

PRIMUS GUARANTY LTD

Form 10-K

March 31, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2010**  
**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**  
(State or other jurisdiction of  
incorporation or organization)

**98-0402357**  
(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)

**Securities registered pursuant to Section 12(b) of the Exchange Act:**

<b>Title of each class</b>	<b>Name on each exchange on which registered</b>
Common Shares, \$0.08 par value	New York Stock Exchange
7% Senior Notes due 2036	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Exchange Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

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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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's common shares held by non-affiliates of the registrant was approximately \$58,197,163 based on the closing price quoted by the New York Stock Exchange as of the last business day of the most recently completed second fiscal quarter (June 30, 2010).

As of March 14, 2011, the number of shares outstanding of the registrant's common shares, \$0.08 par value, was 38,091,401.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement relating to the registrant's 2011 annual meeting of shareholders are incorporated by reference into Part III of this Annual Report.

**Primus Guaranty, Ltd.**  
**Form 10-K**  
**For the fiscal year ended December 31, 2010**  
**INDEX**

	<b>Page</b>
<b><u>Part I.</u></b>	
<u>Item 1. Business</u>	3
<u>Item 1A. Risk Factors</u>	16
<u>Item 1B. Unresolved Staff Comments</u>	23
<u>Item 2. Properties</u>	23
<u>Item 3. Legal Proceedings</u>	23
<b><u>Part II.</u></b>	
<u>Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</u>	24
<u>Item 6. Selected Financial Data</u>	27
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
<u>Item 7A. Quantitative and Qualitative Disclosures about Market Risk</u>	49
<u>Item 8. Financial Statements and Supplementary Data</u>	50
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	95
<u>Item 9A. Controls and Procedures</u>	95
<u>Item 9B. Other Information</u>	95
<b><u>Part III.</u></b>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	95
<u>Item 11. Executive Compensation</u>	97
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</u>	97
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	97

<u>Item 14. Principal Accountant Fees and Services</u>	97
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**Part IV.**

<u>Item 15. Exhibits and Financial Statement Schedules</u>	98
--	----

<b><u>Signatures</u></b>	100
--------------------------	-----

- EX-10.2
- EX-10.3
- EX-10.4
- EX-10.9
- EX-10.11
- EX-10.12
- EX-10.15
- EX-12
- EX-21
- EX-23
- EX-31.1
- EX-31.2
- EX-32

**Table of Contents****CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*This Annual Report on Form 10-K contains forward-looking statements within the meaning of the safe harbor provisions of U.S. Private Securities Litigation Reform Act of 1995 with respect to our future financial or business performance, strategies or expectations. Forward-looking statements are subject to numerous assumptions, risks and uncertainties, which change over time. All statements, other than statements of historical facts, included in this document regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words anticipate, believe, estimate, expect, intend, may, plan, potential, project, opportunity, seek, will, would and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make and future results could differ materially from historical performance. We have included important factors in the cautionary statements included in this Annual Report on Form 10-K, particularly in the Risk Factors section, that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. Forward-looking statements speak only as of the date they are made, and we do not assume any obligation to, and do not undertake to, update any forward-looking statements.*

**Part I.****Item 1. Business**

*Unless otherwise indicated or the context otherwise requires, references to (i) we, us, our, Company, Primus or Primus Guaranty refers to the consolidated operations of Primus Guaranty, Ltd.; (ii) Primus Asset Management refers to Primus Asset Management, Inc., (iii) references to Primus Financial refers to Primus Financial Products, LLC alone or collectively with its wholly owned subsidiaries; and (iv) each other single company name refers solely to such company.*

**Overview**

We are a Bermuda company that was incorporated in 1998 and are a holding company that currently conducts business through our wholly owned operating subsidiary, Primus Financial Products, LLC. Primus Financial Products, LLC is a credit derivative product company ( CDPC ). Primus Asset Management, another wholly owned subsidiary, acts as manager of the credit swap and cash investment portfolios of its affiliate, Primus Financial.

Our registered office is at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda, and our telephone number is 441-296-0519. The offices of Primus Financial and Primus Asset Management are located at 360 Madison Avenue, New York, New York 10017, and their telephone number is 212-697-2227. Our common shares, par value \$0.08 per share ( common shares ), are listed on the New York Stock Exchange, ( the NYSE ), under the symbol PRS. During 2010, we announced our intention to divest the asset management businesses we had previously established. On December 1, 2010, we divested our CLO asset management business, which included the sale of CypressTree Investment Management, LLC ( CypressTree ), a manager and sub-advisor of collateral loan obligations ( CLOs ) and a wholly owned subsidiary. See notes 6 and 7 in the notes to consolidated financial statements for further discussion. Going forward, our focus will be directed toward managing Primus Financial's credit swap portfolio as it amortizes, optimizing our capital structure and managing our portfolio of investments and expenses.

**Table of Contents**

**Primus Financial**

Primus Financial is a Delaware limited liability company that, as a CDPC, was established to sell credit protection in the form of credit swaps primarily to global financial institutions and major credit swap dealers, referred to as counterparties, against primarily investment grade credit obligations of corporate and sovereign issuers. In exchange for a fixed quarterly premium, Primus Financial agreed, upon the occurrence of a defined credit event (e.g., bankruptcy, failure to pay or restructuring) affecting a designated issuer, referred to as a Reference Entity, to pay to its counterparty an amount determined through industry-sponsored auctions equivalent to the notional amount of the credit swap less the auction-determined recovery price of the underlying debt obligation. Primus Financial may elect to acquire the underlying security in the related auction or in the market and seek to sell such obligation at a later date. Credit swaps sold by Primus Financial on a single specified 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 are referenced to residential mortgage-backed securities. Credit events related to CDS on ABS may include any or all of the following: failure to pay principal, write-down in the reference obligation and distressed ratings downgrades on the reference obligation as defined in the related credit swap agreement.

During 2009, we announced our intention to amortize Primus Financial's credit swap portfolio. Under the amortization model, Primus Financial's credit swap contracts will expire at maturity (unless terminated early) and it is not expected that additional credit swaps will be added to its portfolio, unless associated with a risk mitigation transaction.

*Bankruptcy Remoteness*

Primus Financial and each of its subsidiaries have been structured so that neither Primus Financial nor any of its subsidiaries should be substantively consolidated in a bankruptcy case with each other, or with Primus Guaranty or with any of its other Primus affiliates in the event of bankruptcy.

*Credit Swap Portfolio-Primus Financial*

As of December 31, 2010, Primus Financial had a credit swap portfolio with a total notional amount of \$10.4 billion, weighted average credit ratings of A+ using available credit ratings by Standard & Poor's Ratings Services (S&P) and a weighted average remaining maturity of 2.18 years. At December 31, 2010, approximately 64% of Primus Financial's outstanding notional credit swap portfolio was denominated in U.S. dollars and 36% was denominated in euros.

Single Name Credit Swaps

As of December 31, 2010, Primus Financial's portfolio of single name credit swaps sold was \$6.6 billion (in notional amount), had a weighted average credit rating of A- (S&P) and a weighted average remaining maturity of 1.39 years. The last single name credit swap transaction in the portfolio is scheduled to mature in September 2013. Primus Financial's portfolio of single name credit swaps sold was denominated in U.S. dollars and euros. The portfolio included 334 corporate and sovereign Reference Entities spread across 58 industries in 28 countries. Reference Entities that were domiciled in the United States and outside of the United States comprised 35% and 65%, respectively, of the single name credit swap portfolio at December 31, 2010. At December 31, 2010, 57% of Primus Financial's single name credit swaps were denominated in U.S. dollars and 43% denominated in euros. The percentage of single name credit swaps in the portfolio relating to investment grade Reference Entities as rated by S&P was approximately 90% at December 31, 2010.

**Table of Contents**

The following chart provides a summary of the S&P Industry Classification of the Reference Entities in Primus Financial's single name credit swap portfolio at December 31, 2010. The chart represents the notional principal associated with each industry classification as a percentage of the total notional principal of the single name credit swap portfolio.

*Single Name Portfolio Distribution by S&P Industry Classification*



**Table of Contents**

**Tranches**

As of December 31, 2010, Primus Financial's portfolio of credit swap tranches sold was \$3.8 billion (in notional amount). The tranches had a weighted average credit rating of AA (S&P) and a weighted average remaining maturity of 3.55 years. The last tranche transaction in the portfolio is scheduled to mature in December 2014. Primus Financial's portfolio of credit swap tranches sold was entirely denominated in U.S. dollars and includes corporate and sovereign Reference Entities.

**CDS on ABS**

As of December 31, 2010, Primus Financial's portfolio of CDS on ABS was \$23.7 million (in notional amount).

Primus Financial's portfolio of CDS on ABS was entirely denominated in U.S. dollars.

The last CDS on ABS transaction in the portfolio is estimated to mature in August 2020. The actual maturity for any CDS on ABS contract may be earlier or later than the estimated maturity.

**Counterparties**

At December 31, 2010, Primus Financial had outstanding credit swap transactions with 27 counterparties. These counterparties primarily consisted of global financial institutions and major credit swap dealers. Primus Financial's top counterparty and top five counterparties represented approximately 17% and 50%, respectively, of its credit swap portfolio in notional amounts outstanding at December 31, 2010. One individual counterparty accounted for more than 10% of consolidated net premiums earned for the year ended December 31, 2010. While Primus Financial does not post collateral to its counterparties nor are there any ratings triggers or other conditions which would require collateral to be posted, in connection with certain portfolio repositioning transactions, subsidiaries of Primus Financial have granted security interests in their assets in favor of certain counterparties.

Primus Financial transacted credit swaps under contracts which incorporate standard market terms and conditions as defined by the International Swaps and Derivatives Association, Inc. ( ISDA ). These agreements include a Master Agreement and trade confirmations that govern the terms of its credit swap transactions. The ISDA Master Agreement allows Primus Financial to conduct many separate transactions with a counterparty on an efficient basis, each subject to a specific confirmation.

**Primus Asset Management**

Primus Asset Management, a Delaware corporation, acts as manager of the credit swap and cash investment portfolios of its affiliate, Primus Financial. Primus Asset Management also has entered into a Services Agreement with its affiliates, whereby it provides management, consulting and information technology services, among others, to its affiliates. As of December 31, 2010, Primus Asset Management managed Primus Financial's credit swap portfolio of \$10.4 billion in notional amount.

**Primus Guaranty (UK)**

Primus Guaranty (UK), Ltd. ( PGUK ), a subsidiary, was established in London to provide a base of operations to support Primus' business in Europe. During 2010, we made the decision to close PGUK, which is now preparing to enter into voluntary liquidation. PGUK's authorization under the United Kingdom's Financial Services Authority was cancelled on November 18, 2010. PGUK supplied services to affiliated companies, including Primus Financial, that included marketing to and maintaining relations with counterparties.

**Primus Re**

Primus Re, Ltd. ( Primus Re ), a subsidiary, is a Bermuda company that was registered as a class 3 insurer under the Bermuda Insurance Act 1978, as amended, and related regulations, (together, the Bermuda Insurance Act ). During 2010, we made the decision to close Primus Re. Primus Re's registration as a class 3 insurer was cancelled on November 30, 2010 and it is now in liquidation. Primus Re has been inactive since 2007.

**Table of Contents**

**Other Subsidiaries**

We own two intermediate holding companies, Primus (Bermuda), Ltd. ( Primus Bermuda ) and Primus Group Holdings, LLC. ( Primus Group Holdings ). Primus Financial has established two wholly owned subsidiaries in connection with its portfolio repositioning transactions.

**Risk Management Policies and Oversight**

The risk management policies of the Company are overseen by the board of directors of Primus Guaranty. The Audit Committee of our board oversees the Company s compliance with the Company s risk management policies.

**Investments and Investment Policy**

The cash balances of the Company have been invested primarily in corporate securities and money market funds. The corporate securities primarily consist of short-term debt principally issued by investment grade U.S. financial and corporate entities.

**Technology**

We are dependent on our technology infrastructure to manage our business. Our technology primarily consists of licensed third-party software. It is designed to provide risk management, financial and operational support for Primus Financial s credit swap and cash investment portfolios managed by Primus Asset Management. We have a business continuity plan that includes redundant power sources, fault tolerant hardware, backups and capabilities to reach our technology from multiple locations. Our security plan includes firewall protection, password controls, individual logins, an audit log and user reviews.

**Competition**

During 2010, we announced our intention to divest from the asset management businesses we had previously established. Accordingly, we no longer compete in the market for asset management services. The Company s business priorities include the management of Primus Financial s credit swap portfolio and its invested capital. Under the amortization model, the existing credit swap contracts will expire at maturity (unless terminated early) and it is not expected that additional credit swaps will be added to its portfolio, unless associated with a risk mitigation transaction. Primus Financial has not written any additional credit swap protection since the second quarter of 2008.

**Employees**

As of December 31, 2010, we had 19 employees. None of our employees is party to a collective bargaining agreement or represented by any labor organization. We consider our relations with our employees to be good.

**Additional Information**

We make available, free of charge, access to Primus Guaranty, Ltd. s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Section 16(a) filings, our Proxy Statement, and all amendments to those reports as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC through our home page at [www.primusguaranty.com](http://www.primusguaranty.com). The information on our Web site is not incorporated by reference into this Annual Report on Form 10-K. You may read and copy materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains a Web site that contains our SEC filings at [www.sec.gov](http://www.sec.gov).

**Table of Contents**

As required by Section 303A.12 (a) of the New York Stock Exchange Corporate Government Standards, our Chief Executive Officer has filed the required certification on May 12, 2010.

**Certain Bermuda Law Considerations**

*In this discussion, references to (i) Primus Guaranty are references solely to Primus Guaranty, Ltd. and not to any of its consolidated operations; and (ii) BD\$ are references to Bermuda Dollars.*

Primus Guaranty, Primus Bermuda and Primus Re have been designated as non-residents for exchange control purposes by the BMA. Common shares of a Bermuda company may be offered or sold in Bermuda only in compliance with the provisions of the Exchange Control Act, 1972 and related regulations, which regulates the sale of securities in Bermuda. All three companies are required to obtain the prior permission of the BMA for the issuance and transferability of their shares. We have received consent from the BMA for the issue and free transferability of the common shares of Primus Guaranty, as long as the shares of Primus Guaranty are listed on an appointed stock exchange (including the NYSE), to and among persons who are non-residents of Bermuda for exchange control purposes.

Primus Guaranty, Primus Bermuda and Primus Re have each been incorporated in Bermuda as an exempted company. Under Bermuda law, exempted companies are companies formed for the purpose of conducting business outside Bermuda from a principal place in Bermuda. As a result, they are exempt from Bermuda laws restricting the percentage of share capital that may be held by non-Bermudians, but they may not participate in certain transactions, including (1) the acquisition or holding of land in Bermuda (except as may be required for their business and held by way of lease or tenancy for terms of not more than 50 years or which is used to provide accommodation or recreational facilities for their officers and employees and held with the consent of the Bermuda Minister of Finance, for a term not exceeding 21 years) without the express authorization of the Bermuda legislature, (2) the taking of mortgages on land in Bermuda to secure an amount in excess of BD\$50,000 without the consent of the Bermuda Minister of Finance, (3) the acquisition of any bonds or debentures secured by any land in Bermuda, other than certain types of Bermuda government securities or (4) the carrying on of business of any kind in Bermuda, except in furtherance of their business carried on outside Bermuda (and certain other limited circumstances) or under license granted by the Bermuda Minister of Finance.

Primus Guaranty must comply with the provisions of The Companies Act 1981, as amended, of Bermuda (the Bermuda Companies Act ) regulating the payment of dividends, and making distributions from contributed surplus and purchases of shares. A Bermuda company may not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the company's assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. Under the Bermuda Companies Act, when a Bermuda company issues shares at a premium (that is for a price above the par value), whether for cash or otherwise, a sum equal to the aggregate amount or value of the premium on those shares must be transferred to an account called the share premium account. The provisions of the Bermuda Companies Act relating to the reduction of the share capital of a company apply as if the share premium account were paid-up share capital of that company, except for certain matters such as premium arising on a particular class of shares which may be used in paying up unissued shares to be issued to shareholders as fully paid bonus shares. The paid-up share capital may not be reduced if on the date the reduction is to be effected there are reasonable grounds for believing that the company is, or after the reduction would be, unable to pay its liabilities as they become due. Similarly, no purchase by a company of its own shares may be effected if, on the date on which the purchase is to be effected, there are reasonable grounds for believing that the company is, or after the purchase would be, unable to pay its liabilities as they become due. Under Bermuda law, non-Bermudians (other than spouses of Bermudians, or holders of a permanent resident's certificate, or holders of a working resident's certificate) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. A work permit may be granted or extended upon showing that, after proper public advertisement, no Bermudian (or spouse of a Bermudian, or holder of a permanent resident's certificate, or holder of a working resident's certificate) is available who meets the minimum standards reasonably required by the employer. The current policy of the Bermuda government is to place a six-year term limit on individuals with work permits, subject to certain exemptions for key employees. There are employee protection laws

and social security laws in Bermuda that will apply if we ever have employees based in Bermuda.

