PRIMUS GUARANTY LTD
Form 10-Q
November 08, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

or

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

Not Required (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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of November 1, 2007, the number of shares outstanding of the issuer's common shares, $0.08 par value, was 45,029,203.

Primus Guaranty, Ltd.
Form 10-Q
For the three months ended September 30, 2007

INDEX

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

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

	September 30, 2007 (unaudited)	December 31, 2006
Assets		
Cash and cash equivalents	$ 265,439	$ 204,428
Available-for-sale investments	599,257	584,911
Trading account assets	18,558	14,537
Accrued interest receivable	8,412	6,374
Accrued premiums and receivables on credit and other swaps	4,097	4,022
Unrealized gain on credit and other swaps, at fair value	14,856	73,330
Fixed assets and software costs, net	6,319	5,510
Debt issuance costs, net	7,043	7,399
Other assets	2,738	1,957
Total assets	$ 926,719	$ 902,468
Liabilities and shareholders’ equity		
Accounts payable and accrued expenses	$ 3,297	$ 2,854
Accrued compensation	5,378	8,800
Interest payable	662	625
Unrealized loss on credit and other swaps, at fair value	135,052	2,931
Accrued premiums and payables on credit and other swaps	38,057	44
Trading account liabilities	9,888	1,002
Long-term debt	323,496	325,000
Other liabilities	2,046	600
Total liabilities	517,876	341,856
Preferred securities of subsidiary	98,521	98,521
Shareholders’ equity		
Common shares, $0.08 par value, 62,500,000 shares authorized, 45,025,269 and 43,380,893 shares issued and outstanding at September 30, 2007 and December 31, 2006	3,602	3,470
Additional paid-in-capital	279,508	269,420
Warrants	—	612
Accumulated other comprehensive loss	(4,083)	(2,375)
Retained earnings	31,295	190,964
Total shareholders’ equity	310,322	462,091
Total liabilities, preferred securities of subsidiary and shareholders’ equity	$ 926,719	$ 902,468

See accompanying notes.

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
	(unaudited)		(unaudited)	
Revenues				
Net credit swap revenue (loss)	$ (120,122)	$ 28,905	$ (140,994)	$ 85,865
Premiums earned on financial guarantees	—	100	—	300
Asset management and advisory fees	1,097	542	2,383	709
Interest income	10,881	7,143	31,174	20,530
Other trading revenue (loss)	(3,887)	389	(1,920)	513
Foreign currency revaluation loss	—	(32)	(12)	(56)
Total net revenues (losses)	(112,031)	37,047	(109,369)	107,861
Expenses				
Compensation and employee benefits	4,890	5,023	16,866	15,517
Professional and legal fees	1,355	1,361	3,794	3,645
Depreciation and amortization	387	649	1,334	1,846
Technology and data	1,286	726	3,241	1,546
Interest expense	5,315	2,831	15,036	7,933
Other	1,469	1,302	4,414	3,632
Total expenses	14,702	11,892	44,685	34,119
Distributions on preferred securities of subsidiary	1,702	1,437	5,563	4,206
Income (loss) before provision for income taxes	(128,435)	23,718	(159,617)	69,536
Provision (benefit) for income taxes	—	(14)	52	41
Net income (loss) available to common shares	$ (128,435)	$ 23,732	$ (159,669)	$ 69,495
Income (loss) per common share:				
Basic	$ (2.85)	$ 0.55	$ (3.57)	$ 1.61
Diluted	$ (2.85)	$ 0.54	$ (3.57)	$ 1.56
Average common shares outstanding:				
Basic	45,024	43,314	44,734	43,285
Diluted	45,024	44,341	44,734	44,410

See accompanying notes.

