PRIMUS GUARANTY LTD
Form 10-Q
May 13, 2011

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011

or

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

For the transition period from __________ to __________.

Commission File Number: 001-32307

Primus Guaranty, Ltd.
(Exact name of registrant as specified in its charter)

Bermuda	**98-0402357**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Clarendon House
2 Church Street
Hamilton HM 11, Bermuda
(Address of principal executive offices, including zip code)
441-296-0519
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

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

As of May 6, 2011, the number of shares outstanding of the issuer s common shares, $0.08 par value, was 37,481,146.

Primus Guaranty, Ltd.
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Part I. Financial Information

Item 1. Financial Statements

Primus Guaranty, Ltd.
Condensed Consolidated Statements of Financial Condition (Unaudited)
(in thousands except share amounts)

	March 31, 2011	December 31, 2010
Assets		
Cash and cash equivalents	$ 63,021	$ 177,736
Investments (includes $381,585 and $288,815 at fair value as of March 31, 2011 and December 31, 2010, respectively)	381,756	288,985
Restricted cash and investments	140,228	138,540
Accrued interest and premiums	6,935	5,860
Unrealized gain on credit swaps, at fair value	3,259	2,006
Debt issuance costs, net	3,856	4,072
Other assets (includes $10,947 and 11,559 at fair value as of March 31, 2011 and December 31, 2010, respectively)	19,141	17,660
Total assets	$ 618,196	$ 634,859
Liabilities and Equity (deficit)		
Liabilities		
Accounts payable and accrued expenses	$ 4,498	$ 8,701
Unrealized loss on credit swaps, at fair value	313,679	395,164
Payable for credit events	2,963	3,447
Long-term debt	203,091	215,828
Restructuring liabilities	506	3,729
Other liabilities	7,670	6,025
Total liabilities	532,407	632,894
Commitments and contingencies		
Equity (deficit)		
Common shares, $0.08 par value, 62,500,000 shares authorized, 37,996,854 and 38,078,790 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	3,040	3,046
Additional paid-in capital	274,687	275,453
Accumulated other comprehensive income	3,229	3,333
Retained earnings (deficit)	(288,269)	(372,969)
Total shareholders equity (deficit) of Primus Guaranty, Ltd.	(7,313)	(91,137)
Preferred securities of subsidiary	93,102	93,102
Total equity (deficit)	85,789	1,965

Total liabilities and equity (deficit)	$ 618,196	$ 634,859

See accompanying notes.

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Primus Guaranty, Ltd.
Condensed Consolidated Statements of Operations (Unaudited)
(in thousands except per share amounts)

	Three Months Ended March 31,	
	2011	2010
Revenues		
Net credit swap revenue	$ 86,098	$ 87,530
Interest income	2,611	2,699
Gain on retirement of long-term debt	2,760	4,757
Other income	297	183
Total revenues	91,766	95,169
Expenses		
Compensation and employee benefits	2,122	4,580
Professional and legal fees	822	1,485
Interest expense	1,567	1,869
Other	1,316	1,723
Total expenses	5,827	9,657
Income from continuing operations before provision for income taxes	85,939	85,512
Provision for income taxes	10	140
Income from continuing operations, net of tax	85,929	85,372
Income (loss) from discontinued operations, net of tax	(270)	91,551
Net income	85,659	176,923
Less:		
Distributions on preferred securities of subsidiary	959	988
Net income from discontinued operations attributable to non-parent interests in CLOs		89,413
Net income available to common shares	$ 84,700	$ 86,522
Income per common share:		
Basic:		
Income from continuing operations	$ 2.23	$ 2.18
Income (loss) from discontinued operations	$ (0.01)	$ 0.06
Net income available to common shares	$ 2.22	$ 2.24
Diluted:		
Income from continuing operations	$ 2.21	$ 2.09
Income (loss) from discontinued operations	$	$ 0.06

Net income available to common shares	$ 2.21	$ 2.15
Weighted average common shares outstanding:		
Basic	38,124	38,686
Diluted	38,376	40,280

See accompanying notes.