**Table of Contents**

**TAX CONSIDERATIONS**

The following summary of the taxation of holders of common shares of Primus Guaranty and the taxation of Primus Guaranty describes the material Bermuda and U.S. federal income tax considerations as of the date of this document. The summary is for general information only and does not purport to be a complete analysis or listing of all tax considerations that may be applicable, nor does it address the effect of any potentially applicable U.S. state or local tax laws, or the tax laws of any jurisdiction outside the United States or Bermuda. The tax treatment of a holder of common shares for U.S. federal, state, local, and non-U.S. tax purposes may vary depending on the holder's particular status. Legislative, judicial, or administrative changes may be forthcoming, including changes that could have a retroactive effect that could affect this summary. Primus Guaranty has not sought, and does not intend to seek, a tax ruling with respect to any of the issues described below. All statements herein, with respect to facts, determinations, or conclusions relating to the business or activities of Primus Guaranty have been provided by us. All references in the following summary with regard to Bermuda taxation to Primus Guaranty do not include its consolidated operations. Prospective investors are urged to consult their own tax advisors concerning their particular circumstances and the U.S. federal, state, local, and non-U.S. tax consequences to them of owning and disposing of our common shares.

**Taxation of Shareholders**

*Bermuda Taxation*

Under current Bermuda law, dividends paid by Primus Guaranty to holders of common shares will not be subject to Bermuda withholding tax.

*U.S. Taxation*

Except as noted in this sentence, the following summary addresses the material U.S. federal income tax consequences with respect to common shares held as capital assets and does not deal with the tax consequences applicable to all categories of investors, some of which (such as broker-dealers; banks; insurance companies; tax-exempt entities; investors who own, or are deemed to own, 10% or more of the total combined voting power or value of Primus Guaranty; investors who hold or will hold common shares as part of hedging or conversion transactions; investors subject to the U.S. federal alternative minimum tax; investors that have a principal place of business or tax home outside the United States; and investors whose functional currency is not the U.S. dollar) may be subject to special rules. Prospective investors in common shares are advised to consult their own tax advisors with respect to their particular circumstances and with respect to the effects of U.S. federal, state, local, or other countries' tax laws to which they may be subject.

*U.S. Holders*

Except as noted in the first sentence of the preceding paragraph, the following discussion summarizes the material U.S. federal income tax consequences relating to the ownership and disposition of our common shares by a beneficial owner thereof that is for U.S. federal income tax purposes (i) an individual citizen or resident of the United States, (ii) a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the U.S. or any political subdivision thereof, or (iii) an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

**Table of Contents**

As discussed in greater detail below under *Passive Foreign Investment Companies* and *Taxation of Primus Guaranty and its Subsidiaries* U.S. Taxation Primus Guaranty, Primus Bermuda, Primus Financial and PGUK, subject to the limitations and caveats described below, Primus Guaranty believes that (1) neither Primus Guaranty nor Primus Bermuda should be treated as engaged in a trade or business within the United States and (2) Primus Guaranty and Primus Bermuda should be and continue to be passive foreign investment companies ( PFICs ) for U.S. federal income tax purposes. This discussion assumes both of these conclusions, unless otherwise stated.

*Passive Foreign Investment Companies.* Special and adverse U.S. federal income tax rules apply to shareholders who are direct or indirect owners of foreign corporations that are PFICs. In general, a foreign corporation will be a PFIC if 75% or more of its gross income constitutes passive income or 50% or more of its assets produce passive income. Various rules require that a foreign corporation look through its ownership interest in lower-tier subsidiaries in determining whether it satisfies the asset or the income test. Based on the operations, assets and income of our entire group, and in particular the operations, assets and income of Primus Financial, Primus Guaranty believes that both Primus Guaranty and Primus Bermuda (as well as certain CLOs for which Primus Asset Management acts as collateral manager in which Primus Bermuda has invested; references to Primus Bermuda in the remainder of this section includes those CLOs) should satisfy either or both of the income or asset tests and as a result should be and continue to be PFICs. If it were determined that Primus Financial's activities with respect to credit swaps constituted a U.S. trade or business, Primus Guaranty and Primus Bermuda as a result might not be PFICs.

Holders of common shares are urged to consult with their tax advisors as to the tax consequences of holding shares directly and indirectly (in the case of Primus Bermuda) of PFICs and the possible advisability of electing to have each of Primus Guaranty and Primus Bermuda treated as a qualified electing fund ( QEF ), or of making a mark-to-market election with respect to Primus Guaranty.

If Primus Guaranty and Primus Bermuda are treated as PFICs during the period in which a shareholder holds common shares (a holding period ) and such shareholder has not made a QEF election or a mark-to-market election (as described below) with respect to each of Primus Guaranty and Primus Bermuda, the shareholder will be subject to the following adverse tax consequences. Upon a disposition of common shares of Primus Guaranty (or the sale of Primus Bermuda shares by Primus Guaranty), including, under certain circumstances, pursuant to an otherwise tax-free transaction, gain recognized by the shareholder would be allocated ratably over the shareholder's holding period for the common shares. The amounts allocated to the taxable year of the sale or other exchange would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest marginal U.S. federal income tax rate in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the tax attributable to such allocated amounts. Further, any distribution in respect of common shares of Primus Guaranty (or to Primus Guaranty in respect of shares of Primus Bermuda) will be taxed as above if the amount of the distribution is more than 125% of the average distribution with respect to the common shares received by the shareholder (or by Primus Guaranty in the case of a distribution in respect of Primus Bermuda shares) during the preceding three years or the shareholder's holding period, whichever is shorter. Distributions by a PFIC are not eligible for the reduced tax rate of 15% that applies to certain dividends paid to non-corporate U.S. shareholders.

If Primus Guaranty and Primus Bermuda are PFICs and a shareholder does not make a QEF election or a mark-to-market election (as described below) at the time the shareholder purchases the common shares, the corporations will continue to be treated as PFICs with respect to the common shares held directly or indirectly by the shareholder, even if they subsequently cease to qualify as PFICs, unless an election as described below is made to purge the PFIC taint. A purging election would itself accelerate PFIC tax treatment but would avoid PFIC tax treatment for subsequent years when Primus Guaranty and Primus Bermuda are not PFICs and for years in which a QEF election as discussed below is in effect. Different methods of purging the PFIC taint are available depending on whether the corporation is a PFIC at the time the election is made and certain other facts.

**Table of Contents**

Under the U.S. Internal Revenue Code of 1986, as amended (the Code), a direct or indirect shareholder of a PFIC may elect to have the PFIC treated as a QEF with respect to such shareholder (a QEF election). If during a holding period, a shareholder always has had a QEF election in effect for both Primus Guaranty and Primus Bermuda while they were PFICs, the shareholder will not be subject to the PFIC tax treatment described in the preceding paragraphs. Instead, the shareholder will be required to include in its income each year its pro rata share of their capital gain and ordinary earnings for that year, and any excess obtained with respect to the common shares by disposition is generally treated as capital gain. If a shareholder makes the QEF election, the shareholder's basis in its PFIC shares will be increased by the earnings included in gross income and decreased by a distribution to the extent of previously taxed amounts. For this purpose, a corporation owning an interest in an entity which is a partnership for U.S. federal income tax purposes, such as Primus Bermuda owning an interest in Primus Financial, would be allocated the share of the capital gain and ordinary earnings of the partnership attributable to the interest it owns. Thus, if a shareholder makes a QEF election with respect to Primus Bermuda, as well as Primus Guaranty, the shareholder will be required to include a portion of the capital gain and ordinary income of Primus Financial in its income. As a result, a shareholder may be subject to current tax based on the income of Primus Guaranty or Primus Bermuda without any distribution of cash to enable such tax to be paid. If a shareholder has made a QEF election for both Primus Guaranty and Primus Bermuda, the shareholder may elect to defer the payment of the tax on such income items, subject to an interest charge, until the corresponding amounts are distributed, or until the shareholder disposes its common shares.

As discussed in more detail below, we have determined that the credit swaps sold by Primus Financial are best treated as the sale of options for U.S. federal income tax purposes. Accordingly, Primus Financial will recognize income or loss as a protection seller, only upon default, termination or expiration of the credit swaps. There is no definitive authority in support of the treatment by Primus Financial of its credit swaps as options for U.S. federal income tax purposes, and we have not sought, and do not intend to seek, a ruling from the U.S. Internal Revenue Service (IRS), on this point. In addition, the IRS has been studying the treatment of derivative transactions generally, including credit swaps, and has issued a notice requesting submissions from taxpayers regarding the manner in which they conduct their credit swap activities and indicating that the U.S. Department of the Treasury (the Treasury Department) and the IRS are contemplating issuing specific guidance in this area. No assurance can be given as to whether or when such guidance may be issued, whether it would be applied retroactively or whether it will be adverse to Primus Financial. The notice describes numerous potential alternative characterizations of credit swaps, including a characterization consistent with the treatment adopted by Primus Financial and other characterizations that would have adverse tax consequences for Primus Financial. If the IRS were to assert successfully that the credit swaps sold by Primus Financial should be treated other than as the sale of options, the timing of the income recognized by Primus Financial could be accelerated, which would accelerate the inclusion of taxable income by a shareholder if it makes QEF elections. In addition, because the option treatment adopted by Primus Financial for the tax treatment of credit swaps differs from the treatment used for financial accounting purposes, the amount of taxable income that a shareholder would include in a particular year as a result of a QEF election may differ significantly from, and in particular years may be significantly greater than, the amount that the shareholder would have included were taxable income calculated in the manner used for financial accounting purposes.

Primus Guaranty intends to comply, and to cause Primus Bermuda to comply, with all record-keeping, reporting and other requirements so that shareholders may maintain a QEF election with respect to Primus Guaranty and Primus Bermuda. If a shareholder desires to make and maintain a QEF election, the shareholder may contact us for the PFIC annual information statement, which may be used to complete the annual QEF election filings. Shareholders also may obtain this information on our Web site at [www.primusguaranty.com](http://www.primusguaranty.com). Shareholders will need to rely on the information provided by us in the annual information statement in preparing their income tax filings.

A QEF election is made on a shareholder-by-shareholder basis and can be revoked only with the consent of the IRS. A QEF election is made by attaching a completed IRS Form 8621 (using the information provided by us in the PFIC annual information statement) to a timely filed U.S. federal income tax return. Even if a QEF election is not made, shareholders must file a completed IRS Form 8621 every year.





**Table of Contents**

Alternatively, if shares of a PFIC are regularly traded on a qualified exchange (which includes certain U.S. exchanges and other exchanges designated by the Treasury Department), or marketable shares, a U.S. holder of such shares may make a mark-to-market election. In general, a class of shares is treated as regularly traded for a calendar year if it is traded, other than in de minimis amounts, for at least 15 days during each calendar year quarter. The common shares of Primus Guaranty trade on the NYSE, a qualified exchange, and it is anticipated that they qualify as regularly traded on that exchange for this purpose, although there can be no assurance that they actually so qualify or that the common shares will continue to be listed on the NYSE or any other qualified exchange.

If a shareholder makes a valid mark-to-market election with respect to Primus Guaranty, the shareholder will not be subject to the PFIC rules described above with respect to Primus Guaranty, and instead will include each year in ordinary income the excess, if any, of the fair market value of its PFIC shares at the end of the taxable year over its adjusted basis in such shares. The excess, if any, of the adjusted basis over the fair market value at the end of the taxable year will be permitted as an ordinary loss (but only to the extent of the net amount previously included in income as a result of the mark-to-market election). If a shareholder makes the election, the shareholder's basis in the PFIC shares will be adjusted to reflect any such income or loss amounts.

Even if the common shares of Primus Guaranty qualify as marketable shares for this purpose, the shares of Primus Bermuda, which also is expected to be a PFIC, will not be marketable shares for these purposes. There is no authority on how a mark-to-market election for a corporation which is a PFIC affects that holder's treatment of a subsidiary of that corporation which is also a PFIC. If a shareholder makes a mark-to-market election with respect to Primus Guaranty, it may continue to be subject to PFIC tax treatment with respect to Primus Bermuda, in the absence of a QEF election with respect to Primus Bermuda, and to additional inclusions of taxable income, if such a QEF election is made. Shareholders should consult their tax advisor as to the possibility of making a QEF election with respect to their indirect ownership of the shares of Primus Bermuda, which shares will not qualify as marketable shares.

**Shareholders are urged to consult with their tax advisors regarding the likely classification of Primus Guaranty and Primus Bermuda as PFICs and the advisability of making QEF elections with respect to Primus Guaranty and Primus Bermuda.**

*Alternative Characterizations.* If Primus Guaranty and Primus Bermuda were not PFICs, distributions with respect to the common shares would be treated as ordinary dividend income to the extent of Primus Guaranty's current or accumulated earnings and profits as determined for U.S. federal income tax purposes. Dividends paid by Primus Guaranty to U.S. corporations are not eligible for the dividends-received deduction and dividends paid on its common shares to non-corporate U.S. shareholders would be eligible for the reduced tax on dividends at a maximum rate of 15%, as our common shares are listed on the NYSE and therefore readily tradeable on an established securities market in the United States for purposes of Section 1(h)(11) of the Code. Distributions in excess of Primus Guaranty's current and accumulated earnings and profits would first be applied to reduce a shareholder's tax basis in the common shares, and any amounts distributed in excess of such tax basis would be treated as gain from the sale or exchange of the common shares.

If Primus Guaranty and Primus Bermuda were not PFICs, a shareholder would, upon the sale or exchange of common shares, generally recognize gain or loss for federal income tax purposes equal to the excess of the amount realized upon such sale or exchange over the shareholder's U.S. federal income tax basis for such common shares. Such long-term capital gain is currently generally subject to a reduced rate of U.S. federal income tax if recognized by non-corporate U.S. holders, which rate is currently a maximum of 15% for years prior to 2011. Limitations apply to the deduction of capital losses.

*Non-U.S. Holders*

Subject to certain exceptions, persons that are not U.S. persons will be subject to U.S. federal income tax on dividend distributions with respect to, and gain realized from, the sale or exchange of common shares only if such dividends or gains are effectively connected with the conduct of a trade or business within the United States.

**Table of Contents****Taxation of Primus Guaranty and Its Subsidiaries***Bermuda Taxation*

*Primus Guaranty, Primus Bermuda and Primus Re.* Each of Primus Guaranty, Primus Bermuda and Primus Re has received an assurance under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, (the Tax Protection Act ), to the effect that in the event of any legislation imposing tax computed on profits or income, or computed on any capital asset, gain, or appreciation, or any tax in the nature of estate duty or inheritance tax being enacted in Bermuda, then the imposition of any such tax shall not be applicable to Primus Guaranty, Primus Bermuda or Primus Re, or to any of their operations, or the shares, debentures, or other obligations of Primus Guaranty, Primus Bermuda and Primus Re until March 28, 2016. This assurance does not prevent the application of any such tax or duty to such persons who are ordinarily resident in Bermuda or the application of any tax payable in accordance with the provisions of the Land Tax Act 1967 of Bermuda or otherwise payable in relation to the property leased to Primus Guaranty, Primus Bermuda or Primus Re. Each of Primus Guaranty, Primus Bermuda and Primus Re is required to pay certain annual Bermuda government fees. In addition, all entities employing individuals in Bermuda are required to pay a payroll tax to the Bermuda government. Currently, there is no Bermuda withholding tax on dividends paid by Primus Guaranty, Primus Bermuda or Primus Re.

*U.S. Taxation*

*Primus Guaranty, Primus Bermuda, Primus Financial and PGUK.* Based on how Primus Guaranty and Primus Bermuda operate and will continue to operate their businesses, Primus Guaranty believes that Primus Guaranty and Primus Bermuda should not be treated as engaged in a trade or business within the United States. Primus Guaranty also believes that Primus Bermuda should not be treated as engaged in a U.S. trade or business through its ownership interest in PGUK or its indirect ownership interest in Primus Financial. In reaching this view, Primus Guaranty has concluded that, although the matter is not free from doubt and there is no governing authority on the point, Primus Financial's activity of selling credit swaps, together with its other activities, are best viewed as transactions in securities or commodities as an investor or trader (rather than as a dealer or as part of a financing business) for Primus Financial's own account in the United States under Section 864(b)(2) of the Code, and Primus Financial (and Primus Bermuda, as a non-U.S. partner in Primus Financial for U.S. federal income tax purposes) should not be viewed as engaged in a U.S. trade or business. In reaching this conclusion, Primus Guaranty is relying on statements by the IRS that taxpayers engaged in derivative transactions may take any reasonable position pending the adoption of final regulations regarding the treatment of derivative transactions for purposes of Section 864(b)(2) of the Code. These IRS statements do not have the force of Code provisions or adopted regulations and may be revoked or amended retroactively, subject only to review for abuse of discretion. Because the determination of whether a foreign corporation is engaged in a trade or business in the United States is inherently factual and there are no definitive standards for making such determination, and the treatment in particular of credit swaps and Primus Financial's current and anticipated activities is unsettled, there can be no assurance that the IRS will not contend successfully that Primus Guaranty, Primus Bermuda or Primus Financial is engaged in a trade or business in the United States. Primus Guaranty, Primus Bermuda and Primus Financial have undergone a U.S. federal income tax audit covering the tax years 2004 through 2006. Although management has not received formal notification from the IRS that the audit has been completed, the statute of limitations for the years in question has expired, and the Company has taken the position that the audit has concluded without any additional liability on behalf of the Company. Should this position be incorrect and should any issues considered in the audit be resolved in a manner not consistent with management's expectations, Primus Guaranty or Primus Bermuda could be required to pay U.S. corporate income tax.