4

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

Nine months ended September 30,	2007	2006
	(unaudited)	
Cash flows from operating activities		
Net income (loss)	$ (159,669)	$ 69,495
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Non-cash items included in net income (loss):		
Depreciation and amortization	1,334	1,846
Share compensation	2,865	2,747
Net unrealized (gain) loss on credit swap portfolio	190,595	(36,759)
Net amortization of premium and discount on securities	(6,710)	(2,669)
Loss on disposal of assets	—	25
Amortization of debt issuance costs	233	128
Distributions on preferred securities of subsidiary	5,563	4,206
Increase (decrease) in cash resulting from changes in:		
Accrued interest receivable	(2,038)	(773)
Accrued premiums and receivables on credit and other swaps	(75)	(352)
Deposit and warehouse loan agreement	—	(4,116)
Other assets	(781)	(187)
Trading account assets	(4,021)	(1,257)
Accounts payable and accrued expenses	566	(799)
Accrued compensation	(3,422)	1,141
Trading account liabilities	8,886	—
Interest payable	37	(65)
Accrued premiums and payables on credit and other swaps	38,013	—
Other liabilities	(58)	(141)
Net cash provided by operating activities	71,318	32,470
Cash flows from investing activities		
Fixed asset purchases and capitalized software costs	(2,143)	(2,631)
Cash receipts on CLO investment	693	—
Purchases of available-for-sale investments	(529,957)	(103,129)
Maturities and sales of available-for-sale investments	519,897	67,000
Net cash used in investing activities	(11,510)	(38,760)
Cash flows from financing activities		
Repurchase and retirement of common shares	(1,149)	(684)
Proceeds from employee exercise of options	557	454
Proceeds from exercise of warrants	7,335	—
Debt issuance costs	—	(13)
Net preferred distributions of subsidiary	(5,563)	(4,206)
Net cash provided by (used in) financing activities	1,180	(4,449)
Net effect of exchange rate changes on cash	23	85
Net increase (decrease) in cash	61,011	(10,654)
Cash and cash equivalents at beginning of period	204,428	69,355
Cash and cash equivalents at end of period	$ 265,439	$ 58,701
Supplemental disclosures		
Cash paid for interest	$ 14,915	$ 7,870
Cash paid for taxes	$ 36	$ 76

See accompanying notes.

5

Table of Contents

1. Organization and Basis of Presentation

Primus Guaranty, Ltd., together with its consolidated subsidiaries (''Primus Guaranty'' or ''the Company''), is a Bermuda holding company that conducts business through several operating subsidiaries, including Primus Financial Products, LLC (''Primus Financial''), Primus Asset Management, Inc. (''Primus Asset Management''), Harrier Credit Strategies Master Fund, LP (''Harrier'') and PRS Trading Strategies, LLC (''PRS Trading Strategies'').

Primus Financial is a Delaware financial products limited liability company that maintains a long-term counterparty credit rating of AAA from Standard & Poor's (''S&P'') and Aaa from Moody's Investors Service, Inc. (''Moody's'' and, together with S&P, the ''Rating Agencies''). Primus Financial is primarily a seller of credit swaps against investment grade credit obligations of corporate and sovereign reference entities. Primus Financial also sells credit swaps referencing portfolios containing obligations of multiple reference entities, which are referred to as ''tranches.'' During the fourth quarter of 2006, Primus Financial received the rating agencies' approval to sell credit swaps referencing residential mortgage-backed securities and commercial mortgage-backed securities, which are referred to as ABS. Primus Financial has begun selling credit swaps against ABS having an assigned rating of ''BBB/Baa'' (or the equivalent thereof) or better from a recognized rating agency, referencing residential mortgage-backed securities.

Primus Asset Management, a Delaware services company, acts as an investment manager to affiliated companies and third party entities. It currently manages the investment portfolios of its affiliates, Primus Financial and Harrier. In addition, Primus Asset Management manages three investment grade synthetic collateralized debt obligations, or SCDO's, on behalf of third parties. The SCDO's issue securities backed by one or more credit swaps sold against a diversified pool of investment grade corporate and sovereign reference entities. Primus Asset Management also manages two collateralized loan obligations, or CLO, transactions on behalf of third parties. A CLO issues securities backed by a diversified pool of primarily senior secured loans of corporations. Primus Asset Management receives fees from third party entities for its investment management services. Primus Asset Management's business plan includes the expansion of its assets under management.

