

PRIMUS GUARANTY LTD  
Form 10-Q  
November 08, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

or

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

For the transition period from                      to                      .

Commission File Number: 001-32307

Primus Guaranty, Ltd.

(Exact name of registrant as specified in its charter)

Bermuda

Not Required (State or other jurisdiction of  
incorporation or organization) (I.R.S. Employer Identification No.)

Clarendon House  
2 Church Street  
Hamilton HM 11, Bermuda

(Address of principal executive offices, including zip code)

441-296-0519

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

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

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

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## Part I. Financial Information

## Item 1. Financial Statements

Primus Guaranty, Ltd.

Condensed Consolidated Statements of Financial Condition

(in thousands except per share amounts)

September 30,

2007 December 31,

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

See accompanying notes.

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

## Three Months Ended

September 30, Nine Months Ended

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

44,410

See accompanying notes.

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Primus Guaranty, Ltd.

Condensed Consolidated Statements of Cash Flows

(in thousands except per share amounts)

Nine months ended

|                    |           |             |  |  |   |
|--------------------|-----------|-------------|--|--|---|
| September 30, 2007 | 2006      | (unaudited) | Cash flows from operating activities   | Net income (loss)  | \$  |
| (159,669)          | \$ 69,495 |             | Adjustments to reconcile net income (loss) to net cash provided by operating activities: |  |   |
|                    |           |             | Non-cash items included in net income (loss):  | Depreciation and amortization                              | 1,334 1,846   |
|                    |           |             | Share compensation   | 2,865 2,747  | Net unrealized (gain) loss on credit swap portfolio |
|                    |           |             | amortization of premium and discount on securities                                       | (6,710) (2,669)  | Loss on disposal of assets                          |
|                    |           |             | Amortization of debt issuance costs  | 233 128  | Distributions on preferred securities of subsidiary |
|                    |           |             | 4,206  | Increase (decrease) in cash resulting from changes in:     | Accrued interest receivable                         |
|                    |           |             | ( )  | Accrued premiums and receivables on credit and other swaps | (75) (352)  |
|                    |           |             | agreement  | — (4,116)  | Other assets  |
|                    |           |             | liabilities  | 8,886 —  | Interest payable                                    |
|                    |           |             | 38,013   | —  | Other liabilities                                   |
|                    |           |             | flows from investing activities  | Fixed asset purchases and capitalized software costs       | (2,143) (2,631)                                     |
|                    |           |             | Cash receipts on CLO investment  | 693 —  | Purchases of available-for-sale investments         |
|                    |           |             | ( )  | Maturities and sales of available-for-sale investments     | 519,897 67,000                                      |
|                    |           |             | (11,510)   | (38,760)   | Cash flows from financing activities                |
|                    |           |             | (1,149)  | (684)  | Proceeds from employee exercise of options          |
|                    |           |             | 7,335  | —  | Debt issuance costs                                 |
|                    |           |             | 23   | 85   | Net increase (decrease) in cash                     |
|                    |           |             | 204,428  | 69,355   | Cash and cash equivalents at beginning of period    |
|                    |           |             |  |  | Cash and cash equivalents at end of period          |
|                    |           |             |  |  | Cash paid for interest                              |
|                    |           |             |  |  | Cash paid for taxes                                 |

See accompanying notes.

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### 1. Organization and Basis of Presentation

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

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

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

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

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

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

The accompanying unaudited condensed consolidated financial statements of Primus Guaranty, Ltd. have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information

and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have

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been included. The results of operations for any interim period are not necessarily indicative of the results for a full year. The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances have been eliminated.

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

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

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

## 2. Recent Accounting Pronouncements

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

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

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

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

3. Available-for-sale Investments

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

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

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

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

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

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

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

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

|   | December 31, 2006 |            | Securities with Unrealized Losses |            | Less than 12 months | 12 months or more |
|---|-------------------|------------|-----------------------------------|------------|---------------------|-------------------|
| Total                                     | Fair              |            |                                   |            |                     |                   |
| Value                                     | Gross             |            |                                   |            |                     |                   |
| Unrealized                                |                   |            |                                   |            |                     |                   |
| Losses                                    | Fair              |            |                                   |            |                     |                   |
| Value                                     | Gross             |            |                                   |            |                     |                   |
| Unrealized                                |                   |            |                                   |            |                     |                   |
| Losses                                    | Fair              |            |                                   |            |                     |                   |
| Value                                     | Gross             |            |                                   |            |                     |                   |
| Unrealized                                |                   |            |                                   |            |                     |                   |
| Losses U.S. government agency obligations | \$ 19,978         | \$ (90)    | \$ 331,709                        | \$ (2,461) | \$ 351,687          | \$ (2,551)        |
| ) Collateralized loan obligation          | 6,406             | (130)      | —                                 | —          | 6,406               | (130)             |
|   | 331,709           | \$ (2,461) | \$ 358,093                        | \$ (2,681) | Total               | \$ 26,384         |
|   |                   |            |                                   |            |                     | \$ (220)          |

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The Company makes an assessment to determine whether unrealized losses reflect declines in value of securities that are other-than-temporarily impaired. The Company considers many factors including the length of time and significance of the decline in fair value; the Company's intent and ability to hold the investment for a sufficient period of time for a recovery in fair value; recent events specific to the issuer or industry; credit ratings and asset quality of collateral structure; and any significant changes in estimated cash flows. If the Company, based on its evaluation of the above factors, determines that the impairment is other-than-temporary, the carrying value of the security is written down to fair value and the unrealized loss is recognized through a charge to earnings in the consolidated statements of operations. Based on the Company's evaluation, it does not consider these investments to be other-than-temporarily impaired at September 30, 2007 and December 31, 2006.

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

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### 4. Net Credit Swap Revenues and Portfolio

#### Overview

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

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

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

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

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

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

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

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

### Primus Financial

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

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

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

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

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

### Harrier

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



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

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Consolidated Net Credit Swap Revenue and Credit Swap Portfolio Information

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

Three Months Ended

September 30, Nine Months Ended

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

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

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

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

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

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

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

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

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September 30, 2007 December 31, 2006 S&P Rating Category Notional

Amount Fair

Value Notional

Amount Fair

Value By Single Name Reference Entity/Tranche

Credit Swaps Sold – Single Name:

|                                       |               |             |               |           |                                |               |            |            |         |
|---------------------------------------|---------------|-------------|---------------|-----------|--------------------------------|---------------|------------|------------|---------|
| AAA                                   | \$ 1,116,983  | \$ (5,902)  | \$ 940,031    | \$ 1,721  | AA                             | 3,315,745     | (11,020)   | 2,275,564  | 8,845   |
| A                                     | 5,960,956     | (421)       | 6,490,958     | 30,644    | BBB                            | 6,104,161     | 18,339     | 5,271,390  | 32,958  |
| BB                                    | 510,271       | (7,829)     | 438,499       | 1,060     | B                              | 106,993       | (6,600)    | 68,703     | (1,333) |
| Total                                 | \$ 17,115,109 |             |               |           | Total                          | \$ 17,115,109 |            |            |         |
| AAA                                   | \$ 3,000,000  |             |               |           | AAA                            | \$ 3,000,000  |            |            |         |
| AA                                    | 500,000       | (18,459)    | 200,000       | (1,613)   | A                              | 100,000       | (8,564)    |            |         |
| BBB                                   | 100,000       | (8,805)     | —             | —         | Total                          | \$ 3,700,000  |            |            |         |
| Total                                 | \$ (85,790)   |             |               |           | AAA                            | \$ 500,000    |            |            |         |
| Credit Swaps Sold – ABS:              |               |             |               |           | AA                             | \$ 10,000     | \$ (6,844) | \$ —       | \$ —    |
| A                                     | 50,000        |             |               |           | A                              | 50,000        |            |            |         |
| BBB                                   | 15,000        | (23)        | 15,000        | (5,428)   | BB                             | 5,000         | (2,690)    | —          | —       |
| Total                                 | \$            |             |               |           | Total                          | \$            |            |            |         |
| Credit Swaps Purchased – Single Name: |               |             |               |           | AA                             | \$            |            |            |         |
| A                                     | (152,820)     | (1,551)     | (56,000)      | (10)      | BBB                            | (228,752)     |            |            |         |
| BB                                    | (15,280)      | (62)        | (13,961)      | 214       | B                              | (3,000)       | (102)      | (4,000)    |         |
| Total                                 | \$ (457,931)  | \$ (2,551)  | \$ (147,597)  | \$ (493)  | By Counterparty Buyer/(Seller) |               |            |            |         |
| Credit Swaps Sold – Single Name:      |               |             |               |           | AAA                            | \$ 5,000      | \$ 8       | \$ 31,406  | \$ 104  |
| A                                     | 3,250,276     | (3,053)     | 3,721,709     | 15,093    | Total                          | \$            |            |            |         |
| Total                                 | \$ 17,115,109 | \$ (13,433) | \$ 15,485,145 | \$ 73,895 | Credit Swaps Sold – Tranche:   |               |            |            |         |
| AAA                                   | \$ —          | \$ 100,000  | \$ (1,335)    | AA        | 3,250,000                      | (76,454)      | 400,000    | (1,693)    | A       |
| A                                     | 450,000       | (9,336)     | —             | Total     | \$ 3,700,000                   | \$ (85,790)   | \$ 500,000 | \$ (3,028) |         |

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| September 30, 2007  | December 31, 2006 | S&P Rating Category | Notional Amount | Fair Value |
|---|-------------------|---------------------|-----------------|------------|
| Value Credit Swaps Sold – ABS:                            |                   |                     |                 |            |
| (1,499)   | —                 | AA                  | \$ 75,000       | \$(27,104) |
| —   | —                 | A                   | \$ 15,000       | \$(23)     |
| Total \$ 80,000    \$(28,603)    \$ 15,000    \$(23)      |                   |                     |                 |            |
| Credit Swaps Purchased – Single Name:                     |                   |                     |                 |            |
| —   | —                 | AA                  | \$ (457,931)    | \$(2,551)  |
| —   | —                 | A                   | —               | —          |
| Total \$ (457,931)    \$(2,551)    \$(147,597)    \$(493) |                   |                     |                 |            |

Primus Financial's and Harrier's counterparties are generally financial institutions with whom they have entered into ISDA Master Agreements that consolidate the counterparty risk to one office of that counterparty. For the nine months ended September 30, 2007 and 2006, respectively, one and two counterparties each generated greater than ten percent of the Company's consolidated net premium revenue.