**Table of Contents**

If the IRS were to successfully assert that Primus Guaranty or Primus Bermuda (either directly or through its interest in Primus Financial or its interest in PGUK, which has elected to be treated as a disregarded entity, or branch, of Primus Bermuda for U.S. federal income tax purposes) is engaged in a trade or business in the United States, it will be subject to U.S. federal income tax, as well as, potentially, the branch profits tax, on its net income that is effectively connected with the conduct of the trade or business, unless the corporation is entitled to relief under an income tax treaty. Such income tax would be imposed on effectively connected net income, which is computed in a manner generally analogous to that applied to the net income of a domestic corporation. However, if a foreign corporation does not timely file a U.S. federal income tax return, even if its failure to do so is based upon a good faith determination that it was not engaged in a trade or business in the United States, it is not entitled to deductions and credits allocable to its effectively connected income. Moreover, penalties may be assessed for failure to file such tax returns. Primus Guaranty and Primus Bermuda file protective U.S. federal income tax returns so that if they are held to be engaged in a trade or business in the United States, they would be allowed to deduct expenses and utilize credits allocable to income determined to be effectively connected with such trade or business and would not be subject to a failure to file penalty.

The maximum U.S. corporate income tax rate currently is 35% for a corporation's effectively connected net income. In addition, if Primus Financial is found to be engaged in a U.S. trade or business, as a partnership for U.S. federal income tax purposes, it will be required to perform U.S. federal income tax withholding, at the rate of 35%, in respect of Primus Bermuda's allocable share of Primus Financial's income that is effectively connected with such U.S. trade or business under Section 1446 of the Code, regardless of whether distributions are actually made by Primus Financial to Primus Bermuda or Primus Group Holdings. In such a circumstance, Primus Bermuda will be entitled to credit any such withholding tax against its liability for U.S. federal income tax.

The U.S. branch profits tax rate currently is 30%, subject to reduction by applicable tax treaties. The branch profits tax, which is based on net income after subtracting the regular corporate tax and making certain other adjustments, is imposed on the amount of net income deemed to have been withdrawn from the United States. If Primus Financial or PGUK, is found to be, or to have been engaged in a U.S. trade or business, and as a result the U.S. branch profits tax applies to Primus Bermuda, the branch profits tax may be imposed at a rate of 30%.

As discussed above, Primus Guaranty has determined that the credit swaps sold by Primus Financial, are best treated as the sale of options for U.S. federal income tax purposes, such that Primus Financial will recognize income or loss as a protection seller only upon default or expiration of the credit swaps. There is no definitive authority in support of the treatment by Primus Financial of its credit swaps as options for U.S. federal income tax purposes. We have not sought, and do not intend to seek, a ruling from the IRS on this point. In addition, the IRS has been studying the treatment of derivative transactions generally, including credit swaps and has recently issued a notice requesting submissions from taxpayers regarding the manner in which they conduct their credit swap activities and indicating that the Treasury Department and the IRS are contemplating issuing specific guidance in this area. No assurance can be given as to whether or when such guidance may be issued, whether it would be applied retroactively or whether it will be adverse to Primus Financial. The notice describes numerous potential alternative characterizations of credit swaps, including a characterization consistent with the treatment adopted by Primus Financial, and other characterizations that would have adverse tax consequences for Primus Financial. If the IRS were to successfully assert that the credit swaps sold by Primus Financial, should be treated other than as an option, (i) the timing of the income recognized by Primus Financial could be accelerated, (ii) the character of this income could be altered and (iii) Primus Bermuda and Primus Guaranty, as non-U.S. persons, could be subject to U.S. income or withholding tax at the rate of 30% on its FDAP income (discussed below). In addition, were these changes in character to apply and were Primus Bermuda (through its investment in Primus Financial) found to be engaged in a U.S. trade or business, Primus Bermuda's recognition of taxable income would be accelerated.

A foreign corporation not engaged in a trade or business in the United States generally is subject to U.S. federal income tax at the rate of 30% on its fixed or determinable annual or periodic gains, profits and income (FDAP income) derived from sources within the United States (for example, dividends and certain interest income). Thus, even if Primus Guaranty and Primus Bermuda are not engaged in a trade or business in the United States, they could be subject to the 30% tax on certain FDAP income, depending upon the types of instruments in which they invest.

Premium income from credit swap sales does not constitute FDAP income, assuming as discussed above, that the credit swaps sold by Primus Financial are treated as the sale of options for U.S. federal income tax purposes.

**Table of Contents**

The above analysis generally assumes that Primus Financial is and continues to be a partnership other than a publicly traded partnership for U.S. federal income tax purposes. Generally, a partnership with fewer than 100 partners at all times is treated as a partnership that is not a publicly traded partnership. Because of restrictions on the ownership composition of Primus Financial, Primus Guaranty believes that Primus Financial is not and will not become a publicly traded partnership and thus will not be required to pay U.S. federal income tax on its income. However, there can be no assurance that Primus Financial is not or will not become a publicly traded partnership, which could have a materially adverse effect on our financial condition and results of operations. Were Primus Financial to be a publicly traded partnership for U.S. federal income tax purposes, it could be required to pay U.S. federal income tax on its income (without regard to whether it is engaged in a U.S. trade or business), instead of passing through its income and loss to its partners, and it will be required to perform U.S. federal income tax withholding, at the rate of 30%, in respect of amounts paid to Primus Bermuda.

*Primus Asset Management.* Primus Asset Management is a Delaware corporation which owns 100% of the shares of Primus Re and is owned by Primus Bermuda through Primus Group Holdings, a disregarded entity for U.S. federal income tax purposes. Primus Asset Management is subject to U.S. federal income tax on a net basis on its income. Primus Asset Management manages Primus Financial's credit swap portfolios and provides services to affiliated companies. See *Primus Asset Management* for further discussion.

Primus Asset Management has reported on its U.S. federal income tax returns a net operating loss carryforward and other tax attributes reflecting various items of loss and deduction, including with respect to predecessor companies. Various restrictions may apply to these tax attributes, including under Section 382 of the Code, and no assurance can be given that the availability of some or all of these tax attributes will not be successfully challenged by the IRS. Any dividends paid by Primus Asset Management to Primus Bermuda through Primus Group Holdings from its earnings will be subject to U.S. federal income tax withholding at a rate of 30%.

*Primus Re.* Primus Re historically has conducted only limited operations and was inactive from 2007 until it entered liquidation in 2011. Primus Re is expected to be liquidated by June 30, 2011.

*Personal Holding Company Tax and Accumulated Earnings Tax.* A personal holding company tax is imposed at a current rate of 15% on the undistributed personal holding company income (subject to certain adjustments) of a personal holding company. The accumulated earnings tax is imposed on corporations (including foreign corporations with direct or indirect shareholders subject to U.S. tax) that accumulate earnings in excess of the reasonably anticipated needs of the business, generally at a current rate of 15% on a corporation's excess accumulated earnings. These taxes only apply in certain circumstances, but, in any case, neither tax applies to a corporation that is a PFIC. Because Primus Guaranty and Primus Bermuda likely are and will continue to be PFICs, these taxes should not apply to them.

*Backup Withholding.* Payment of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to backup withholding unless a shareholder (i) is a corporation or comes within certain other exempt categories and, when required, demonstrates this fact, or (ii) provides a taxpayer identification number, certifies as to no loss of exemption from backup withholding and otherwise complies with applicable requirements of the backup withholding rules. The backup withholding tax is not an additional tax and may be credited against a shareholder's regular U.S. federal income tax liability.

**Table of Contents**

**Item 1A. Risk Factors**

**Risks Related to Our Business and Operations**

***General economic and conditions in the global financial and credit markets may materially adversely affect our loss experience and our financial results.***

The global economy appears to have continued its recovery from the low point of the financial crisis of 2008, but remains fragile and subject to future downturns. There remain sectors of the global and financial markets which could create a greater level of risk to our business. Primus Financial may experience a higher level of credit events which would have a material adverse impact on our financial condition and results of operations.

The successful execution of the amortization of the Primus Financial credit swap portfolio will be highly dependent on the level of credit losses in that portfolio over its remaining life. Management expects the credit markets will continue to be uncertain and volatile for some time and that certain industry sectors could continue to experience further deterioration in their balance sheets and poor financial performance. This could increase the potential for additional credit events. It is possible that the level of credit event losses that Primus Financial experiences will exceed its ability to pay claims.

Primus Financial's portfolio includes significant exposure on credit swaps sold referencing a number of global financial intermediaries and banks, including senior and subordinated debt issued by financial institutions. A number of these institutions have received capital infusions and support from governments and central banks. Many of these institutions also have had to raise new capital at very expensive levels as their balance sheets have deteriorated, primarily as a result of concerns relating to sectors of the European market. In addition, concerns regarding residential and commercial real estate exposures, as well as concerns about holdings of certain sovereign debt obligations, could put further stress on these institutions.

At December 31, 2010, Primus Financial's portfolio of single name credit swaps referencing financial guaranty companies in a total aggregate notional amount was approximately \$127.0 million. Some of the financial guarantors have had significant deterioration in their balance sheets and capital ratios and, as a result, have sought to re-structure by effecting commutations with their counterparties on various structured credit positions in their portfolios.

***The failure to manage effectively the risk of credit losses would have a material adverse effect on our financial condition and results of operations.***

During 2010 and 2009, we completed several risk mitigation transactions in Primus Financial's credit swap portfolio as part of our plan to actively manage this portfolio in amortization. The objectives of these transactions, which included both portfolio repositioning transactions of single name credit swaps and tranche transactions with certain counterparties and terminations of selected credit swaps referencing specific Reference Entities, were to reduce the risk of certain Reference Entity concentrations, as well as to improve the capital subordination levels in certain tranche transactions. However, there cannot be any assurance that any of the transactions which we have completed or which we may complete in the future will be effective. In addition, if the level of credit events were to exceed our expectations, the payments Primus Financial would be required to make under its related credit swaps could materially and adversely affect our financial condition and results of operations. Moreover, even though we may identify a heightened risk of default with respect to a particular Reference Entity or Entities, our ability to limit Primus Financial's losses, through hedging, terminating credit swaps or other risk mitigation transactions, before defined credit events actually occur could be limited by conditions of inadequate liquidity in the credit swap market or conditions which render terminations, hedging or such other risk mitigation transactions economically impractical. There can be no assurance that we will be able to manage higher risks of credit losses effectively. It is possible that the level of credit events that Primus Financial experiences will exceed its ability to pay claims.

**Table of Contents*****Primus Financial's tranche portfolio of credit swaps also creates risks for us.***

As of December 31, 2010, Primus Financial's portfolio of credit swap tranches sold was \$3.8 billion (in notional amount). Tranches generally reference pools of credit swaps and have capital subordination levels that are designed to protect against making cash payments upon some number of credit events affecting the Reference Entities referenced in the tranche. Since 2008, a combination of credit events with respect to certain Reference Entities in Primus Financial's tranche portfolio has caused the subordination levels to be reduced or eradicated. Additional credit events in the future may further reduce subordination levels, and if subordination is eradicated, Primus Financial may be required to make cash payments to the relevant counterparty, potentially to the full notional amount of the tranche transaction. This would have a material adverse impact on our financial condition and results of operations. While management of Primus Financial has terminated certain tranche transactions and completed risk mitigation transactions seeking to improve the capital subordination levels in certain tranche transactions, there can be no assurance that any such risk mitigation transactions, previously completed or completed in the future, will be successful.

***Primus Financial's counterparties are primarily global financial institutions and major credit swap dealers. A default by a major counterparty could have a material adverse impact on Primus Financial.***

The insolvency of a major swap counterparty could have a material adverse impact on Primus Financial as it is likely the insolvent counterparty would cease making premium payments on its credit swap agreements. It may be difficult for Primus Financial to cancel its contracts with an insolvent counterparty, with the contingent risk that the counterparty may be successful in making claims for credit events on a Reference Entity under a credit swap agreement with a defaulting counterparty. We were dependent on one single counterparty, which generated greater than 10% of our consolidated net premium revenue in each of the years ended December 31, 2010 and 2009.

***Variations in market credit swap premiums and correlation levels could cause our financial results to be volatile.***

Events causing market credit swap premium levels to widen or tighten or correlation levels to change significantly on underlying Reference Entities in Primus Financial's credit swap portfolio will affect the fair value of related credit swaps and may increase the volatility of our financial results reported under U.S. generally accepted accounting principles (GAAP). In accordance with GAAP, we are required to report credit swaps at fair value, with changes in fair value during periods recorded as unrealized gains or losses in our consolidated statements of operations. The principal determinant of the fair value of a credit swap is the prevailing market premium associated with the underlying Reference Entity at the time the valuation is derived. The valuation of Primus Financial's tranche portfolio also incorporates assumptions relating to the correlation of defaults between Reference Entities. The fair value of credit swaps also is affected by our estimation of counterparties and Primus Financial's ability to perform under the credit swap contracts. Generally, valuations for credit swaps in Primus Financial's portfolio rely upon market pricing quotations from third-party pricing providers and dealers. We cannot provide assurance that there will be a broadly based and liquid market to provide reliable market quotations in the future, particularly in circumstances where there is abnormal volatility or lack of liquidity in the market. Factors that may cause market credit swap premiums and correlation assumptions to fluctuate include changes in national or regional economic conditions, industry cyclicality, credit events within an industry, changes in a Reference Entity's operating results, credit swap market liquidity, credit rating, cost of funds, management or any other factors leading investors to revise expectations about a Reference Entity's ability to pay principal and interest on its debt obligations when due. Volatility in our reported GAAP results may cause our common share price to fluctuate significantly.

**Table of Contents*****We are exposed to significant credit market risk related to changes in foreign exchange rates which may adversely affect our results of operations, financial condition or cash flows.***

Primus Financial's credit swaps are denominated in both U.S. dollars and euros. Approximately 36% of Primus Financial's outstanding total credit swap portfolio of \$10.4 billion (in notional amount) at December 31, 2010 was denominated in euros. The notional principal of the credit swap is denominated in euros and the premiums are payable in euros, and therefore our credit exposure is affected by changes in the exchange rate between euros and U.S. dollars. We translate euros into U.S. dollars at the current market exchange rates for the purpose of recognizing credit swap premium income and the computation of fair values in our consolidated statements of operations. Changes in the exchange rates between euros and U.S. dollars may have an adverse affect on the fair value of credit swaps, settlement of potential credit event losses and premium income in our consolidated statements of operations. We do not hedge against foreign exchange rate risk.

***A significant proportion of our capital is invested in corporate securities. We cannot be assured that there will not be defaults or adverse price movements or defaults in these securities.***

At December 31, 2010, approximately \$287.2 million of our investment capital was invested in securities issued by corporations, predominantly domiciled in the United States. These securities are, as a general rule, investment grade and have a remaining tenor of less than five years. However, we cannot be assured that there will not be adverse price movements or defaults in these securities resulting in a weakening of our financial position and adverse financial results.

***Our operations may become subject to increased regulation or existing regulations may change, which may result in administrative burdens, increased costs or other adverse consequences.***

There can be no assurance that new legal or administrative interpretations or regulations under the U.S. commodities and securities laws, or other applicable legislation on the federal or state levels, or in Bermuda or other jurisdictions, will not adversely affect our business by, among other things, imposing administrative burdens, increased costs or other adverse consequences. In 2010, the U.S. Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act, and this act potentially affects Primus Financial as a seller of credit swaps. The rules for implementation of this legislation are being drafted and promulgated by a number of U.S. federal regulatory agencies and it is not yet possible to estimate how the new law and regulations will affect the operations of Primus Financial.

***During 2010, the Company changed its strategy and sold or terminated the majority of its asset management initiatives in order to concentrate on the amortization of Primus Financial's credit swap portfolio.***

The disposition of Primus' CLO business was effected through a merger and a revenue-sharing arrangement with a third-party CLO manager. The proceeds from the sale and the shared revenues are contingent upon the future collection of management fees on the CLOs, which in turn depends on the financial performance of the CLOs and continued management of the CLOs by the third-party CLO manager. The sale of our CLO business was effected through an earn-out process whereby the CLOs are managed or sub-advised by a third party but Primus continues to collect a portion of the CLO management fee streams. If CLO management fees are reduced or eradicated in the future then the earn-out of the fees will be reduced or eradicated and our financial results will be adversely affected.

***We may have difficulty in servicing our outstanding debt.***

At December 31, 2010, Primus Guaranty, Ltd. had \$90.4 million outstanding of its 7% Senior Notes due 2036 (the 7% Senior Notes). We have entered into an interest rate swap, with a notional principal of \$75 million, which converts the fixed rate on the debt to a floating rate for the notional amount of the swap. This swap may be terminated at the option of the counterparty in December 2011, which will have the effect of increasing the effective cost of servicing the 7% Senior Notes. At December 31, 2010, Primus Guaranty, Ltd. had \$23.7 million of cash and cash equivalents and investments. As a holding company, we currently rely on investment income from our portfolio of investments, capital resources of the holding company and dividends and/or distributions from our subsidiaries to service the interest on the 7% Senior Notes above current levels. If our investment income or our capital resources were to decline such that they were insufficient to pay interest on the 7% Senior Notes, we may have difficulty finding other sources of income or capital to pay such interest and, as a result, have difficulty in servicing such debt.