In April 2007, Primus Guaranty formed Harrier, a Cayman Islands exempted limited partnership. During the second quarter of 2007, Primus Guaranty transferred the trading portfolio of PRS Trading Strategies to Harrier. During June 2007, Primus Guaranty contributed an additional $25 million of capital to Harrier, in addition to the original $50 million of capital contributed to PRS Trading Strategies by Primus Guaranty. Currently, no third parties have contributed capital to Harrier. Harrier trades in a broad range of fixed income products, including single name credit swaps, credit swap indices, total return swaps on loan transactions, leveraged loans and investment grade and non-investment grade securities. Unlike Primus Financial, Harrier has no counterparty ratings from rating agencies and, accordingly, has entered into agreements with its counterparties to post collateral to support its contractual obligations. Harrier does not engage in trading activity with Primus Financial, but may invest in similar instruments.

Primus Re, Ltd. (''Primus Re''), is a Bermuda company that operates as a financial guaranty insurance company and is licensed as a Class 3 Insurer under the Bermuda Insurance Act of 1978. Primus Re's business is to act as a conduit, or transformer, between parties interested in buying or selling protection in insurance form and other parties interested in assuming the opposite risk position in the form of credit swaps.

Primus Guaranty (UK), Ltd. (''PGUK'') was incorporated in England to expand the Company's presence and further develop its business and relationships across Europe.

The accompanying unaudited condensed consolidated financial statements of Primus Guaranty, Ltd. have been prepared in accordance with U.S. generally accepted accounting principles (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 generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of the results for a full year. The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances have been eliminated.

The condensed consolidated financial statements represent a single reportable segment, as defined in Statement of Financial Accounting Standards (''SFAS'') No. 131, Disclosures about Segments of an Enterprise and Related Information.

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 or loss as a result of these reclassifications.

2. Recent Accounting Pronouncements

In April 2006, the FASB issued FASB Staff Position FIN 46(R)-6, Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R) (''FSP FIN 46(R)-6''). FSP FIN 46(R)-6 addresses how variability should be considered when applying FIN 46(R). Variability affects the determination of whether an entity is a variable interest entity (VIE), which interests are variable interests, and which party, if any, is the primary beneficiary of the VIE required to consolidate. FSP FIN 46(R)-6 clarifies that the design of the entity also should be considered when identifying which interests are variable interests. The Company adopted FSP FIN 46(R)-6 during the third quarter of 2006 and applied it prospectively to all entities in which the Company first became involved with. The adoption of FSP FIN 46(R)-6 did not have a material effect on the Company's consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. Effective January 1, 2007, the Company adopted FIN 48. The adoption did not have a material effect on the Company's consolidated financial statements. See note 10 for further discussion.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact that adoption of SFAS No.157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities (''SFAS No. 159''). SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact that adoption of SFAS No. 159 will have on its consolidated financial statements.

3. Available-for-sale Investments

Available-for-sale investments include U.S. government agency obligations (including government-sponsored enterprises) rated AAA and Aaa by the respective rating agencies, commercial paper rated A-1 and P-1 by the respective rating agencies and the Company’s collateralized loan

7

Table of Contents

obligations or CLO investments. The Company accounts for its CLO investments as debt securities and fixed maturity securities in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115) and Emerging Issues Task Force (‘‘EITF’’) Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets (EITF 99-20). Accordingly, the CLO investments are classified as available-for-sale investments. Available-for-sale investments are carried at fair value with the unrealized gains or losses reported in accumulated other comprehensive loss as a separate component of shareholders’ equity. Available-for-sale investments have original maturities or maturities at time of purchase greater than 90 days.