The table below shows the geographical distribution of the Company's credit swap portfolio by domicile of the Reference Entity and domicile of the counterparty as of September 30, 2007 and December 31, 2006 (in thousands):

| September 30, 2007  | December 31, 2006 | Country of Domicile | Notional Amount | Fair Value |
|---|-------------------|---------------------|-----------------|------------|
| Value Credit Swaps Sold – Single Name                       |                   |                     |                 |            |
| \$ 9,387,889  | \$(26,348)        | North America       | \$ 9,133,328    | \$ 46,286  |
| 647,000   | (87)              | Europe              | 6,901,220       | 12,321     |
| 17,115,109  | \$(13,433)        | Pacific             | 5,612,817       | 25,097     |
| 8,925,328   | \$(13,682)        | Others              | 1,351           | 179,000    |
| 132,000   | 446               | Total               | 169,000         | 1,161      |
| By Counterparty:  |                   |                     |                 |            |
| \$ 15,485,145   | \$ 73,895         | North America       | \$ 15,485,145   | \$ 73,895  |
| 3,700,000   | \$(85,790)        | Europe              | 8,047,781       | (252)      |
| 3,700,000   | \$(85,790)        | Pacific             | 7,486,121       | 37,502     |
| 500,000   | \$(3,028)         | Others              | 10,000          | 55         |
| Total \$ 17,115,109    \$(13,433)                           |                   |                     |                 |            |
| Credit Swaps Sold – Tranche                                 |                   |                     |                 |            |
| —   | —                 | North America       | \$ 50,000       | \$ 851     |
| —   | —                 | Europe              | 3,700,000       | (85,790)   |
| —   | —                 | Pacific             | 450,000         | (3,879)    |
| Total \$ 3,700,000    \$(85,790)    \$ 500,000    \$(3,028) |                   |                     |                 |            |

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| September 30, 2007                   | December 31, 2006 | Country of Domicile | Notional Amount | Fair Value    |
|--------------------------------------|-------------------|---------------------|-----------------|---------------|
| Value Credit Swaps Sold – ABS        |                   |                     |                 |               |
| 80,000                               | \$ (28,603 )      | \$ 15,000           | \$ (23 )        | Total         |
| By Reference Entity:                 |                   |                     |                 |               |
|                                      | North America     | \$ 80,000           | \$ (28,603 )    | \$ 10,000     |
|                                      | Europe            | —                   | —               | 5,000         |
|                                      | Others            | —                   | —               | (8 )          |
| Total                                | \$ 80,000         | \$ (28,603 )        | \$ 15,000       | \$ (23 )      |
| Credit Swaps Purchased – Single Name |                   |                     |                 |               |
| By Reference Entity:                 |                   |                     |                 |               |
|                                      | North America     | \$ (263,210 )       | \$ (1,766 )     | \$ (127,000 ) |
|                                      | Europe            | (173,041 )          | (831 )          | (20,597 )     |
|                                      | Pacific           | (2 )                | (12,600 )       | 127           |
|                                      | Others            | (9,080 )            | (81 )           | —             |
| —                                    | Total             | \$ (457,931 )       | \$ (2,551 )     | \$ (147,597 ) |
| By Counterparty:                     |                   |                     |                 |               |
|                                      | North America     | \$ (314,438 )       | \$ (776 )       | \$ (65,563 )  |
|                                      | Europe            | (143,493 )          | (1,775 )        | (82,034 )     |
|                                      | Others            | (131 )              | —               | —             |
| Total                                | \$ (457,931 )     | \$ (2,551 )         | \$ (147,597 )   | \$ (493 )     |

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The table below shows the distribution of the Company's credit swap portfolio by year of maturity as of September 30, 2007 and December 31, 2006 (in thousands). With respect to the credit swaps sold – ABS caption below, the actual maturity date for any contract will vary depending on the level of voluntary prepayments, defaults and interest rates with respect to the underlying mortgage loans. As a result, the actual maturity date for any contract may be earlier or later than indicated.

| September 30, 2007                    |                | December 31, 2006 |                | Notional            |              |
|---------------------------------------|----------------|-------------------|----------------|---------------------|--------------|
| Amount                                | Fair           | Value             | Notional       | Amount              | Fair         |
| Value Credit Swaps Sold – Single Name |                |                   |                |                     |              |
| \$ 156                                | \$ 2,432,827   | \$ 6,589          | 2008 1,221,010 | 2,122               | 1,127,551    |
| 2,739,561                             | 16,964         | 2010 6,072,664    | (1,164)        | 6,132,240           | 33,056       |
| 3,004,357                             | 10,842         | 2012 3,570,191    | (8,449)        | 44,609              | (41)         |
| 3,000                                 | (119)          | —                 | —              | Total \$ 17,115,109 | \$(13,433)   |
| Tranche                               |                |                   |                |                     |              |
|                                       |                | Year of Maturity  |                | 2007 \$ 597,133     |              |
| 350,000                               | (21,462)       | 350,000           | (2,544)        | 2014 3,350,000      | (64,328)     |
| 3,700,000                             | \$(85,790)     | \$ 500,000        | \$(3,028)      | 2011 10,000         | (3,746)      |
| Credit Swaps Sold – ABS               |                |                   |                |                     |              |
|                                       |                | Year of Maturity  |                | 2009 2,714,574      |              |
| 15,000                                | (7,995)        | 5,000             | (12)           | 2013 15,000         | (4,874)      |
| —                                     | 2016 10,000    | (1,200)           | —              | 2014 5,000          | (3)          |
| Total \$ 80,000                       |                |                   |                |                     |              |
| \$(28,603)                            |                |                   |                |                     |              |
| \$ 15,000                             |                |                   |                |                     |              |
| \$(23)                                |                |                   |                |                     |              |
| Credit Swaps Purchased – Single Name  |                |                   |                |                     |              |
|                                       |                | Year of Maturity  |                | 2011 \$ —           |              |
| (255)                                 | 2012 (197,328) | (1,002)           | (16,602)       | (16)                | 2013 (4,000) |
| (256,603)                             | (1,511)        | —                 | —              | Total \$ (457,931)  | \$(2,551)    |
| Total \$ (457,931)                    |                |                   |                |                     |              |
| \$(2,551)                             |                |                   |                |                     |              |
| \$(147,597)                           |                |                   |                |                     |              |
| \$(493)                               |                |                   |                |                     |              |



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## 5. Earnings per Share

Basic earnings per share (“EPS”) is calculated by dividing earnings available to common stockholders by the weighted average number of common shares outstanding. Diluted EPS is similar to basic EPS, but adjusts for the effect of the potential issuance of common shares. The following table presents the computations of basic and diluted EPS (in thousands, except per share data):

| Three months ended                                   |           | September 30, 2007                                   |              | September 30, 2006                                   |              |
|--|-----------|--|--------------|--|--------------|
| September 30, 2007                                   | \$ 23,732 | September 30, 2006                                   | \$ (159,669) | September 30, 2007                                   | \$ 69,495    |
| Net earnings (loss) available to common stockholders |           | Net earnings (loss) available to common stockholders |              | Net earnings (loss) available to common stockholders | \$ (128,435) |
| Weighted-average basic shares outstanding            | 45,024    | Weighted-average basic shares outstanding            | 43,314       | Weighted-average basic shares outstanding            | 44,734       |
| Effect of dilutive instruments                       |           | Effect of dilutive instruments                       |              | Effect of dilutive instruments                       |              |
| Employee stock options                               | — 49      | Employee stock options                               | — 59         | Employee stock options                               | — 59         |
| Restricted share units                               | — 210     | Restricted share units                               | — 275        | Restricted share units                               | — 275        |
| Warrants   | — 768     | Warrants   | — 791        | Warrants   | — 791        |
| Dilutive potential shares                            | — 1,027   | Dilutive potential shares                            | — 1,027      | Dilutive potential shares                            | — 1,027      |
| Weighted-average diluted shares                      | 45,024    | Weighted-average diluted shares                      | 44,341       | Weighted-average diluted shares                      | 44,734       |
| Basic EPS  | \$ (2.85) | Basic EPS  | \$ 0.55      | Basic EPS  | \$ (2.85)    |
| Diluted EPS  | \$ (3.57) | Diluted EPS  | \$ 1.61      | Diluted EPS  | \$ (3.57)    |
|  |           |  |              |  | \$ 1.56      |

For the three months ended September 30, 2007 and 2006, approximately 1.9 million shares and 510 thousand shares, respectively, were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented.

For the nine months ended September 30, 2007 and 2006, approximately 1.8 million shares and 611 thousand shares, respectively, were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented.

On February 14, 2007, XL Insurance (Bermuda) Ltd., a subsidiary of XL Capital Ltd., exercised its warrants to purchase 1,414,747 common shares of the Company at an exercise price of approximately \$5.18 per share, yielding proceeds to the Company of \$7.3 million.

## 6. Share Based Compensation

Effective January 1, 2006, the Company adopted SFAS No. 123(R), Share-Based Payment using the modified prospective transition method. SFAS No. 123(R) requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee options and other forms of equity compensation based on estimated fair values.

Compensation expense is recognized based on the fair value of options, performance shares, restricted shares and restricted share units (“RSU”) as determined on the date of grant and is being expensed over the related vesting period. The fair value of the options granted is determined using the Black-Scholes option-pricing model. Upon the adoption of SFAS No. 123(R), the Company continues to apply the Black-Scholes option pricing model for determining the estimated fair value for share awards as it deems it to be the most appropriate model. The use of the Black-Scholes model requires certain estimates for values of variables used in the model as noted in the table that follows.



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The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The weighted average fair value and assumptions used for options granted during the nine months ended September 30, 2007 were:

Nine months ended

September 30, 2007 Risk free interest rate 5.32% Volatility 32.83% Expected dividend yield 0.00% Expected option life 7 years Fair value of option \$3.73

The following table is a summary of option activity for the nine months ended September 30, 2007:

| September 30, 2007 | Number of shares | Weighted average exercise price | Outstanding at December 31, 2006 | Granted  | Exercised | Forfeited | Outstanding at September 30, 2007 | Exercisable at September 30, 2007 |
|--------------------|------------------|---------------------------------|----------------------------------|----------|-----------|-----------|-----------------------------------|-----------------------------------|
|                    |                  |                                 | 858,158                          | 847,607  | (67,968)  | (195,735) | 1,442,062                         | 360,269                           |
|                    |                  |                                 | \$ 11.18                         | \$ 11.70 |           | \$ 12.07  | \$ 11.50                          | \$ 10.40                          |

The following table summarizes the status of the Company's options as of September 30, 2007:

| Options Outstanding | Options Exercisable | Range of Exercise Prices | Number of Shares | Average Contractual Life (Years) | Weighted Average Exercise Price | Number of Shares | Weighted Average Exercise Price |
|---------------------|---------------------|--------------------------|------------------|----------------------------------|---------------------------------|------------------|---------------------------------|
| Remaining           |                     |                          | 103,594          | 5.4                              | \$ 9.76                         | 103,594          | \$ 9.76                         |
|                     |                     |                          | 90,625           | 5.4                              | \$ 6.94                         | 90,625           | \$ 6.94                         |
|                     |                     |                          | 1,219,562        | 5.9                              | \$ 12.03                        | 166,050          | \$ 12.68                        |
|                     |                     |                          | 360,269          |                                  |                                 | 1,442,062        |                                 |

The Company recorded share compensation expense, which includes options and restricted share units, of approximately \$2.9 million and \$2.7 million during the nine months ended September 30, 2007 and 2006, respectively. Share compensation expense is included in compensation and employee benefits in the consolidated statements of operations.

