QUANTA CAPITAL HOLDINGS LTD
Form 10-K
March 14, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from to

Commission File number: 000-50885

QUANTA CAPITAL HOLDINGS LTD.
(Exact name of registrant as specified in its charter)

Bermuda

n/a (State or other jurisdiction of

incorporation or organization) (I.R.S. Employer Identification No.) 22 Church Street, Penthouse
Hamilton, Bermuda HM
(Address of principal executive offices) HM 11
(Zip code) Securities registered pursuant to Section 12(b) of the Act: Title of each class Name of each exchange on which registered Common Shares, Par Value $0.01 The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the 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 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.

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 definition 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 (do not check if a smaller reporting company}
Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the Registrant's common shares, $0.01 par value, held by non-affiliates of the Registrant as of June 30, 2007, was $167,819,906. For purposes of the foregoing calculation only, all directors, executive officers and 10% beneficial owners have been deemed affiliates.

Number of the Registrant's common shares outstanding as of February 15, 2008 was 70,135,502.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's proxy statement for the 2008 annual general meeting of shareholders are incorporated by reference into Part III.

QUANTA CAPITAL HOLDINGS LTD.
FORM 10-K
TABLE OF CONTENTS

Table of Contents

PART I

Item 1. Business

General

In this annual report, references to the ‘‘company,’’ ‘‘we,’’ ‘‘us’’ or ‘‘our’’ refer to Quanta Capital Holdings Ltd. and its subsidiaries (which include, Quanta Reinsurance Ltd., Quanta U.S. Holdings Inc., Quanta Reinsurance U.S. Ltd., Quanta 4000 Holding Company Ltd., Quanta Indemnity Company, Quanta Specialty Lines Insurance Company, Quanta Europe Ltd., Quanta Technical Services LLC and, on or before February 13, 2008, Quanta 4000 Ltd.) unless the context suggests otherwise. We refer to Quanta Reinsurance Ltd., Quanta Reinsurance U.S. Ltd., Quanta Indemnity Company, Quanta Specialty Lines Insurance Company, Quanta Europe Ltd., Quanta 4000 Ltd. and Pembroke JV Ltd. as Quanta Re, Quanta U.S. Re, Quanta Indemnity, Quanta Specialty Lines, Quanta Europe, Syndicate 4000 and Pembroke JV, as the case may be. References to Quanta Holdings refer solely to Quanta Capital Holdings Ltd.

In this annual report, amounts are expressed in U.S. dollars, except as otherwise indicated, and the financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, except as otherwise indicated. We have registered the mark ‘‘Quanta’’ in the U.S. Patent and Trademark Office. All other brand names or trade names appearing in this annual report are the property of their respective holders.

Overview and Recent Events

Quanta Holdings was incorporated on May 23, 2003 as a Bermuda holding company formed to provide specialty lines insurance, reinsurance, risk assessment and risk technical services on a global basis through its affiliated companies. Following events in the first half of 2006, we have been conducting a self-managed run-off of our insurance and reinsurance businesses as more fully described below. Until February 13, 2008, we also participated in the ‘‘A’’ rated Lloyd’s market through Syndicate 4000.

We conduct our operations principally through our subsidiaries domiciled in Bermuda, Ireland and the United States. We may change our corporate organization from time to time as we run-off our business.

On February 13, 2008, we completed the disposition of all of our interests at Lloyd’s which was our only line of business not in active run-off and on March 13, 2008, we announced that we declared a dividend of $1.75 per common share payable on March 28, 2008 to our shareholders of record on March 25, 2008. We continue to consider and evaluate strategic alternatives that may include the sale of the company or some or all of our remaining businesses or assets, or a combination of one or more alternatives. There can be no assurance as to the timing, structure or terms of such a transaction.

Our Business

Run-off of Our Specialty Insurance and Reinsurance Portfolios

On March 2, 2006, A.M. Best announced that it had downgraded the financial strength rating assigned to Quanta Re and its subsidiaries and Quanta Europe to ‘‘B++’’ (very good), under review with negative implications. The A.M. Best ‘‘A’’ (excellent) rated Lloyd’s market, including Syndicate 4000, was not subject to the rating downgrade. Following this rating action, our board of directors decided to explore strategic alternatives, including the potential sale of some or all of our businesses, the run-off of certain product lines or business or a combination of alternatives. On June 7, 2006, A.M. Best, downgraded our financial strength rating, from ‘‘B++’’ (Very Good) to ‘‘B’’ (Fair). Following this rating action, A.M. Best, at our request, withdrew the financial strength ratings of Quanta Holdings and its operating subsidiaries, excluding Syndicate 4000 in the A-rated Lloyd’s market. During the third quarter of 2006, following A.M. Best’s rating actions our board of directors,

Table of Contents

after a review of strategic alternatives, decided to substantially cease writing new insurance and reinsurance business and commenced a self-managed run-off of our remaining insurance and reinsurance portfolios. Also during the third quarter of 2006, we sold ESC, a subsidiary through which we provided environmental consulting services, including investigation, remediation and engineering services, assessment services, information management services and other technical services.

The self-managed run-off of insurance and reinsurance portfolios, is expected to continue to take place over a number of years (because our policy obligations remain in force during that period) and may result in the dissolution or sale of our Company. During this time, the main activities we are undertaking are:

- negotiating cancellations, commutations, novations and portfolio transfers with counterparties;
- collecting premium receivables and reinsurance recoverables;
- managing our investment assets;
- supervising claims handling by our third party claims administrators; and
- reporting to and negotiating with regulatory agencies in multiple jurisdictions, including regarding license renewals, withdrawal plans and return of capital following satisfaction of policy obligations and other requirements.

Until we substantially ceased writing new business, our two traditional product lines were specialty insurance and specialty reinsurance. Our specialty insurance product line focused on professional liability, environmental liability, fidelity and crime, technical risk property, trade credit, political risk and surety. Our specialty reinsurance product line included marine and aviation reinsurance and casualty reinsurance. Some of the products offered to our clients were written as programs or as a structured product or a combination of a traditional policy with a program or a structured product. Programs rely on third parties, called program managers, who are engaged in the business of managing one or a combination of the underwriting, administration and claim related activities of a group of distinct specialty insurance policies under the supervision of an insurance company. Traditionally, program managers contract with an insurance company, which provides the insurance policies and capacity and supervises the program manager. Each group of policies and the related relationship with the program manager is called a program. Our largest program was our residential builders' and contractors' program that provides general liability, builders' risk and excess liability insurance coverages and reinsurance warranty coverages for new home contractors throughout the U.S. We refer to this program as the HBW program.

Syndicate 4000 at Lloyd's

On February 13, 2008, we sold Quanta 4000 and our interest in Pembroke JV to Chaucer Holdings PLC and received the return of $117.2 million which had previously been pledged to Lloyd's as security for the business being written by Syndicate 4000. Therefore, we no longer participate in Syndicate 4000. The sale of our insurance operations at Lloyd's follows the restructuring of those operations on March 1, 2007 through which we diversified the capital that was provided to Syndicate 4000 by obtaining 10% of this capital commitment from a subsidiary of Chaucer Holdings PLC and maintaining the capital we had previously pledged which then accounted for the remaining 90% of Syndicate 4000's capital. This restructuring also resulted in the appointment of Pembroke Managing Agency as the managing agent of Syndicate 4000, a role that was previously held by a subsidiary of Chaucer Holdings PLC.

During 2007, Syndicate 4000 wrote financial institution, professional indemnity and directors' and officers', specie and fine art coverage in the A.M. Best ''A'' rated Lloyd's market in London. The location of the risks that were written in Syndicate 4000 may be anywhere in the world. Syndicate 4000 was the market lead on a significant number of policies in the syndicate, which allowed it to deal with the broker or insured in establishing policy terms and managing particular claims.

Our Website

We maintain a website at www.quantaholdings.com where we make available, free of charge, our annual, quarterly and other reports, proxy statements and other information generally on the same

4

Table of Contents

day as we electronically file such material with, or furnish it to, the U.S. Securities and Exchange Commission (the ‘‘SEC’’). Information about the code of business conduct on our website and any amendment or waivers is included in Part III, Item 10 below. Information contained on our website is not part of this annual report.

Claims Management

In the fourth quarter of 2007, we outsourced our claims to third party claim administrators, over whom we have direct oversight. The third party claims administrators strive to investigate, evaluate and settle claims as efficiently and effectively as possible.

When a claim is reported, the third party claims administrators conduct an initial review of the validity of the claim and communicate the assessment of coverage and, if possible, the proposed method of handling the claim to the insured. Depending on the severity, the third party claims administrators also communicate with our management team. We base the authority for payment and establishing reserves on the level and experience of our management team.

We have established procedures, along with our third-party claim administrators, to record reported insurance claims upon receipt of notice of the claim. To assist with the adjustment and tracking of losses, we have established an information database for all insurance claims. The database is also used for management reporting and accumulation of significant reported events.

The third party claims administrators draw on internal and external resources to analyze the basis for coverage and determine the proper settlement of claims. We have also established networks of external legal and claims experts to augment the third party claims administrators.

With respect to reinsurance contracts, claims are mainly managed by the claims department of the ceding company or primary insurer. As individual claims become larger and more complex, we may confer with underlying carriers and ceding companies. From time to time, our claims professionals conduct audits of specific claims and the overall claims procedures of our clients. Through these audits, we seek to evaluate their claims-handling practices, including the organization of their claims departments, their fact-finding and investigation techniques, their reinsurance loss notification procedures, the adequacy of their reserves, their negotiation and settlement practices, their adherence to claims-handling guidelines and the validity of claims.

Reserves

We are required to establish reserves for losses and loss expenses under applicable insurance laws and regulations and U.S. GAAP. These reserves are balance sheet liabilities representing estimates of future amounts required to pay losses and loss expenses for insured and/or reinsured claims that have occurred at or before the balance sheet date, whether already known to us or not yet reported. Our policy is to establish these losses and loss reserves prudently after considering all information known to us as of the date they are recorded.

Loss reserves fall into two categories: case reserves for reported losses and loss expenses associated with a specific reported insured claim and reserves for incurred but not reported, or IBNR, losses and loss expenses. We have established these two categories of loss reserves as follows:

- Case reserves — Following our analysis of a notice of claim received from an insured, broker or ceding company, we determine whether the claim is valid and, if so, we establish a case reserve for the estimated amount of its ultimate settlement and its estimated loss expenses. We establish case reserves based upon the availability of coverage and may subsequently supplement or reduce the reserves as our claims department deems necessary. We also review our case reserves on a quarterly basis.

• IBNR reserves — We estimate and establish reserves for loss amounts incurred but not yet reported, including expected development of reported claims. These IBNR reserves include estimated loss expenses. We calculate IBNR reserves by using generally accepted actuarial techniques. We rely on the most recent information available, including pricing information, industry information and our historical reported claims data. We will revise these reserves for losses and loss expenses as additional information becomes available and as claims are reported and paid. We also review our IBNR reserves on a quarterly basis.

Table of Contents

Loss reserves represent our best estimate, at a given point in time, of the ultimate settlement and administration cost associated with incurred claims. Our ultimate liability may exceed or be less than these estimates. The process of estimating loss reserves requires significant judgment due to a number of variables. Internal and external events, such as fluctuations in inflation, judicial trends, legislative changes and changes in claims handling procedures, will affect these variables. We are not able to directly quantify many of these items, particularly on a prospective basis. There may also be significant lags between the occurrence of the insured event and the time it is actually reported to us.

Several aspects of our insurance and reinsurance products we offered until we ceased writing new business and our Lloyd’s insurance products further complicate the actuarial reserving techniques for loss reserves as compared to other insurance and reinsurance carriers. Among these aspects are the differences in our policy forms from more traditional forms, the lack of complete historical data for losses and our expectation that losses in excess of our attachment levels will be characterized by low frequency and high severity claims. All of these factors tend to limit the amount of relevant loss experience that we can use to gauge the emergence, severity and payout characteristics of our loss reserves.

We use statistical and actuarial methods to estimate our ultimate expected losses and loss expenses. Several years may pass between the time an insured or reinsured reports a loss to us and the time we settle our liability. During this period, we will learn additional facts and trends related to the loss. As we learn these additional facts and trends, we will adjust case reserves and incurred but not reported reserves as necessary. These adjustments will sometimes require us to increase our overall reserves and at other times will require us to reallocate incurred but not reported reserves to specific case reserves.

We base reserves for losses and loss expenses in part upon our estimates of losses. Initially, it may be difficult for us to estimate losses based upon our own historical claim experiences because of our lack of operating history. Therefore, we utilize commercially available models to evaluate future trends and estimate our ultimate claims costs.

U.S. GAAP does not permit us to establish loss reserves until the occurrence of an actual loss event. Once such an event occurs, we establish reserves based upon estimates of total losses as a result of the event and our estimate of the portion of the loss we have insured or reinsured. As a result, we set aside only loss reserves applicable to losses incurred up to the reporting date, with no allowance for the provision of a contingency reserve to account for expected future losses. We will estimate and recognize losses arising from future events at the time the loss is incurred.

To assist us in establishing appropriate reserves for losses and loss expense, we analyze a significant amount of insurance industry information with respect to the pricing environment and loss settlement patterns. In combination with our individual pricing analyses, we use this industry information to guide our loss and loss expense estimates. We regularly review these estimates, and we reflect adjustments, if any, in earnings in the periods in which they are determined. We have engaged, and we expect that we will continue, from time to time, to engage, independent external actuarial specialists to review specific reserving methods and results.

With respect to the year ended December 31, 2007, in establishing our reserves for losses and loss expenses, we reviewed reserve estimates of an actuary employed with our company and of an external actuary specialist. We recorded these reserves as of the year ended December 31, 2007 based on the highest aggregate reserve amount of the estimates we reviewed. While we believe that we are able to make a reasonable estimate of our ultimate losses, we may not be able to predict our ultimate claims experience as reliably as other companies that have had insurance and reinsurance operations for a period of time, and we cannot assure you that our losses and loss expenses will not exceed our total reserves.

For more discussion of our estimation and establishment of loss reserves, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Table of Contents

Ceded Reinsurance

During 2007, Syndicate 4000 ceded a portion of its written premiums through excess of loss treaty and facultative reinsurance contracts, as well as other agreements, which provide substantially similar financial protections. Prior to ceasing the writing of insurance, we also ceded a portion of our written premiums and purchased retrocessional coverage, which is reinsurance of a reinsurer’s business.

We use ceded reinsurance to lower our net exposure to our planned net limit and risk of individual loss, to control our aggregate exposures to a particular risk or class of risks and to reduce our overall risk of loss. Reinsurance companies cede risks under retrocessional agreements to other reinsurers, known as retrocessionaires, for reasons similar to those that cause primary insurers to purchase reinsurance. The amount of ceded reinsurance and retrocessional protection that we purchased varied based on business segment market conditions, pricing terms and credit risk, as well as other factors.

Ceded reinsurance and retrocessional protection do not relieve us of our obligations to our insureds or reinsureds. We must pay these obligations without the benefit of reinsurance to the extent our reinsurers or retocessionaires do not pay us. We evaluate and monitor the financial condition of our reinsurers and monitor concentrations of credit risk. We have sought to purchase reinsurance from entities rated ‘‘A–’’ or better by S&P or A.M. Best, and we regularly monitor its collectibility, making balance sheet provisions for amounts we consider potentially uncollectible and requesting collateral where possible.

Investments

Our board of directors established our investment policies and mandated a list of authorized investments for company funds. Management implements our investment strategy with the assistance of external managers, who use guidelines which are created by us and compliant with the investment mandates of our board to establish their portfolios. Our investment guidelines specify minimum criteria on the overall credit quality, liquidity and risk-return characteristics of our investment portfolio and include limitations on the size of particular holdings, as well as restrictions on investments in different asset classes. The board of directors monitors our overall investment returns and reviews compliance with our investment guidelines.

Our investment strategy seeks to preserve principal and maintain liquidity while trying to maximize total return through a high quality, diversified portfolio. Investment decision making is guided mainly by the nature and timing of our expected liability payouts, management’s forecast of our cash flows and the possibility that we will have unexpected cash demands, for example, to satisfy claims due to catastrophic losses. Our investment portfolio currently consists mainly of highly rated and liquid fixed income securities. However, to the extent our insurance liabilities are correlated with an asset class outside our minimum criteria, our investment guidelines will allow a deviation from those minimum criteria provided such deviations reduce overall risk. In addition, although we record our investments at fair value as required by GAAP and based on information provided by our external investment managers, there can be no assurance that we would collect these amounts in cash if we were to liquidate portions or our entire investment portfolio at this time. For more information about our investments, see ‘‘Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations’’ below.

Our investment guidelines require compliance with applicable local regulations and laws. Without board approval, we will not purchase financial futures, forwards, options, swaps and other derivatives, except for instruments that are purchased as part of our business, for purposes of hedging capital market risks (including those within our structured product transactions), or as replication transactions, which are defined as a set of derivative, insurance and/or securities transactions that when combined produce the equivalent economic results of an investment meeting our investment guidelines. While we expect that the majority of our investment holdings will continue to be denominated in U.S. dollars, we may make investments in other currency denominations depending upon the currencies in which loss reserves are maintained, or as may be required by regulation or law.

Table of Contents

Risk Management in Syndicate 4000

In Syndicate 4000, during 2007, underwriting authority was granted to Mark H. Wheeler who, in turn, issued detailed letters of underwriting authority to each of the leaders of our product lines at Lloyd's. Mr. Wheeler reviewed these letters annually. These letters contain underwriting eligibility criteria and quantifiable limits depending on the product line.

While we were conducting insurance business through Syndicate 4000, we believe we employed a disciplined approach to underwriting and risk management that relied heavily upon the collective underwriting expertise of our management and staff. We believe this expertise was guided by the following underwriting principles:

- Our own independent pricing or risk review of insurance and facultative risks;
- Acceptance of only those risks that we believed would earn a level of profit commensurate with the risk they present; and
- Limitation of the business we accepted to only that business that was consistent with our corporate risk objectives.

Additionally, underwriters at Syndicate 4000 used contract exclusions and terms and conditions, as appropriate, to further eliminate particular risk exposures that our underwriting team deems to be unacceptable.

Relationships with Brokers in Syndicate 4000

During 2007, Syndicate 4000 produced substantially all of its business through insurance brokers worldwide who receive a brokerage commission usually equal to a percentage of gross premiums. Brokerage commissions are generally negotiated on a policy by policy basis. Aon Ltd and Marsh Ltd. accounted for approximately 19% and 17% of the gross premiums of Syndicate 4000 during 2007. Eight other brokers accounted for approximately 41% of additional gross premiums of Syndicate 4000 during 2007.

Competition for Syndicate 4000

The insurance industry is highly competitive. During 2007, Syndicate 4000 competed both within the Lloyd's market and with insurance carriers outside of the Lloyd's market. Competition varied depending on the type of business being insured or reinsured. Syndicate 4000 competed on an international and regional basis with major U.S., Bermuda, European and other international insurers and certain underwriting syndicates.

Regulation

The business of insurance and reinsurance is regulated in most countries, although the degree and type of regulation varies significantly from one jurisdiction to another. Reinsurers are generally subject to less direct regulation than primary insurers.

Our run-off activities are subject to regulation in Bermuda, Ireland and the United States.

Bermuda Regulation

As a holding company, Quanta Holdings is not subject to Bermuda insurance regulations.

Quanta Re and Quanta U.S. Re are registered as Class 4 and Class 3 insurers under the Insurance Act by the Bermuda Monetary Authority, or the BMA, which is responsible for the day-to-day supervision of insurers. Under the Insurance Act, insurance business includes reinsurance business. Since the businesses of Quanta Re and Quanta U.S. Re are in run-off, the BMA has amended the licenses of these entities to require that they seek the approval from the BMA prior to paying any dividend to Quanta Holdings and to prohibit them from engaging in any new transactions.

The Insurance Act imposes on Bermuda insurance companies, including those in run-off, solvency and liquidity standards and auditing and reporting requirements and grants to the BMA powers to

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supervise, investigate and intervene in the affairs of insurance companies. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below.

Cancellation of Insurer's Registration

An insurer's registration may be canceled by the BMA on certain grounds specified in the Insurance Act, including failure of the insurer to comply with its obligations under the Insurance Act or if, in the opinion of the BMA, the insurer has not been carrying on business in accordance with sound insurance principles.

Statutory Financial Statements

An insurer must prepare annual statutory financial statements. The Insurance Act prescribes rules for the preparation and substance of such statutory financial statements (which include, in statutory form, a balance sheet, an income statement, a statement of capital and surplus and notes thereto). The insurer is required to give detailed information and analyses regarding premiums, claims, reinsurance and investments. The statutory financial statements are not prepared in accordance with U.S. GAAP and are distinct from the financial statements prepared for presentation to the insurer's shareholders under the Companies Act, which financial statements will be prepared in accordance with U.S. GAAP. Each of Quanta Re and Quanta U.S. Re, as a general business insurer, is required to submit the annual statutory financial statements as part of the annual statutory financial return. The statutory financial statements and the statutory financial return do not form part of the public records maintained by the BMA.

The BMA has announced that it is proposing that Class 4 insurers file, with their annual statutory return, audited GAAP financial statements, which will be published subject to certain conditions.

Annual Statutory Financial Return

Quanta Re and Quanta U.S. Re are required to file with the BMA statutory financial returns no later than four months after their financial year end (unless specifically extended). The statutory financial return for an insurer includes, among other matters, a report of the approved auditor on the statutory financial statements of such insurer, the solvency certificates, the declaration of statutory ratios, the statutory financial statements, the opinion of the loss reserve specialist and a schedule of reinsurance ceded. The solvency certificates must be signed by the principal representative and at least two directors of the insurer who are required to certify, among other matters, whether the minimum solvency margin has been met and whether the insurer complied with the conditions attached to its certificate of registration. The approved auditor is required to state whether in his opinion it was reasonable for the directors to so certify. Where an insurer's accounts have been audited for any purpose other than compliance with the Insurance Act, a statement to that effect must be filed with the statutory financial return.

The BMA has announced that it proposes to expand the statutory financial return to include additional forward-looking risk management information, such as pro forma financial statements and prescribed stress and scenario testing.

Minimum Solvency Margin and Restrictions on Dividends and Distributions

Under the Insurance Act, the value of the general business assets of a Class 4 insurer, such as Quanta Re must exceed the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin. Quanta Re is required, with respect to its general business, to maintain a minimum solvency margin equal to the greatest of:

(A) $100,000,000;

(B) 50% of net premiums written (being gross premiums written less any premiums ceded by Quanta Re, but Quanta Re may not deduct more than 25% of gross premiums when computing net premiums written); and

(C) 15% of loss and other insurance reserves.

9

Table of Contents

Quanta Re is prohibited from declaring or paying any dividends during any financial year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio. In addition, if it has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any financial year, Quanta Re will be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next financial year. Quanta Re is also prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year’s statutory balance sheet) unless it files with the BMA at least seven days before payment of such dividends an affidavit stating that it will continue to meet the required margins.

Quanta Re is prohibited, without the approval of the BMA, from reducing by 15% or more its total statutory capital as set out in its previous year’s financial statements, and any application for such approval must include an affidavit stating that it will continue to meet the required margins. In addition, at any time it fails to meet its solvency margin, Quanta Re will be required, within 30 days (45 days where total statutory capital and surplus falls to $75 million or less) after becoming aware of such failure or having reason to believe that such failure has occurred, to file with the BMA a written report containing certain information.

Under the Insurance Act, the value of the general business assets of a Class 3 insurer, such as Quanta U.S. Re must exceed the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin. Quanta U.S. Re is required, with respect to its general business, to maintain a minimum solvency margin equal to the greatest of:

(A)
$1,000,000 (B) Net Premium Income (‘‘NPI’’) Prescribed Amount Up to $6,000,000 20% of NPI
Greater than $6,000,000 The aggregate of $1,200,000 and 15% of the amount by which NPI exceeds $6,000,000 in that year.
In general, net premium income equals gross premium income after deduction of any premium ceded by the insurer for reinsurance; or

(C) 15%
of the aggregate of the insurer’s loss expense provisions and other general business insurance reserves.

Quanta U.S. Re is prohibited from declaring or paying any dividends during any financial year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio. In addition, if it has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any financial year, Quanta U.S. Re will be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next financial year. Quanta U.S. Re is prohibited, without the approval of the BMA, from reducing by 15% or more its total statutory capital as set out in its previous year’s financial statements, and any application for such approval shall provide such information as the BMA may require. In addition, at any time it fails to meet its solvency margin, Quanta U.S. Re will be required, within 30 days after becoming aware of such failure or having reason to believe that such failure has occurred, to file with the BMA a written report containing certain information.