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Primus Guaranty, Ltd.
Condensed Consolidated Statements of Cash Flows (Unaudited)
(in thousands)

	Three Months Ended March 31, 2011	2010
Cash flows from operating activities		
Net income available to common shares	$ 84,700	$ 86,522
Net income attributable to non-parent interests in CLOs		89,413
Distributions on preferred securities of subsidiary	959	988
Net income	85,659	176,923
Adjustments to reconcile net income to net cash used in operating activities:		
Non-cash items included in net income:		
Net unrealized gains on CLO loans and securities		(62,077)
Net unrealized losses on CLO notes		14,143
Net realized gains by the CLOs		(26,758)
Net unrealized gains on credit swaps	(82,738)	(127,136)
Gain on retirement of long-term debt	(2,760)	(4,757)
Other	2,545	2,574
Increase (decrease) in cash resulting from changes in:		
CLO cash and cash equivalents		(46,468)
CLO other assets		11,317
CLO other liabilities		41,969
Proceeds from sale of CLO loans and securities		222,496
Purchases of CLO loans and securities		(228,413)
Restricted cash	(1,004)	(993)
Accrued interest and premiums	(1,075)	(1,009)
Other assets	(2,229)	2,068
Trading account assets		(26,698)
Accounts payable and accrued expenses	(3,024)	(4,932)
Payable for credit events	(484)	(23,269)
Restructuring liabilities	(3,223)	
Other liabilities	656	9,027
Net cash used in operating activities	(7,677)	(71,993)
Cash flows from investing activities		
Purchases of available-for-sale investments	(222,849)	(78,928)
Maturities and sales of available-for-sale investments	127,756	22,716
Payments received from CLO investments	623	
Purchases of fixed assets	(6)	
Net cash used in investing activities	(94,476)	(56,212)
Cash flows from financing activities		

Repayment of CLO notes by the CLOs		(15,623)
Retirement of long-term debt	(9,069)	(6,665)
Purchase and retirement of common shares	(2,534)	(1,034)
Net preferred distributions of subsidiary	(959)	(988)
Net cash used in financing activities	(12,562)	(24,310)
Net effect of exchange rate changes on cash		(38)
Net increase (decrease) in cash	(114,715)	(152,553)
Cash and cash equivalents at beginning of period	177,736	299,514
Cash and cash equivalents at end of period	$ 63,021	$ 146,961
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 1,550	$ 2,833
Cash paid for taxes	$	$ 8

See accompanying notes.

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Primus Guaranty, Ltd.
Condensed Consolidated Statements of Equity (Deficit) (Unaudited)
(in thousands)

	Three Months Ended March 31, 2011	Year Ended December 31, 2010
Common shares		
Balance at beginning of period	$ 3,046	$ 3,061
Common shares purchased and retired	(34)	(166)
Shares issued under employee compensation plans	28	151
Balance at end of period	3,040	3,046
Additional paid-in capital		
Balance at beginning of period	275,453	280,685
Common shares purchased and retired	(2,529)	(13,135)
Shares vested under employee compensation plans	1,763	7,903
Balance at end of period	274,687	275,453
Accumulated other comprehensive income (loss)		
Balance at beginning of period	3,333	2,148
Foreign currency translation adjustments		30
Change in unrealized holding gains on available-for-sale securities	(104)	1,155
Balance at end of period	3,229	3,333
Retained earnings (deficit)		
Balance at beginning of period	(372,969)	(628,443)
Net income	85,659	197,462
Net loss attributable to non-parent interests in CLOs		61,174
Distributions on preferred securities of subsidiary	(959)	(3,162)
Balance at end of period	(288,269)	(372,969)
Appropriated retained earnings from CLO consolidation		
Adoption of ASC Topic 810, Consolidation		265,639
Net income attributable to non-parent interests in CLOs		(61,174)
Deconsolidation of CLOs		(204,465)
Balance at end of period		

Total shareholders equity (deficit) of Primus Guaranty, Ltd.		(7,313)		(91,137)
Preferred securities of subsidiary				
Balance at beginning of period		93,102		93,102
Balance at end of period		93,102		93,102
Total equity (deficit) at end of period	$	85,789	$	1,965

See accompanying notes.

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Organization and Business

In these notes, the terms Primus Guaranty and the Company refer to Primus Guaranty, Ltd., a Bermuda company, collectively with its subsidiaries; Primus Financial refers to Primus Financial Products, LLC, a Delaware limited liability company, collectively with its subsidiaries, and Primus Asset Management refers to Primus Asset Management, Inc., a Delaware corporation. Primus Financial and Primus Asset Management are subsidiaries of Primus Guaranty, Ltd.

Primus Financial was established to sell credit protection in the form of credit swaps to global financial institutions and major credit swap dealers against primarily investment grade credit obligations of corporate and sovereign issuers. During 2009, the Company announced its intention to amortize Primus Financial s credit swap portfolio. It is expected that Primus Financial s existing credit swap contracts will expire at maturity unless terminated early through credit events or credit risk mitigation transactions. It is not expected that additional credit swaps will be added to Primus Financial s portfolio.