As of September 30, 2007, total unrecognized share-based compensation expense related to nonvested share awards was \$8.7 million. This expense is expected to be recognized over a weighted average period of 2.3 years.



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## 7. Comprehensive Income (Loss)

Comprehensive income (loss) for the three and nine months ended September 30, 2007 and 2006 is as follows (in thousands):

## Three Months Ended

September 30, Nine Months Ended

|                    |           |               |           |   |               |           |               |     |
|--------------------|-----------|---------------|-----------|---|---------------|-----------|---------------|-----|
| September 30, 2007 | 2006      | 2007          | 2006      | Net income (loss)   | \$ (128,435 ) | \$ 23,732 | \$ (159,669 ) | \$  |
| 69,495             |           |               |           | Foreign currency translation adjustments                                  | 28            | 46        | 23            | 85  |
|                    |           |               |           | Change in net unrealized gains (losses) on available-for-sale investments | (1,939 )      | 3,155     | (1,731 )      | 987 |
| (130,346 )         | \$ 26,933 | \$ (161,377 ) | \$ 70,567 | Total comprehensive income (loss)   |               |           |               | \$  |

## 8. Interest Rate Swap Agreement

In February 2007, the Company entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75.0 million of the Company's \$125.0 million, 7% fixed rate senior notes due in December 2036, to floating rate debt based on the three month LIBOR rate plus a spread as defined in the agreement. The interest rate swap is designated as a fair value hedge on the fixed senior notes in accordance with SFAS No. 133. The fair value of the interest rate swap is included in other liabilities and the offsetting adjustment to the carrying value of the debt is included in long term debt in the accompanying consolidated statements of financial condition. Payments or receipts on the interest rate swap are recorded in the interest expense caption in the consolidated statements of operations.

## 9. Primus CLO II, Ltd.

On July 10, 2007, the Company completed its second CLO offering, Primus CLO II, Ltd., and as a result, Primus Asset Management has added approximately \$400 million to its existing assets under management. The \$5 million cash collateral deposited in connection with warehousing period was returned to Harrier. Primus Asset Management receives management fees quarterly for managing the selection, acquisition and disposition of the underlying collateral and monitoring the underlying collateral, subject to the terms of the agreement. The Company has invested \$7.9 million or a 25% interest in the Subordinated Notes of Primus CLO II, Ltd. The Company's ultimate exposure to loss in Primus CLO II, Ltd. is limited to its investment of \$7.9 million. See note 3 of notes to condensed consolidated financial statements for further discussion.

Revenue generated from the warehouse loan agreements was recorded in other trading revenues, as presented in the condensed consolidated statements of operations, and comprises the Company's share under the warehouse loan transaction of net realized losses on the termination of individual loan positions and net interest earned on the warehouse loans.

The Company determined, pursuant to FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities, that it is not the primary beneficiary of Primus CLO II, Ltd. and accordingly, the special purpose entity or SPE will not be consolidated in the Company's financial statements.

## 10. Income Taxes

Effective January 1, 2007, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). The adoption did not have a material effect on the Company's consolidated financial statements.

As of September 30, 2007, and January 1, 2007, the Company did not have any unrecognized tax benefits. The Company's accounting policy with respect to interest and penalties, if any, would be to recognize them in the provision for income taxes in the consolidated statements of operations. The Company did not incur any income tax related interest income, interest expense or penalties for the three and nine months ended September 30, 2007 and 2006.

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The Company and certain subsidiaries file income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions, which are no longer subject to U.S. federal, state, local and foreign income tax examinations by tax authorities for years before 2003.

11. Subsequent Event

During the fourth quarter of 2007, the Company decided to discontinue Harrier's operations, and expects to unwind its remaining positions by the year end of 2007. The Company intends to reallocate approximately \$65 million of capital invested in Harrier to support the continued growth of its credit protection business. The Company expects to take a charge in the range of \$2 million to \$3 million in the fourth quarter of 2007 in connection with severance and other employee compensation costs and certain technology related costs associated with Harrier's discontinuation.

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### Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial condition and results of operations. This discussion should be read in conjunction with our consolidated financial statements and accompanying notes which appear in the Company's Annual Report on Form 10-K. It contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and in the Company's Annual Report on Form 10-K, particularly under Item 1A "Risk Factors" and the heading "Cautionary Note Regarding Forward-Looking Statements."

#### Business Overview

Primus Guaranty, Ltd. is a holding company that was incorporated in Bermuda in 1998 and conducts business through several operating subsidiaries. Our principal business is acting as a seller of credit swaps through Primus Financial Products, LLC, a limited liability company with "AAA/Aaa" counterparty ratings by Standard & Poor's Ratings Group, or S&P, and Moody's Investors Service, Inc., or Moody's, respectively. Primus Asset Management, Inc., or Primus Asset Management, one of our other principal operating subsidiaries, acts as an investment manager to affiliated companies and third party entities.

#### Primus Financial

Primus Financial Products, LLC, or Primus Financial, is a "AAA/Aaa" rated seller of credit swaps against credit obligations of corporate and sovereign issuers. In exchange for a fixed quarterly premium we agree, upon the occurrence of a default or other credit event (e.g., bankruptcy, failure to pay or restructuring) affecting a designated issuer, which we refer to as a Reference Entity, to pay our counterparty an agreed amount, which are referred to as "single name credit swaps." To date, we have not experienced a credit event on any Reference Entity in our portfolio. We seek to minimize the risk inherent in our credit swap portfolio by maintaining a high quality, highly diversified credit swap portfolio across Reference Entities, industries and countries. Primus Financial is also permitted to sell credit swaps referencing portfolios containing obligations of multiple Reference Entities, which we refer to as "tranches". During the fourth quarter of 2006, Primus Financial received the rating agencies' approval to sell credit swaps referencing residential mortgage-backed securities and commercial mortgage-backed securities, which we refer to as ABS. Primus Financial has begun selling credit swaps against ABS having an assigned rating of "BBB/Baa" (or the equivalent thereof) or better from a recognized rating agency referencing residential mortgage-backed securities.

#### Harrier/PRS Trading

In April 2007, Primus Guaranty formed Harrier Credit Strategies Master Fund, LP ("Harrier"), a Cayman Islands exempted limited partnership. During the second quarter of 2007, Primus Guaranty transferred the trading portfolio of PRS Trading Strategies to Harrier. During June 2007, Primus Guaranty contributed an additional \$25 million of capital to Harrier, in addition to the original \$50 million of capital contributed to PRS Trading Strategies by Primus Guaranty. Currently, no third parties have contributed capital to Harrier. Harrier trades in a broad range of fixed income products, including credit swaps, total return swaps on loan transactions, leveraged loans and investment grade and non-investment grade securities. Harrier also transacts in high yield and investment grade credit swap indices ("CDS index") and tranches within these CDS indices, at different levels of risk subordination within the index. CDS indices include credit swaps of a standardized basket of reference entities. Unlike Primus Financial, Harrier has no counterparty ratings from rating agencies and, accordingly, has entered into agreements with its counterparties to post collateral to support its contractual obligations. Harrier does not engage in trading activity with Primus Financial,



but may invest in similar instruments.

During the fourth quarter of 2007, the Company decided to discontinue Harrier's operations, and expects to unwind its remaining positions by the year end of 2007. The Company intends to reallocate

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approximately \$65 million of capital invested in Harrier to support the continued growth of its credit protection business. The Company expects to take a charge in the range of \$2 million to \$3 million in the fourth quarter of 2007 in connection with severance and other employee compensation costs and certain technology related costs associated with Harrier's discontinuation.

## Primus Asset Management

Primus Asset Management, Inc., or Primus Asset Management, acts as an investment manager to affiliated companies and third party entities. It currently manages the investment portfolios of its affiliates, Primus Financial and Harrier. Primus Asset Management manages three investment grade synthetic collateralized debt obligations, or SCDO's, on behalf of third parties. The SCDO's issue securities backed by one or more credit swaps sold against a diversified pool of investment grade corporate and sovereign reference entities. Primus Asset Management also manages two collateralized loan obligations, or CLO, transactions. A CLO issues securities backed by a diversified pool of primarily senior secured loans of corporations. Primus Asset Management receives fees from third party entities for its investment management services. Primus Asset Management's business plan is to expand its assets under management. Primus Asset Management is managed by an experienced team of professionals with expertise in credit analysis and structuring, investing, risk management and market analysis.

## Net Credit Swap Revenues

Net credit swap revenue in our consolidated statements of operations, comprises the premiums earned and expensed on credit swaps, gains or losses realized as a result of the termination of credit swaps and changes in the fair value of our credit swaps. Net credit swap revenue is earned by both Primus Financial and Harrier. Although both companies earn net credit swap revenue, the strategies of the two companies are different. Primus Financial generally sells credit swaps in order to earn premium income over the tenor of the contract, generally five years, whereas Harrier engages in the active buying and selling of credit swaps and generally will only hold positions for a limited portion of the swap's full tenor.

We receive premium income from the credit swaps we sell. In general, premiums are received quarterly in arrears and are accrued daily into income. In accordance with GAAP, we carry our credit swaps on our consolidated statements of financial condition at their fair value. Changes in the fair value of our credit swap portfolio are included as a component of net credit swap revenue in our consolidated statements of operations. If a credit swap has an increase or decline in fair value during a period, the increase will add to our net credit swap revenue and the decline will subtract from our net credit swap revenue for that period. Changes in the fair value of our credit swap portfolio are a function of the notional amount and composition of the portfolio and prevailing market credit swap premiums for comparable credit swaps. In our experience, considerable fluctuations may occur in the fair values of credit swaps from period to period and, as a result, the reader of our financial statements should not infer future results from historical net credit swap revenues or losses.

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

whether the individual contract was at a gain or a loss.

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

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First, whenever we receive new information suggesting that the credit quality of the underlying risk has deteriorated to a material degree, we consider the possibility of terminating the transaction, usually at a loss, to avoid a larger loss that could result if the credit swap were to remain in place until a credit event occurs. The principal factor that governs our decision regarding termination in these circumstances is whether we believe that the underlying risk has become substantially greater than the level of risk we would choose to assume in entering into a new sale of credit swaps. Since inception, we have terminated due to credit considerations less than 2% of the notional amount of credit swaps sold.