Additionally, under the Companies Act, neither Quanta Holdings nor Quanta Re nor Quanta U.S. Re may declare or pay a dividend, or make a distribution from contributed surplus, if there are reasonable grounds for believing that it is, or would after the payment be, unable to pay its liabilities as they become due, or the realizable value of its assets would be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

Bermuda Solvency Capital Requirement

As part of the BMA's ongoing review of Bermuda's insurance supervisory framework, the BMA is introducing a new risk-based capital model (the ''Bermuda Solvency Requirement'' or ''BSCR'') as a tool to assist both in measuring risk and determining appropriate capitalization. It is expected that formal legislation will come into force in 2008 to apply these standards. In addition, the BMA intends to allow insurers to make application to the BMA to use their own internal capital models instead of the BSCR in cases where insurers can establish that their respective internal capital models better reflect their company characteristics. The BMA intends to consult further with insurers on these proposals prior to their formal implementation.

Minimum Liquidity Ratio

The Insurance Act provides a minimum liquidity ratio for general business insurers. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable and reinsurance balances receivable. There are certain categories of assets which, unless specifically permitted by the BMA, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans. The relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (by interpretation, those not specifically defined).

Supervision, Investigation and Intervention

The BMA may appoint an inspector with extensive powers to investigate the affairs of an insurer if the BMA believes that an investigation is required in the interest of the insurer's policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to the BMA, the BMA may direct an insurer to produce documents or information relating to matters connected with the insurer's business.

If it appears to the BMA that there is a risk of the insurer becoming insolvent, or that it is in breach of the Insurance Act or any conditions imposed upon its registration, the BMA may, among other things, direct the insurer (1) not to take on any new insurance business, (2) not to vary any insurance contract if the effect would be to increase the insurer's liabilities, (3) not to make certain investments, (4) to realize certain investments, (5) to maintain in, or transfer to the custody of, a specified bank, certain assets, (6) not to declare or pay any dividends or other distributions or to restrict the making of such payments and/or (7) to limit its premium income.

Disclosure of Information

In addition to powers under the Insurance Act to investigate the affairs of an insurer, the BMA may require certain information from an insurer (or certain other persons) to be produced to it. Further, the BMA has been given powers to assist other regulatory authorities, including foreign insurance regulatory authorities, with their investigations involving insurance and reinsurance companies in Bermuda but subject to restrictions. For example, the BMA must be satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities of the foreign regulatory authority. Further, the BMA must consider whether cooperation is in the public interest. The grounds for disclosure are limited and the Insurance Act provides sanctions for breach of the statutory duty of confidentiality.

Notification by shareholder of new or increased control

Any person who, directly or indirectly, becomes a holder of at least 10% , 20%, 33% or 50% of the common shares of Quanta Holdings must notify the BMA in writing within 45 days of becoming such a holder or 30 days from the date they have knowledge of having such a holding, whichever is

11

later. The BMA may, by written notice, object to such a person if it appears to the BMA that the person is not fit and proper to be such a holder. The BMA may require the holder to reduce their holding of shares and direct, among other things, that voting rights attaching to those shares shall not be exercisable.

Objection to existing shareholder

For so long as Quanta Holdings has as a subsidiary an insurer registered under the Insurance Act, the BMA may at any time, by written notice, object to a person holding 10% or more of Quanta Holdings' common shares if it appears to the BMA that the person is not or is no longer fit and proper to be such a holder. In such a case, the BMA may require the shareholder to reduce its holding of shares and direct, among other things, that such shareholder's voting rights attaching to those shares shall not be exercisable.

Certain other Considerations

Although Quanta Holdings is incorporated in Bermuda, it is classified as a non-resident of Bermuda for exchange control purposes by the BMA. Pursuant to its non-resident status, Quanta Holdings may engage in transactions in currencies other than Bermuda dollars and there are no restrictions on its ability to transfer funds (other than funds denominated in Bermuda dollars) in and out of Bermuda or to pay dividends to U.S. residents who are holders of its common shares.

Under Bermuda law, exempted companies are companies formed for the purpose of conducting business outside Bermuda from a principal place of business in Bermuda. As ‘‘exempted’’ companies, Quanta Holdings, Quanta Re and Quanta U.S. Re may not, without the express authorization of the Bermuda legislature or under a license or consent granted by the Minister of Finance, participate in certain business transactions, including: (1) the acquisition or holding of land in Bermuda (except that held by way of lease or tenancy agreement which is required for its business and held for a term not exceeding 50 years, or which is used to provide accommodation or recreational facilities for its officers and employees and held with the consent of the Bermuda Minister of Finance, for a term not exceeding 21 years); (2) the taking of mortgages on land in Bermuda to secure an amount in excess of $50,000; or (3) the carrying on of business of any kind for which it is not licensed in Bermuda, except in certain limited circumstances such as doing business with another exempted undertaking in furtherance of Quanta Holdings' business, Quanta Re's business or Quanta U.S. Re's business (as the case may be) carried on outside Bermuda. Quanta Re and Quanta U.S. Re both are licensed insurers in Bermuda, and it is expected that they will be able to carry on activities from Bermuda that are related to and in support of their insurance business in accordance with their licenses.

Shares may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act of 2003 of Bermuda, which regulates the sale of securities in Bermuda. In addition the BMA must approve all issuances and transfers of shares of a Bermuda exempted company.

The Bermuda government actively encourages foreign investment in ‘‘exempted’’ entities like Quanta Holdings that are based in Bermuda, but which do not operate in competition with local businesses. Quanta Holdings, Quanta Re and Quanta U.S. Re are not currently subject to taxes 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 or to any foreign exchange controls in Bermuda; however, Quanta U.S. Re will be taxed as a U.S. corporation.

Under Bermuda law, non-Bermudians (other than spouses of Bermudians) may not engage in any gainful occupation in Bermuda without the specific permission of the appropriate governmental authority. Such permission may be granted or extended upon showing that, after proper public advertisement, no Bermudian, or spouse of a Bermudian or individual holding a permanent resident certificate is available who meets the minimum standards for the advertised position. We employ primarily non-Bermudians. None of the executive officers of Quanta Holdings is a Bermudian, and all of these officers work in Bermuda under work permits. The Bermuda government recently announced a new policy that places a six-year term limit on individuals with work permits, subject to certain exceptions for key employees.

Table of Contents

Irish Regulation

Quanta Europe is incorporated under the laws of Ireland, has a registered office in Ireland and is in the process of running off its business. In March 2007, it submitted a withdrawal plan to the Irish Financial Services Regulatory Authority (which has recently re-branded itself as the Financial Regulator), or FR. During the second quarter of 2007, Quanta Europe returned $12.2 million which was the majority of its capital to Quanta Holdings, its parent, and it continues to execute on the withdrawal plan so that it may return the remaining portion of its capital to its parent in the future. As a non-life insurance company, Quanta Europe is subject to the regulation and supervision of FR pursuant to the Insurance Acts and Regulations and is authorized to undertake various classes of non-life insurance business.

Quanta Europe is primarily regulated under the Insurance Acts and Regulations. In addition, Quanta Europe is subject to supervisory requirements imposed by FR. These include the guidelines referred to in this section.

In addition to the obligations imposed on Quanta Europe by the Insurance Acts and Regulations, FR has granted the authorization subject to certain conditions as is typical for Irish authorized insurers. The following are the main conditions that have been imposed:

- Quanta Europe will not be permitted to reduce the level of its initial capital without the consent of FR;
- Quanta Europe may not make any dividend payments without FR’s prior approval;
- no loans may be made by Quanta Europe without prior notification to and approval of FR;
- Quanta Europe must maintain a minimum solvency margin equal to 200% of the solvency margin laid down by the Insurance Acts and Regulations (and a solvency ratio (of free assets to net premium) of 50%); and
- Quanta Europe is required to maintain a minimum guarantee fund (minimum capital) irrespective of capital requirements under solvency calculations of 3.0 million Euro.

Annual Returns

Quanta Europe must file annual statutory insurance returns with FR in the format prescribed by the European Communities (Non-Life Insurance Accounts) Regulations, 1995. Insurers must also pay annual supervision fees.

Qualifying Shareholding

The Insurance Acts and Regulations require that anyone acquiring or disposing of a ‘‘qualifying holding’’ in an Irish authorized insurer or anyone who proposes to increase that holding or to decrease it below specified levels must first notify FR of their intention to do so. Any Irish-authorized insurer that becomes aware of any acquisition or disposal of a qualifying holding in that insurer or which result in a holding reaching or being reduced below one of the ‘‘specified levels’’ is required to notify FR.

FR has three months from the date of submission of a notification within which to oppose any such proposed acquisition if FR is not satisfied as to the suitability of the acquiror ‘‘in view of the necessity to ensure sound and prudent management of the insurance undertaking.’’

A ‘‘qualifying holding’’ means a direct or indirect holding in an insurer that represents 10% or more of the capital or of the voting rights of the insurer or that makes it possible to exercise a significant influence over the management of the insurer. The specified levels are 20%, 33% and 50%, or such other level of ownership that results in the insurer becoming the acquiror’s subsidiary.

Any person having a shareholding of 10% or more of our issued share capital would be considered to have an indirect qualifying holding in Quanta Europe, whether or not those shares confer 10% or more of our voting rights. FR will need to pre-clear any change that results in the

13

Table of Contents

direct or indirect acquisition of a qualifying holding in Quanta Europe or a change that results in an increase in a holding to one of the specified levels.

Quanta Europe is required, at such times as may be specified by FR, and at least once a year, to notify FR of the names of shareholders possessing qualifying holdings and the size of such holdings.

Transactions with Related Companies

Under the Insurance Acts and Regulations, prior to entering into any transaction of a material nature with a related company or companies (including, in particular, the provision of loans to and acceptance of loans from a related company or companies) Quanta Europe must submit to FR a draft of any contract or agreement which is to be entered into by Quanta Europe in relation to the transaction. In addition to the above, there is a requirement that Quanta Europe notify FR on an annual basis of transactions with related companies in excess of 10,000 Euro.

Financial Requirements

Quanta Europe is required to maintain technical reserves calculated in accordance with the Insurance Acts and Regulations. Assets representing its technical reserves are required to cover Quanta Europe's underwriting liabilities.

Quanta Europe is obligated to prepare annual accounts (comprising balance sheet, profit and loss account and notes) in accordance with the provisions of the European Communities (Insurance Undertakings: Accounts) Regulations, 1996 (the ''Insurance Accounts Regulations''). Such accounts must be filed with FR and with the Registrar of Companies in Ireland.

Additionally, Quanta Europe is required to establish and maintain an adequate solvency margin and a minimum guarantee fund, both of which must be free from all foreseeable liabilities and not available for other purposes such as use as reserves.

The minimum guarantee fund is equal to one third of the solvency margin requirement as set out above, subject to a minimum. It is not an additional fund and is included in the solvency margin. Where an insurer is part of an insurance group, the solvency margin must be recalculated to eliminate any double counting of capital within the group.

Investment Restrictions

The Insurance Acts and Regulations limit the categories of assets that may be used to represent technical reserves and the required solvency margin. They also impose asset diversification, localization and currency matching rules and limit the use of derivatives in relation to assets used to represent technical reserves.

The localization rules require that assets representing technical reserves in respect of EU risks be localized in the EU. The documents of title must be held in the EU and the assets themselves must comply with the tests for localization set out in the Insurance Acts and Regulations. The currency matching rules require that a proportion of the assets representing risks arising in any currency must be held in assets denominated or readily realizable in that currency.

Withdrawal of Authorization

An insurer supervised by FR may have its authorization revoked by FR, if FR is satisfied that the insurer:

- has not used its authorization for the last 12 months, has expressly renounced its authorization or has ceased to carry on business covered by the authorization for more than six months;
- has been convicted of certain offences under the Insurance Acts and Regulations;
- no longer fulfils the conditions for authorization required by the Insurance Acts and Regulations;

14

Table of Contents

- has been unable to take measures contained in a restoration plan or finance scheme envisaged by the Insurance Acts and Regulations;
- fails seriously in its obligations under the Insurance Acts and Regulations;
- fails to comply with a requirement to produce certain documentation pursuant to an investigation; or
- fails to comply with a direction from FR as provided for in the Insurance Acts and Regulations.

FR may also suspend an authorization in certain circumstances. If FR revokes the authorization of an insurer, the right of that insurer to continue its activities in another European Economic Area member state, whether by way of freedom of services or through a right of establishment of a branch, will immediately cease.

Approval of Directors and Managers

In addition to the restrictions set forth above, FR must approve the appointment of any new directors or managers of Quanta Europe.

Supervision, Investigation and Intervention

The Insurance Acts and Regulations confer on FR wide-ranging powers in relation to the supervision and investigation of insurers, including the following:

- FR has power to require an insurer to submit returns and documents to it in such form as may be prescribed by regulation and to require that they be attested by directors and officers of the insurer. FR may also require that such returns and documents be attested by independent professionals and be published. Additionally, FR has a right to disclose any such returns or documents to the supervisory authorities of other EU Member States;
- FR may require information in relation to the insurer or any connected body;
- FR has power to direct that an investigation of an insurer's affairs be carried out in order to be satisfied that the insurer is complying or has the ability to continue to comply with its obligations under the Insurance Acts and Regulations. If necessary FR may seek a High Court order prohibiting the free disposal of an insurer's assets;
- In certain circumstances, including where FR believes that an insurer may be unable to meet its liabilities or provide the required solvency margin, FR may direct the insurer to take measures including: closing to new business, limiting its premium income, restricting its investments in certain assets, realizing assets, maintaining assets in Ireland and any further measures specified in the direction;
- If FR considers that policyholders' rights are threatened, it can require the insurer concerned to produce a financial recovery plan, covering the next three years and to maintain a higher solvency margin; FR is prohibited from issuing a certificate that the insurer meets the required solvency margin while it believes that policyholders' rights are threatened;
- If the solvency margin of the insurer falls below the minimum guarantee fund, FR must require the insurer to submit a short-term finance scheme; and
- FR may confer wide ranging powers on ''authorized officers'' in relation to insurers for the purpose of the Insurance Acts and Regulations.

These powers include permitting an authorized officer to search a premises and remove documents. An authorized officer may also be empowered to compel persons to provide information and documentation and to prepare a report on specified aspects of the business or activities of an insurer and other prescribed persons.

Auditors to an insurer have a statutory duty to report to FR in certain circumstances.

Certain breaches of the Insurance Acts and Regulations may constitute criminal offences and render the persons found guilty of such offences liable to fines and/or imprisonment.

Table of Contents

Certain other Irish Law Considerations

Quanta Europe is subject to the laws and regulations of Ireland. The Irish Companies Acts, 1963 to 2005 (the ‘‘Companies Acts’’) and the common law include the following restrictions applicable to Quanta Europe:

- Irish law requires the directors of a company to act in good faith for the benefit of the company and for example, prohibits the gratuitous use of corporate assets for the benefit of directors and persons connected with them;
- Irish company law applies capital maintenance rules. In particular, Quanta Europe is restricted to declaring dividends only out of ‘‘profits available for distribution.’’ Profits available for distribution are a company’s accumulated realized profits less its accumulated realized losses. Such profits may not include profits previously utilized either by distribution or capitalization and such losses do not include amounts previously written-off in a reduction or reorganization of capital;
- Irish law restricts a company from entering into certain types of transactions with its directors and officers by either completely prohibiting such transactions or permitting them only subject to conditions;
- Irish law restricts the giving of financial assistance by a company in connection with the purchase of its own shares or those of its holding company;
- All Irish companies are obliged to file prescribed returns (including, in most cases, audited accounts) in the Companies Registration Office annually and on the happening of certain events such as the creation of new shares, a change in directors or the passing of certain shareholder resolutions;
- A private limited company cannot offer shares or debentures to the public. Quanta Europe is a private limited company;
- A statutory body known as the Office of the Director of Corporate Enforcement (the ‘‘ODCE’’) has power to carry out investigations into the affairs of Irish companies in circumstances prescribed in the Companies Acts. The powers of the ODCE include the prosecution (both civil and criminal) of persons for suspected breaches of the Companies Acts; and
- Certain civil and criminal sanctions exist for breaches of the Companies Acts.

Quanta Europe is also required to comply with laws such as Irish Data Protection law.

U.S. Regulation

Quanta Indemnity and Quanta Specialty Lines are regulated insurance companies in Colorado and Indiana respectively.

Holding Company Acts

State insurance holding company system statutes and related regulations provide a regulatory apparatus that is designed to protect the financial condition of domestic insurers operating within a holding company system. All insurance holding company statutes require disclosure and, in some instances, prior approval of material transactions between the domestic insurer and an affiliate. These transactions typically include sales, purchases, exchanges, loans and extensions of credit, reinsurance agreements, service agreements, guarantees and investments between an insurance company and its affiliates, involving in the aggregate specified percentages of an insurance company’s admitted assets or policyholders surplus, or dividends that exceed specified percentages of an insurance company's surplus or income.

The state insurance holding company system statutes may discourage potential acquisition proposals and may delay, deter or prevent a change of control of Quanta Holdings, Quanta

Table of Contents

U.S. Holdings, Quanta Indemnity or Quanta Specialty Lines including through transactions, and in particular unsolicited transactions, that we or our shareholders might consider to be desirable.

Before a person can acquire control of a domestic insurer or reinsurer, prior written approval must be obtained from the insurance commissioner of the state where the domestic insurer is domiciled. Prior to granting approval of an application to acquire control of a domestic insurer, the state insurance commissioner where the insurer is domiciled will consider such factors as the financial strength of the applicant, the integrity and management of the applicant’s board of directors and executive officers, the acquiror’s plans for the future operations of the domestic insurer and any anti-competitive results that may arise from the closing of the acquisition of control. Generally, state statutes provide that ‘‘control’’ over a domestic insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent or more of the voting securities of the domestic insurer. Because a person acquiring ten percent or more of the common shares of Quanta Holdings would indirectly acquire the same percentage of Quanta Specialty Lines’ and Quanta Indemnity’s common stock, the U.S. insurance change of control laws will likely apply to such a transaction.

Typically, the holding company statutes will also require each of our U.S. subsidiaries periodically to file information with state insurance regulatory authorities, including information concerning capital structure, ownership, financial condition and general business operations.

Regulation of Dividends and other Payments from Insurance Subsidiaries

The ability of a U.S. insurer to pay dividends or make other distributions is subject to insurance regulatory limitations of the insurance company’s state of domicile. Generally, these laws require prior regulatory approval before an insurer may pay a dividend or make a distribution above a specified level. In many U.S. jurisdictions, including the State of Indiana where Quanta Specialty Lines is domiciled and the State of Colorado where Quanta Indemnity is domiciled, dividends may only be paid out of earned surplus and may not exceed the greater of (1) 10% of the insurer’s statutory surplus as of the end of the last preceding calendar year or (2) levels of the insurer’s net income for the prior calendar year. In addition, the laws of many U.S. jurisdictions require an insurer to report for informational purposes to the insurance commissioner of its state of domicile all declarations and proposed payments of dividends and other distributions to security holders. Any return of capital from a U.S. insurance company would require prior approval of the domestic regulators.

The dividend limitations imposed by the state laws are based on statutory financial results, determined by using statutory accounting practices which differ in certain respects from accounting principles used in financial statements prepared in conformity with U.S. GAAP. The significant differences relate to treatment of deferred acquisition costs, deferred income taxes, required investment reserves, reserve calculation assumptions and surplus notes. In connection with the acquisition of a U.S. insurer, insurance regulators in the United States often impose, as a condition to the approval of the acquisition, additional restrictions on the ability of the U.S. insurer to pay dividends or make other distributions. These restrictions generally prohibit the U.S. insurer from paying dividends or making other distributions for a number of years without prior enhanced regulatory approval.

Insurance Regulatory Information System Ratios

The NAIC Insurance Regulatory Information System (‘‘IRIS’’) was developed by a committee of state insurance regulators and is intended primarily to assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states. IRIS identifies 11 industry ratios and specifies ‘‘usual values’’ for each ratio. Departure from the usual values of the ratios can lead to inquiries from individual state insurance commissioners regarding different aspects of an insurer’s business. Insurers that report four or more unusual values are generally targeted for regulatory review.

Accreditation

The NAIC has instituted its Financial Regulatory Accreditation Standards Program (‘‘FRASP’’) in response to federal initiatives to regulate the business of insurance. FRASP provides a set of

17

Table of Contents

standards designed to establish effective state regulation of the financial condition of insurance companies. Under FRASP, a state must adopt certain laws and regulations, institute required regulatory practices and procedures, and have adequate personnel to enforce these laws and regulations in order to become an ‘‘accredited’’ state. Accredited states are not able to accept certain financial examination reports of insurers prepared solely by the regulatory agency in an unaccredited state.

Risk-Based Capital Requirements

In order to enhance the regulation of insurer solvency, the NAIC adopted in December 1993 a formula and model law to implement risk-based capital requirements for property and casualty insurance companies. These risk-based capital requirements change from time to time and are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policyholder obligations. The risk-based capital model for property and casualty insurance companies measures three major areas of risk facing property and casualty insurers:

- underwriting, which encompasses the risk of adverse loss developments and inadequate pricing;
- declines in asset values arising from credit risk; and
- declines in asset values arising from investment risks.

Insurers having less statutory surplus than required by the risk-based capital calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. Equity investments in common stock typically are valued at 85% of their market value under the risk-based capital guidelines.

Under the approved formula, an insurer’s statutory surplus is compared to its risk-based capital requirement. If this ratio is above a minimum threshold, no company or regulatory action is necessary. Below this threshold are four distinct action levels at which a regulator can intervene with increasing degrees of authority over an insurer as the ratio of surplus to risk-based capital requirement decreases. The four action levels include:

- insurer is required to submit a plan for corrective action,
- insurer is subject to examination, analysis and specific corrective action,
- regulators may place insurer under regulatory control, and
- regulators are required to place insurer under regulatory control.

Guaranty Funds and Assigned Risk Plans

Most states require all admitted insurance companies to participate in their respective guaranty funds that cover various claims against insolvent insurers. Solvent insurers licensed in these states are required to cover the losses paid on behalf of insolvent insurers by the guaranty funds and are generally subject to annual assessments in the state by its guaranty fund to cover these losses. Some states also require licensed insurance companies to participate in assigned risk plans which provide coverage for automobile insurance and other lines for insureds which, for various reasons, cannot otherwise obtain insurance in the open market. This participation may take the form of reinsuring a portion of a pool of policies or the direct issuance of policies to insureds. The calculation of an insurer's participation in these plans is usually based on the amount of premium for that type of coverage that was written by the insurer on a voluntary basis in a prior year. Participation in assigned risk pools tends to produce losses which result in assessments to insurers writing the same lines on a voluntary basis.

Credit for Reinsurance

Licensed reinsurers in the United States are subject to insurance regulation and supervision that is similar to the regulation of licensed primary insurers. However, the terms and conditions of

Table of Contents

reinsurance agreements generally are not subject to regulation by any governmental authority with respect to rates or policy terms. This contrasts with primary insurance policies and agreements, the rates and terms of which generally are regulated by state insurance regulators. As a practical matter, however, the rates charged by primary insurers do have an effect on the rates that can be charged by reinsurers.

A primary insurer ordinarily will enter into a reinsurance agreement only if it can obtain credit for the reinsurance ceded on its statutory financial statements. In general, credit for reinsurance is allowed in the following circumstances:

- if the reinsurer is licensed in the state in which the primary insurer is domiciled or, in some instances, in certain states in which the primary insurer is licensed;
- if the reinsurer is an ‘‘accredited’’ or otherwise approved reinsurer in the state in which the primary insurer is domiciled or, in some instances, in certain states in which the primary insurer is licensed;
- in some instances, if the reinsurer (a) is domiciled in a state that is deemed to have substantially similar credit for reinsurance standards as the state in which the primary insurer is domiciled and (b) meets financial requirements; or
- if none of the above apply, to the extent that the reinsurance obligations of the reinsurer are secured appropriately, typically through the posting of a letter of credit for the benefit of the primary insurer or the deposit of assets into a trust fund established for the benefit of the primary insurer.

As a result of the requirements relating to the provision of credit for reinsurance, Quanta Re, Quanta U.S. Re and Quanta Europe are indirectly subject to some regulatory requirements imposed by jurisdictions in which ceding companies are licensed. Because Quanta Re, Quanta U.S. Re and Quanta Europe were not licensed, accredited or otherwise approved by or domiciled in any state in the United States, primary insurers were only willing to cede business to Quanta Re, Quanta U.S. Re and Quanta Europe if we provided adequate security to allow the primary insurer to take credit on its balance sheet for the reinsurance it purchased. We typically provided this security through the posting of a letter of credit or deposit of assets into a trust fund for the benefit of the primary insurer.