**Table of Contents**

At December 31, 2010, Primus Financial Products, LLC had \$217.3 million outstanding in aggregate of its perpetual preferred securities and subordinated deferrable interest notes. Primus Financial relies on its credit swap premiums and its investment income from its portfolio of investments to service the interest on its outstanding debt and make distribution payments on its perpetual preferred securities. If Primus Financial's credit swap portfolio suffers significant credit events, it will be forced to liquidate significant portions of its investment portfolio in order to pay claims to its counterparties, thereby also reducing the source of its investment income utilized to service its outstanding debt.

***We may require additional capital in the future, which may not be available on favorable terms or at all.***

In the current environment, as well as based upon our current strategic focus, it would be very difficult for Primus Guaranty or Primus Financial to raise additional capital should Primus Guaranty or Primus Financial need to do so. Any equity or debt financing, if available at all, would likely be on terms that are not favorable to us or our shareholders but nonetheless, we might have to accept those terms. Any defaults on interest payments by either Primus Guaranty or Primus Financial on their respective debt and preferred security obligations would have a material adverse effect on our ability to raise additional capital in the future.

In addition, Primus Guaranty has been repurchasing its common shares and its 7% Senior Notes and Primus Financial has been repurchasing its perpetual preferred securities and subordinated deferrable interest notes. Since the inception of these buyback programs in 2008 and through December 31, 2010, Primus Guaranty purchased and retired 10.0 million common shares at a cost of \$21.8 million and \$34.6 million of face amount of its 7% Senior Notes at a cost of \$14.5 million. Primus Financial has repurchased \$77.2 million of face amount of its outstanding debt securities at a cost of \$32.5 million. There is no assurance that the capital repurchased in these transactions can be replaced. The Company may continue to make discretionary repurchases of its shares and debt in the future, if it believes it is appropriate to do so.

If we cannot obtain or replace adequate capital when we need to do so, our business, results of operations and financial condition could be adversely affected.

***Certain of our principal shareholders control us.***

At December 31, 2010, a few shareholders collectively owned the majority of our outstanding common shares. As a result, these shareholders, collectively, are able to control the election of our directors, determine our corporate and management policies and determine, without the consent of our other shareholders, the outcome of any corporate action submitted to our shareholders for approval, including potential mergers, amalgamations or acquisitions, asset sales and other significant corporate transactions. These shareholders also have sufficient voting power to amend our organizational documents. There is no assurance that the interests of our principal shareholders will coincide with the interests of other holders of our common shares. This concentration of ownership may discourage, delay or prevent a change in control of our company, which could deprive our shareholders of an opportunity to receive a premium for their common shares as part of a sale of our company and might reduce our share price.

***Our rights plan may have anti-takeover effects that could prevent a change of control.***

On May 29, 2009, we entered into a Rights Agreement with Mellon Investor Services LLC, which we refer to as the rights plan, to contribute to the preservation of long-term value for our shareholders and to protect our shareholders from coercive or otherwise unfair takeover tactics. In general terms, the rights plan works by imposing a significant penalty upon any person or group which acquires 20% or more of the outstanding common shares without the approval of our board of directors, subject to certain grandfather provisions. The provisions of our rights plan could make it more difficult for a third party to acquire the Company, which could hinder shareholders' ability to receive a premium for the Company's common shares over the prevailing market prices.

**Table of Contents**

***There can be no assurance that funds will be available to pay cash dividends on our common shares.***

Currently, we do not pay cash dividends on our common shares and we cannot be assured that funds will be available in the future to pay dividends. We currently expect to retain all available funds for use in the operation of our business. We are a holding company with no operations or significant assets other than our ownership of all of our subsidiaries. The majority of our capital is held at Primus Financial, and any determination for it to pay dividends or return capital to Primus Guaranty will be at the discretion of Primus Financial's board of directors. Further, the payment of dividends and making of distributions by each of Primus Guaranty and Primus Bermuda is limited under Bermuda law and regulations. Any determination to pay cash dividends will be at the discretion of our board of directors and will be dependent upon our results of operations and cash flows, our financial position and capital requirements, general business conditions, legal, tax, regulatory and any contractual restrictions on the payment of dividends and any other factors our board of directors deems relevant.

***We depend on a limited number of key employees. If we are not able to retain or replace key employees, we may be unable to operate our business successfully.***

We cannot assure you that we will continue to be able to employ key personnel and retain qualified personnel in the future. The sale or termination of the majority of the asset management business and change of the credit swap portfolio to an amortization status had the effect of decreasing the number of employees required to service the business. Accordingly, during 2010 we reduced the number of employees and anticipate a continued reduction in employee headcount in the future. We believe we have sufficient employees to manage the amortization of the Primus Financial credit swap portfolio and to maintain our status as a public company. However, given the reduction in staff, it may be difficult to provide coverage and find qualified replacements for employees who leave unexpectedly.

***We are highly dependent on information systems and third-party service providers.***

Our businesses are highly dependent on information systems and technology. We outsource a significant portion of our information systems operations to third parties who are responsible for providing the management, maintenance and updating of such systems. Any failure or interruption of our systems could cause delays or other problems in our business activities and our ongoing credit analysis and risk management assessments. This could have a material adverse effect on our financial condition and results of operations.

***We face potential exposure to litigation and claims within our business and strategy.***

The volume of litigation and claims against financial services firms has increased over the past several years. The risk of litigation is difficult to assess or quantify, and may occur years after activities, transactions or events at issue. Any legal action brought against us and the costs to defend such action, could have a material adverse impact on our financial condition and results of operations.

**Table of Contents****Risks Related to Taxation*****Our status as a PFIC may result in significant additional tax costs for shareholders who are U.S. taxpayers.***

Primus Guaranty and Primus Bermuda (which for purposes of the discussion in this section includes its investments in certain CLOs) are likely to be and remain PFICs for U.S. federal income tax purposes. There are potentially adverse U.S. federal income tax consequences of investing in a PFIC for a shareholder who is a U.S. taxpayer. These consequences include the following: (1) if a shareholder makes a QEF election with respect to Primus Guaranty and Primus Bermuda, the shareholder will have to include annually in its taxable income an amount reflecting an allocable share of the income of Primus Guaranty or Primus Bermuda, regardless of whether dividends are paid by Primus Guaranty to the shareholder, (2) if a shareholder makes a mark-to-market election with respect to Primus Guaranty, the shareholder will have to include annually in its taxable income an amount reflecting any year-end increases in the price of our common shares, regardless of whether dividends are paid by Primus Guaranty to the shareholder (moreover, it is unclear how such an election would affect the shareholder with respect to Primus Bermuda), and (3) if a shareholder does not make a QEF election or a mark-to-market election, the shareholder may incur significant additional U.S. federal income taxes with respect to dividends on, or gain from, the sale or other disposition of, our common shares, or with respect to dividends from Primus Bermuda to us, or with respect to our gain on any sale or other disposition of Primus Bermuda shares. In addition, if a shareholder makes a the QEF election with respect to Primus Guaranty and Primus Bermuda, it is possible that the shareholder's allocable share of income from Primus Guaranty and/or Primus Bermuda may be significantly greater in the tax years from 2011 onward than in prior years. This potential outcome reflects, among other factors, potential reductions in operating expenses and the potential timing of recognition of items of taxable income and loss relating to the Primus Financial's credit swap portfolio as it amortizes.

***If we are found to be engaged in a U.S. trade or business, we may be liable for significant U.S. taxes.***

We believe that Primus Guaranty and Primus Bermuda, both directly and through Primus Bermuda's indirect ownership interest in Primus Financial (which, for U.S. federal income tax purposes, is treated as a partnership interest) and Primus Bermuda's ownership interest in PGUK (which for U.S. federal income tax purposes is treated as a disregarded entity, or branch, of Primus Bermuda), will operate their businesses in a manner that should not result in their being treated as engaged in a trade or business within the United States for U.S. federal income tax purposes. Consequently, we do not expect to pay U.S. corporate income or branch profits tax on Primus Financial's or PGUK's income. However, because the determination of whether a foreign corporation is engaged in a trade or business in the United States is fact-based and there are no definitive standards for making such a determination, there can be no assurance that the IRS will not contend successfully that Primus Guaranty, Primus Bermuda, Primus Financial or PGUK are engaged in a trade or business in the United States. The maximum combined rate of U.S. corporate federal, state and local income tax that could apply to Primus Financial, Primus Bermuda, Primus Guaranty or PGUK, were they found to be engaged in a U.S. trade or business in New York City and subject to income tax, is currently approximately 46%. This combined income tax rate does not include U.S. branch profits tax that would be imposed on Primus Bermuda, were Primus Financial or PGUK, found to be engaged in a U.S. trade or business and deemed to be making distributions to Primus Bermuda. The branch profits tax, were it to apply, would apply at the rate of 30% on amounts deemed distributed. Primus Guaranty, Primus Bermuda and Primus Financial have undergone a U.S. federal income tax audit covering the tax years 2004 through 2006. Although management has not received formal notification from the IRS that the audit has been completed, the statute of limitations for the years in question has expired, and the Company has taken the position that the audit has concluded without any additional liability on behalf of the Company. Should this position be incorrect and should any issues considered in the audit be resolved in a manner not consistent with management's expectations, Primus Guaranty or Primus Bermuda could be required to pay U.S. corporate income tax.

**Table of Contents*****If the IRS successfully challenges the treatment Primus Financial has adopted for its credit swap transactions, the timing and character of taxable income recognized by Primus Financial could be adversely affected.***

Consistent with its treatment of the credit swaps sold by Primus Financial as the sale of options for U.S. federal income tax purposes, we have determined that in general Primus Financial will recognize income or loss as a protection seller or buyer only upon default, termination or expiration of the credit swaps. There is no definitive authority in support of the treatment by Primus Financial of its credit swaps as options for U.S. federal income tax purposes, and we have not sought, and do not intend to seek, a ruling from the IRS on this point. In addition, the IRS has been studying the treatment of derivative transactions generally, including credit swaps, and has issued a notice requesting submissions from taxpayers regarding the manner in which they conduct their credit swap activities and indicating that the Treasury Department and the IRS are contemplating issuing specific guidance in this area. No assurance can be given as to whether or when such guidance may be issued, whether it would be applied retroactively or whether it will be adverse to Primus Financial. Certain proposals under discussion could be inconsistent with the tax treatment adopted by Primus Financial. If the IRS were to assert successfully that the credit swaps sold by Primus Financial should be treated differently or these proposals were adopted, (1) the timing of the income recognized by Primus Financial could be accelerated, (2) the character of this income could be altered and (3) Primus Bermuda and Primus Guaranty, as non-U.S. persons, could be subject to U.S. income tax, or withholding tax at the rate of 30%. In addition, were these changes in character to apply and were Primus Bermuda (through its investment in Primus Financial) and Primus Guaranty (through its investment in Primus Financial) found to be engaged in a U.S. trade or business, Primus Bermuda's and Primus Guaranty's recognition of taxable income would be accelerated.

**Risks Related to Our Status as a Bermuda Company*****It may be difficult to effect service of process and enforcement of judgments against us and our officers and directors.***

Because Primus Guaranty is organized under the laws of Bermuda, it may not be possible to enforce court judgments obtained in the United States against Primus Guaranty based on the civil liability provisions of the federal or state securities laws of the United States in Bermuda or in countries other than the United States where Primus Guaranty has assets. In addition, there is some doubt as to whether the courts of Bermuda and other countries would recognize or enforce judgments of U.S. courts obtained against Primus Guaranty or its directors or officers based on the civil liabilities provisions of the federal or state securities laws of the United States, or would hear actions against Primus Guaranty or those persons based on those laws. We have been advised by our legal advisors in Bermuda that the United States and Bermuda do not currently have a treaty providing for the reciprocal recognition and enforcement of judgments in civil and commercial matters. Therefore, a final judgment for the payment of money rendered by any federal or state court in the United States based on civil liability, whether or not based solely on U.S. federal or state securities law, would not automatically be enforceable in Bermuda. There are grounds upon which a Bermuda court may not enforce the judgments of U.S. courts and some remedies available under the laws of U.S. jurisdictions, including some remedies available under U.S. federal securities laws, may not be permitted under Bermuda courts as contrary to public policy in Bermuda. Similarly, those judgments may not be enforceable in countries other than the United States where Primus Guaranty has assets. Further, no claim may be brought in Bermuda by or against Primus Guaranty or its directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial application under Bermuda law and do not have force of law in Bermuda; however, a Bermuda court may impose civil liability, including the possibility of monetary damages, on Primus Guaranty or its directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda law. ***U.S. persons who own our common shares may have more difficulty in protecting their interests than U.S. persons who are shareholders of a U.S. corporation.***

The Bermuda Companies Act, which applies to Primus Guaranty and Primus Bermuda, differs in certain material respects from laws generally applicable to U.S. corporations and their shareholders. As a result of these differences, U.S. persons who own our common shares may have more difficulty protecting their interests than would U.S. persons who own common shares of a U.S. corporation.



**Table of Contents**

***We may become subject to taxes in Bermuda after 2016, which may have a material adverse effect on our financial condition and operating results.***

The Bermuda Minister of Finance, under the Tax Protection Act, has given Primus Guaranty and Primus Bermuda an assurance that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then, subject to certain limitations, the imposition of any such tax will not be applicable to Primus Guaranty, Primus Bermuda, or any of their respective operations, shares, debentures or other obligations until March 28, 2016. Given the limited duration of the Minister of Finance's assurance, we cannot be certain that we will not be subject to any Bermuda tax after March 28, 2016. Since we are incorporated in Bermuda, we will be subject to changes of law or regulation in Bermuda that may have an adverse impact on our operations, including imposition of tax liability.

***Considerations related to the Organization for Economic Cooperation and Development and the European Union.***

The impact of Bermuda's letter of commitment to the Organization for Economic Cooperation and Development, which is commonly referred to as the OECD, to eliminate harmful tax practices is uncertain and could adversely affect our tax status in Bermuda.

The OECD has published reports and launched a global dialogue among member and non-member countries on measures to limit harmful tax competition. These measures are largely directed at counteracting the effects of tax havens and preferential tax regimes in countries around the world. According to the OECD, Bermuda is a jurisdiction that has substantially implemented the internationally agreed tax standard and as such is listed on the OECD's white list. However, we are not able to predict what changes will be made to this classification or whether such changes will subject us to additional taxes.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

At December 31, 2010, Primus Financial leased approximately 17,500 square feet of office space at 360 Madison Avenue, New York, New York, at a fixed yearly rental (subject to certain escalations specified in the lease). In December 2010, Primus Financial entered into an agreement to sublease approximately 12,000 square feet of this New York office space. We believe the remaining 5,500 square feet of office space is adequate to meet our current needs. The Company also leases approximately 13,800 square feet of office space in Boston, Massachusetts, pursuant to a lease, which Primus Asset Management assumed from CypressTree in December 2010. Subsequently, Primus Asset Management agreed to early terminate this lease prior to its scheduled expiration of October 31, 2012 and to vacate the premises no later than May 31, 2011.

There are no material restrictions imposed by our lease agreements and the leases are categorized as operating leases. We do not lease or own real property in Bermuda.

**Item 3. Legal Proceedings**

In the ordinary course of operating our business, we may encounter litigation from time to time. However, we are not party to nor are we currently aware of any material pending or overtly threatened litigation.

However, at the time Primus Asset Management, Inc. acquired CypressTree Investment Management, LLP, a proceeding that had been initiated on May 6, 2005 was pending before the United States District Court for the Southern District of New York. The proceeding was brought by Fern D. Simmons, as plaintiff, against the former partners of CypressTree and CypressTree, as defendants. After trial in March 2011, the jury returned a verdict on March 23, 2011, finding that certain of the partners had engaged in, and breached, a joint venture with plaintiff; that certain of the partners breached their fiduciary duties to the plaintiff; that CypressTree was unjustly enriched by plaintiff, and that CypressTree owed quantum meruit damages to plaintiff. The court issued a ruling on March 29, 2011 which, among other things, aggregated the damage awards on the unjust enrichment and quantum meruit claims against CypressTree in the amount of approximately \$1,400,000, including interest to date. The time for plaintiff and the defendants to appeal has not yet run. The Company believes it has adequate rights against the former partners of and other stakeholders in CypressTree to cover the legal costs and liability arising out of this litigation.





**Table of Contents****Part II.****Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities****Market Information**

Our common shares trade on the NYSE under the symbol PRS. The following table sets forth, for the indicated periods, the high, low and closing sales prices of our common shares in U.S. dollars, as reported on the NYSE:

<b>Year ended December 31, 2010</b>	<b>High</b>	<b>Low</b>	<b>Close</b>
First Quarter	\$ 4.38	\$ 3.04	\$ 4.20
Second Quarter	\$ 4.82	\$ 3.44	\$ 3.69
Third Quarter	\$ 4.78	\$ 3.41	\$ 4.56
Fourth Quarter	\$ 5.66	\$ 4.49	\$ 5.08
<b>Year ended December 31, 2009</b>	<b>High</b>	<b>Low</b>	<b>Close</b>
First Quarter	\$ 1.99	\$ 1.00	\$ 1.57
Second Quarter	\$ 2.99	\$ 1.53	\$ 2.36
Third Quarter	\$ 4.41	\$ 2.15	\$ 4.27
Fourth Quarter	\$ 4.27	\$ 1.89	\$ 3.05

**Table of Contents****Issuer Purchases of Equity Securities**

The following table provides information about our purchases of our common shares during the fourth quarter ended December 31, 2010:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs (a)</b>
October 1 - 31	221,561	\$ 4.82	221,561	\$ 33,821,861
November 1 - 30	121,511	\$ 4.94	121,511	\$ 33,221,597
December 1 - 31	7,000	\$ 5.05	7,000	\$ 33,186,247
<b>Total</b>	<b>350,072</b>	<b>\$ 4.86</b>	<b>350,072</b>	

(a) On October 8, 2008, our board of directors authorized the implementation of a buyback program for the purchase of our common shares and/or our 7% Senior Notes in the aggregate up to \$25.0 million. On February 3, 2010, our board of directors authorized an additional expenditure of up to \$15.0 million of available cash for the purchase of our common shares and/or our 7% Senior Notes. On July 29, 2010, our board of directors authorized an additional expenditure of up to \$5.0 million of available cash for the purchase of our common shares and/or our 7% Senior Notes. On October 27, 2010, our board of directors authorized an additional expenditure of up to \$10.0 million of available cash for the purchase of our common shares and/or our 7% Senior Notes. The amounts in this column do not reflect the cost of approximately \$14.5 million for purchases of our 7% Senior Notes, since inception of our buyback program through the quarter ended December 31, 2010.