Second, we may elect to terminate a transaction for reasons other than credit considerations. Terminations of this type may generate gains or losses. In making a decision to terminate a transaction for reasons other than credit considerations, we consider a number of different factors, including the likelihood of additional gains or losses arising from the position, our view as to whether the capital dedicated to the position could be profitably reallocated to other opportunities over a foreseeable horizon, the total size of our portfolio in relation to our capital and the total size of our swap positions and exposures with a particular counterparty. We refer to terminations effected under these circumstances as “resizing” or “rebalancing”. Since inception, we have terminated less than 10% of credit swaps under which we sold credit swaps based on resizing or rebalancing considerations.

We may terminate a credit swap in one of two ways. We may negotiate an agreed termination through the original counterparty (an unwind). We may negotiate an assignment and novation of our rights and obligations under the credit swap to a third party (an assignment).

In the event of an unwind or assignment, we pay or receive a cash settlement negotiated with the counterparty or assignee, based on the fair value of the credit swap contract and the accrued premium on the swap contract at the time of negotiation. The amounts we pay or receive are recorded as a realization of fair value and as a realization of accrued premiums in the period in which the termination occurs.

## Interest Income

The Company earns interest income on its cash and cash equivalents, including commercial paper and available-for-sale securities, which include the accretion of discount and amortization of the premium recorded upon the acquisition of such securities, corporate and sovereign bonds.

## Other trading revenue (loss)

Other trading revenue (loss) comprises of the net trading gains or losses from Harrier/PRS Trading. Other trading revenue (loss) includes the realized and unrealized gains or losses on total return swaps, corporate and sovereign bonds and the net interest earned on the total return swaps and from the loans in the warehousing period.

## CLO Transactions

Each time the Company is involved in a CLO transaction, the Company performs an analysis to determine whether it is the primary beneficiary and accordingly, would be required to consolidate the SPE in its consolidated financial statements. The Company determined, pursuant to FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities, that it is not the primary beneficiary of Primus CLO II, Ltd. and accordingly, the special purpose entity or SPE will not be consolidated in the Company’s financial statements.

Revenue generated from the warehouse loan agreements during the warehouse period is recorded in other trading revenues, as presented in the condensed consolidated statements of operations, and comprises the Company's share under the warehouse loan transaction of net realized losses on the termination of individual loan positions and net interest earned on the warehouse loans.

Primus CLO I, Ltd.

On December 19, 2006, the Company completed its first CLO offering through Primus CLO I, Ltd ("CLO I", a special purpose entity or SPE). Primus Asset Management has added approximately

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\$400 million to its assets under management and is acting as collateral manager of CLO I. Under the terms of the collateral management agreement of the CLO, Primus Asset Management will receive management fees quarterly for managing the selection, acquisition and disposition of the underlying collateral and for monitoring the underlying collateral, subject to the terms of the agreement. The Company has invested \$6.5 million for a 25% interest in the Subordinated Notes of CLO I. The Company's ultimate exposure to loss in CLO I is limited to the \$6.5 million of its investment in CLO I. The Company has determined, that it is not the primary beneficiary of Primus CLO I, Ltd. and, accordingly, the SPE is not consolidated in the Company's financial statements. At September 30, 2007, the fair value of the Company's investment in CLO I was \$4.5 million. The unrealized loss is reported in accumulated other comprehensive loss as a component of shareholders' equity in the consolidated statements of financial condition.

## Primus CLO II, Ltd.

On July 10, 2007, the Company completed its second CLO offering, Primus CLO II, Ltd., and as a result, Primus Asset Management has added approximately \$400 million to its existing assets under management. The \$5 million cash collateral deposited in connection with the warehousing period was returned to Harrier. Primus Asset Management receives management fees quarterly for managing the selection, acquisition and disposition of the underlying collateral and monitoring the underlying collateral, subject to the terms of the agreement. The Company has invested \$7.9 million or a 25% interest in the Subordinated Notes of Primus CLO II, Ltd. The Company's ultimate exposure to loss in Primus CLO II, Ltd. is limited to its investment of \$7.9 million. At September 30, 2007, the fair value of the Company's investment in Primus CLO II was \$6.0 million. The unrealized loss is reported in accumulated other comprehensive loss as a component of shareholders' equity in the consolidated statements of financial condition.

## Income Taxes

Primus Guaranty, PRS Trading Strategies, Primus Bermuda, Primus Financial and Harrier are not expected to be engaged in the active conduct of a trade or business in the United States and as a result are not expected to be subject to United States federal, state or local income tax. Primus Asset Management is a United States domiciled corporation and is subject to United States federal, state and local income tax on its income, including on fees received from Primus Financial. Primus Re may be subject to United States federal, state or local income tax, or Primus Asset Management may be required to include all or part of Primus Re's income in calculating its liability for United States federal, state or local income tax, depending on the manner in which Primus Re conducts its business and the tax elections it makes. The maximum combined rate of United States corporate federal, state and local income tax that could apply to Primus Financial or Primus Bermuda, were they found to be engaged in a United States business in New York City and subject to income tax, is approximately 46% (not including United States branch profits tax that would be imposed on Primus Bermuda were Primus Financial deemed to be making distributions to Primus Bermuda). For United States federal income tax purposes, Primus Guaranty and Primus Bermuda are likely to be treated as passive foreign investment companies, or PFICs. For the year ending December 31, 2007, we anticipate that shareholders who are United States taxpayers that have made a qualified electing fund, or QEF, election should expect a significant increase in PFIC taxable income over the prior year ended December 31, 2006.

## Critical Accounting Policies

### Valuation of Credit Swaps

From the inception of our business, we have applied Statement of Financial Accounting Standards, or SFAS, 133, Accounting for Derivative Instruments and Hedging Activities, which established accounting and reporting standards for derivative instruments. SFAS 133 requires recognition of all credit swaps on the consolidated statements of

financial condition at fair value.

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The fair value of the credit swaps depends on a number of factors, primarily the market level of credit swap premiums associated with individual Reference Entities. Credit swaps are valued using market-standard pricing models which calculate the net present value of differences between future premiums on currently quoted market credit swaps and the contractual future credit swap premiums on contracts we have undertaken. Our pricing model has been internally developed but is benchmarked against a market-standard model. Generally, our model uses quoted market credit swap premium data that we purchase from independent pricing services. This service takes pricing information from a number of prominent dealers and brokers in the credit swap market across a range of standard maturities and restructuring terms, and creates average mid-market credit swap premium quotes on specific Reference Entities. We adjust the mid-market pricing we receive from the pricing service to reflect an estimate of the cost to close the position.

We believe there are a variety of factors that may influence market credit swap premium levels. The principal factor is the market's view of the probability that a Reference Entity will default over the multi-year horizon typical for a credit swap contract. Those views in turn are influenced by the state of the economy, the outlook for corporate financial health in general as well as the outlook for particular industries and companies. Additional factors include the magnitude of debt outstanding and debt paying capacity within those same industries and companies. One factor specific to the credit swap market is the capacity of credit swap market participants to sell credit swaps. If, for example, commercial banks are actively buying protection to manage their regulatory capital, this will tend, other factors being equal, to absorb the capacity of protection sellers and cause an increase in market credit swap premiums. Conversely, creation of special purpose vehicles that sell protection create additional protection seller capacity and, absent additional demand, can cause a decrease in market premiums. Absent rapid and steep changes, interest rates have, at most, a limited effect on market credit swap premium levels.

## Share-Based Employee Compensation Plans

Effective January 1, 2006, the Company adopted SFAS No. 123(R), Share-Based Payment, using the modified prospective transition method. SFAS No. 123(R) requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including employee options and other forms of equity compensation based on estimated fair values.

Compensation expense is recognized based on the fair value of options, performance shares, restricted shares and restricted share units ("RSU") as determined on the date of grant and is being expensed over the related vesting period. The fair value of the options granted is determined using the Black-Scholes option-pricing model. Upon the adoption of SFAS No. 123(R), the Company continues to apply the Black-Scholes option pricing model for determining the estimated fair value for share awards as it deems it to be the most appropriate model. The use of the Black-Scholes model requires certain estimates for values of variables used in the model.

## Results of Operations

Three Months Ended September 30, 2007 Compared With Three Months Ended September 30, 2006

### Overview

During the third quarter of 2007, the global credit markets experienced difficult market conditions. These conditions resulted in sharp widening of credit spreads, greater volatility, lower levels of liquidity, significant re-pricing of credit risk and downgrades by rating agencies. These challenging market conditions negatively impacted our results for the third quarter of 2007, primarily resulting from significant unrealized losses from the mark-to-market losses of our



credit swap portfolio. The market volatility did present renewed opportunities for new transaction volume in Primus Financial, but negatively impacted our Harrier results.

Our net income (loss) for the third quarter of 2007 was \$(128.4) million compared with \$23.7 million for the third quarter of 2006. The net loss during the third quarter of 2007 was primarily

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due to unrealized losses from the mark-to-market losses of our credit swap portfolio as compared with unrealized gains from the mark-to-market gains on our credit swap portfolio during the third quarter of 2006.

Net credit swap premiums earned were \$22.4 million in the third quarter of 2007, compared with \$18.0 million in the third quarter of 2006. The increase in net premiums is attributable to the growth in our portfolio of credit swaps sold.

Interest income on our portfolio of investments was \$10.9 million in the third quarter of 2007, compared with \$7.1 million in the third quarter of 2006. The increase is due to higher market interest rates, together with increased invested balances, mainly arising from the investment of the proceeds of the \$125 million senior notes offering by Primus Guaranty in December 2006.

Other trading revenue (loss) incurred by Harrier/PRS Trading was \$(3.9) million during the third quarter of 2007 compared with \$389 thousand during the third quarter of 2006. The losses during the third quarter of 2007 primarily reflect the difficult market conditions resulting in mark downs in the value of loans and bond positions.

Interest expense and distributions on preferred securities were \$7.0 million in the third quarter of 2007, compared with \$4.3 million in the third quarter of 2006. The increase is due to higher short-term market interest rates, together with higher debt balances associated with the \$125 million senior notes offering by Primus Guaranty in December 2006. In addition, the turbulent market conditions also affected the debt capital markets. Beginning in August 2007, investor demand was limited for our preferred securities and certain of our subordinated deferrable notes during the standard 28 day auction rate resets. As a result of the insufficient demand, the auctions didn't clear and the rates on these preferred securities and deferrable notes were set at the maximum spread rates at current rating levels, as specified in the respective security agreements. This resulted in additional interest expense of \$500 thousand during the third quarter of 2007. If these securities continue to be set at the maximum spread rates, we anticipate incremental interest costs of approximately \$6.0 million on an annualized basis.