Statutory Accounting Principles

Statutory accounting principles, or SAP, is a basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. It is primarily concerned with measuring an insurer’s surplus to policyholders. Accordingly, statutory accounting focuses on valuing assets and liabilities of insurers at financial reporting dates in accordance with appropriate insurance law and regulatory provisions applicable in each insurer’s domiciliary state.

U.S. GAAP is concerned with a company’s solvency, but it is also concerned with other financial measurements, such as income and cash flows. Accordingly, U.S. GAAP gives more consideration to appropriate matching of revenue and expenses and accounting for management’s stewardship of assets than does SAP. As a direct result, different assets and liabilities and different amounts of assets and liabilities will be reflected in financial statements prepared in accordance with U.S. GAAP as opposed to SAP.

Statutory accounting practices established by the NAIC and adopted, in part, by State Insurance Departments, will determine, among other things, the amount of statutory surplus and statutory net income of our U.S. insurance subsidiaries, which will affect, in part, the amount of funds they have available to pay dividends to us.

Federal Regulation

We are subject to numerous federal regulations, including the Securities Act of 1933, the Securities Exchange Act of 1934 (the ‘‘Exchange Act’’) and other federal securities laws. As we

19

continue with the run-off of our business, we must monitor our compliance with these laws, including our maintenance of any available exemptions from registration as an investment company under the Investment Company Act of 1940. Any failure to comply with these laws or maintain our exemption could have a material adverse effect on our operations and on the market price of our common shares. Although state regulation is the dominant form of U.S. regulation for insurance and reinsurance business, from time to time Congress has shown concern over the adequacy and efficiency of the state regulation.

Material Tax Considerations

The following is a summary of our taxation under certain tax laws, does not purport to be a comprehensive discussion of all the tax considerations that may be relevant and is for general information only. The discussion is based upon current law. Legislative, judicial or administrative changes or interpretations may be forthcoming that could be retroactive and could affect the tax consequences discussed herein. Statements contained in this report as to the beliefs, expectations and conditions of Quanta Holdings and its subsidiaries as to the application of such tax laws or facts represent the view of management as to the application of such laws and do not represent the opinions of counsel.

You should consult your own tax advisor concerning the U.S. federal, state, local and non-U.S. tax consequences of owning our securities.

Taxation of Quanta Holdings and Subsidiaries

Certain Bermuda Tax Considerations

Bermuda does not currently impose any income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax on us or our shareholders, other than shareholders ordinarily resident in Bermuda, if any. There is currently no Bermuda withholding or other tax on principal, interest or dividends paid to holders of the shares, other than holders ordinarily resident in Bermuda, if any. We cannot assure you that we or our shareholders will not be subject to any such tax in the future.

Quanta Holdings has received written assurance dated May 27, 2003 from the Bermuda Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, as amended, that if any legislation is enacted in Bermuda 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, then the imposition of that tax would not be applicable to Quanta Holdings or to any of its operations, shares, debentures or obligations until March 28, 2016; provided, that the assurance is subject to the condition that it will not be construed to prevent the application of such tax to people ordinarily resident in Bermuda, or to prevent the application of any taxes payable by Quanta Holdings in respect of real property or leasehold interests in Bermuda held by it. Quanta Re and Quanta U.S. Re also received such written assurance dated June 23, 2003.

Certain Irish Tax Considerations

We intend that Quanta Europe, a company incorporated in Ireland, will be managed and controlled in Ireland and, therefore, will be resident in Ireland for Irish tax purposes and subject to Irish corporation tax on its worldwide profits (including revenue profits and capital gains). Income derived by Quanta Europe, once authorized, from an Irish trade (that is, a trade that is not carried on wholly outside of Ireland) will be subject to Irish corporation tax at the current rate of 12.5%. Other income (that is income from passive investments, income from non-Irish trades and income from certain dealings in land) will generally be subject to Irish corporation tax at the current rate of 25%.

The Irish Revenue Commissioners have published a statement indicating that deposit interest earned by an insurance company on funds held for regulatory purposes will be regarded as part of its trading income, and accordingly will be part of the profits taxed at 12.5%. This statement also indicates acceptance of case law which states that investment income of an insurance company will likewise be considered as trading income where it is integral to the insurance trade and available for satisfying the liabilities of the insurance business.

Other investment income earned by Quanta Europe will generally be taxed in Ireland at a rate of 25%. Capital gains realized by Quanta Europe will generally be subject to Irish corporation tax at an effective rate of 20%.

We expect that none of Quanta Holdings and its subsidiaries, other than Quanta Europe, will be resident in Ireland for Irish tax purposes unless the central management and control of such companies is, as a matter of fact, located in Ireland. A company not resident in Ireland for Irish tax purposes can be subject to Irish corporation tax if it carries on a trade through a branch or agency in Ireland or disposes of certain specified assets (e.g., Irish land, minerals, or mineral rights, or shares deriving the greater part of their value from such assets). In such cases, the charge to Irish corporation tax is limited to trading income connected with the branch or agency, and capital gains on the disposal of assets used in the branch or agency which are situated in Ireland at or before the time of disposal, and capital gains arising on the disposal of specified assets, with tax imposed at the rates discussed above. A company not resident in Ireland is otherwise subject to Irish income tax at the standard rate, currently 20%, on other taxable income arising from sources within Ireland, and to capital gains tax at the current rate of 20% of the taxable gain, on disposals of certain specified assets, Irish land, minerals, exploration and exploitation rights, and unquoted shares directly or indirectly deriving the greater part of their value from such assets.

Certain United Kingdom Tax Considerations

The following is a summary of certain U.K. tax considerations under current U.K. law relating to Quanta Holdings and its subsidiaries.

U.K. Taxation of Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines, Quanta Indemnity and Quanta 4000

U.K. Residence. None of Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines nor Quanta Indemnity are incorporated in the U.K. Accordingly, they should not be treated as being resident in the U.K. unless their central management and control is exercised in the U.K. The concept of central management and control is indicative of the highest level of control of a company, which is wholly a question of fact. We intend to manage Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines and Quanta Indemnity so they are not resident in the U.K. for U.K. corporation tax purposes. Quanta 4000 and Pembroke JV, as companies incorporated in the U.K., are treated as being resident in the U.K. and are subject to U.K. corporation tax on their respective worldwide income and gains. The maximum rate of U.K. corporation tax is currently 30%.

U.K. Permanent Establishment. As a matter of U.K. domestic tax law, a company not resident in the U.K. for U.K. corporation tax purposes can be subject to U.K. corporation tax if it carries on a trade in the U.K. through a permanent establishment in the U.K. but the charge to U.K. corporation tax is limited to all profits (including revenue profits and capital gains), wherever arising, that are attributable to such permanent establishment. The term ‘‘permanent establishment’’ is defined for these purposes in a manner that is consistent with various internationally recognized characteristics commonly used in the U.K.’s double tax treaties. The maximum rate of U.K. corporation tax is currently 30%.

We intend to operate in such a manner that none of Quanta Holdings nor any of its subsidiaries will carry on a trade in the U.K. through a permanent establishment in the U.K. Whether a trade is being carried on in the U.K. through a permanent establishment in the U.K. is an inherently factual determination. Since U.K. case law and U.K. statutes fail to identify definitively activities that constitute a trade being carried on in the U.K. through a permanent establishment in the U.K., we

21

cannot assure you that HM Revenue & Customs will not contend successfully that Quanta Holdings or any of its subsidiaries has been or will be carrying on a trade in the U.K. through a permanent establishment in the U.K. We believe that the U.S. subsidiaries of Quanta Holdings qualify for benefits under the tax treaty between the U.K. and the United States. If any of our U.S. subsidiaries qualifying for such benefits were to be carrying on a trade in the U.K. through a U.K. permanent establishment, they would only be subject to U.K. corporation tax if the U.K. permanent establishment constituted a permanent establishment for the purposes of that treaty and then only to the extent that any profits were attributable to that permanent establishment in the U.K. determined in accordance with the provisions of the U.K.—United States tax treaty.

The U.K. has no tax treaty with Bermuda and if any of Quanta Holdings or our subsidiaries in Bermuda were to be carrying on a trade in the U.K. through a permanent establishment in the U.K., they would be subject to U.K. corporation tax on all profits, wherever arising, attributable to that permanent establishment in accordance with the provisions of U.K. tax law.

There are circumstances in which companies that are neither resident in the U.K. nor entitled to the protection afforded by a tax treaty between the U.K. and the jurisdiction in which they are resident may be exposed to income tax in the U.K. on income arising in the U.K. (other than by deduction or withholding) but we intend to operate in such a manner that none of us will fall within the charge to income tax in the U.K. (other than by deduction or withholding) in this respect.

If we or any of our subsidiaries, other than any subsidiary incorporated in the U.K. as a contact office for Quanta Re, were treated as being resident in the U.K. for U.K. corporation tax purposes, or, were to be carrying on a trade in the U.K. through a permanent establishment in the U.K., the results of our operations and your investment could be materially adversely affected.

The U.K. imposes Insurance Premium Tax, or IPT, on the receipt of premiums by insurers under insurance contracts in respect of risks situated in the U.K. Certain types of insurance risks situated in the U.K. are exempt from IPT, including reinsurance. IPT is generally collected from the insurer, although the economic cost of the IPT is usually passed to the insured by way of an IPT-inclusive premium. The rate of IPT is 5% (or 17.5% for insurance contracts relating to certain goods in certain circumstances) and is calculated as a percentage of the premium received.

Certain U.S. Federal Income Tax Considerations

The following discussion is a summary of certain U.S. federal income tax considerations relating to Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines, Quanta Indemnity and Quanta U.S. Re and the ownership of our shares by investors. As discussed further in this annual report and based on our expected business, properties, ownership, organization, source of income and manner of operation, we believe that (1) no U.S. Person that owns shares in Quanta Holdings directly or indirectly through foreign entities should be subject to treatment as a 10% U.S. Shareholder of a controlled foreign corporation, or CFC, and (2) Quanta Holdings should not be considered a passive foreign investment company, for the year ended December 31, 2007. We have not sought and do not intend to seek an opinion of legal counsel as to whether or not we were a passive foreign investment company for the year ended December 31, 2007.

This summary is based upon the Internal Revenue Code, the Treasury Regulations promulgated under the Internal Revenue Code, rulings and other administrative pronouncements issued by the IRS, judicial decisions, the tax treaty between the United States and Bermuda, or the ‘‘Bermuda Treaty’’ and the tax treaty between the United States and Ireland, or the ‘‘Irish Treaty’’, all as currently in effect, and all of which are subject to differing interpretations or to change, possibly with retroactive effect. No assurance can be given that the IRS would not assert, or that a court would not sustain, a position contrary to any of the tax consequences described below. No advance ruling has been or will be sought from the IRS regarding any matter discussed in this annual report. This summary is for general information only, and does not purport to discuss all aspects of U.S. federal income taxation that may be important to a particular investor in light of such investor's investment or tax circumstances, or to investors subject to special tax rules, such as shareholders who own directly, or indirectly through certain foreign entities or through the constructive ownership rules of the

Table of Contents

Internal Revenue Code, 10% or more of the voting power or value of Quanta Holdings (or how those ownership rules may apply in certain circumstances), tax-exempt organizations, dealers in securities, banks, insurance companies, persons that hold shares that are a hedge or that are hedged against interest rate or insurance risks or that are part of a straddle or conversion transaction, or persons whose functional currency is not the U.S. dollar. This summary generally does not discuss the federal alternative minimum tax and federal taxes other than income tax or other U.S. taxes such as state or local income taxes. This summary assumes that an investor will acquire and hold our shares as capital assets, which generally means as property held for investment. Special rules, not discussed herein, apply to U.S. persons who are partners in a partnership investing in shares. Prospective investors should consult their tax advisors concerning the consequences, in their particular circumstances, of the ownership of shares under U.S. federal, state, local and other tax laws.

For U.S. federal income tax purposes and purposes of the following discussion, a ''U.S. Person'' means (1) a citizen or resident of the United States, (2) a corporation or other entity created or organized in the United States or under the laws of the United States or of any of its political subdivisions, (3) an estate the income of which is subject to U.S. federal income tax without regard to its source or (4) a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. Persons have the authority to control all substantial decisions of the trust, as well as certain electing trusts.

U.S. Taxation of Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines, Quanta U.S. Re and Quanta Indemnity

U.S. Income and Branch Profits Tax. A foreign corporation deemed to be engaged in the conduct of a trade or business in the U.S. will generally be subject to U.S. federal income tax (at a current maximum rate of 35%), as well as a 30% branch profits tax in certain circumstances, on its income which is treated as effectively connected with the conduct of that trade or business unless the corporation is entitled to relief under an applicable income tax treaty, as discussed below. Quanta Holdings, Quanta Europe and Quanta Re intend to operate in such a manner that they will not be considered to be conducting a trade or business within the United States for purposes of U.S. federal income taxation. Whether a trade or business is being conducted in the United States is an inherently factual determination. Because the Internal Revenue Code, Treasury Regulations and court decisions fail to identify definitively activities that constitute being engaged in a trade or business in the United States, we cannot assure you that the IRS will not contend successfully that Quanta Holdings, Quanta Re and/or Quanta Europe are or will be engaged in a trade or business in the United States. Such income tax, if imposed, would be based on effectively connected income computed in a manner generally analogous to that applied to the income of a U.S. corporation, except that a foreign corporation is entitled to deductions and credits only if it timely files a U.S. federal income tax return (which requirement may be waived if the foreign corporation establishes that it acted reasonably and in good faith in its failure to timely file such return). Quanta Holdings, Quanta Europe and Quanta Re intend to file protective U.S. federal income tax returns on a timely basis in order to preserve the right to claim income tax deductions and credits if it is ever determined that they are subject to U.S. federal income tax.

An insurance enterprise resident in Bermuda generally will be entitled to the benefits of the Bermuda Treaty if (1) more than 50% of its shares are owned beneficially, directly or indirectly, by individual residents of the United States or Bermuda or U.S. citizens and (2) its income is not used in substantial part, directly or indirectly, to make disproportionate distributions to, or to meet certain liabilities of, persons who are neither residents of either the United States or Bermuda nor U.S. citizens. Quanta Re believes it is entitled to the benefits of the Bermuda Treaty. Assuming Quanta Re is entitled to the benefits under the Bermuda Treaty, it will not be subject to U.S. federal income tax on any insurance income found to be effectively connected with a U.S. trade or business unless that trade or business is conducted through a permanent establishment in the United States. Whether business is being conducted in the United

States through a permanent establishment is an inherently factual determination. Quanta Re intends to conduct its activities so as not to have a permanent establishment in the United States, although we cannot assure you that it will achieve this result.

Table of Contents

A company resident in Ireland will generally be entitled to the benefit of the Irish Treaty if (1) more than 50% of its shares are owned beneficially, directly or indirectly, by individual residents of the United States or Ireland or U.S. citizens and (2) deductible amounts paid for certain purposes to persons who are neither residents of either the U.S. or Ireland, nor U.S. citizens do not exceed 50% of the Irish company’s income. An Irish company which does not meet those standards may nevertheless be entitled to the benefits of the Irish Treaty with respect to an item of income if the Irish company is engaged in the active conduct of a trade or business in Ireland, and the item of income is connected with or incidental to that trade or business. Quanta Europe believes it is entitled to the benefits of the Irish Treaty. Assuming Quanta Europe is entitled to the benefits of the Irish Treaty, it will not be subject to U.S. federal income tax on any income found to be effectively connected with a U.S. trade or business unless that trade or business is conducted through a permanent establishment in the United States. Quanta Europe intends to conduct its activities in a manner so that it does not have a permanent establishment in the United States, although we cannot assure you that it will achieve this result.

If a non-U.S. company is characterized as engaged in an insurance business in the United States, a portion of its net investment income will be characterized as effectively connected with such U.S. trade or business. The amount so characterized depends on a formula. It is unclear whether applicable income tax treaties apply to the characterization of net investment income and, if so, such benefit would only apply if the non-U.S. insurance company is eligible for such treaty benefit.

Foreign corporations also are subject to U.S. withholding tax at a rate of 30% of the gross amount of certain ‘‘fixed or determinable annual or periodical gains, profits and income’’ derived from sources within the United States (such as dividends and certain interest on investments), to the extent such amounts are not effectively connected with the foreign corporation’s conduct of a trade or business in the United States. The tax rate is subject to reduction by applicable treaties. The Bermuda Treaty does not provide such a reduction. Dividends, if any, paid by Quanta U.S. Holdings to Quanta Holdings, therefore, will be subject to 30% U.S. withholding tax. The United States also imposes an excise tax on insurance and reinsurance premiums paid to foreign insurers or reinsurers with respect to risks located in the United States. The rate of tax applicable to premiums paid to Quanta Re is 4% for insurance premiums and 1% for reinsurance premiums. The excise tax does not apply to premiums paid to Quanta Europe assuming that Quanta Europe is entitled to the benefits of the Irish Treaty, to the extent that Quanta Europe does not reinsure the risk with a reinsurer which is not entitled to the benefits of a bilateral tax treaty with the United States in which the United States has waived the excise tax.

Quanta U.S. Holdings is a Delaware corporation, Quanta Indemnity is a Colorado corporation and Quanta Specialty Lines is an Indiana corporation. Quanta U.S. Re is a Bermuda corporation that will be taxed as a U.S. corporation pursuant to an election under section 953(d) of the Internal Revenue Code. Each will be subject to taxation in the United States on its worldwide income at regular corporate rates.

Personal Holding Companies.   Quanta Holdings’ U.S. subsidiaries could be subject to additional U.S. tax on a portion of their income earned from U.S. sources if any of them is considered to be a personal holding company, or ‘‘PHC’’ for U.S. federal income tax purposes. A corporation generally will be classified as a PHC for U.S. federal income tax purposes in a given taxable year if (1) at any time during the last half of such taxable year, five or fewer individuals (without regard to their citizenship or residency) own or are deemed to own (pursuant to certain constructive ownership rules) more than 50% of the stock of the corporation by value and (2) at least 60% of the corporation’s adjusted ordinary gross income, as determined for U.S. federal income tax purposes, for such taxable year consists of ‘‘PHC income.’’ PHC income includes, among other things, dividends, certain interest, certain royalties, annuities and, under certain circumstances, rents. For purposes of the 50% test, each partner of an investment partnership who is an individual will be treated as owning his/her proportionate share of any stock owned by the partnership. Additionally, certain entities (such as tax-exempt organizations and pension funds) will be treated as individuals. The PHC rules contain an exception for foreign corporations.

Table of Contents

If any of Quanta Holdings' U.S. subsidiaries were a PHC in a given taxable year, such corporation would be subject to PHC tax on its ‘‘undistributed PHC income’’ at a rate of 15%. For taxable years beginning after December 31, 2008, the PHC tax rate would be the highest marginal rate on ordinary income applicable to individuals.

Although Quanta Holdings believes that none of its U.S. subsidiaries is a PHC, we cannot provide assurance that this will be the case because of factors including legal and factual uncertainties regarding the application of the constructive ownership rules, the makeup of Quanta Holdings' shareholder base, the gross income of Quanta Holdings' U.S. subsidiaries and other circumstances that could change the application of the PHC rules to Quanta Holdings and its subsidiaries. In addition, if any of Quanta Holdings' U.S. subsidiaries were to become PHCs we cannot be certain that the amount of PHC income would be immaterial.

Employees

As of March 10, 2008, we employed approximately 46 full-time employees, all of whom are engaged in our run-off activities. Of these employees, the majority deal with financial, legal, regulatory and general administrative matters, four are engaged in assumed and ceded reinsurance, four serve in the policy servicing administration and one handles claims. We also engage consultants and temporary personnel when needed.

In order to retain the services of Jonathan J.R. Dodd, our chief financial officer, and a number of other key employees, we have entered into retention agreements with these employees that provide for specified severance payments in the event of their termination without cause or following a change of control. These agreements also contain non-competition and non-solicitation provisions. However, generally, our other employees, including our chief executive officer, do not have non-competition agreements with us or agreements requiring us to employ them over a fixed term. Therefore, these other employees, including our chief executive officer, may voluntarily terminate their employment with us at any time and are not restricted from seeking employment with others who may seek their expertise.

Item 1A. Risk Factors

Because of the following factors, as well as other variables affecting our operating results, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods. Though we have attempted to list comprehensively important cautionary risk factors, we wish to caution investors and others that other factors may in the future prove to be important in affecting our business or results of operations.

Risks Related to the Run-off

Our self-managed run-off is subject to a number of risks.

We recently sold our remaining insurance business and our only remaining business is the run-off of our insurance and reinsurance operations. Running off these businesses includes a number of risks, including the risk that we may not be able to mitigate our existing exposures to our historical underwriting risks, obtain the release of collateral when contracts are cancelled, recover amounts owed to us by our reinsurers and retrocessionaires, enter into commutations, cancellations or other arrangements to mitigate our liabilities, obtain premium that has been due but not paid to us for an extended period of time, release capital from our subsidiaries to our holding company where it is available to our shareholders, reduce our expenses such that they do not exceed income from investments, prevent investment losses or maintain sufficient liquidity in each of our subsidiaries to meet the obligations of those subsidiaries. Furthermore, we remain subject to extensive regulation and the risk that regulators may seek to supervise or gain and retain control over our subsidiaries, which would impede our efforts to extract capital from those subsidiaries over time. In addition, running-off these businesses creates substantial uncertainties and risks that may result in restructuring charges and unforeseen expenses and costs. In addition, as a result of commutations, loss portfolio transfers or other transactions, we may realize gains or losses of assets and liabilities that are different than the amount at which these are currently recorded. If any of these risks materializes, it may have a material adverse impact on the value of our assets, increase our operating costs or result in liquidity strains.

We may experience unfavorable claims development or receive additional claims which could result in additional losses.

Unfavorable claims experience related to the run-off of any or all of our lines of business may occur and would result in losses in the future as we still have policies in force that have terms in excess of ten years. In addition, as required by U.S. Generally Accepted Accounting Principles, we have not established reserves for claims that may arise from losses occurring in the future on the policies that remain in force. If our reserves associated with the underlying reinsurance exposures are insufficient, it could result in losses and an increase in cost and management time related to arbitration and other dispute resolution.

Risks related to any dissolution of our business

In the future, it is possible that we could be placed into liquidation either as a solvent entity or as an insolvent entity. A liquidation as a solvent entity is a voluntary liquidation approved by shareholders. If we were to become insolvent, we would have to be liquidated under the supervision of the Bermuda Supreme Court during which a court appointed liquidator of our company may or may not pursue a scheme of arrangement to shorten the time otherwise required to wind up our business.

In a winding up or liquidation as described above, a liquidator would be appointed and would sell or otherwise dispose of our remaining assets, pay our existing liabilities, including contingent obligations (which would have to be estimated in advance of payment) and distribute net proceeds, if any, to our shareholders in one or more liquidation distributions. In a liquidation, we may not receive any material amounts for the sale or other disposition of our assets. Further, in a liquidation, we will have significant obligations, including the costs incurred by the independent liquidator appointed and the work required to estimate liabilities and realize assets.

Table of Contents

The amount and timing of distributions, if any, to shareholders in a liquidation cannot be predicted at this time because any distribution would depend on a variety of factors, including the amount of proceeds received from any asset sales or dispositions, the time and amount required to resolve outstanding obligations and the amount of any reserves for future contingencies. If we were to become insolvent, it is unlikely that there will be distributions payable to our common shareholders. Common shareholders will rank last in order of priority of distribution in a liquidation.

We are dependent on our executives and other key employees to run-off our business and to identify, evaluate and complete any strategic transaction. We may not be able to retain our personnel or attract any needed new personnel, which may have a material adverse effect on our company and the execution of our run-off plan.

Our failure to retain members of our management team, key employees and other personnel and our inability to attract any needed new personnel or to use our existing personnel in new, altered or expanded roles could significantly and negatively affect our ability to conduct our self-managed run-off and to evaluate and complete any strategic transaction. In order to retain the services of Jonathan J.R. Dodd, our chief financial officer, and a number of other key employees, we have entered into retention agreements with these employees that provide for specified severance payments in the event of their termination without cause or following a change of control. These agreements also contain non-competition and non-solicitation provisions. However, we do not have a retention agreement with Peter D. Johnson, our chief executive officer. He and our other employees who we did not enter into retention agreements with are not restricted from seeking employment with our competitors or others who may seek their expertise.

We face significant litigation relating to alleged securities law violations.

Two class action lawsuits have been filed against Quanta Holdings and certain of its officers and directors on behalf of putative classes consisting of investors who purchased our publicly traded series A preferred securities and common shares. The complaints allege, among other things, that we made false, misleading and incomplete statements regarding loss estimates in violation of the federal securities laws. It is possible that additional lawsuits relating to these matters may be filed against us and/or certain of our current and former officers and directors in the future. It is also possible that administrative proceedings or regulatory proceedings could be commenced against us in the future.