Primus Asset Management acts as manager of the credit swap and investment portfolios of Primus Financial. Primus Asset Management has entered into a Services Agreement with its affiliates, whereby it provides management, consulting, information technology and other services.

On December 1, 2010, the Company divested its collateralized loan obligation (CLO) asset management business, which included the sale of CypressTree Investment Management, LLC (CypressTree).

See note 7 of these notes to condensed consolidated financial statements for further discussion on Discontinued Operations.

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Primus Guaranty have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and the use of estimates) considered necessary for a fair presentation pursuant to these requirements have been included. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010. The results of operations for any interim period are not necessarily indicative of the results for a full year.

The condensed consolidated financial statements are presented in U.S. dollar equivalents. During the periods presented, the Company s credit swap activities were conducted in U.S. dollars and euros.

Certain prior year amounts have been reclassified to conform to current year presentation. There was no effect on net income available to common shares as a result of these reclassifications.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest, including CLOs under management during 2010, for which Primus Guaranty was deemed to be the primary beneficiary. All significant intercompany balances have been eliminated.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820) Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 provides amended disclosure requirements related to fair value measurements, including transfers in and out of Levels 1 and 2 and activity in Level 3 under the fair value hierarchy. ASU No. 2010-06 is effective for financial statements issued for reporting periods beginning after December 15, 2009 for certain disclosures and for reporting periods beginning after December 15, 2010 for certain additional disclosures regarding activity in Level 3 fair value measurements. Since these amended principles require only additional disclosures concerning fair value measurements, adoption of ASU No. 2010-06 did not affect the Company s financial condition, results of operations or cash flows.

The Company has considered all other newly issued accounting pronouncements that are applicable to the Company s operations and the preparation of the condensed consolidated financial statements, including those which are not yet effective.

Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

3. Investments

The following tables summarize the composition of the Company s investments at March 31, 2011 and December 31, 2010 (in thousands):

	March 31, 2011			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Available-for-sale:				
Corporate debt securities	$ 376,706	$ 3,411	$ (253)	$ 379,864
Asset-backed securities	1,915		(194)	1,721
Total available-for-sale	378,621	3,411	(447)	381,585
Held-to-maturity:				
Certificate of deposit	171			171
Total held-to-maturity	171			171
Total investments	$ 378,792	$ 3,411	$ (447)	$ 381,756

	December 31, 2010			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Available-for-sale:				
Corporate debt securities	$ 284,090	$ 3,378	$ (311)	$ 287,157
Asset-backed securities	1,392	266		1,658
Total available-for-sale	285,482	3,644	(311)	288,815
Held-to-maturity:				
Certificate of deposit	170			170
Total held-to-maturity	170			170
Total investments	$ 285,652	$ 3,644	$ (311)	$ 288,985

As of March 31, 2011, all of the corporate debt securities will mature before December 2014. The asset-backed securities are estimated to mature between 2012 and 2035, although the actual maturity may be sooner.

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

The tables below summarize the fair value of available-for-sale investments that have been in a continuous unrealized loss position for less than 12 months and for 12 months or more at March 31, 2011 and December 31, 2010 (in thousands).

	March 31, 2011					
	Securities with Unrealized Losses					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate debt securities	$ 143,177	$ (253)	$	$	$ 143,177	$ (253)
Asset-backed securities	1,721	(194)			1,721	(194)
Total	$ 144,898	$ (447)	$	$	$ 144,898	$ (447)

	December 31, 2010					
	Securities with Unrealized Losses					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate debt securities	$ 78,053	$ (311)	$	$	$ 78,053	$ (311)
Total	$ 78,053	$ (311)	$	$	$ 78,053	$ (311)

The Company makes an assessment to determine whether unrealized losses reflect declines in value of securities that are other-than-temporarily impaired. The Company considers many factors, including the length of time and significance of the decline in fair value of the investment; the intent to sell the investment or if it is more likely than not it will be required to sell the investment before recovery in fair value; recent events specific to the issuer or industry; credit ratings and asset quality of collateral structure; and any significant changes in estimated cash flows of the investment. If the Company, based on its evaluation, determines that the credit related impairment is other-than-temporary, the carrying value of the security is written down to fair value and the unrealized loss is recognized through a charge to earnings in the condensed consolidated statements of operations.

