

Global Indemnity plc
Form 10-Q
November 09, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2011

OR

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

For the Transition Period From to

001-34809

Commission File Number

GLOBAL INDEMNITY PLC

(Exact name of registrant as specified in its charter)

Ireland
(State or other jurisdiction of
incorporation or organization)

98-0664891
(I.R.S. Employer
Identification No.)

ARTHUR COX BUILDING

EARLSFORT TERRACE

DUBLIN 2

IRELAND

(Address of principal executive office, including zip code)

353 (0) 1 618 0517

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that registrant was required to submit and post such files.). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.:

Large accelerated filer ; Accelerated filer ;

Non-accelerated filer ; Smaller reporting company

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

As of November 4, 2011, the registrant had outstanding 18,381,059 Class A Ordinary Shares and 12,061,370 Class B Ordinary Shares.

Table of Contents

TABLE OF CONTENTS

| | Page |
|---|-------------|
| <u>PART I FINANCIAL INFORMATION</u> | |
| Item 1. <u>Financial Statements:</u> | |
| <u>Consolidated Balance Sheets As of September 30, 2011 (Unaudited) and December 31, 2010</u> | 3 |
| <u>Consolidated Statements of Operations Quarters and Nine Months Ended September 30, 2011 (Unaudited) and September 30, 2010 (Unaudited)</u> | 4 |
| <u>Consolidated Statements of Comprehensive Income Quarters and Nine Months Ended September 30, 2011 (Unaudited) and September 30, 2010 (Unaudited)</u> | 5 |
| <u>Consolidated Statements of Changes in Shareholders' Equity As of September 30, 2011 (Unaudited) and December 31, 2010</u> | 6 |
| <u>Consolidated Statements of Cash Flows Nine Months Ended September 30, 2011 (Unaudited) and September 30, 2010 (Unaudited)</u> | 7 |
| <u>Notes to Consolidated Financial Statements (Unaudited)</u> | 8 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 35 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 62 |
| Item 4. <u>Controls and Procedures</u> | 63 |

PART II OTHER INFORMATION

| | |
|--|----|
| Item 1. <u>Legal Proceedings</u> | 64 |
| Item 1A. <u>Risk Factors</u> | 64 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 64 |
| Item 5. <u>Other Information</u> | 64 |
| Item 6. <u>Exhibits</u> | 64 |
| <u>Signature</u> | 66 |

As used in this quarterly report, unless the context requires otherwise:

- 1) Global Indemnity refers to Global Indemnity plc, an exempted company incorporated with limited liability under the laws of Ireland, and its U.S. and Non-U.S. Subsidiaries;
- 2) we, us, our, and the Company refer to Global Indemnity and its subsidiaries or, prior to July 2, 2010, to United America Indemnity;
- 3) ordinary shares refers to Global Indemnity Class A and Class B ordinary shares, or, prior to July 2, 2010, to United America Indemnity Class A and Class B common shares;
- 4) United America Indemnity refers to United America Indemnity, Ltd., a Cayman Islands exempted company that, on July 2, 2010, became a direct, wholly-owned subsidiary of Global Indemnity plc, and its subsidiaries;
- 5) our U.S. Subsidiaries refers to Global Indemnity Group, Global Indemnity Group Services, LLC, AIS, Penn-America Group, Inc., and our Insurance Operations;

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- 6) our United States Based Insurance Operations and Insurance Operations refer to the insurance and related operations conducted by the U.S. Insurance Companies, American Insurance Adjustment Agency, Inc., Collectibles Insurance Services, LLC, United America Insurance Services, LLC, and J.H. Ferguson & Associates, LLC;
- 7) our U.S. Insurance Companies refers to the insurance and related operations conducted by United National Insurance

Table of Contents

- Company, Diamond State Insurance Company, United National Casualty Insurance Company, United National Specialty Insurance Company, Penn-America Insurance Company, Penn-Star Insurance Company and Penn-Patriot Insurance Company;
- 8) our Non-U.S. Subsidiaries refers to Global Indemnity Services Ltd., Global Indemnity (Gibraltar) Ltd., Global Indemnity (Cayman) Ltd., Global Indemnity (Luxembourg) Ltd., Wind River Reinsurance, the Luxembourg Companies, and U.A.I. (Ireland) Ltd.;
- 9) Wind River Reinsurance refers to Wind River Reinsurance Company, Ltd.;
- 10) the Luxembourg Companies refers to U.A.I. (Luxembourg) I S.à r.l., U.A.I. (Luxembourg) II S.à r.l., U.A.I. (Luxembourg) III S.à r.l., U.A.I. (Luxembourg) IV S.à r.l., U.A.I. (Luxembourg) Investment S.à r.l., and Wind River (Luxembourg) S.à r.l.;
- 11) AIS refers to American Insurance Service, Inc.;
- 12) our Predecessor Insurance Operations refers to Wind River Investment Corporation, which was dissolved on May 31, 2006, AIS, American Insurance Adjustment Agency, Inc., Emerald Insurance Company, which was dissolved on March 24, 2008, United National Insurance Company, Diamond State Insurance Company, United National Casualty Insurance Company, United National Specialty Insurance Company, and J.H. Ferguson & Associates, LLC;
- 13) our International Reinsurance Operations and Reinsurance Operations refer to the reinsurance and related operations of Wind River Reinsurance;
- 14) Global Indemnity Group refers to Global Indemnity Group, Inc., (formerly known as United America Indemnity Group, Inc.);
- 15) Penn-America refers to our product classification that includes property and general liability products for small commercial businesses distributed through a select network of wholesale general agents with specific binding authority;
- 16) United National refers to our product classification that includes property, casualty, and professional liability lines products distributed through program administrators with specific binding authority;
- 17) Diamond State refers to our product classification that includes property, casualty, and professional liability lines products distributed through wholesale brokers and program administrators with specific binding authority;
- 18) the Statutory Trusts refers to United National Group Capital Trust I, United National Group Capital Statutory Trust II, Penn-America Statutory Trust I, whose registration was cancelled effective January 15, 2008, and Penn-America Statutory Trust II, whose registration was cancelled effective February 2, 2009;
- 19) Fox Paine & Company refers to Fox Paine & Company, LLC and affiliated investment funds;
- 20) GAAP refers to accounting principles generally accepted in the United States of America; and

21) \$ or dollars refers to U.S. dollars.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GLOBAL INDEMNITY PLC****Consolidated Balance Sheets**

(In thousands, except share amounts)

| | (Unaudited) September 30, 2011 | December 31, 2010 |
|---|--------------------------------------|---------------------|
| ASSETS | | |
| Fixed maturities: | | |
| Available for sale, at fair value (amortized cost: \$1,370,288 and \$1,393,655) | \$ 1,406,342 | \$ 1,444,392 |
| Equity securities: | | |
| Available for sale, at fair value (cost: \$154,110 and \$121,604) | 146,067 | 147,526 |
| Other invested assets | | |
| Available for sale, at fair value (cost: \$14,150 and \$4,255) | 16,169 | 4,268 |
| Securities classified as trading, at fair value (cost: \$0 and \$1,112) | | 1,112 |
| Total investments | 1,568,578 | 1,597,298 |
| Cash and cash equivalents | 93,281 | 119,888 |
| Premiums receivable, net | 60,268 | 56,657 |
| Reinsurance receivables | 303,950 | 422,844 |
| Deferred federal income taxes | 20,173 | 6,926 |
| Deferred acquisition costs | 28,753 | 35,344 |
| Intangible assets | 18,798 | 19,082 |
| Goodwill | 4,820 | 4,820 |
| Prepaid reinsurance premiums | 7,762 | 11,104 |
| Receivable for securities sold | 4,388 | |
| Other assets | 22,118 | 20,720 |
| Total assets | \$ 2,132,889 | \$ 2,294,683 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Liabilities: | | |
| Unpaid losses and loss adjustment expenses | \$ 971,222 | \$ 1,052,743 |
| Unearned premiums | 135,866 | 135,872 |
| Ceded balances payable | 8,539 | 12,376 |
| Contingent commissions | 5,693 | 9,260 |
| Payable for securities purchased | | 4,768 |
| Federal income taxes payable | 1,993 | 55 |
| Notes and debentures payable | 103,071 | 121,285 |
| Other liabilities | 29,018 | 29,655 |
| Total liabilities | 1,255,402 | 1,366,014 |

Commitments and contingencies (Note 11)

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Shareholders' equity:

| | | |
|---|----------------|----------------|
| Ordinary shares, \$0.0001 par value, 900,000,000 ordinary shares authorized; Class A ordinary shares issued: 21,414,007 and 21,340,821, respectively; Class A ordinary shares outstanding: 18,365,802 and 18,300,544, respectively; Class B ordinary shares issued and outstanding: 12,061,370 and 12,061,370, respectively | | |
| | 3 | 3 |
| Additional paid-in capital | 621,442 | 622,725 |
| Accumulated other comprehensive income, net of taxes | 23,500 | 57,211 |
| Retained earnings | 333,621 | 349,642 |
| Class A ordinary shares in treasury, at cost: 3,048,205 and 3,040,277 shares, respectively | (101,079) | (100,912) |
| Total shareholders' equity | 877,487 | 928,669 |
| | | |
| Total liabilities and shareholders' equity | \$ 2,132,889 | \$ 2,294,683 |

See accompanying notes to consolidated financial statements.

Table of Contents**GLOBAL INDEMNITY PLC****Consolidated Statements of Operations**

(In thousands, except shares and per share data)

| | (Unaudited) Quarters Ended September 30, | | (Unaudited) Nine Months Ended September 30, | |
|--|---|-----------|---|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues: | | | | |
| Gross premiums written | \$ 73,092 | \$ 86,235 | \$ 255,720 | \$ 271,138 |
| Net premiums written | \$ 64,934 | \$ 73,206 | \$ 234,449 | \$ 234,210 |
| Net premiums earned | \$ 77,090 | \$ 70,089 | \$ 231,114 | \$ 215,579 |
| Net investment income | 12,880 | 14,089 | 41,224 | 42,609 |
| Net realized investment gains: | | | | |
| Other-than-temporary impairment losses on investments | (1,824) | (15) | (3,730) | (467) |
| Other-than-temporary impairment losses on investments recognized in other comprehensive income | | | | 43 |
| Other net realized investment gains | 3,112 | 1,833 | 25,401 | 22,043 |
| Total net realized investment gains | 1,288 | 1,818 | 21,671 | 21,619 |
| Other income | 167 | 173 | 11,999 | 515 |
| Total revenues | 91,425 | 86,169 | 306,008 | 280,322 |
| Losses and Expenses: | | | | |
| Net losses and loss adjustment expenses | 86,234 | 29,789 | 206,329 | 104,253 |
| Acquisition costs and other underwriting expenses | 34,597 | 28,541 | 94,646 | 87,697 |
| Corporate and other operating expenses | 2,862 | 5,106 | 10,329 | 15,065 |
| Interest expense | 1,525 | 1,825 | 5,020 | 5,397 |
| Income (loss) before income taxes | (33,793) | 20,908 | (10,316) | 67,910 |
| Income tax expense | 454 | 1,146 | 5,758 | 4,706 |
| Income (loss) before equity in net income (loss) of partnerships | (34,247) | 19,762 | (16,074) | 63,204 |
| Equity in net income (loss) of partnerships, net of taxes | | | 53 | (29) |
| Net income (loss) | \$ (34,247) | \$ 19,762 | \$ (16,021) | \$ 63,175 |
| Per share data ⁽¹⁾: | | | | |
| Net income (loss) | | | | |
| Basic | \$ (1.13) | \$ 0.65 | \$ (0.53) | \$ 2.09 |
| Diluted | \$ (1.13) | \$ 0.65 | \$ (0.53) | \$ 2.09 |
| Weighted-average number of shares outstanding | | | | |

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| | | | | |
|---------|------------|------------|------------|------------|
| Basic | 30,338,010 | 30,273,757 | 30,320,538 | 30,222,074 |
| Diluted | 30,352,850 | 30,308,489 | 30,341,713 | 30,245,890 |

- (1) Shares outstanding and per share amounts for 2010 have been retrospectively restated to reflect the 1-for-2 stock exchange effective July 2, 2010 when the Company completed its re-domestication to Ireland.

See accompanying notes to consolidated financial statements.

Table of Contents**GLOBAL INDEMNITY PLC****Consolidated Statements of Comprehensive Income**

(In thousands)

| | (Unaudited) Quarters Ended September 30, 2011 2010 | | (Unaudited) Nine Months Ended September 30, 2011 2010 | |
|---|--|-----------|---|-----------|
| Net income (loss) | \$ (34,247) | \$ 19,762 | \$ (16,021) | \$ 63,175 |
| Other comprehensive income (loss), net of taxes: | | | | |
| Unrealized holding gains (losses) arising during period | (28,475) | 19,607 | (18,072) | 29,728 |
| Portion of other-than-temporary impairment losses (gains) recognized in other comprehensive income (loss), net of taxes | (16) | 23 | (26) | 135 |
| Recognition of previously unrealized holding gains | (594) | (1,272) | (15,559) | (16,066) |
| Unrealized foreign currency translation gains (losses) | (54) | 175 | (54) | (43) |
| Other comprehensive income (loss), net of taxes | (29,139) | 18,533 | (33,711) | 13,754 |
| Comprehensive income (loss), net of taxes | \$ (63,386) | \$ 38,295 | \$ (49,732) | \$ 76,929 |

See accompanying notes to consolidated financial statements.

Table of Contents**GLOBAL INDEMNITY PLC****Consolidated Statements of Changes in Shareholders' Equity**

(In thousands, except share amounts)

| | (Unaudited) Nine Months Ended September 30, 2011 | Year Ended December 31, 2010 |
|--|---|---------------------------------|
| Number of Class A ordinary shares issued: | | |
| Number at beginning of period | 21,340,821 | 21,243,345 |
| Ordinary shares issued under share incentive plans | 33,511 | 20,828 |
| Ordinary shares issued to directors | 39,675 | 76,648 |
| Number at end of period | 21,414,007 | 21,340,821 |
| Number of Class B ordinary shares issued: | | |
| Number at beginning and end of period | 12,061,370 | 12,061,370 |
| Par value of Class A ordinary shares: | | |
| Balance at beginning and end of period | \$ 2 | \$ 2 |
| Par value of Class B ordinary shares: | | |
| Balance at beginning and end of period | \$ 1 | \$ 1 |
| Additional paid-in capital: | | |
| Balance at beginning of period | \$ 622,725 | \$ 619,473 |
| Share compensation plans | (1,283) | 3,252 |
| Balance at end of period | \$ 621,442 | \$ 622,725 |
| Accumulated other comprehensive income, net of deferred income tax: | | |
| Balance at beginning of period | \$ 57,211 | \$ 48,481 |
| Other comprehensive income (loss): | | |
| Unrealized holding gains (losses) arising during the period | (33,633) | 8,703 |
| Change in other-than-temporary impairment losses (gains) recognized in other comprehensive income (loss), net of taxes | (24) | 70 |
| Unrealized foreign currency translation losses | (54) | (43) |
| Other comprehensive income (loss) | (33,711) | 8,730 |
| Balance at end of period | \$ 23,500 | \$ 57,211 |
| Retained earnings: | | |
| Balance at beginning of period | \$ 349,642 | \$ 264,739 |
| Net income (loss) | (16,021) | 84,903 |
| Balance at end of period | \$ 333,621 | \$ 349,642 |

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Number of Treasury Shares:

| | | |
|-----------------------------------|-----------|-----------|
| Number at beginning of period | 3,040,277 | 3,028,106 |
| Class A ordinary shares purchased | 7,928 | 12,171 |
| Number at end of period | 3,048,205 | 3,040,277 |

Treasury Shares, at cost:

| | | |
|--|--------------|--------------|
| Balance at beginning of period | \$ (100,912) | \$ (100,720) |
| Class A ordinary shares purchased, at cost | (167) | (192) |
| Balance at end of period | \$ (101,079) | \$ (100,912) |

| | | |
|----------------------------|------------|------------|
| Total shareholders' equity | \$ 877,487 | \$ 928,669 |
|----------------------------|------------|------------|

Share amounts for 2010 have been retrospectively restated to reflect the 1-for-2 stock exchange effective July 2, 2010 when the Company completed its re-domestication to Ireland.

See accompanying notes to consolidated financial statements.

Table of Contents**GLOBAL INDEMNITY PLC****Consolidated Statements of Cash Flows**

(In thousands)

| | (Unaudited) | |
|---|----------------------------|-------------|
| | Nine Months | |
| | Ended September 30, | |
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ (16,021) | \$ 63,175 |
| Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities: | | |
| Amortization of trust preferred securities issuance costs | 59 | 62 |
| Amortization and depreciation | 1,556 | 1,825 |
| Restricted stock expense | (1,177) | 2,713 |
| Deferred federal income taxes | (341) | 3,560 |
| Amortization of bond premium and discount, net | 4,234 | 2,579 |
| Net realized investment gains | (21,671) | (21,619) |
| Equity in net (income) loss of partnerships | (53) | 29 |
| Changes in: | | |
| Premiums receivable, net | (3,611) | 1,111 |
| Reinsurance receivables | 118,894 | 80,240 |
| Unpaid losses and loss adjustment expenses | (81,521) | (137,278) |
| Unearned premiums | (6) | 14,151 |
| Ceded balances payable | (3,837) | (10,834) |
| Other assets and liabilities, net | (3,370) | (8,464) |
| Contingent commissions | (3,567) | (4,449) |
| Federal income taxes payable | 1,939 | (4,264) |
| Deferred acquisition costs | 6,591 | (2,911) |
| Prepaid reinsurance premiums | 3,342 | 4,482 |
| Net cash provided by (used for) operating activities | 1,440 | (15,892) |
| Cash flows from investing activities: | | |
| Proceeds from sale of fixed maturities | 604,606 | 560,306 |
| Proceeds from sale of stocks | 78,491 | 30,442 |
| Proceeds from maturity of fixed maturities | 37,900 | 36,245 |
| Proceeds from sale of other invested assets | 1,348 | 68 |
| Purchases of fixed maturities | (621,350) | (595,832) |
| Purchases of stocks | (100,505) | (91,417) |
| Purchases of other invested assets | (10,050) | |
| Acquisition of business, net of cash acquired | | (14,970) |
| Net cash used for investing activities | (9,560) | (75,158) |
| Cash flows from financing activities: | | |
| Tax expense associated with share-based compensation plans | (106) | (221) |
| Purchases of Class A ordinary shares | (167) | (163) |
| Principal payments of term debt | (18,214) | (213) |
| Net cash used for financing activities | (18,487) | (597) |

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| | | |
|---|-----------|-----------|
| Effect of exchange rates on cash and cash equivalents | | (43) |
| Net change in cash and cash equivalents | (26,607) | (91,690) |
| Cash and cash equivalents at beginning of period | 119,888 | 186,087 |
| Cash and cash equivalents at end of period | \$ 93,281 | \$ 94,397 |

See accompanying notes to consolidated financial statements.

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Principles of Consolidation and Basis of Presentation

Global Indemnity plc (Global Indemnity or the Company) was incorporated on March 9, 2010 and is domiciled in Ireland. Global Indemnity replaced the Company's predecessor, United America Indemnity, Ltd., as the ultimate parent company as a result of a re-domestication transaction. See Note 3 below for details regarding the re-domestication. United America Indemnity, Ltd. was incorporated on August 26, 2003, and is domiciled in the Cayman Islands. United America Indemnity, Ltd. is now a subsidiary of the Company and an Irish tax resident. The Company's Class A ordinary shares are publicly traded on the NASDAQ Global Select Market. On July 6, 2010, the Company changed its trading symbol on the NASDAQ Global Select Market from INDM to GBLI.

The interim consolidated financial statements are unaudited, but have been prepared in conformity with GAAP, which differs in certain respects from those principles followed in reports to insurance regulatory authorities. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The unaudited consolidated financial statements include all adjustments that are, in the opinion of management, of a normal recurring nature and are necessary for a fair statement of results for the interim periods. Results of operations for the quarters and nine months ended September 30, 2011 and 2010 are not necessarily indicative of the results of a full year. The accompanying notes to the unaudited consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements contained in the Company's 2010 Annual Report on Form 10-K.

The consolidated financial statements include the accounts of Global Indemnity and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

The Company's wholly owned business trust subsidiaries, United National Group Capital Trust I (UNG Trust I) and United National Group Capital Statutory Trust II (UNG Trust II), are not consolidated pursuant to the Financial Accounting Standards Board (FASB) Accounting Standards Codification (the Codification). The Company's business trust subsidiaries have issued \$30.0 million in floating rate capital securities (Trust Preferred Securities) and \$0.9 million of floating rate common securities. The sole assets of the Company's business trust subsidiaries are \$30.9 million of junior subordinated debentures issued by the Company, which have the same terms with respect to maturity, payments, and distributions as the Trust Preferred Securities and the floating rate common securities.

2. Premium Deficiency

The Company recognizes a premium deficiency if the sum of expected loss and loss adjustment expenses and unamortized acquisition costs exceeds related unearned premium after consideration of investment income. Any future expected loss on the related unearned premium is recorded first by impairing the unamortized acquisition costs on the related unearned premium followed by an increase to loss and loss adjustment expense reserves on additional expected loss in excess of unamortized acquisition costs.

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

During the quarter and nine months ended September 30, 2011, the Company incurred a pre-tax premium deficiency charge of \$10.5 million, or \$0.35 per diluted share, and \$11.0 million, or \$0.36 per diluted share, respectively. There were no premium deficiency charges incurred during the quarter or nine months ended September 30, 2010.

The charge of \$10.5 million incurred during the quarter ended September 30, 2011 consisted of \$7.6 million charged to our U.S. Insurance Operations and \$2.9 million charged to our Reinsurance Operations. The \$7.6 million charge to our U.S. Insurance Operations consisted of \$3.7 million recorded to acquisition costs and other underwriting expenses and \$3.9 million recorded to loss and loss adjustment expenses. The \$2.9 million charge to our Reinsurance Operations was recorded to acquisition costs and other underwriting expenses.

The charge of \$11.0 million incurred during the nine months ended September 30, 2011 consisted of \$7.6 million charged to our U.S. Insurance Operations and \$3.3 million charged to our Reinsurance Operations. The \$7.6 million charge to our U.S. Insurance Operations consisted of \$3.7 million recorded to acquisition costs and other underwriting expenses and \$3.9 million recorded to loss and loss adjustment expenses. The \$3.3 million charge to our Reinsurance Operations was recorded to acquisition costs and other underwriting expenses.

As a result of these charges, the Company reduced deferred acquisition costs during the quarter and nine months ended September 30, 2011 by \$6.6 million and \$7.0 million, respectively. Additionally, the Company accrued a premium deficiency reserve of \$3.9 million included in loss and loss adjustment expense reserves during the quarter and nine months ended September 30, 2011.

3. Redomestication

In February 2010, the Company's Board of Directors approved a plan for the Company to re-domesticate from the Cayman Islands to Ireland. At a special shareholders meeting held on May 27, 2010, the Company's shareholders voted in favor of completing the re-domestication proposal pursuant to which all United America Indemnity, Ltd. ordinary shares would be cancelled and all holders of such shares would receive ordinary shares of Global Indemnity plc, a newly formed Irish company that was incorporated on March 9, 2010, on a one-for-two basis (two United America Indemnity, Ltd. shares exchanged for one Global Indemnity plc share). The re-domestication transaction was completed on July 2, 2010, following approval from the Grand Court of the Cayman Islands, at which time Global Indemnity plc replaced United America Indemnity, Ltd. as the ultimate parent company, and United America Indemnity, Ltd. became a wholly-owned subsidiary of Global Indemnity plc. Shares of United America Indemnity, Ltd. previously traded on the NASDAQ Global Select Market under the symbol INDM. Shares of the Irish company, Global Indemnity plc, began trading on the NASDAQ Global Select Market on July 6, 2010 under the symbol GBLL.