The following table summarizes the composition of the Company’s available-for-sale investments at September 30, 2007 and December 31, 2006 (in thousands):

September 30, 2007	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S government agency obligations	$ 588,884	$ 372	$ (469)	$ 588,787
Commercial paper	—	—	—	—
Collateralized loan obligations	14,576	—	(4,106)	10,470
Total	$ 603,460	$ 372	$ (4,575)	$ 599,257

December 31, 2006	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S government agency obligations	$ 554,691	$ 89	$ (2,551)	$ 552,229
Commercial paper	26,275	1	—	26,276
Collateralized loan obligation	6,536	—	(130)	6,406
Total	$ 587,502	$ 90	$ (2,681)	$ 584,911

The following table summarizes the fair value of investments that have been in a continuous unrealized loss position for less than 12 months and for 12 months or more at September 30, 2007 and December 31, 2006 (in thousands):

September 30, 2007	Less than 12 months		12 months or more		Total	
Securities with Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized

Losses U.S. government agency obligations $ 39,875 $ (8) $ 169,321 $ (461) $ 209,196 $ (469) Collateralized loan obligations 10,470 (4,106) — — 10,470 (4,106) Total $ 50,345 $ (4,114) $ 169,321 $ (461) $ 219,666 $ (4,575)

December 31, 2006 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 U.S. government agency obligations $ 19,978 $ (90) $ 331,709 $ (2,461) $ 351,687 $ (2,551) Collateralized loan obligation 6,406 (130) — — 6,406 (130) Total $ 26,384 $ (220) $ 331,709 $ (2,461) $ 358,093 $ (2,681)
8

Table of Contents

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; the Company's intent and ability to hold the investment for a sufficient period of time for a 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. If the Company, based on its evaluation of the above factors, determines that the 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 consolidated statements of operations. Based on the Company's evaluation, it does not consider these investments to be other-than-temporarily impaired at September 30, 2007 and December 31, 2006.

The U.S. government agency obligations mature before November 2008. The two CLO investments are scheduled to mature in 2019 and 2021, respectively, although the actual maturity of each may be sooner.

Table of Contents

4. Net Credit Swap Revenues and Portfolio

Overview

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

Credit swaps are derivative transactions that obligate one party to the transaction (the ‘‘Seller’’) to pay an amount to the other party to the transaction (the ‘‘Buyer’’) should an unrelated third party or portfolio of third parties (the ‘‘Reference Entity’’) specified in the contract be subject to one of a specified group of events (‘‘Credit Events’’). The amount to be paid by the Seller will either be (a) the notional amount of the transaction, in exchange for which the Seller must be delivered a defined obligation of the Reference Entity (called physical settlement), or (b) the difference between the current market value of a defined obligation of the Reference Entity and the notional amount of the transaction (called cash settlement). In exchange for taking the risk of the contract, the Seller will receive a fixed premium for the term of the contract (or until the occurrence of a Credit Event). The fixed premium is generally paid quarterly in arrears over the term of the transaction. Premium income is recognized ratably over the life of the transaction as a component of net credit swap revenue. When the Company purchases credit swaps from its counterparties, the Company pays fixed premiums over the term of the contract. Premium expense is recognized ratably over the life of the transaction as a component of net credit swap revenue.

All credit swap transactions entered into between the Buyer and the Seller are, or will shortly be, subject to an International Swaps and Derivatives Association, Inc. Master Agreement or (‘‘ISDA Master Agreement’’) executed by both parties. The ISDA Master Agreement allows for the aggregation of the market exposures and termination of all transactions between the Buyer and Seller in the event a default (as defined by the ISDA Master Agreement) occurs in respect of either party.

The primary risks inherent in the Company’s activities are (a) where the Company is a Seller that Reference Entities specified in its credit swap transactions will experience Credit Events that will require the Company to make payments to the Buyers of the transactions. Credit Events may include any or all of the following: bankruptcy, failure to pay, repudiation or moratorium, and modified or original restructuring, (b) where the Company is a Buyer of a credit swap and a Credit Event occurs, the Seller fails to make payment to the Company, and (c) that Buyers of the transactions from the Company will default on their required premium payments. Credit Events related to the Company’s credit swaps against ABS may include any or all of the following: failure to pay principal, write-down in the reference obligation and distressed ratings downgrade of the reference obligation. The Company has not experienced any Credit Events since its inception.