During the three months ended March 31, 2011 and 2010, it was determined that there were no credit related impairment losses on investments.

4. Restricted Cash and Investments

Restricted cash represents amounts held by a counterparty as security for credit swap contracts. Restricted investments are comprised of a held-to-maturity corporate note issued by a counterparty as security for credit swap contracts, which is scheduled to mature in March 2013, and the Company s investments in securities issued by CLOs, classified as a trading account investment. The carrying value of the held-to-maturity corporate note was $38.1 million and $37.8 million at March 31, 2011 and December 31, 2010, respectively. The amortized cost of the held-to-maturity corporate note approximates fair value. As of March 31, 2011 and December 31, 2010, the Company s consolidated financial statements include $140.2 million and $138.5 million, respectively, of restricted cash and investments.

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

5. Credit Swaps

Net Credit Swap Revenue

Net credit swap revenue as presented in the condensed consolidated statements of operations comprises of changes in the fair value of credit swaps, realized gains or losses on the termination of credit swaps before their stated maturity, realized losses on credit events and premium income or expense. The realization of gains or losses on the termination of credit swaps or credit events generally will result in a reduction in unrealized gains or losses and accrued premium at the point in time realization occurs.

Credit swaps sold by Primus Financial on a single corporate or sovereign issuer, specified as a Reference Entity, are referred to as single name credit swaps. Primus Financial also has sold credit swaps referencing portfolios containing obligations of multiple Reference Entities, which are referred to as tranches. Additionally, Primus Financial has sold credit swaps on asset-backed securities, which are referred to as CDS on ABS. These asset-backed securities reference residential mortgage-backed securities.

The table below presents the components of net credit swap revenue for the three months ended March 31, 2011 and 2010 (in thousands).

	Three Months Ended March 31,	
	2011	**2010**
Net premium earned	$ 11,171	$ 16,436
Net realized losses on credit swaps	(7,811)	(56,042)
Net unrealized gains on credit swaps	82,738	127,136
Net credit swap revenue	$ 86,098	$ 87,530

Net realized losses in the table above include gains and losses on terminated credit swaps and losses on credit events.

Credit Events and Terminations of Credit Swaps

The following table presents the components of net realized losses recorded by Primus Financial related to risk mitigation transactions, terminations of credit swaps and credit events for the three months ended March 31, 2011 and 2010 (in thousands):

	Three Months Ended March 31,	
	2011	**2010**
Net realized gains (losses) on single name credit swaps	$ 47	$ (19,223)
Net realized losses on tranches		(35,000)
Net realized losses on CDS on ABS	(7,858)	(1,819)
Total net realized losses	$ (7,811)	$ (56,042)

Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

Net realized losses on credit swaps were $7.8 million and $56.0 million for the three months ended March 31, 2011 and 2010, respectively.

Net realized losses for the three months ended March 31, 2011 primarily consisted of the settlement of a credit event on CDS on ABS.

Net realized losses for the three months ended March 31, 2010 primarily comprised payments of $19.2 million to terminate single name credit swaps referencing Ambac Financial Group, Inc. and $35.0 million relating to the termination of three tranche transactions.

Credit Swap Portfolio Information

The tables below summarize, by Standard & Poor s Ratings Services (S&P) credit rating of Reference Entities and of counterparties, the notional amounts and unrealized gain or loss for fair values of credit swap transactions outstanding as of March 31, 2011 and December 31, 2010 (in thousands). If a Reference Entity is not rated by S&P, an equivalent credit rating is obtained from another Nationally Recognized Statistical Rating Organization, if available.

	March 31, 2011		December 31, 2010	
Rating Category	**Notional Amount**	**Fair Value**	**Notional Amount**	**Fair Value**
By Single Name Reference Entity/Tranche				
Credit Swaps Sold-Single Name:				
AAA	$ 57,474	$ (18)	$ 55,143	$ (144)
AA	1,095,031	(3,380)	1,137,217	(8,776)
A	2,320,174	(405)	2,831,049	(8,407)
BBB	1,712,744	2,513	1,946,885	(1,094)
BB	255,738	(889)	231,167	(359)
B	57,079	(331)	66,691	(886)
CCC	35,000	(476)	40,000	(638)
Non rated	298,965	(57,049)	302,819	(57,286)
Total	$ 5,832,205	$ (60,035)	$ 6,610,971	$ (77,590)
Credit Swaps Sold-Tranche:				
AAA	$ 2,650,000	$ (132,322)	$ 2,650,000	$ (168,627)
AA	200,000	(9,768)	450,000	(49,035)
A	300,000	(25,500)	300,000	(30,390)
BBB	550,000	(46,885)	300,000	(22,193)
BB	50,000	(3,992)	50,000	(5,175)
Non rated	43,317	(18,208)	43,317	(19,373)
Total	$ 3,793,317	$ (236,675)	$ 3,793,317	$ (294,793)
CDS on ABS:				
BBB	$ 736	$ (402)	$ 736	$ (358)
CCC	10,000	(8,585)	18,000	(15,794)
CC	5,000	(4,723)	5,000	(4,683)
Total	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