4. Profit Enhancement Initiative

On November 2, 2010, we committed to a Profit Enhancement Initiative with respect to our U.S. Insurance Operations. The plan was initiated on November 4, 2010, and is part of our efforts to streamline our operations in response to the continuing impact of the domestic recession as well as the competitive landscape within the excess and surplus lines market. This initiative is intended to enhance profitability and earnings by aligning corporate overhead costs with changes in our business. In the fourth quarter of 2010, the Company reduced its U.S. based census by approximately 25%, closed underperforming U.S. facilities, and supplemented staffing in Bermuda and in Ireland. All action items relating to this initiative were implemented by December 31, 2010.

The total cost of implementing this initiative was recorded in our consolidated statements of operations within our Insurance Operations segment in the fourth quarter of 2010. Components of the initiative included: (1) employee termination and severance charges of \$1.71 million; (2) expenses of \$1.53 million relating to discontinuing use of leased office space, net of expected sub-lease income; (3) restructuring expenses of \$0.63 million for related asset and leasehold improvement impairments; and (4) expenses of \$2.91 million relating to the curtailment of our workers' compensation product initiative, consisting of a minimum ceded premium charge of \$1.48 million on our workers' compensation reinsurance treaty and \$1.43 million in asset impairments.

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The following table summarizes charges incurred in 2010 by expense type and the remaining liability as of December 31, 2010 and September 30, 2011:

| (Dollars in thousands) | Employee Termination | Operating Leases | Asset Impairments | Workers Compensation | Total |
|--|-------------------------|---------------------|----------------------|-------------------------|----------|
| Charges incurred in 2010 | \$ 1,711 | \$ 1,532 | \$ 631 | \$ 2,907 | \$ 6,781 |
| Cash payments for 2010 actions | (758) | | | (985) | (1,743) |
| Non-cash adjustments | 176 | | (631) | (1,430) | (1,885) |
| Liability at December 31, 2010 | \$ 1,129 | \$ 1,532 | \$ | \$ 492 | \$ 3,153 |
| Cash payments in 2011 for 2010 actions | (1,022) | (597) | | (492) | (2,111) |
| Non-cash adjustments | | (64) | | | (64) |
| Liability at September 30, 2011 | \$ 107 | \$ 871 | \$ | \$ | \$ 978 |

There were charges incurred related to the Profit Enhancement Initiative in our statement of operations for the nine months ending September 30, 2011 of (\$0.064) million which was included in the Corporate and other operating expenses line item. There were no charges incurred related to the Profit Enhancement Initiative in our statement of operations for the quarter ended September 30, 2011, or the quarter or nine months ending September 30, 2010.

5. Investments

The Company's investments in fixed maturities, preferred stock, and common stock are classified as available for sale and are carried at their fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair values of the Company's available for sale portfolio, excluding the limited partnership interest, are determined on the basis of quoted market prices where available. If quoted market prices are not available, the Company uses third party pricing services to assist in determining fair value. In many instances, these services examine the pricing of similar instruments to estimate fair value. The Company purchases bonds with the expectation of holding them to their maturity; however, changes to the portfolio are sometimes required to assure it is appropriately matched to liabilities. In addition, changes in financial market conditions and tax considerations may cause the Company to sell an investment before it matures. Corporate loans have stated maturities; however, they generally do not reach their final maturity due to borrowers refinancing. The difference between amortized cost and fair value of the Company's available for sale investments, excluding the Company's convertible bond and convertible preferred stock portfolios, net of the effect of deferred income taxes, is reflected in accumulated other comprehensive income in shareholders' equity and, accordingly, has no effect on net income other than for the credit loss component of impairments deemed to be other than temporary. The difference between amortized cost and fair value of the convertible bonds and convertible preferred stocks is included in income.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

The Company's investments in other invested assets are comprised of limited liability partnership interests and a mutual fund. Partnership interests where we owned more than 3% at any time are carried at their fair value. The change in the difference between amortized cost and fair value of partnership interests of 3% ownership or greater, net of the effect of deferred income taxes, is reflected in income. The mutual fund and partnership interests of less than 3% ownership are carried at their fair value. The change in the difference between amortized cost and the fair value of the mutual fund and partnership interests of less than 3% ownership, net of the effect of deferred income taxes, is reflected in accumulated other comprehensive income in shareholders' equity and, accordingly, has no effect on net income other than for impairments deemed to be other than temporary.

The amortized cost and estimated fair value of investments were as follows as of September 30, 2011 and December 31, 2010:

| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Other than temporary impairments recognized in AOCI ⁽¹⁾ |
|--|---------------------|------------------------------|-------------------------------|-------------------------|--|
| As of September 30, 2011 | | | | | |
| Fixed maturities: | | | | | |
| U.S. treasury and agency obligations | \$ 123,210 | \$ 8,261 | \$ (3) | \$ 131,468 | \$ |
| Obligations of states and political subdivisions | 210,532 | 8,158 | (75) | 218,615 | |
| Mortgage-backed securities | 288,698 | 9,851 | (337) | 298,212 | (15) |
| Asset-backed securities | 100,368 | 2,426 | (39) | 102,755 | (33) |
| Commercial mortgage-backed securities | 34,677 | 38 | (144) | 34,571 | |
| Corporate bonds and loans | 559,339 | 14,537 | (7,937) | 565,939 | (134) |
| Foreign corporate bonds | 53,464 | 1,450 | (132) | 54,782 | |
| Total fixed maturities | 1,370,288 | 44,721 | (8,667) | 1,406,342 | (182) |
| Common stock | 154,110 | 7,739 | (15,782) | 146,067 | |
| Other invested assets | 14,150 | 3,071 | (1,052) | 16,169 | |
| Total | \$ 1,538,548 | \$ 55,531 | \$ (25,501) | \$ 1,568,578 | \$ (182) |

(1) Represents the total amount of other than temporary impairment losses relating to factors other than credit losses recognized in accumulated other comprehensive income (AOCI).

| (Dollars in thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Other than temporary impairments recognized in AOCI ⁽¹⁾ |
|--|-------------------|------------------------------|-------------------------------|-------------------------|--|
| As of December 31, 2010 | | | | | |
| Fixed maturities: | | | | | |
| U.S. treasury and agency obligations | \$ 192,746 | \$ 9,948 | \$ (4) | \$ 202,690 | \$ |
| Obligations of states and political subdivisions | 239,872 | 5,756 | (616) | 245,012 | |

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| | | | | | |
|---------------------------------------|---------------------|------------------|-------------------|---------------------|-----------------|
| Mortgage-backed securities | 239,265 | 9,864 | (49) | 249,080 | (19) |
| Asset-backed securities | 112,626 | 2,548 | (75) | 115,099 | (41) |
| Commercial mortgage-backed securities | 38,963 | 9 | (239) | 38,733 | |
| Corporate bonds and loans | 511,754 | 21,594 | (564) | 532,784 | (134) |
| Foreign corporate bonds | 58,429 | 2,570 | (5) | 60,994 | |
| Total fixed maturities | 1,393,655 | 52,289 | (1,552) | 1,444,392 | (194) |
| Common stock | 120,674 | 25,300 | (700) | 145,274 | |
| Preferred stock | 930 | 1,322 | | 2,252 | |
| Other invested assets | 5,367 | 13 | | 5,380 | |
| Total | \$ 1,520,626 | \$ 78,924 | \$ (2,252) | \$ 1,597,298 | \$ (194) |

(1) Represents the total amount of other than temporary impairment losses relating to factors other than credit losses recognized in accumulated other comprehensive income (AOCI).

The Company held a mortgage-backed security (MBS) issued by Government National Mortgage Association (GNMA) which represented approximately 3% and 8% of shareholders' equity as of September 30, 2011 and December 31, 2010, respectively. Excluding U.S. treasuries, agency bonds, and the MBS issued by GNMA, the Company did not hold any debt or equity investments in a single issuer that was in excess of 4% and 2% of shareholders' equity at September 30, 2011 and December 31, 2010, respectively.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

The amortized cost and estimated fair value of the Company's fixed maturities portfolio classified as available for sale at September 30, 2011, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (Dollars in thousands) | Amortized Cost | Estimated Fair Value |
|---|-------------------|-------------------------|
| Due in one year or less | \$ 70,950 | \$ 71,837 |
| Due after one year through five years | 650,117 | 671,162 |
| Due after five years through ten years | 182,007 | 182,367 |
| Due after ten years through fifteen years | 10,221 | 11,641 |
| Due after fifteen years | 33,250 | 33,797 |
| Mortgaged-backed securities | 288,698 | 298,212 |
| Asset-backed securities | 100,368 | 102,755 |
| Commercial mortgage-backed securities | 34,677 | 34,571 |
| | \$ 1,370,288 | \$ 1,406,342 |

The following table contains an analysis of the Company's securities with gross unrealized losses, categorized by the period that the securities were in a continuous loss position as of September 30, 2011:

| (Dollars in thousands) | Less than 12 months Gross Unrealized | | 12 months or longer ⁽¹⁾ Gross Unrealized | | Total Gross Unrealized | |
|--|--|--------------------|---|-----------------|------------------------------|--------------------|
| | Fair Value | Losses | Fair Value | Losses | Fair Value | Losses |
| Fixed maturities: | | | | | | |
| U.S. treasury and agency obligations | \$ 2,244 | \$ (3) | \$ | \$ | \$ 2,244 | \$ (3) |
| Obligations of states and political subdivisions | 1,792 | (9) | 6,845 | (66) | 8,637 | (75) |
| Mortgage-backed securities | 27,856 | (319) | 521 | (18) | 28,377 | (337) |
| Asset-backed securities | 2,009 | (6) | 707 | (33) | 2,716 | (39) |
| Commercial mortgage-backed securities | 20,731 | (69) | 10,071 | (75) | 30,802 | (144) |
| Corporate bonds and loans | 221,625 | (7,919) | 830 | (18) | 222,455 | (7,937) |
| Foreign corporate bonds | 7,488 | (132) | | | 7,488 | (132) |
| Total fixed maturities | 283,745 | (8,457) | 18,974 | (210) | 302,719 | (8,667) |
| Common stock | 125,505 | (15,423) | 932 | (359) | 126,437 | (15,782) |
| Other invested assets | 8,948 | (1,052) | | | 8,948 | (1,052) |
| Total | \$ 418,198 | \$ (24,932) | \$ 19,906 | \$ (569) | \$ 438,104 | \$ (25,501) |

(1)

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Fixed maturities in a gross unrealized loss position for twelve months or longer are primarily comprised of non-credit losses on investment grade securities where management does not intend to sell, and it is more likely than not that the Company will not be forced to sell the security before recovery. The Company has analyzed these securities and has determined that they are not impaired. The following table contains an analysis of the Company's securities with gross unrealized losses, categorized by the period that the securities were in a continuous loss position as of December 31, 2010:

| (Dollars in thousands) | Less than 12 months | | 12 months or longer <small>(1)</small> | | Total | |
|--|---------------------|-------------------------|---|-------------------------|-------------------|-------------------------|
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fixed maturities: | | | | | | |
| U.S. treasury and agency obligations | \$ 1,015 | \$ (4) | \$ | \$ | \$ 1,015 | \$ (4) |
| Obligations of states and political subdivisions | 38,601 | (553) | 1,651 | (63) | 40,252 | (616) |
| Mortgage-backed securities | 2,298 | (29) | 561 | (20) | 2,859 | (49) |
| Asset-backed securities | 7,021 | (17) | 880 | (58) | 7,901 | (75) |
| Commercial mortgage-backed securities | 32,889 | (239) | | | 32,889 | (239) |
| Corporate bonds and loans | 35,063 | (559) | 1,014 | (5) | 36,077 | (564) |
| Foreign corporate bonds | 1,990 | (5) | | | 1,990 | (5) |
| Total fixed maturities | 118,877 | (1,406) | 4,106 | (146) | 122,983 | (1,552) |
| Common stock | 12,580 | (700) | | | 12,580 | (700) |
| Total | \$ 131,457 | \$ (2,106) | \$ 4,106 | \$ (146) | \$ 135,563 | \$ (2,252) |

(1) Fixed maturities in a gross unrealized loss position for twelve months or longer are primarily comprised of non-credit losses on investment grade

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

securities where management does not intend to sell, and it is more likely than not that the Company will not be forced to sell the security before recovery. The Company has analyzed these securities and has determined that they are not impaired.

The Company regularly performs various analytical valuation procedures with respect to its investments, including reviewing each fixed maturity security in an unrealized loss position to assess whether the security is a candidate for credit loss. Specifically, the Company considers credit rating, market price, and issuer specific financial information, among other factors, to assess the likelihood of collection of all principal and interest as contractually due. Securities for which the Company determines that a credit loss is likely are subjected to further analysis through discounted cash flow testing to estimate the credit loss to be recognized in earnings, if any. The specific methodologies and significant assumptions used by asset class are discussed below. Upon identification of such securities and periodically thereafter, a detailed review is performed to determine whether the decline is considered other than temporary. This review includes an analysis of several factors, including but not limited to, the credit ratings and cash flows of the securities and the magnitude and length of time that the fair value of such securities is below cost.

For fixed maturities, the factors considered in reaching the conclusion that a decline below cost is other than temporary include, among others, whether:

- (1) the issuer is in financial distress;
- (2) the investment is secured;
- (3) a significant credit rating action occurred;
- (4) scheduled interest payments were delayed or missed;
- (5) changes in laws or regulations have affected an issuer or industry;
- (6) the investment has an unrealized loss and was identified by the Company's investment manager as an investment to be sold before recovery or maturity; and
- (7) the investment failed cash flow projection testing to determine if anticipated principal and interest payments will be realized.

According to accounting guidance, for debt securities in an unrealized loss position, the Company is required to assess whether the Company has the intent to sell the debt security or more likely than not will be required to sell the debt security before the anticipated recovery. If either of these conditions is met, the Company must recognize an other than temporary impairment with the entire unrealized loss being recorded through earnings. For debt securities in an unrealized loss position not meeting these conditions, the Company assesses whether the impairment of a security is other than temporary. If the impairment is deemed to be other than temporary, the Company must separate the other than temporary impairment into two components: the amount representing the credit loss and the amount related to all other factors, such as changes in interest rates. The credit loss represents the portion of the amortized book value in excess of the net present value of the projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. The credit loss component of the other than temporary impairment is recorded through earnings, whereas the amount relating to factors other than credit losses are recorded in other comprehensive

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income, net of taxes.

For equity securities, management carefully reviews all securities with unrealized losses and further focuses on securities that have either:

- (1) persisted for more than twelve consecutive months or
- (2) the value of the investment has been 20% or more below cost for six continuous months or more to determine if the security should be impaired.

The amount of any write-down, including those that are deemed to be other than temporary, is included in earnings as a realized loss in the period in which the impairment arose.

The following is a description, by asset type, of the methodology and significant inputs that the Company used to measure the amount of credit loss recognized in earnings, if any:

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

U.S. treasury and agency obligations As of September 30, 2011, gross unrealized losses related to U.S. treasury and agency obligations were \$0.003 million. All unrealized losses have been in an unrealized loss position for less than twelve months. All of these securities are rated AA+. The Company's investment manager's analysis for this sector includes on-site visits and meetings with officials in addition to the standard rigorous analysis that determines the financial condition of the issuer.

Obligations of states and political subdivisions As of September 30, 2011, gross unrealized losses related to obligations of states and political subdivisions were \$0.075 million. Of this amount, \$0.066 million has been in an unrealized loss position for twelve months or greater. These securities are rated A- or higher. The Company's investment manager's analysis for this sector includes on-site visits and meetings with officials in addition to the standard rigorous analysis that determines the financial condition of the issuer.

Mortgage-backed securities As of September 30, 2011, gross unrealized losses related to mortgage-backed securities were \$0.337 million. Of this amount, \$0.018 million has been in an unrealized loss position for twelve months or greater. All of the securities in an unrealized loss position for twelve months or greater are rated AA+. The Company's investment manager models each mortgage-backed security to project principal losses under downside, base, and upside scenarios for the economy and home prices. The primary assumption that drives the security and loan level modeling is the Home Price Index (HPI) projection. The Company's investment manager first projects HPI at the national level, then at the Metropolitan Statistical Area (MSA) level based on the historical relationship between the individual MSA HPI and the national HPI, using inputs from its macroeconomic team, mortgage portfolio management team, and structured analyst team. The model utilizes loan level data and borrower characteristics including FICO score, geographic location, original and current loan size, loan age, mortgage rate and type (fixed rate / interest-only / adjustable rate mortgage), issuer / originator, residential type (owner occupied / investor property), dwelling type (single family / multi-family), loan purpose, level of documentation, and delinquency status as inputs.

Asset-backed securities (ABS) As of September 30, 2011, gross unrealized losses related to asset-backed securities were \$0.039 million. Of this amount, \$0.033 million has been in an unrealized loss position for twelve months or greater. These securities are rated A- or higher. The weighted average credit enhancement for the Company's asset-backed portfolio is 34.9. The Company's investment manager analyzes every ABS transaction on a stand-alone basis. This analysis involves a thorough review of the collateral, prepayment, and structural risk in each transaction. Additionally, their analysis includes an in-depth credit analysis of the originator and servicer of the collateral. The Company's investment manager projects an expected loss for a deal given a set of assumptions specific to the asset type. These assumptions are used to calculate at what level of losses that the deal will incur a dollar of loss. The major assumptions used to calculate this ratio are loss severities, recovery lags, and no advances on principal and interest.

Commercial mortgage-backed securities (CMBS) As of September 30, 2011, gross unrealized losses related to CMBS were \$0.144 million. Of this amount, \$0.075 million has been in an unrealized loss position for twelve months or greater. All of the securities in an unrealized loss position for twelve months or greater are rated AAA. The weighted average credit enhancement for the Company's CMBS portfolio is 27.2. This represents the percentage of pool losses that can occur before a mortgage-backed security will incur its first dollar of principle losses. For the Company's CMBS portfolio, a loan level analysis is utilized where every underlying CMBS loan is re-underwritten based on the Company's investment manager's internally generated set of assumptions that reflect their expectation for the future path of the economy. In the analysis, the focus is centered on stressing the significant variables that influence commercial loan defaults and collateral losses in CMBS deals. These variables include: (1) occupancies are projected to drop; (2) capitalization rates vary by property type and are forecasted to return to more normalized levels as the capital markets repair and capital begins to flow again; and (3) property value was stressed by using projected property performance and projected capitalization rates. Term risk is triggered if projected debt service coverage rate falls below 1x. Balloon risk is triggered if a property's projected performance does not satisfy new, tighter mortgage standards.

Corporate bonds and loans As of September 30, 2011, gross unrealized losses related to corporate bonds and loans were \$7.937 million. Of this amount, \$0.018 million has been in an unrealized loss position for twelve months

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

or greater. All of the securities in an unrealized loss position for twelve months or greater are rated below investment grade. The Company's investment manager's analysis for this sector includes maintaining detailed financial models that include a projection of each issuer's future financial performance, including prospective debt servicing capabilities, capital structure composition, and the value of the collateral. The analysis incorporates the macroeconomic environment, industry conditions in which the issuer operates, issuer's current competitive position, vulnerability to changes in the competitive environment, regulatory environment, issuer liquidity, issuer commitment to bondholders, issuer creditworthiness, and asset protection. Part of the process also includes running downside scenarios to evaluate the expected likelihood of default as well as potential losses in the event of default.

Foreign bonds As of September 30, 2011, gross unrealized losses related to foreign bonds were \$0.132 million. All unrealized losses have been in an unrealized loss position for less than twelve months. These securities are rated A- or higher. The Company's investment manager maintains financial models for the Company's bond issuers. These models include a projection of each issuer's future financial performance including prospective debt servicing capabilities and capital structure composition. The analysis incorporates the macroeconomic environment, industry conditions in which the issuer operates, issuer's current competitive position, vulnerability to changes in the competitive environment, regulatory environment, issuer liquidity, issuer commitment to bondholders, issuer creditworthiness, and asset protection.

Common stocks As of September 30, 2011, gross unrealized losses related to common stock were \$15.782 million. Of this amount, \$0.359 million has been in an unrealized loss position for twelve months or greater. To determine if an other than temporary impairment of an equity security has occurred, the Company considers, among other things, the severity and duration of the decline in fair value of the equity security. The Company also examines other factors to determine if the equity security could recover its value in a reasonable period of time.

Other Investments As of September 30, 2011, gross unrealized losses related to other investments were \$1.052 million. All unrealized losses have been in an unrealized loss position for less than twelve months.