These lawsuits and any future proceedings could be expensive and could divert management’s attention and other resources away from other matters. Any such diversion of management’s attention or other resources could negatively and materially impact our self-managed run-off. We cannot predict the timing of any trials with respect to these lawsuits and any future proceedings. We are not currently able to estimate legal defense costs or the amount of any damages that we may be required to pay in connection with these lawsuits and any future proceedings. The class action lawsuits which could continue for a significant period, are currently at an early stage and we have very little information as to the course either will take. In view of the inherent difficulty of predicting the outcome of litigation, particularly where the claimants seek indeterminate damages, we are unable to predict the outcome of these matters and at this time cannot reasonably estimate the possible loss or range of loss with respect to this lawsuit and any future proceedings.

We have not established any reserves for any potential liability relating to the class action lawsuits. We have insurance coverage (above a certain self-insured retention) with respect to claims such as these lawsuits but it is not currently possible to determine whether such insurance coverage will be adequate to cover our defensive costs and any losses.

The existence of the class action lawsuits or the perceived probability of future proceedings could have a material adverse effect on the market price of our common stock.

Our business, results of operations and financial condition have been and could continue to be adversely affected by catastrophic events.

Although we are no longer writing property reinsurance business that is exposed to catastrophes, certain lines of business that we have underwritten, including marine and aviation reinsurance and

27

environmental, have large aggregate exposures, including to natural and man-made disasters such as hurricane, typhoon, windstorm, flood, earthquake, acts of war, acts of terrorism and political instability for periods of up to ten years. Additionally, we retain property exposure from our program business. Our loss experience generally has and, despite our exit from the property reinsurance and the technical risk property insurance markets, we expect that it will continue to be subject to infrequent events of great severity. In the future we may recognize additional net losses related to Hurricanes Katrina, Rita and Wilma and other catastrophes. If our actual losses from Hurricanes Katrina, Rita and Wilma are materially greater than our estimated losses, our results of operations and financial condition could be materially adversely affected.

We purchase reinsurance for our insurance and reinsurance operations in order to mitigate the volatility of losses upon our financial results. Based on our current estimate of losses related to Hurricanes Katrina and Rita, we have exhausted our reinsurance and retrocessional protection with respect to Hurricane Katrina and our marine reinsurance with respect to Hurricane Rita. If our Hurricane Katrina losses prove to be greater than currently anticipated, we have no further reinsurance and retrocessional coverage available for that windstorm. If our marine reinsurance losses for Hurricane Rita prove greater than currently anticipated, we will have no further retrocessional coverage available for marine reinsurance losses for that windstorm. Additionally, the occurrence of additional large loss events could reduce the reinsurance coverage that is available to us and could weaken the financial condition of our reinsurers, which could have a material adverse effect on our results of operations.

Losses from these types of catastrophic events could eliminate our shareholders’ equity and statutory surplus (which is the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets, as determined under statutory accounting principles). Increases in the values and geographic concentrations of insured property and the effects of inflation have resulted in increased severity of industry losses in recent years and we expect that those factors will increase the severity of catastrophe losses in the future.

We may be required to post additional security under insurance and reinsurance agreements.

If our actual losses exceed our estimates or as a result of future losses and other events, we may be required to post additional security under some of our insurance and reinsurance contracts either through the issuance of letters of credit or the placement of securities in trust under the terms of those insurance or reinsurance contracts. If we fail to maintain or enter into adequate letter of credit facilities on a timely basis, we would be required to place securities in trust or similar arrangements, which would be more difficult and costly to establish and administer and could lead to liquidity strains.

Our reliance on brokers subjects us to their credit risk.

In accordance with industry practice, we frequently pay amounts owed on claims under our insurance or reinsurance contracts to brokers, and these brokers, in turn, are expected to pay these amounts over to the clients that have purchased insurance or reinsurance from us in the past. If a broker fails to make such a payment in a significant portion of business that we write, it is highly likely that we will be liable to the client for the deficiency under local laws or contractual obligations. Likewise, when we are required to return premiums in connection with a cancellation or commutation, the brokers collect these payments from us but these premiums are not considered returned. Accordingly, the policy is not cancelled or commuted and our risk is not terminated until the broker returns these premiums to the client. Lastly, our reinsurers and retrocessionaires in many cases make payments owed to us to brokers and these brokers, in turn, are expected to pay these amounts to us. If a broker fails to make such a payment to us, we may be unsuccessful in obtaining payment from the reinsurer or retrocessionaire or we may incur costs in enforcing the payment of amounts owed to us. Consequently, we assume a degree of credit risk associated with brokers around the world with respect to most of our business.

Table of Contents

If actual claims exceed our loss reserves, our financial position could be significantly adversely affected.

Our success depends upon our ability to accurately assess the risks associated with the businesses that we insured and reinsured. To the extent actual claims exceed our expectations we will be required to immediately recognize the less favorable experience as we become aware of it. This could cause a material increase in our liabilities and reduction of capital. It is early in our history and the number and size of reported claims may increase, and their size could exceed our expectations.

A portion of our business has high attachment points of coverage. Reserving for losses is inherently complicated in that losses in excess of the attachment level of our policies are characterized by high severity and low frequency, and other factors which could vary significantly as claims are settled. This limits the volume of relevant industry claims experience available from which to reliably predict ultimate losses following a loss event. In addition, there always exists a reporting lag between a loss event taking place and the reporting of the loss to us. These incurred but not reported losses are inherently difficult to predict. Because of the variability and uncertainty associated with loss estimation, it is possible that our individual case reserves for each catastrophic event and other case reserves are incorrect, possibly materially.

These factors require us to make significant assumptions when establishing loss reserves. Since we have insufficient past loss experience, we supplement this information with industry data. This industry data may not match our risk profile, which introduces a further degree of uncertainty into the process. Accordingly, actual claims and claim expenses paid may deviate, perhaps substantially, from the reserve estimates reflected in our financial statements.

In our reinsurance business line, like other reinsurers, we do not separately evaluate each of the individual risks assumed under reinsurance treaties. Therefore, we are largely dependent on the original underwriting decisions made by ceding companies. We are subject to the risk that the ceding companies may not have adequately evaluated the risks to be reinsured and that the premiums ceded may not adequately compensate us for the risks we assume.

If our loss reserves are determined to be inadequate, we will be required to increase loss reserves at the time of such determination with a corresponding reduction in our net income in the period in which the deficiency is rectified. It is possible that claims in respect of events that have occurred could exceed our loss reserves and have a material adverse effect on our results of operations or our financial condition in general.

The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations.

We have sought to limit our loss exposure by writing a number of our reinsurance contracts on an excess of loss basis, adhering to maximum limitations on reinsurance written in defined geographical zones, limiting program size for each client and by prudent underwriting of each program written. In the case of proportional treaties, we sought per occurrence limitations or loss ratio caps to limit the impact of losses from any one event. We cannot be sure that any of these loss limitation methods has been or will be effective. We cannot assure you that various provisions of our policies, such as limitations or exclusions from coverage or choice of forum, will be enforceable in the manner we intended. Disputes relating to coverage and choice of legal forum may also arise. Underwriting is inherently a matter of judgment, involving important assumptions about matters that are inherently unpredictable and beyond our control, and for which historical experience and probability analysis may not provide sufficient guidance. As a result, our actual claims could substantially exceed our expectations, which could have a material adverse effect on our financial condition or our results of operations, possibly to the extent of eliminating our shareholders' equity.

A significant amount of our invested assets is subject to market volatility.

We invest the premiums we received from customers. Our investment portfolio currently contains highly rated and liquid fixed income securities. Our investment portfolio is invested by professional investment advisory management firms under the direction of our management team in accordance with our investment guidelines and are subject to market-wide risks and fluctuations, as well as to risks inherent in particular securities. The volatility of our claims may force us to liquidate securities. The obligations under the credit facility are currently fully secured by investments and cash. If a default occurs under the credit agreement, our lenders may require us to cash collateralize a portion or all of the outstanding letters of credit issued under the facility, which may be accomplished through the substitution or liquidation of collateral. These events may cause us to incur capital losses. Our investment results and, therefore, our financial condition may also be impacted by changes in the business, financial condition or results of operations of the entities in which we invest, as well as changes in interest rates, government monetary policies, general economic conditions and overall market conditions. Further, if we do not structure our investment portfolio so that it is appropriately matched with our insurance and reinsurance liabilities, we may be forced to liquidate investments prior to maturity at a significant loss to cover such liabilities. Investment losses could significantly decrease our asset base, which will affect our ability to conduct business.

Our utilization of program managers and other third parties to support our business exposes us to operational and financial risks.

In our program product line, we relied on program managers, and other agents and brokers participating in our programs, to produce and service a substantial portion of our business in this segment. In these arrangements, we typically granted the program manager the right to bind us to newly issued insurance policies, subject to underwriting guidelines we provided and other contractual restrictions and obligations. Should our managers have issued policies that contravene these guidelines, restrictions or obligations, we could nonetheless be deemed liable for these policies. We aim to resist claims related to policies that exceeded or expanded on our underwriting intention, however, it is possible that we would not prevail in such an action, or that our program managers would be unable to substantially indemnify us for their contractual breach.

We also relied on our managers, or other third parties we retained, to collect premiums and to pay valid claims. While we strive to mitigate these risks through our contractual arrangement with the program managers and other third parties, we remain exposed to these credit and operational risks, without necessarily relieving us of our obligations to potential insureds. We could also be exposed to potential liabilities relating to the claims practices of the third-party administrators we have retained to manage claims activity that we expect to arise in our program operations. Although we have implemented auditing and other oversight protocols for our program, we cannot assure you that these measures will be sufficient to alleviate all of these exposures.

Assessments and other surcharges for guaranty funds and similar arrangements may have a negative impact on our financial condition.

Virtually all states in the U.S. require insurers licensed to do business therein to bear a portion of the unfunded obligations of impaired or insolvent insurance companies. These obligations are funded by assessments, which are levied by guaranty associations or similar entities within the state, up to prescribed limits, on all member insurers in the state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired, insolvent or failed insurer was engaged during the period in which the member insurer was engaged in those lines of business. Accordingly, we may be assessed in the future on a portion of premiums we wrote before we commenced our self-managed run-off. The effect of these assessments and arrangements, or changes in them, could have a negative impact on our financial condition in any given period.

The availability of reinsurance and retrocessional coverage that we use to limit our exposure to risks may be limited, and counterparty credit and other risks associated with our reinsurance arrangements may result in losses which could adversely affect our financial condition and results of operations.

To limit our risk of loss and to mitigate the volatility of losses upon our financial results, we used reinsurance and retrocessional coverage, which is reinsurance of a reinsurer’s business. The availability and cost of reinsurance and retrocessional protection is subject to market conditions, which are beyond our control. Currently, there is a high level of demand for these arrangements. The occurrence of additional large loss events could reduce the reinsurance coverage that is available to us and could weaken the financial condition of our reinsurers which could have a material adverse effect on our results of operations. We cannot assure you that we will be able to renew adequate protection at cost-effective levels in the future. Our failure to maintain adequate reinsurance or retrocessional arrangements could adversely affect our business, financial condition and results of operations.

As a result of market conditions and other factors, we may not be able to successfully alleviate risk through reinsurance and retrocessional arrangements. Further, we are subject to credit risk with respect to our reinsurance and retrocessional arrangements because the ceding of risk to reinsurers and retrocessionaires will not relieve us of our liability to the clients or companies we insure or reinsure. In addition, we have experienced some instances of slower payments from, and disputes about amounts owed to us with, our reinsurers and retrocessionaires. As a result, we may incur losses attributable to our inability to recover amounts from retrocessionaires or ceding companies either due to disputes with the retrocessionaires or ceding companies, their financial condition or both. If our reserves for amounts recoverable from retrocessionaires or ceding companies, as well as reserves associated with the underlying reinsurance exposures are insufficient, it could result in losses and an increase in cost and management time related to arbitration and other dispute resolution.

We could face unanticipated losses from war, terrorism and political unrest, and these or other unanticipated losses could have a material adverse effect on our financial condition and results of operations.

We may have exposure to unexpected losses resulting from future man-made catastrophic events, such as acts of war, acts of terrorism and political instability. Although we may attempt to exclude losses from terrorism and certain other similar risks from some coverages we wrote, we may not be successful in doing so. In addition, we have written policies explicitly limiting the exposure of our clients to the credit worthiness of their commercial trade partners in some emerging markets or to political uncertainty in those countries which could interfere with the execution of commercial contracts they have entered into. These risks are inherently unpredictable and may increase the frequency or severity of losses. It is difficult to predict the timing of such events or to estimate the amount of loss that any given occurrence will generate. To the extent that losses from such risks occur, our financial condition and results of operation could be materially adversely affected.

We rely on our information technology and telecommunication systems, and the failure of these systems could materially and adversely affect our business.

We are highly dependent upon the successful and uninterrupted functioning of our information technology and telecommunications systems. We rely on these systems to process claims, commutations and cancellations, to facilitate collections and to monitor our investment portfolio. These systems also enable us to perform actuarial and other modeling functions. We believe our technology and telecommunications systems are critical to our business and our ability to compete successfully. The failure of these systems, or the termination of a third-party software license upon which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we cannot be certain that we will have continued access to these third-party systems and we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. In addition, we cannot make any assurances that our systems will continue to operate as intended. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to write and process new and renewal business and provide customer service or compromise our ability to pay claims in a timely manner. This could result in a material adverse effect on our business.

Our holding company structure and certain regulatory and other constraints, including our credit facility, affect our ability to pay dividends on our shares and return capital.

Quanta Holdings is a holding company. As a result, we do not, and will not, have any significant operations or assets other than our ownership of our subsidiaries. Dividends and other permitted distributions from our operating subsidiaries will be our sole source of funds to pay dividends, if any, to our common shareholders and to meet ongoing cash requirements. Additionally, as we continue to run-off and wind-up our businesses we will be seeking, over time and subject to the approval of our regulators, to extract additional capital from our subsidiaries and dividend it to our holding company where it can be available to our shareholders. Because we are a holding company, our ability to pay additional dividends on our common shares is limited by restrictions on our ability to obtain funds through dividends from our subsidiaries.

The ability of our operating subsidiaries to make payments to Quanta Holdings is limited by the applicable laws and regulations of the domiciles in which the subsidiaries operate. These laws and regulations subject our subsidiaries to significant restrictions and require, among other things, the submission and approval of a withdrawal plan or similar arrangements by regulators, the maintenance by some of our subsidiaries of minimum solvency requirements and the limitation of the amount of dividends that these subsidiaries can pay to us. In addition, following the withdrawal of our A.M. Best rating, the BMA, the regulator of one or our principal insurance subsidiaries, Quanta Re, amended Quanta Re’s license to, among other things, restrict it from making any dividend payments to Quanta Holdings without the prior approval of the BMA and to prohibit it from entering into certain transactions. The inability of our operating subsidiaries to pay dividends or to return capital in an amount sufficient to enable us to meet our cash requirements at the holding company level could have a material adverse effect on our operations and on our ability to pay additional dividends. The paying of dividends or the return of capital to the holding company requires regulatory approval. We have worked, and will continue to work, over time, with applicable regulatory authorities to facilitate further dividends from our insurance subsidiaries to Quanta Holdings. Working with these regulators takes time and will require us to meet many conditions, especially given that most of our business is in run-off.

We are subject to Bermuda regulatory constraints that affect our ability to pay dividends on our shares and make other payments. Under the Companies Act 1981 of Bermuda, as amended, or the Companies Act, even though we are solvent and able to pay our liabilities as they become due, we may not declare or pay a dividend or make a distribution if we have reasonable grounds for believing that we are, or will after the payment be, unable to pay our liabilities as they become due or if the realizable value of our assets will thereby be less than the aggregate of our liabilities and our issued share capital and share premium accounts.

Our business could be adversely affected by Bermuda employment restrictions.

We have hired a number of non-Bermudians to work for us in Bermuda. Under Bermuda law, non-Bermudians (other than spouses of Bermudians) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian) or a holder of a permanent resident’s certificate or holder of a working resident’s certificate is available who meets the minimum standard requirements for the advertised position. The Bermuda government recently announced a new policy limiting the duration of work permits to six years, with certain exemptions for key employees. While we have been able to obtain work permits that we have needed for our employees to date, we can not assure you that we will not encounter difficulties in the future. We may not be able to use the services of one or more of our key employees if we are not able to obtain work permits for them, which could have a material adverse effect on our business.

We may be adversely affected by interest rate changes.

Our investment portfolio contains interest rate-sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates. Because of the unpredictable nature of losses that may arise under insurance and reinsurance policies, we expect our liquidity needs will be substantial and may arise at any time. Increases in interest rates during periods when we sell investments to satisfy liquidity needs may result in losses. Changes in interest rates could also have an adverse effect on our investment income and results of operations. For example, if interest rates decline, reinvested funds will earn less than expected.

In addition, our investment portfolio includes highly-rated mortgage-backed securities. As with other fixed income investments, the fair market value of these securities fluctuates depending on market and other general economic conditions and the interest rate environment. Changes in interest rates can expose us to prepayment risks on these investments. In periods of declining interest rates, mortgage prepayments generally increase and mortgage-backed securities are prepaid more quickly, requiring us to reinvest the proceeds at the then current market rates. In periods of increasing interest rates, these investments are exposed to extension risk, which occurs when the holders of underlying mortgages reduce the frequency on which they prepay the outstanding principal before the maturity date and delay any refinancing of the outstanding principal.

Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond our control. Although we attempt to take measures to manage the risks of investing in a changing interest rate environment, we may not be able to mitigate interest rate sensitivity effectively. Our mitigation efforts include maintaining a high quality portfolio with a relatively short duration to reduce the effect of interest rate changes on book value. Despite our mitigation efforts, a significant increase in interest rates could have a material adverse effect on our book value.

Fluctuations in currency exchange rates may cause us to experience losses.

Our functional currency is the U.S. dollar. Our operating currency generally is also the U.S. dollar. However, the premiums receivable and losses payable in respect of a portion of our business is denominated in currencies of other countries. For example, Quanta Europe operated in a variety of currencies. We attempt to manage our foreign currency risk by seeking to match our liabilities under insurance and reinsurance policies that are payable in foreign currencies either with forward purchase contracts or with investments that are denominated in these currencies.

To the extent we believe that it may be practical, we hedge our foreign currency exposure with respect to potential losses by maintaining assets denominated in the same currency or entering into forward purchase contracts for specific currencies. We may use forward purchase contracts if we are advised of known or probable significant losses that will be paid in non-U.S. currencies in order to manage currency fluctuation exposure. We may also use forward purchase contracts to hedge our non-U.S. dollar currency exposure with respect to premiums receivable, which will be generally collected over the relevant contract term to the extent practical and to the extent we do not expect we will need these receipts to fund potential losses in such currencies. We may also make foreign currency-denominated investments, generally for the purpose of improving overall portfolio yield. However, we may not be successful in reducing foreign currency exchange risks. As a result, we may from time to time experience losses resulting from fluctuations in values of foreign currencies, which could have a material adverse effect on our results of operations.

Our returns may be adversely impacted by inflation.

The effects of inflation could cause the severity of claims to rise in the future. Our reserve for losses and loss expenses will include assumptions about future payments for settlement of claims and claims handling expenses, such as medical treatments and litigation costs. To the extent inflation causes these costs to increase above reserves established for these costs, we would be required to increase our loss reserves with a corresponding reduction in our net income in the period in which the deficiency is identified.

Our liability transfer program may expose us to liability.

We have created two liability assumption programs under which a special-purpose entity assumes specified liabilities associated with environmental exposures. Our liability assumption program requires extensive technical skills and judgments in order to evaluate the significant risks associated with the properties subject to the program. We are exposed to substantial liabilities related to the environmental conditions associated with assuming liabilities with respect to these properties that could materially adversely affect our financial position.

Table of Contents

We are subject to extensive regulation in Bermuda, the United States and Ireland, which may adversely affect our ability to achieve our run-off objectives. If we do not comply with these regulations, we may be subject to penalties, including fines, suspensions and withdrawals of licenses, which may adversely affect our financial condition and results of operations.

We are subject to extensive governmental regulation and supervision. Most insurance regulations are designed to protect the interests of policyholders rather than shareholders and other investors. These regulations, generally administered by a department of insurance in each jurisdiction in which we will do business, relate to, among other things:

- standards of solvency, including risk-based capital measurements;
- licensing of insurers and their agents;
- limits on the size and nature of risks assumed;
- restrictions on the nature, quality and concentration of investments;
- restrictions on the ability of our insurance company subsidiaries to pay dividends to us;
- restrictions on our ability to transfer shares in our insurance company subsidiaries;
- restrictions on transactions between insurance company subsidiaries and their affiliates;
- restrictions on the size of risks insurable under a single policy;
- requiring deposits for the benefit of policyholders;
- approval of policy forms and premium rates;
- requiring certain methods of accounting;
- periodic examinations of our operations and finances;
- prescribing the form and content of records of financial condition required to be filed; and
- requiring reserves for unearned premium, losses and other purposes.

Insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. These regulatory requirements and the periodic examinations which, because of our run-off activities, we may be more frequently subject to than more established companies, may adversely affect or inhibit our ability to achieve some or all of our business objectives.

Regulation in the United States. In recent years, the state insurance regulatory framework in the United States has come under increased federal scrutiny, and some state legislators have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. Moreover, the National Association of Insurance Commissioners, which is an association of the insurance regulatory officials of all 50 states and the District of Columbia, and state insurance regulators regularly reexamine existing laws and regulations, interpretations of existing laws and the development of new laws. In addition, surplus lines associations in various states are asserting themselves more aggressively. Federal legislation is also being discussed that would require all states to adopt uniform standards relating to the regulation of products, licensing, rates and market conduct. We are unable to predict whether any of these or other proposed laws and regulations will be adopted, the form in which any such laws and regulations would be adopted, or the effect, if any, these developments would have on our run-off operations and financial condition.

We are subject to numerous federal regulations, including the Securities Act of 1933, the Exchange Act and other federal securities laws. As we continue with the run-off of our business, we must monitor our compliance with these laws, including our maintenance of any available exemptions from registration as an investment company under the Investment Company Act of 1940. Any failure to comply with these laws or maintain our exemption could have a material adverse effect on our operations and on the market price of our common shares.

Regulation in Bermuda. Quanta Re and Quanta U.S. Re are registered Bermuda insurance companies and subject to regulation and supervision in Bermuda. The applicable Bermuda statutes and regulations generally are designed to protect insureds and ceding insurance companies, not our shareholders. Quanta Re and Quanta U.S. Re are not registered or licensed as insurance companies in any jurisdiction outside Bermuda, conduct business through offices in Bermuda and do not maintain an office, and their personnel do not conduct any insurance activities, in the United States or elsewhere. Inquiries or challenges to the activities of Quanta Re or Quanta U.S. Re. may be raised in the future.

Regulation in Ireland. Quanta Europe is a non-life insurance company incorporated under the laws of Ireland subject to the regulation and supervision of the Irish Financial Regulator, or FR, under the Irish Insurance Acts, 1909 to 2000 and the regulations relating to insurance business and directions made under those regulations, or together, the Insurance Acts and Regulations. In addition, Quanta Europe is subject to certain additional supervisory requirements of the FR for authorized non-life insurers that fall outside the strict legislative framework, such as guidelines issued by the FR in 2001 requiring actuarial certification of certain reserves. Among other things, without consent of the FR, Quanta Europe is not permitted to reduce the level of its initial capital, or make any dividend payments or loans.

We may be subject to U.S. tax that may have a material adverse effect on our results of operations and your investment.

Quanta Holdings and Quanta Re are Bermuda companies and Quanta Europe is an Irish company. We believe we are managing our business so that each of these companies is not treated as engaged in a trade or business within the United States and, as a result, will not be subject to U.S. tax (other than U.S. excise tax on insurance and reinsurance premium income attributable to insuring or reinsuring U.S. risks and U.S. withholding tax on certain U.S. source investment income). However, because there is considerable uncertainty as to what activities constitute being engaged in a trade or business within the United States, we cannot be certain that the U.S. Internal Revenue Service will not be able to successfully contend that any of Quanta Holdings or its foreign subsidiaries are engaged in a trade or business in the United States. If Quanta Holdings or any of its foreign subsidiaries were considered to be engaged in a business in the United States, we could be subject to U.S. corporate income and branch profits taxes on the portion of our earnings effectively connected to such U.S. business, in which case our results of operations and your investment could be materially adversely affected. See ‘‘Item 1. Business—Material Tax Considerations—Certain U.S. Federal Income Tax Considerations—U.S. Taxation of Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines, Quanta U.S. Re and Quanta Indemnity.’’

