Equity Price Risk

As an economic hedge against a decline in the equity markets, the Company entered into total return swap transactions on Standard & Poor's 500 Depository Receipts ("SPDRs") and The Financial Select SPDR Fund ("XLF") and, as described below, purchased long Standard & Poor's and XLF index call options on 100% of the securities underlying the swap transactions. The aggregate notional amount of the swap transactions is $451.8 million. The swap transactions terminate during the fourth quarter of 2006. As of December 31, 2004, the Company has provided $99.2 million of US Treasury bills as collateral for the swap transactions. The swap transactions are recorded at fair value, based on the remainder of the notional amount less the fair value of the underlying securities. Changes in the fair value of the swap transactions are recorded as realized gains or losses in the consolidated statement of operations. As of December 31, 2004, the net change in the fair value of the swap transactions resulted in a net realized loss of $44.9 million.

In the third quarter of 2004 the Company sold short SPDRs and XLF as an economic hedge against a decline in its equity portfolio. In order to reduce the margin maintenance requirements for these short positions, the Company replaced the short positions with the total return swaps described above. The margin maintenance requirement related to the total return swaps was $99.2 million as of December 31, 2004.

As a component of the swap transactions, the Company continues to own Standard & Poor's 500 and XLF index call options at a cost of $13.6 million, with a strike price of approximately 120% of the notional amount of the swap transactions. A call option gives the purchaser the right, but not the obligation, to purchase an underlying security at a specific price or prices at or for a certain time. The call options limit the maximum potential loss on the swap transactions to 20% ($90.4 million) of the notional amount of the swap transactions. The call options are recorded at fair value in other invested assets in the consolidated balance sheet, and changes in the fair value are recorded as a realized gain or loss in the consolidated statement of operations. As of December 31, 2004, the net change in the fair value of call options resulted in a net realized gain of $6.7 million.

In addition, as of December 31, 2004, the Company had sold short $49.8 million of borrowed securities, for which it recorded a liability of $56.1 million. The net realized loss was $13.3 million for the year ended December 31, 2004. As of December 31, 2004, the Company provided cash and fixed income securities of $84.7 million as collateral for the borrowed securities. The Company's net investment income for the year ended December 31, 2004 reflects $2.7 million related to interest expense associated with the borrowed securities.

In connection with the short sales described above, the Company purchased a Standard & Poor's 500 index call option at a cost of $1.5 million with a strike price of 120% of the price at which the borrowed securities were sold short. The call option is recorded at fair value in other invested assets in the consolidated balance sheet and changes in the fair value are recorded as a realized gain or loss in the consolidated statement of operations. As of December 31, 2004, the net change in the fair market value of the call option resulted in a net realized gain of $0.4 million.

As of December 31, 2004 and 2003, 19.8% and 13.3%, respectively, of our investment and cash portfolio, was in common stocks (unaffiliated and affiliated). Marketable equity securities, which represented approximately 18.9% and 12.2% as of December 31, 2004 and 2003, respectively, of our investment and cash portfolio, are exposed to equity price risk, defined as the potential for loss in market value owing to a decline in equity prices. A 10% decline in the price of each of these marketable equity securities would result in a decline of $98.8 million and $51.5 million as of December 31, 2004 and 2003, respectively, in the fair market value of the total investment portfolio.

Foreign Currency Risk

Through investment in securities denominated in foreign currencies, we are exposed to foreign (i.e., non-U.S.) currency risk. Foreign currency exchange rate risk is the potential for loss in market value owing to a decline in the U.S. dollar value of these investments resulting from a decline in the exchange rate of the foreign currency in which these assets are denominated. As of December 31, 2004 and 2003, our total exposure to foreign denominated securities in U.S. dollar terms was approximately $1.1 billion and $816.4 million, respectively, or 21.6% and 18.9%, respectively, of our investment portfolio, including cash and cash equivalents. The primary foreign currency exposure was in Canadian dollar denominated securities, which represented 4.8% and 5.4% of our investment portfolio as of December 31, 2004 and 2003, respectively, and the British pound, which represented 7.8%