The Company recorded the following other than temporary impairments (OTTI) on its investment portfolio for the quarters and nine months ended September 30, 2011 and 2010:

| (Dollars in thousands) | Quarters Ended | | Nine Months Ended | |
|--|----------------|---------------|-------------------|---------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2011 | 2010 | 2011 | 2010 |
| Fixed maturities: | | | | |
| OTTI losses, gross | \$ 1,002 | \$ 15 | \$ 1,002 | \$ 121 |
| Portion of loss recognized in other comprehensive income (pre-tax) | | | | (43) |
| Net impairment losses on fixed maturities recognized in earnings | 1,002 | 15 | 1,002 | 78 |
| Common stock | 822 | | 2,728 | 346 |
| Total | \$ 1,824 | \$ 15 | \$ 3,730 | \$ 424 |

The following table is an analysis of the credit losses recognized in earnings on debt securities held by the Company for the quarters and nine months ended September 30, 2011 and 2010 for which a portion of the OTTI loss was recognized in other comprehensive income.

| (Dollars in thousands) | Quarters Ended | Nine Months Ended |
|------------------------|----------------|-------------------|
| | September 30, | September 30, |

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| | 2011 | 2010 | 2011 | 2010 |
|--|-------|--------|--------|--------|
| Balance at beginning of period | \$ 86 | \$ 113 | \$ 115 | \$ 50 |
| Additions where no OTTI was previously recorded | | | | 47 |
| Additions where an OTTI was previously recorded | | 15 | | 31 |
| Reductions for securities for which the company intends to sell or more likely than not will be required to sell before recovery | | | | |
| Reductions reflecting increases in expected cash flows to be collected | | | | |
| Reductions for securities sold during the period | | | (29) | |
| Balance at end of period | \$ 86 | \$ 128 | \$ 86 | \$ 128 |

Accumulated Other Comprehensive Income

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

Accumulated other comprehensive income as of September 30, 2011 and December 31, 2010 was as follows:

| (Dollars in thousands) | September 30, 2011 | December 31, 2010 |
|--|--------------------|-------------------|
| Net unrealized gains (losses) from: | | |
| Fixed maturities | \$ 36,054 | \$ 50,737 |
| Preferred stock | | 1,322 |
| Common stock | (8,043) | 24,600 |
| Mutual Fund | (1,052) | |
| Partnerships < 3% owned | 3,071 | 13 |
| Deferred federal income taxes | (6,530) | (19,461) |
| Accumulated other comprehensive income | \$ 23,500 | \$ 57,211 |

Net Realized Investment Gains

The components of net realized investment gains for the quarters and nine months ended September 30, 2011 and 2010 were as follows:

| (Dollars in thousands) | Quarters Ended September 30, | | Nine Months Ended September 30, | |
|------------------------|---------------------------------|-----------------|------------------------------------|------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Fixed maturities | \$ 562 | \$ 846 | \$ 11,178 | \$ 16,225 |
| Convertibles | | | | 3 |
| Common stock | 726 | 972 | 8,947 | 5,391 |
| Preferred stock | | | 1,546 | |
| Total | \$ 1,288 | \$ 1,818 | \$ 21,671 | \$ 21,619 |

The proceeds from sales of available-for-sale securities resulting in net realized investment gains for the nine months ended September 30, 2011 and 2010 were as follows:

| (Dollars in thousands) | Nine Months Ended September 30, | |
|------------------------|------------------------------------|------------|
| | 2011 | 2010 |
| Fixed maturities | \$ 604,606 | \$ 560,306 |
| Equity securities | 78,491 | 30,442 |

Net Investment Income

The sources of net investment income for the quarters and nine months ended September 30, 2011 and 2010 were as follows:

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| (Dollars in thousands) | Quarters Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------|---------------------------------|------------------|------------------------------------|------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Fixed maturities | \$ 13,153 | \$ 14,885 | \$ 42,031 | \$ 45,597 |
| Preferred and common stocks | 914 | 613 | 2,645 | 1,419 |
| Cash and cash equivalents | 10 | 32 | 56 | 141 |
| Other invested assets | | | | 4 |
| Total investment income | 14,077 | 15,530 | 44,732 | 47,161 |
| Investment expense | (1,197) | (1,441) | (3,508) | (4,552) |
| Net investment income | \$ 12,880 | \$ 14,089 | \$ 41,224 | \$ 42,609 |

The Company's total investment return on an after-tax basis for the quarters and nine months ended September 30, 2011 and 2010 were as follows:

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

| (Dollars in thousands) | Quarters Ended September 30, | | Nine Months Ended September 30, | |
|--|---|--------------|--|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net investment income | \$ 11,106 | \$ 12,039 | \$ 35,749 | \$ 36,109 |
| Net realized investment gains | 594 | 1,272 | 15,559 | 16,066 |
| Net equity in net income (loss) of partnership | | | 53 | (29) |
| Net unrealized investment gains (losses) | (29,139) | 18,358 | (33,711) | 13,797 |
| Net investment gains (losses) | (28,545) | 19,630 | (18,099) | 29,834 |
| Total investment return | \$ (17,439) | \$ 31,669 | \$ 17,650 | \$ 65,943 |
| Total investment return % ⁽¹⁾ | (1.0%) | 1.9% | 1.0% | 3.9% |
| Average investment portfolio ⁽²⁾ | \$ 1,698,039 | \$ 1,686,638 | \$ 1,689,333 | \$ 1,696,376 |

(1) Not annualized.**(2)** Average of total cash and invested assets, net of receivable/payable for securities, as of the beginning and ending of the period.**Insurance Enhanced Municipal Bonds**

As of September 30, 2011, the Company held insurance enhanced municipal bonds of approximately \$89.3 million, which represented approximately 5.4% of the Company's total cash and invested assets. These securities had an average rating of AA. Approximately \$36.3 million of these bonds are pre-refunded with U.S. treasury securities, of which \$25.1 million are backed by financial guarantors, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond. Of the remaining \$53.0 million of insurance enhanced municipal bonds, \$21.2 million would have carried a lower credit rating had they not been insured. The following table provides a breakdown of the ratings for these municipal bonds with and without insurance.

| (Dollars in thousands) | Ratings | |
|-------------------------------|---------------------------|------------------------------|
| | with Insurance | without Insurance |
| Rating | | |
| AA | \$ 11,075 | \$ 812 |
| A | 10,115 | 19,353 |
| BBB | | 1,025 |
| Total | \$ 21,190 | \$ 21,190 |

A summary of the Company's insurance enhanced municipal bonds that are backed by financial guarantors, including the pre-refunded bonds that are escrowed in U.S. government obligations, as of September 30, 2011, is as follows:

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

| (Dollars in thousands) | | | | Exposure Net of Pre-refunded & Government Guaranteed Securities |
|---|-----------|----------------------------|--|--|
| Financial Guarantor | Total | Pre-refunded Securities | Government Guaranteed Securities | |
| Ambac Financial Group | \$ 7,017 | \$ 3,015 | \$ | \$ 4,002 |
| Financial Guaranty Insurance Company | 1,231 | 1,231 | | |
| Assured Guaranty Insurance Group | 34,354 | 11,958 | | 22,396 |
| Municipal Bond Insurance Association | 30,983 | 8,315 | | 22,668 |
| Federal Housing Association | 513 | | 513 | |
| Government National Housing Association | 2,962 | 620 | 2,342 | |
| Permanent School Fund Guaranty | 1,151 | | 1,151 | |
| Total backed by financial guarantors | 78,211 | 25,139 | 4,006 | 49,066 |
| Other credit enhanced municipal bonds | 11,111 | 11,111 | | |
| Total | \$ 89,322 | \$ 36,250 | \$ 4,006 | \$ 49,066 |

In addition to the \$89.3 million of insurance enhanced municipal bonds, the Company also held insurance enhanced asset-backed and credit securities with a market value of approximately \$31.0 million, which represented approximately 1.9% of the Company's total cash and invested assets. The financial guarantors of the Company's \$31.0 million of insurance enhanced asset-backed and credit securities include Financial Guaranty Insurance Company (\$0.7 million), Municipal Bond Insurance Association (\$12.5 million), Ambac (\$2.5 million), Assured Guaranty Insurance Group (\$10.1 million), and Other (\$5.2 million).

The Company had no direct investments in the entities that have provided financial guarantees or other credit support to any security held by the Company at September 30, 2011.

Bonds Held on Deposit

Certain cash balances, cash equivalents, and bonds available for sale were deposited with various governmental authorities in accordance with statutory requirements or were held in trust pursuant to intercompany reinsurance agreements. The estimated fair values of cash, cash equivalents, and bonds available for sale and on deposit or held in trust were as follows as of September 30, 2011 and December 31, 2010:

| (Dollars in thousands) | Estimated Fair Value | |
|--|----------------------|-------------------|
| | September 30, 2011 | December 31, 2010 |
| On deposit with governmental authorities | \$ 44,164 | \$ 43,656 |
| Intercompany trusts held for the benefit of U.S. policyholders | 541,668 | 609,242 |
| Held in trust pursuant to third party requirements | 98,122 | 68,900 |
| Held in trust pursuant to U.S. regulatory requirements for the benefit of U.S. policyholders | 6,055 | 5,871 |
| Total | \$ 690,009 | \$ 727,669 |

6. Fair Value Measurements

The Company elected to apply the fair value option within its limited partnership investment portfolio to an investment where the Company previously owned more than a 3% interest. The fair value of this investment was \$1.1 million as of December 31, 2010. In February, 2011, the Company liquidated its remaining interest in this limited partnership.

During the quarters and nine months ended September 30, 2011 and 2010, the Company recognized the following gains (losses), net of taxes, due to changes in the value of these investments.

| (Dollars in thousands) | Quarter Ended | | Nine Months | |
|------------------------------------|-----------------------|-----------------------|--------------------------------|--------------------------------|
| | September 30, 2011 | September 30, 2010 | Ended September 30, 2011 | Ended September 30, 2010 |
| Limited partnership > 3% ownership | \$ | \$ | \$ 53 | \$ (29) |

These gains (losses) are reflected on the consolidated statement of operations as equity in net income (loss) of partnerships, net of taxes.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

The fair value option was not elected for the Company's investments in limited partnerships with less than a 3% ownership interest.

The accounting standards related to fair value measurements define fair value, establish a framework for measuring fair value, outline a fair value hierarchy based on inputs used to measure fair value, and enhance disclosure requirements for fair value measurements. These standards do not change existing guidance as to whether or not an instrument is carried at fair value. The Company has determined that its fair value measurements are in accordance with the requirements of these accounting standards.

The Company's invested assets are carried at their fair value and are categorized based upon a fair value hierarchy:

Level 1 - inputs utilize quoted prices (unadjusted) in active markets for identical assets that the Company has the ability to access at the measurement date.

Level 2 - inputs utilize other than quoted prices included in Level 1 that are observable for the similar assets, either directly or indirectly.

Level 3 - inputs are unobservable for the asset, and include situations where there is little, if any, market activity for the asset. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset.

Both observable and unobservable inputs may be used to determine the fair value of positions that the Company has classified within the Level 3 category. As a result, the unrealized gains and losses for invested assets within the Level 3 category presented in the tables below may include changes in fair value that are attributed to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in unobservable long-dated volatilities) inputs.

The following tables present information about the Company's invested assets measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value.

| As of September 30, 2011 (Dollars in thousands) | \$0,000,000 | \$0,000,000 | \$0,000,000 | \$0,000,000 |
|--|--------------------|--------------------|--------------------|--------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Fixed maturities: | | | | |
| U.S. treasury and agency obligations | \$ 90,579 | \$ 40,889 | \$ | \$ 131,468 |
| Obligations of states and political subdivisions | | 218,615 | | 218,615 |
| Mortgage-backed securities | | 298,212 | | 298,212 |
| Commercial mortgage-backed securities | | 34,571 | | 34,571 |
| Asset-backed securities | | 102,755 | | 102,755 |
| Corporate bonds and loans | | 565,939 | | 565,939 |

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| | | | | |
|-------------------------------|-------------------|---------------------|------------------|---------------------|
| Foreign corporate bonds | | 54,782 | | 54,782 |
| Total fixed maturities | 90,579 | 1,315,763 | | 1,406,342 |
| Common shares | 146,067 | | | 146,067 |
| Other invested assets | | | 16,169 | 16,169 |
| Total invested assets | \$ 236,646 | \$ 1,315,763 | \$ 16,169 | \$ 1,568,578 |

| As of December 31, 2010 | \$0,000,000 | \$0,000,000 | \$0,000,000 | \$0,000,000 |
|--|--------------------|--|--------------------|--------------------|
| (Dollars in thousands) | Level 1 | Fair Value Measurements Level 2 | Level 3 | Total |
| Fixed maturities: | | | | |
| U.S. treasury and agency obligations | \$ 89,187 | \$ 113,503 | \$ | \$ 202,690 |
| Obligations of states and political subdivisions | | 245,012 | | 245,012 |

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

| | \$0,000,000 | \$0,000,000 | \$0,000,000 | \$0,000,000 |
|---------------------------------------|-------------|--------------|-------------|--------------|
| Mortgage-backed securities | | 249,080 | | 249,080 |
| Commercial mortgage-backed securities | | 38,733 | | 38,733 |
| Asset-backed securities | | 115,099 | | 115,099 |
| Corporate bonds and loans | | 532,784 | | 532,784 |
| Foreign corporate bonds | | 60,994 | | 60,994 |
| Total fixed maturities | 89,187 | 1,355,205 | | 1,444,392 |
| Preferred shares | | 2,252 | | 2,252 |
| Common shares | 145,274 | | | 145,274 |
| Other invested assets | | | 5,380 | 5,380 |
| Total invested assets | \$ 234,461 | \$ 1,357,457 | \$ 5,380 | \$ 1,597,298 |

The securities classified as Level 1 in the above table consist of U.S. Treasuries and equity securities actively traded on an exchange.

The securities classified as Level 2 in the above table consist primarily of fixed maturity securities. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, security prices are derived through recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information. If there are no recent reported trades, matrix or model processes are used to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Included in the pricing of asset-backed securities, collateralized mortgage obligations, and mortgage-backed securities are estimates of the rate of future prepayments of principal over the remaining life of the securities. Such estimates are derived based on the characteristics of the underlying structure and prepayment speeds previously experienced at the interest rate levels projected for the underlying collateral. For corporate loans, price quotes from multiple dealers along with recent reported trades for identical or similar securities are used to develop prices.

There were no significant transfers between Level 1 and Level 2 during the quarters or nine months ended September 30, 2011 or 2010.

The following tables present changes in Level 3 investments measured at fair value on a recurring basis for the quarter and nine months ended September 30, 2011:

| Quarter Ended September 30, 2011 | Other Invested Assets |
|--|--------------------------------------|
| (Dollars in thousands) | |
| Beginning balance at July 1, 2011 | \$ 17,579 |
| Total losses (realized / unrealized): | |
| Included in accumulated other comprehensive income | (1,434) |
| Purchases | 24 |
| Ending balance at September 30, 2011 | \$ 16,169 |
| Net unrealized losses included in net income for the period related to assets still held at September 30, 2011 | \$ |

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Nine Months Ended September 30, 2011

| (Dollars in thousands) | Other Invested Assets |
|--|--------------------------------------|
| Beginning balance at January 1, 2011 | \$ 5,380 |
| Total losses (realized / unrealized): | |
| Included in equity in net income of partnership | 81 |
| Included in accumulated other comprehensive income | 2,006 |
| Purchases | 10,049 |
| Sales | (1,347) |
| Ending balance at September 30, 2011 | \$ 16,169 |
| Net unrealized losses included in net income for the period related to assets still held at September 30, 2011 | \$ |

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

The \$16.2 million is comprised of \$7.2 million related to investments in limited partnerships and \$9.0 million related to an investment in a mutual fund. The \$7.2 million related to investments in limited partnerships was comprised of securities for which the Company does not have the ability to see the underlying valuations. The estimated fair value of these limited partnerships is measured utilizing the Company's net asset value as a practical expedient for each limited partnership. Material assumptions and factors utilized in pricing these securities include future cash flows, constant default rates, recovery rates, and any market clearing activity that may have occurred since the prior month-end pricing period. The Company's investment in a mutual fund of \$9.0 million is measured utilizing the fund's net asset value. The net asset value of the fund is based on the actual market price of the assets of the portfolio, including accrued income less liabilities and provisions for accrued expenses. The fund is comprised primarily of foreign equities. However, since the Company does not have the ability to see the invested asset composition of the mutual fund on a daily basis, this investment has been classified within the Level 3 category.

The following tables present changes in Level 3 investments measured at fair value on a recurring basis for the quarter and nine months ended September 30, 2010:

| Quarter Ended September 30, 2010 | Other Invested Assets |
|--|--------------------------------------|
| (Dollars in thousands) | |
| Beginning balance at July 1, 2010 | \$ 6,490 |
| Total losses (realized / unrealized): | |
| Included in accumulated other comprehensive income | (1,275) |
| Ending balance at September 30, 2010 | \$ 5,215 |
| Net unrealized losses included in net income for the period related to assets still held at September 30, 2010 | \$ |
| | |
| Nine Months Ended September 30, 2010 | Other Invested Assets |
| (Dollars in thousands) | |
| Beginning balance at January 1, 2010 | \$ 7,999 |
| Total losses (realized / unrealized): | |
| Included in equity in net loss of partnership | (44) |
| Included in accumulated other comprehensive income | (2,672) |
| Distribution | (68) |
| Ending balance at September 30, 2010 | \$ 5,215 |
| Net unrealized losses included in net income for the period related to assets still held at September 30, 2010 | \$ (44) |

The \$5.2 million is related to investments in limited partnerships. Of the investments in limited partnerships, \$4.1 million was comprised of securities for which the Company does not have the ability to see the underlying valuations. The estimated fair value of these limited

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partnerships is measured utilizing the Company's net asset value as a practical expedient for each limited partnership. Material assumptions and factors utilized in pricing these securities include future cash flows, constant default rates, recovery rates, and any market clearing activity that may have occurred since the prior month-end pricing period. Of our investments in limited partnerships, \$1.1 million was related to a limited partnership which holds convertible preferred securities of a privately held company. In February, 2011, the Company's remaining interest of \$1.1 million was liquidated.

Fair Value of Alternative Investments

Included in "Other invested assets" in the fair value hierarchy at September 30, 2011 are limited liability partnerships and a mutual fund measured at fair value. The following table provides the fair value and future funding commitments related to these investments at September 30, 2011.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

| (Dollars in thousands) | Fair Value | Future Funding Commitments |
|-------------------------------------|-------------------|---|
| Equity Fund, LP ⁽¹⁾ | \$ 7,221 | \$ 2,520 |
| Real Estate Fund, LP ⁽²⁾ | | |
| Mutual Fund ⁽³⁾ | 8,948 | |
| Total | \$ 16,169 | \$ 2,520 |

- (1) This limited partnership invests in companies, from various business sectors, whereby the partnership has acquired control of the operating business as a lead or organizing investor. The Company does not have the contractual option to redeem its limited partnership interest but receives distributions based on the liquidation of the underlying assets. The Company does not have the ability to sell or transfer its limited partnership interest without consent from the general partner.
- (2) This limited partnership invests in real estate assets through a combination of direct or indirect investments in partnerships, limited liability companies, mortgage loans, and lines of credit. The Company does not have the contractual option to redeem its limited partnership interest but receives distributions based on the liquidation of the underlying assets. The Company does not have the ability to sell or transfer its limited partnership interest without consent from the general partner. The Company continues to hold an investment in this limited partnership and has written the fair value down to zero in 2010.
- (3) This is an open-ended unincorporated mutual investment fund which seeks to generate attractive long term total returns by investing in companies which benefit from increasing levels of domestic consumption expenditure in the Asia ex Japan region. Investments will primarily be in equity securities within the consumer staples, consumer discretionary and healthcare sectors in the Asia ex Japan region; however, the approach is unconstrained and may opportunistically invest in any sector. The Company may request to redeem units of the portfolio. However, depending on the size of the redemption request, certain restrictions may apply.

Pricing

The Company's pricing vendors provide prices for all investment categories except for investments in limited partnerships. One vendor provides prices for equity securities and select fixed maturity categories including: corporate loans, commercial mortgage backed securities, high yield, investment grade, short term securities, and international fixed income securities, if any. A second vendor provides prices for other fixed maturity categories including: asset backed securities (ABS), collateralized mortgage obligations (CMO), and municipals. A third vendor provides prices for the remaining fixed maturity categories including mortgage backed securities (MBS) and treasuries.

The following is a description of the valuation methodologies used by the Company's pricing vendors for investment securities carried at fair value:

Equity prices are received from all primary and secondary exchanges.

Corporate bonds are individually evaluated on a nominal spread or an option adjusted spread basis depending on how the market trades a security or sector. Spreads are updated each day and compared with those from the broker/dealer community and contributing firms. Issues are generally benchmarked off of the U.S. treasuries or LIBOR.

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For CMOs, which are categorized with mortgage-backed securities in the tables listed above, a volatility-driven, multi-dimensional single cash flow stream model or option-adjusted spread model is used. For ABSs, a single expected cash flow stream model is utilized. For both asset classes, evaluations utilize standard inputs plus new issue data, monthly payment information, and collateral performance. The evaluated pricing models incorporate security set-up, prepayment speeds, cash flows, treasury, swap curves and spread adjustments.

For municipals, a series of matrices are used to evaluate securities within this asset class. The evaluated pricing models for this asset class incorporate security set-up, sector curves, yield to worst, ratings updates, and adjustments for material events notices.

U.S. Treasuries are priced on the bid side by a market maker.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

For MBSs, the pricing vendor utilizes a matrix model correlation to TBA (a forward MBS trade) or benchmarking to value a security.

Corporate loans are priced using averages of bids and offers obtained from the broker/dealer community involved in trading such loans.

The Company performs certain procedures to validate whether the pricing information received from the pricing vendors is reasonable, to ensure that the fair value determination is consistent with the most recent accounting guidance, and to ensure that its assets are properly classified in the fair value hierarchy. The Company's procedures include, but are not limited to:

Reviewing periodic reports provided by the Investment Manager that provides information regarding rating changes and securities placed on watch. This procedure allows the Company to understand why a particular security's market value may have changed.

Understanding and periodically evaluating the various pricing methods and procedures used by the Company's pricing vendors to ensure that investments are properly classified within the fair value hierarchy.

During the quarter and nine months ended September 30, 2011, the Company did not consider it necessary to adjust quotes or prices obtained from the pricing vendors.

7. Reinsurance

The Company cedes risk to unrelated reinsurers on a pro rata (quota share) and excess of loss basis in the ordinary course of business to limit its net loss exposure on insurance contracts. Reinsurance ceded arrangements do not discharge the Company of primary liability. Moreover, reinsurers may fail to pay the Company due to a lack of reinsurer liquidity, perceived improper underwriting, losses for risks that are excluded from reinsurance coverage, and other similar factors, all of which could adversely affect the Company's financial results.

The Company had the following reinsurance balances as of September 30, 2011 and December 31, 2010:

| (Dollars in thousands) | September 30, 2011 | December 31, 2010 |
|---|--------------------|-------------------|
| Reinsurance receivables | \$ 303,950 | \$ 422,844 |
| Collateral securing reinsurance receivables | (178,916) | (289,284) |
| Reinsurance receivables, net of collateral | \$ 125,034 | \$ 133,560 |
| Allowance for uncollectible reinsurance receivables | \$ 9,693 | \$ 12,742 |
| Prepaid reinsurance premiums | 7,762 | 11,104 |

The Company regularly evaluates retention levels and reinsurance limits to ensure that net retained losses are aligned with corporate risk tolerance and capital levels. The Company's U.S. Insurance Operations' primary reinsurance treaties are as follows:

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Property Catastrophe Excess of Loss The Company's current property writings create exposure to catastrophic events. To protect against these exposures, the Company purchases a property catastrophe treaty. Effective June 1, 2011, the Company renewed its property catastrophe excess of loss treaty which provides occurrence coverage for losses of \$80.0 million in excess of \$20.0 million. This treaty provides for one full reinstatement of coverage at 100% additional premium as to time and pro rata as to amount of limit reinstated. This replaces the treaty that expired on May 31, 2011, which provided occurrence coverage for losses of \$75.0 million in excess of \$15.0 million.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

Property Per Risk Excess of Loss Effective January 1, 2011, the Company renewed its property per risk excess of loss treaty which provides coverage of \$13.0 million per risk in excess of \$2.0 million per risk. This replaces the treaty that expired December 31, 2010, which provided coverage of \$14.0 million per risk in excess of \$1.0 million per risk. The renewal treaty provides coverage in two layers: \$3.0 million per risk in excess of \$2.0 million per risk, and \$10.0 million per risk in excess of \$5.0 million per risk. The first layer is split into two sections, each subject to a \$3.0 million limit of liability for all risks involved in one loss occurrence, and the second layer is subject to a \$10.0 million limit for all risks involved in one loss occurrence.

Professional Liability Excess of Loss Effective April 30, 2011, the Company's professional liability excess of loss treaty was terminated. This treaty provided coverage of \$4.0 million per policy/occurrence in excess of \$1.0 million per policy/occurrence. Effective May 1, 2011, the professional liability exposure was added to the casualty excess of loss treaty.

Casualty and Professional Liability Excess of Loss Effective May 1, 2011, the Company renewed its casualty excess of loss treaty and added the professional liability exposure as a separate section to the treaty. The casualty section provides coverage for \$2.0 million per occurrence in excess of \$1.0 million per occurrence for general liability and auto liability. Allocated loss adjustment expenses are included within limits. The stand-alone casualty treaty that expired April 30, 2011 provided identical coverage. The professional liability section provides coverage of \$4.0 million per policy/occurrence in excess of \$1.0 million per policy/occurrence.

Casualty Clash Excess of Loss Effective January 1, 2011, the Company renewed its casualty clash excess of loss treaty which provides coverage of \$10.0 million per occurrence in excess of \$3.0 million per occurrence, subject to a \$20.0 million limit for all loss occurrences. This replaces the treaty that expired December 31, 2010, which provided identical coverage.

Property Quota Share Effective January 1, 2010, the Company renewed its 40% quota share treaty related to the Penn-America property line of business. This treaty covers premiums earned in 2010 on policies written in 2009 and 2010. During 2010, the Company ceded \$14.1 million of earned premium. This treaty expired on December 31, 2010 and was not renewed.

Marine Excess of Loss Effective May 24, 2010, the Company entered into a marine excess of loss treaty which provides coverage in three layers for \$13.0 million per occurrence in excess of \$2.0 million per occurrence. The first layer of \$3.0 million in excess of \$2.0 million, and the second layer of \$5.0 million in excess of \$5.0 million, provides for two full reinstatements of coverage at 100% additional premium. The third layer of \$5.0 million in excess of \$10.0 million provides for one full reinstatement of coverage at 100% additional premium. This treaty will expire on November 30, 2011.

There were no other significant changes to any of the Company's other reinsurance treaties during the quarter and nine months ended September 30, 2011. To the extent that there may be an increase or decrease in catastrophe or casualty clash exposure in the future, the Company may increase or decrease its reinsurance protection for these exposures commensurately.