Quanta Holdings’ U.S. subsidiaries might be subject to additional U.S. tax on a portion of their income if a subsidiary is considered a personal holding company, or PHC, for U.S. federal income tax purposes. This status will depend on whether more than 50% of our shares by value could be deemed to be owned (under some constructive ownership rules) by five or fewer individuals and whether 60% or more of the income of any of its U.S. subsidiaries, as determined for U.S. federal income tax purposes, consists of ‘‘personal holding company income,’’ which is, in general, certain forms of passive and investment income. We believe based upon information made available to us regarding our shareholder base that none of Quanta Holdings’ subsidiaries should be considered a PHC. Additionally, we believe we are managing our business to minimize the possibility that we will meet the 60% income threshold. However, because of the lack of complete information regarding our ultimate share ownership (i.e., as determined by the constructive ownership rules for PHCs), we cannot assure you that none of Quanta Holdings’ subsidiaries will be considered a PHC or that the amount of U.S. tax that would be imposed if it were not the case would be immaterial. See ‘‘Item 1. Business—Material Tax Considerations—Certain U.S. Federal Income Tax Considerations—U.S. Taxation of Quanta Holdings, Quanta Re, Quanta Europe, Quanta U.S. Holdings, Quanta Specialty Lines, Quanta U.S. Re and Quanta Indemnity—Personal Holding Companies.’’

We may be subject to additional Irish tax or U.K. tax.

If any of our non-Irish companies were considered to be resident in Ireland, or to be doing business in Ireland, or, in the case of our U.S. subsidiaries which qualify for the benefits of an existing

35

Table of Contents

tax treaty with Ireland, to be doing business through a permanent establishment in Ireland, those companies would be subject to Irish tax. If we or any of our subsidiaries were considered to be resident in the United Kingdom, or to be carrying on a trade in the United Kingdom through a permanent establishment in the United Kingdom, those companies would be subject to United Kingdom tax. If any of our U.S. subsidiaries were subject to Irish tax or U.K. tax, that tax would generally be creditable against their U.S. tax liability, subject to limitations. If we or any of our Bermuda subsidiaries were subject to Irish tax or U.K. tax, that could have a material adverse impact on our results of operation and on the value of our shares.

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

A number of multinational organizations, including the European Union, the Financial Action Task Force, the Financial Stability Forum, and the Organization for Economic Cooperation and Development, which is commonly referred to as the OECD, have 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. Tax haven jurisdictions that do not cooperate with the OECD could face sanctions imposed by OECD member countries. In the OECD's report dated June 26, 2000, Bermuda was not listed as a tax haven jurisdiction because it had previously signed a letter committing itself to eliminate harmful tax practices by the end of 2005 and to embrace international tax standards for transparency, exchange of information and the elimination of any aspects of the regimes for financial and other services that attract business with no substantial domestic activity. We are not able to predict what changes will arise from the commitment or whether these changes will subject us to additional taxes. In addition, we cannot assure you that the OECD will not adopt measures that will have a negative impact on Bermuda companies.

We may become subject to taxes in Bermuda after March 28, 2016, which may have a material adverse effect on our results of operations and your investment.

The Bermuda Minister of Finance, under the Exempted Undertakings Tax Protection Act 1966, as amended, of Bermuda, has given each of Quanta Holdings, Quanta Re and Quanta U.S. Re, 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 the imposition of any such tax will not be applicable to Quanta Holdings, Quanta Re and Quanta U.S. Re or any of their operations, shares, debentures or other obligations until March 28, 2016. See ''Item 1. Business—Material Tax Considerations—Certain Bermuda Tax Considerations.'' 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.

Risks Related to the Industry

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected issues related to claims and coverage may emerge. These issues may adversely affect the run-off of our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued insurance or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance or reinsurance contracts may not be known for many years after a contract is issued.

Recent examples of emerging claims and coverage issues include:

- larger settlements and jury awards against professionals and corporate directors and officers covered by professional liability and directors' and officers' liability insurance; and

36

- a growing trend of plaintiffs targeting property and casualty insurers in purported class action litigation relating to claims-handling, insurance sales practices and other practices related to the conduct of business in our industry.

The effects of these and other unforeseen emerging claim and coverage issues are extremely hard to predict and could harm our business, financial condition and results of operations.

Risks Related to our Securities

Provisions in our charter documents may reduce or increase the voting power associated with our shares.

Our bye-laws generally provide that common shareholders have one vote for each common share held by them and are entitled to vote, on a non-cumulative basis, at all meetings of shareholders.

Pursuant to a mechanism specified in our bye-laws, the voting rights exercisable by a shareholder may be limited so that certain persons or groups are not deemed to hold more than 9.5% of the voting power conferred by our shares. In addition, our board of directors retains certain discretion to make adjustments to the aggregate number of votes attaching to the shares of any shareholder that they consider fair and reasonable in all the circumstances to ensure that no person will hold more than 9.5% of the voting power represented by our then outstanding shares.

Under these provisions, some shareholders may have the right to exercise their voting rights limited to less than one vote per share. Moreover, these provisions could have the effect of reducing the voting power of certain shareholders who would not otherwise be subject to the limitation by virtue of their direct share ownership. As a result of any reduction in the votes of other shareholders, your voting power might increase above 5% of the aggregate voting power of the outstanding shares, which may result in your becoming a reporting person subject to Schedule 13D or 13G filing requirements under the Securities Exchange Act of 1934, as amended, or the Exchange Act.

We also have the authority under our bye-laws to request information from any shareholder for the purpose of determining whether a shareholder's voting rights are to be reduced pursuant to the bye-laws. If a shareholder fails to respond to our request for information or submits incomplete or inaccurate information in response to our request, we may, in our sole discretion, determine that the votes of that shareholder shall be disregarded until the shareholder provides the requested information.

It may be difficult for a third party to acquire us.

Provisions of our organizational documents may discourage, delay or prevent a merger, tender offer or other change of control that holders of our shares may consider favorable. These provisions impose various procedural and other requirements that could make it more difficult for shareholders to effect various corporate actions. These provisions could:

- have the effect of delaying, deferring or preventing a change in control of us;
- discourage bids for our securities at a premium over the price;
- adversely affect the price of, and the voting and other rights of the holders of, our securities; or
- impede the ability of the holders of our securities to change our management.

U.S. persons who own our shares may have more difficulty in protecting their interests than U.S. persons who are shareholders of a U.S. corporation.

The Companies Act, which applies to us, differs in certain material respects from laws generally applicable to U.S. corporations and their shareholders including:

- Interested director transactions. Under Bermuda law and our bye-laws, any transaction entered into by us in which a director has an interest is not voidable by us nor can such

37

director be accountable to us for any benefit realized under that transaction provided the nature of the interest is disclosed at the first opportunity at a meeting of directors, or in writing to the directors. In addition, our bye-laws allow a director to be taken into account in determining whether a quorum is present and to vote on a transaction in which he has an interest following a declaration of the interest pursuant to the Companies Act unless the chairman of the meeting determines otherwise. U.S. companies are generally required to obtain the approval of a majority of disinterested directors or the approval of shareholders before entering into any transaction or arrangement in which any of their directors have an interest, unless the transaction or arrangement is fair to the company at the time it is authorized by the company's board or shareholders.

• Certain transactions with significant shareholders. As a Bermuda company, we may enter into certain business transactions with our significant shareholders, including asset sales, in which a significant shareholder receives, or could receive, a financial benefit that is greater than that received, or to be received, by other shareholders. Such transactions may be entered into with prior approval from our board of directors but without obtaining prior approval from our shareholders. U.S. companies in general may not enter into business combinations with interested shareholders, namely certain large shareholders and affiliates, unless the business combination had been approved by the board in advance or by a supermajority of shareholders or the business combination meets specified conditions.

• Shareholders' suits. The rights of shareholders under Bermuda law are not as extensive as the rights of shareholders under legislation or judicial precedent in many U.S. jurisdictions. Class actions and derivative actions are generally not available to shareholders under the laws of Bermuda. In general, under Bermuda law, derivative actions are permitted only when the act complained of is alleged to be beyond the corporate power of the company, is illegal or would result in the violation of the company's memorandum of association or bye-laws. In addition, Bermuda courts would consider permitting a derivative action for acts that are alleged to constitute a fraud against the minority shareholders or, for instance, acts that require the approval of a greater percentage of the company's shareholders than those who actually approved them.

• Indemnification of directors and officers. Under Bermuda law and our bye-laws, we may indemnify our directors, officers or any other person appointed to a committee of the board of directors (and their respective heirs, executors or administrators) to the full extent permitted by law against all actions, costs, charges, liabilities, loss, damage or expense incurred or suffered by such person by reason of any act done, concurred in or omitted in the conduct of our business or in the discharge of his/her duties; provided that such indemnification shall not extend to any matter involving any fraud or dishonesty (as determined in a final judgment or decree not subject to appeal) on the part of such director, officer or other person. Under our bye-laws, each of our shareholders agrees to waive any claim or right of action, other than those involving fraud or dishonesty, against us or any of our officers or directors. In general, U.S. companies may limit the personal liability of their directors as long as they acted in good faith and without knowing violation of law.

As a result of these differences, U.S. persons who own our shares may have more difficulty protecting their interests than U.S. persons who own shares of a U.S. corporation.

We are a Bermuda company and it may be difficult for you to enforce judgments against us or our directors and executive officers.

We are incorporated under the laws of Bermuda and our business is based in Bermuda. In addition, some of our officers reside outside the United States, and all or a substantial portion of our assets and the assets of these persons are, and will continue to be, located in jurisdictions outside the United States. As such, it may be difficult or impossible to effect service of process within the United States upon us or those persons or to recover against us or them on judgments of U.S. courts, including judgments predicated upon civil liability provisions of the U.S. federal securities laws.

Further, no claim may be brought in Bermuda against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial jurisdiction under Bermuda law and do not have force of law in Bermuda. A Bermuda court may, however, impose civil liability, including the possibility of monetary damages, on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda law.

We have been advised that there is doubt as to whether the courts of Bermuda would enforce judgments of U.S. courts obtained in actions against us or our directors and officers predicated upon the civil liability provisions of the U.S. federal securities laws or original actions brought in Bermuda against us or these persons predicated solely upon U.S. federal securities laws. Further, we have been advised that there is no treaty in effect between the United States and Bermuda providing for the enforcement of judgments of U.S. courts, and there are grounds upon which Bermuda courts may not enforce judgments of U.S. courts. Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Bermuda courts as contrary to that jurisdiction's public policy. Because judgments of U.S. courts are not automatically enforceable in Bermuda, it may be difficult for you to recover against us based upon such judgments.

Holders of our shares who own 10% or more of our voting power may be subject to taxation under the ''controlled foreign corporation,'' or CFC, Rules.

Each ''10% U.S. Shareholder'' of a foreign corporation that is a CFC for an uninterrupted period of 30 days or more during a taxable year, and that owns shares in the CFC directly or indirectly through foreign entities on the last day of the CFC's taxable year, must include in its gross income for U.S. federal income tax purposes its pro rata share of the CFC's ''subpart F income,'' even if the subpart income is not distributed. A foreign corporation is considered a CFC if ''10% U.S. Shareholders'' own more than 50% of the total combined voting power of all classes of voting stock of the foreign corporation, or the total value of all stock of the corporation. A 10% U.S. Shareholder is a U.S. person, as defined in the Internal Revenue Code, that owns at least 10% of the total combined voting power of all classes of stock entitled to vote of the foreign corporation. A CFC also includes a foreign corporation in which more than 25% of the total combined voting power of all classes of stock (or more than 25% of the total value of the stock) is owned by 10% U.S. Shareholders, on any day during the taxable year of such corporation, if the gross amount of premiums or other consideration for the reinsurance or the issuing of insurance or annuity contracts generating subpart F income exceeds specified limits. For purposes of determining whether a corporation is a CFC, and therefore whether the more-than-50% (or more-than-25%, in the case of insurance income) and 10% ownership tests have been satisfied, shares owned includes shares owned directly or indirectly through foreign entities or shares considered owned under constructive ownership rules. The attribution rules are complicated and depend on the particular facts relating to each investor.

Due to certain bye-law provisions that impose limitations on the concentration of voting power of its shares and that authorize the board to purchase our shares under specified circumstances we believe that we could seek, under certain circumstances, to take action to prevent shareholders from becoming 10% U.S. Shareholders. It is possible, however that the IRS could challenge the effectiveness of these provisions and that a court could sustain such a challenge.

If we determine that your ownership of our shares may result in adverse consequences, we may require you to sell your shares to us.

Our bye-laws provide that we have the option, but not the obligation, to require a shareholder to sell its shares at a purchase price equal to their fair market value to us, to other shareholders or to third parties if our board of directors in its absolute discretion determines that the share ownership of that shareholder may result in adverse tax consequences to us, any of our subsidiaries or any other shareholder. To the extent possible under the circumstances, the board of directors will use its best

39

Table of Contents

efforts to exercise this option equally among similarly situated shareholders. Our right to require a shareholder to sell its shares to us will be limited to the purchase of a number of shares that we determine is necessary to avoid or cure those adverse tax consequences.

U.S. persons who hold shares could be subject to adverse tax consequences if we are considered a ‘‘passive foreign investment company’’ for U.S. federal income tax purposes.

We do not intend to conduct our activities in a manner that would cause us to become a passive foreign investment company. However, it is possible that we could be deemed a passive foreign investment company by the IRS for any prior or future year. If we were considered a passive foreign investment company it could have material adverse tax consequences for an investor that is subject to U.S. federal income taxation, including subjecting the investor to a greater tax liability than might otherwise apply or subjecting the investor to tax on amounts in advance of when tax would otherwise be imposed. There are currently no regulations regarding the application of the passive foreign investment company provisions to an insurance company. New regulations or pronouncements interpreting or clarifying these rules may be issued in the future. We cannot predict what impact, if any, this guidance would have on a shareholder that is subject to U.S. federal income taxation. We have not sought and do not intend to seek an opinion of legal counsel as to whether or not we were a passive foreign investment company for any period.

U.S. persons who hold shares may be subject to U.S. income taxation on their pro rata share of our ‘‘related party insurance income.’’

If:

- Quanta Europe’s or Quanta Re’s related party insurance income equals or exceeds 20% of that company’s gross insurance income in any taxable year,
- direct or indirect insureds (and persons related to such insureds) own (or are treated as owning directly or indirectly) 20% or more of the voting power or value of the shares of Quanta Europe or Quanta Re, and
- U.S. persons are considered to own in the aggregate 25% or more of the stock of either corporation by vote or value,

then a U.S. person who owns shares of Quanta Holdings directly or indirectly through foreign entities on the last day of the taxable year would be required to include in its income for U.S. federal income tax purposes the shareholder’s pro rata share of Quanta Europe’s or Quanta Re’s related party insurance income for the U.S. person’s taxable year that includes the end of the corporation’s taxable year determined as if such related party insurance income were distributed proportionately to such U.S. shareholders at that date regardless of whether such income is distributed. In addition any related party insurance income that is includible in the income of a U.S. tax-exempt organization will be treated as unrelated business taxable income. The amount of related party insurance income earned by Quanta Europe or Quanta Re (generally, premium and related investment income from the direct or indirect insurance or reinsurance of any direct or indirect U.S. shareholder of Quanta Europe or Quanta Re or any person related to such shareholder) will depend on a number of factors, including the geographic distribution of Quanta Europe’s or Quanta Re’s business and the identity of persons directly or indirectly insured or reinsured by Quanta Europe or Quanta Re. Although we do not expect our related party insurance income to exceed 20% of our gross insurance income in the foreseeable future, some of the factors which determine the extent of related party insurance income in any period may be beyond Quanta Europe’s or Quanta Re’s control. Consequently, Quanta Europe’s or Quanta Re’s related party insurance income could equal or exceed 20% of its gross insurance income in any taxable year and ownership of its shares by direct or indirect insureds and related persons could equal or exceed the 20% threshold described above.

The related party insurance income rules provide that if a shareholder that is a U.S. person disposes of shares in a foreign insurance corporation that has related party insurance income (even if the amount of related party insurance income is less than 20% of the corporation's gross insurance income or the ownership of its shares by direct or indirect insureds and related persons is less than the 20% threshold) and in which U.S. persons own 25% or more of the shares, any gain from the disposition will generally be treated as ordinary income to the extent of the shareholder's share of the corporation's undistributed earnings and profits that were accumulated during the period that the shareholder owned the shares (whether or not such earnings and profits are attributable to related party insurance income). In addition, such a shareholder will be required to comply with reporting requirements, regardless of the amount of shares owned by the shareholder. These rules should not apply to dispositions of our shares because Quanta Holdings will not itself be directly engaged in the insurance business and because proposed U.S. Treasury regulations appear to apply only in the case of shares of corporations that are directly engaged in the insurance business. However, the IRS might interpret the proposed regulations in a different manner and the applicable proposed regulations may be promulgated in final form in a manner that would cause these rules to apply to dispositions of our shares.

Changes in U.S. federal income tax law could materially adversely affect an investment in our shares.

The U.S. federal income tax laws and interpretations regarding whether a company is engaged in a trade or business within the United States, or is a passive foreign investment company or whether U.S. persons would be required to include in their gross income the subpart F income or the related party insurance income of a CFC are subject to change, possibly on a retroactive basis. There are currently no regulations regarding the application of the passive foreign investment company rules to insurance companies and the regulations regarding related party insurance income are still in proposed form. New regulations or pronouncements interpreting or clarifying such rules may be issued in the future. We cannot be certain if, when or in what form such regulations or pronouncements may be provided and whether such regulations or guidance will have a retroactive effect.

Information Regarding Forward-Looking Statements

Some of the statements included in this annual report, including those using words such as ‘‘believes,’’ ‘‘expects,’’ ‘‘intends,’’ ‘‘estimates,’’ ‘‘projects,’’ ‘‘predicts,’’ ‘‘assumes,’’ ‘‘anticipates,’’ ‘‘plans,’’ and ‘‘seeks’’ and comparable terms, are forward-l statements. The Private Securities Litigation Reform Act of 1995 provides a ‘‘safe harbor’’ for forward-looking statements. Forward-looking statements are not statements of historical fact and reflect our views and assumptions as of the date of this annual report regarding future events and operating performance. Because of our limited operating history, many statements relating to us and our self-managed run-off including statements relating to our position, operations and business strategies, are forward-looking statements.

All forward-looking statements address matters that involve risks and uncertainties. There are important factors that could cause our actual results to differ materially from those indicated in these statements. We believe that these factors include but are not limited to the following:

• We have placed all of our lines of businesses in run-off. Running off these businesses includes a number of risks, including the risk that we may not be able to mitigate our existing exposures to our historical underwriting risks, obtain the release of collateral when contracts are cancelled, recover amounts owed to us by our reinsurers and retrocessionaires, enter into commutations or other arrangements to mitigate our liabilities, obtain premium that has been due but not paid to us for an extended period of time, release capital from our subsidiaries to our holding company where it is available to our shareholders, reduce our expenses such that they do not exceed income from investments, prevent investment losses, maintain sufficient liquidity in each of our subsidiaries to meet the obligations of those subsidiaries or retain control over our subsidiaries;

• The execution of

our run-off plan is expected to create substantial uncertainties and risks that may result in restructuring charges and unforeseen expenses and costs, including expenses related to increased arbitration activities as we seek to enforce our rights. In addition, as a result of commutations, loss portfolio transfers or other transactions, we may realize gains or losses of assets and liabilities that are different than the amount at which these are currently recorded. There can be no assurance that any of these initiatives or their results will not negatively impact our results of operations;

Table of Contents

- Our existing policy obligations in certain lines of business that we have underwritten, including marine and aviation reinsurance and environmental insurance, continue to have large aggregate exposures to natural and man-made disasters such as hurricane, typhoon, windstorm, flood, earthquake, acts of war, acts of terrorism and political instability, in certain cases for in excess of ten years, and our results may continue to be volatile as a result;
- Our ability to pay additional dividends from our subsidiaries to Quanta Holdings is restricted by regulations in Bermuda, several states in the United States and the European Union. In addition, the BMA has, pursuant to its regulatory discretion, amended the license of Quanta Re, our principal subsidiary in Bermuda, to require that it, among other things, seek the approval from the BMA prior to paying any dividend to Quanta Holdings and prohibiting it from engaging in any new transactions. We will continue to work with the applicable regulatory authorities to facilitate dividends from our insurance operating subsidiaries to Quanta Holdings. Completing this work is expected to take a long period of time and requires us to meet many conditions, particularly the discharge of all our policy obligations;
- Our current estimates of our exposure to ultimate claim costs associated with Hurricanes Katrina, Rita and Wilma are based on available information, claims notifications received to date, industry loss estimates, output from industry models, a review of affected contracts and discussions with brokers and clients. The actual amount of losses from Hurricanes Katrina, Rita and Wilma may vary significantly from our estimates based on such data, which could have a material adverse effect on our financial condition or our results of operations;
- Our ability to execute our run-off plan and evaluate and complete any strategic transactions is dependent on our ability to retain our, or attract any needed new, executives and key employees. Our inability to retain, attract and integrate members of our management team, key employees and other personnel could significantly and negatively affect the execution of our run-off plan and the preservation of shareholder value;
- If actual claims exceed our loss reserves, our financial results could be significantly adversely affected;
- The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations;
- Based on our current estimate of losses related to Hurricanes Katrina and Rita, we have exhausted our reinsurance and retrocessional protection with respect to Hurricane Katrina and our marine reinsurance with respect to Hurricane Rita. If our Hurricane Katrina and Rita losses prove to be greater than currently anticipated, we have no further reinsurance and retrocessional coverage available for those windstorms. Furthermore, if there are further catastrophic events relating to our underwriting exposures, our retrocessional coverage for these events may be limited or we may have no coverage at all;
- If we receive additional premium estimate reductions and cancellations in future periods, we may not receive all of our premiums receivable in cash, and our cash flows could be adversely affected;
- We have a significant amount due from reinsurers and retrocessionaires who may refuse to pay our claims because we are a run-off company or for other reasons even when we believe those payments are contractually due to us. These actions, if taken, will increase our expenses as we take legal action and if we are unsuccessful in recovering these amounts, may have a negative impact on our financial results and position;
- Changes in the future availability, cost or quality of reinsurance;
- Risks relating to potential litigation and arbitration;

- Changes in regulation or tax laws applicable to us or our customers;
- Risks relating to our reliance on program managers, third-party administrators, consultants and other supporting vendors for claims handling, data, premium collection, IT and administrative functions;

42

Table of Contents

- Changes in accounting policies or practices; and
- Changes in general economic conditions, including inflation, foreign currency exchange rates, interest rates and other factors.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from our projections. Additionally, the list of factors above is not exhaustive and should be read with the other cautionary statements that are included in this annual report under ‘‘Item 1A. Risk Factors’’ and that are otherwise described from time to time in our U.S. Securities and Exchange Commission reports filed after this annual report. Any forward-looking statements you read in this annual report reflect our current views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to, among other things, our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by this paragraph. You should specifically consider the factors identified in this annual report that could cause actual results to differ from those discussed in the forward-looking statements before making an investment decision. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future events or otherwise.

Market data and forecasts used in this annual report have been obtained from independent industry sources as well as from research reports prepared for other purposes. We have not independently verified the data obtained from these sources and we cannot assure you of the accuracy or completeness of the data. Forecasts and other forward-looking information obtained from these sources are subject to the same qualifications and uncertainties applicable to the other forward-looking statements in this annual report.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We have entered into a lease for office space in Bermuda that contains 5,400 square feet. The lease expires on September 30, 2010. The annual lease payment for this office space is approximately $244,300.

The lease for office space in Dublin expired on July 31, 2007. However, we extended this lease for a further period expiring on June 30, 2008 and moved into a smaller office of approximately 80 square feet. This lease may be cancelled prior to that date following three months notice. The annual lease payments for this office space is approximately $55,000

The headquarters of Quanta U.S. Holdings and our other U.S. subsidiaries is located in New York, New York and contains approximately 13,650 square feet. The term of the lease expires in February 2012 with an option to extend the lease term by an additional five years. The annual lease payment for this office starts at approximately $464,100 and increases in annual increments to approximately $555,220 at the end of the lease term. Our other offices in the U.S. are located in Hartford, Connecticut with a lease cost of approximately $230,000 per year.

We believe that these facilities are sufficient for our current purposes and that alternative space will be available, if needed, on commercially reasonable terms.

Item 3. Legal Proceedings

On February 5, 2007, plaintiff Harold Zirkin filed a complaint against the Company in the U.S. District Court for the Southern District of New York. (Zirkin v. Quanta Capital Holdings, Ltd. et al., U.S. District Court, Southern District of New York, Case No. 07 CV 851.) On February 26, 2007, plaintiff Jorge Coronel filed a complaint against the Company in the same Court. (Coronel v. Quanta Capital Holdings, Ltd. et al., U.S. District Court, Southern District of New York, Case No. 07 CV 1405.) Both complaints alleged that the Company violated the federal securities laws as a result of false or misleading statements in disclosures to the investing public.

