, a number of Fairfax’s common shares equal in value to 30% of the employee’s contribution. In the event that the Company achieves a growth in common shareholders’ equity of at least 15% in any calendar year, additional shares are purchased by the Company for the employee’s benefit, in an amount equal in value to 20% of the employee’s contribution during that year. During the year ended December 31, 2011, the Company purchased 9,440 shares on behalf of employees pursuant to

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

the 2010 ESPP, at an average purchase price of \$394.39. The compensation expense recognized by the Company for purchases of Fairfax's common shares under the 2010 ESPP was \$0.9 million for the year ended December 31, 2011.

In 2001, the Company established the Employee Share Purchase Plan (the "ESPP"). Under the terms of the ESPP, eligible employees were given the election to purchase Company common shares in an amount up to 10% of their annual base salary. The Company issued, or purchased on the employee's behalf, a number of the Company's common shares equal in value to 30% of the employee's contribution. In the event that the Company achieved a return on equity of at least 15% in any calendar year, additional shares were issued or purchased by the Company for the employee's benefit, in an amount equal in value to 20% of the employee's contribution during that year. As a result of the Merger (see Note 1), the Company suspended issuances, purchases and contributions made for the ESPP. During the year ended December 31, 2009, the Company purchased 58,699 shares, on behalf of employees pursuant to the ESPP, at an average purchase price of \$43.23. The compensation expense recognized by the Company for purchases of the Company's common shares under the ESPP was \$0.8 million for the year ended December 31, 2009.

General

For the year ended December 31, 2009, the Company received \$0.9 million, in cash from employees for the exercise of stock options. For the year ended December 31, 2009, the Company recognized an expense related to all stock-based compensation of \$11.9 million. The total tax benefit recognized for the year ended December 31, 2009 was \$4.2 million.

19. Transfer of Ownership of Clearwater (Unaudited)

The following tables summarize the Company's consolidated balance sheet as of December 31, 2010 and the Company's consolidated statements of operations for the years ended December 31, 2010 and 2009 as reported and on a pro forma basis as if the transfer of ownership of Clearwater to TIG occurred on January 1, 2009 (in thousands):

Consolidated Balance Sheets

	As of December 31,		
	2010		
	As Reported	Less Clearwater	OdysseyRe Excluding Clearwater
Total investments and cash.....	\$ 8,904,147	\$ (803,408)	\$ 8,100,739
Accrued investment income	78,312	(8,765)	69,547
Premiums receivable.....	424,893	(5,542)	419,351
Reinsurance recoverable.....	1,269,114	(287,625)	981,489
Deferred acquisition costs.....	119,578	-	119,578
Federal and foreign income taxes receivable.....	225,011	(32,047)	192,964
Other assets.....	93,589	17,085	110,674
Total assets.....	<u>\$ 11,114,644</u>	<u>\$ (1,120,302)</u>	<u>\$ 9,994,342</u>
Unpaid losses and loss adjustment expenses.....	\$ 5,809,665	\$ (748,866)	\$ 5,060,799
Unearned premiums.....	662,787	(2)	662,785
Reinsurance balances payable.....	167,247	(13,051)	154,196
Debt obligations.....	487,148	-	487,148
Other liabilities.....	318,764	(9,854)	308,910
Total liabilities.....	<u>7,445,611</u>	<u>(771,773)</u>	<u>6,673,838</u>
Total equity.....	3,669,033	(348,529)	3,320,504
Total liabilities and equity.....	<u>\$ 11,114,644</u>	<u>\$ (1,120,302)</u>	<u>\$ 9,994,342</u>

ODYSSEY RE HOLDINGS CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statement of Operations

	For the Years Ended December 31, 2010		
	As Reported	Less Clearwater	OdysseyRe Excluding Clearwater
Gross premiums written.....	\$ 2,167,338	\$ 288	\$ 2,167,626
Net premiums written.....	1,853,798	(168)	1,853,630
Net premiums earned.....	1,885,714	(190)	1,885,524
Net investment income.....	327,875	(39,942)	287,933
Total net realized investment gains	170,349	(28,638)	141,711
Total revenues.....	<u>2,383,938</u>	<u>(68,770)</u>	<u>2,315,168</u>
Losses and loss adjustment expenses.....	1,317,053	(65,650)	1,251,403
Acquisition costs and other underwriting expenses.....	541,448	(1,837)	539,611
Interest and other expense, net.....	94,055	-	94,055
Total expenses.....	<u>1,952,556</u>	<u>(67,487)</u>	<u>1,885,069</u>
Income before income tax.....	431,382	(1,283)	430,099
Total federal and foreign income tax provision.....	98,107	15,915	114,022
Net Income.....	333,275	(17,198)	316,077
Preferred dividends.....	(3,966)	-	(3,966)
Loss on redemption of preferred shares.....	(2,183)	-	(2,183)
Gain on purchase of preferred shares.....	5	-	5
Net income available to common shareholders.....	<u>\$ 327,131</u>	<u>\$ (17,198)</u>	<u>\$ 309,933</u>
<u>Underwriting Ratio:</u>			
Loss and loss adjustment expense ratio.....	69.8 %		66.4 %
Acquisition costs and other underwriting expense ratio.....	28.8		28.6
Combined ratio.....	<u>98.6 %</u>		<u>95.0 %</u>

	For the Years Ended December 31, 2009		
	As Reported	Less Clearwater	OdysseyRe Excluding Clearwater
Gross premiums written.....	\$ 2,195,035	\$ (479)	\$ 2,194,556
Net premiums written.....	1,893,813	(479)	1,893,334
Net premiums earned.....	1,927,412	(481)	1,926,931
Net investment income.....	316,329	(50,466)	265,863
Total net realized investment gains	189,088	2,376	191,464
Total revenues.....	<u>2,432,829</u>	<u>(48,571)</u>	<u>2,384,258</u>
Losses and loss adjustment expenses.....	1,301,996	(56,710)	1,245,286
Acquisition costs and other underwriting expenses.....	560,947	(2,212)	558,735
Interest and other expense, net.....	75,456	-	75,456
Total expenses.....	<u>1,938,399</u>	<u>(58,922)</u>	<u>1,879,477</u>
Income before income tax.....	494,430	10,351	504,781
Total federal and foreign income tax provision.....	121,094	14,196	135,290
Net Income.....	373,336	(3,845)	369,491
Preferred dividends.....	(5,233)	-	(5,233)
Gain on redemption of preferred shares.....	7,997	-	7,997
Net income available to common shareholders.....	<u>\$ 376,100</u>	<u>\$ (3,845)</u>	<u>\$ 372,255</u>
<u>Underwriting Ratio:</u>			
Loss and loss adjustment expense ratio.....	67.6 %		64.6 %
Acquisition costs and other underwriting expense ratio.....	29.1		29.0
Combined ratio.....	<u>96.7 %</u>		<u>93.6 %</u>

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We emerged from
the past 12 months

as strong
and
committed
as ever.

Our balance sheet has demonstrated its resiliency and our **capital base remains rock solid**. OdysseyRe enters 2012 with a renewed risk appetite and a willingness to put our capital to use for **the benefit of our clients**.



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