8. Income Taxes

The statutory income tax rates of the countries where the Company does business are 35.0% in the United States, 0.0% in Bermuda, 0.0% in the Cayman Islands, 0.0% in Gibraltar, 28.59% in the Grand Duchy of Luxembourg, and 25.0% on non-trading income and 12.5% on trading income in the Republic of Ireland. For 2010, on an interim basis, the statutory income tax rate of each country is applied against the expected annual taxable income of the Company in each country to estimate the annual income tax expense. Total estimated annual income tax expense was divided by total estimated annual pre-tax income to determine the expected annual income tax rate used to compute the income tax provision. The expected annual income tax rate was applied against interim pre-tax income, excluding net realized gains and losses and limited partnership distributions, and then adding that amount to actual income taxes on net realized gains and losses, discrete items and limited partnership distributions. For the quarter and nine months ended September 30, 2011, the Company recorded the actual income tax provision in lieu of using the estimated effective income tax rate due to wide variability in the expected annual effective income tax rate.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

across several similar pre-tax income scenarios. The Company's income before income taxes from the Non-U.S. Subsidiaries and U.S. Subsidiaries, including the results of the quota share agreement between Wind River Reinsurance and the Insurance Operations, for the quarters and nine months ended September 30, 2011 and 2010 were as follows:

| | \$000000000 | \$000000000 | \$000000000 | \$000000000 |
|---|------------------------------|--------------------------|---------------------|--------------|
| Quarter Ended September 30, 2011: | | | | |
| (Dollars in thousands) | Non-U.S. Subsidiaries | U.S. Subsidiaries | Eliminations | Total |
| Revenues: | | | | |
| Gross premiums written | \$ 42,603 | \$ 55,262 | \$ (24,773) | \$ 73,092 |
| Net premiums written | \$ 42,603 | \$ 22,331 | \$ | \$ 64,934 |
| Net premiums earned | \$ 51,075 | \$ 26,015 | \$ | \$ 77,090 |
| Net investment income | 10,602 | 6,926 | (4,648) | 12,880 |
| Net realized investment gains (losses) | (762) | 2,050 | | 1,288 |
| Other income | | 167 | | 167 |
| Total revenues | 60,915 | 35,158 | (4,648) | 91,425 |
| Losses and Expenses: | | | | |
| Net losses and loss adjustment expenses | 76,539 | 9,695 | | 86,234 |
| Acquisition costs and other underwriting expenses | 21,812 | 12,785 | | 34,597 |
| Corporate and other operating expenses | 1,585 | 1,277 | | 2,862 |
| Interest expense | | 6,173 | (4,648) | 1,525 |
| Income (loss) before income taxes | \$ (39,021) | \$ 5,228 | \$ | \$ (33,793) |
| | \$000000000 | \$000000000 | \$000000000 | \$000000000 |
| Quarter Ended September 30, 2010: | | | | |
| (Dollars in thousands) | Non-U.S. Subsidiaries | U.S. Subsidiaries | Eliminations | Total |
| Revenues: | | | | |
| Gross premiums written | \$ 47,586 | \$ 66,213 | \$ (27,564) | \$ 86,235 |
| Net premiums written | \$ 47,586 | \$ 25,620 | \$ | \$ 73,206 |
| Net premiums earned | \$ 47,225 | \$ 22,864 | \$ | \$ 70,089 |
| Net investment income | 11,089 | 7,648 | (4,648) | 14,089 |

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| | | | | |
|---|-----------|----------|---------|-----------|
| Net realized investment gains | 258 | 1,560 | | 1,818 |
| Other income | | 173 | | 173 |
| Total revenues | 58,572 | 32,245 | (4,648) | 86,169 |
| Losses and Expenses: | | | | |
| Net losses and loss adjustment expenses | 24,412 | 5,377 | | 29,789 |
| Acquisition costs and other underwriting expenses | 17,243 | 11,298 | | 28,541 |
| Corporate and other operating expenses | 2,802 | 2,304 | | 5,106 |
| Interest expense | | 6,473 | (4,648) | 1,825 |
| Income before income taxes | \$ 14,115 | \$ 6,793 | \$ | \$ 20,908 |

\$000000000 \$000000000 \$000000000 \$000000000

Nine Months Ended September 30, 2011:

| (Dollars in thousands) | Non-U.S. Subsidiaries | U.S. Subsidiaries | Eliminations | Total |
|---|--------------------------|----------------------|--------------|-------------|
| Revenues: | | | | |
| Gross premiums written | \$ 158,058 | \$ 182,102 | \$ (84,440) | \$ 255,720 |
| Net premiums written | \$ 157,556 | \$ 76,893 | \$ | \$ 234,449 |
| Net premiums earned | \$ 151,538 | \$ 79,576 | \$ | \$ 231,114 |
| Net investment income | 33,548 | 21,469 | (13,793) | 41,224 |
| Net realized investment gains | 5,024 | 16,647 | | 21,671 |
| Other income | | 11,999 | | 11,999 |
| Total revenues | 190,110 | 129,691 | (13,793) | 306,008 |
| Losses and Expenses: | | | | |
| Net losses and loss adjustment expenses | 156,075 | 50,254 | | 206,329 |
| Acquisition costs and other underwriting expenses | 60,562 | 34,084 | | 94,646 |
| Corporate and other operating expenses | 7,035 | 3,294 | | 10,329 |
| Interest expense | | 18,813 | (13,793) | 5,020 |
| Income (loss) before income taxes | \$ (33,562) | \$ 23,246 | \$ | \$ (10,316) |

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

| | \$000000000 | \$000000000 | \$000000000 | \$000000000 |
|---|------------------------------|--------------------------|---------------------|--------------|
| Nine Months Ended September 30, 2010: | | | | |
| (Dollars in thousands) | Non-U.S. Subsidiaries | U.S. Subsidiaries | Eliminations | Total |
| Revenues: | | | | |
| Gross premiums written | \$ 165,372 | \$ 181,815 | \$ (76,049) | \$ 271,138 |
| Net premiums written | \$ 164,588 | \$ 69,622 | \$ | \$ 234,210 |
| Net premiums earned | \$ 145,724 | \$ 69,855 | \$ | \$ 215,579 |
| Net investment income | 32,760 | 23,641 | (13,792) | 42,609 |
| Net realized investment gains | 5,754 | 15,865 | | 21,619 |
| Other income | | 515 | | 515 |
| Total revenues | 184,238 | 109,876 | (13,792) | 280,322 |
| Losses and Expenses: | | | | |
| Net losses and loss adjustment expenses | 76,485 | 27,768 | | 104,253 |
| Acquisition costs and other underwriting expenses | 56,292 | 31,405 | | 87,697 |
| Corporate and other operating expenses | 7,795 | 7,270 | | 15,065 |
| Interest expense | | 19,189 | (13,792) | 5,397 |
| Income before income taxes | \$ 43,666 | \$ 24,244 | \$ | \$ 67,910 |

The following tables summarize the differences between the tax provisions under accounting guidance applicable to interim financial statement periods and the expected tax provision at the weighted average tax rate:

| (Dollars in thousands) | Quarters Ended September 30, | | | |
|---|-------------------------------------|----------------------------|---------------|----------------------------|
| | 2011 | % of Pre-Tax Income | 2010 | % of Pre-Tax Income |
| | Amount | | Amount | |
| Expected tax provision at weighted average rate | \$ 1,845 | (5.5%) | \$ 2,379 | 11.4% |
| Adjustments: | | | | |
| Tax exempt interest | (478) | 1.4 | (504) | (2.4) |
| Dividend exclusion | (173) | 0.5 | (123) | (0.6) |
| Effective tax rate adjustment | | | 150 | 0.7 |
| Other | (740) | 2.3 | (756) | (3.6) |
| Income tax expense | \$ 454 | (1.3%) | \$ 1,146 | 5.5% |

The effective income tax rate for the quarter ended September 30, 2011 was (1.3%), compared to an effective income tax rate of 5.5% for the quarter ended September 30, 2010. Due to potential volatility in the 2011 expected effective tax rate, the Company recorded its actual year-to-date tax provision during the quarter ended September 30, 2011 as compared with an estimated annual effective rate during the quarter

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ended September 30, 2010. The effective rate differed from the weighted average expected income tax expense rate of (5.5%) for the quarter ended September 30, 2011 due to the fact that the Company records income tax expense net of tax-exempt interest and dividends. The effective rate differed from the weighted average expected income tax expense rate of 11.4% for the quarter ended September 30, 2010 primarily due to the fact that the Company recorded income tax expense during interim periods using an expected annual effective tax rate, net of tax-exempt interest and dividends.

| (Dollars in thousands) | Nine Months Ended September 30, | | | |
|---|---------------------------------|------------------------|-----------------|------------------------|
| | 2011 | % of Pre-Tax Income | 2010 | % of Pre-Tax Income |
| | Amount | | Amount | |
| Expected tax provision at weighted average rate | \$ 8,481 | (82.2%) | \$ 8,564 | 12.6% |
| Adjustments: | | | | |
| Tax exempt interest | (1,498) | 14.5 | (1,488) | (2.2) |
| Dividend exclusion | (540) | 5.2 | (286) | (0.4) |
| Effective tax rate adjustment | | | (1,376) | (2.0) |
| Other | (685) | 6.7 | (708) | (1.1) |
| Income tax expense | \$ 5,758 | (55.8%) | \$ 4,706 | 6.9% |

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

The weighted average expected tax provision was \$8.5 million and \$8.6 million for the nine months ended September 30, 2011 and 2010, respectively. Although the Company incurred a pre-tax loss in 2011, our U.S. Insurance Operations segment recognized \$23.2 million of income. U.S. Insurance Operations income includes \$16.6 million of realized gains and \$11.5 million related to a litigation settlement with AON. The income generated in the U.S. is the primary driver of the weighted average expected income tax expense of \$8.5 million. The effective rate differed from the weighted average expected tax provision in 2011 and 2010 primarily due to the impact of tax-exempt interest and dividends.

The Company and some of its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The Company is no longer subject to U.S. federal tax examinations by tax authorities for tax years before 2008.

The alternative minimum tax credit carryforward was \$5.6 million as of September 30, 2011 and \$6.5 million as of December 31, 2010, respectively.

The Company applies a more-likely-than-not recognition threshold for all tax uncertainties whereby it only recognizes those tax benefits that have a greater than 50% likelihood of being sustained upon examination by the taxing authorities. The Company's unrecognized tax benefits were \$0.3 million as of September 30, 2011 and \$0.7 million as of December 31, 2010. If recognized, the gross unrecognized tax benefits could lower the effective income tax rate in any future period.

The Company classifies all interest and penalties related to uncertain tax positions as income tax expense. As of September 30, 2011, the Company has recorded \$0.03 million in liabilities for tax-related interest and penalties on its consolidated balance sheet.

9. Liability for Unpaid Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses reflects the Company's best estimate for future amounts needed to pay claims and related settlement expenses and the impact of the Company's reinsurance coverage with respect to insured events. Estimating the ultimate claims liability of the Company is a complex and judgmental process because the amounts are based on management's informed estimates and judgments using data currently available. In some cases, significant periods of time, up to several years or more, may elapse between the occurrence of an insured loss and the reporting of such to the Company. The method for determining the Company's liability for unpaid losses and loss adjustment expenses includes, but is not limited to, reviewing past loss experience and considering other factors such as industry data and legal, social, and economic developments. As additional experience and data become available, the Company's estimate for the liability for unpaid losses and loss adjustment expenses is revised accordingly. If the Company's ultimate losses, net of reinsurance, prove to differ substantially from the amounts recorded with respect to unpaid losses and loss adjustment expenses at September 30, 2011, the related adjustments could have a material impact on the Company's future results of operations.

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

| | \$0,000 | \$0,000 | \$0,000 | \$0,000 |
|-------------------------------------|-----------------------|--------------|--------------------------|--------------|
| | Quarters Ended | | Nine Months Ended | |
| | September 30, | | September 30, | |
| (Dollars in thousands) | 2011 | 2010 | 2011 | 2010 |
| Balance at beginning of period | \$ 975,192 | \$ 1,168,759 | \$ 1,052,743 | \$ 1,257,744 |
| Less: Ceded reinsurance receivables | 320,127 | 466,955 | 407,197 | 514,467 |

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| | | | | |
|---|---------|----------|---------|----------|
| Net balance at beginning of period | 655,065 | 701,804 | 645,546 | 743,277 |
| Incurring losses and loss adjustment expenses related to: | | | | |
| Current year | 83,665 | 44,852 | 214,403 | 137,972 |
| Prior years | 2,569 | (15,063) | (8,074) | (33,719) |
| Total incurred losses and loss adjustment expenses | 86,234 | 29,789 | 206,329 | 104,253 |

Paid losses and loss adjustment expenses related to:

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

| | \$0,000 | \$0,000 | \$0,000 | \$0,000 |
|---|---------------|---------------|----------------|----------------|
| Current year | 26,124 | 14,664 | 53,145 | 29,877 |
| Prior years | 38,367 | 41,650 | 121,922 | 142,366 |
| Total paid losses and loss adjustment expenses | 64,491 | 56,314 | 175,067 | 172,243 |
| Net balance at end of period | 676,808 | 675,287 | 676,808 | 675,287 |
| Plus: Ceded reinsurance receivables | 294,414 | 445,175 | 294,414 | 445,175 |
| Balance at end of period | \$ 971,222 | \$ 1,120,462 | \$ 971,222 | \$ 1,120,462 |

When analyzing loss reserves and prior year development, the Company considers many factors, including the frequency and severity of claims, loss trends, case reserve settlements that may have resulted in significant development, and any other additional or pertinent factors that may impact reserve estimates.

In the third quarter of 2011, the Company increased its prior accident year loss reserves by \$2.6 million, which consisted mainly of a \$3.3 million increase in auto liability lines, a \$0.5 million increase in professional liability lines, and a \$0.3 million increase in all other lines, offset partially by a \$1.1 million reduction in general liability lines and a \$0.5 million reduction in property lines:

Auto liability: The \$3.3 million increase primarily related to increases in our Reinsurance Operations. This consisted of a \$3.8 million increase to accident year 2010 resulting from further unexpected development on non-standard auto treaties which were not renewed in 2011. This was partially offset by a \$1.2 million decrease in accident year 2009. Our Insurance Operations also saw an increase of \$0.7 million in accident years 2009 and 2010 due to recent unfavorable development on a few large claims.

Professional liability: The \$0.5 million increase consisted of increases of \$2.5 million primarily related to accident years 2009 and 2010 primarily due to unfavorable development in certain product classes. We are addressing profitability concerns by exiting certain classes of business which have proven to be unprofitable. This was offset by a decrease of \$2.0 million related to all other prior accident years.

General liability: The \$1.1 million reduction primarily consisted of reductions of \$2.1 million related to our Insurance Operations. This amount included an \$8.2 million reduction in accident years 2008 and prior due to continued favorable emergence. Incurred losses in these years have developed at a rate lower than the Company's historical averages. We also decreased our reinsurance allowance by \$0.9 million in this line due to changes in our reinsurance exposure on specifically identified claims and general decreases in ceded reserves. Offsetting these decreases were increases of \$6.9 million in accident years 2009 and 2010 related to loss emergence in one of our classes of business as well as revised exposure estimates for construction defect liability. Increased estimates for construction defect were the result of a methodology change in the quarter, and were not driven by claim frequency or severity trends. We are addressing profitability concerns by exiting certain classes of business that have proven to be unprofitable. At our Reinsurance Operations we increased our general liability reserves by \$1.1 million, which primarily related to accident years 2009 and 2010. These changes related to higher than expected loss emergence.

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Property: The \$0.5 million reduction primarily related to accident year 2010 and is primarily related to favorable loss emergence on a worldwide catastrophe treaty in our Reinsurance Operations.

In the third quarter of 2010, the Company reduced its prior accident year loss reserves by \$15.1 million, which consisted of a \$14.2 million reduction in general liability lines, a \$1.6 million reduction in property lines, and a \$1.3 million reduction in umbrella lines, offset by a \$1.7 million increase in commercial auto lines and a \$0.1 million increase in professional liability lines:

General liability: The \$14.2 million reduction primarily consisted of reductions of \$16.3 million related to accident years 2004 through 2009 due to lower than anticipated frequency and severity. Incurred losses for these segments have developed at a rate lower than the Company's historical averages. This reduction was offset by a net increase of \$2.1 million related to accident years 2003 and prior primarily due to increases in expected unallocated loss adjustment expenses, as well as, higher than expected claim frequency and severity.

Property: The \$1.6 million reduction primarily consisted of net reductions of \$1.7 million related to

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

accident years 2009, 2008, and 2006 and prior due to decreases in expected unallocated loss adjustment expenses and lower than anticipated severity. This reduction was offset by an increase of \$0.1 million related to accident year 2007.

Umbrella: The \$1.3 million reduction primarily consisted of net reductions of \$1.5 million related to accident years 2009 and 2007 and prior due to lower than anticipated severity. As these accident years have matured, more weight has been given to experience based methods which continue to develop favorably compared to the Company's initial indications. This reduction was offset by an increase of \$0.2 million related to accident year 2008 due to an increase in severity.

Commercial auto: The \$1.7 million increase consisted of an increase of \$1.9 million related to accident year 2009 due to increased frequency on two non-standard auto treaties. This increase was offset by net reductions of \$0.2 million related to accident years 2008 and prior. Programs related to these accident years are in run-off, and loss severity has been lower than the Company's prior projections.

Professional liability: The \$0.1 million increase primarily consisted of an increase of \$1.9 million related to accident years 2007 and 2009 where the Company experienced higher than expected claim frequency and severity. This increase was offset by a reduction of \$1.8 million related to accident years 2008 and 2006 and prior driven by lower than expected paid and incurred activity during the quarter.

In the nine months ended September 30, 2011, the Company reduced its prior accident year loss reserves by \$8.1 million, which consisted mainly of a \$15.9 million reduction in general liability lines, a \$1.1 million reduction in umbrella lines, and a \$1.0 million reduction in property lines, offset by a \$4.7 million increase in auto liability lines, a \$4.4 million increase in professional liability lines and a \$0.9 million increase in workers' compensation lines:

General liability: The \$15.9 million reduction primarily consisted of reductions of \$21.3 million related to our Insurance Operations. This amount included a \$31.0 million reduction in accident years 2008 and prior due to continued favorable emergence. Incurred losses have developed at a rate lower than the Company's historical averages. We also decreased our reinsurance allowance by \$3.1 million in this line due to changes in our reinsurance exposure on specifically identified claims and general decreases in ceded reserves. Offsetting these decreases were increases of \$12.8 million in accident years 2009 and 2010 primarily driven by loss emergence in one of our classes of business as well as revised exposure estimates for construction defect liability. Increased estimates for construction defect were the result of a methodology change in the quarter, and were not driven by claim frequency or severity trends. We are addressing profitability concerns by exiting certain classes of business that have proven to be unprofitable. At our Reinsurance Operations we increased our general liability reserves by \$5.5 million in accident years 2009 and 2010 due to loss emergence that was greater than expected.

Umbrella: The \$1.1 million reduction primarily related to accident years 2010 and prior in our Insurance Operations primarily due to continued favorable emergence. Umbrella coverage typically attaches to other coverage lines, so these net decreases follow the decreases in general liability above.

Property: The \$1.0 million reduction primarily related to a \$1.8 million decrease in our Insurance Operations primarily related to accident years 2009 and 2010 related to anticipated subrogation on a large equine mortality claim as well as favorable development on prior year catastrophe claims. This was offset by a \$0.7 million increase related to accident year 2010 in our Reinsurance

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Operations due to loss emergence on a worldwide catastrophe treaty.

Auto liability: The \$4.7 million increase primarily consisted of an increase of \$1.2 million in our Insurance Operations related to accident years 2009 and 2010 due to higher than expected severity. There was also a \$3.5 million increase in our Reinsurance Operations primarily related to a \$4.0 million increase to accident year 2010 resulting from greater severity on non-standard auto treaties which were not renewed in 2011. This was offset by a decrease of \$0.5 million in accident year 2009.

Professional liability: The \$4.4 million increase was primarily related to our Insurance Operations and primarily consisted of increases of \$15.1 million related to accident years 1998, 2009 and 2010, offset partially by decreases of \$10.8 million related to all other accident years. In 2011, we exited certain classes of business where the volume of premium was low and loss volatility was high. We are focused on writing business where we expect to realize profit that meets our return on investment thresholds.

Workers compensation: The \$0.9 million increase primarily related to accident years 2009 and 2010 in

Table of Contents

GLOBAL INDEMNITY PLC

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

our Reinsurance Operations and is the result of expected losses recorded on adjustment premiums recorded in 2011. In the nine months ended September 30, 2010, the Company reduced its prior accident year loss reserves by \$33.7 million, which consisted of a \$26.9 million reduction in general liability lines, a \$3.7 million reduction in umbrella lines, a \$2.9 million reduction in professional liability lines, and a \$1.9 million reduction in property lines, offset by a \$1.5 million increase in commercial auto lines:

General liability: The \$26.9 million reduction primarily consisted of net reductions of \$30.2 million related to accident years 2002 through 2009 due to severity that was lower than originally anticipated. Incurred losses for these years have developed at a rate lower than the Company's historical averages. This reduction was partially offset by a net increase of \$3.3 million related to accident years 2001 and prior where the Company experienced higher than expected claim frequency and severity.

Umbrella: The \$3.7 million reduction primarily consisted of net reductions related to accident years 2009 and prior primarily due to lower than anticipated severity. As these accident years have matured, more weight has been given to experience based methods which continue to develop favorably compared to the Company's initial indications.

Professional liability: The \$2.9 million reduction primarily consisted of net reductions of \$6.1 million related to accident years 2008 and prior due to severity that was lower than originally anticipated, partially offset by an increase of \$3.2 million related to accident year 2009 where the Company experienced higher than expected claim frequency and severity.

Property: The \$1.9 million reduction primarily consisted of net reductions of \$2.4 million related to accident years 2008 and prior primarily due to lower than anticipated severity. This reduction was offset by an increase of \$0.5 million to accident year 2009 that was driven by higher than expected claim frequency and severity.

Commercial auto: The \$1.5 million increase primarily consisted of a net increase of \$2.1 million related to accident years 2008 and 2009 where losses were higher than anticipated. This increase was offset by net reductions of \$0.6 million related to accident years 2007 and prior. Programs related to these accident years are in run-off, and loss severity has been lower than the Company's prior projections.

10. Related Party Transactions

Fox Paine & Company

As of September 30, 2011, Fox Paine & Company beneficially owned shares having approximately 89.5% of the Company's total outstanding voting power. Fox Paine & Company can nominate a certain number of Directors, dependent on Fox Paine & Company's percentage ownership of voting shares in the Company, for so long as Fox Paine & Company hold an aggregate of 25% or more of the voting power in the Company. Fox Paine & Company controls the election of all of our Directors due to its controlling share ownership. The Company's Chairman is a member of Fox Paine & Company. The Company relies on Fox Paine & Company to provide management services and other services related to the operations of the Company.

The Company incurred management fees of \$0.3 million in each of the quarters ended September 30, 2011 and 2010 and \$1.1 million in each of the nine months ended September 30, 2011 and 2010 as part of the annual management fee that is paid to Fox Paine & Company.

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At September 30, 2011 and December 31, 2010, Wind River Reinsurance was a limited partner in Fox Paine Capital Fund, II, which is managed by Fox Paine & Company. This investment was originally made by United National Insurance Company in June 2000 and pre-dates the September 5, 2003 acquisition by Fox Paine & Company of Wind River Investment Corporation, the holding company for the Company's Predecessor Insurance Operations. The Company's investment in this limited partnership was valued at \$7.2 million and \$4.3 million at September 30, 2011 and December 31, 2010, respectively. At September 30, 2011, the Company had an unfunded capital commitment of \$2.5 million to the partnership. Distributions of \$0.15 million and \$0.07 million were received from the limited partnership during the nine months ended September 30, 2011 and 2010, respectively. There were no

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

distributions received from the limited partnership during the quarters ended September 30, 2011 and 2010.