Table of Contents

Both of these cases are now pending before U.S. District Judge Robert P. Patterson, Jr. On May 7, 2007, Judge Patterson appointed Zirkin-Cutler Investments, Inc. as lead plaintiff for a putative class of investors who purchased our preferred shares, and appointed Washington State Plumbing and Pipefitting Pension Trust as lead plaintiff for a putative class of investors who purchased our common shares. Judge Patterson directed Zirkin and Washington to filed amended pleadings that would supersede the complaints previously filed by Mr. Zirkin and Mr. Coronel.

On July 16, 2007, Zirkin filed an Amended Complaint (the ''Zirkin Complaint''). Zirkin purports to sue on behalf of itself and a class of investors who purchased preferred shares of the Company between December 14, 2005 and March 2, 2006. The Zirkin Complaint alleges that the Company made false statements concerning reserves for hurricane-related losses in a registration statement and prospectus that were circulated to investors in connection with a securities offering the Company completed in December 2005. The complaint alleges that the Company is liable under Sections 11 and 12(a)(2) of the Securities Act of 1933.

Zirkin has named as defendants, in addition to the Company, two firms that served as underwriters for this offering (Friedman, Billings, Ramsey & Co., Inc. and BB&T Capital Markets), and six individuals who served as officers or directors of the company at the time of the offering (James Ritchie, Jonathan Dodd, Robert Lippincott III, Michael Murphy, Nigel Morris, and W. Russell Ramsey).

Washington filed a separate Amended Complaint (the ''Washington Complaint'') on July 16, 2007. Washington purports to sue on behalf of itself and a class of investors who purchased our common shares between October 4, 2005 and April 3, 2006. The Washington Complaint alleges that during that period, the Company made false and misleading statements, and omitted to state material information, in various disclosures. The disclosures and alleged omissions at issue in the case relate to reserves for hurricane-related losses, reserves related to an oil pipeline leak, and the quality of the Company’s internal controls over financial reporting. The Washington Complaint alleges claims against the Company under Sections 11 and 12(a)(2) of the Securities Act of 1933, based on statements made in connection with the above-referenced securities offering; and under Section 10(b) of the Securities Act of 1934 and Rule 10b-5 promulgated thereunder, based on statements made at various times in various contexts.

The Company, FBR, BBT, and the six individuals named as individual defendants in the Zirkin Complaint (Messrs. Ritchie, Dodd, Lippincott, Murphy, Morris, and Ramsey) are all named as defendants in the Washington Complaint as well. In addition, the Washington Complaint also names as a defendant Tobey Russ (former Chairman of the Company’s Board of Directors and former Chief Executive Officer).

In September 2007, the Company filed motions challenging the legal sufficiency of the claims asserted in both cases, and asked the Court to dismiss both cases. The briefing on these motions was completed in January 2008, but the Court has not yet addressed the motions. In accordance with the Private Securities Litigation Reform Act, discovery in these cases has been stayed pending a ruling by the Court on the motions.

The Court has not yet made any rulings addressing the merits of these cases, nor has the Court decided whether it will certify any case against the Company to proceed as a class action. The Company intends to continue to defend these actions vigorously.

In the normal course of business, we are involved in various claims and legal proceedings, including litigation and arbitration. Management does not believe that the eventual outcome of any such pending ordinary course of business litigation or arbitration is likely to have a material effect on our financial condition. Many of our insurance and reinsurance arrangements require disputes thereunder to be finally settled by binding arbitration. Assets and liabilities which are or may be the subject of arbitration are reflected in the financial statements based on management’s estimates of the ultimate amount to be realized as paid.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of shareholders during the fourth quarter of the fiscal year ended December 31, 2007.

Table of Contents

PART II

Item 5.
Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our common shares have been traded on the NASDAQ Global Market of The NASDAQ Stock Market LLC (''NASDAQ'') under the symbol ''QNTA'' since May 14, 2004. The following table contains, for the periods indicated, the high and low sales prices per common share.

	Common Shares	
	High	Low
2005		
First Quarter	$ 10.25	$ 7.60
Second Quarter	$ 8.50	$ 5.86
Third Quarter	$ 7.45	$ 5.40
Fourth Quarter	$ 6.02	$ 3.55
2006		
First Quarter	$ 5.80	$ 2.20
Second Quarter	$ 3.10	$ 2.19
Third Quarter	$ 2.62	$ 1.22
Fourth Quarter	$ 2.51	$ 1.65
2007		
First Quarter	$ 2.45	$ 1.97
Second Quarter	$ 3.23	$ 1.94
Third Quarter	$ 2.95	$ 2.25
Fourth Quarter	$ 2.94	$ 2.44

Holders

As of February 29, 2008, we had 70,135,502 common shares issued and outstanding, which were held by two holders of record. The two holders of record include Cede & Co., which holds shares on behalf of The Depository Trust Company, which itself holds shares on behalf of approximately 1,845 beneficial owners of our common shares.

Dividends

As a holding company, we depend on dividends and other permitted payments from our subsidiaries to pay dividends to our common shareholders. Our subsidiaries' ability to pay dividends, as well as our ability to pay dividends, is subject to regulatory, contractual and other constraints. Furthermore, the terms of our letter of credit facility prohibit us from paying dividends on our shares without the consent of our lenders. Future credit agreements or other agreements relating to indebtedness may also contain provisions prohibiting or limiting the payment of dividends on our shares under certain circumstances.

For a discussion about the regulatory environment relating to dividends from our subsidiaries to Quanta Holdings, see ''Item 1. Business—Regulation.'' For additional discussion concerning risks relating to our dividend policy and our holding company structure and its effect on our ability to receive and pay dividends, see ''Item 1A.—Risk Factors—Risks Related to the Run-Off—Our holding company structure and certain regulatory and other constraints, including our credit facility, affect our ability to pay dividends on our shares and return capital.''

Table of Contents

To date, we have not paid any dividends on our common shares, but we have declared a dividend of $1.75 per common share payable on March 28, 2008 to shareholders of record on March 25, 2008. It is our intent to dividend additional assets of our subsidiaries to Quanta Holdings once a portion or all of those assets are released by the applicable regulators, a process which will take time. Subject to the above limitations, our board of directors is free to change our dividend practices from time to time and to decrease or increase the dividend paid, or to not pay a dividend, on our common shares based on factors such as the results of operations, financial condition, cash requirements and future prospects and other factors deemed relevant by our board of directors.

Stock Performance Graph

Set forth below is a line graph comparing the dollar change in the cumulative total shareholder return since May 14, 2004, the date on which the common shares of the Company started trading on NASDAQ, through December 31, 2007 as compared to the cumulative total return of the NASDAQ Insurance Group and the NASDAQ Market Index. This graph assumes that the value of investment in the Company’s common shares and each index was $100 on May 14, 2004 and that all dividends were reinvested. The performance shown below is not necessarily indicative of future performance.

COMPARISON OF CUMULATIVE TOTAL RETURN AMONG QUANTA CAPITAL HOLDINGS LTD., NASDAQ MARKET INDEX AND NASDAQ INSURANCE GROUP

CUMULATIVE TOTAL RETURN

	5/14/2004	12/31/2004	12/30/2005	12/29/2006	12/31/2007
Quanta Capital Holdings Ltd.	$ 100.00	$ 93.23	$ 51.57	$ 21.74	$ 25.78
NASDAQ Insurance Group	$ 100.00	$ 114.64	$ 130.74	$ 147.68	$ 146.51
NASDAQ Market Index	$ 100.00	$ 113.76	$ 116.26	$ 128.19	$ 127.67

Table of Contents

Recent Sales of Unregistered Securities

During the year ended December 2007, the Company issued to certain employees and members of the Board of Directors of Quanta Holdings, an aggregate of 121,000 options to purchase common shares. These transactions were completed without registration of the relevant security under the Securities Act of 1933, as amended, in reliance upon the exemptions provided by Section 4(2) for transactions not involving a public offering.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

We did not repurchase any of our equity securities during the fourth quarter of the year ended December 31, 2007 and have not adopted a stock repurchase program.

Table of Contents

Item 6. Selected Financial Data

(Expressed in thousands of U.S. dollars except for share and per share amounts)

	Quanta Capital Holdings Ltd. (3)					Predecessor
	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005	Year ended December 31, 2004	Period ended December 31, 2003 (4)	Period ended September 3, 2003 (4)
Selected Income Statement Data						
Revenues:						
Net premiums earned	$ 87,247	$ 225,299	$ 364,075	$ 237,140	$ 1,940	$ —
Total revenues	142,390	258,483	401,165	254,625	4,465	—
Expenses:						
Net losses and loss expenses	31,077	156,121	324,249	198,916	1,191	—
General and administrative expenses, depreciation and impairment of intangibles	59,866	100,006	109,607	58,882	42,307	—
Total expenses	122,327	309,124	510,646	311,864	43,943	—
Net income (loss) from continuing operations	20,051	(50,655)	(109,713)	(57,239)	(39,478)	—
Net (loss) income from discontinued operations	—	(12,249)	3,761	2,658	1,001	1,400
Net income (loss)	20,051	(62,904)	(105,952)	(54,581)	(38,477)	1,400
Gain on repurchase of Series A preferred shares	2,364	—	—	—	—	—
Dividends on preferred shares	—	(1,916)	—	—	—	—
Net income (loss) to common shareholders	$ 22,415	$ (64,820)	$ (105,952)	$ (54,581)	$ (38,477)	1,400
Weighted average common shares and common share equivalents outstanding basic	70,076,562	69,971,646	57,205,342	56,798,218	31,369,001	1,093,250
Weighted average common shares and common share equivalents outstanding diluted	70,118,100	69,971,646	57,205,342	56,798,218	31,369,001	1,093,250
Income (loss) from continuing operations per share basic and diluted (2)	$ 0.29	$ (0.72)	$ (1.92)	$ (1.01)	$ (1.26)	$ —
(Loss) income from discontinued operations per share basic and diluted (2)	$ —	$ (0.19)	$ 0.07	$ 0.05	$ 0.03	$ 1.28
Income from disposal of discontinued operations per share basic and diluted (2)	$ —	$ 0.01	$ —	$ —	$ —	$ —
Gain on repurchase of Series A preferred shares per share basic and diluted (2)	$ 0.03	$ —	$ —	$ —	$ —	$ —
Dividends on Preferred shares per share basic and diluted (2)	$ —	$ (0.03)	$ —	$ —	$ —	$ —
Net income (loss) per share basic and diluted (2)	$ 0.32	$ (0.93)	$ (1.85)	$ (0.96)	$ (1.23)	$ 1.28
Predecessor Pro Forma Data (unaudited):						
Net income as shown above						$ 1,400
Pro forma provision for income taxes (1)						545
Net income adjusted for pro forma income taxes						$ 855
Pro forma net income per share basic and diluted (2)						$ 0.78

48

Table of Contents

	Quanta Capital Holdings Ltd. (3)					Predecessor
	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005	Year ended December 31, 2004	Period ended December 31, 2003 (4)	Period ended September 3, 2003 (4)
Summary Balance Sheet Data						
Total assets	1,081,355	1,329,226	1,552,091	980,733	573,761	11,249
Reserves for losses and loss expenses	525,088	623,618	533,983	159,794	4,454	—
Unearned premiums	95,586	119,197	336,550	247,936	20,044	—
Deposit liabilities	36,867	37,014	51,509	43,365	—	—
Junior subordinated debentures	—	61,857	61,857	41,238	—	—
Total liabilities	730,693	925,892	1,096,089	549,824	86,278	5,198
Redeemable preferred shares	—	74,998	71,838	—	—	—
Total shareholders' equity	$ 350,662	$ 328,336	$ 384,164	$ 430,909	$ 487,483	$ 6,051

(1) As an S corporation, ESC, our predecessor, was not subject to U.S. federal income taxes. At the time of its acquisition, ESC became subject to U.S. income tax. Accordingly, the predecessor historical operating earnings have been adjusted, on a pro forma basis, to reflect taxes at a 38.9% rate including a 35% statutory rate for U.S. federal income taxes and a 3.9% rate, based on a 6% statutory rate for Virginia state income taxes less the related federal tax benefit.

(2) Basic earnings per share are computed using the weighted average number of common shares outstanding during the period. All potentially dilutive securities including stock options, restricted stock and warrants are excluded from the basic earnings per share computation. In calculating diluted earnings per share, the weighted average number of shares outstanding for the period is increased to include all potentially dilutive securities using the treasury stock method. Any common stock equivalent shares are excluded from the computation if their effect is anti-dilutive. Basic and diluted earnings per share are calculated by dividing income available to ordinary shareholders by the applicable weighted average number of shares outstanding during the year.

(3) Includes the operations of ESC from September 3, 2003, the date of acquisition. We accounted for the acquisition of ESC as a purchase. Following the disposal of ESC during the third quarter of 2006, ESC was presented in the discontinued operations in the Income Statement. See Note 3 to our consolidated financial statements.

(4) Included in our predecessor information are amounts relating to the period from January 1, 2003 to September 3, 2003. The information relating to the period ended December 31, 2003 refers to the period September 3, 2003 to December 31, 2003.

Table of Contents

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

The following discussion and analysis of our results of operations, financial condition and liquidity and capital resources should be read in conjunction with our audited consolidated financial statements and related notes for the year ended December 31, 2007 contained in this annual report on pages F-1 to F-64 and with the risk factors appearing under ''Item 1A. Risk Factors'' in this annual report.

Overview

General

Quanta Holdings was incorporated on May 23, 2003 as a Bermuda holding company formed to provide specialty lines insurance, reinsurance, risk assessment and risk technical services on a global basis through its affiliated companies. From the beginning of 2004 until the second half of 2006 we mainly provided specialty lines insurance and reinsurance services on a global basis and to a lesser extent provided risk assessment and risk technical services. Following A.M. Best's rating action in the first quarter of 2006 in the wake of losses from the 2005 hurricanes and subsequent decisions by our Board of Directors after a review of strategic alternatives, we substantially ceased writing new business and began conducting a self-managed run-off of our remaining insurance and reinsurance businesses with the exception of our business at Lloyd's which we had been conducting since the beginning of 2005 and which is more fully described below. On September 15, 2006, we sold Environmental Strategies Consulting LLC (''ESC'') for total consideration of $12.5 million. Prior to its sale, we provided environmental consulting services through ESC.

On February 13, 2008, we sold our business at Lloyd's and from that date forward our operations have been limited to the run off of our insurance and reinsurance businesses. On March 13, 2008, we announced the payment of a special dividend in the aggregate amount of $122.7 million payable in cash on March 28, 2008. Our Board of Directors is currently considering and evaluating strategic alternatives that may include the sale of our company or some or all of our remaining businesses or assets, or a combination of one or more alternatives. There can be no assurance as to the timing, structure or terms of such a transaction.

During 2007, the following significant events and achievements occurred, all of which are more fully described throughout this annual report:

- We recorded total net favorable loss development (including $9.0 million from commutations) related to prior year accident periods of $39.1 million.
- We further reduced our net loss reserves by $5.1 million through cancellation of insurance contracts with our clients, primarily as a result of policy cancellations in our HBW program.
- We returned approximately $23.5 million in premiums to our clients during 2007 in connection with cancellations and terminations of insurance policies.
- In the fourth quarter of 2007, we recorded $9.8 million of net losses and loss expenses in our Lloyd's segment related to Syndicate 4000's professional liability exposure to the subprime mortgage developments in the United States. We expect claims activity within the D&O and E&O insurance markets to rise as a result of an increase in class action lawsuits filed against public companies due to market losses and related stock price depreciation associated with the subprime mortgage and credit crisis in the United States. Furthermore, we recorded a premium deficiency reserve amounting to approximately

$8.0 million. This premium deficiency reserve relates to the write-off of deferred acquisition costs that are deemed irrecoverable from the future earning of unearned premium reserves because we expect that potential future subprime reported losses on claims made policies may exceed those unearned premium reserves.

- We recognized net gains on commutation of reinsurance contracts of approximately $9.7 million which consisted of net favorable loss development of approximately $9.0 million

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and other income of $1.9 million. This amount was partially offset by returned earned premium of approximately $1.3 million. The net commutation payments resulted in a reduction in net loss and loss expenses reserves of approximately $47.1 million and a reduction in premium receivables of approximately $15.6 million.

- In the fourth quarter of 2007, we recorded approximately $4.7 million of charges (including $1.0 million of legal costs) related to our decision to rescind a non-traditional statutory surplus relief life reinsurance contract, which is more fully described below.
- During the third quarter of 2007, we repurchased all of the outstanding Series A preferred shares at a price of $22.50 per share. The aggregate purchase price for the Series A preferred shares was $70.4 million which resulted in a gain of $2.4 million, net of repurchase costs and write off of original deferred issuance costs, which is reported as an increase in net income available to common shareholders.
- In the third quarter of 2007, we purchased all of the outstanding junior subordinated debentures for an aggregate purchase price of $54.5 million. We originally issued and sold an aggregate $60.0 million of the junior subordinated debentures in private placements. We recognized a gain on repurchase of $4.4 million, net of repurchase costs and write off of original deferred issuance costs.
- In the first quarter of 2007, we entered into a 100% quota share reinsurance transaction to replace the expired retrocession of substantially all the in-force business in our technical risk property lines of business and to provide protection from future natural peril or catastrophe events in that line.
- We reduced our total general and administrative costs to $59.9 million (including $13.8 million in our Lloyd’s segment) for the year ended December 31, 2007.
- We generated net investment income of $41.9 million, excluding net gains on investments, during the year ended December 31, 2007.
- We have further reduced the total amount of letters of credit outstanding under our credit facility to $91.6 million at December 31, 2007.
- We have reduced the amount of assets placed in trust as collateral for our clients in our run-off segments to $153.8 million at December 31, 2007.

Summary of Our Financial and Capital Positions

At December 31, 2007, our unrestricted cash and invested assets totaled approximately $228.8 million. As of March 3, 2008, our total unrestricted assets increased to $352.9 million primarily as a result of the release of our funds at Lloyd’s. This amount will reduce significantly on March 28, 2008 mainly as a result of the dividend payment more fully described below. As at December 31, 2007, our cash and invested assets, which were invested in instruments with an average rating of ‘‘AAA’’, totaled $801.7 million. At December 31, 2007, a total of $331.9 million were restricted, or pledged, under letters of credit or trusts established for the benefit of our clients or deposited with U.S. regulatory authorities and approximately $241.0 million was pledged or deposited with Lloyd’s in support of our participation in Syndicate 4000. We continue to seek ways to reduce these restrictions and encumbrances including through commutations, cancellations and transfers and negotiations with our clients, through claim payments and obtaining recoveries from our reinsurers and by reducing the collateral requirements we have under our credit facility.

Our total gross loss reserves were $525.1 million at December 31, 2007 as compared to $623.6 million at December 31, 2006. Included in these amounts are $160.3 million and $99.6 million relating to our gross loss reserves in our Lloyd's segment at December 31, 2007 and 2006. The decrease on our total gross loss reserves primarily reflects claims paid during the year of $89.3 million (which includes the effect of continued contract commutations of $47.1 million), net favorable loss development on our maturing policy years of $39.1 million, as more fully described below, and a reduction in our losses and loss expense reserves of $5.1 million as a result of cancellations on policies primarily in our HBW program and the related reduction in reserves associated with those cancellations. This is partially offset by the increase in reserves in our Lloyd's segment as it continued to expand its business during 2007 and incurred subprime related professional liability losses. Our loss reserves represent obligations with short and long term duration. We believe that our shorter term obligations include reinsurance property, reinsurance marine, fidelity, technical risk property, surety and portions of our programs business, including the property component of HBW. The total gross loss and loss expense reserves associated with these lines was approximately $89.3 million at December 31, 2007. We believe that our longer term obligations include reinsurance casualty, professional, environmental, the warranty portion of our HBW program. The total gross loss and loss expense reserves associated with these lines, excluding Lloyd's, were approximately $275.5 million at December 31, 2007. The actual period over which we will pay losses for both of our short and long term business could significantly vary from our expectations given the immaturity of our business and our limited claims paying history and run-off status. Excluding Lloyd's, we estimate that approximately 74% of our total gross loss and loss expense reserves are recorded as incurred but not reported, or IBNR, reserves and there can be no certainty as to when these IBNR amounts may become reported, and ultimately, paid losses. Furthermore, our loss and loss expense reserves may change significantly in future periods as we seek to commute, cancel or otherwise transfer our insurance and reinsurance contracts.

During the year ended December 31, 2007, we recorded total net favorable loss development (including those arising from commutations) related to prior year accident periods of $39.1 million. This amount includes favorable loss development as follows:

- $14.9 million in several product lines related to mature accident periods in which actual loss experience was better than expected;
- $9.0 million relating to the commutations of a number of our reinsurance policies;
- $8.0 million in our Lloyd's segment particularly in relation to the 2005 and 2006 underwriting years;
- $6.7 million related to the 2005 and 2004 hurricanes; and
- $0.5 million related to the tornadoes that occurred in the first quarter of 2006.

Partially offsetting these net favorable loss developments are:

- $65.5 million of estimated loss and loss expense reserves arising from the earning of our unearned premium reserves; and
- $9.8 million of net loss and loss expenses recorded in our Lloyd's segment related to our estimate of claims associated with Syndicate 4000's professional liability exposure to the subprime mortgage developments in the United States more fully described below under ''Our Lloyd's Business''.

We also recorded a reduction in our losses and loss expense reserves of $5.1 million as a result of cancellations on policies, primarily in our HBW program.

With respect to our remaining policies with current and future exposure periods, our gross unearned premium reserves were approximately $95.6 million at December 31, 2007, which includes $58.5 million relating to our Lloyd's segment. Some of these policies have exposure periods that extend beyond one year. Excluding Lloyd's, we believe that approximately 30.6% of our gross unearned premium reserves will be earned within one year. The balance will be earned after one year over the remaining term of the underlying exposure periods to the extent these premiums are not returned following future commutations or cancellations. In the first quarter of 2007 we purchased 100% quota share reinsurance for future losses from natural peril or catastrophe or accidental events that may occur in our technical risk property product line. This reinsurance purchase resulted in approximately $4.8 million in ceded premium in the first quarter of 2007, and we believe that this significantly reduces our future net loss exposure from these events. We continue to seek to reduce these exposure periods through policy commutation, cancellation and loss portfolio transfers and, where appropriate, through the purchase of reinsurance protection.

Table of Contents

The specialty insurance and reinsurance business that is subject to our self-managed run-off is still exposed to new losses on unexpired policies particularly on our HBW program and in our environmental line of business and adverse development on recorded loss and loss expense reserves. During the run-off we will continue to pay losses as they fall due and collect outstanding loss and loss expenses recoverable from our reinsurers. As we continue to run-off and wind-up our businesses we have sought and will be seeking, over time and subject to the approval of our regulators, to extract capital from our subsidiaries.

We believe that important factors that have a direct impact on the amount of capital that may ultimately be available to our shareholders and the timing of when it will be available include our ability to (1) determine which portion of our business to maintain, commute, cancel, transfer, or otherwise mitigate, as the case may be, (2) mitigate exposures to our capital by purchasing additional reinsurance, (3) make available sufficient assets to facilitate distributions from our subsidiaries, (4) invest our assets in a way that balances risk with return and that is adequately matched with the expected payment periods of our obligations, (5) reduce our expenses, (6) manage our claims and collect premiums receivable and losses recoverable, (7) achieve the release of cash and investment encumbrances relating to reinsurance deposits and other security requirements, (8) manage our capital structure and (9) obtain the approval of our regulators to extract capital from our subsidiaries and distribute it to Quanta Holdings. This process will take a long period of time and require us to meet many conditions. We have engaged our regulators in this process. Following approval from the Bermuda Monetary Authority we declared a dividend of $1.75 per share or $122.7 million which is payable on March 28, 2008 to shareholders of record on March 25, 2008. We refer to this as the March dividend payment.

As of December 31, 2007 our total capital was approximately $350.7 million. Following the March dividend payment of $122.7 million our capital will decrease and will be subject to regulation mainly in Bermuda and the United States (in Colorado and in Indiana).

Our Lloyd’s Business

On February 13, 2008, we sold all of our interests in Syndicate 4000 through the sale of Quanta 4000 Ltd. (‘‘Quanta 4000’’) and our interest in Pembroke JV. We expect that, in the first quarter of 2008, we will recognize a gain on the sale of our interest in Quanta 4000, with the amount of such gain being determined based on recorded balances as of the date of sale. If the sale had occurred on December 31, 2007, based on balances recorded at that date, the pro forma amount of the gain would have been approximately $17.9 million. This gain is net of transaction costs, the payment of bonuses to the management and employees of Syndicate 4000 and writing off the cost of our investment in Pembroke JV. There can be no assurances that the gain we record in the first quarter of 2008 will be substantially similar to the amount stated above or that there will be a gain at all. If we record a loss, it could have a material adverse impact on our financial results and statement of operations.