Rating Category	March 31, 2011 Notional Amount	March 31, 2011 Fair Value	December 31, 2010 Notional Amount	December 31, 2010 Fair Value
By Single Name Reference Entity/Tranche				
Credit Swaps Purchased-Single Name:				
A	$	$	$ (4,120)	$ 60
Total	$	$	$ (4,120)	$ 60
By Counterparty Buyer / (Seller)				
Credit Swaps Sold-Single Name:				
AA	$ 1,363,536	$ (1,163)	$ 1,675,212	$ (5,970)
A	4,468,669	(58,872)	4,935,759	(71,620)
Total	$ 5,832,205	$ (60,035)	$ 6,610,971	$ (77,590)
Credit Swaps Sold-Tranche:				
AA	$ 2,293,317	$ (160,425)	$ 1,843,317	$ (147,723)
A	1,500,000	(76,250)	1,500,000	(98,034)
BBB			450,000	(49,036)
Total	$ 3,793,317	$ (236,675)	$ 3,793,317	$ (294,793)
CDS on ABS:				
A	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)
Total	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)
Credit Swaps Purchased-Single Name:				
A	$	$	$ (4,120)	$ 60
Total	$	$	$ (4,120)	$ 60

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

The table below shows the geographical distribution of the credit swap portfolio by domicile of the Reference Entity and domicile of the counterparty, as of March 31, 2011 and December 31, 2010 (in thousands).

	March 31, 2011		December 31, 2010	
Domicile	**Notional Amount**	**Fair Value**	**Notional Amount**	**Fair Value**
Credit Swaps Sold-Single Name				
By Reference Entity:				
North America	$ 2,000,027	$ (53,252)	$ 2,429,477	$ (57,512)
Europe	3,525,178	(5,673)	3,834,494	(17,814)
Asia-Pacific	277,000	(1,101)	317,000	(2,065)
Others	30,000	(9)	30,000	(199)
Total	$ 5,832,205	$ (60,035)	$ 6,610,971	$ (77,590)
By Counterparty:				
North America	$ 2,238,792	$ (5,625)	$ 2,649,509	$ (13,665)
Europe	3,556,413	(54,170)	3,924,462	(63,603)
Asia-Pacific	37,000	(240)	37,000	(322)
Total	$ 5,832,205	$ (60,035)	$ 6,610,971	$ (77,590)
Credit Swaps Sold -Tranche				
By Counterparty:				
North America	$ 600,000	$ (24,635)	$ 600,000	$ (31,442)
Europe	3,193,317	(212,040)	3,193,317	(263,351)
Total	$ 3,793,317	$ (236,675)	$ 3,793,317	$ (294,793)
CDS on ABS				
By Reference Entity:				
North America	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)
Total	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)
By Counterparty:				
North America	$ 5,736	$ (5,125)	$ 13,736	$ (12,038)
Europe	10,000	(8,585)	10,000	(8,797)
Total	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)
Credit Swaps Purchased-Single Name				

By Reference Entity:				
North America	$	$	$ (4,120)	$ 60
Total	$	$	$ (4,120)	$ 60
By Counterparty:				
Europe	$	$	$ (4,120)	$ 60
Total	$	$	$ (4,120)	$ 60

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Primus Guaranty, Ltd.
Notes to Condensed Consolidated Financial Statements (Unaudited)

The table below shows the distribution of the credit swap portfolio, by year of maturity as of March 31, 2011 and December 31, 2010 (in thousands). With respect to the CDS on ABS caption below, the maturity dates presented are estimated maturities; the actual maturity date for any contract will vary depending on the level of voluntary prepayments, defaults and interest rates with respect to the underlying mortgage loans. As a result, the actual maturity date for any such contract may be earlier or later than the estimated maturity indicated.