On July 2, 2010, United America Indemnity, Ltd. entered into an agreement to indemnify the affected indirect owners of the affiliates of Fox Paine & Company that were shareholders of United America Indemnity, Ltd. immediately prior to the effective date of our re-domestication to Ireland (See Note 3 for details). The agreement indemnifies them for any tax cost (including interest on tax and penalties, if any) of any triggering event and such affected indirect owners will pay us an amount equal to any tax benefits, if any, realized by them as a result of a triggering event for which they were indemnified, provided that the indirect owners will not be required to pay any amount of tax benefits in excess of the tax costs for which we have indemnified them. A sale or other disposition by these indirect owners of our ordinary shares will not constitute a triggering event for this purpose. In addition, the indemnification agreement provides that, under certain circumstances, in the event the conversion of Global Indemnity plc's Class B ordinary shares to Class A ordinary shares or a sale or other disposition of Global Indemnity plc's Class B ordinary shares is subject to Irish stamp duty, we will indemnify such affiliates of Fox Paine & Company and their transferees against such Irish stamp duty.

Cozen O Connor

During the quarter and nine months ended September 30, 2010, the Company incurred \$0.1 million and \$0.2 million, respectively, for legal services rendered by Cozen O Connor. Stephen A. Cozen, the chairman of Cozen O Connor, was a member of the Company's Board of Directors until his retirement effective December 31, 2010.

Validus Reinsurance, Ltd.

Validus is a participant in a quota share retrocession agreement with Wind River Reinsurance. The Company estimated that the following written premium and losses related to the quota share retrocession agreement have been assumed by Validus from Wind River Reinsurance:

| (Dollars in thousands) | Quarter Ended | | Nine Months Ended | |
|------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| Ceded written premium | \$ | \$ | \$ (76) | \$ (2,401) |
| Ceded losses | | | 54 | 644 |

Edward J. Noonan, the chairman and chief executive officer of Validus, was a member of the Company's Board of Directors until June 1, 2007, when he resigned from the Company's Board. Validus remains a related party since the current quota share retrocession agreement between Validus and Wind River Reinsurance was put in place during the period when Mr. Noonan was a member of the Company's Board of Directors.

Frank Crystal & Company

During each of the quarter and nine months ended September 30, 2011 and 2010, the Company paid \$0.1 million and \$0.2 million, respectively, in brokerage fees to Frank Crystal & Company, an insurance broker. James W. Crystal, the chairman and chief executive officer of Frank Crystal & Company, became a member of the Company's Board of Directors effective July 6, 2010.

11. Commitments and Contingencies**Legal Proceedings**

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The Company is, from time to time, involved in various legal proceedings in the ordinary course of business. The Company purchases insurance and reinsurance policies covering such risks in amounts that it considers adequate. However, there can be no assurance that the insurance and reinsurance coverage that the Company maintains is sufficient or will be available in adequate amounts or at a reasonable cost. The Company does not believe that the

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

resolution of any currently pending legal proceedings, either individually or taken as a whole, will have a material adverse effect on the Company's business, results of operations, cash flows, or financial condition.

There is a greater potential for disputes with reinsurers who are in a runoff of their reinsurance operations. Some of the Company's reinsurers reinsurance operations are in runoff, and therefore, the Company closely monitors those relationships. The Company anticipates that, similar to the rest of the insurance and reinsurance industry, it will continue to be subject to litigation and arbitration proceedings in the ordinary course of business.

On December 4, 2008, a federal jury in the U.S. District Court for the Eastern District of Pennsylvania (Philadelphia) returned a \$24.0 million verdict in favor of United National Insurance Company (United National), an indirect wholly owned subsidiary of the Company, against AON Corp., an insurance and reinsurance broker. On July 24, 2009, a federal judge from the U.S. District Court for the Eastern District of Pennsylvania (Philadelphia) upheld that jury verdict. In doing so, the U.S. District Judge increased the verdict to \$32.2 million by adding more than \$8.2 million in prejudgment interest. AON filed its Notice of Appeal and a Bond in the amount of \$33.0 million. Oral arguments were heard by the Appellate Court on October 26, 2010. In January, 2011, we settled with AON for \$16.3 million. We realized approximately \$7.5 million, net of income taxes and attorney's fees.

12. Share-Based Compensation Plans

During the nine months ended September 30, 2011, the Company granted 65,481 Class A ordinary shares at a weighted average grant date value of \$21.44 per share, to key employees of the Company under the Global Indemnity plc Share Incentive Plan (the Plan). Of those shares, 54,233 were subject to certain restrictions and 11,248 vested immediately. The Company did not grant any shares to employees during the quarter ended September 30, 2011.

During the quarter and nine months ended September 30, 2011, the Company granted an aggregate of 12,864 and 39,675 fully vested Class A ordinary shares, respectively, subject to certain restrictions, at a weighted average grant date value of \$22.31 and \$21.52 per share, respectively, to non-employee directors of the Company under the Plan.

During the quarter and nine months ended September 30, 2011, the Company granted 300,000 Time-Based Options under the Plan. The Time-Based Options vest in 33% increments over a three-year period and expire ten years after the grant date.

13. Earnings Per Share

Earnings per share have been computed using the weighted average number of ordinary shares and ordinary share equivalents outstanding during the period. All share counts and corresponding per share market prices for 2010 have been adjusted to reflect the one-for-two stock exchange of Global Indemnity plc shares for United America Indemnity, Ltd. shares as part of the re-domestication to Ireland. See Note 3 above for more information regarding the re-domestication.

The following table sets forth the computation of basic and diluted earnings per share.

| (Dollars in thousands, except per share data) | Quarters Ended | | Nine Months Ended | |
|---|----------------|------|-------------------|------|
| | September 30, | 2010 | September 30, | 2010 |
| | 2011 | | 2011 | |

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| | | | | |
|---|-------------|------------|-------------|------------|
| Net income (loss) | \$ (34,247) | \$ 19,762 | \$ (16,021) | \$ 63,175 |
| <i>Basic earnings per share:</i> | | | | |
| Weighted average shares outstanding - basic | 30,338,010 | 30,273,757 | 30,320,538 | 30,222,074 |
| Net income (loss) per share | \$ (1.13) | \$ 0.65 | \$ (0.53) | \$ 2.09 |
| <i>Diluted earnings per share:</i> | | | | |
| Weighted average shares outstanding - diluted | 30,352,850 | 30,308,489 | 30,341,713 | 30,245,890 |
| Net income (loss) per share | \$ (1.13) | \$ 0.65 | \$ (0.53) | \$ 2.09 |

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

A reconciliation of weighted average shares for basic earnings per share to weighted average shares for diluted earnings per share is as follows:

| | Quarters Ended September 30, | | Nine Months Ended September 30, | |
|--|---------------------------------|------------|------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Weighted average shares for basic earnings per share | 30,338,010 | 30,273,757 | 30,320,538 | 30,222,074 |
| Non-vested restricted stock | 14,824 | 34,732 | 12,399 | 23,816 |
| Options | 16 | | 8,776 | |
| Weighted average shares for diluted earnings per share | 30,352,850 | 30,308,489 | 30,341,713 | 30,245,890 |

The weighted average shares outstanding used to determine dilutive earnings per share for the quarters ended September 30, 2011 and 2010 do not include 465,775 and 341,809 shares, respectively, which were deemed to be anti-dilutive. The weighted average shares outstanding used to determine dilutive earnings per share for the nine months ended September 30, 2011 and 2010 do not include 450,232 and 352,309 shares, respectively, which were deemed to be anti-dilutive.

14. Segment Information

The Company manages its business through two business segments: Insurance Operations, which includes the operations of the U.S. Insurance Companies, and Reinsurance Operations, which includes the operations of Wind River Reinsurance.

The Insurance Operations segment and the Reinsurance Operations segment follow the same accounting policies used for the Company's consolidated financial statements. For further disclosure regarding the Company's accounting policies, please see Note 4 of the notes to the consolidated financial statements in Item 8 of Part II of the Company's 2010 Annual Report on Form 10-K.

The following are tabulations of business segment information for the quarters and nine months ended September 30, 2011 and 2010.

Quarter Ended September 30, 2011:

| (Dollars in thousands) | Insurance Operations ⁽¹⁾ | Reinsurance Operations ⁽²⁾ | Total |
|------------------------|--|--|-----------|
| Revenues: | | | |
| Gross premiums written | \$ 55,260 | \$ 17,832 | \$ 73,092 |
| Net premiums written | \$ 47,102 | \$ 17,832 | \$ 64,934 |
| Net premiums earned | \$ 54,063 | \$ 23,027 | \$ 77,090 |
| Other income | 167 | | 167 |

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| | | | |
|---|-----------------------|---------------------------|--------------|
| Total revenues | 54,230 | 23,027 | 77,257 |
| Losses and Expenses: | | | |
| Net losses and loss adjustment expenses | 58,174 | 28,060 | 86,234 |
| Acquisition costs and other underwriting expenses | 24,998 ⁽³⁾ | 9,599 | 34,597 |
| Loss from segments | \$ (28,942) | \$ (14,632) | (43,574) |
| Unallocated Items: | | | |
| Net investment income | | | 12,880 |
| Net realized investment gains | | | 1,288 |
| Corporate and other operating expenses | | | (2,862) |
| Interest expense | | | (1,525) |
| Loss before income taxes | | | (33,793) |
| Income tax expense | | | 454 |
| Net loss | | | \$ (34,247) |
| Total assets | \$ 1,474,174 | \$ 658,715 ⁽⁴⁾ | \$ 2,132,889 |

(1) Includes business ceded to Reinsurance Operations.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

- (2) External business only, excluding business assumed from Insurance Operations.
(3) Includes federal excise tax of \$281 relating to cessions from Insurance Operations to Reinsurance Operations.
(4) Comprised of Wind River Reinsurance's total assets less its investment in subsidiaries.

Quarter Ended September 30, 2010:

| (Dollars in thousands) | Insurance Operations ⁽¹⁾ | Reinsurance Operations ⁽²⁾ | Total |
|---|--|--|--------------|
| Revenues: | | | |
| Gross premiums written | \$ 66,213 | \$ 20,022 | \$ 86,235 |
| Net premiums written | \$ 53,185 | \$ 20,021 | \$ 73,206 |
| Net premiums earned | \$ 47,932 | \$ 22,157 | \$ 70,089 |
| Other income | 173 | | 173 |
| Total revenues | 48,105 | 22,157 | 70,262 |
| Losses and Expenses: | | | |
| Net losses and loss adjustment expenses | 13,584 | 16,205 | 29,789 |
| Acquisition costs and other underwriting expenses | 22,556 ⁽³⁾ | 5,985 | 28,541 |
| Income (loss) from segments | \$ 11,965 | \$ (33) | 11,932 |
| Unallocated Items: | | | |
| Net investment income | | | 14,089 |
| Net realized investment gains | | | 1,818 |
| Corporate and other operating expenses | | | (5,106) |
| Interest expense | | | (1,825) |
| Income before income taxes | | | 20,908 |
| Income tax expense | | | 1,146 |
| Net income | | | \$ 19,762 |
| Total assets | \$ 1,698,557 | \$ 654,472 ⁽⁴⁾ | \$ 2,353,029 |

- (1) Includes business ceded to Reinsurance Operations.
(2) External business only, excluding business assumed from Insurance Operations.
(3) Includes federal excise tax of \$251 relating to cessions from Insurance Operations to Reinsurance Operations.
(4) Comprised of Wind River Reinsurance's total assets less its investment in subsidiaries.

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Nine Months Ended September 30, 2011:

| (Dollars in thousands) | Insurance Operations ⁽¹⁾ | Reinsurance Operations ⁽²⁾ | Total |
|---|--|--|--------------|
| Revenues: | | | |
| Gross premiums written | \$ 182,102 | \$ 73,618 | \$ 255,720 |
| Net premiums written | \$ 161,333 | \$ 73,116 | \$ 234,449 |
| Net premiums earned | \$ 165,354 | \$ 65,760 | \$ 231,114 |
| Other income | 11,999 | | 11,999 |
| Total revenues | 177,353 | 65,760 | 243,113 |
| Losses and Expenses: | | | |
| Net losses and loss adjustment expenses | 135,217 | 71,112 | 206,329 |
| Acquisition costs and other underwriting expenses | 73,581 ⁽³⁾ | 21,065 | 94,646 |
| Loss from segments | \$ (31,445) | \$ (26,417) | (57,862) |
| Unallocated Items: | | | |
| Net investment income | | | 41,224 |
| Net realized investment gains | | | 21,671 |
| Corporate and other operating expenses | | | (10,329) |
| Interest expense | | | (5,020) |
| Loss before income taxes | | | (10,316) |
| Income tax expense | | | 5,758 |
| Loss before equity in net income of partnership | | | (16,074) |
| Equity in net income of partnership, net of tax | | | 53 |
| Net loss | | | \$ (16,021) |
| Total assets | \$ 1,474,174 | \$ 658,715 ⁽⁴⁾ | \$ 2,132,889 |

(1) Includes business ceded to Reinsurance Operations.

(2) External business only, excluding business assumed from Insurance Operations.

(3) Includes federal excise tax of \$858 relating to cessions from Insurance Operations to Reinsurance Operations.

Table of Contents**GLOBAL INDEMNITY PLC****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)****(Unaudited)**

- (4) Comprised of Wind River Reinsurance's total assets less its investment in subsidiaries.

| Nine Months Ended September 30, 2010: (Dollars in thousands) | Insurance Operations (1) | Reinsurance Operations (2) | Total |
|---|--------------------------------|-------------------------------|--------------|
| Revenues: | | | |
| Gross premiums written | \$ 181,815 | \$ 89,323 | \$ 271,138 |
| Net premiums written | \$ 145,674 | \$ 88,536 | \$ 234,210 |
| Net premiums earned | \$ 146,412 | \$ 69,167 | \$ 215,579 |
| Other income | 515 | | 515 |
| Total revenues | 146,927 | 69,167 | 216,094 |
| Losses and Expenses: | | | |
| Net losses and loss adjustment expenses | 59,582 | 44,671 | 104,253 |
| Acquisition costs and other underwriting expenses | 67,666 ⁽³⁾ | 20,031 | 87,697 |
| Income from segments | \$ 19,679 | \$ 4,465 | 24,144 |
| Unallocated Items: | | | |
| Net investment income | | | 42,609 |
| Net realized investment gains | | | 21,619 |
| Corporate and other operating expenses | | | (15,065) |
| Interest expense | | | (5,397) |
| Income before income taxes | | | 67,910 |
| Income tax expense | | | 4,706 |
| Income before equity in net loss of partnership | | | 63,204 |
| Equity in net loss of partnership, net of tax | | | (29) |
| Net income | | | \$ 63,175 |
| Total assets | \$ 1,698,557 | \$ 654,472 ⁽⁴⁾ | \$ 2,353,029 |

(1) Includes business ceded to Reinsurance Operations.

(2) External business only, excluding business assumed from Insurance Operations.

(3) Includes federal excise tax of \$766 relating to cessions from Insurance Operations to Reinsurance Operations.

(4) Comprised of Wind River Reinsurance's total assets less its investment in subsidiaries.

15. Supplemental Cash Flow Information

The Company paid the following amounts in cash for net U.S. federal income taxes and interest during the quarters and nine months ended September 30, 2011 and 2010:

| (Dollars in thousands) | Quarters Ended | | Nine Months Ended | |
|------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| Net U.S. federal income taxes paid | \$ 62 | \$ 1,650 | \$ 4,160 | \$ 3,704 |
| Interest paid | 3,136 | 3,182 | 6,579 | 6,625 |

16. New Accounting Pronouncements

In September, 2011, the FASB issued new accounting guidance surrounding an entity's goodwill impairment testing. The new guidance allows for an entity to elect to assess qualitative factors when evaluating for goodwill impairment. If qualitative factors indicate that there may be impairment, prior guidance using quantitative factors should still be applied. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. This guidance will not have a material impact on our consolidated statements of financial position or results of operations.

In October, 2010, the FASB issued new accounting guidance that modified the definition of costs that can be capitalized in the acquisition of new and renewal business for insurance companies. The guidance defines criteria for the capitalization of acquisition costs in a more specific manner than defined in previous guidance. The guidance is effective for calendar years beginning after December 15, 2011. We intend to adopt this guidance prospectively on January 1, 2012. The amount of acquisition costs we will defer under the new guidance will be less than the amount deferred under our current accounting practice. The adoption of this guidance is not expected to have a material impact on our financial condition.

Table of Contents

GLOBAL INDEMNITY PLC

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and accompanying notes of Global Indemnity included elsewhere in this report. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategy, constitutes forward-looking statements that involve risks and uncertainties. Please see **Cautionary Note Regarding Forward-Looking Statements** at the end of this Item 2 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained herein. For more information regarding our business and operations, please see our Annual Report on Form 10-K for the year ended December 31, 2010.

Recent Developments

On September 15, 2011, we announced the appointment of Cynthia Valko as Chief Executive Officer and a member of the Company's Board of Directors, both effective September 19, 2011. Ms. Valko succeeds Larry Frakes, who had informed the Board of Directors of his intention to retire at the expiration of his contract as of December 31, 2011.

On September 15, 2011, the Board of Directors, having completed its previously announced evaluation of the Company's strategic alternatives, determined that the Company will continue as an independent provider of primary and reinsurance specialty insurance products and services.

On September 15, 2011, the Company's Board of Directors authorized the repurchase of up to \$100 million of the Company's Class A ordinary shares. Stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of derivative contracts, structured share repurchase agreements and Rule 10b5-1 trading plans. The timing and amount of any repurchase transactions, if any, under this program will depend upon market conditions as well as other factors. We may decide to buy or not buy any of our ordinary shares or discontinue our share repurchase program at any time, any of which may impact our stock price. Important factors that could cause us to discontinue our share repurchases include, among others, market conditions, increases in the market price of our ordinary shares, the nature of other investment opportunities presented to us from time to time, and the availability of funds necessary to continue purchasing common stock. There have been no share repurchases under this program to date.

Overview

Our Insurance Operations distribute property and casualty insurance products through a group of approximately 97 professional general agencies that have limited quoting and binding authority, as well as a number of wholesale insurance brokers who in turn sell our insurance products to insureds through retail insurance brokers. We operate predominantly in the excess and surplus lines marketplace. To manage our operations, we differentiate them by product classification. These product classifications are: 1) Penn-America, which includes property and general liability products for small commercial businesses distributed through a select network of wholesale general agents with specific binding authority; 2) United National, which includes property, general liability, and professional lines products distributed through program administrators with specific binding authority; and 3) Diamond State, which includes property, casualty, and professional lines products distributed through wholesale brokers and program administrators with specific binding authority.

Our Reinsurance Operations are comprised of the operations of Wind River Reinsurance; a Bermuda based treaty reinsurer of excess and surplus lines and specialty property and casualty insurance.

We derive our revenues primarily from premiums paid on insurance policies that we write and from income generated by our investment portfolio, net of fees paid for investment management services. The amount of insurance premiums that we receive is a function of the amount and type of policies we write, as well as of

Table of Contents

GLOBAL INDEMNITY PLC

prevailing market prices.

Our expenses include losses and loss adjustment expenses, acquisition costs and other underwriting expenses, corporate and other operating expenses, interest, other investment expenses, and income taxes. Losses and loss adjustment expenses are estimated by management and reflect our best estimate of ultimate losses and costs arising during the reporting period and revisions of prior period estimates. We record losses and loss adjustment expenses based on an actuarial analysis of the estimated losses we expect to incur on the insurance policies we write. The ultimate losses and loss adjustment expenses will depend on the actual costs to resolve claims. Acquisition costs consist principally of commissions that are typically a percentage of the premiums on the insurance policies we write, net of ceding commissions earned from reinsurers and allocated internal costs. Other underwriting expenses consist primarily of personnel expenses and general operating expenses. Corporate and other operating expenses are comprised primarily of outside legal fees, other professional fees, including accounting fees, directors' fees, management fees, salaries and benefits for company personnel whose services relate to the support of corporate activities, and capital duty taxes incurred. Interest expense consists primarily of interest on senior notes payable, junior subordinated debentures, and funds held on behalf of others.

Critical Accounting Estimates and Policies

Our consolidated financial statements are prepared in conformity with GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates and assumptions. We believe that of our significant accounting policies, the following may involve a higher degree of judgment and estimation.

Liability for Unpaid Losses and Loss Adjustment Expenses

Although variability is inherent in estimates, we believe that the liability for unpaid losses and loss adjustment expenses reflects our best estimate for future amounts needed to pay losses and related loss adjustment expenses and the impact of our reinsurance coverages with respect to insured events.

In developing loss and loss adjustment expense (loss or losses) reserve estimates for our Insurance Operations, our actuaries perform detailed reserve analyses each quarter. To perform the analysis, the data is organized at a reserve category level. A reserve category can be a line of business such as commercial automobile liability, or it can be a particular type of claim such as construction defect. The reserves within a reserve category level are characterized as short-tail through long-tail. Most of our business can be characterized as medium to long-tail. For medium to long-tail business, it will generally be several years between the time the business is written and the time when all claims are settled. Our long-tail exposures include general liability, professional liability, products liability, commercial automobile liability, and excess and umbrella. Short-tail exposures include property, commercial automobile physical damage, and equine mortality. For further discussion about our product classifications, see General Business Segments Our Insurance Operations in Item 1 of Part I of our 2010 Annual Report on Form 10-K. Each of our product classifications contain both long-tail and short-tail exposures. Every reserve category is analyzed by our actuaries each quarter. The analyses generally include reviews of losses gross and net of reinsurance.

In addition to our internal reserve analysis, independent external actuaries perform a full, detailed review of our Insurance Operations reserves during the second and fourth quarters. Our independent external actuaries performed an additional higher level review as of September 30, 2011. Our independent external actuaries also perform a full, detailed review of our Reinsurance Operations reserves on a quarterly basis. We do not rely upon the review of the independent actuaries to develop our reserves; however, the data is used to corroborate the analysis performed by the in-house actuarial staff.

Loss reserve estimates for our Reinsurance Operations are developed internally and by independent, external actuaries. Similar to our Insurance Operations, the data provided by our external actuaries is used to corroborate the analysis performed by the in-house actuarial staff. Consistent with industry practices the estimates developed by our Reinsurance Operations do rely in part, or in whole, on the accuracy, timeliness and completeness of information reported to us by our cedant partners. The data for this analysis is organized by treaty and treaty year. As with our reserves for our Insurance Operations, reserves for our Reinsurance Operations are characterized as short-tail through long-tail. Most of our business can be characterized as medium to long-tail. Medium to long-tail

Table of Contents

GLOBAL INDEMNITY PLC

exposures include workers compensation, professional liability, auto liability, marine liability, and excess and umbrella liability. Short-tail exposures are primarily catastrophe exposed property accounts and marine hull. Every treaty is reviewed each quarter, both gross and net of reinsurance.

The methods that we use to project ultimate losses for long-tail through short-tail exposures include, but are not limited to, the following:

Paid Development method;

Incurred Development method;

Expected Loss Ratio method;

Bornhuetter-Ferguson method using premiums and paid loss;

Bornhuetter-Ferguson method using premiums and incurred loss;

Average Loss method; and

Claim department estimates (particularly with respect to major catastrophe events).

The Paid Development method estimates ultimate losses by reviewing paid loss patterns and applying them to accident years with further expected changes in paid loss. Selection of the paid loss pattern requires analysis of several factors including the impact of inflation on claims costs, the rate at which claims professionals make claim payments and close claims, the impact of judicial decisions, the impact of underwriting changes, the impact of large claim payments and other factors. Claim cost inflation itself requires evaluation of changes in the cost of repairing or replacing property, changes in the cost of medical care, changes in the cost of wage replacement, judicial decisions, legislative changes and other factors. Because this method assumes that losses are paid at a consistent rate, changes in any of these factors can impact the results. Since the method does not rely on case reserves, it is not directly influenced by changes in the adequacy of case reserves.