For the year ended December 31, 2007, our Lloyd’s business:

- contributed $124.0 million and $96.4 million in gross and net written premium to our results for the year ended December 31, 2007 as compared to $91.8 million and $61.7 million in gross and net written premiums for the year ended December 31, 2006.
- contributed net earned premium of $80.8 million for the year ended December 31, 2007 as compared to $65.5 million in net earned premium for the year ended December 31, 2006.
- incurred charges amounting to $17.8 million related to our estimate of claims associated with exposures to professional liability

exposure to the subprime mortgage developments in the United States. We have initially based these charges and our net reserves for losses to a significant degree on industry loss estimates of the total expected losses. Any adjustment to these charges will have an impact on the gain or loss on the sale of our interest at Lloyd's we expect to record in the first quarter of 2008 and may have a material impact on our results for the period.

Table of Contents

- had a net loss ratio of 66.7% for the year ended December 31, 2007 as compared to 76.9% for the year ended December 31, 2006.

During the fourth quarter of 2007, charges of $17.8 million in our Lloyd’s segment’s professional liability exposure to the subprime mortgage developments in the United States include the following:

- $3.9 million of net reserves for reported claims. These claims were reported in Syndicate 4000’s professional directors and officers (‘‘D&O’’) and errors and omissions (‘‘E&O’’) product lines.
- $5.9 million of incurred but not reported reserves, net of reinsurance recoverable. Our estimate of IBNR is primarily based on publicly available industry loss estimates for D&O and E&O insurance combined with our estimate of the market share of Lloyd’s in this market as well as our estimate of Syndicate 4000’s market share in the Lloyd’s professional products market.
- A premium deficiency reserve amounting to approximately $8.0 million. This reserve relates to the write-off of deferred acquisition costs that are deemed irrecoverable from the future earning of unearned premium reserves because we expect that potential future subprime reported losses may exceed those unearned premium reserves.

Our Results

Our net income available to common shareholders was $22.4 million for the year ended December 31, 2007 as compared to a net loss available to common shareholders of $64.8 million for the year ended December 31, 2006. Our 2007 results were impacted by total net favorable loss development of $39.1 million across all segments (including gains on commutation of a number of reinsurance policies of $9.0 million), losses incurred in our Lloyd’s segment related to our estimate of claims associated with exposures to subprime in certain professional lines of $9.8 million (and the associated premium deficiency of $8.0 million), a charge of $4.7 million (including $1.0 million of legal costs) in relation to the decision to rescind one of our non-traditional statutory surplus relief life reinsurance contracts, the gain on repurchase of junior subordinated debentures of $4.4 million and the gain on repurchase of our Series A preferred shares of $2.4 million. Our 2006 results were impacted primarily by the A.M. Best downgrade and our decision to engage in a self-managed run-off in all our business lines other than our Lloyd’s business. As a result, we received significantly lower revenues from premiums earned and had significantly higher costs related to employee severance, professional, legal and advisory fees. Our 2006 results were also impacted to a lesser extent by adverse reserve developments on hurricanes Katrina, Rita and Wilma, the oil pipeline claim and other than temporary impairment charges on our invested assets.

In 2007, we generated approximately $77.9 million of net premiums written, including $96.4 million from Syndicate 4000, after premiums ceded on purchased reinsurance protection as compared to approximately $80.6 million of net premiums written, after premiums ceded on purchased reinsurance protection in 2006. The reduction reflects the continuation of our self-managed run-off as well as the purchase of more additional reinsurance protection in 2007 than in 2006, and the return of premiums to our clients through policy cancellations and commutations of approximately $24.9 million in 2007 and $97.8 million in 2006 as we sought to reduce our loss exposures. These amounts were partially offset by an increase in the net premiums written by Syndicate 4000.

Similarly, our net premiums earned were $87.2 million in 2007 as compared to $225.3 million in 2006. Our net premiums earned were impacted by significantly lower premium writings and, to a lesser extent, by premium returns associated with policy cancellations. Subsequent to the sale of our interest in Syndicate 4000, we expect continued decreases in net premiums earned in future periods as we do not expect to underwrite new policies. The reductions in premium revenues will likely have a material adverse effect on our future operating results, financial position and liquidity. Historically, net premiums earned have been our primary source of revenue. In 2006 net premiums earned contributed approximately 87% to our total revenues, and in 2007 this contribution reduced to 61%, and we expect further significant reductions in future periods.

In 2007, net revenues from non-underwriting activities, for example net investment income and technical services revenues, were not sufficient to offset general and administrative expenses, interest expense and depreciation and amortization. We expect that this trend may continue and that we may incur net losses in future periods. We seek to mitigate any losses through continued overhead reduction strategies.

Our general and administrative expenses in 2007 were $59.9 million, including $13.8 million of direct expenses related to our Lloyd’s business. Our general and administrative expenses excluding those direct costs associated with our Lloyd’s business were $46.1 million in 2007 as compared to $87.1 million in 2006. In the fourth quarter of 2007 our total general and administrative expenses were $13.2 million compared to $16.0 million in the same period in 2006, and our headcount has reduced to 47 as at December 31, 2007, compared to 81 on December 31, 2006. Our workforce is now allocated to the run-off of our existing business lines, finance, actuarial, general corporate and administrative functions and claims handling. During the years ended December 31, 2007 and 2006, we recorded severance costs of approximately $0.3 million and $14.3 million as a result of employee reductions following our decision to place our specialty insurance and reinsurance lines, other than Syndicate 4000, into run-off. This severance cost relates to the cost associated with those employees who have been provided notice and those who we expect to be terminating in the future and excludes those who we deem to be part of our run-off operation. We continue to seek to reduce our general and administrative expenses (including through further employee reductions) and expect, barring unforeseen circumstances that our 2008 general and administrative expenses will be lower than those incurred during 2007.

During 2007 we incurred professional, legal and consulting costs of $16.3 million compared to $22.5 million in 2006. During 2007 we incurred significant professional, legal and consulting costs in connection with the management of our Lloyd’s business, engagement of third party run-off advisors to assist in certain projects related to our run-off, the restructuring of our Lloyd’s business and costs associated with ongoing litigation.

Our investment portfolio generated net investment income of $41.9 million during the year ended December 31, 2007, compared to $45.9 million for the year ended December 31, 2006. This decrease is primarily attributable to a decrease in a lower level of invested assets. The lower level of invested assets is a result of the repurchases of our Series A preferred shares and of our junior subordinated debentures, our insurance and reinsurance business being in run-off, reduced cash inflows from premiums written and increased cash outflows associated with loss and loss expenses, commutations and overhead payments. Our average annualized effective yield (calculated by dividing net investment income by the average amortized cost of invested assets, net of amounts payable or receivable for investments purchased or sold) was approximately 4.7% for the year ended December 31, 2007 compared to 5.0% for the year ended December 31, 2006.

During the year ended December 31, 2004, we wrote a non-traditional statutory surplus relief life reinsurance contract that was deemed not to meet the risk transfer criteria set out in the accounting literature and was therefore accounted for as a deposit under the accounting rules. For additional information regarding accounting policies relating to non-traditional contracts, see ‘‘Critical Accounting Policies-Non-traditional contracts’’. Under this contract, we provided reinsurance on certain underlying life insurance contracts written by our client, a U.S. life insurance company. The client is subject to insurance regulation in the United States and, therefore, is required to maintain a certain amount of statutory capital. The client was entitled to reduce its statutory capital requirements as a result of entering into a reinsurance contract with us. The reinsurance transaction was done partially on a funds withheld basis under which some funds are held by the life insurance company. We received fees for this transaction. Other than receipt of our fees, there were no net cash flows at inception of this contract, nor were there expected to be net cash flows other than fees through the life of the contract. We monitor this transaction on a quarterly basis to, among other things, ensure that the performance of the underlying life insurance

55

policies is in line with the representations made by our client to us. During our monitoring process in 2007, it became apparent that this transaction was not performing as anticipated. We continue to obtain facts to evaluate and to analyze the performance of the life insurance policies that are underlying this transaction. We continue to evaluate the validity of data received from the client and the validity of risks ceded to us by our client as provided for by the terms of the reinsurance contract. On February 27, 2008, we exercised our right to cancel the contract ab initio, as we believe there have been material breaches of the contract as defined within the contract. As a result of this rescission notice, and in accordance with the cancellation provisions in the contract, at December 31, 2007 we recorded the return of all fee income, net of commissions, in the amount of $3.7 million reflecting net fee income earned since inception of the contract. Included in contingencies on the consolidated balance sheet is an amount of $2.5 million of fees due to be returned upon the rescission of this contract. In addition we have recorded an estimated $1.0 million in legal costs that may be incurred in pursuing cancellation and any other legal remedies. We have provided approximately $29.6 million of letters of credit and trust collateral in support of the amount of statutory surplus relief that the U.S. life insurance company has obtained. While the final outcome cannot be ascertained at this time, based on current facts and circumstances, knowledge of the data that has been received and our understanding of the original contract, we believe that the outcome could have a further material adverse effect on its financial position and results of operations in the future. We will continue to pursue any legal remedies against the insurance company that we believe are available and warranted under the circumstances.

Loss and Loss Expense Reserve Development

Our analysis of consolidated losses and loss expense development shown below presents the subsequent development of our estimated year end liability for net loss and loss expenses (net of loss and loss adjustment expenses recoverable) at the end of each balance sheet date for the years ended December 31, 2003 through 2007. The top line of the table shows our estimated net liability for unpaid losses and loss expense reserves recorded at the balance sheet date for each of the indicated periods. The net liability for loss and loss expenses represents the estimated aggregate amount of losses and loss expenses for claims arising from all prior years' accident periods that were unpaid at the balance sheet date.

The upper portion of the table shows our re-estimated amount of the previously recorded net liability as of the end of each succeeding calendar year. The estimate for our liability for loss and loss expense changes as more information becomes known about the frequency and severity of claims for individual years and, accordingly, as we update our actuarial techniques and selections of the appropriate method. The ‘‘Cumulative increase (decrease)’’ line represents the aggregate change in our estimates over all prior years. These increases or decreases in net liabilities generally arise either from net unfavorable or favorable loss development where the emergence of actual reported claims has been worse or better than expected or where we have cancelled or commuted policies. As described earlier, as our business has matured we have placed more reliance on the Bornhuetter-Ferguson actuarial methodologies which utilize our historical loss data in developing our estimate of ultimate loss liabilities.

The lower portion of the table presents the amounts paid as of subsequent periods on those claims for which we recorded reserves as of each balance sheet date. Conditions and trends that have affected development of the liabilities in the past are not indicative of events or development that may occur in the future. Accordingly, it is inappropriate to extrapolate future redundancies or deficiencies based on the tables below.

Analysis of Consolidated Losses and Loss Expense Reserve Development
Net of Reinsurance Recoverables

(U.S. dollars in thousands) Years ended December 31	2003	2004	2005	2006	2007
Net loss and loss expense reserves	$ 1,191	$ 146,275	$ 349,573	$ 442,348	$ 389,876
Liability re-estimated as of:					
One year later	1,184	150,297	343,283	398,108	—
Two years later	1,184	148,555	310,286	—	—
Three years later	1,368	145,918	—	—	—
Four years later	1,323	—	—	—	—
Cumulative increase (decrease)	132	(357)	(39,288)	(44,240)	—
Cumulative paid losses					
One year later	26	53,310	53,910	84,634	—
Two years later	79	67,205	111,895	—	—
Three years later	59	79,526	—	—	—
Four years later	59	—	—	—	—

Overall, we have experienced net favorable loss developments as our estimates of ultimate loss liabilities have been adjusted to lower amounts than we had estimated when we were first required to record reserves. This is particularly noticeable in our shorter tail policies we underwrote or in lines of business where policies and periods of exposure have expired with either a fewer number of claims than expected or with lower than expected claim amounts. Prior to 2004 we did not have significant development in our estimation of loss and loss expense reserves since we started our operations in 2003 and only wrote a small number of contracts during that year.

During the year ended December 31, 2004 we recorded approximately $61.3 million in net loss and loss expenses in our property and marine reinsurance product lines associated with hurricanes Charley, Frances, Ivan and Jeanne (the ‘‘2004 hurricanes’’).

During the year ended December 31, 2005 we recorded:

- approximately $83.3 million in net loss and loss expenses in our property and marine reinsurance and technical property and fidelity insurance product lines associated with the hurricanes Katrina, Rita and Wilma (the ‘‘2005 hurricanes’’);
- approximately $13.0 million in net loss and loss expenses associated with an oil pipeline claim in our environmental product line;
- an increase of $5.9 million in loss estimates for the 2004 hurricanes as new information was reported to us by our clients; and
- $1.9 million of net favorable loss development in certain of our other short-tail policies and product lines.

During the year ended December 31, 2006, we recorded a decrease in our loss reserves of $6.3 million. The decreases from the 2004 and 2005 accident years were $1.7 million and $4.6 million and were primarily driven by the following:

- $10.4 million of net favorable loss development in several of our product lines, including our fidelity, the property component of HBW, environmental and surety lines where actual loss experience in these product lines was better than expected for the 2005 accident year; and
- $3.5 million of net favorable loss development as a result of transitioning our ultimate loss selection method in our professional insurance product line from the expected loss ratio method to the Bornhuetter-Ferguson method of which $1.7 million related to

2004 and $1.8 million related to 2005.

These net favorable developments of $13.9 million were offset mainly by:

- a $5.0 million increase in our loss estimates in relation to the 2005 hurricanes as new information was reported to us by our clients and others; and

57

Table of Contents

- a $2.6 million increase in our net loss reserves on the oil pipeline claim during 2006 as we were required by the relevant environmental agencies to extend our remediation activities.

During the year ended December 31, 2007, we recorded a decrease in our loss reserves of $44.2 million. The decreases from the 2004, 2005 and 2006 accident years were $2.6 million, $30.4 million and $11.2 million and were primarily driven by the following:

- $14.9 million in several product lines related to mature accident periods in which aggregate loss experience was better than expected for the 2004, 2005 and 2006 accident years. This included approximately $14.7 million in our professional liability and $2.2 million in environmental product lines, offset by a small amount of additional reported losses in our other product lines;
- $9.0 million related to the commutations of a number of our reinsurance policies relating to the 2005 and 2006 accident years;
- $8.0 million recorded in our Lloyd's segment of which $6.7 million related to 2005 and $1.3 million related to 2006 accident year;
- $5.8 million in relation to the 2005 hurricanes as new information was reported to us by our clients and others;
- $5.1 million related to cancellations on policies, primarily in our HBW program, and the related reduction in reserves associated with those cancellations of which $3.6 million related to the 2006 accident year and $1.5 million related to the 2005 accident year;
- $0.9 million related to the 2004 hurricanes; and
- $0.5 million related to tornadoes that occurred in 2006.

Segment Information

Following the decision of our Board of Directors to place most of our business in run-off in 2006, we changed the composition of our reportable segments and renamed our specialty insurance segment and specialty reinsurance segment as specialty insurance run-off segment and specialty reinsurance run-off segment. We continue to earn premiums in our insurance and reinsurance run-off segments related to business written in prior periods and related to extensions and renewals of policies which we are legally required to write in business lines we have exited. The specialty insurance run-off and specialty reinsurance run-off segments, along with our Lloyd's and technical services segments, are more fully described as follows:

- Specialty insurance run-off. Our specialty insurance run-off segment includes the remaining policies written in our traditional, structured and program specialty insurance product line until the second quarter of 2006 and those policies that we were required by regulation to write in the remainder of 2006 and 2007. Our traditional specialty insurance products included technical risk property, professional liability, environmental liability, fidelity and crime, surety, trade credit and political risk and marine and aviation. These products were written both on a direct basis with insured clients or by reinsuring policies that were issued on our behalf by third-party insurers and reinsurers. Our specialty insurance programs include the HBW program.
- Specialty reinsurance run-off. Our specialty reinsurance run-off segment includes the remaining contracts written in our

traditional specialty reinsurance products line. Our specialty reinsurance products included property, casualty and marine and aviation products.

• Lloyd's. Syndicate 4000 at Lloyd's, our Lloyd's segment, was created in December 2004 and wrote traditional specialty insurance products including professional liability (professional indemnity and directors' and officers' coverage), fidelity and crime (financial institutions), specie and fine art and kidnap and ransom. For the 2007 underwriting year, we provided 90% of the capital of Syndicate 4000 as compared to all of the capital commitment from Syndicate 4000's inception through the 2006 underwriting year. The remaining 10% of Syndicate 4000's capital for the 2007 underwriting year was provided by Chaucer Holdings PLC. We included all of the results of insurance business written by Syndicate 4000 since its inception in 2004 through the 2006 underwriting year and 90% of the results of Syndicate 4000 for the 2007 underwriting year. Due to the sale of our interest in Syndicate 4000, this segment will be reclassified as discontinued operations in 2008.

• Technical services. Prior to the sale of ESC in the third quarter of 2006, our technical services segment provided diversified environmental investigation, remediation and engineering services, assessment services, other technical and information management services primarily in the environmental area in the U.S. Our technical services segment also provided technical and information management services to our specialty insurance run-off and reinsurance run-off segments. Following the sale of ESC, the technical services segment now consists of our two environmental liability assumption programs, QLT of Buffalo LLC and QLT of Alabama LLC. The results for the prior years have been reclassified to conform with the presentation of ESC in discontinued operations.

During 2006, we created a Lloyd’s operating segment for the results of Syndicate 4000 which was previously aggregated with our specialty insurance run-off reportable segment. We believe it is no longer appropriate to aggregate Lloyd’s and specialty insurance run-off operating segments given the different economic characteristics of the specialty insurance run-off segment that is no longer writing new or renewal business while our Lloyd’s syndicate continued to write new and renewal business.

We refer to the specialty insurance run-off, specialty reinsurance run-off and Lloyd’s segments as our underwriting segments. We refer to our environmental assumption programs as our technical services segment. We evaluate each segment based on its underwriting or technical services results, as applicable, including items of revenue and expense that are associated with, and directly related to, each segment.

During the fourth quarter of 2006 we ceased allocating our indirect corporate, general and administrative expenses to our operating segments. Prior to the fourth quarter of 2006, we allocated corporate general and administrative expenses to each segment based upon each product line’s allocated capital for the relevant reporting period. We allocated capital to each of our product lines through the estimated value-at-risk method, which used statistical analyses of historical market trends and volatility to estimate the probable amounts of capital at risk for each reporting period. Since our decision to conduct a self-managed run-off of most of our businesses we no longer allocate capital to our segments and corporate expenses are no longer evaluated at the segment level. We also do not evaluate net investment income, and depreciation and amortization at the segment level.

The geographic locations in which we have conducted our business are the United States, Europe and Bermuda. The location of the risks that are the subject of our remaining insurance and reinsurance policies may be anywhere in the world.

Main Drivers of our Results

Revenues

We have derived the majority of our revenues from two principal sources: premiums from policies written by Syndicate 4000 at Lloyd’s in our Lloyd’s operating segment and investment income from our investment portfolios.

We record premiums written at the time that there is sufficient evidence of agreement to the significant terms of the contract but no earlier than the effective date of the policy. The amount of our insurance premiums written and earned depends on the number and type of policies we write, as well as prevailing market prices. Furthermore, the amount of net premiums earned depends upon the type of contracts we have written, the contractual periods of the contracts we write, policy cancellations and commutations, the inception date of the contracts, the expired portions of the

Table of Contents

contract periods and the type of purchased reinsurance protection. Because of all these factors, the amount of premiums written and ceded may not result in a correlative level of profitability.

Our investment income depends on the average invested assets in our investment portfolios and the yield that we earn on those invested assets. Our investment yield is a function of market interest rates and the credit quality and maturity period of our invested assets. Our investment portfolio consists principally of fixed income securities, short-term investments, cash, and cash equivalents. In addition, we realize capital gains or losses on sales of investments as a result of changing market conditions, including changes in market interest rates and changes in the credit quality of our invested assets. We also recognize capital gains and losses on investments as a result of fluctuations in the fair market values of the investments. The objective of our current investment strategy is to preserve investment principal, maintain liquidity and manage duration risk between investment assets and insurance liabilities (when they become due, at the time of either loss settlement, cancellations or commutations), while maximizing investment returns through a diversified portfolio.

Expenses

Our expenses primarily consist of general and administrative expenses, net loss and loss expenses and acquisition expenses.

General and administrative expenses consist primarily of personnel related expenses (including severance costs), professional fees and other operating overheads. From time to time we engage administrative service providers and legal, accounting, tax and financial advisors. These general and administrative expenses may be incurred directly by a segment or indirectly at the corporate level.

Net loss and loss expenses, which are net of loss and loss expenses recovered under our ceded reinsurance contracts, depend on the number and type of insurance and reinsurance contracts we write and reflect our best estimate of ultimate losses and loss expenses we expect to incur on each contract written using various actuarial analyses. Actual losses and loss expenses will depend on either actual costs to settle insurance and reinsurance claims, or the estimated loss amount that we may agree with our policyholders under the terms of commutation and cancellation arrangements. Our ability to accurately estimate expected ultimate loss and loss expense at the time of pricing each insurance and reinsurance contract and the occurrence of unexpected high loss severity catastrophe events are critical factors in determining our profitability.

Acquisition expenses, which are net of expenses recovered under our ceded reinsurance contracts, consist principally of commissions, fees, brokerage and tax expenses that are directly related to obtaining and writing insurance and reinsurance contracts. Typically, acquisition expenses are based on a certain percentage of the premiums written on contracts of insurance and reinsurance and may be adjustable based upon loss experience. These expenses are a function of the number and type of insurance and reinsurance contracts written. We may not be able to recover all or a portion of our acquisition costs on commuted or cancelled policies. A premium deficiency reserve is recognized if the sum of expected losses and loss expenses and unamortized acquisition costs exceeds related unearned premiums. A premium deficiency reserve is recognized by charging unamortized acquisition costs to acquisition expenses in the consolidated statement of operations to the extent required in order to eliminate the deficiency. If the premium deficiency reserve exceeds unamortized acquisition costs then a liability is accrued for the excess deficiency.

Financial Ratios

The financial ratios we use in our Lloyd’s segment include the net loss and loss expense ratio, the acquisition expense ratio and the general and administrative expense ratio. Our net loss and loss expense ratio is calculated as net losses and loss expenses incurred divided by net premiums earned. Our acquisition expense ratio is calculated by dividing acquisition expenses by net premiums earned. Our general and administrative expense ratio is calculated by dividing general and administrative expenses by net premiums earned. Our financial ratios provide a measure of the current profitability of the earned portions of insurance contracts that were written in our Lloyd’s

Table of Contents

segment. In this report we only present financial ratios related to our Lloyd's segment as our specialty insurance and reinsurance segments are in run-off.

Results of Operations

Our specialty insurance and reinsurance run-off segments are both in run-off. A comparison between our results for the year ended December 31, 2007 and 2006 highlights the differences between running-off our business, which includes, among other things, returning premium upon contract commutations and cancellations, on the one hand, during the year ended December 31, 2007 and writing and earning premium on the other hand in the beginning of the year ended December 31, 2006 before our A.M. Best rating downgrading in March 2006. As a result, a comparison of our results of these periods may not be a meaningful means of analyzing our results of operations.

Years ended December 31, 2007 compared to December 31, 2006

Results of operations for the years ended December 31, 2007 and 2006 were as follows:

	2007	2006
($ in thousands)		
Revenues		
Gross premiums written	$ 106,587	$ 158,729
Premiums ceded	(28,645)	(78,175)
Net premiums written	77,942	80,554
Change in unearned premium	9,305	144,745
Net premiums earned	87,247	225,299
Technical services revenues	1,707	3,331
Net investment income	41,900	45,934
Net gains (losses) on investments	5,818	(15,945)
Net foreign exchange gains (losses)	850	(3,790)
Gain on repurchase of junior subordinated debentures	4,421	—
Other income	447	3,654
Total revenues	142,390	258,483
Expenses		
Net losses and loss expenses	31,077	156,121
Acquisition expenses	26,728	42,540
General and administrative expenses	59,866	100,006
Interest expense	3,632	5,458
Depreciation and amortization of intangible assets	1,024	4,999
Total expenses	122,327	309,124
Income (loss) from continuing operations before income taxes	20,063	(50,641)
Income tax expense	12	14
Net income (loss) from continuing operations	20,051	(50,655)
Discontinued operations:		
Loss from operations of discontinued operations	—	(12,953)
Income on disposal of discontinued operations	—	704
Net loss from discontinued operations	—	(12,249)
Net income (loss)	20,051	(62,904)
Gain on repurchase of Series A preferred shares	2,364	—
Dividends on preferred shares	—	(1,916)
Net income (loss) to common shareholders	$ 22,415	$ (64,820)

Revenues

Substantially all of our revenues were generated by our underwriting subsidiaries in the U.S., Bermuda and Europe.