Our operating expenses were \$9.4 million in the third quarter of 2007, compared with \$9.1 million in the third quarter of 2006. The increase was primarily due to higher technology and data costs attributable to the expansion of our technology platform to accommodate new trading strategies associated with our asset management build-out, partially offset by lower compensation costs.

## Consolidated Net Credit Swap Revenue (Loss)

Consolidated net credit swap revenue (loss) was \$(120.1) million and \$28.9 million for the three months ended September 30, 2007 and 2006, respectively.

The table below shows the Company's consolidated net credit swap revenue (loss), which is generated by Primus Financial and Harrier/PRS Trading Strategies for the three months ended September 30, 2007 and 2006 (in thousands):

|               |   |      |                  |               |           | Three               |               |
|---------------|---|------|------------------|---------------|-----------|---------------------|---------------|
|               | months ended                                      |      |                  |               |           |                     |               |
| September 30, | 2007  | 2006 | Primus Financial | \$ (117,464 ) | \$ 29,366 | Harrier/PRS Trading | (2,658 ) (461 |
| )             | Total consolidated net credit swap revenue (loss) |      |                  | \$ (120,122 ) | \$ 28,905 |                     |               |

Net credit swap loss for Harrier/PRS Trading primarily consisted of mark-to-mark unrealized losses on its credit swap portfolio during the periods presented. See other trading revenues for further discussion of Harrier/PRS Trading activities during the period.

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

Net Credit Swap Revenue – Primus Financial

Net credit swap revenue (loss) was \$(117.5) million and \$29.4 million for the three months ended September 30, 2007 and 2006, respectively. Net credit swap revenue for Primus Financial excludes

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\$72 thousand for the three months ended September 30, 2006 of net revenue earned on three credit swap transactions with its affiliate, Primus Re, as this amount is eliminated in consolidation.

Net credit swap revenue (loss) includes:

- Net premiums earned;
- Net realized gains (losses) on credit swaps; and
- Net unrealized gains (losses) on credit swaps.

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

| ended                                  | Three months |   |           |           |
|--|--------------|---|-----------|-----------|
| September 30, 2007                     | 2006         | Net premiums earned                           | \$ 22,316 | \$ 18,129 |
| swaps                                  | 1,040        | Net unrealized gains (losses) on credit swaps | (140,820) | 12,776    |
| swap revenue (loss)                    | \$ (117,464) |   | \$ 29,366 |           |
| Net Premiums Earned – Primus Financial |              |   |           |           |

Net premiums earned were \$22.3 million and \$18.1 million for the three months ended September 30, 2007 and 2006, respectively. Net premiums earned include:

- Premium income on single name credit swaps sold;
- Premium income on tranches sold;
- Premium income on credit swaps sold on asset backed securities (ABS);
- Net premium expense on credit swaps undertaken to offset credit risk.

The table below shows the components of net premiums earned for the three months ended September 30, 2007 and 2006 (in thousands).

| ended  | Three months |   |           |           |
|--|--------------|---|-----------|-----------|
| September 30, 2007                                       | 2006         | Premium income on single name credit swaps sold | \$ 17,723 | \$ 17,175 |
| income on tranches sold                                  | 4,328        | Premium income on credit swaps sold on ABS      | 283       | —         |
| expense on credit swaps undertaken to offset credit risk | (18)         |   | —         |           |
|  |              | Total net premiums earned                       | \$ 22,316 | \$ 18,129 |

Premium income on single name credit swaps sold was \$17.7 million and \$17.2 million during the three months ended September 30, 2007 and 2006, respectively. The increase was primarily due to the expansion of our credit swap portfolio. The average notional amounts outstanding of credit swaps sold were \$16.1 billion and \$15.2 billion for the three months ended September 30, 2007 and 2006, respectively.

Premium income from tranches sold was \$4.3 million and \$954 thousand for the three months ended September 30, 2007 and 2006, respectively. The average notional amount of tranches outstanding was \$3.6 billion and \$350.0 million for the three months ended September 30, 2007 and 2006, respectively.

During the fourth quarter of 2006, we received rating agency approval to sell credit protection on asset-backed securities (ABS). Premium income on credit swaps sold on ABS was \$283 thousand

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during the three months ended September 30, 2007. The average notional amount of credit swaps sold on ABS outstanding was \$80.0 million for the three months ended September 30, 2007.

## Net Realized Gains (Losses) on Credit Swaps – Primus Financial

Net realized gains (losses) for the three months ended September 30, 2007 and 2006 are summarized below (in thousands):

|                    | Three months |   |
|--------------------|--------------|---|
| ended              |              |   |
| September 30, 2007 | 2006         | Realized gains on terminated credit swaps sold \$ 1,184 \$ 12                           |
|                    |              | Realized losses on terminated credit swaps sold (17) (1,551)                            |
|                    |              | Net realized losses on terminated credit swaps undertaken to offset credit risk (127) — |
|                    |              | Total net realized gains (losses) on credit swaps \$ 1,040 \$ (1,539)                   |

Net realized gains (losses) on the early termination of credit swaps sold were \$1.0 million and \$(1.5) million for the three months ended September 30, 2007 and 2006, respectively. During the three months ended September 30, 2007 and 2006, we terminated \$144.4 million and \$134.4 million notional amount of credit swaps sold, respectively. Realized gains incurred during the three months ended September 30, 2007 and 2006 were primarily the result of rebalancing our credit swap portfolio. The realized losses incurred during the three months ended September 30, 2007 and 2006 were primarily the result of our decision to reduce our exposure to a limited number of reference entities against which we had sold credit protection.

## Net Unrealized Gains (Losses) on Credit Swaps – Primus Financial

The unrealized gains (losses) on credit swaps sold for the three months ended September 30, 2007 and 2006 are summarized below (in thousands):

|                    | Three |  |
|--------------------|-------|--|
| months ended       |       |  |
| September 30, 2007 | 2006  | Net unrealized gains (losses) on credit swaps sold \$ (65,137) \$ 9,973        |
|                    |       | Net unrealized gains (losses) on tranches sold (52,457) 2,803                  |
|                    |       | Net unrealized losses on credit swaps sold on ABS (22,731) —                   |
|                    |       | Net unrealized losses on credit swaps undertaken to offset credit risk (495) — |
|                    |       | Total net unrealized gains (losses) on credit swaps \$ (140,820) \$ 12,776     |

Net unrealized gains (losses) on credit swaps were \$(140.8) million and \$12.8 million for the three months ended September 30, 2007 and 2006, respectively. The change in unrealized gains (losses) on credit swaps reflects the change in the fair value of our credit swap portfolio during these periods. As previously discussed, during the third quarter of 2007, significantly wider credit spreads as a result of re-pricing of credit risk led to the unrealized losses on our credit swap portfolio. The unrealized gain in the third quarter of 2006 on credit swaps sold was primarily attributable to the increase in the fair value of the portfolio as market premiums fell during that quarter.

## Asset Management and Advisory Fees

We recognized \$1.1 million and \$542 thousand of asset management and advisory fees for the three months ended September 30, 2007 and 2006, respectively. The increase was primarily due to asset management fees related to our

first CLO offering, Primus CLO I, Ltd. in December 2006.

On December 19, 2006, the Company completed its first CLO offering of Primus CLO I, Ltd. and on July 10, 2007, the Company completed its second CLO offering, Primus CLO II, Ltd. Primus Asset

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Management acts as collateral manager for both. Under the terms of the collateral management agreements, Primus Asset Management receives management fees quarterly for managing the selection, acquisition and disposition of the underlying collateral and for monitoring the underlying collateral, subject to the terms of the agreement.

In addition, Primus Asset Management manages three investment grade synthetic collateralized debt obligations, or SCDO's, on behalf of third parties. Some of our SCDO asset management contracts also provide for the receipt of contingent performance fees at the maturity of the contracts, none of which has been earned or accrued at September 30, 2007 or 2006, respectively.

## Interest Income

We earned interest income of \$10.9 million and \$7.1 million for the three months ended September 30, 2007 and 2006, respectively. The increase in interest income is attributable to higher average invested balances resulting from the December 2006 senior notes offering of \$125 million by Primus Guaranty and retained cash earnings, and higher yields on our investment portfolio. The increase in yields is attributable to generally higher short-term market rates of interest during 2006 and 2007.

Weighted average yields on our cash, cash equivalents and investments were 5.18% in the three months ended September 30, 2007 compared with 4.40% for the three months ended September 30, 2006.

The table below summarizes our interest income for the three months ended September 30, 2007 and 2006 and our total cash, cash equivalents, available-for-sale and trading account securities at September 30, 2007 and 2006 (in thousands).

|               |      |      |   |            | Three      |                               |            |
|---------------|------|------|---|------------|------------|-------------------------------|------------|
| months ended  |      |      |   |            |            |                               |            |
| September 30, | 2007 | 2006 | Interest income                                   | \$ 10,881  | \$ 7,143   | Cash and cash equivalents     | \$ 265,439 |
|               |      |      | Available-for-sale and trading account securities | 617,815    | 601,189    | Total cash, cash equivalents, |            |
|               |      |      | available-for-sale and trading account securities | \$ 883,254 | \$ 659,890 |                               |            |
|               |      |      | Other Trading Revenue                             |            |            |                               |            |

During the three months ended September 30, 2007 and 2006, Harrier/PRS Trading Strategies recorded other trading revenue (loss) of \$(3.9) million and \$389 thousand, respectively. These amounts exclude Harrier/PRS Trading Strategies' net credit swap loss of \$2.7 million and \$461 thousand for the three months ended September 30, 2007 and 2006, respectively, as discussed under net credit swap revenue (loss) caption. Other trading revenue comprises the net trading gains or losses from Harrier/PRS Trading's total return swaps, loan warehousing and trading activities.

## Foreign currency revaluation

We transact credit swaps denominated in U.S. dollars and euros. Euro-denominated credit swaps comprised 37% of the notional amount of our Primus Financial credit swaps sold portfolio at September 30, 2007. We sell the majority of our euro premium receipts as they are received for U.S dollars, retaining only a small working cash balance in euros. During the three months ended September 30, 2007 and 2006, we recorded foreign currency revaluation losses of zero and \$32 thousand, respectively.