For many reserve categories, paid loss data for recent periods may be too immature or erratic for accurate predictions. This situation often exists for long-tail exposures. In addition, changes in the factors described above may result in inconsistent payment patterns. Finally, estimating the paid loss pattern subsequent to the most mature point available in the data analyzed often involves considerable uncertainty for long-tail reserve categories.

The Incurred Development method is similar to the Paid Development method, but it uses case incurred losses instead of paid losses. Since this method uses more data (case reserves in addition to paid losses) than the Paid Development method, the incurred development patterns may be less variable than paid development patterns. However, selection of the incurred loss pattern requires analysis of all of the factors listed in the description of the Paid Development method. Additionally, the inclusion of case reserves can lead to distortions if changes in case reserving practices have taken place and the use of case incurred losses may not eliminate the issues associated with estimating the incurred loss pattern subsequent to the most mature point available.

The Expected Loss Ratio method multiplies premiums by an expected loss ratio to produce ultimate loss estimates for each accident year. This method may be useful if loss development patterns are inconsistent, losses emerge very slowly, or there is relatively little loss history from which to estimate future losses. The selection of the expected loss ratio requires analysis of loss ratios from earlier accident years or pricing

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studies and analysis of inflationary trends, frequency trends, rate changes, underwriting changes, and other applicable factors.

The Bornhuetter-Ferguson method using premiums and paid losses is a combination of the Paid Development method and the Expected Loss Ratio method. This method normally determines expected loss ratios similar to the method used for the Expected Loss Ratio method and requires analysis of the same factors described above. The method assumes that only future losses will develop at the expected loss ratio level. The percent of paid loss to ultimate loss implied from the Paid Development method is used to determine what percentage of ultimate loss is yet to be paid. The use of the pattern from the Paid Development method requires consideration of all factors listed in the description of the Paid Development method. The estimate of losses yet to be paid is added to current paid losses to estimate the ultimate loss for each year. This method will react very slowly if actual ultimate loss ratios are different from expectations due to changes not accounted for by the expected loss ratio calculation.

The Bornhuetter-Ferguson method using premiums and incurred losses is similar to the Bornhuetter-Ferguson method using premiums and paid losses except that it uses case incurred losses. The use of case incurred losses

Table of Contents

GLOBAL INDEMNITY PLC

instead of paid losses can result in development patterns that are less variable than paid development patterns. However, the inclusion of case reserves can lead to distortions if changes in case reserving practices have taken place, and the method requires analysis of all the factors that need to be reviewed for the Expected Loss Ratio and Incurred Development methods.

The Average Loss method multiplies a projected number of ultimate claims by an estimated ultimate average loss for each accident year to produce ultimate loss estimates. Since projections of the ultimate number of claims are often less variable than projections of ultimate loss, this method can provide more reliable results for reserve categories where loss development patterns are inconsistent or too variable to be relied on exclusively. In addition, this method can more directly account for changes in coverage that impact the number and size of claims. However, this method can be difficult to apply to situations where very large claims or a substantial number of unusual claims result in volatile average claim sizes. Projecting the ultimate number of claims requires analysis of several factors including the rate at which policyholders report claims to us, the impact of judicial decisions, the impact of underwriting changes and other factors. Estimating the ultimate average loss requires analysis of the impact of large losses and claim cost trends based on changes in the cost of repairing or replacing property, changes in the cost of medical care, changes in the cost of wage replacement, judicial decisions, legislative changes and other factors.

For many exposures, especially those that can be considered long-tail, a particular accident year may not have a sufficient volume of paid losses to produce a statistically reliable estimate of ultimate losses. In such a case, our actuaries typically assign more weight to the Incurred Development method than to the Paid Development method. As claims continue to settle and the volume of paid losses increases, the actuaries may assign additional weight to the Paid Development method. For most of our reserve categories, even the incurred losses for accident years that are early in the claim settlement process will not be of sufficient volume to produce a reliable estimate of ultimate losses. In these cases, we will not assign any weight to the Paid and Incurred Development methods and will use the Bornhuetter-Ferguson and Expected Loss Ratio methods. For short-tail exposures, the Paid and Incurred Development methods can often be relied on sooner primarily because our history includes a sufficient number of years to cover the entire period over which paid and incurred losses are expected to change. However, we may also use the Expected Loss Ratio, Bornhuetter-Ferguson and Average Loss methods for short-tail exposures.

Generally, reserves for long-tail lines use the Expected Loss Ratio method for the most recent accident year, shift to the Bornhuetter-Ferguson methods for the next two years, and then shift to the Incurred and/or Paid Development method. Claims related to umbrella business are usually reported later than claims for other long-tail lines. For umbrella business, the Expected Loss Ratio and Bornhuetter-Ferguson methods are used for as many as six years before shifting to the Incurred Development method. Reserves for short-tail lines use the Bornhuetter-Ferguson methods for the most recent accident year and shift to the Incurred and/or Paid Development method in subsequent years.

For other more complex reserve categories where the above methods may not produce reliable indications, we use additional methods tailored to the characteristics of the specific situation. Such reserve categories include losses from construction defects and asbestos and environmental losses (A&E).

For construction defect losses, our actuaries organize losses by the year in which they were reported. To estimate losses from claims that have not been reported, various extrapolation techniques are applied to the pattern of claims that have been reported to estimate the number of claims yet to be reported. This process requires analysis of several factors including the rate at which policyholders report claims to us, the impact of judicial decisions, the impact of underwriting changes and other factors. An average claim size is determined from past experience and applied to the number of unreported claims to estimate reserves for these claims.

Establishing reserves for A&E and other mass tort claims involves considerably more judgment than other types of claims due to, among other things, inconsistent court decisions, an increase in bankruptcy filings as a result of asbestos-related liabilities, and judicial interpretations that often expand theories of recovery and broaden the scope of coverage. The insurance industry continues to receive a substantial number of asbestos-related bodily injury claims, with an increasing focus being directed toward other parties, including installers of products containing asbestos rather than against asbestos manufacturers. This shift has resulted in significant insurance coverage litigation implicating applicable coverage defenses or determinations, if any, including but not limited to, determinations as to whether or not an asbestos-related bodily injury claim is subject to aggregate limits of liability

Table of Contents**GLOBAL INDEMNITY PLC**

found in most comprehensive general liability policies. In response to these continuing developments, management increased gross and net A&E reserves during the second quarter of 2008 to reflect its best estimate of A&E exposures. In 2009, one of our insurance companies was dismissed from a lawsuit seeking coverage from it and other unrelated insurance companies. The suit involved issues related to approximately 3,900 existing asbestos related bodily injury claims and future claims. The dismissal was the result of a settlement of a disputed claim related to accident year 1984. The settlement is conditioned upon certain legal events occurring which will trigger financial obligations by the insurance company. Management will continue to monitor the developments of the litigation to determine if any additional financial exposure is present.

Reserve analyses performed by our internal and external actuaries result in actuarial point estimates. The results of the detailed reserve reviews were summarized and discussed with our senior management to determine the best estimate of reserves. This group considered many factors in making this decision. The factors included, but were not limited to, the historical pattern and volatility of the actuarial indications, the sensitivity of the actuarial indications to changes in paid and incurred loss patterns, the consistency of claims handling processes, the consistency of case reserving practices, changes in our pricing and underwriting, and overall pricing and underwriting trends in the insurance market.

Management's best estimate at September 30, 2011 was recorded as the loss reserve. Management's best estimate is as of a particular point in time and is based upon known facts, our actuarial analyses, current law, and our judgment. This resulted in carried gross and net reserves of \$971.2 million and \$676.8 million, respectively, as of September 30, 2011. A breakout of our gross and net reserves, excluding the effects of our intercompany pooling arrangements and intercompany stop loss and quota share reinsurance agreements, as of September 30, 2011 is as follows:

| (Dollars in thousands) | Case | Gross Reserves | |
|------------------------|-------------------|---------------------|-------------------|
| | | IBNR ⁽¹⁾ | Total |
| Insurance Operations | \$ 317,295 | \$ 539,525 | \$ 856,820 |
| Reinsurance Operations | 38,723 | 75,679 | 114,402 |
| Total | \$ 356,018 | \$ 615,204 | \$ 971,222 |

| | Case | Net Reserves ⁽²⁾ | |
|------------------------|-------------------|-----------------------------|-------------------|
| | | IBNR ⁽¹⁾ | Total |
| Insurance Operations | \$ 204,551 | \$ 358,822 | \$ 563,373 |
| Reinsurance Operations | 38,602 | 74,833 | 113,435 |
| Total | \$ 243,153 | \$ 433,655 | \$ 676,808 |

(1) Losses incurred but not reported, including the expected future emergence of case reserves.

(2) Does not include reinsurance receivable on paid losses.

We continually review these estimates and, based on new developments and information, we include adjustments of the estimated ultimate liability in the operating results for the periods in which the adjustments are made. The establishment of loss and loss adjustment expense reserves makes no provision for the possible broadening of coverage by legislative action or judicial interpretation, or the emergence of new types of losses not sufficiently represented in our historical experience or that cannot yet be quantified or estimated. We regularly analyze our reserves and review pricing and reserving methodologies so that future adjustments to prior year reserves can be minimized. However, given the complexity of this process, reserves require continual updates and the ultimate liability may be higher or lower than previously indicated. Changes in estimates for loss and loss adjustment expense reserves are recorded in the period that the change in these estimates is made. See Note 9 of the notes to the consolidated financial statements in Item 1 of Part I of this report for details concerning the changes in the estimate for incurred loss and loss adjustment expenses related to prior accident years.

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The detailed reserve analyses that our internal and external actuaries complete use a variety of generally accepted actuarial methods and techniques to produce a number of estimates of ultimate loss. We determine our best estimate of ultimate loss by reviewing the various estimates and assigning weight to each estimate given the characteristics of the reserve category being reviewed. The reserve estimate is the difference between the estimated ultimate loss and the losses paid to date. The difference between the estimated ultimate loss and the case incurred loss (paid loss plus case reserve) is considered to be IBNR. IBNR calculated as such includes a provision for development on known

Table of Contents**GLOBAL INDEMNITY PLC**

cases (supplemental development) as well as a provision for claims that have occurred but have not yet been reported (pure IBNR).

In light of the many uncertainties associated with establishing the estimates and making the assumptions necessary to establish reserve levels, we review our reserve estimates on a regular basis and make adjustments in the period that the need for such adjustments is determined. The anticipated future loss emergence continues to be reflective of historical patterns, and the selected development patterns have not changed significantly from those underlying our most recent analyses.

The key assumptions fundamental to the reserving process are often different for various reserve categories and accident years. Some of these assumptions are explicit assumptions that are required of a particular method, but most of the assumptions are implicit and cannot be precisely quantified. An example of an explicit assumption is the pattern employed in the Paid Development method. However, the assumed pattern is itself based on several implicit assumptions such as the impact of inflation on medical costs and the rate at which claim professionals close claims. Loss frequency is a measure of the number of claims per unit of insured exposure, and loss severity is a measure of the average size of claims. Each reserve segment has an implicit frequency and severity for each accident year as a result of the various assumptions made.

Previous reserve analyses have resulted in our identification of information and trends that have caused us to increase or decrease our frequency and severity assumptions in prior periods and could lead to the identification of a need for additional material changes in loss and loss adjustment expense reserves, which could materially affect our results of operations, equity, business and insurer financial strength and debt ratings. Factors affecting loss frequency include, among other things, the effectiveness of loss controls and safety programs and changes in economic activity or weather patterns. Factors affecting loss severity include, among other things, changes in policy limits and deductibles, rate of inflation and judicial interpretations. Another factor affecting estimates of loss frequency and severity is the loss reporting lag, which is the period of time between the occurrence of a loss and the date the loss is reported to us. The length of the loss reporting lag affects our ability to accurately predict loss frequency (loss frequencies are more predictable for short-tail lines) as well as the amount of reserves needed for IBNR.

If the actual levels of loss frequency and severity are higher or lower than expected, the ultimate losses will be different than management's best estimate. For most of our reserving classes, we believe that frequency can be predicted with greater accuracy than severity. Therefore, we believe management's best estimate is more sensitive to changes in severity than frequency. The following table, which we believe reflects a reasonable range of variability around our best estimate based on our historical loss experience and management's judgment, reflects the impact of changes (which could be favorable or unfavorable) in frequency and severity on our current accident year net loss estimate of \$214.4 million for claims occurring during the nine months ended September 30, 2011:

| (Dollars in thousands) | | Severity Change | | | | |
|-------------------------|------------|-----------------|-------------|-------------|----------|----------|
| | | -10% | -5% | 0% | 5% | 10% |
| Frequency Change | -5% | \$ (31,088) | \$ (20,904) | \$ (10,720) | \$ (536) | \$ 9,648 |
| | -3% | (27,229) | (16,831) | (6,432) | 3,966 | 14,365 |
| | -2% | (25,300) | (14,794) | (4,288) | 6,218 | 16,723 |
| | -1% | (23,370) | (12,757) | (2,144) | 8,469 | 19,082 |
| | 0% | (21,440) | (10,720) | | 10,720 | 21,440 |
| | 1% | (19,511) | (8,683) | 2,144 | 12,971 | 23,799 |
| | 2% | (17,581) | (6,646) | 4,288 | 15,223 | 26,157 |
| | 3% | (15,651) | (4,610) | 6,432 | 17,474 | 28,516 |
| | 5% | (11,792) | (536) | 10,720 | 21,976 | 33,232 |

Our net reserves for losses and loss expenses of \$676.8 million as of September 30, 2011 relate to multiple accident years. Therefore, the impact of changes in frequency and severity for more than one accident year could be higher or lower than the amounts reflected above.

Deferred Acquisition Costs

The costs of acquiring new and renewal insurance and reinsurance contracts include commissions, premium taxes and certain other costs that vary with and are primarily related to the acquisition of new and renewal insurance and reinsurance contracts. The excess of the Company's costs of acquiring new and renewal insurance and reinsurance contracts over the related ceding commissions earned from reinsurers is capitalized as deferred acquisition costs and amortized over the period in which the related premiums are earned.

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In accordance with accounting guidance for insurance enterprises, the method followed in computing such amounts limits them to their estimated realizable value that gives effect to the premium to be earned, related investment income, losses and loss adjustment expenses, and certain other costs expected to be incurred as the premium is earned. A premium deficiency shall be recognized if the sum of expected loss and loss adjustment expenses and unamortized acquisition costs exceeds related unearned premium after consideration of investment income. Any future expected loss on the related unearned premium is recorded first by impairing the unamortized acquisition costs on the related unearned premium followed by an increase to loss and loss adjustment expense reserves on additional expected loss in excess of unamortized acquisition costs.

During the quarter and nine months ended September 30, 2011, the Company incurred a pre-tax premium deficiency charge of \$10.5 million, or \$0.35 per diluted share, and \$11.0 million, or \$0.36 per diluted share, respectively. There were no premium deficiency charges incurred during the quarter or nine months ended September 30, 2010.

The charge of \$10.5 million incurred during the quarter ended September 30, 2011 consisted of \$7.6 million charged to our U.S. Insurance Operations and \$2.9 million charged to our Reinsurance Operations. The \$7.6 million charge to our U.S. Insurance Operations consisted of \$3.7 million recorded to acquisition costs and other underwriting expenses and \$3.9 million recorded to loss and loss adjustment expenses. The \$2.9 million charge to our Reinsurance Operations was recorded to acquisition costs and other underwriting expenses.

The charge of \$11.0 million incurred during the nine months ended September 30, 2011 consisted of \$7.6 million charged to our U.S. Insurance Operations and \$3.3 million charged to our Reinsurance Operations. The \$7.6 million charge to our U.S. Insurance Operations consisted of \$3.7 million recorded to acquisition costs and other underwriting expenses and \$3.9 million recorded to loss and loss adjustment expenses. The \$3.3 million charge to our Reinsurance Operations was recorded to acquisition costs and other underwriting expenses.

As a result of these charges, the Company reduced deferred acquisition costs during the quarter and nine months ended September 30, 2011 by \$6.6 million and \$7.0 million, respectively. Additionally, the Company accrued a premium deficiency reserve of \$3.9 million included in loss and loss adjustment expense reserves during the quarter and nine months ended September 30, 2011.

Recoverability of Reinsurance Receivables

We regularly review the collectability of our reinsurance receivables and include adjustments resulting from this review in earnings in the period in which the adjustment arises. A.M. Best ratings, financial history, available

Table of Contents

GLOBAL INDEMNITY PLC

collateral, and payment history with reinsurers are several of the factors that we consider when judging collectability. Changes in loss reserves can also affect the valuation of reinsurance receivables if the change is related to loss reserves that are ceded to reinsurers. Certain amounts may be uncollectible if our reinsurers dispute a loss or if the reinsurer is unable to pay. If our reinsurers do not pay, we are still legally obligated to pay the loss. At September 30, 2011, our reinsurance receivables were \$304.0 million, net of an allowance for uncollectible reinsurance receivables of \$9.7 million. See Note 7 of the notes to the consolidated financial statements in Item 1 of Part I of this report for more details concerning the collectability of our reinsurance receivables.

Investments

The carrying amount of our investments approximates their estimated fair value. We regularly perform various analytical valuation procedures with respect to investments, including reviewing each fixed maturity security in an unrealized loss position to determine the amount of unrealized loss related to credit loss and the amount related to all other factors, such as changes in interest rates. The credit loss represents the portion of the amortized book value in excess of the net present value of the projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. The credit loss component of the other than temporary impairment is recorded through earnings, whereas the amount relating to factors other than credit losses are recorded in other comprehensive income, net of taxes. During our review, we consider credit rating, market price, and issuer specific financial information, among other factors, to assess the likelihood of collection of all principal and interest as contractually due. Securities for which we determine that a credit loss is likely are subjected to further analysis to estimate the credit loss to be recognized in earnings, if any. See Note 5 of the notes to consolidated financial statements in Item 1 of Part I of this report for the specific methodologies and significant assumptions used by asset class. Upon identification of such securities and periodically thereafter, a detailed review is performed to determine whether the decline is considered other than temporary. This review includes an analysis of several factors, including but not limited to, the credit ratings and cash flows of the securities, and the magnitude and length of time that the fair value of such securities is below cost.

For an analysis of our securities with gross unrealized losses as of September 30, 2011 and December 31, 2010, and for other than temporary impairment losses that we recorded for the quarters and nine months ended September 30, 2011 and 2010, please see Note 5 of the notes to the consolidated financial statements in Item 1 of Part I of this report.

Fair Value Measurements

We categorize our assets that are accounted for at fair value in the consolidated financial statements into a fair value hierarchy. The fair value hierarchy is directly related to the amount of subjectivity associated with the inputs utilized to determine the fair value of these assets. See Note 6 of the notes to the consolidated financial statements in Item 1 of Part I of this report for further information about the fair value hierarchy and our assets that are accounted for at fair value.

Goodwill and Intangible Assets

The Company tests for impairment of goodwill at least annually and more frequently as circumstances warrant in accordance with applicable accounting guidance. Impairment of goodwill is recognized only if the carrying amount of the business unit, including goodwill, exceeds the fair value of the reporting unit. The amount of the impairment loss would be equal to the excess carrying value of the goodwill over the implied fair value of the reporting unit goodwill.

Impairment of intangible assets with indefinite useful lives is tested at least annually and more frequently as circumstances warrant in accordance with applicable accounting guidance. Impairment of indefinite lived intangible assets is recognized only if the carrying amount of the intangible assets exceeds the fair value of said assets. The amount of the impairment loss would be equal to the excess carrying value of the assets over the fair value of said assets.

Intangible assets that are not deemed to have an indefinite useful life are amortized over their estimated useful lives. The carrying amounts of definite lived intangible assets are regularly reviewed for indicators of impairment in

Table of Contents

GLOBAL INDEMNITY PLC

accordance with applicable accounting guidance. Impairment is recognized only if the carrying amount of the intangible asset is in excess of its undiscounted projected cash flows. The impairment is measured as the difference between the carrying amount and the estimated fair value of the asset.

Taxation

We provide for income taxes in accordance with applicable accounting guidance. Our deferred tax assets and liabilities primarily result from temporary differences between the amounts recorded in our consolidated financial statements and the tax basis of our assets and liabilities.

At each balance sheet date, management assesses the need to establish a valuation allowance that reduces deferred tax assets when it is more likely than not that all, or some portion, of the deferred tax assets will not be realized. A valuation allowance would be based on all available information including our assessment of uncertain tax positions and projections of future taxable income from each tax-paying component in each jurisdiction, principally derived from business plans and available tax planning strategies. There are no valuation allowances as of September 30, 2011 or December 31, 2010. The deferred tax asset balance is analyzed regularly by management. Based on these analyses, we have determined that our deferred tax asset is recoverable. Projections of future taxable income incorporate several assumptions of future business and operations that are apt to differ from actual experience. If, in the future, our assumptions and estimates that resulted in our forecast of future taxable income for each tax-paying component prove to be incorrect, a valuation allowance may be required. This could have a material adverse effect on our financial condition, results of operations, and liquidity.

Historically, except for the second and third quarters of 2011, on an interim basis, we book our tax provision using the expected full year effective tax rate. Forecasts which compute taxable income and taxes expected to be incurred in the jurisdictions where we do business are prepared several times per year. The effective tax rate is computed by dividing forecasted income tax expense not including net realized investment gains (losses) and limited partnership distributions by forecasted pre-tax income not including net realized investment gains (losses) and limited partnership distributions. Changes in pre-tax and taxable income in the jurisdictions where we do business can change the effective tax rate. In 2010, to compute our income tax expense on an interim basis, we applied our expected full year effective tax rate against our pre-tax income excluding net realized investment gains (losses) and limited partnership distributions and then added actual tax on net realized investment gains (losses) and limited partnership distributions to that result. During the quarter and nine months ended September 30, 2011, our tax provision was recorded using our current year-to-date income tax provision in lieu of using the full year's effective tax rate due to wide variability in the expected annual effective income tax rate across several similar pre-tax income scenarios.

We apply a more likely than not recognition threshold for all tax uncertainties, only allowing the recognition of those tax benefits that have a greater than 50% likelihood of being sustained upon examination by the taxing authorities. Please see Note 8 of the notes to the consolidated financial statements in Item 1 of Part I of this report for a discussion of our tax uncertainties.

Our Business Segments

We manage our business through two business segments: Insurance Operations, which includes the operations of the U.S. Insurance Companies, and Reinsurance Operations, which are the operations of Wind River Reinsurance.

We evaluate the performance of our Insurance Operations and Reinsurance Operations segments based on gross and net premiums written, revenues in the form of net premiums earned and commission and fee income, and expenses in the form of (1) net losses and loss adjustment expenses, (2) acquisition costs, and (3) other underwriting expenses.

For a description of our segments, see **Business Segments** in Item 1 of Part I in our 2010 Annual Report on Form 10-K.