**Securities Authorized for Issuance under Equity Compensation Plans**

Information regarding securities authorized for issuance under equity compensation plans is set forth under the caption Securities Authorized for Issuance Under Equity Compensation Plans included in Item 12 of this Annual Report on Form 10-K.

**Shareholder Information**

As of March 14, 2011, 38,091,401 common shares were issued and outstanding, and held by approximately 41 shareholders of record. Due to the number of common shares held in nominee or street name, we believe that there are a significantly greater number of beneficial owners of our common shares. As of March 14, 2011, the closing share price on the NYSE of our common shares was \$4.79.

**Dividend and Distribution Information**

Currently, we do not pay cash dividends on our common shares and we cannot be assured that funds will be available in the future to pay dividends. We currently expect to retain all available funds for use in the operation of our business. Further, and as appropriate, it is our intention to return to the shareholders capital no longer required for our operations or for the amortization of Primus Financial's credit swap portfolio. Any determination to pay cash dividends in the future will be at the discretion of our board of directors and will be dependent on our results of operations, financial condition, contractual restrictions and other factors deemed relevant by our board of directors.

In addition, we are subject to Bermuda law and regulatory constraints that will affect our ability to pay dividends on our common shares and make other payments. Under the Bermuda Companies Act, each of Primus Guaranty and Primus Bermuda may not declare or pay a dividend out of distributable reserves if there are reasonable grounds for believing that they are, or would after the payment be, unable to pay their respective liabilities as they become due; or

if the realizable value of their respective assets would thereby be less than the aggregate of their respective liabilities and issued share capital and share premium accounts.

**Table of Contents****Performance Graph**

Set forth below is a performance graph comparing the cumulative total shareholder return through December 31, 2010 on our common shares against the cumulative return of the S&P Small Cap 600 Index and Russell 1000 Financial Sector, assuming an investment of \$100 on December 31, 2005.

	<b>Cumulative Total Return</b>					
	<b>12/31/05</b>	<b>12/31/06</b>	<b>12/31/07</b>	<b>12/31/08</b>	<b>12/31/09</b>	<b>12/31/10</b>
Primus Guaranty, Ltd.	\$ 100.00	\$ 88.50	\$ 53.67	\$ 8.74	\$ 23.37	\$ 38.93
S&P Small Cap 600 Index	\$ 100.00	\$ 115.12	\$ 114.78	\$ 79.11	\$ 99.35	\$ 125.49
Russell 1000 Financial Sector	\$ 100.00	\$ 116.29	\$ 94.71	\$ 44.61	\$ 52.36	\$ 57.64

**Table of Contents****Item 6. Selected Financial Data**

The following tables present our historical financial and operating data as of the dates or for the periods indicated. We derived the data for years ended December 31, 2010, 2009, 2008, 2007 and 2006 from our consolidated financial statements, which have been prepared in accordance with GAAP. The following information should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes appearing elsewhere in this Annual Report on Form 10-K.

<i>(in thousands, except per share data)</i>	<b>Years Ended December 31,</b>				
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Statements of Operations Data:</b>					
<b>Revenues:</b>					
Net credit swap revenue (loss) (1)	\$ 267,756	\$ 1,455,802	\$ (1,688,872)	\$ (535,064)	\$ 116,083
Interest income	13,140	6,685	25,483	40,401	28,374
Gain on retirement of long-term debt	9,866	43,151	9,716		
Other income	3,391	3,797	(240)	(3,476)	2,267
<b>Total revenues (losses)</b>	<b>\$ 294,153</b>	<b>\$ 1,509,435</b>	<b>\$ (1,653,913)</b>	<b>\$ (498,139)</b>	<b>\$ 146,724</b>
<b>Expenses:</b>					
Compensation and employee benefits	\$ 18,650	\$ 17,661	\$ 14,595	\$ 20,097	\$ 19,844
Interest expense	7,031	9,116	17,032	20,729	10,849
Other expenses	21,600	15,355	14,363	19,809	14,157
<b>Total expenses</b>	<b>\$ 47,281</b>	<b>\$ 42,132</b>	<b>\$ 45,990</b>	<b>\$ 60,635</b>	<b>\$ 44,850</b>
Income (loss) from continuing operations before provision (benefit) for income taxes	\$ 246,872	\$ 1,467,303	\$ (1,699,903)	\$ (558,774)	\$ 101,874
Provision (benefit) for income tax	(134)	184	61	52	42
Income (loss) from continuing operations	247,006	1,467,119	(1,699,964)	(558,826)	101,832
Income (loss) from discontinued operations, net of tax	(49,544)	(3,422)	(9,540)	2,853	(1,258)
<b>Net income (loss)</b>	<b>\$ 197,462</b>	<b>\$ 1,463,697</b>	<b>\$ (1,709,504)</b>	<b>\$ (555,973)</b>	<b>\$ 100,574</b>
Distributions on preferred securities of subsidiary	\$ 3,162	\$ 3,417	\$ 6,642	\$ 7,568	\$ 5,683
Net loss from discontinued operations attributable to non-parent interests in CLOs	(61,174)				
<b>Net income (loss) available to common shares</b>	<b>\$ 255,474</b>	<b>\$ 1,460,280</b>	<b>\$ (1,716,146)</b>	<b>\$ (563,541)</b>	<b>\$ 94,891</b>
<b>Basic earnings (loss) per share:</b>					
Income (loss) from continuing operations	\$ 6.36	\$ 36.46	\$ (38.16)	\$ (12.64)	\$ 2.22
Income (loss) from discontinued operations	\$ 0.30	\$ (0.08)	\$ (0.21)	\$ 0.06	\$ (0.03)

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Net income (loss) available to common shares	\$	6.66	\$	36.38	\$	(38.37)	\$	(12.58)	\$	2.19
<b>Diluted earnings (loss) per share:</b>										
Income (loss) from continuing operations	\$	6.04	\$	35.34	\$	(38.16)	\$	(12.64)	\$	2.16
Income (loss) from discontinued operations	\$	0.29	\$	(0.08)	\$	(0.21)	\$	0.06	\$	(0.03)
Net income (loss) available to common shares	\$	6.33	\$	35.26	\$	(38.37)	\$	(12.58)	\$	2.13

**Weighted average number of common shares outstanding:**

Basic	38,361	40,142	44,722	44,808	43,306
Diluted	40,366	41,414	44,722	44,808	44,472

(1) Net credit swap revenue (loss) consists of the following:

Net premiums earned	\$	58,100	\$	85,116	\$	102,515	\$	84,771	\$	69,408
Net realized gains (losses) on credit swaps		(86,884)		(113,077)		(161,957)		(5,190)		(1,769)
Net unrealized gains (losses) on credit swaps		296,540		1,483,763		(1,629,430)		(614,645)		48,444
Total net credit swap revenue (loss)	\$	267,756	\$	1,455,802	\$	(1,688,872)	\$	(535,064)	\$	116,083

**Table of Contents**

<i>(in thousands, except per share data)</i>	<b>As of December 31,</b>				
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Balance Sheet Data:</b>					
<b>Assets</b>					
Cash and cash equivalents	\$ 177,736	\$ 299,514	\$ 280,912	\$ 242,665	\$ 204,428
Investments	288,985	274,444	486,870	617,631	599,448
Restricted cash and investments	138,540	127,116			
Unrealized gain on swaps, at fair value	2,006	2,207		606	73,330
Other assets	27,592	29,466	26,449	27,744	25,262
<b>Total assets</b>	<b>\$ 634,859</b>	<b>\$ 732,747</b>	<b>\$ 794,231</b>	<b>\$ 888,646</b>	<b>\$ 902,468</b>
<b>Liabilities and Equity (deficit)</b>					
Unrealized loss on swaps, at fair value	\$ 395,164	\$ 691,905	\$ 2,173,461	\$ 544,731	\$ 2,931
Long-term debt	215,828	244,051	317,535	325,904	325,000
Other liabilities	21,902	46,238	7,670	12,952	13,925
<b>Total liabilities</b>	<b>\$ 632,894</b>	<b>\$ 982,194</b>	<b>\$ 2,498,666</b>	<b>\$ 883,587</b>	<b>\$ 341,856</b>
<b>Equity (deficit)</b>					
Common shares	\$ 3,046	\$ 3,061	\$ 3,263	\$ 3,603	\$ 3,470
Additional paid-in-capital	275,453	280,685	281,596	280,224	269,420
Warrants					612
Accumulated other comprehensive income (loss)	3,333	2,148	908	(4,712)	(2,375)
Retained earnings (deficit)	(372,969)	(628,443)	(2,088,723)	(372,577)	190,964
<b>Total shareholders equity (deficit) of Primus Guaranty, Ltd.</b>	<b>(91,137)</b>	<b>(342,549)</b>	<b>(1,802,956)</b>	<b>(93,462)</b>	<b>462,091</b>
Preferred securities of subsidiary	\$ 93,102	\$ 93,102	\$ 98,521	\$ 98,521	\$ 98,521
<b>Total equity (deficit)</b>	<b>1,965</b>	<b>(249,447)</b>	<b>(1,704,435)</b>	<b>5,059</b>	<b>560,612</b>
<b>Total liabilities and equity (deficit)</b>	<b>\$ 634,859</b>	<b>\$ 732,747</b>	<b>\$ 794,231</b>	<b>\$ 888,646</b>	<b>\$ 902,468</b>
<b>Per Share Data:</b>					
Book value per share <sup>(1)</sup>	\$ (2.39)	\$ (8.95)	\$ (44.21)	\$ (2.08)	\$ 10.65

(1) Book value per share is based on total shareholders equity (deficit) of Primus Guaranty, Ltd. divided by basic common shares outstanding.

**Table of Contents**

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following is a discussion and analysis of our financial condition and results of operations. This discussion should be read in conjunction with our consolidated financial statements and accompanying notes, which appear elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in the Risk Factors section and under the heading Cautionary Note Regarding Forward-Looking Statements. Capitalized and certain other terms used in this discussion have been defined or construed elsewhere in this Annual Report on Form 10-K.*

**Business Introduction**

Primus Guaranty, Ltd. is a Bermuda holding company with offices in New York. Through its wholly owned operating subsidiary, Primus Financial Products, LLC, the Company provides credit protection chiefly against the risk of default on primarily investment grade corporate and sovereign reference entities. Primus Asset Management, Inc., another wholly owned subsidiary, acts as manager of the credit swap and cash investment portfolios of its affiliate, Primus Financial.

*Primus Financial*

Primus Financial was established to sell credit protection in the form of credit swaps primarily to global financial institutions and major credit swap dealers, referred to as counterparties, against primarily investment grade credit obligations of corporate and sovereign issuers.

In exchange for a fixed quarterly premium, Primus Financial agreed, upon the occurrence of a default or other defined credit event (e.g., bankruptcy, failure to pay or restructuring) affecting a designated issuer, referred to as a Reference Entity, to pay its counterparty an amount determined through industry-sponsored auctions equivalent to the notional amount of the credit swap less the auction-determined recovery price of the underlying debt obligation. Primus Financial may elect to acquire the underlying security in the related auction or in the market and seek to sell such obligation at a later date. Credit swaps related to a single specified 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 (ABS), which are referred to as CDS on ABS. These asset-backed securities are referenced to residential mortgage-backed securities. Credit events related to CDS on ABS may include any or all of the following: failure to pay principal, write-downs in the reference obligations (principal write-downs) and distressed ratings downgrades on the reference obligation as defined in the credit swap agreement. Upon the occurrence of a defined credit event, a counterparty has the right to present the underlying ABS, in whole or part, to Primus Financial, in exchange for a cash payment by Primus Financial, up to the notional amount of the credit swap (Physical Settlement). If there is a principal write-down of the ABS, a counterparty may claim for cash compensation for the amount of the principal write-down, up to the notional value of the credit swap, without presentation of the ABS.

During 2009, the Company announced its intention to amortize Primus Financial's credit swap portfolio. Under the amortization model, Primus Financial's credit swap contracts will expire at maturity (unless terminated early) and it is not expected that additional credit swaps will be added to its portfolio, unless associated with a risk mitigation transaction.

At December 31, 2010, Primus Financial's credit swap portfolio had a total notional amount of \$10.4 billion, which included \$6.6 billion of single name credit swaps, \$3.8 billion of tranches and \$23.7 million of CDS on ABS. See note 4 of notes to consolidated financial statements for further information on the credit swap portfolio.



**Table of Contents**

*Primus Asset Management*

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

**Executive Overview and Business Outlook**

During 2010, we announced our intention to divest the asset management businesses we had previously established. On December 1, 2010, we divested our CLO asset management business, which included the sale of CypressTree, a manager and sub-advisor of CLOs and a wholly owned subsidiary. By the end of 2010, substantially all of our asset management businesses had been sold or terminated.

Going forward, our focus will be directed toward managing Primus Financial's credit swap portfolio as it amortizes, optimizing our capital structure and managing our portfolio of investments and expenses.

The financial crisis of 2008 signaled significant changes in the credit markets and for Primus Financial. The principal change was that counterparties were no longer willing to transact with CDPCs, including Primus Financial, which do not post collateral as a general rule. Accordingly, Primus Financial has not written any new credit swaps since 2008, although the terms of certain previously written credit swaps were amended in connection with the portfolio repositioning transactions noted below. Our focus shifted to preserving the value we believe we had created in Primus Financial's credit protection business. Over the last two years, Primus Financial has undertaken a series of portfolio repositioning and risk mitigating transactions designed to reduce the risk in its credit swap portfolio. These efforts were focused on reducing Primus Financial's exposure to certain higher risk tranches, single-name reference entities and industry concentrations, particularly the monoline financial guarantors. In conjunction with its risk mitigation efforts, Primus Financial terminated all credit swaps and settled all outstanding claims with Lehman Brothers Special Financing Inc. (LBSF), a counterparty in bankruptcy, in the third quarter of 2010. Primus Financial paid LBSF \$17.5 million in connection with the settlement.

A source of value to shareholders is returns from the investment of the Company's cash. At December 31, 2010, our cash, cash equivalents, restricted cash and investments were \$605.3 million. Since requesting the withdrawal of Primus Financial's credit ratings in 2009, Primus Financial's investment strategy has been amended to enable investments in investment grade corporate debt.

Our long-term debt consists of \$90.4 million of debt issued by Primus Guaranty and \$122.8 million issued by Primus Financial. The debt is due to mature between 2021 and 2036. In addition to the debt, Primus Financial also has \$94.5 million of perpetual preferred shares outstanding. During 2010, we purchased a total of \$4.2 million in par value of Primus Guaranty's 7% Senior Notes at a cost of \$3.0 million and \$24.8 million in par value of Primus Financial's long-term debt at a cost of \$15.7 million, resulting in net realized gains of \$9.9 million, net of related write-off of unamortized issuance costs. Also during 2010, we purchased approximately 2.1 million shares of our common shares at an aggregate cost of \$8.7 million.

Going forward, we anticipate significantly lowering our operating expenses as a result of reduced employee headcount and the general reduction in the scope of our business activities.

Details of the results of the year ended December 31, 2010 are discussed under [Overview of Financial Results](#) below.

**Table of Contents**

**Critical Accounting Policies**

The discussion and analysis of our financial condition and results of operations are based on our audited consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Actual results could differ from those estimates, and those differences may be material.

Critical accounting policies and estimates are defined as those that require management to make significant judgments and involve a higher degree of complexity. See note 2 of notes to consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K for information regarding our Summary of Significant Accounting Policies. We have identified the valuation of our credit swaps as the most significant of our critical accounting policies. Our critical accounting policies are set forth below.

***Valuation of Credit Swaps***

The fair value of the credit swap portfolio of single name credit swaps, tranches and CDS on ABS, depends upon a number of factors, including:

The contractual terms of the swap contract, which include the Reference Entity, the notional value, the maturity, the credit swap premium and the currency of the swap.

Current market data, including credit swap premium levels pertinent to each Reference Entity, estimated recovery rates on Reference Entities, market interest rates, foreign exchange rates, an estimate of mid-market prices to exit prices, and for tranche transactions, estimates of the correlation of the underlying Reference Entities within each tranche transaction.

Valuation models are used to derive a fair value of credit swaps.

Consideration of our own nonperformance risk, as well as the credit risk of credit swap counterparties. ASC Topic 820, *Fair Value Measurements and Disclosures*, requires that nonperformance risk be considered when determining the fair value of credit swaps.