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Operating Expenses

Our operating expenses were \$9.4 million and \$9.1 million for the three months ending September 30, 2007 and 2006, respectively, as summarized below (in thousands):

|   |          |          |                             | Three months  |          |
|---|----------|----------|-----------------------------|---------------|----------|
|   |          |          |                             | ended         |          |
|   |          |          |                             | September 30, |          |
|   |          |          |                             | 2007          |          |
|   |          |          |                             | 2006          |          |
| Compensation and employee benefits              | \$ 4,890 | \$ 5,023 | Professional and legal fees | 1,355         | 1,361    |
| Depreciation and amortization                   | 387      | 649      | Technology and data         | 1,286         | 726      |
| Other   | 1,469    | 1,302    | Total operating expenses    | \$ 9,387      | \$ 9,061 |
| Number of full-time employees, at end of period | 62       | 46       |                             |               |          |

Compensation expense for the three months ended September 30, 2007 decreased approximately \$0.1 million over the comparable prior period. The decrease was primarily the result of lower performance based incentives, offset by an increase in compensation costs as a result of higher headcount as we expanded our business activities. Our accrued cash incentive compensation expense was \$1.3 million for the three months ended September 30, 2007, compared with an accrued expense of \$2.1 million for the corresponding prior period. Share compensation expense was approximately \$0.6 million in each of the three months ended September 30, 2007 and 2006, respectively.

Professional and legal fees expense includes audit and tax advisor fees, legal costs, recruitment fees and director and officer insurance expense. Professional and legal fees were consistent for the three months ended September 30, 2007 compared with the corresponding prior period.

Depreciation and amortization expense decreased primarily as a result of certain capitalized software development costs being fully amortized, partially offset by increases in depreciation expense on new fixed asset purchases and capitalized software costs.

The increase in technology and data expense was primarily attributable to the expansion of our technology platform to accommodate new trading strategies associated with our asset management build-out.

Other operating expenses include rent, bank fees, rating agency fees, brokerage expense, travel and entertainment, exchange fees and other administrative expenses. The increase in other expenses was primarily due to higher bank, debt and investment management fees.

Interest Expense and Preferred Distributions

During the third quarter of 2007, the turbulent market conditions as previously discussed, also affected the debt capital markets. Beginning in August 2007, investor demand was limited for our preferred securities and certain of our subordinated deferrable notes during the standard 28 day auction rate resets. As a result of the insufficient demand, the auctions didn't clear and the rates on these preferred securities and deferrable notes were set at the maximum spread rates at current rating levels, as specified in the respective security agreements. This resulted in additional interest expense of \$500 thousand during the quarter.

For the three months ended September 30, 2007 and 2006, we recorded \$5.3 million and \$2.8 million of interest expense, respectively. The increase in interest expense was primarily the result of higher debt balances as a result of the \$125 million senior notes offering by Primus Guaranty in December 2006, higher short-term interest rates and the

maximum spread rates noted above.

In February 2007, the Company entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75.0 million of the Company's \$125.0 million, 7% fixed rate senior notes due in December 2036, to floating rate debt based on the three month LIBOR rate plus a spread as defined in the agreement.

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Primus Financial also made net distributions of \$1.7 million and \$1.4 million during the three months ended September 30, 2007 and 2006, respectively, on the Primus Financial Cumulative Preferred Securities issued in December 2002. The increase in net distributions was primarily due to increased short-term interest rates and the maximum spread rates noted above.

Income Taxes

Provision (benefit) for income taxes was zero and \$(14) thousand for the three months ended September 30, 2007 and 2006, respectively. Primus Guaranty had a net deferred tax asset, fully offset by a valuation allowance, of \$10.2 million and \$9.5 million as of September 30, 2007 and December 31, 2006, respectively. The change in the deferred tax asset and valuation allowance resulted primarily from Primus Asset Management's estimated net operating loss. It is expected that only the income of Primus Asset Management and its subsidiary, Primus Re, are likely to be subject to United States federal and local income taxes. However, were Primus Bermuda to be subject to income tax, at a combined United States federal, New York State and New York City income tax rate of 46%, on its United States GAAP income or loss, then its income tax expense or (benefit), excluding interest and penalties, would have been approximately \$(54.7) million and \$12.4 million for the three months ended September 30, 2007 and 2006, respectively. These figures assume that Primus Financial is not deemed to be making distributions to Primus Bermuda; such distributions would subject Primus Bermuda to an additional United States federal branch profits tax.

Nine Months Ended September 30, 2007 Compared With Nine Months Ended September 30, 2006

Overview

Our net income (loss) for the nine months ended September 30, 2007 was \$(159.7) million compared with \$69.5 million for the nine months ended September 30, 2006. The net loss during the first nine months of 2007 was primarily due to unrealized losses from the mark-to-market losses of our credit swap portfolio as compared with unrealized gains from the mark-to-market gains of our credit swap portfolio during the comparable period of 2006. Net credit swap premiums earned were \$61.2 million in the first nine months of 2007, compared with \$51.1 million in the comparable period of 2006. The increase in net premiums is attributable to the growth in our portfolio of credit swaps sold. Our operating expenses were \$29.6 million in the nine months ended September 30, 2007, compared with \$26.2 million in the nine months ended September 30, 2006. The increase was primarily due to higher compensation and employee benefits as a result of increased headcount, higher technology and data costs attributable to the expansion of our technology platform to accommodate new trading strategies associated with our asset management build-out.

Consolidated Net Credit Swap Revenue (Loss)

Consolidated net credit swap revenue (loss) was \$(140.9) million and \$85.9 million for the nine months ended September 30, 2007 and 2006, respectively.

The table below shows the Company's consolidated net credit swap revenue (loss), which is generated by Primus Financial and Harrier/PRS Trading Strategies for the nine months ended September 30, 2007 and 2006 (in thousands):

Nine months  
ended

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|   |      |                  |               |           |                     |          |        |
|---|------|------------------|---------------|-----------|---------------------|----------|--------|
| September 30, 2007                                  | 2006 | Primus Financial | \$ (136,630 ) | \$ 86,587 | Harrier/PRS Trading | (4,364 ) | (722 ) |
| ) Total consolidated net credit swap revenue (loss) |      |                  | \$ (140,994 ) | \$ 85,865 |                     |          |        |

Net credit swap loss for Harrier/PRS Trading primarily consisted of mark-to-mark unrealized losses on its credit swap portfolio during the periods presented. See other trading revenues for further discussion of Harrier/PRS Trading activities during the period.

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

Net Credit Swap Revenue – Primus Financial

Net credit swap revenue (loss) was \$(136.6) million and \$86.6 million for the nine months ended September 30, 2007 and 2006, respectively. Net credit swap revenue for Primus Financial excludes \$233 thousand for the nine months ended September 30, 2006 of net revenue earned on three credit swap transactions with its affiliate, Primus Re, as this amount is eliminated in consolidation.

Net credit swap revenue (loss) includes:

- Net premiums earned;
- Net realized gains (losses) on credit swaps; and
- Net unrealized gains (losses) on credit swaps.

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

|  |      |         |   |              | Nine months |   |
|--|------|---------|---|--------------|-------------|---|
| ended                                  |      |         |   |              |             |   |
| September 30,                          | 2007 | 2006    | Net premiums earned                           | \$ 60,893    | \$ 51,143   | Net realized gains (losses) on credit swaps |
|  | 810  | (1,922) | Net unrealized gains (losses) on credit swaps | (198,333)    | 37,366      | Total net credit swap revenue (loss)        |
|  |      |         |   | \$ (136,630) | \$ 86,587   |   |
| Net Premiums Earned – Primus Financial |      |         |   |              |             |   |

Net premiums earned were \$60.9 million and \$51.1 million for the nine months ended September 30, 2007 and 2006, respectively. Net premiums earned include:

- Premium income on single name credit swaps sold;
- Premium income on tranches sold;
- Premium income on credit swaps sold on asset backed securities (ABS);
- Net premium expense on credit swaps undertaken to offset credit risk.

The table below shows the components of net premiums earned for the nine months ended September 30, 2007 and 2006 (in thousands).

Nine months

ended

|                    |      |   |           |           |                                 |       |       |  |     |   |  |      |   |                           |           |           |
|--------------------|------|---|-----------|-----------|---------------------------------|-------|-------|--|-----|---|--|------|---|---------------------------|-----------|-----------|
| September 30, 2007 | 2006 | Premium income on single name credit swaps sold | \$ 52,131 | \$ 49,529 | Premium income on tranches sold | 8,329 | 1,614 | Premium income on credit swaps sold on ABS | 451 | — | Net premium expense on credit swaps undertaken to offset credit risk | (18) | — | Total net premiums earned | \$ 60,893 | \$ 51,143 |
|--------------------|------|---|-----------|-----------|---------------------------------|-------|-------|--|-----|---|--|------|---|---------------------------|-----------|-----------|

Premium income on single name credit swaps sold was \$52.1 million and \$49.5 million during the nine months ended September 30, 2007 and 2006, respectively. The increase was primarily due to the expansion of our credit swap portfolio. The average notional amounts outstanding of credit swaps sold were \$15.7 billion and \$14.8 billion for the nine months ended September 30, 2007 and 2006, respectively.

Premium income from tranches sold was \$8.3 million and \$1.6 million for the nine months ended September 30, 2007 and 2006, respectively. The average notional amount of tranches outstanding was \$2.3 billion and \$233.3 million for the nine months ended September 30, 2007 and 2006, respectively.

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During the fourth quarter of 2006, we received rating agency approval to sell credit protection on asset-backed securities (ABS). Premium income on credit swaps sold on ABS was \$451 thousand during the nine months ended September 30, 2007. The average notional amount of credit swaps sold on ABS outstanding was \$55.0 million for the nine months ended September 30, 2007.

Net Realized Gains (Losses) on Credit Swaps – Primus Financial

Net realized gains (losses) for the nine months ended September 30, 2007 and 2006 are summarized below (in thousands):

|   | Nine months |            |
|---|-------------|------------|
| ended   | 2007        | 2006       |
| September 30, 2007  | \$ 3,197    | \$ 625     |
| September 30, 2006  | (2,387)     | (2,547)    |
| Realized gains on terminated credit swaps sold                                  |             |            |
| Net realized losses on terminated credit swaps undertaken to offset credit risk | \$ 810      | \$ (1,922) |
| Total net realized gains (losses) on credit swaps                               |             |            |

Net realized gains (losses) on the early termination of credit swaps sold were \$810 thousand and \$(1.9) million for the nine months ended September 30, 2007 and 2006, respectively. We terminated \$503.0 million and \$271.9 million notional amount of credit swaps sold during the nine months ended September 30, 2007 and 2006, respectively. Realized gains incurred during the nine months ended September 30, 2007 and 2006 were primarily the result of rebalancing our credit swap portfolio. The realized losses incurred during the nine months ended September 30, 2007 and 2006 were primarily the result of our decision to reduce our exposure to a limited number of reference entities against which we had sold credit protection.