The following table sets forth an analysis of financial data for our segments during the periods indicated:

Table of Contents**GLOBAL INDEMNITY PLC**

| (Dollars in thousands) | Quarters Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 30, 2011 | September 30, 2010 | September 30, 2011 | September 30, 2010 |
| Insurance Operations premiums written: | | | | |
| Gross premiums written | \$ 55,260 | \$ 66,213 | \$ 182,102 | \$ 181,815 |
| Ceded premiums written | 8,158 | 13,028 | 20,769 | 36,141 |
| Net premiums written | \$ 47,102 | \$ 53,185 | \$ 161,333 | \$ 145,674 |
| Reinsurance Operations premiums written: | | | | |
| Gross premiums written | \$ 17,832 | \$ 20,022 | \$ 73,618 | \$ 89,323 |
| Ceded premiums written | | 1 | 502 | 787 |
| Net premiums written | \$ 17,832 | \$ 20,021 | \$ 73,116 | \$ 88,536 |
| Revenues: ⁽¹⁾ | | | | |
| Insurance Operations ⁽²⁾ | \$ 54,230 | \$ 48,105 | \$ 177,353 | \$ 146,927 |
| Reinsurance Operations | 23,027 | 22,157 | 65,760 | 69,167 |
| Total revenues | \$ 77,257 | \$ 70,262 | \$ 243,113 | \$ 216,094 |
| Expenses: ⁽³⁾ | | | | |
| Insurance Operations ⁽⁴⁾ | \$ 83,172 | \$ 36,140 | \$ 208,798 | \$ 127,248 |
| Reinsurance Operations | 37,659 | 22,190 | 92,177 | 64,702 |
| Total expenses | \$ 120,831 | \$ 58,330 | \$ 300,975 | \$ 191,950 |
| Income (loss) from segments: | | | | |
| Insurance Operations | \$ (28,942) | \$ 11,965 | \$ (31,445) | \$ 19,679 |
| Reinsurance Operations | (14,632) | (33) | (26,417) | 4,465 |
| Total income (loss) from segments | \$ (43,574) | \$ 11,932 | \$ (57,862) | \$ 24,144 |
| Insurance combined ratio analysis: ⁽⁵⁾ | | | | |
| Insurance Operations | | | | |
| Loss ratio | 107.6 | 28.4 | 81.7 | 40.7 |
| Expense ratio | 46.2 | 47.1 | 44.5 | 46.2 |
| Combined ratio | 153.8 | 75.5 | 126.2 | 86.9 |
| Reinsurance Operations | | | | |
| Loss ratio | 121.8 | 73.1 | 108.2 | 64.6 |
| Expense ratio | 41.7 | 27.0 | 32.0 | 29.0 |
| Combined ratio | 163.5 | 100.1 | 140.2 | 93.6 |

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| | | | | |
|----------------|-------|------|-------|------|
| Loss ratio | 111.8 | 42.5 | 89.3 | 48.4 |
| Expense ratio | 44.9 | 40.7 | 41.0 | 40.7 |
| Combined ratio | 156.7 | 83.2 | 130.3 | 89.1 |

- (1) Excludes net investment income and net realized investment gains, which are not allocated to our segments.
- (2) Includes fee income of \$167 and \$173 for the quarters ended September 30, 2011 and 2010, respectively, and fee and other income of \$11,999 and \$515 for the nine months ended September 30, 2011 and 2010, respectively.
- (3) Excludes corporate and other operating expenses and interest expense, which are not allocated to our segments.
- (4) Includes excise tax of \$281 and \$251 for the quarters ended September 30, 2011 and 2010, respectively, and excise tax of \$858 and \$766 for the nine months ended September 30, 2011 and 2010, respectively, related to cessions from our Insurance Operations to our Reinsurance Operations.
- (5) Our insurance combined ratios are non-GAAP financial measures that are generally viewed in the insurance industry as indicators of underwriting profitability. The loss ratio is the ratio of net losses and loss adjustment expenses to net premiums earned. The expense ratio is the ratio of acquisition costs and other underwriting expenses to net premiums earned. The combined ratio is the sum of the loss and expense ratios.

Table of Contents**GLOBAL INDEMNITY PLC****Results of Operations**

All percentage changes included in the text below have been calculated using the corresponding amounts from the applicable tables.

Quarter Ended September 30, 2011 Compared with the Quarter Ended September 30, 2010**Insurance Operations**

The components of income from our Insurance Operations segment and corresponding underwriting ratios are as follows:

| (Dollars in thousands) | Quarters Ended September 30, | | Increase / (Decrease) | |
|--|------------------------------|-----------|-----------------------|----------|
| | 2011 | 2010 | \$ | % |
| Gross premiums written | \$ 55,260 | \$ 66,213 | \$ (10,953) | (16.5%) |
| Net premiums written | \$ 47,102 | \$ 53,185 | \$ (6,083) | (11.4%) |
| Net premiums earned | \$ 54,063 | \$ 47,932 | \$ 6,131 | 12.8% |
| Other income | 167 | 173 | (6) | (3.5%) |
| Total revenues | \$ 54,230 | \$ 48,105 | \$ 6,125 | 12.7% |
| Losses and expenses: | | | | |
| Net losses and loss adjustment expenses | 58,174 | 13,584 | 44,590 | 328.3% |
| Acquisition costs and other underwriting expenses ⁽¹⁾ | 24,998 | 22,556 | 2,442 | 10.8% |
| Income (loss) from segment | \$ (28,942) | \$ 11,965 | \$ (40,907) | (341.9%) |
| Underwriting Ratios: | | | | |
| Loss ratio: | | | | |
| Current accident year | 109.1 | 63.6 | 45.5 | |
| Prior accident year | (1.5) | (35.2) | 33.7 | |
| Calendar year loss ratio | 107.6 | 28.4 | 79.2 | |
| Expense ratio | 46.2 | 47.1 | (0.9) | |
| Combined ratio | 153.8 | 75.5 | 78.3 | |

(1) Includes excise tax of \$281 and \$251 related to cessions from our Insurance Operations to our Reinsurance Operations for the quarters ended September 30, 2011 and 2010, respectively.

Premiums

Gross premiums written, which represent the amount received or to be received for insurance policies written without reduction for reinsurance costs or other deductions, were \$55.3 million for the quarter ended September 30, 2011, compared with \$66.2 million for the quarter ended September 30, 2010, a decrease of \$11.0 million or 16.5%. The decrease is primarily related to terminated programs as well as termination of

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certain general liability products, partially offset by increases in property lines.

Net premiums written, which equal gross premiums written less ceded premiums written, were \$47.1 million for the quarter ended September 30, 2011, compared with \$53.2 million for the quarter ended September 30, 2010, a decrease of \$6.1 million or 11.4%. The decrease was primarily due to the decrease in gross premiums written above, offset partially by the cancellation of a property quota share reinsurance treaty effective January 1, 2011 and an increase in retention related to the property excess of loss treaty which renewed January 1, 2011.

The ratio of net premiums written to gross premiums written was 85.2% for the quarter ended September 30, 2011 and 80.3% for the quarter ended September 30, 2010, an increase of 4.9 points, which was primarily due to changes in our reinsurance structure on our property business noted above.

Table of Contents

GLOBAL INDEMNITY PLC

Net premiums earned were \$54.1 million for the quarter ended September 30, 2011, compared with \$47.9 million for the quarter ended September 30, 2010, an increase of \$6.1 million or 12.8%. Property net premiums earned for the quarters ended September 30, 2011 and 2010 were \$24.5 million and \$18.4 million, respectively. Casualty net premiums earned for the quarters ended September 30, 2011 and 2010 were \$29.6 million and \$29.5 million, respectively.

Other Income

Other income was \$0.2 million for both of the quarters ended September 30, 2011 and 2010, respectively. Other income is comprised of commission and fee income.

Net Losses and Loss Adjustment Expenses

The loss ratio for our Insurance Operations was 107.6% for the quarter ended September 30, 2011 compared with 28.4% for the quarter ended September 30, 2010. The current accident year loss ratio increased 45.5 points from 63.6% for the quarter ended September 30, 2010 to 109.1% for the quarter ended September 30, 2011. The impact of changes to prior accident years was 1.5 points resulting from a reduction of net losses and loss adjustment expenses for prior accident years of \$0.8 million in the quarter ended September 30, 2011, compared to a reduction of \$16.9 million in the quarter ended September 30, 2010, which resulted in a 35.2 point reduction in net losses and loss adjustment expenses for prior accident years. The loss ratio is a non-GAAP financial measure that is generally viewed in the insurance industry as an indicator of underwriting profitability and is calculated by dividing net losses and loss adjustment expenses by net premiums earned.

The current accident year loss ratio for the quarter ended September 30, 2011 increased 45.5 points from the quarter ended September 30, 2010:

The current accident year property loss ratio increased 36.0 points from 56.4% in the quarter ended September 30, 2010 to 92.4% in the quarter ended September 30, 2011. Property net premiums earned for the quarters ended September 30, 2011 and 2010 were \$24.5 million and \$18.4 million, respectively.

The non-catastrophe loss ratio increased 13.4 points from 53.6% in the quarter ended September 30, 2010 to 67.0% in the quarter ended September 30, 2011. The increase is primarily due to increased severity from fire losses and storms. Non-catastrophe losses were \$16.4 million and \$9.9 million for the quarters ended September 30, 2011 and 2010, respectively.

The catastrophe loss ratio increased 22.5 points from 2.9% in the quarter ended September 30, 2010 to 25.4% in the quarter ended September 30, 2011. The increase in the catastrophe loss ratio is primarily due to severe losses as a result of Hurricane Irene and Tropical Storm Lee. Catastrophe losses were \$6.2 million and \$0.5 million for the quarters ended September 30, 2011 and 2010, respectively.

The current accident year casualty loss ratio increased 54.9 points from 68.0% in the quarter ended September 30, 2010 to 122.9% in the quarter ended September 30, 2011 primarily due to loss emergence and a premium deficiency charge of \$3.9 million in our general liability line. We increased the current accident year expected loss ratio for a class of business within our general liability line to 172.4% during the third quarter, which had a 23.3 point impact on the casualty lines loss ratio during the quarter. On a pro forma basis excluding the impact of the premium deficiency charge and the general liability line increase noted above, the current year casualty loss ratio increased 14.9 points from 68.7% in the quarter ended September 30, 2010 to 83.6% during the quarter ended September 30, 2011. We are addressing profitability concerns by exiting certain classes of business within the general liability line. Casualty net premiums earned for the quarters ended September 30, 2011 and 2010 were \$29.6 million and \$29.5 million, respectively.

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The impact of changes to prior accident years is 1.5 points resulting from a reduction of net losses and loss adjustment expenses for prior accident years of \$0.8 million in the quarter ended September 30, 2011. This was compared to a reduction of \$16.9 million in the quarter ended September 30, 2010, which resulted in a 35.2 point reduction in net losses and loss adjustment expenses for prior accident years. When analyzing loss reserves and prior year development, we consider many factors, including the frequency and severity of claims, loss trends, case reserve settlements that may have resulted in significant development, and any other additional or pertinent factors that may impact reserve estimates.

In the third quarter of 2011, the Company reduced its prior accident year loss reserves by \$0.8 million, which consisted of a \$2.1 million reduction in general liability lines offset by a \$0.7 million increase in auto liability lines, a \$0.4 million increase in professional liability lines and a \$0.2 million increase in all other lines:

Table of Contents

GLOBAL INDEMNITY PLC

General liability: The \$2.1 million reduction primarily consisted of reductions of \$8.2 million in accident years 2008 and prior due to continued favorable emergence. Incurred losses for these years have developed at a rate lower than the Company's historical averages. We also decreased our reinsurance allowance by \$0.9 million in this line due to changes in our reinsurance exposure on specifically identified claims and general decreases in ceded reserves. Offsetting these decreases were increases of \$6.9 million in accident years 2009 and 2010 related to loss emergence in a specific class of business as well as revised exposure estimates for construction defect liability. Increased estimates for construction defect were the result of a methodology change in the quarter, and were not driven by claim frequency or severity trends. We are addressing profitability concerns by exiting certain unprofitable classes of business within this line.

Auto liability: The \$0.7 million increase primarily related to accident years 2009 and 2010 due to recent unfavorable development on a few large claims.

Professional liability: The \$0.4 million increase consisted of increases of \$2.5 million primarily related to accident years 2009 and 2010 primarily due to unfavorable development in certain product classes. We are addressing profitability concerns by exiting certain classes of business which have proven to be unprofitable. This was offset by a decrease of \$2.1 million related to all other prior accident years.

In the third quarter of 2010, the Company reduced its prior accident year loss reserves by \$16.9 million. The reduction of our prior accident year loss reserves primarily consisted of a \$14.2 million reduction in our general liability lines, a \$1.6 million reduction in our property lines, and a \$1.3 million reduction in our umbrella lines:

General liability: The \$14.2 million reduction primarily consisted of reductions of \$16.3 million related to accident years 2004 through 2009 due to lower than anticipated severity. Incurred losses for these years have developed at a rate lower than our historical averages. This reduction was offset by a net increase of \$2.1 million related to accident years 2003 and prior primarily due to increases in expected unallocated loss adjustment expense, as well as higher than expected claim frequency and severity.

Property: The \$1.6 million reduction is primarily due to a net reduction of \$1.7 million related to accident years 2009, 2008, and 2006 and prior due to decreases in expected unallocated loss adjustment expenses, and lower than anticipated severity. This reduction was offset by an increase of \$0.1 million related to accident year 2007.

Umbrella: The \$1.3 million reduction primarily consisted of net reductions of \$1.5 million related to accident years 2009 and 2007 and prior primarily due to lower than anticipated severity. As these accident years have matured, more weight has been given to experience based methods which continue to develop favorably compared to our initial indications. This reduction was offset by an increase of \$0.2 million related to accident year 2008 due to an increase in severity.

Net losses and loss adjustment expenses were \$58.2 million for the quarter ended September 30, 2011, compared with \$13.6 million for the quarter ended September 30, 2010, an increase of \$44.6 million or 328.3%. Excluding the \$0.8 million reduction of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2011 and the \$16.9 million reduction of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2010, the current accident year net losses and loss adjustment expenses were \$59.0 million and \$30.5 million for the quarters ended September 30, 2011 and 2010, respectively. The increase is primarily attributable to a \$3.9 million premium deficiency charge and the impact of an increase in current accident year loss reserves related to a class of business within our general liability lines, recorded on a year-to-date basis during the quarter ended September 30, 2011, as well as the increase in current accident year severity as described above.

Acquisition Costs and Other Underwriting Expenses

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Acquisition costs and other underwriting expenses were \$25.0 million for the quarter ended September 30, 2011, compared with \$22.6 million for the quarter ended September 30, 2010, an increase of \$2.4 million or 10.8%. The increase is primarily due to a \$5.8 million increase in acquisition costs, partially offset by a \$3.4 million decrease in other

Table of Contents**GLOBAL INDEMNITY PLC**

underwriting expenses:

The \$5.8 million increase in acquisition costs is primarily due to a premium deficiency charge of \$3.7 million, an increase in commissions resulting mainly from an increase in net earned premiums, and a decrease in ceding commissions resulting from an increase in retained business, offset partially by a net decrease in contingent commissions related to loss emergence.

The \$3.4 million decrease in other underwriting expenses is primarily due to an overall decrease in employee compensation related to the Profit Enhancement Initiative as well as a decrease in share-based compensation related to the forfeiture of unvested restricted shares and options. See Note 4 of the notes to the consolidated financial statements in Item 1 of Part I of this report for details related to the Profit Enhancement Initiative.

Expense and Combined Ratios

The expense ratio for our Insurance Operations was 46.2% for the quarter ended September 30, 2011, compared with 47.1% for the quarter ended September 30, 2010. The expense ratio is a non-GAAP financial measure that is calculated by dividing the sum of acquisition costs and other underwriting expenses by net premiums earned. The decrease in the expense ratio is primarily due to decreases in employee compensation costs related to the Profit Enhancement Initiative, as well as a decrease in share-based compensation related to the forfeiture of unvested restricted shares and options, partially offset by a premium deficiency charge, an increase in our average commission rates due to changes in our mix of business, and a decrease in contingent commissions related to loss emergence. Excluding the impact of the premium deficiency charge, the expense ratio for our Insurance Operations was 39.3% for the quarter ended September 30, 2011.

The combined ratio for our Insurance Operations was 153.8% for the quarter ended September 30, 2011, compared with 75.5% for the quarter ended September 30, 2010. The combined ratio is a non-GAAP financial measure and is the sum of our loss and expense ratios. Excluding the \$0.8 million reduction of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2011 and the \$16.9 million reduction of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2010, the combined ratio increased from 110.7% for the quarter ended September 30, 2010 to 155.3% for the quarter ended September 30, 2011. Excluding the impact of the premium deficiency charge, the current accident year combined ratio was 141.2% for the quarter ended September 30, 2011. See discussion of loss ratio included in *Net Losses and Loss Adjustment Expenses* above and discussion of expense ratio in preceding paragraph above for an explanation of this increase.

Income (loss) from segment

The factors described above resulted in a loss for our Insurance Operations of \$28.9 million for the quarter ended September 30, 2011, compared to income of \$12.0 million for the quarter ended September 30, 2010.

Reinsurance Operations

The components of income from our Reinsurance Operations segment and corresponding underwriting ratios are as follows:

| (Dollars in thousands) | \$(00,000.0) Quarters Ended September 30, 2011 | \$(00,000.0) 2010 | \$(00,000.0) Increase / (Decrease) \$ | \$(00,000.0) % |
|------------------------|--|----------------------|---|-------------------|
| Gross premiums written | \$ 17,832 | \$ 20,022 | \$ (2,190) | (10.9%) |
| Net premiums written | \$ 17,832 | \$ 20,021 | \$ (2,189) | (10.9%) |

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| | | | | | | | |
|---|----|--------|----|--------|----|--------|-------|
| Net premiums earned | \$ | 23,027 | \$ | 22,157 | \$ | 870 | 3.9% |
| Losses and expenses: | | | | | | | |
| Net losses and loss adjustment expenses | | 28,060 | | 16,205 | | 11,855 | 73.2% |
| Acquisition costs and other underwriting expenses | | 9,599 | | 5,985 | | 3,614 | 60.4% |

Table of Contents**GLOBAL INDEMNITY PLC**

| | \$(00,000.0) | \$(00,000.0) | \$(00,000.0) | \$(00,000.0) |
|--------------------------|--------------|--------------|--------------|--------------|
| Loss from segment | \$ (14,632) | \$ (33) | \$ (14,599) | N/M |
| Underwriting Ratios: | | | | |
| Loss ratio: | | | | |
| Current accident year | 107.2 | 64.9 | 42.3 | |
| Prior accident year | 14.6 | 8.2 | 6.4 | |
| Calendar year loss ratio | | | | |
| Expense ratio | 121.8 | 73.1 | 48.7 | |
| | 41.7 | 27.0 | 14.7 | |
| Combined ratio | | | | |
| | 163.5 | 100.1 | 63.4 | |

N/M Not meaningful.

Premiums

Gross premiums written, which represent the amount received or to be received for reinsurance agreements written without reduction for reinsurance costs or other deductions, were \$17.8 million for the quarter ended September 30, 2011, compared with \$20.0 million for the quarter ended September 30, 2010, a decrease of \$2.2 million or 10.9%. The decrease was primarily due to the sale of a company that elected not to renew its treaty with Wind River post-acquisition and non-renewing treaties that did not meet our return hurdles, offset partially by several new treaties written in 2011.

Net premiums written, which equal gross premiums written less ceded premiums written, were \$17.8 million for the quarter ended September 30, 2011, compared with \$20.0 million for the quarter ended September 30, 2010, a decrease of \$2.2 million or 10.9%. The decrease was primarily due to the decrease in gross premiums written noted above. The ratio of net premiums written to gross premiums written was 100.0% for both of the quarters ended September 30, 2011 and 2010.

Net premiums earned were \$23.0 million for the quarter ended September 30, 2011, compared with \$22.2 million for the quarter ended September 30, 2010, an increase of \$0.9 million or 3.9%. Property net premiums earned for the quarters ended September 30, 2011 and 2010 were \$9.8 million and \$7.8 million, respectively. Casualty net premiums earned for the quarters ended September 30, 2011 and 2010 were \$13.2 million and \$14.4 million, respectively.

Net Losses and Loss Adjustment Expenses

The loss ratio for our Reinsurance Operations was 121.8% for the quarter ended September 30, 2011 compared with 73.1% for the quarter ended September 30, 2010. The current accident year loss ratio increased 42.3 points from 64.9% for the quarter ended September 30, 2010 to 107.2% for the quarter ended September 30, 2011. The impact of changes to prior accident years was 14.6 points resulting from an increase of net losses and loss adjustment expenses for prior accident years of \$3.4 million in the quarter ended September 30, 2011, compared to an increase of \$1.8 million in the quarter ended September 30, 2010, which resulted in a 8.2 point increase in net losses and loss adjustment expenses for prior accident years. The loss ratio is a non-GAAP financial measure that is generally viewed in the insurance industry as an indicator of underwriting profitability and is calculated by dividing net losses and loss adjustment expenses by net premiums earned.

The current accident year loss ratio for the quarter ended September 30, 2011 increased 42.3 points from the quarter ended September 30, 2010.

The current accident year property loss ratio increased 70.9 points from 43.9% in the quarter ended September 30, 2010 to 114.8% in the quarter ended September 30, 2011. This increase was primarily due to losses on our worldwide catastrophe treaty in 2011 related

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to Hurricane Irene and Tropical Storm Lee. Current accident year property losses for the quarters ended September 30, 2011 and 2010 were \$11.3 million and \$3.4 million, respectively.

The current accident year casualty loss ratio increased 25.3 points from 76.3% in the quarter ended September 30, 2010 to 101.6% in the quarter ended September 30, 2011. This increase was primarily due to higher than expected reported losses on general liability treaties.

The impact of changes to prior accident years is 14.6 points resulting from an increase in net losses and loss adjustment expenses for prior accident years of \$3.4 million in the quarter ended September 30, 2011. This was compared to an increase of \$1.8 million in the quarter ended September 30, 2010, which resulted in an 8.2 point increase in net losses and loss adjustment expenses for prior accident years. When analyzing loss reserves and prior year development, we may, as necessary for each treaty, consider many factors, including the frequency and severity of claims, loss trends, case

Table of Contents

GLOBAL INDEMNITY PLC

reserve settlements that may have resulted in significant development, and any other additional or pertinent factors that may impact reserve estimates.

In the third quarter of 2011, the Company increased its prior accident year loss reserves by \$3.4 million, which consisted of a \$2.6 million increase in auto liability lines and a \$1.1 million increase in general liability lines, offset by a \$0.4 million decrease in property lines:

Auto liability: The \$2.6 million increase primarily related to a \$3.8 million increase to accident year 2010 resulting from further unexpected development on non-standard auto treaties which were not renewed in 2011. This was partially offset by a \$1.2 million decrease in accident year 2009.

General liability: The \$1.1 million increase primarily related to accident years 2009 and 2010. This change related to higher than expected loss emergence.

Property: The \$0.4 million decrease primarily related to accident year 2010 and is primarily related to favorable loss emergence on a worldwide catastrophe treaty.

In the third quarter of 2010, the Company increased its prior accident year loss reserves by \$1.8 million. This increase is primarily related to our commercial auto liability lines and is due to higher than expected reported losses on two non-standard auto treaties.

Net losses and loss adjustment expenses were \$28.1 million for the quarter ended September 30, 2011, compared with \$16.2 million for the quarter ended September 30, 2010, an increase of \$11.9 million or 73.2%. Excluding the \$3.4 million increase of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2011 and the \$1.8 million increase of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2010, the current accident year net losses and loss adjustment expenses increased from \$14.4 million for the quarter ended September 30, 2010 to \$24.7 million for the quarter ended September 30, 2011. This increase is primarily attributable to an increase in property catastrophe losses during the quarter and to a lesser extent higher than expected loss emergence on general liability treaties. Property net premiums earned for the quarters ended September 30, 2011 and 2010 were \$9.8 million and \$7.8 million, respectively. Casualty net premiums earned for the quarters ended September 30, 2011 and 2010 were \$13.2 million and \$14.4 million, respectively.

Acquisition Costs and Other Underwriting Expenses

Acquisition costs and other underwriting expenses were \$9.6 million for the quarter ended September 30, 2011, compared with \$6.0 million for the quarter ended September 30, 2010, an increase of \$3.6 million or 60.4%. The increase is due to a \$3.6 million increase in acquisition costs, primarily due to a \$2.9 million premium deficiency charge incurred during the quarter as well as a higher commission rate on new 2011 treaties.

Expense and Combined Ratios

The expense ratio for our Reinsurance Operations was 41.7% for the quarter ended September 30, 2011, compared with 27.0% for the quarter ended September 30, 2010. The expense ratio is a non-GAAP financial measure that is calculated by dividing the sum of acquisition costs and other underwriting expenses by net premiums earned. The increase in the expense ratio is primarily due to a premium deficiency charge and a higher commission rate on new 2011 treaties. Excluding the impact of the premium deficiency charge, the expense ratio for our Reinsurance Operations was 29.3% for the quarter ended September 30, 2011.