61

Table of Contents

Premiums. Gross premiums written were $106.6 million for the year ended December 31, 2007, a decrease of $52.1 million, compared to $158.7 million for the year ended December 31, 2006. The decrease in our gross premiums written reflects the decision to discontinue writing new business in our insurance and reinsurance lines of business, other than in our Lloyd’s segment and the effect of premium returns to our clients when policies are cancelled.

Our Lloyd’s segment contributed $124.0 million of total gross written premiums in 2007, compared to $91.8 million in 2006. We believe this increase is due to the enhanced ability of Syndicate 4000 to attract new and secure renewal business during the year because of the provision of third party capital to the syndicate, the establishment of the Pembroke Managing Agency and the fact that Syndicate 4000, in its third year, benefited from increased market recognition.

Premiums ceded were $28.6 million for the year ended December 31, 2007, a decrease of $49.6 million, compared to $78.2 million for the year ended December 31, 2006. The decrease in premiums ceded primarily reflects the reduction in gross premiums written.

Net premiums earned were $87.2 million for the year ended December 31, 2007, a decrease of $138.1 million, compared to $225.3 million for the year ended December 31, 2006. The decrease in net premiums earned reflects the decision to discontinue writing new business in our insurance and reinsurance lines of business, other than in our Lloyd’s segment, and the continued return of premiums to our clients following policy commutations or cancellations. Our net premiums written are typically earned over the risk periods of the underlying insurance policies which are generally twelve months. Net premiums written that are not yet earned and are deferred as unearned premium reserves, net of deferred reinsurance premiums, totaled $75.6 million at December 31, 2007 and will be earned and recognized in our results of operations in future periods to the extent these premiums are not returned following future commutations or cancellations. The contribution to net premiums earned from our Lloyd’s segment is detailed under ‘‘Results by Segments’’ below.

Technical services revenues. Technical services revenues were $1.7 million for the year ended December 31, 2007, a decrease of $1.6 million, compared to $3.3 million for the year ended December 31, 2006. We expect that our technical services revenues will decrease in future periods as the remediation activities near completion. Technical services revenues prior to the quarter ended September 30, 2006 were derived from the operations of ESC which was sold on September 16, 2006 and from the operations of our environmental liability assumption programs. This revenue is included in the results of our discontinued operations.

Net investment income and net gains (losses) on investments. Net investment income and net gains (losses) on investments consisted of the following for the years ended December 31, 2007 and 2006:

	2007	2006
($ in thousands)		
Net investment income	$ 41,900	$ 45,934
Net realized gains (losses) on investments	2,794	(15,945)
Net change in the fair market value of trading investments	3,024	—
	$ 47,718	$ 29,989

Net investment income was $41.9 million for the year ended December 31, 2007 a decrease of $4.0 million, compared to $45.9 million for the year ended December 31, 2006. This decrease was primarily due to a decrease in interest earned on fixed maturity and short term investments plus amortization of discounts on fixed maturity investments. Net investment income decreased in the year ended December 31, 2007 as compared to 2006 due to a lower level of invested assets at December 31, 2007 compared to December 31, 2006. The lower level of invested assets is a result of our insurance and reinsurance businesses being in run-off as well as the repurchase of our Series A preferred shares and junior subordinated debentures. Our average annualized effective yield (calculated by dividing net investment income by the average amortized cost of invested assets, net

Table of Contents

of amounts payable or receivable for investments purchased or sold) was approximately 4.7% for the year ended December 31, 2007 compared to 5.0% for the year ended December 31, 2006. This decrease is due to shortening of the duration of some of our invested assets during 2007 as compared to 2006 and the resulting lowering of the yield on those invested assets.

Net realized losses for the year ended December 31, 2006 of $15.9 million were generated primarily from an other than temporary impairment charge of $16.9 million.

On January 1, 2007 we converted our available-for-sale portfolio to trading as permitted under the early adoption rules of SFAS 159. This resulted in all changes in the fair market value of investments during the year ended December 31, 2007 being recorded as net gains or losses within our statement of operations. During the year ended December 31, 2006 any change in the fair market value of investments were reflected within other comprehensive income within the equity section of the balance sheet unless any securities were deemed to be other than temporarily impaired in which case unrealized losses were recognized as a realized loss in the statement of operations. Other comprehensive income for the year ended December 31, 2006 included $9.7 million of net change in unrealized losses.

Net foreign exchange losses.   Net foreign exchange gains were $0.9 million for the year ended December 31, 2007 compared to a loss of $3.8 million for the year ended December 31, 2006. The net foreign exchange gains and losses were driven primarily by our Lloyd’s segment and the relationship between the U.S. Dollar and the British Pound. Due to the sale of our interest in Syndicate 4000, we expect that our exposure to foreign currency movements will be significantly reduced in 2008.

Gain on repurchase of junior subordinated debentures.   During the year ended December 31, 2007, we repurchased all of our junior subordinated debentures for an aggregate purchase price of $54.5 million. We originally issued and sold $60.0 million of the junior subordinated debentures in private placements. A gain on repurchase of $4.4 million was recognized, net of repurchase costs of $0.5 million and write off of original deferred issuance costs of $1.7 million.

Other income.   Other income was $0.4 million for the year ended December 31, 2007 compared to $3.7 million for the year ended December 31, 2006. The decrease in other income is due to the return of fee income as a result of our decision to cancel one of our non-traditional statutory surplus relief life reinsurance contracts as described more fully in ‘‘Our results’’ above. At December 31, 2007 we have recorded the return of all fee income, net of commissions, in the amount of $3.7 million reflecting net fee income earned since inception of the contract.

Expenses

Net losses and loss expenses.   Net losses and loss expenses were $31.1 million for the year ended December 31, 2007, a decrease of $125.0 million, compared to $156.1 million for the year ended December 31, 2006. Net losses and loss expenses are a function of our net premiums earned and changes in our expected ultimate losses and loss expenses for reported and unreported claims on contracts of insurance and reinsurance underwritten. The decrease in net losses and loss expenses is due to:

- the reduced number of insurance contracts we entered into in 2007 as compared to the number of insurance and reinsurance contracts we entered into in 2006 and the associated net premiums earned as our insurance and reinsurance portfolios continue to run-off;

- favorable loss experience in mature accident periods in certain of our product lines; and
- favorable loss experience arising on commutation of certain assumed reinsurance contracts.

This decrease was partially offset by net losses incurred in our Lloyd's segment of $9.8 million related to Syndicate 4000's professional liability exposure to the subprime mortgage developments in the United States.

Our expected ultimate losses and loss expenses during the year ended December 31, 2007, included total net favorable loss development (including those arising from commutations) related to prior year accident periods of $39.1 million. This was comprised of $14.9 million in several product lines related to mature accident periods in which actual loss experience was better than expected, $9.0 million relating to the commutations of a number of our reinsurance policies, $8.0 million in our Lloyd’s segment particularly in relation to the 2005 underwriting year, $6.7 million related to the 2005 and 2004 hurricanes and $0.5 million related to the tornadoes that occurred in the first quarter of 2006. We expect future developments in the loss and loss expenses of our product lines as we continue to receive information related to our loss and loss expense reserves and as those reserves develop over time. We continue to be exposed to potentially significant losses in lines of business where claims may not be reported for some period of time after those claims are incurred. We also recorded a reduction in our losses and loss expense reserves of $5.1 million as a result of cancellations on policies primarily in our HBW program and the related reduction in reserves associated with those cancellations.

In estimating reserves we may utilize a variety of standard actuarial methods in line with industry practice, including the expected loss ratio method, the Bornhuetter-Ferguson method, paid loss development method and reported loss development method. The loss reserves are based on the loss development characteristics of the specific line of business and specific contracts within that line of business, and consider coverage, type of business, maturity of loss data and claims.

Our total net loss ratio (calculated by dividing net losses and loss expenses by net premiums earned) was 35.6% for the year ended December 31, 2007, a decrease of 33.7% compared to a total net loss ratio of 69.3% for the year ended December 31, 2006. The decrease in the total net loss and loss expense ratio is due to the significant favorable development recognized in our insurance and reinsurance run-off segments and the commutation of several assumed reinsurance contracts.

Acquisition expenses. Acquisition expenses were $26.7 million for the year ended December 31, 2007, a decrease of $15.8 million, compared to $42.5 million for the year ended December 31, 2006. The decrease in acquisition expenses is due to the decrease in net premiums earned and the number of insurance contracts we entered into in 2007 as compared to the number of insurance and reinsurance contract we entered into in 2006.

Within acquisition costs for the year ended December 31, 2007 we have recorded a premium deficiency reserve of approximately $8.0 million. This premium deficiency reserve relates to the write-off of deferred acquisition costs in our Lloyd’s segment that are deemed irrecoverable from the future earning of unearned premium reserves because we expect that potential future subprime reported losses may exceed those unearned premium reserves.

General and administrative expenses. General and administrative expenses were $59.9 million for the year ended December 31, 2007, a decrease of $40.1 million, compared to $100.0 million for the year ended December 31, 2006. General and administrative expenses were comprised of $28.2 million of personnel related expenses (including $0.3 million of severance costs), $16.3 million of professional fees (which includes Lloyd’s managing agency fees, legal fees, audit fees, consulting and actuarial) and $15.4 million of other expenses during the year ended December 31, 2007 compared to $55.2 million of personnel related expenses (including $14.3 million of severance costs) and, $22.6 million of professional fees and $22.2 million of other expenses during the year ended December 31, 2006. The decrease in general and administrative expenses is due to the cost saving measures taken in response to the decision to cease writing new business in 2006, including the reduction of workforce headcount that was 47 as of December 31, 2007 compared to 81 as of December 31, 2006.

Interest expense. Interest expense was $3.6 million for the year ended December 31, 2007, a decrease of $1.9 million compared to $5.5 million for the year ended December 31, 2006. Interest expense for the year ended December 31, 2007 consists of incurred interest on our junior subordinated debentures. Due to the repurchase of the junior subordinated debentures in the third quarter of 2007, we did not incur a full year of interest in 2007 as compared to 2006 when we recorded incurred interest for the entire year.

Depreciation and amortization of intangible assets. Depreciation and amortization of intangible assets was $1.0 million for the year ended December 31, 2007, a decrease of $4.0 million compared

Table of Contents

to $5.0 million for the year ended December 31, 2006. The majority of the decrease relates to the following three items. Firstly, an impairment charge of $1.7 million with respect to our intangible assets associated with our U.S. insurance licenses was made in 2006 to record these licenses at their estimated net realizable value and secondly, amortized $0.4 million in the year ended December 31, 2007 related to software costs compared to $1.2 million for the year ended December 31, 2006. Finally, we also amortized approximately $0.8 million of leasehold improvements during the fourth quarter of 2006 associated with our anticipated relocation of our New York operations. The remaining decrease is due to the decreasing value of our fixed assets.

We have recorded a net deferred income tax benefit of $5.3 million related to tax operating losses generated in our Lloyd’s segment for the year ended December 31, 2007. For the year ended December 31, 2007, the net valuation allowance increased by approximately $1.8 million, to $50.9 million.

The realization of deferred tax assets is dependent on future taxable income and future reversals of existing taxable temporary differences. Based upon our assessment of historical data and future earnings, it is our belief that it is more likely than not that the $5.3 million net deferred tax asset established for the U.K. NOL carryforwards will be realized in future periods by Quanta 4000. We will continue to periodically assess the realizability of the net deferred tax asset and adjust the valuation allowance accordingly.

In relation to the U.S. NOL and Irish NOL, due to prior and existing operating losses, we believe that it is more likely than not that the deferred tax asset will not be realized. Accordingly, we have recorded a full valuation allowance against these net deferred tax assets as of December 31, 2007 and 2006.

Discontinued operations.

(Loss) from operations of discontinued operations. We had no income from discontinued operations for the year ended December 31, 2007. For the period from January 1, 2006 to September 15, 2006, the loss from discontinued operations represented the revenues and expenses from ESC, which was sold on September 15, 2006.

During the period from January 1, 2006 to September 15, 2006, our loss from operations of discontinued operations generated by ESC, previously included in the technical services segment, now reported in discontinued operations was as follows:

	Period from January 1, 2006 to September 15, 2006
	($ in thousands)
Technical services revenues	$ 21,954
Other income	14
Direct technical services costs	(13,968)
General and administrative expenses	(7,725)
Loss on impairment of goodwill	(12,561)
Depreciation of fixed assets and amortization of intangible assets	(647)
Income tax expense	(20)
Loss from operations of discontinued operations	$ (12,953)

Table of Contents

Income on disposal of discontinued operations. Income on disposal of discontinued operations was $0.7 million for the year ended December 31, 2006. This income is presented in the Consolidated Statement of Operations as Income on disposal of discontinued operations, a component of discontinued operations. The components of this income are summarized below.

	($ in thousands)
Cash proceeds from WSP(1)	$ 11,484
Debt forgiveness	1,000
Total consideration	12,484
Less:	
Carrying value of ESC(2)	(11,140)
Estimated transaction costs(3)	(640)
Income on disposal of ESC	$ 704

(1) Total proceeds from disposition include post closing adjustments.

(2) Net assets of ESC at September 15, 2006, prior to the impact of the sale transaction.

(3) Transaction costs include advisory fees directly associated with the sale.

Preferred Shares

Gain on repurchase of preferred shares. During the year ended December 31, 2007, we repurchased all of our Series A preferred shares at a price of $22.50 per share. The aggregate purchase price for the Series A preferred shares was $70.4 million which resulted in a gain of $2.4 million, net of repurchase costs of $2.2 million and write off of original deferred issuance costs of $3.3 million, increasing net income to common shareholders.

Dividends on preferred shares. During the year ended December 31, 2007, we paid no dividend on our Series A preferred shares. During the year ended December 31, 2006, we paid a dividend of $1.9 million to our Series A preferred shareholders.

Table of Contents

Years ended December 31, 2006 compared to December 31, 2005

Results of operations for the years ended December 31, 2006 and 2005 were as follows:

	2006	2005
	($ in thousands)	
Revenues		
Gross premiums written	$ 158,729	$ 608,935
Premiums ceded	(78,175)	(218,894)
Net premiums written	80,554	390,041
Change in unearned premium	144,745	(25,966)
Net premiums earned	225,299	364,075
Technical services revenues	3,331	19,037
Net investment income	45,934	27,181
Net losses on investments	(15,945)	(13,020)
Net foreign exchange (losses) gains	(3,790)	331
Other income	3,654	3,561
Total revenues	258,483	401,165
Expenses		
Net losses and loss expenses	156,121	324,249
Acquisition expenses	42,540	69,624
General and administrative expenses	100,006	109,607
Interest expense	5,458	4,165
Depreciation and amortization of intangible assets	4,999	3,001
Total expenses	309,124	510,646
Loss from continuing operations before income taxes	(50,641)	(109,481)
Income tax expense	14	232
Net loss from continuing operations	(50,655)	(109,713)
Discontinued operations:		
(Loss) income from operations of discontinued operations	(12,953)	3,761
Income on disposal of discontinued operations	704	—
Net (loss) income from discontinued operations	(12,249)	3,761
Net loss	(62,904)	(105,952)
Dividends on preferred shares	(1,916)	—
Net loss to common shareholders	$ (64,820)	$ (105,952)

Revenues

Substantially all of our revenues were generated by our underwriting subsidiaries in the U.S., Bermuda and Europe. Technical services revenues were derived from the operations of ESC through its sale on September 16, 2006 and from the operations of QLT Buffalo LLC and QLT of Alabama, LLC.

Premiums.   Gross premiums written were $158.7 million for the year ended December 31, 2006, a decrease of $450.2 million, or 73.9%, compared to $608.9 million for the year ended December 31, 2005. The decrease in our gross premiums written reflects the decision to discontinue writing new business in our insurance and reinsurance lines of business, other than in our Lloyd’s segment.

Our Lloyd’s segment contributed $91.8 million of total gross written premiums in 2006, or 59.4%, compared to $80.7 million, or 13.2% in 2005. This increase in Lloyd’s contribution reflects the run-off status of other segments in 2006 and modest growth in our Lloyd’s operations in 2006.

Table of Contents

Premiums ceded were $78.2 million for the year ended December 31, 2006 a decrease of $140.8 million, or 64.3% compared to $218.9 million for the year ended December 31, 2005. The decrease in premiums ceded primarily reflects the reduction in gross premiums written.

Net premiums earned were $225.3 million for the year ended December 31, 2006, a decrease of $138.8 million, or 38.9%, compared to $364.1 million for the year ended December 31, 2005. The decrease in net premiums earned reflects the decision to discontinue writing new business in our insurance and reinsurance lines of business, other than in our Lloyd's segment. Our net premiums written are typically earned over the risk periods of the underlying insurance policies. Net premiums written that are not yet earned and are deferred as unearned premium reserves, net of deferred reinsurance premiums, totaled $119.2 million at December 31, 2006 and will be earned and recognized in our results of operations in future periods. The contribution to net premiums earned from our Lloyd's segment is detailed under ''Results by Segments'' below.

Technical services revenues. Technical services revenues were $3.3 million for the year ended December 31, 2006 a decrease of $15.7 million compared to $19.0 million for the year ended December 31, 2005. The decrease is due to a significant portion of remediation of our QLT Buffalo LLC environmental liability assumption program occurring during the second and third quarters of 2005. The remediation was close to being completed and, as a result, did not generate technical services revenues in 2006 to the same extent as it did in 2005.

Net investment income and net losses on investments. Net investment income and net realized losses totaled $30.0 million for the year ended December 31, 2006, an increase of $15.8 million compared to $14.2 million for the year ended December 31, 2005. The amounts consisted of the following:

($ in thousands)	2006	2005
Net investment income	$ 45,934	$ 27,181
Net realized losses on investments	(15,945)	(13,020)
Net change in the fair market value of trading investments	—	—
	$ 29,989	$ 14,161

The increase is primarily due to an increase in net investment income of $18.7 million because of our larger amount of invested assets and rises in market interest rates, which is partially offset by an increase in net realized losses of $2.9 million, of which $16.9 million is attributable to other than temporary impairment losses recognized during the year ended December 31, 2006, compared to other than temporary losses of $10.2 million in 2005.

Net investment income was $45.9 million for the year ended December 31, 2006 an increase of $18.7 million, or 68.8% compared to $27.2 million for the year ended December 31, 2005. This was derived primarily from interest earned on fixed maturity and short term investments plus amortization of discounts on fixed maturity investments, partially offset by investment management fees. Our average annualized effective yield (calculated by dividing net investment income by the average amortized cost of invested assets, net of amounts payable or receivable for investments purchased or sold) was approximately 5.0% for the year ended December 31, 2006 compared to 3.5% for the year ended December 31, 2005, reflecting rises in market interest rates. Net realized losses of $15.9 million were generated primarily from our other than temporary impairment charge of $16.9 million.

As of December 31, 2006, the average duration of our investment portfolio was approximately 2.5 years with an average credit rating of approximately ''AA+'', compared to 2.6 years with an average credit rating of approximately ''AA+'' as at December 31, 2005.

Net foreign exchange losses. Net foreign exchange losses were $3.8 million for the year ended December 31, 2006 compared to net foreign exchange gains of $0.3 million in 2005. The increase in net foreign exchange losses was due to an increase in foreign currency assets, liabilities, particularly in Syndicate 4000 combined with a weakening US dollar during 2006 against those foreign currencies.

Expenses

Net losses and loss expenses. Net losses and loss expenses were $156.1 million for the year ended December 31, 2006, a decrease of $168.1 million, or 51.9%, compared to $324.2 million for the year ended December 31, 2005. Net losses and loss expenses are a function of our net premiums earned and changes in our expected ultimate losses and loss expenses for reported and unreported claims on contracts of insurance and reinsurance underwritten. The decrease in net losses and loss expenses is due to:

- the reduced number of insurance and reinsurance contracts we entered into and the associated net premiums earned as our insurance and reinsurance portfolios begin to run-off;
- the lack of natural catastrophe events reported during 2006 to which our in-force contracts may be exposed;
- favorable loss experience in mature accident periods in certain of our product lines; and
- several commutations of assumed reinsurance contracts.

Our expected ultimate losses during the year ended December 31, 2006 included adverse development of approximately $5.0 million related to the 2005 hurricanes and additional net losses of $2.6 million related to damage caused by an oil pipeline in California which ruptured during a mudslide in the first quarter of 2005, for which the damage is covered by an insurance contract issued by our environmental liability product line. This development in 2006 was primarily related to extended remediation activities required by the relevant environmental agencies.

Our total net loss ratio (calculated by dividing net losses and loss expenses by net premiums earned) was 69.3% for the year ended December 31, 2006, a decrease of 19.8% compared to a total net loss ratio of 89.1% for the year ended December 31, 2005. The decrease in the total net loss and loss expense ratio is due primarily to the hurricanes and the oil pipeline loss that occurred in 2005.

Acquisition expenses. Acquisition expenses were $42.5 million for the year ended December 31, 2006, a decrease of $27.1 million, or 38.9%, compared to $69.6 million for the year ended December 31, 2005. The decrease in acquisition expenses is due to the decrease in the number of insurance and reinsurance contracts we entered into and the associated net premiums earned.

Our acquisition expense ratio for the year ended December 31, 2006 was 18.9%, which is comparable to our acquisition expense ratio of 19.1% for the year ended December 31, 2005. Deferred acquisition costs include, as of December 31, 2006, $12.1 million of acquisition expenses on written contracts of insurance and reinsurance.

General and administrative expenses. General and administrative expenses were $100.0 million for the year ended December 31, 2006, a decrease of $9.6 million, or 8.8%, compared to $109.6 million for the year ended December 31, 2005. General and administrative expenses were comprised of $55.2 million of personnel related expenses (including $14.3 million of severance costs) and $44.8 million of other expenses during the year ended December 31, 2006 compared to $52.4 million of personnel related expenses (including $6.4 million of severance costs) and $57.2 million of other expenses during the year ended December 31, 2005. The decrease in general and administrative expenses is due to the cost saving measures taken in response to the decision to cease writing new business in 2006 but were mitigated by increased severance costs and to a lesser extent, the increased fees associated with ongoing efforts relating to Sarbanes-Oxley Section 404 compliance and costs relating to information technology development.

Interest expense. Interest expense was $5.5 million for the year ended December 31, 2006, an increase of $1.3 million compared to $4.2 million for the year ended December 31, 2005 and relates to the increase in interest rates during 2006 leading to a higher interest charge on the junior subordinated debentures.

Depreciation and amortization of intangible assets. Depreciation and amortization of intangible assets was $5.0 million for the year ended December 31, 2006, an increase of $2.0 million compared to $3.0 million for the year ended December 31, 2005. The majority of the increase relates to an

Table of Contents

impairment charge of $1.7 million with respect to our intangible assets associated with our U.S. insurance licenses. At December 31, 2006, the carrying value of these licenses approximates their estimated net realizable value.

We have not recorded any net deferred income tax benefits or assets relating to tax operating losses generated by our subsidiaries since our results of operations include a 100% valuation allowance against net deferred tax assets. For the year ended December 31, 2006, the net valuation allowance increased by approximately $24.4 million, to $49.1 million.

Discontinued operations.

(Loss) income from operations of discontinued operations. The loss from discontinued operations was $13.0 million for the period from January 1, 2006 to September 15, 2006, compared to income of $3.7 million for the year ended December 31, 2005 and consisted of revenues and expenses from ESC, which was sold on September 15, 2006.

ESC's (Loss) income from operations, previously included in the technical services segment, for the period from January 1, 2006 to September 15, 2006, and the year ended December 31, 2005, now reported in discontinued operations, are as follows:

	Period from January 1, 2006 to September 15, 2006	For the year ended December 31, 2005
	($ in thousands)	
Technical services revenues	$ 21,954	$ 50,752
Other income	14	165
Direct technical services costs	(13,968)	(37,027)
General and administrative expenses	(7,725)	(9,129)
Loss on impairment of goodwill	(12,561)	—
Depreciation of fixed assets and amortization of intangible assets	(647)	(988)
Income tax expense	(20)	(12)
(Loss) income from operations of discontinued operations.	$ (12,953)	$ 3,761

ESC's technical services revenues include the inter-company revenues charged by ESC to the QLT's and to our underwriting segment.

Technical services revenues. Technical services revenues were $22.0 million for the period ended December 31, 2006 compared to $50.8 million for year ended December 31, 2005. The decrease was mainly due to ESC generating significant inter-company revenue for the remediation of the sites of QLT Buffalo, LLC during the second and third quarter of 2005 as compared to the period from January 1, 2006 to September 15, 2006 when there was much less remediation activity. The decrease was also due to our exit from the environmental insurance business.

Direct technical services costs. Direct technical services costs were $14.0 million for the period ended Decembe