Net Unrealized Gains (Losses) on Credit Swaps – Primus Financial

The unrealized gains (losses) on credit swaps sold for the nine months ended September 30, 2007 and 2006 are summarized below (in thousands):

|  | Nine months  |           |
|--|--------------|-----------|
| ended  | 2007         | 2006      |
| September 30, 2007   | \$ (86,496)  | \$ 39,189 |
| September 30, 2006   | (82,762)     | (1,823)   |
| Net unrealized gains (losses) on credit swaps sold                     |              |           |
| Net unrealized losses on tranches sold                                 | (28,580)     | —         |
| Net unrealized losses on credit swaps undertaken to offset credit risk | \$ (198,333) | \$ 37,366 |
| Total net unrealized gains (losses) on credit swaps                    |              |           |

Net unrealized gains (losses) on credit swaps were \$(198.3) million and \$37.4 million for the nine months ended September 30, 2007 and 2006, respectively. The change in unrealized losses on credit swaps reflects the change in the fair value of our credit swap portfolio during these periods. As previously discussed, significantly wider credit spreads as a result of re-pricing of credit risk led to the unrealized losses on our credit swap portfolio. The unrealized gain in the first nine months of 2006 on credit swaps sold is primarily attributable to the increase in the fair value of the portfolio as market premiums fell during that period.

Asset Management and Advisory Fees



We recognized \$2.4 million and \$709 thousand of asset management and advisory fees for the nine months ended September 30, 2007 and 2006, respectively. The increase was primarily due to asset management fees related to our first CLO offering in December 2006.

On December 19, 2006, the Company completed its first CLO offering of Primus CLO I, Ltd. and on July 10, 2007, the Company completed its second CLO offering, Primus CLO II, Ltd. Primus Asset

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Management acts as collateral manager for both. Under the terms of the collateral management agreements, Primus Asset Management receives management fees quarterly for managing the selection, acquisition and disposition of the underlying collateral and for monitoring the underlying collateral, subject to the terms of the agreements.

In addition, Primus Asset Management manages three investment grade synthetic collateralized debt obligations, or SCDO's, on behalf of third parties. Some of our SCDO asset management contracts also provide for the receipt of contingent performance fees at the maturity of the contracts, none of which has been earned or accrued at September 30, 2007 or 2006, respectively.

## Interest Income

We earned interest income of \$31.2 million and \$20.5 million for the nine months ended September 30, 2007 and 2006, respectively. The increase in interest income is attributable to higher average invested balances resulting from the December 2006 senior notes offering of \$125 million by Primus Guaranty and retained cash earnings, and higher yields on our investment portfolio. The increase in yields is attributable to generally higher short-term market rates of interest during 2006 and 2007.

Weighted average yields on our cash, cash equivalents and investments were 5.05% in the nine months ended September 30, 2007 compared with 4.29% for the nine months ended September 30, 2006.

The table below summarizes our interest income for the nine months ended September 30, 2007 and 2006 and our total cash, cash equivalents, available-for-sale and trading account securities at September 30, 2007 and 2006 (in thousands).

|   | ended |         | September 30, |         | 2007  |    | 2006    |    |
|---|-------|---------|---------------|---------|---|----|---------|----|
| Interest income                                   | \$    | 31,174  | \$            | 20,530  | Cash and cash equivalents   | \$ | 265,439 | \$ |
| Available-for-sale and trading account securities |       | 617,815 |               | 601,189 | Total cash, cash equivalents, available-for-sale and trading account securities | \$ | 883,254 | \$ |
| Other Trading Revenue                             |       |         |               |         |   |    |         |    |

During the nine months ended September 30, 2007 and 2006, Harrier/PRS Trading Strategies recorded other trading revenue (loss) of \$(1.9) million and \$513 thousand, respectively. These amounts exclude Harrier/PRS Trading Strategies' net credit swap loss of \$4.4 million and \$722 thousand for the nine months ended September 30, 2007 and 2006, respectively, as discussed under net credit swap revenue (loss) caption. Other trading revenue (loss) comprises the net trading gains or losses from Harrier/PRS Trading's total return swaps, loan warehousing and trading activities.

## Foreign currency revaluation

We transact credit swaps denominated in U.S. dollars and euros. Euro-denominated credit swaps comprised 37% of the notional amount of our Primus Financial credit swaps sold portfolio at September 30, 2007. We sell the majority of our euro premium receipts as they are received for U.S dollars, retaining only a small working cash balance in euros. During the nine months ended September 30, 2007 and 2006, we recorded foreign currency revaluation losses of \$12 thousand and \$56 thousand, respectively.



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## Operating Expenses

Our operating expenses were \$29.6 million and \$26.2 million for the nine months ending September 30, 2007 and 2006, respectively, as summarized below (in thousands):

|                                    |           |           |   | Nine months   |           |
|------------------------------------|-----------|-----------|---|---------------|-----------|
|                                    |           |           |   | ended         |           |
|                                    |           |           |   | September 30, |           |
| Compensation and employee benefits | \$ 16,866 | \$ 15,517 | Professional and legal fees                     | 3,794         | 3,645     |
| Depreciation and amortization      | 1,334     | 1,846     | Technology and data                             | 3,241         | 1,546     |
| Other                              | 4,414     | 3,632     | Total operating expenses                        | \$ 29,649     | \$ 26,186 |
|                                    | 62        | 46        | Number of full-time employees, at end of period | 62            | 46        |

Compensation expense for the nine months ended September 30, 2007 increased approximately \$1.3 million over the comparable prior period. Overall, the increase was primarily the result of an increase in headcount as we expanded our business activities, partially offset by lower performance based incentives. Our accrued cash incentive compensation expense was \$5.4 million for the nine months ended September 30, 2007, compared with an accrued expense of \$6.0 million for the corresponding prior period. Share compensation expense was approximately \$2.9 million and \$2.7 million for the nine months ended September 30, 2007 and 2006, respectively.

Professional and legal fees expense includes audit and tax advisor fees, legal costs, recruitment fees and director and officer insurance expense. The increase in professional fees is primarily due to higher legal fees associated with the expansion of our business activities.

Depreciation and amortization expense decreased primarily as a result of certain capitalized software development costs being fully amortized, partially offset by increases in depreciation expense on new fixed asset purchases and capitalized software costs.

The increase in technology and data expense was primarily attributable to the expansion of our technology platform to accommodate new trading strategies associated with our asset management build-out.

Other operating expenses include rent, bank fees, rating agency fees, brokerage expense, travel and entertainment, exchange fees and other administrative expenses. The increase in other expenses was primarily due to higher bank, debt and investment management fees.

## Interest Expense and Preferred Distributions

For the nine months ended September 30, 2007 and 2006, we recorded \$15.0 million and \$7.9 million of interest expense, respectively. The increase in interest expense was primarily the result of higher debt balances as a result of the \$125 million senior notes offering by Primus Guaranty in December 2006 along with increased short-term interest rates.

In February 2007, the Company entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75.0 million of the Company's \$125.0 million, 7% fixed rate senior notes due in December 2036, to floating rate debt based on the three month LIBOR rate plus a spread as defined in the agreement.

Primus Financial also made net distributions of \$5.6 million and \$4.2 million during the nine months ended September 30, 2007 and 2006, respectively, on the Primus Financial Cumulative Preferred Securities issued in December 2002. The increase in net distributions was primarily due to increased short-term interest rates.

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### Income Taxes

Provision for income taxes was \$52 thousand and \$41 thousand for the nine months ended September 30, 2007 and 2006, respectively. Primus Guaranty had a net deferred tax asset, fully offset by a valuation allowance, of \$10.2 million and \$9.5 million as of September 30, 2007 and December 31, 2006, respectively. The change in the deferred tax asset and valuation allowance resulted primarily from Primus Asset Management's estimated net operating loss. It is expected that only the income of Primus Asset Management and its subsidiary, Primus Re, are likely to be subject to United States federal and local income taxes. However, were Primus Bermuda to be subject to income tax, at a combined United States federal, New York State and New York City income tax rate of 46%, on its United States GAAP income or loss, then its income tax expense or (benefit), excluding interest and penalties, would have been approximately \$(66.5) million and \$36.2 million for the nine months ended September 30, 2007 and 2006, respectively. These figures assume that Primus Financial is not deemed to be making distributions to Primus Bermuda; such distributions would subject Primus Bermuda to an additional United States federal branch profits tax.

### Non-GAAP Financial Measures – Economic Results

In addition to the results of operations presented in accordance with U.S. generally accepted accounting principles (GAAP), our management and our Board of Directors use certain non-GAAP financial measures called Economic Results. We believe that our Economic Results provide information useful to investors in understanding our underlying operational performance and business and performance trends. However, Economic Results is not a measurement of financial performance or liquidity under GAAP, therefore, these non-GAAP financial measures should not be considered as an alternative or substitute for GAAP.

We define Economic Results as GAAP net income (loss) adjusted for the following:

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

We exclude unrealized gains (losses) on credit swaps sold because the fair value will fluctuate significantly as a result of changes in market credit swap premium levels and are not necessarily indicative of the performance of our underlying business and our general strategy of holding credit swaps sold until maturity, at which time the mark to market values would revert to zero, to the extent no realized gains or losses had occurred. We exclude realized gains on credit swaps sold because our strategy is focused on generation of premium income as opposed to trading gains and losses, although we amortize these realized gains over the original remaining life of the terminated contracts.

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The following table below presents a reconciliation of our Economic Results (non GAAP measures) to GAAP:

## Three Months Ended

September 30, Nine Months Ended

|                    |              |         |      |  |               |           |                     |
|--------------------|--------------|---------|------|--|---------------|-----------|---------------------|
| September 30, 2007 | 2006         | 2007    | 2006 | GAAP net income (loss)   | \$ (128,435 ) | \$ 23,732 | \$ (159,669 )       |
| \$ 69,495          | Adjustments: |         |      | Less: Change in unrealized fair value of credit swaps sold (gain) loss by Primus Financial             | 140,820       | (12,776 ) | 198,333 (37,366 )   |
|                    |              |         |      | Less: Realized gains from early termination of credit swaps sold by Primus Financial                   | (1,182 )      | (12 )     | (3,197 ) (625 )     |
|                    |              |         |      | Add: Amortization of realized gains from the early termination of credit swap sold by Primus Financial | 1,399         | 1,777     | 5,232 5,274         |
|                    |              |         |      | Net Economic Results   | \$ 12,602     | \$ 12,721 | \$ 40,699 \$ 36,778 |
| \$ 0.29            | \$ 0.90      | \$ 0.83 |      | Economic earnings per diluted share  | 45,206        | 44,341    | 45,130 44,410       |
|                    |              |         |      | Economic weighted average common shares outstanding – diluted  |               |           |                     |

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

## Off-Balance Sheet Arrangements

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

## Contractual Obligations

The following table summarizes our contractual obligations at September 30, 2007 and the effect that those obligations are expected to have on our liquidity and cash flows in future periods (in thousands):

|                                     | Payment due by period |           |           |           | Total    | Less than    |              |           |           |
|-------------------------------------|-----------------------|-----------|-----------|-----------|----------|--------------|--------------|-----------|-----------|
|                                     | 1 year                | 1-3 years | 3-5 years | More than |          |              |              |           |           |
| 5 years Property leases             | \$ 10,269             | \$ 1,261  | \$ 2,523  | \$ 2,539  | \$ 3,946 | Senior notes | 125,000      | —         | —         |
| 125,000 Interest on senior notes(b) |                       | 255,840   | 8,750     | 17,500    | 17,500   | 212,090      | Subordinated |           |           |
| deferrable interest notes           | 200,000               | — (a)     | — (a)     | — (a)     | 200,000  | Total        | \$ 591,109   | \$ 10,011 | \$ 20,023 |
| \$ 20,039                           | \$ 541,036            |           |           |           |          |              |              |           |           |

(a)

Payments on the subordinated deferrable interest notes for the next five years cannot be determined, as the notes are auction rate obligations. (b) Net interest payments on the 7% fixed senior notes will vary due to the interest rate swap agreement, as previously discussed.