	March 31, 2011		December 31, 2010	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Credit Swaps Sold-Single Name				
Year of Maturity				
2011	$ 1,317,214	$ (55,079)	$ 2,261,170	$ (57,836)
2012	3,786,249	(8,594)	3,659,132	(22,212)
2013	728,742	3,638	690,669	2,458
Total	$ 5,832,205	$ (60,035)	$ 6,610,971	$ (77,590)
Credit Swaps Sold-Tranche				
Year of Maturity				
2012	$ 375,000	$ (2,739)	$ 375,000	$ (5,117)
2013	93,317	(22,201)	93,317	(24,548)
2014	3,325,000	(211,735)	3,325,000	(265,128)
Total	$ 3,793,317	$ (236,675)	$ 3,793,317	$ (294,793)
CDS on ABS				
Estimated Year of Maturity				
2011	$ 5,000	$ (4,280)	$ 18,000	$ (16,000)
2012	5,000	(4,723)	5,000	(4,477)
2013	5,000	(4,305)		
2020			736	(358)
2021	736	(402)		
Total	$ 15,736	$ (13,710)	$ 23,736	$ (20,835)
Credit Swaps Purchased-Single Name				
Year of Maturity				
2014	$	$	$ (4,120)	$ 60
Total	$	$	$ (4,120)	$ 60

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6. Financial Instruments and Fair Value Disclosures

A significant number of the Company s financial instruments are carried at fair value with changes in fair value recognized in earnings each period. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). In determining fair value, the Company uses various valuation techniques and considers the fair value hierarchy.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to valuation techniques using unobservable inputs (Level 3). Observable inputs are inputs that market participants would use in pricing the asset or liability that are based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company s estimates of the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. These valuation techniques involve some level of management estimation and judgment. The degree to which management s estimation and judgment is required is generally dependent upon the market price transparency for the instruments, the availability of observable inputs, frequency of trading in the instruments and the instrument s complexity.

In measuring the fair market values of its financial instruments, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs based on the fair value hierarchy. The hierarchy is categorized into three levels based on the reliability of inputs as follows:

Level 1 Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities.

Cash and cash equivalents, which include deposits in banks, money market accounts and money market funds, are categorized within Level 1 of the fair value hierarchy.

Level 2 Valuations based on quoted prices in markets that are not considered to be active; or valuations for which all significant inputs are observable or can be corroborated by observable market data, either directly or indirectly.

Corporate debt securities and the interest rate swap are categorized within Level 2 of the fair value hierarchy. The interest rate swap is included in other assets in the condensed consolidated statements of financial condition.

Level 3 Valuations in which a significant input or inputs are unobservable and that are supported by little or no market activity.

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The fair value of the credit swap portfolio is categorized within Level 3 of the fair value hierarchy, which includes single name credit swaps, tranches and CDS on ABS. The credit swap portfolio classification in Level 3 primarily is the result of the estimation of nonperformance risk as discussed below. In addition, investments in securities issued by CLOs, asset-backed securities, contingent payables related to the Company s original purchase of CypressTree and contingent receivables from the buyer of CypressTree are categorized within Level 3. The contingent receivables from the buyer of CypressTree are included in the Other assets caption in the condensed consolidated statements of financial condition. The contingent payables are included in the Other liabilities caption in the condensed consolidated statements of financial condition.

Nonperformance Risk Adjustment Credit Swap Portfolio

The Company considers the effect of its nonperformance risk in determining the fair value of its liabilities. Since the adoption of ASC Topic 820, *Fair Value Measurements and Disclosures,* on January 1, 2008, the Company has incorporated a nonperformance risk adjustment in the computation of the fair value of the credit swap portfolio. An industry standard for calculating this adjustment is to incorporate changes in an entity s own credit spread into the computation of the mark-to-market of liabilities. The Company derives an estimate of a credit spread because there is no observable market credit spread on Primus Financial. This estimated credit spread was obtained by reference to similar entities, primarily in the financial insurance industry, which have observable spreads.

The following table represents the effect of the nonperformance risk adjustments on the Company s unrealized loss on credit swaps, at fair value in the condensed consolidated statements of financial condition as of March 31, 2011 and December 31, 2010 (in thousands):

	March 31, 2011	December 31, 2010
Unrealized loss on credit swaps, at fair value, without nonperformance risk adjustments	$ 352,243	$ 456,498
Nonperformance risk adjustments	(38,564)	(61,334)
Unrealized loss on credit swaps, at fair value, after nonperformance risk adjustments	$ 313,679	$ 395,164

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