The Company terminates a credit swap in one of two ways. The Company may negotiate an agreed termination with the original counterparty (an unwind). The Company may negotiate an assignment and novation of its rights and obligations under the credit swap to a third party (an assignment). In the event of an unwind or assignment, the Company pays or receives a cash settlement negotiated with the counterparty or assignee, based on the fair value of the credit swap contract and the accrued premium on the swap contract at the time of negotiation. The amounts the Company pays or receives are recorded as a realization of fair value and as a realization of accrued premiums in the period in which the termination occurs.

In accordance with accounting principles generally accepted in the United States, the Company carries its credit swaps on its consolidated statements of financial condition at their fair value. Changes in the fair value of the Company's credit swap portfolio are recorded as unrealized gains or losses as a component of net credit swap revenue in the Company's consolidated statements of operations. If a credit swap has an increase or decline in fair value during a period, the increase will add to the Company's net credit swap revenue and the decline will subtract from the Company's net credit swap

Table of Contents

revenue for that period, respectively. Changes in the fair value of the Company's credit swap portfolio are a function of the notional amount and composition of the portfolio and prevailing market credit swap premiums for comparable credit swaps. The Company generally holds the credit swaps it sells to maturity, at which point, assuming no credit event has occurred, the cumulative unrealized gains and losses on each credit swap would equal zero.

Primus Financial and Harrier each enters into valid ISDA Master Agreements with their counterparties and each aggregates their respective transactions on a counterparty basis for presentation on the Company's consolidated statements of financial condition. If the aggregate total of fair values with a counterparty is a net gain, the total is recorded as a component of unrealized gains on credit swaps, at fair value in the consolidated statements of financial condition. If the aggregate total of fair values with a counterparty is a net loss, the total is recorded as a component of unrealized losses on credit swaps, at fair value in the consolidated statements of financial condition. In instances where the Company does not have a valid ISDA Master Agreement with the counterparty, the fair values of individual swap transactions are not aggregated and are recorded as components of unrealized gains or losses on credit swaps, at fair value, dependent upon whether the individual contract was at a gain or a loss.

Primus Financial

Under the terms of Primus Financial's operating guidelines, derivatives transactions can only include credit swaps.

Primus Financial is primarily a Seller of credit swaps. As a general rule, when Primus Financial sells credit swaps, it intends to maintain the transaction until maturity. However, there are two sets of circumstances in which the Company could elect to terminate transactions prior to maturity, and the Company monitors its portfolio on a continuing basis to assess whether those circumstances are present.

First, whenever Primus Financial receives new information suggesting that the credit quality of the underlying risk has deteriorated to a material degree, the Company considers the possibility of terminating the transaction, usually at a loss, to avoid the larger loss that could result if the credit swap were to remain in place until a credit event occurs.

Second, Primus Financial may elect to terminate a transaction for which it has an unrealized gain or loss based on one or more of the following considerations: the likelihood of further gains or losses arising from the position, its view as to whether the capital dedicated to the position could be profitably reallocated, its total exposure to a particular Reference Entity, the total size of its portfolio in relation to its capital and the total size of its swap positions and exposures with a particular counterparty which might be reduced so that the counterparty may enter into additional swaps with Primus Financial.

Primus Financial distinguishes among credit swaps sold – single name and credit swaps sold – tranche. Credit swaps sold – single name refers to credit swaps referencing a single entity. Credit swaps sold – tranche refers to credit swaps referencing portfolios containing obligations of multiple reference entities.

Harrier

In April 2007, Primus Guaranty formed Harrier, a Cayman Islands exempted limited partnership. During the second quarter of 2007, Primus Guaranty transferred the trading portfolio of PRS Trading Strategies to Harrier. Harrier trades in a broad range of fixed income products, including credit swaps, total return swaps on loan transactions, leveraged loans and investment grade and non-investment grade securities. Harrier also transacts in high yield and investment grade credit swap indices (''CDS index'') and tranches within these CDS indices, at different levels of risk subordination within the index. CDS indices include credit swaps of a standardized basket of reference entities. Unlike Primus

Financial, Harrier has no counterparty ratings from rating agencies and, accordingly, has entered into agreements with its counterparties to post collateral to support its contractual obligations. Harrier does not engage in trading activity with Primus Financial.