Estimates of fair values of credit swaps from third-party valuation services and/or credit swap counterparties. In general, the most significant component of the credit swap valuation is the difference between the contractual credit swap premium on the credit swaps transacted and the comparable current market premium. The valuation process the Company uses to obtain fair value is described below:

For single name credit swaps, the valuation model uses mid-market credit swap premium data obtained from an independent provider. The independent provider obtains mid-market credit swap premium quotes from a number of dealers in the credit swap market across a range of standard maturities and restructuring terms, and computes composite credit swap premium quotes on specific Reference Entities, where available. When quotes are not available, management uses observable market data on comparable Reference Entities. The inputs to the valuation model include: current credit swap premium quotes on the Reference Entities, estimated recovery rates on each Reference Entity, current interest rates and foreign exchange rates. We adjust the independent mid-market credit swap premium quotes to derive estimated exit price valuations.

**Table of Contents**

For tranche credit swaps, a mid-market valuation is calculated for each tranche transaction using a tranche valuation model. The inputs to the tranche valuation model include: current credit swap premium quotes obtained from an independent provider on the Reference Entities within the tranche, estimated recovery rates on the Reference Entities within the tranche, current market interest rates and correlation levels derived from credit swap indices. The mid-market valuations obtained from the model are adjusted to estimated exit price valuations.

For CDS on ABS, exit price valuations are obtained from an independent provider and compared against quotes from credit swap counterparties where available.

**Nonperformance Risk Adjustment**

We consider the effect of our nonperformance risk in determining the fair value of our liabilities. Since the adoption of ASC Topic 820, *Fair Value Measurements and Disclosures*, on January 1, 2008, we have 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. We derive 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 business, which have observable spreads.

The following table represents the effect of the nonperformance risk adjustments on our unrealized loss on credit swaps, at fair value in the consolidated statements of financial condition as of December 31, 2010 and 2009 (in thousands):

	<b>December 31, 2010</b>	<b>December 31, 2009</b>
Unrealized loss on credit swaps, at fair value, without nonperformance risk adjustments	\$ 456,498	\$ 906,382
Nonperformance risk adjustments	(61,334)	(214,477)
Unrealized loss on credit swaps, at fair value, after nonperformance risk adjustments	\$ 395,164	\$ 691,905

The following table represents the effect of the changes in nonperformance risk adjustment on our net credit swap revenue (loss) in the consolidated statements of operations for the years ended December 31, 2010, 2009 and 2008 (in thousands):

	<b>Years Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
Net credit swap revenue (loss) without nonperformance risk adjustments	\$ 420,899	\$ 2,494,940	\$ (2,942,487)
Nonperformance risk adjustments	(153,143)	(1,039,138)	1,253,615
Net credit swap revenue (loss) after nonperformance risk adjustments	267,756	1,455,802	(1,688,872)

**Table of Contents*****Fair Value Hierarchy Level 3***

Level 3 assets at December 31, 2010, which included the unrealized gain on credit swaps, investments in securities issued by CLOs, ABS bonds and contingent consideration from the buyer of CypressTree, were \$18.7 million, or 3.9% of the total assets measured at fair value. Level 3 liabilities at December 31, 2010, which included the unrealized loss on credit swaps sold and contingent consideration payments to the sellers of CypressTree, were \$400.3 million, or 100% of total liabilities measured at fair value.

Level 3 assets at December 31, 2009, which included the unrealized gain on credit swaps, investments in CLOs and ABS, were \$3.6 million, or 0.6% of the total assets measured at fair value. Level 3 liabilities at December 31, 2009, which included the unrealized loss on credit swaps sold and a contingent consideration liability, were \$697.4 million, or 100% of total liabilities measured at fair value. Primus Financial's credit swap valuation techniques are described above.

See note 5 of notes to consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K for further discussion of Financial Instruments and Fair Value Disclosures.

***Impact of Adoption of ASC Topic 810, Consolidation***

We adopted ASC Topic 810, *Consolidation*, on January 1, 2010. The consolidation of CLOs under management resulted in an increase in total assets of approximately \$2.5 billion, an increase in total liabilities of \$2.3 billion and an increase to total shareholders' equity of \$266 million as required under the accounting standard.

Consolidated results of operations for the CLOs on a standalone basis are included in our financial statements for the period from January 1, 2010 through December 1, 2010, the date at which we divested our CLO asset management business, at which point we determined we were no longer the primary beneficiary of the CLOs and accordingly deconsolidated the assets and liabilities and shareholder's equity associated with the CLOs. The operating results of the CLO business have been classified as discontinued operations.

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

***Contingent Consideration from the Buyer of CypressTree***

We agreed with the buyer of CypressTree that the proceeds from the sale would be contingent on the amount of future management fees earned on the CLOs managed by CypressTree. We measure the contingent consideration from the buyer at fair value. At December 31, 2010, the fair value of the contingent consideration from the buyer of CypressTree was approximately \$9.0 million. The fair value of the contingent consideration is based upon a valuation model which discounts the projected future cash fees and distributions for each CLO. Significant inputs to the valuation model include the fee structure of the CLO, estimates related to loan default rates, recoveries, discount rates and an estimate of the risk of forfeiture of collateral management. See notes 2, 6 and 7 of notes to consolidated financial statements for further discussion.

***Contingent Consideration Payments to the Sellers of CypressTree***

In purchasing CypressTree in July 2009, Primus Asset Management agreed to make contingent consideration payments to the sellers of CypressTree, based on a fixed percentage of certain future management fees earned through 2015. The liability for contingent consideration payments to the sellers was not included in the subsequent sale of CypressTree in December 2010 and accordingly, remained with Primus Asset Management. At December 31, 2010, the fair value of the contingent consideration payments to the sellers was \$3.7 million. The fair value of the contingent consideration is based upon a valuation model which discounts the projected future cash fees and distributions for each CLO. Significant inputs to the valuation model include the fee structure of the CLO, estimates related to loan default rates, recoveries, discount rates and an estimate of the risk of forfeiture of collateral management. See notes 6 and 7 of notes to consolidated financial statements for further discussion.

**Table of Contents**

**Lehman Brothers Special Financing Inc.**

Primus Financial had entered into credit swap transactions with LBSF, pursuant to an ISDA Master Agreement. At the time of these transactions, LBSF was an indirect subsidiary of Lehman Brothers Holdings Inc. ( LBH ), and LBH was the credit support provider under these transactions. During and subsequent to the end of the third quarter of 2008, LBSF suffered a number of events of default under the ISDA Master Agreement, including bankruptcy, failure to pay premiums when due and bankruptcy of its credit support provider. Primus Financial did not designate any early termination date under the ISDA Master Agreement, and accordingly, continued the credit swap agreements, which referenced approximately \$1.1 billion of underlying reference obligations. Included in these credit swaps were five reference entities referencing \$66 million of obligations of which credit events had occurred prior to and after the LBSF and LBH bankruptcy events. Under relevant accounting standards, Primus Financial continued to carry outstanding credit swaps at their fair value. LBSF was obligated to pay premiums on its credit swap transactions from the third quarter of 2008 until the third quarter of 2010, but had failed to do so.

In September 2010, Primus Financial entered into a termination agreement with LBSF to settle all outstanding claims and credit swap transactions between the parties. Under the terms of the agreement, Primus Financial and LBSF terminated approximately \$1.1 billion notional principal of credit swaps, which represented LBSF's entire portfolio with Primus Financial. Primus Financial paid LBSF \$17.5 million to terminate all these credit swaps and settle all outstanding claims of LBSF for credit events and of Primus Financial for unpaid premiums.

**Results of Operations**

**Introduction**

Net credit swap revenue (loss) incorporates credit swap premium income, together with realized gains and losses arising from the termination of credit swaps, as a result of credit events or credit mitigation decisions. In addition, changes in the unrealized gains (losses) fair value of credit swap portfolio are included in net credit swap revenue (loss).

Other sources of revenue consist of interest income earned on our investments and gains recognized on retirement of long-term debt.

Expenses include interest expense on the debt issued by Primus Guaranty and Primus Financial, employee compensation, restructuring costs and other expenses.

Primus Financial also makes distributions on its preferred securities.

Net loss from discontinued operations attributable to non-parent interests in CLOs represents the non controlling interests of the CLOs on a standalone basis from January 1, 2010 through December 1, 2010. See Discontinued Operations below for further discussion.

These components are discussed in greater detail below.

***Year Ended December 31, 2010 Compared with Year Ended December 31, 2009***

**Overview of Financial Results**

GAAP net income available to common shares for the year ended December 31, 2010 was \$255.5 million, compared with GAAP net income available to common shares of \$1.5 billion for the year ended December 31, 2009. The Company's GAAP net income available to common shares primarily was driven by net credit swap revenue of \$267.8 million and \$1.5 billion, respectively. Net credit swap revenue for the periods was attributable primarily to mark-to-market unrealized gains on Primus Financial's credit swap portfolio.

**Table of Contents**

Interest income on our portfolio of investments was \$13.1 million for the year ended December 31, 2010, compared with \$6.7 million for the year ended December 31, 2009. The increase is primarily attributable to higher returns on our investments.

During the year ended December 31, 2010, we recorded a net gain of approximately \$9.9 million on the retirement of long-term debt, which included purchases by Primus Guaranty of its 7% Senior Notes and purchases by our subsidiary, Primus Financial, of its long-term debt.

Interest expense and distributions on preferred securities issued by Primus Financial were \$10.2 million for the year ended December 31, 2010, compared with \$12.5 million for the year ended December 31, 2009. The decrease is primarily attributable to lower London Interbank Offered Rate ( LIBOR ) and reduced debt levels during 2010. Operating expenses, excluding restructuring costs, were \$32.1 million for the year ended December 31, 2010 and remained relatively flat, compared with \$33.0 million for the year ended December 31, 2009.

On December 1, 2010, we divested our CLO asset management business, which included the sale of CypressTree, a CLO manager and a wholly owned subsidiary. As a result of the sale of CypressTree, the results of operations for CypressTree were reclassified as discontinued operations. Discontinued operations are comprised primarily of activities related to the CLO asset management business. This includes the CLO asset management activities of CypressTree and Primus Asset Management and the operating results of the standalone CLOs. Results of operations related to these businesses are reported as discontinued operations for all periods presented. See below for further information.

***Net Credit Swap Revenue***

Net credit swap revenue was \$267.8 million and \$1.5 billion for the years ended December 31, 2010 and 2009, respectively.

Net credit swap revenue includes:

Net premiums earned;

Net realized gains (losses) on credit swaps, which include gains (losses) on terminated credit swaps sold and losses on credit events during the period; and

Net unrealized gains (losses) on credit swaps.

The table below shows the components of net credit swap revenue for the years ended December 31, 2010 and 2009 (in thousands).

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Net premiums earned	\$ 58,100	\$ 85,116
Net realized losses on credit swaps	(86,884)	(113,077)
Net unrealized gains on credit swaps	296,540	1,483,763
Total net credit swap revenue	\$ 267,756	\$ 1,455,802

**Table of Contents***Net Premiums Earned*

Net premiums earned were \$58.1 million and \$85.1 million for the years ended December 31, 2010 and 2009, respectively. The decrease was primarily attributable to the reduced notional principal of Primus Financial's credit swap portfolio. Primus Financial did not write any new credit protection during these periods.

*Net Realized Losses on Credit Swaps*

Net realized losses on credit swaps sold were \$86.9 million and \$113.1 million for the years ended December 31, 2010 and 2009, respectively. Net realized losses for the year ended December 31, 2010 included a \$17.5 million payment to LBSF to terminate all credit swaps and settle all outstanding claims with LBSF, a \$35.0 million payment to a counterparty relating to the termination of three tranche transactions, a \$29.2 million payment to terminate single name credit swaps referencing Ambac Financial Group, Inc. and MBIA Inc. and realized losses of \$1.8 million on the CDS on ABS portfolio. Primus Financial realized a gain of approximately \$3.6 million relating to the settlement of a credit event on a Reference Entity on which it had purchased single name credit swap protection.

Net realized losses of \$113.1 million for the year ended December 31, 2009 primarily related to payments to two counterparties for portfolio repositioning transactions, realized losses related to credit events on three single name Reference Entities and realized losses on the CDS on ABS portfolio.

*Net Unrealized Gains on Credit Swaps*

Net unrealized gains on credit swaps were \$296.5 million and \$1.5 billion for the years ended December 31, 2010 and 2009, respectively. The change in unrealized gains on credit swaps reflected the change in the fair value of Primus Financial's credit swap portfolio during these periods. The unrealized gains recorded for the years ended December 31, 2010 and 2009 reflect general reductions in market credit swap premium levels and maturities of credit swaps in the credit swap portfolio. In addition, payments to counterparties for the early termination of credit swaps or for credit events during the years ended December 31, 2010 and 2009 have reduced the credit swap liability for unrealized losses on credit swaps, resulting in unrealized gains in these periods. During the years ended December 31, 2010 and 2009, Primus Financial recorded nonperformance risk adjustments of \$(153.1) million and \$(1.0) billion, respectively.

*Interest Income*

We earned interest income of \$13.1 million and \$6.7 million for the years ended December 31, 2010 and 2009, respectively. The increase in interest income is attributable to higher average yields on our investment portfolio, principally a result of an increase in corporate debt securities held in the portfolio.

Weighted average yields on our cash, cash equivalents and investments were 2.19% in the year ended December 31, 2010, compared with 0.91% for the year ended December 31, 2009.

*Gain on Retirement of Long-Term Debt*

During the years ended December 31, 2010 and 2009, in aggregate, we recorded gains of \$9.9 million and \$43.2 million, respectively, on the purchase and retirement of long-term debt, net of a related write-off of unamortized issuance costs.

During the year ended December 31, 2010, Primus Financial purchased approximately \$24.8 million in face value of its subordinated deferrable notes at a cost of approximately \$15.7 million. These transactions resulted in a net gain of \$8.8 million on retirement of long-term debt, net of a related write-off of \$0.3 million of unamortized issuance costs. During the year ended December 31, 2010, Primus Guaranty purchased and retired approximately \$4.2 million in face value of its 7% Senior Notes at a cost of approximately \$3.0 million. As a result, we recorded a net gain of \$1.1 million on the retirement of our long-term debt, net of a related write-off of \$0.1 million of unamortized issuance costs.

**Table of Contents***Other Income*

Other income includes realized and unrealized gains or losses on investment securities, foreign currency revaluation losses and sublease rental income. Other income was \$3.4 million and \$3.8 million during the years ended December 31, 2010 and 2009, respectively.

Other income during the year ended December 31, 2010 consisted primarily of realized gains on investment securities and sublease rental income, offset by foreign currency losses. Other income during the year ended December 31, 2009 consisted primarily of realized gains on Primus Financial's sale of corporate bonds, which had previously been delivered in settlement of a credit event on a single name credit swap sold.

*Operating Expenses*

Operating expenses, excluding restructuring costs, were \$32.1 million and \$33.0 million for the years ended December 31, 2010 and 2009, respectively, as summarized in the table below (dollars in thousands).

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Compensation and employee benefits	\$ 18,650	\$ 17,661
Professional and legal fees	6,718	6,848
Other	6,774	8,507
Total operating expenses	\$ 32,142	\$ 33,016

Number of full-time employees, at end of period 19 47

Compensation and employee benefits include salaries, benefits, accrual for incentive bonuses and share-based compensation. Compensation expense for the year ended December 31, 2010 increased by approximately \$1.0 million over the comparable prior period. The increase was primarily the result of higher share-based compensation expenses, partially offset by a reduction in accrual for incentive bonuses during the year ended December 31, 2010. During the fourth quarter of 2010, in connection with the reduction in workforce, we offered to our terminated employees the ability to settle certain vested share awards in either shares or cash. As a result, we classified certain share awards to a share-based liability plan, which resulted in additional share-based compensation of \$3.9 million. Share-based compensation expense was approximately \$6.7 million and \$4.5 million for the years ended December 31, 2010 and 2009, respectively. See note 2 of notes to consolidated financial statements for discussion of valuation methodologies used for share-based compensation.

Professional and legal fees expense includes audit and tax advisor fees, legal costs, consulting fees, and director and officer liability insurance expense. In aggregate, professional fees remained flat year over year, although insurance costs were higher in 2010 than in 2009, which were largely offset by lower legal fees incurred in 2010.

Other operating expenses include rent, depreciation and amortization, bank fees, ratings agency fees, travel and entertainment, exchange fees and other administrative expenses. The decrease in other operating expenses in 2010 was primarily the result of lower depreciation and amortization expense in 2010 and write-offs of capitalized software costs in 2009.

*Restructuring Costs*

We made significant reductions in our workforce and operating infrastructure primarily in the fourth quarter of 2010 as a consequence of our decision to divest the asset management business and focus our efforts on the amortization of Primus Financial's credit swap portfolio. In total, we incurred restructuring costs of \$8.1 million for the year ended December 31, 2010. The restructuring costs comprised mainly employee severance and accelerated share-based compensation expenses, costs associated with the write-off of fixed assets and the CypressTree office lease termination.





**Table of Contents**

We anticipate incurring restructuring charges in the future as the Primus Financial credit swap portfolio continues to amortize and we reduce the size of our operations to reflect the smaller credit swap portfolio. We anticipate that the future restructuring charges will not be material. At December 31, 2010, we recorded restructuring liabilities of approximately \$3.7 million, of which substantially all of the balance is expected to be paid by the end of the first quarter of 2011. See note 8 of notes to consolidated financial statements for further discussion.