Property leases: Primus Financial currently occupies approximately 17,500 square feet of office space at 360 Madison Avenue, New York, New York at a fixed yearly rental (subject to certain escalations specified in the lease). In 2006, Primus Financial amended the original lease to extend its





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term to 2016 and add approximately 5,500 square feet of additional space. In addition, in 2006, we leased approximately 2,900 square feet of office space in London under a lease that expires in 2012. There are no material restrictions imposed by our lease agreements and the leases are categorized as operating leases.

We have no other material long-term contractual obligations.

## Liquidity and Capital Resources

### Capital Strategy

Our consolidated cash, cash equivalents, available-for-sale and trading account securities were \$883.3 million and \$803.9 million as of September 30, 2007 and December 31, 2006, respectively. Since its inception, Primus Guaranty has raised both debt and equity capital and has contributed capital to its operating subsidiaries. Primus Guaranty is a holding company with no direct operations of its own, and as such, it is largely dependent upon the ability of its operating subsidiaries to generate cash to service its debt obligations and working capital needs.

On December 27, 2006, Primus Guaranty completed an offering of \$125 million of 7% senior notes, which mature in December 2036. The senior notes are senior unsecured obligations and rank equally with all of our other unsecured and unsubordinated indebtedness. The senior notes are also structurally subordinated to all liabilities of Primus Guaranty's subsidiaries. The senior notes are redeemable at the option of Primus Guaranty, in whole or in part, at any time on or after December 27, 2011, at redemption price equal to 100% of the principal amount to be redeemed, plus any accrued and unpaid interest thereon to the redemption date. Interest on the senior notes is payable quarterly, beginning on March 27, 2007. The senior notes are rated BBB+/Baa1 by S&P and Moody's, respectively.

Primus Financial, in order to support its AAA/Aaa ratings, is required to maintain capital in an amount determined by the capital models it has agreed upon with S&P and Moody's. The capital required is primarily a function of Primus Financial's credit swap portfolio characteristics, operating expenses and tax position. Retained cash flow and proceeds from financings are utilized to increase our capital resources to support our credit swap business. At September 30, 2007 and December 31, 2006, Primus Financial had cash, cash equivalents and investments of \$678.7 million and \$624.5 million, respectively, which management believes is sufficient to operate its credit swap business.

Primus Financial receives cash from the receipt of credit swap premiums, realized gains from the early termination of credit swaps, interest income earned on our investment portfolio and capital raising activities. Cash is used to pay operating and administrative expenses, premiums on credit swaps purchased, realized losses from the early termination of credit swaps, interest on debt and preferred share distributions. As previously discussed, rates on our preferred securities and deferrable notes have been set at the maximum spread rates at current rating levels, which will result in additional interest expense.

In April 2007, Primus Guaranty formed Harrier, a Cayman Islands exempted limited partnership. During the second quarter of 2007, Primus Guaranty transferred the trading portfolio of PRS Trading Strategies to Harrier. During June 2007, Primus Guaranty contributed an additional \$25 million of capital to Harrier, in addition to the original \$50 million of capital contributed to PRS Trading Strategies by Primus Guaranty. Currently, no third parties have contributed capital to Harrier. Harrier trades in a broad range of fixed income products, including credit swaps, total return swaps on loan transactions, leveraged loans and investment grade and non-investment grade securities. Harrier also transacts in high yield and investment grade credit swap indices ("CDS index") and tranches within these CDS indices, at different levels of risk subordination within the index. CDS indices include credit swaps of a standardized

basket of reference entities. Unlike Primus Financial, Harrier has no counterparty ratings from rating agencies and, accordingly, has entered into agreements with its counterparties to post collateral to support its contractual obligations. Harrier does not engage in trading activity with Primus Financial, but may invest in similar instruments.

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### Cash Flows

Cash flows from operating activities – Net cash provided by operating activities were \$71.3 million and \$32.5 million for the nine months ended September 30, 2007 and 2006, respectively. This increase is primarily attributable to a timing difference of settlements related to payables on credit swaps during the first nine months of 2007 compared with the first nine months of 2006.

Cash flows from investing activities – Net cash used in investing activities was \$11.5 million and \$38.8 million for the nine months ended September 30, 2007 and 2006, respectively. This increase was primarily due to lower net purchases of available-for-sale-investments in 2007 compared with 2006.

Cash flows from financing activities – Net cash provided by (used in) financing activities was \$1.2 million and \$(4.4) million for the nine months ended September 30, 2007 and 2006, respectively. This increase is primarily due to the proceeds received from the exercise of warrants by XL Insurance (Bermuda) Ltd., partially offset by an increase in preferred distributions of our subsidiary.

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

### Recent Accounting Pronouncements

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

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

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

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities (“SFAS No. 159”). SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value

recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact that adoption of SFAS No. 159 will have on its consolidated financial statements.

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Cautionary Note Regarding Forward-Looking Statements

This quarterly report of Primus Guaranty includes statements that are not historical or current facts and are “forward-looking statements” made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words “believe,” “anticipate,” “project,” “plan,” “expect,” “intend,” “will likely result,” “looking forward to,” “continue,” and similar expressions identify forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. Primus Guaranty cautions readers not to place undue reliance on any such forward-looking statements, which speak only to their respective dates. The following are some of the factors that could affect financial performance or could cause actual results to differ materially from estimates contained in or underlying the Company’s forward-looking statements:

- fluctuations in the economic, credit, interest rate or foreign currency environment in the United States (U.S.) and abroad;
- the level of activity within the national and international credit markets;
- the level of activity in the leveraged buyout and private equity markets;
- competitive conditions and pricing levels;
- legislative and regulatory developments;
- technological developments;
- changes in tax laws;
  - changes
- uncertainties that in international or national political or economic conditions, including any terrorist attacks;
- have not been identified at this time.

The Company undertakes no obligation to publicly correct or update any forward-looking statement if it later becomes aware that such results are not likely to be achieved.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk represents the potential for gains or losses that may result from changes in the value of a financial instrument as a consequence of changes in market conditions. Our primary market risk is changes in market credit swap premium levels, which increase or decrease the fair value of our credit swap portfolio. Market credit swap premium levels change as a result of specific events or news related to a Reference Entity, such as a change in a credit rating by any of the rating agencies. Additionally, market credit swap premium levels can vary as a result of changes in market sentiment. As a general matter, given our strategy of holding credit swaps sold until maturity, we do not seek to manage our overall exposure to market credit swap premium levels, and we expect fluctuations in the fair value of our credit swap portfolio as a result of these changes. As of September 30, 2007, each one basis point increase or decrease in market credit swap premiums would decrease or increase the fair value of our credit swap portfolio by approximately \$8.7 million.

We face other market risks, which are likely to have a lesser impact upon our net income than those associated with market credit swap premium level risk. These other risks include interest rate risk associated with market interest rate movements. These movements may affect the value of our credit swap portfolio as our pricing model includes an interest rate component, which is used to discount future expected cash flows. Interest rate movements may also affect the carrying value of and yield on our investments. The Primus Financial Cumulative Preferred Shares pays distributions that are based upon the auction rate preferred market. A difference between the rates we pay in the auction rate preferred market and the interest rates we receive on our investments may result in an additional cost to our company. Assuming that auction results with respect to the Primus Financial Cumulative Preferred Shares reflect prevailing short-term interest rates, each 25 basis point increase or decrease in the level of those rates would increase or decrease Primus Financial's annual distribution cost by approximately \$125,000 for each of the Series A and Series B MMP Receipts. In addition, interest rate movements may increase or decrease the interest expense we incur on our \$200 million of subordinated deferrable interest notes. A 25 basis point increase in the level of those rates would increase Primus Financial's interest expense by \$500,000 annually.

In February 2007, the Company entered into an interest rate swap agreement with a major financial institution that effectively converted a notional amount of \$75.0 million of the Company's \$125.0 million, 7% fixed rate senior notes due in December 2036, to floating rate debt based on the three month LIBOR rate plus a spread as defined in the agreement. Assuming a 25 basis point increase or decrease in the three month LIBOR rate, our interest expense would increase or decrease by \$187,500 annually.

Counterparty risk represents the potential for loss should one or more of our counterparties be unable to meet its obligations due to bankruptcy or a similar event, which could adversely affect our results of operations. Our counterparties generally have investment grade credit ratings.

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Item 4. Controls and Procedures

The Company has carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of disclosure controls and procedures pursuant to rules 13a-15 and 15-15d promulgated under the Securities and Exchange Act of 1934 as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that all material information relating to the Company required to be filed in this report have been made known to them in a timely fashion. There have been no changes in internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to affect, internal control over financial reporting.

The Company's management, including the Chief Executive Officer and the Chief Financial Officer, does not expect that the Company's disclosure controls or its internal controls can prevent all errors and all fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making are faulty, and that breakdowns can occur because of simple error or mistake. As a result of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. Accordingly, the Company's disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the disclosure controls and procedures are met.

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Part II. Other Information

Item 1. Legal Proceedings

In the ordinary course of operating our business, we may encounter a significant risk of litigation from time to time. However, we are not party to or currently aware of any material pending litigation.

Item 1A. Risk Factors

There have not been any material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

Item 6. Exhibits

|  |    |       |
|--|----|-------|
|  | 12 | Ratio |
| of Earnings to Combined Fixed Charges and Preferred Share Dividend Requirements  | 31 | .1    |
| Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   | 31 | .2    |
| Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   | 32 |       |
| Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted by Section 906 of the Sarbanes-Oxley Act of 2002 | 44 |       |



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

PRIMUS GUARANTY, LTD. /s/ Richard Claiden Richard Claiden  
Chief Financial Officer  
(Duly Authorized Officer and Principal Financial Officer)  
Date: November 8, 2007

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