Table of Contents

Consolidated Net Credit Swap Revenue and Credit Swap Portfolio Information

The table below presents the components of consolidated net credit swap revenue for the three and nine months ended September 30, 2007 and 2006 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net premium income	$ 22,382	$ 18,034	$ 61,168	$ 51,081
Net realized losses	(12,326)	(1,826)	(13,150)	(2,098)
Change in unrealized gains (losses)	(130,178)	12,697	(189,012)	36,882
Total net credit swap revenue (loss)	$ (120,122)	$ 28,905	$ (140,994)	$ 85,865

The table below, in thousands, represent the Company's consolidated notional amount, fair value and average fair value of open credit swap transactions entered into with third parties at September 30, 2007 and December 31, 2006 (excluding CDS index and index tranches and total return swaps with net fair values of $10.2 million and $48 thousand as of September 30, 2007 and December 31, 2006, respectively):

	September 30, 2007	December 31, 2006
Gross Notional Amounts:		
Credit swaps sold – single name	$ 17,115,109	$ 15,485,145
Credit swaps sold – tranche	3,700,000	500,000
Credit swaps sold – ABS	80,000	15,000
Credit swaps purchased – single name	(457,931)	(147,597)
Fair value:		
Asset	4,177	73,281
Liability	134,554	2,930
Average fair value:		
Asset	42,674	57,433
Liability	76,164	1,990

''Asset'' in the table above represents unrealized gains on credit swaps while ''Liability'' represents unrealized losses on credit swaps. All credit swaps are subject to netting arrangements that have been contractually established independently by Primus Financial and Harrier with each of their counterparties under an ISDA Master Agreement. The notional amounts of the credit swap contracts in the preceding table are presented on a gross basis and the fair values of such contracts are netted by counterparty.

The tables that follow summarize in thousands, by credit rating of Reference Entities and of counterparties, the notional amounts and fair values of credit swap transactions outstanding for the Company as of September 30, 2007 and December 31, 2006 (excluding CDS index and index tranches and total return swaps with net fair values of $10.2 million and $48 thousand as of September 30, 2007 and December 31, 2006, respectively):

	September 30, 2007		December 31, 2006	
Moody's Rating Category	Notional Amount	Fair Value	Notional Amount	Fair Value
By Single Name Reference Entity/Tranche				
Credit Swaps Sold – Single Name:				

Aaa	$ 923,319	$ (318)	$ 761,211	$ 1,483
Aa	3,548,754	(19,046)	2,690,166	9,364
A	5,468,788	(3,515)	6,075,786	29,501
Baa	6,545,953	15,389	5,427,937	32,786