*Interest Expense and Preferred Distributions***Interest Expense**

Interest expense includes costs related to the 7% Senior Notes issued by Primus Guaranty, after adjustment for an interest rate swap, and interest on the subordinated deferrable notes issued by Primus Financial. We recorded interest expense of \$7.0 million and \$9.1 million for the years ended December 31, 2010 and 2009, respectively.

During the course of 2009 and 2010 Primus Guaranty, Ltd. repurchased some of its 7% Senior Notes. In February 2007, we entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75 million of our 7% Senior Notes to floating rate debt based on the three-month LIBOR plus a fixed spread of 0.96%. The interest rate swap may be terminated at the option of the counterparty in December 2011. At December 31, 2010, \$90.4 million of the 7% Senior Notes was outstanding. The reduction in principal outstanding and a decline in LIBOR in 2010 had the effect of reducing the net interest expense on these Notes. The average net interest rate was 2.45% and 3.03% for the year ended December 31, 2010 and 2009, respectively. For the years ended December 31, 2010 and 2009, we recorded \$2.3 million and \$3.0 million of interest expense on the 7% Senior Notes, respectively.

Primus Financial's subordinated deferrable interest notes were issued in the auction rate market. This market continues to be dislocated and as a result, the interest rates on the notes were set at the contractually specified rates over LIBOR during 2009 and 2010. During the course of 2009 and 2010 Primus Financial repurchased a portion of its subordinated deferrable interest notes. At December 31, 2010, \$122.8 million of the subordinated deferrable interest notes was outstanding. At December 31, 2010, Primus Financial's subordinated deferrable interest notes were accruing interest at an all-in rate of 3.39%. The subordinated deferrable interest notes mature in June 2021 and July 2034.

For the years ended December 31, 2010 and 2009, we recorded \$4.7 million and \$6.1 million of interest expense on Primus Financial's subordinated deferrable interest notes, respectively. Interest expense decreased in 2010 primarily as a result of lower LIBOR and reduced debt levels.

**Preferred Distributions**

Primus Financial issued net \$100 million of perpetual preferred securities in 2002. The rate of distributions on the perpetual preferred securities is set by reference to a contractual spread of 3% over LIBOR. During 2009, Primus Financial repurchased \$5.5 million of the perpetual preferred securities. At December 31, 2010, the all-in distribution rate on Primus Financial's perpetual preferred securities was 3.27%.

Primus Financial paid net distributions of approximately \$3.2 million and \$3.4 million during the years ended December 31, 2010 and 2009, respectively, on its perpetual preferred securities. The decrease in net distributions was primarily a result of lower LIBOR and the lower average outstanding balance in 2010. The average distribution rate on these securities was 3.35% and 3.54% for the years ended December 31, 2010 and 2009, respectively.

**Table of Contents***Provision (Benefit) for Income Taxes*

Provision (benefit) for income taxes was \$(134) thousand and \$184 thousand for the years ended December 31, 2010 and 2009, respectively. Primus Guaranty had a net deferred tax asset, fully offset by a valuation allowance of \$16.5 million and \$12.7 million as of December 31, 2010 and December 31, 2009, respectively. The change in the deferred tax asset and valuation allowance resulted primarily from Primus Asset Management's estimated net operating loss and the timing of recognition of book and tax adjustments related to share-based compensation expense. We believe that the income of only Primus Asset Management and its subsidiaries is likely to be subject to U.S. federal and local income taxes.

*Discontinued Operations*

Loss from discontinued operations, net of tax, was \$49.5 million and \$3.4 million for the years ended December 31, 2010 and 2009, respectively. Loss from discontinued operations for the year ended December 31, 2010 primarily consisted of the fee revenues and operating expenses of the CLO asset management business, together with the operating results of the standalone CLOs.

Included in the loss from discontinued operations for the year ended December 31, 2010 was approximately \$11.7 million of income, which represented income attributable to the Primus Guaranty common shareholders, which reflects asset management fees, partially offset by operating expenses of the asset management business.

The loss from discontinued operations for the year ended December 31, 2010 included losses of \$61.2 million which was attributable to non-parent interests in CLOs. This amount included the operating results of standalone CLOs from January 1, 2010, the date of adoption of ASC Topic 810, *Consolidation*, through December 1, 2010, the date of deconsolidation. As a result of the deconsolidation of the CLOs, it is not anticipated that non-parent interests in CLOs will be incorporated in future periods.

In connection with the sale of CypressTree, Primus Asset Management agreed to accept a fixed proportion of the future management fees received on the CLOs which are currently sub-advised by the buyer of CypressTree. This income will be recorded under the discontinued operations caption in the consolidated statements of operations in future periods.

See notes 6 and 7 of notes to consolidated financial statements for further discussion and information related to CypressTree divestiture and Discontinued Operations.

***Year Ended December 31, 2009 Compared with Year Ended December 31, 2008*****Overview of Financial Results**

GAAP net income available to common shares for 2009 was \$1.5 billion, primarily attributable to mark-to-market unrealized gains of approximately \$1.5 billion on Primus Financial's credit swap portfolio during 2009. GAAP net (loss) available to common shares for 2008 was \$(1.7) billion, primarily attributable to mark-to-market unrealized losses of \$(1.6) billion on Primus Financial's credit swap portfolio during 2008.

Interest income on our portfolio of investments was \$6.7 million in 2009, compared with \$25.5 million in 2008. The decrease primarily is attributable to lower market interest rates.

During the year ended December 31, 2009, in aggregate, we recorded a net gain of \$43.2 million on the retirement of long-term debt, which included purchases by Primus Guaranty of its 7% Senior Notes and purchases by our subsidiary, Primus Financial, of its long-term debt.

**Table of Contents**

Primus Financial's perpetual preferred securities and subordinated deferrable interest notes were issued in the auction rate market. The turmoil in the auction rate markets that began in August 2007 continued during 2009. As a result, Primus Financial's perpetual preferred securities and subordinated deferrable interest notes were set at the contractually specified rates over LIBOR. These specified rates were subject to increase if the credit ratings on these securities are downgraded or withdrawn. During 2008, as a result of downgrades on these securities, the spread rates increased to, and during 2009 have remained at, the maximum rates specified in the respective security agreements.

Interest expense and distributions on preferred securities issued by Primus Financial were \$12.5 million in 2009, compared with \$23.7 million in 2008. The decrease primarily is attributable to lower LIBOR, partially offset by increases in the specified spread rates on Primus Financial's preferred securities and debt.

Operating expenses were \$33.0 million in 2009, compared with \$29.0 million in 2008. The increase in operating expenses was principally a result of a higher accrual for incentive bonuses and increases in professional and legal fees. In 2008, compensation expense reflected a significantly lower accrual for incentive bonuses.

**Net Credit Swap Revenue (Loss)**

Consolidated net credit swap revenue (loss) was \$1.5 billion and \$(1.7) billion for the years ended December 31, 2009 and 2008, respectively.

The following table shows the Company's consolidated net credit swap revenue (loss), which was generated by Primus Financial, for the years ended December 31, 2009 and 2008 (in thousands):

	<b>Years Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Primus Financial	\$ 1,455,802	\$ (1,689,584)
Harrier Credit Strategies Master Fund, LP		712
Total consolidated net credit swap revenue (loss)	\$ 1,455,802	\$ (1,688,872)

During the year ended December 31, 2008, net credit swap revenue for Harrier Credit Strategies Master Fund, LP, a discontinued trading fund primarily consisted of realized gains on the terminations of its remaining credit swap positions outstanding at December 31, 2007.

Net credit swap revenue (loss) for Primus Financial is discussed below.

**Net Credit Swap Revenue (Loss)**

Net credit swap revenue (loss) was \$1.5 billion and \$(1.7) billion for the years ended December 31, 2009 and 2008, respectively.

Net credit swap revenue (loss) includes:

Net premiums earned;

Net realized gains (losses) on credit swaps, which include gains (losses) on terminated credit swaps sold and losses on credit events during the period; and

Net unrealized gains (losses) on credit swaps.

**Table of Contents**

The following table shows the components of net credit swap revenue (loss) for the years ended December 31, 2009 and 2008 (in thousands):

	<b>Years Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Net premiums earned	\$ 85,116	\$ 102,501
Net realized gains (losses) on credit swaps	(113,077)	(162,653)
Net unrealized gains (losses) on credit swaps	1,483,763	(1,629,432)
 Total net credit swap revenue (loss)	 \$ 1,455,802	 \$ (1,689,584)

*Net Premiums Earned*

Net premiums earned were \$85.1 million and \$102.5 million for the years ended December 31, 2009 and 2008, respectively. The decrease primarily was attributable to the reduced notional principal of Primus Financial's credit swap portfolio. Primus Financial did not write any additional credit protection during 2009.

*Net Realized Gains (Losses) on Credit Swaps*

Net realized losses on credit swaps sold were \$113.1 million and \$162.7 million for the years ended December 31, 2009 and 2008, respectively. Realized losses on single name credit swaps sold were \$68.5 million for the year ended December 31, 2009 primarily resulting from payments to three counterparties for the portfolio repositioning transactions previously discussed and credit events on three single name Reference Entities, Idearc Inc., CIT Group, Inc., and Financial Guaranty Insurance Company. Total realized losses on the CDS on ABS portfolio was \$34.5 million during the year ended December 31, 2009, which related to Physical Settlement, principal write-downs and other realized losses related to the early termination of a CDS on ABS transaction.

The realized losses on single name credit swaps sold during the year ended December 31, 2008 were primarily the result of credit events on Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, LBH, Washington Mutual, Inc. and Kaupthing Bank hf incurred during the third and fourth quarter of 2008.

*Net Unrealized Gains (Losses) on Credit Swaps*

Net unrealized gains (losses) on credit swaps were \$1.5 billion and \$(1.6) billion for the years ended December 31, 2009 and 2008, respectively. The change in unrealized gains (losses) on credit swaps reflected the change in the fair value of Primus Financial's credit swap portfolio during these periods. The change in fair value was driven primarily by declines in market credit swap premium levels during the course of 2009. During the year ended December 31, 2009, unrealized losses were also reduced as a result of the termination of credit swaps which had suffered credit events or which were subject to portfolio repositioning transactions, as previously discussed under net realized gains (losses).

During the years ended December 31, 2009 and 2008, Primus Financial recorded nonperformance risk adjustments of \$(1.0) billion and \$1.3 billion, respectively, which is reflected in these periods.

*Interest Income*

We earned interest income of \$6.7 million and \$25.5 million for the years ended December 31, 2009 and 2008, respectively. The decrease in interest income is primarily attributable to lower yields on our investment portfolio. The decrease in yields is attributable to a general reduction in short-term market interest rates in 2009.

**Table of Contents**

Weighted average yields on our cash, cash equivalents and investments were 0.91% for the year ended December 31, 2009 compared with 3.11% for the year ended December 31, 2008.

*Gain on Retirement of Long-Term Debt*

During the years ended December 31, 2009 and 2008, in aggregate, we recorded a net gain of \$43.2 million and \$9.7 million, respectively, on the retirement of long-term debt.

During the year ended December 31, 2009, Primus Guaranty purchased and retired approximately \$15.1 million in face value of its 7% Senior Notes at a cost of approximately \$6.4 million. As a result, we recorded a net gain of \$8.2 million on the retirement of our long-term debt, net of a related write-off of \$0.5 million of unamortized issuance costs.

During the year ended December 31, 2008, Primus Guaranty purchased and retired approximately \$15.3 million in face value of its 7% Senior Notes at a cost of approximately \$5.1 million. As a result, we recorded a net gain of \$9.7 million on the retirement of our long-term debt, net of a related write-off of \$0.5 million of unamortized issuance costs.

During the year ended December 31, 2009, Primus Financial purchased approximately \$52.4 million in face value of its subordinated deferrable notes at a cost of approximately \$16.8 million. These transactions resulted in a net realized gain of \$35.0 million on retirement of long-term debt, net of a related write-off of \$0.6 million of unamortized issuance costs.

*Other Income (Loss)*

Other income (loss) includes foreign currency revaluation losses, realized and unrealized gains or losses on trading account securities. Other income (loss) was \$3.8 million and \$(0.2) million during the years ended December 31, 2009 and 2008, respectively. Other income during the year ended December 31, 2009 consisted primarily of realized gains from Primus Financial's sale of bonds delivered in settlement of a credit event which occurred in the fourth quarter of 2008. Other loss during the year ended December 31, 2008 consisted of foreign currency losses and an unrealized holding loss related to bonds delivered upon the settlement of a credit event on a single name credit swap sold.

*Operating Expenses*

Our operating expenses were \$33.0 million and \$29.0 million for the years ending December 31, 2009 and 2008, respectively, as summarized in the following table (dollars in thousands):

	<b>Years Ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
Compensation and employee benefits	\$ 17,661	\$ 14,595
Professional and legal fees	6,848	4,331
Other	8,507	10,032
Total operating expenses	\$ 33,016	\$ 28,958

Number of full-time employees, at end of period 47 42  
 The largest component of our operating expenses is employee compensation, which includes salaries, benefits, accrual for incentive bonuses and share-based compensation. Compensation expense for the year ended December 31, 2009 increased by approximately \$3.1 million over the comparable prior period. The increase primarily was the result of a higher accrual for performance-based incentives and higher share-based compensation. Share-based compensation expense was approximately \$4.5 million and \$4.2 million for the years ended December 31, 2009 and 2008, respectively.

**Table of Contents**

Professional and legal fees expense includes audit and tax advisor fees, legal costs, consulting fees, recruitment fees and director and officer insurance expense. The increase in professional fees primarily is attributable to higher director and officer insurance expense and legal and consulting fees, which related to advisory fees related to Primus Financial's portfolio repositioning transactions.

Other operating expenses include rent, depreciation and amortization, bank fees, ratings agency fees, travel and entertainment, exchange fees and other administrative expenses. The decrease in other expenses primarily was a result of cost cutting initiatives, a reduction in technology and data services and lower write-offs of capitalized software costs and fixed assets taken in 2008.

*Interest Expense and Preferred Distributions***Interest Expense**

Interest expense includes costs related to the 7% Senior Notes issued by Primus Guaranty, after adjustment for an interest rate swap, and interest on the subordinated deferrable notes issued by Primus Financial. We recorded interest expense of \$9.1 million and \$17.0 million for the year ended December 31, 2009 and 2008, respectively. Interest expense decreased primarily as a result of lower LIBOR during the periods and our debt buyback.

Primus Financial's perpetual preferred securities and subordinated deferrable interest notes have been issued in the auction rate market. The dislocation of the auction rate debt market that began in August 2007 has continued through 2009. As a result, Primus Financial's perpetual preferred securities and subordinated deferrable interest notes were set at the contractually specified rates over LIBOR. These specified rates were subject to increases if the credit ratings on these securities were downgraded. During 2008, as a result of downgrades on these securities, the spread rates increased to, and during 2009 have remained at the maximum rates specified in the respective security agreements. At December 31, 2009, Primus Financial's subordinated deferrable interest notes were accruing interest at an all in rate of 3.39%. The subordinated deferrable interest notes mature in June 2021 and July 2034.

In February 2007, we entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75 million of our 7% Senior Notes to floating rate debt based on the three-month LIBOR plus a fixed spread of 0.96%. The interest rate swap may be terminated at the option of the counterparty in December 2011. The decline in LIBOR had the effect of reducing the net interest expense on these Notes. The average net interest rate on our 7% Senior Notes was 3.03% and 5.62% for the years ended December 31, 2009 and 2008, respectively.

**Preferred Distributions**

Primus Financial also made net distributions of \$3.4 million and \$6.6 million during the years ended December 31, 2009 and 2008, respectively, on its preferred securities. The decrease in net distributions primarily was a result of lower LIBOR. The average rate on these securities was 3.54% and 6.64% for the years ended December 31, 2009 and 2008, respectively. At December 31, 2009, the all-in distribution rate on Primus Financial's perpetual preferred securities was 3.23%.

*Income Taxes*

Provision for income taxes was \$184 thousand and \$61 thousand for the years ended December 31, 2009 and 2008, respectively. Primus Guaranty had a net deferred tax asset, fully offset by a valuation allowance, of \$12.7 million and \$9.8 million as of December 31, 2009 and 2008, respectively. The change in the deferred tax asset and valuation allowance resulted primarily from Primus Asset Management's estimated net operating loss and the timing of recognition of book and tax adjustments related to share-based compensation expense. The Company believes that the income of only Primus Asset Management and its subsidiaries is likely to be subject to U.S. federal and local income taxes.

**Table of Contents**

*Discontinued Operations*

Loss from discontinued operations, net of tax, was \$3.4 million and \$9.5 million for the years ended December 31, 2009 and 2008, respectively. Loss from discontinued operations primarily consisted of the fee revenues and operating expenses of the CLO asset management business, for these periods.

**Income Taxes**

Primus Guaranty, Primus Bermuda and Primus Financial are not expected to be engaged in the active conduct of a trade or business in the United States and as a result are not expected to be subject to U.S. federal, state or local income tax. Primus Asset Management is a United States domiciled corporation and is subject to U.S. federal, state and local income tax on its income, including on fees received from Primus Financial. Primus Re, Ltd. ( Primus Re ), one of our wholly owned subsidiaries, may be subject to U.S. federal, state or local income tax, or Primus Asset Management may be required to include all or part of Primus Re s income in calculating its liability for U.S. federal, state or local income tax, depending on the manner in which Primus Re conducted its business and the tax elections it makes.

Primus Guaranty and certain of its subsidiaries have undergone a U.S. federal income tax audit covering the tax years 2004 through 2006. Although management has not received formal notification from the IRS that the audit has been completed, the statute of limitations for the years in question has expired, and the Company has taken the position that the audit has concluded without any additional liability on behalf of the Company. For U.S. federal income tax purposes, Primus Guaranty, Primus Bermuda and Primus Bermuda s investments in the subordinated notes of Primus CLO I, Ltd. and Primus CLO II, Ltd., respectively, are likely to be treated as PFICs.

**Non-GAAP Financial Measures Economic Results**

In addition to the results of operations presented in accordance with GAAP, our management and our board of directors use certain non-GAAP financial measures called Economic Results . We believe that our Economic Results provide information useful to investors in understanding our underlying operational performance and business trends. In addition, Economic Results are useful to investors as they have been used by management and our board of directors in establishing performance-based incentives. Economic Results is an accrual based measure of our financial performance, which in our view, better reflects our long-term buy and hold strategy in our credit protection business. However, Economic Results is not a measurement of financial performance or liquidity under GAAP; therefore, these non-GAAP financial measures should not be considered as an alternative or substitute for GAAP.

Beginning with the first quarter of 2010, we amended our presentation of Economic Results. These amendments have been made primarily to address the adoption of ASC Topic 810, *Consolidation*, in our GAAP financial statements commencing in 2010. We believe that the consolidation of the operating results of the standalone CLOs into the GAAP financial statements may affect a reader s analysis of our underlying results of operations and could result in investor confusion or the production of information by analysts or external credit rating agencies that is not reflective of the underlying financial results of operations and financial condition of Primus Guaranty, Ltd. Accordingly, we exclude for Economic Results the net income (loss) attributable to non-parent interests, which reflects CLO income attributable to third parties. Economic Results have not been restated or amended for any previously published financial results.

We define Economic Results as GAAP net income (loss) available to common shares (which reflects the deduction of net income (loss) attributable to non-parent interests) adjusted for the following:

Unrealized gains (losses) on credit swaps sold by Primus Financial are excluded from GAAP net income (loss) available to common shares;

Realized gains from early termination of credit swaps sold by Primus Financial are excluded from GAAP net income (loss) available to common shares;



**Table of Contents**

Realized gains from early termination of credit swaps sold by Primus Financial are amortized over the period that would have been the remaining life of the credit swap, and that amortization is added to GAAP net income (loss) available to common shares;

Provision for CDS on ABS credit events; and

Reduction in provision for CDS on ABS credit events upon termination of credit swaps.

Economic Results includes realized gains and losses on credit swap transactions undertaken by our managed funds. We exclude unrealized gains (losses) on credit swaps sold because quarterly changes in the fair value of the credit swap portfolio do not necessarily cause Primus Financial to take any specific actions relative to any Reference Entity or group of Reference Entities. We manage the Primus Financial portfolio based on our assessment of credit fundamentals with a general strategy of holding credit swaps to maturity. At maturity, the mark-to-market values would revert to zero, to the extent no realized gains or losses had occurred. Additionally, changes in the fair value of the credit swap portfolio have no impact on our liquidity, as Primus Financial does not provide counterparties with collateral based upon changes in the fair value of its credit swaps. We exclude realized gains on credit swaps sold because our strategy is focused on generation of premium income as opposed to trading gains and losses, although we amortize any realized gains over the original remaining life of the terminated contracts.

As previously discussed, credit events related to CDS on ABS may include any or all of the following: failure to pay principal, write-down in the reference obligation and distressed ratings downgrades on the reference obligation as defined in the related credit swap agreement. There may be a protracted period between the occurrence and the settlement of a credit event on CDS on ABS, and thus the estimated loss resulting from the credit event continues to be classified as an unrealized loss in net credit swap revenues. We make provisions in Economic Results for estimated costs of CDS on ABS credit events in the period in which the credit event occurs since our Economic Results excludes the change in unrealized losses on credit swaps sold for the period. These provisions are adjusted subsequently to reflect the known settlement amount(s) in the period in which the settlement occurs.

The following table below presents a reconciliation of our Economic Results (non-GAAP measures) to GAAP for the years ended December 31, 2010, 2009 and 2008:

	<b>Years Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<i>(in thousands, except per share data)</i>			
GAAP net income (loss) available to common shares	\$ 255,474	\$ 1,460,280	\$ (1,716,146)
<i>Adjustments:</i>			
Change in unrealized fair value of credit swaps sold (gain) loss by Primus Financial	(296,540)	(1,483,763)	1,629,432
Realized gains from early termination of credit swaps sold by Primus Financial			(28)
Amortization of realized gains from the early termination of credit swaps sold by Primus Financial	810	1,414	2,173
Provision for CDS on ABS credit events	(2,374)	(16,208)	(9,328)
Reduction in provision for CDS on ABS credit events upon termination of credit swaps	1,819	34,540	12,216
<b>Economic Results</b>	<b>\$ (40,811)</b>	<b>\$ (3,737)</b>	<b>\$ (81,681)</b>
Economic Results earnings (loss) per GAAP diluted share	\$ (1.01)	\$ (0.09)	\$ (1.83)
Economic Results weighted average common shares outstanding GAAP diluted	40,366	41,414	44,722



**Table of Contents**

Economic Results earnings (loss) per GAAP diluted share is calculated by dividing Economic Results by the weighted average number of common shares adjusted for the potential issuance of common shares (dilutive securities).

**Liquidity and Capital Resources**

***Capital Strategy***

Our cash, cash equivalents, restricted cash and investments were \$605.3 million and \$701.1 million as of December 31, 2010 and 2009, respectively. Since our inception, we have raised both debt and equity capital and have contributed capital to our operating subsidiaries. We are a holding company with no direct operations of our own, and as such, we are largely dependent upon the ability of Primus Financial, our operating subsidiary to generate cash to service our debt obligations and provide for our working capital needs. At December 31, 2010 and 2009, Primus Guaranty, Ltd. had \$23.7 million and \$38.5 million, respectively, of cash and cash equivalents and investments. Since October 2008, Primus Guaranty has been able to purchase and retire approximately \$34.6 million in face value of its 7% Senior Notes at a cost of approximately \$14.5 million. At December 31, 2010, the outstanding balance of the 7% Senior Notes was \$90.4 million.

Since inception of our common share buyback program in 2008, we purchased and retired 10.0 million common shares at a cost of approximately \$21.8 million.

Primus Financial's subordinated deferrable interest notes were issued in the auction rate market. During the year ended December 31, 2010, Primus Financial purchased in the aggregate, approximately \$24.8 million in face value of its subordinated deferrable notes at a cost of approximately \$15.7 million. At December 31, 2010, the total outstanding balance of deferrable interest notes was \$122.8 million.

During the year ended December 31, 2009, Primus Financial purchased approximately \$52.4 million in face value of its subordinated deferrable notes at a cost of approximately \$16.8 million. At December 31, 2009, the total outstanding balance of deferrable interest notes was \$147.6 million. In addition, during the year ended December 31, 2009, Primus Financial purchased \$5.5 million in face value of its preferred securities at a cost of approximately \$0.9 million. At December 31, 2009, the outstanding balance of the preferred securities was \$93.1 million.

As a result of Primus Financial's portfolio repositioning transactions in 2009, approximately \$131.3 million of restricted cash and investments have been pledged as security in favor of two counterparties at December 31, 2010. At December 31, 2010, we had investments in securities issued by CLOs of approximately \$6.1 million, which we have classified as restricted investments. These restricted investments are subject to certain trading restrictions as agreed upon with the buyer of CypressTree.

Primus Financial's capital resources are available to support counterparty claims to the extent there is a defined credit event on a Reference Entity in its portfolio. Counterparties have no right to demand capital from Primus Financial resulting from changes in fair value on its credit swap portfolio. At December 31, 2010 and 2009, Primus Financial had cash, cash equivalents, restricted cash and investments of \$570.3 million and \$651.5 million, respectively. Primus Financial will continue to collect quarterly premium payments from its performing counterparties on outstanding credit swap contracts. At December 31, 2010, the average remaining tenor on the credit swap portfolio was 2.18 years and the total future cash receipts on Primus Financial's single name and tranche credit swap portfolio was approximately \$96 million (assuming all credit swaps in the portfolio run to full maturity).

**Table of Contents**

Primus Financial receives cash from the receipt of credit swap premiums, realized gains from the early termination of credit swaps and interest income earned on its investment portfolio. Cash is used to pay operating and administrative expenses, premiums on credit swaps purchased, realized losses from the early termination of credit swaps, settlement of amounts for credit events, interest on debt and preferred share distributions.

**Cash Flows**

*Cash flows from operating activities* Net cash used in operating activities were \$27.3 million and \$113.3 million for the years ended December 31, 2010 and 2009, respectively. The change primarily was attributable to lower realized losses on the credit swap portfolio and lower gains on the retirement of debt during 2010 compared with 2009. In addition, net cash used in operating activities for the year ended December 31, 2010 included CLO non-cash items and changes in CLO assets and CLO liabilities as a result of the consolidation of the CLOs, which represented non-parent interests in CLOs. The assets of the CLOs were restricted solely to satisfy the liabilities of the CLOs and were not available to us for our general obligations or in satisfaction of our debt obligations.

Net cash used in operating activities were \$113.3 million and \$76.4 million for the years ended December 31, 2009 and 2008, respectively. The change primarily was attributable to realized losses on credit swaps related to portfolio repositioning transactions and credit events and lower premium income on a reduced credit swap portfolio during 2009 compared with 2008.

*Cash flows from investing activities* Net cash (used in) provided by investing activities were \$(21.9) million and \$169.6 million for the years ended December 31, 2010 and 2009, respectively. The change primarily was attributable to the net purchases of available-for-sale-investments during 2010 compared with the maturity of our available-for-sale-investments during 2009.

Net cash provided by investing activities were \$169.6 million and \$130.4 million for the years ended December 31, 2009 and 2008, respectively. The increase primarily was attributable to the maturity of our available-for-sale-investments during 2009 compared with 2008.

*Cash flows from financing activities* Net cash used in financing activities were \$72.6 million and \$37.9 million for the year ended December 31, 2010 and 2009, respectively. The change primarily was attributable to lower purchases and retirement of long-term debt. In addition, net cash used in financing activities for the year ended December 31, 2010 included repayments of CLO notes by the CLOs as a result of the consolidation of the CLOs, which represented non-parent interests in CLOs.

Net cash used in financing activities were \$37.9 million and \$15.3 million for the year ended December 31, 2009 and 2008, respectively. The increase primarily was attributable to our purchases of our common shares and our purchase and retirement of long-term debt.

With our current capital resources and anticipated future credit swap premium receipts, interest and other income, we believe we have sufficient liquidity to pay our operating expenses, debt service obligations and preferred distributions over at least the next twelve months.

**Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements (as such term is defined in Item 303 of Regulation S-K) that are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

**Table of Contents****Contractual Obligations**

The following table summarizes our contractual obligations at December 31, 2010 and the effect that those obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

	<b>Total</b>	<b>Payment due by period</b>			<b>More than 5 years</b>
		<b>Less than 1 year</b>	<b>1-3 years</b>	<b>3-5 years</b>	
Property leases	\$ 7,658	\$ 2,166	\$ 2,312	\$ 2,313	\$ 867
7% Senior Notes	90,426				90,426
Interest on 7% Senior Notes (a)	160,259	2,084	12,660	12,660	132,855
Subordinated deferrable interest notes	122,800				122,800
Interest on subordinated deferrable interest notes (b)	63,728	4,453	8,917	8,905	41,453
<b>Total</b>	<b>\$ 444,871</b>	<b>\$ 8,703</b>	<b>\$ 23,889</b>	<b>\$ 23,878</b>	<b>\$ 388,401</b>

(a) Net interest payments on the outstanding 7% Senior Notes at December 31, 2010 are adjusted by the interest rate swap agreement, which converts a portion of the interest payment on the 7% Senior Notes from a fixed to a floating basis, as previously discussed. Future payments of interest on the interest rate swap will be determined by future LIBOR rates, to which a predetermined contractual rate is added. For the purpose of this table, estimated future LIBOR rates were based on the last rate set during the fourth quarter of 2010. The counterparty has the right to terminate the interest rate swap agreement in December 2011, and for the purpose of this table, the interest rate swap is assumed to be terminated at that date.

(b) Future payments for interest on our subordinated deferrable interest notes will be determined by future LIBOR rates, to which a predetermined contractual spread is added, as previously discussed. For the purpose of this table, estimated future LIBOR rates were based on the last rate set during the fourth quarter of 2010.

*Property leases:* At December 31, 2010, Primus Financial leased approximately 17,500 square feet of office space at 360 Madison Avenue, New York, New York, at a fixed yearly rental (subject to certain escalations specified in the lease). In December 2010, Primus Financial entered into an agreement to sublease approximately 12,000 square feet of this New York office space. We believe the remaining 5,500 square feet of office space is adequate to meet our current needs.

The Company also leases approximately 13,800 square feet of office space in Boston, Massachusetts, pursuant to a lease, which Primus Asset Management assumed from CypressTree in December 2010. Subsequently, Primus Asset Management agreed to early terminate this lease prior to its scheduled expiration of October 31, 2012 and to vacate the premises no later than May 31, 2011.

There are no material restrictions imposed by our lease agreements and the leases are categorized as operating leases. We do not lease or own real property in Bermuda.

*7% Senior Notes and Subordinated deferrable interest notes:* For information on the terms of our debt, see note 10 of our notes to consolidated financial statements.

**Table of Contents**

**Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

Market risk represents the potential for gains or losses that may result from changes in the value of a financial instrument as a consequence of changes in market conditions. Our primary market risk is changes in market credit swap premium levels, which increase or decrease the fair value of the credit swap portfolio. Market credit swap premium levels change as a result of specific events or news related to a Reference Entity, such as a change in a credit rating by any of the rating agencies. Additionally, market credit swap premium levels can vary as a result of changes in market sentiment. As a general matter, given Primus Financial's strategy of holding credit swaps sold until maturity, we do not seek to manage our overall exposure to market credit swap premium levels, and we expect fluctuations in the fair value of the credit swap portfolio as a result of these changes. As of December 31, 2010, each ten basis point increase or decrease in market credit swap premiums would decrease or increase the fair value of the credit swap portfolio by approximately \$47.5 million.

We face other market risks, which are likely to have a lesser impact upon our net income available to common shares than those associated with market credit swap premium level risk. These other risks include interest rate risk associated with market interest rate movements. These movements may affect the value of the credit swap portfolio as our pricing model includes an interest rate component, which is used to discount future expected cash flows. Interest rate movements may also affect the carrying value of and yield on our investments. The Primus Financial Perpetual Preferred Shares pay distributions that are based upon LIBOR. A difference between the rates we pay in the auction rate preferred market and the interest rates we receive on our investments may result in an additional cost to our company. Assuming that the Primus Financial Perpetual Preferred Shares reflect prevailing short-term interest rates, each 25 basis point increase or decrease in the level of those rates would increase or decrease Primus Financial's annual distribution cost by \$239,531 for its perpetual preferred securities. In addition, interest rate movements may increase or decrease the interest expense we incur on Primus Financial's \$122.8 million of subordinated deferrable interest notes at December 31, 2010. A 25 basis point increase in the level of those rates would increase Primus Financial's interest expense by \$311,264 annually.

In February 2007, we entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75 million of our 7% Senior Notes, to floating rate debt based on three-month LIBOR plus a fixed spread of 0.96%. Assuming a 25 basis point increase or decrease in three-month LIBOR, our interest expense would increase or decrease by \$190,104 annually.

**Table of Contents**

**Item 8. Financial Statements and Supplementary Data**

**Primus Guaranty, Ltd.  
Index to Consolidated Financial Statements**

<u>Report of Independent Registered Public Accounting Firm</u>	51
<u>Management's Report on Internal Control over Financial Reporting</u>	52
<u>Consolidated Statements of Financial Condition as of December 31, 2010 and 2009</u>	53
<u>Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008</u>	54
<u>Consolidated Statements of Shareholders' Equity (Deficit) for the years ended December 31, 2010, 2009 and 2008</u>	55
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008</u>	56
<u>Notes to Consolidated Financial Statements</u>	57

All Financial Statement Schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or the Notes thereto.

**Table of Contents**

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of Primus Guaranty, Ltd.

We have audited the accompanying consolidated statements of financial condition of Primus Guaranty, Ltd. (the Company ) as of December 31, 2010 and 2009, and the related consolidated statements of operations, shareholders equity (deficit), and cash flows for each of the three years in the period ended December 31, 2010. 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 in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company s internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Primus Guaranty, Ltd. at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the Company adopted new accounting guidance related to the consolidation of variable interest entities effective January 1, 2010.

/s/ Ernst & Young LLP

New York, New York

March 31, 2011



**Table of Contents**

**Management's Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control-Integrated Framework. Based on our assessment, we believe that as of December 31, 2010, the Company's internal control over financial reporting is effective based on that criteria.

/s/ Richard Claiden

Richard Claiden  
Chief Executive Officer

/s/ Christopher N. Gerosa

Christopher N. Gerosa  
Chief Financial Officer

**Table of Contents**

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