12

Table of Contents

September 30, 2007 December 31, 2006 Moody’s Rating Category Notional
Amount Fair
Value Notional
Amount Fair
Value Ba 570,330 (4,298) 470,842 1,467 B 57,965 (1,645) 59,203 (706) Total $ 17,115,109 $ (13,433) $ 15,485,145 $ 73,895 Credit Swaps Sold – Tranche: Aaa $ 2,450,000 $ (37,182) $ — $ — Aa 1,050,000 (31,238) 300,000 (2,494) A 200,000 (17,370) 200,000 (534) Total $ 3,700,000 $ (85,790) $ 500,000 $ (3,028) Credit Swaps Sold – ABS: A $ 55,000 $ (17,613) $ 10,000 $ (15) Baa 20,000 (8,300) 5,000 (8) Ba 5,000 (2,690) — — Total $ 80,000 $ (28,603) $ 15,000 $ (23) Credit Swaps Purchased – Single Name: Aa $ (58,079) $ (179) $ (15,000) $ (15) A (102,408) (1,104) (36,000) (10) Baa (288,444) (1,213) (83,636) (484) Ba (8,000) (4) (6,961) 235 B (1,000) (51) (6,000) (219) Total $ (457,931) $ (2,551) $ (147,597) $ (493) By Counterparty Buyer/(Seller) Credit Swaps Sold – Single Name: Aaa $ 5,030,727 $ (2,086) $ 982,194 $ 5,003 Aa 10,100,856 (9,579) 12,037,591 57,175 A 1,983,526 (1,768) 2,465,360 11,717 Total $ 17,115,109 $ (13,433) $ 15,485,145 $ 73,895 Credit Swaps Sold – Tranche: Aaa $ 400,000 $ (9,221) $ — $ — Aa 2,850,000 (67,233) 500,000 (3,028) A 450,000 (9,336) — — Total $ 3,700,000 $ (85,790) $ 500,000 $ (3,028) Credit Swaps Sold – ABS: Aaa $ 55,000 $ (15,197) $ 10,000 $ (15) Aa 20,000 (11,907) 5,000 (8) A 5,000 (1,499) — — Total $ 80,000 $ (28,603) $ 15,000 $ (23) Credit Swaps Purchased – Single Name: Aaa $ (178,614) $ (270) $ (9,961) $ (120) Aa (279,317) (2,281) (137,636) (373) Total $ (457,931) $ (2,551) $ (147,597) $ (493)
13

Table of Contents

S&P Rating Category	September 30, 2007 Notional Amount	September 30, 2007 Fair Value	December 31, 2006 Notional Amount	December 31, 2006 Fair Value
By Single Name Reference Entity/Tranche				
Credit Swaps Sold – Single Name:				
AAA	$ 1,116,983	$ (5,902)	$ 940,031	$ 1,721
AA	3,315,745	(11,020)	2,275,564	8,845
A	5,960,956	(421)	6,490,958	30,644
BBB	6,104,161	18,339	5,271,390	32,958
BB	510,271	(7,829)	438,499	1,060
B	106,993	(6,600)	68,703	(1,333)
Total	$ 17,115,109	$ (13,433)	$ 15,485,145	$ 73,895
Credit Swaps Sold – Tranche:				
AAA	$ 3,000,000	$ (49,962)	$ 150,000	$ (2,010)
AA	500,000	(18,459)	200,000	(1,613)
A	100,000	(8,564)	150,000	595
BBB	100,000	(8,805)	—	—
Total	$ 3,700,000	$ (85,790)	$ 500,000	$ (3,028)
Credit Swaps Sold – ABS:				
AA	$ 10,000	$ (6,844)	$ —	$ —
A	50,000	(13,641)	15,000	(23)
BBB	15,000	(5,428)	—	—
BB	5,000	(2,690)	—	—
Total	$ 80,000	$ (28,603)	$ 15,000	$ (23)
Credit Swaps Purchased – Single Name:				
AA	$ (58,079)	$ (179)	$ (15,000)	$ (15)
A	(152,820)	(1,551)	(56,000)	(10)
BBB	(228,752)	(657)	(58,636)	(473)
BB	(15,280)	(62)	(13,961)	214
B	(3,000)	(102)	(4,000)	(209)
Total	$ (457,931)	$ (2,551)	$ (147,597)	$ (493)
By Counterparty Buyer/(Seller)				
Credit Swaps Sold – Single Name:				
AAA	$ 5,000	$ 8	$ 31,406	$ 104
AA	13,859,833	(10,388)	11,732,030	58,698
A	3,250,276	(3,053)	3,721,709	15,093
Total	$ 17,115,109	$ (13,433)	$ 15,485,145	$ 73,895
Credit Swaps Sold – Tranche:				
AAA	$ —	$ —	$ 100,000	$ (1,335)
AA	3,250,000	(76,454)	400,000	(1,693)
A	450,000	(9,336)	—	—
Total	$ 3,700,000	$ (85,790)	$ 500,000	$ (3,028)

Table of Contents

September 30, 2007 December 31, 2006 S&P Rating Category Notional
Amount Fair
Value Notional
Amount Fair
Value Credit Swaps Sold – ABS: AA