The combined ratio for our Reinsurance Operations was 163.5% for the quarter ended September 30, 2011, compared with 100.1% for the quarter ended September 30, 2010. The combined ratio is a non-GAAP financial measure and is the sum of our loss and expense ratios. Excluding the impact of a \$3.4 million increase of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2011 and a \$1.8 million increase of net losses and loss adjustment expenses for prior accident years in the quarter ended September 30, 2010, the combined ratio increased from 91.9% for the quarter ended September 30, 2010 to 148.9% for the quarter ended

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September 30, 2011. Excluding the impact of the premium deficiency charge, the current accident year combined ratio was 136.5% for the quarter ended September 30, 2011. See discussion of loss ratio included in Net Losses

Table of Contents**GLOBAL INDEMNITY PLC**

and Loss Adjustment Expenses above and discussion of expense ratio in the preceding paragraph above for an explanation of this increase.

Loss from segment

The factors described above resulted in a loss from our Reinsurance Operations of \$14.6 million for the quarter ended September 30, 2011 compared to a loss of \$0.03 million for the quarter ended September 30, 2010.

Unallocated Corporate Items

The following items are not allocated to our Insurance Operations or Reinsurance Operations segments:

| (Dollars in thousands) | Quarters Ended September 30, | | Increase / (Decrease) | |
|--|------------------------------|-----------|-----------------------|---------|
| | 2011 | 2010 | \$ | % |
| Net investment income | \$ 12,880 | \$ 14,089 | \$ (1,209) | (8.6%) |
| Net realized investment gains | 1,288 | 1,818 | (530) | (29.2%) |
| Corporate and other operating expenses | (2,862) | (5,106) | (2,244) | (43.9%) |
| Interest expense | (1,525) | (1,825) | (300) | (16.4%) |
| Income tax expense | (454) | (1,146) | (692) | (60.4%) |

Net Investment Income

Net investment income, which is gross investment income less investment expenses, was \$12.9 million and \$14.1 million for the quarters ended September 30, 2011 and 2010, respectively.

Gross investment income, excluding realized gains and losses, was \$14.1 million for the quarter ended September 30, 2011, compared with \$15.5 million for the quarter ended September 30, 2010, a decrease of \$1.4 million or 9.4%. The decrease was primarily due to lower yields on fixed maturities when compared to the corresponding period in 2010.

Investment expenses were \$1.2 million for the quarter ended September 30, 2011, compared with \$1.4 million for the quarter ended September 30, 2010, a decrease of \$0.2 million or 16.9%. The decrease is primarily due to trust fee reductions in the current period. At September 30, 2011, the Company held mortgage-backed securities with a book value of \$266.9 million. Excluding the mortgage-backed securities, the average duration of our fixed maturities portfolio was 2.5 years as of September 30, 2011, compared with 2.7 years as of December 31, 2010 and 2.8 years as of September 30, 2010. Including cash and short-term investments, the average duration of our investments, excluding mortgage-backed securities, was 2.3 years as of September 30, 2011 compared to 2.6 years as of September 30, 2010. At September 30, 2011, our embedded book yield on our fixed maturities, not including cash, was 3.4% compared with 3.8% at September 30, 2010. The embedded book yield on the \$218.6 million of municipal bonds in our portfolio was 3.60% at September 30, 2011, compared to an embedded book yield of 3.66% on our municipal bond portfolio of \$248.1 million at September 30, 2010.

Net Realized Investment Gains

Net realized investment gains were \$1.3 million and \$1.8 million for the quarters ended September 30, 2011 and 2010, respectively. The net realized investment gains for the quarters ended September 30, 2011 and 2010 consist entirely of net gains relative to our fixed maturities and equity portfolios.

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See Note 5 of the notes to the consolidated financial statements in Item 1 of Part I of this report for an analysis of total investment return on an after-tax basis for the quarters ended September 30, 2011 and 2010.

Corporate and Other Operating Expenses

Table of Contents**GLOBAL INDEMNITY PLC**

Corporate and other operating expenses consist of outside legal fees, other professional fees, directors' fees, management fees, salaries and benefits for holding company personnel, development costs for new products, and taxes incurred which are not directly related to operations. Corporate and other operating expenses were \$2.9 million for the quarter ended September 30, 2011, compared with \$5.1 million for the quarter ended September 30, 2010, a decrease of \$2.2 million or 43.9%. The decrease is primarily due to cost savings resulting from our previously disclosed Profit Enhancement Initiative, a decrease in outside legal fees due to the completion of our redomestication to Ireland, and a decrease in share-based compensation related to the forfeiture of unvested restricted shares and options during the quarter.

Interest Expense

Interest expense was \$1.5 million and \$1.8 million for the quarters ended September 30, 2011 and 2010, respectively. On July 20, 2011, the Company made a principal payment of \$18.0 million on our \$90.0 million Guaranteed Senior Notes. We are required to prepay \$18.0 million of the principal amount on July 20th of each year through July 20, 2015, when we will be required to pay any outstanding remaining principal amount on the notes. These notes are guaranteed by Global Indemnity (Cayman), Ltd and United America Indemnity, Ltd. The decrease in interest expense was primarily due to the payment of principal on the Guaranteed Senior Notes. See Note 11 of the notes to the consolidated financial statements in Item 8 of Part II of our 2010 Annual Report on Form 10-K for details on our debt.

Income Tax (Expense) Benefit

Income tax expense was \$0.5 million and \$1.1 million for the quarters ended September 30, 2011 and 2010, respectively. See Note 8 of the notes to the consolidated financial statements in Item 1 of Part I of this report for a comparison of income tax expense between periods.

Net Income (Loss)

The factors described above resulted in a net loss of \$34.2 million and net income of \$19.8 million for the quarters ended September 30, 2011 and 2010, respectively, a decrease of \$54.0 million or 273.3%.

Nine Months Ended September 30, 2011 Compared with the Nine Months Ended September 30, 2010**Insurance Operations**

The components of income from our Insurance Operations segment and corresponding underwriting ratios are as follows:

| (Dollars in thousands) | Nine Months Ended | | Increase / (Decrease) | |
|--|--------------------|--------------------|-----------------------|--------------|
| | September 30, 2011 | September 30, 2010 | \$ | % |
| Gross premiums written | \$ 182,102 | \$ 181,815 | \$ 287 | 0.2% |
| Net premiums written | \$ 161,333 | \$ 145,674 | \$ 15,659 | 10.7% |
| Net premiums earned | \$ 165,354 | \$ 146,412 | \$ 18,942 | 12.9% |
| Other income | 11,999 | 515 | 11,484 | N/M |
| Total revenues | \$ 177,353 | \$ 146,927 | \$ 30,426 | 20.7% |
| Losses and expenses: | | | | |
| Net losses and loss adjustment expenses | 135,217 | 59,582 | 75,635 | 126.9% |
| Acquisition costs and other underwriting expenses ⁽¹⁾ | 73,581 | 67,666 | 5,915 | 8.7% |

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| | | | | |
|----------------------------|-------------|-----------|-------------|----------|
| Income (loss) from segment | \$ (31,445) | \$ 19,679 | \$ (51,124) | (259.8%) |
|----------------------------|-------------|-----------|-------------|----------|

Underwriting Ratios:

Loss ratio:

| | | | |
|-----------------------|--------|--------|------|
| Current accident year | 93.0 | 64.4 | 28.6 |
| Prior accident year | (11.3) | (23.7) | 12.4 |

| | | | |
|--------------------------|------|------|-------|
| Calendar year loss ratio | 81.7 | 40.7 | 41.0 |
| Expense ratio | 44.5 | 46.2 | (1.7) |

| | | | |
|----------------|-------|------|------|
| Combined ratio | 126.2 | 86.9 | 39.3 |
|----------------|-------|------|------|

Table of Contents

GLOBAL INDEMNITY PLC

(1) Includes excise tax of \$858 and \$766 related to cessions from our Insurance Operations to our Reinsurance Operations for the nine months ended September 30, 2011 and 2010, respectively.

N/M Not meaningful.

Premiums

Gross premiums written, which represent the amount received or to be received for insurance policies written without reduction for reinsurance costs or other deductions, were \$182.1 million for the nine months ended September 30, 2011, compared with \$181.8 million for the nine months ended September 30, 2010, an increase of \$0.3 million or 0.2%. The increase is primarily related to growth in certain products within the property and general liability lines. We are exiting certain unprofitable general liability programs.

Net premiums written, which equal gross premiums written less ceded premiums written, were \$161.3 million for the nine months ended September 30, 2011, compared with \$145.7 million for the nine months ended September 30, 2010, an increase of \$15.7 million or 10.7%. The increase was primarily due to the cancellation of a property quota share reinsurance treaty effective January 1, 2011 and an increase in retention related to the property excess of loss treaty which renewed January 1, 2011.

The ratio of net premiums written to gross premiums written was 88.6% for the nine months ended September 30, 2011 and 80.1% for the nine months ended September 30, 2010, an increase of 8.5 points, which was primarily due to changes in our reinsurance structure on our property business noted above.

Net premiums earned were \$165.4 million for the nine months ended September 30, 2011, compared with \$146.4 million for the nine months ended September 30, 2010, an increase of \$18.9 million or 12.9%. The increase was primarily due to increases in net premiums written within the previous year. Property net premiums earned for the nine months ended September 30, 2011 and 2010 were \$73.5 million and \$56.5 million, respectively. Casualty net premiums earned for the nine months ended September 30, 2011 and 2010 were \$91.8 million and \$89.9 million, respectively.

Other Income

Other income was \$12.0 million and \$0.5 million for the nine months ended September 30, 2011 and 2010, respectively. Other income is comprised of commissions and fee income and in addition, for 2011, \$11.5 million received from our settlement with AON, net of attorney's fees. Income from the AON settlement is non-recurring. Please see Note 11 to the consolidated financial statements in Item 1 of Part I of this report for additional details regarding income and related tax expense from this settlement.

Net Losses and Loss Adjustment Expenses

The loss ratio for our Insurance Operations was 81.7% for the nine months ended September 30, 2011 compared with 40.7% for the nine months ended September 30, 2010. The current accident year loss ratio increased 28.6 points from 64.4% for the nine months ended September 30, 2010 to 93.0% for the nine months ended September 30, 2011. The impact of changes to prior accident years was 11.3 points resulting from a reduction of net losses and loss adjustment expenses for prior accident years of \$18.6 million in the nine months ended September 30, 2011, compared to a reduction of \$34.8 million in the nine months ended September 30, 2010, which resulted in a 23.7 point reduction in net losses and loss adjustment expenses for prior accident years. The loss ratio is a non-GAAP financial measure that is generally viewed in the insurance industry as an indicator of underwriting profitability and is calculated by dividing net losses and loss adjustment expenses by net premiums earned.

The current accident year loss ratio for the nine months ended September 30, 2011 increased 28.6 points from the nine months ended September 30, 2010:

The current accident year property loss ratio increased 25.6 points from 60.9% in the nine months ended September 30, 2010 to 86.5% in the nine months ended September 30, 2011. Property net premiums earned for the nine months ended September 30, 2011

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and 2010 were \$73.5 million and \$56.5 million, respectively.

The non-catastrophe loss ratio increased 6.7 points from 55.1% in the nine months ended September 30, 2010 to 61.8% in the nine months ended September 30, 2011.

Table of Contents

GLOBAL INDEMNITY PLC

The increase in the non-catastrophe loss ratio is primarily due to severity from fire losses and storms. Non-catastrophe losses were \$45.5 million and \$31.1 million for the nine months ended September 30, 2011 and 2010, respectively.

The catastrophe loss ratio increased 18.9 points from 5.8% in the nine months ended September 30, 2010 to 24.7% in the nine months ended September 30, 2011. The increase in the catastrophe loss ratio is primarily due to tornado and severe weather related losses in the Midwest, Alabama and North Carolina, as well as the impact of Hurricane Irene and Tropical Storm Lee. Catastrophe losses were \$18.2 million and \$3.3 million for the nine months ended September 30, 2011 and 2010, respectively.

The current accident year casualty loss ratio increased 31.6 points from 66.7% in the nine months ended September 30, 2010 to 98.3% in the nine months ended September 30, 2011 primarily due to a professional lines loss in a class of business that we are exiting, loss emergence in our general liability line and a premium deficiency charge of \$3.9 million. We increased the current accident year expected loss ratio for a class of business within our general liability line to 172.4% during the third quarter, which had a 13.7 point impact on the casualty lines loss ratio during the quarter. On a pro forma basis, excluding the impact of the premium deficiency charge and the general liability line increase noted above, the current year casualty loss ratio increased 12.5 points from 67.1% in the quarter ended September 30, 2010 to 79.6% during the quarter ended September 30, 2011. We are addressing profitability concerns by exiting certain classes of business within the general liability line. Casualty net premiums earned for the nine months ended September 30, 2011 and 2010 were \$91.8 million and \$89.9 million, respectively.

The impact of changes to prior accident years is 11.3 points resulting from a reduction of net losses and loss adjustment expenses for prior accident years of \$18.6 million in the nine months ended September 30, 2011. This was compared to a reduction of \$34.8 million in the nine months ended September 30, 2010, which resulted in a 23.7 point reduction in net losses and loss adjustment expenses for prior accident years. When analyzing loss reserves and prior year development, we consider many factors, including the frequency and severity of claims, loss trends, case reserve settlements that may have resulted in significant development, and any other additional or pertinent factors that may impact reserve estimates.

For the first nine months of 2011, the Company reduced its prior accident year loss reserves by \$18.6 million, which consisted of a \$21.3 million reduction in general liability lines, a \$1.8 million reduction in property lines, and a \$1.1 million reduction in umbrella lines, offset by a \$4.3 million increase in professional liability lines, a \$1.2 million increase in auto liability lines and \$0.1 million in net increases in all other lines:

General liability: The \$21.3 million reduction primarily consisted of reductions of \$31.0 million in accident years 2008 and prior due to continued favorable emergence. Incurred losses for these years have developed at a rate lower than the Company's historical averages. We also decreased our reinsurance allowance by \$3.1 million in this line due to changes in our reinsurance exposure on specifically identified claims and general decreases in ceded reserves. Offsetting these decreases were increases of \$12.8 million in accident years 2009 and 2010 primarily driven by loss emergence as well as revised exposure estimates for construction defect liability. Increased estimates for construction defect were the result of a methodology change in the quarter, and were not driven by claim frequency or severity trends. We are addressing profitability concerns by exiting certain classes of business within this line.

Property: The \$1.8 million reduction primarily related to accident years 2009 and 2010 related to anticipated subrogation on a large equine mortality claim as well as favorable development on prior year catastrophe claims.

Umbrella: The \$1.1 million reduction primarily related to accident years 2010 and prior primarily due to continued favorable emergence. Umbrella coverage typically attaches to other coverage lines, so these net decreases follow the decreases in general liability above.

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Professional liability: The \$4.3 million increase primarily consisted of increases of \$15.1 million related to accident years 1998, 2009 and 2010, offset partially by decreases of \$10.8 million related to all other accident years. In 2011, we exited certain professional liability classes where the volume of premium was low and loss volatility was high. We are focused on writing business where we expect to realize profit that meets our return on investment thresholds.

Auto liability: The \$1.2 million increase is primarily related to accident years 2009 and 2010 due to higher than expected severity.

Table of Contents

GLOBAL INDEMNITY PLC

For the first nine months of 2010, the Company reduced its prior accident year loss reserves by \$34.8 million. The reduction consisted of a \$26.8 million reduction in our general liability lines, a \$3.7 million reduction in our umbrella lines, a \$3.0 million reduction in our professional liability lines, a \$1.2 million reduction in our property lines, and a \$0.3 million reduction in our commercial auto lines:

General liability: The \$26.8 million reduction primarily consisted of net reductions of \$30.1 million related to accident years 2002 through 2009 where incurred losses have developed at a rate lower than our historical averages. This reduction was partially offset by a net increase of \$3.3 million related to accident years 2001 and prior where we experienced higher than expected claim frequency and severity.

Umbrella: The \$3.7 million reduction primarily consisted of net reductions related to accident years 2009 and prior primarily due to lower than anticipated severity. As these accident years have matured, more weight has been given to experience based methods which continue to develop favorably compared to our initial indications.

Professional liability: The \$3.0 million reduction primarily consisted of net reductions of \$6.5 million related to accident years 2008 and prior due to severity that was lower than originally anticipated, partially offset by an increase of \$3.5 million related to accident year 2009 where we experienced higher than expected claim frequency and severity.

Property: The \$1.2 million reduction primarily consisted of net reductions of \$2.6 million related to accident years 2008 and prior primarily due to incurred loss emergence during the period that was lower than our historical averages. This reduction was offset by an increase of \$1.4 million to accident year 2009 due to higher than expected claim frequency and severity.

Commercial auto: The \$0.3 million reduction primarily consisted of net reductions of \$0.6 million related to accident years 2008 and prior. Programs related to these accident years are in run-off, and loss severity has been lower than our prior projections. This reduction was offset by an increase of \$0.3 million to accident year 2009 where losses were higher than anticipated.

Net losses and loss adjustment expenses were \$135.2 million for the nine months ended September 30, 2011, compared with \$59.6 million for the nine months ended September 30, 2010, an increase of \$75.6 million or 126.9%. Excluding the \$18.6 million reduction of net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2011 and the \$34.8 million reduction of net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2010, the current accident year net losses and loss adjustment expenses were \$153.9 million and \$94.3 million for the nine months ended September 30, 2011 and 2010, respectively. This increase is primarily attributable to a \$3.9 million premium deficiency charge and the impact of an increase in current accident year loss reserves related to our general liability lines, the increase in net premiums earned, and the increase in current accident year severity as described above.

Acquisition Costs and Other Underwriting Expenses

Acquisition costs and other underwriting expenses were \$73.6 million for the nine months ended September 30, 2011, compared with \$67.7 million for the nine months ended September 30, 2010, an increase of \$5.9 million or 8.7%. The increase is comprised of a \$9.3 million increase in acquisition costs partially offset by a \$3.4 million decrease in other underwriting expenses:

The \$9.3 million increase in acquisition costs is primarily due to a premium deficiency charge of \$3.7 million, an increase in commissions and premium taxes resulting mainly from an increase in net earned premiums and a decrease in ceding commissions resulting from an increase in retained business.

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The \$3.4 million decrease in other underwriting expenses is primarily due to an overall decrease in employee compensation related to the Profit Enhancement Initiative as well as a decrease in share-based compensation related to the forfeiture of unvested restricted shares and options.

Table of Contents**GLOBAL INDEMNITY PLC*****Expense and Combined Ratios***

The expense ratio for our Insurance Operations was 44.5% for the nine months ended September 30, 2011, compared with 46.2% for the nine months ended September 30, 2010. The expense ratio is a non-GAAP financial measure that is calculated by dividing the sum of acquisition costs and other underwriting expenses by net premiums earned. The decrease in the expense ratio is primarily due to a decrease in contingent commissions recorded in the current period compared to the same period last year, a decrease in employee compensation costs related to the Profit Enhancement Initiative, and a decrease in share-based compensation related to the forfeiture of unvested restricted shares and options, partially offset by a premium deficiency charge. Excluding the impact of the premium deficiency charge, the expense ratio for our Insurance Operations was 42.2% for the nine months ended September 30, 2011.

The combined ratio for our Insurance Operations was 126.2% for the nine months ended September 30, 2011, compared with 86.9% for the nine months ended September 30, 2010. The combined ratio is a non-GAAP financial measure and is the sum of our loss and expense ratios. Excluding the \$18.6 million reduction of net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2011 and the \$34.8 million reduction of net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2010, the combined ratio increased from 110.6% for the nine months ended September 30, 2010 to 137.5% for the nine months ended September 30, 2011. Excluding the impact of the premium deficiency charge, the current accident year combined ratio was 132.9% for the nine months ended September 30, 2011. See discussion of loss ratio included in *Net Losses and Loss Adjustment Expenses* above and discussion of expense ratio in preceding paragraph above for an explanation of this increase.

Income (loss) from segment

The factors described above resulted in a loss for our Insurance Operations of \$31.4 million for the nine months ended September 30, 2011, compared to income of \$19.7 million for the nine months ended September 30, 2010.

Reinsurance Operations

The components of income from our Reinsurance Operations segment and corresponding underwriting ratios are as follows:

| (Dollars in thousands) | Nine Months Ended | | Increase / (Decrease) | |
|---|---------------------------|---------------------------|------------------------------|----------|
| | September 30, 2011 | September 30, 2010 | \$ | % |
| Gross premiums written | \$ 73,618 | \$ 89,323 | \$ (15,705) | (17.6%) |
| Net premiums written | \$ 73,116 | \$ 88,536 | \$ (15,420) | (17.4%) |
| Net premiums earned | \$ 65,760 | \$ 69,167 | \$ (3,407) | (4.9%) |
| Losses and expenses: | | | | |
| Net losses and loss adjustment expenses | 71,112 | 44,671 | 26,441 | 59.2% |
| Acquisition costs and other underwriting expenses | 21,065 | 20,031 | 1,034 | 5.2% |
| Income (loss) from segment | \$ (26,417) | \$ 4,465 | \$ (30,882) | (691.6%) |
| Underwriting Ratios: | | | | |
| Loss ratio: | | | | |
| Current accident year | 92.1 | 63.1 | 29.0 | |
| Prior accident year | 16.1 | 1.5 | 14.6 | |

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| | | | |
|--------------------------|-------|------|------|
| Calendar year loss ratio | 108.2 | 64.6 | 43.6 |
| Expense ratio | 32.0 | 29.0 | 3.0 |
| Combined ratio | 140.2 | 93.6 | 46.6 |

Table of Contents

GLOBAL INDEMNITY PLC

Premiums

Gross premiums written, which represent the amount received or to be received for reinsurance agreements written without reduction for reinsurance costs or other deductions, were \$73.6 million for the nine months ended September 30, 2011, compared with \$89.3 million for the nine months ended September 30, 2010, a decrease of \$15.7 million or 17.6%. The decrease was primarily due to the sale of a company that elected not to renew its treaty with Wind River post-acquisition and non-renewing treaties that did not meet our return hurdles, offset partially by several new treaties written in 2011.

Net premiums written, which equal gross premiums written less ceded premiums written, were \$73.1 million for the nine months ended September 30, 2011, compared with \$88.5 million for the nine months ended September 30, 2010, a decrease of \$15.4 million or 17.4%. The decrease was primarily due to the decrease of gross premiums written noted above. The ratio of net premiums written to gross premiums written was 99.3% for the nine months ended September 30, 2011 and 99.1% for the nine months ended September 30, 2010, an increase of 0.2 points.

Net premiums earned were \$65.8 million for the nine months ended September 30, 2011, compared with \$69.2 million for the nine months ended September 30, 2010, a decrease of \$3.4 million or 4.9%. Property net premiums earned for the nine months ended September 30, 2011 and 2010 were \$26.6 million and \$26.0 million, respectively. Casualty net premiums earned for the nine months ended September 30, 2011 and 2010 were \$39.2 million and \$43.2 million, respectively.

Net Losses and Loss Adjustment Expenses

The loss ratio for our Reinsurance Operations was 108.2% for the nine months ended September 30, 2011 compared with 64.6% for the nine months ended September 30, 2010. The current accident year loss ratio increased 29.0 points from 63.1% for the nine months ended September 30, 2010 to 92.1% for the nine months ended September 30, 2011. The impact of changes to prior accident years was 16.1 points resulting from an increase of net losses and loss adjustment expenses for prior accident years of \$10.6 million in the nine months ended September 30, 2011, compared to an increase of \$1.0 million in the nine months ended September 30, 2010, which resulted in a 1.5 point increase in net losses and loss adjustment expenses for prior accident years. The loss ratio is a non-GAAP financial measure that is generally viewed in the insurance industry as an indicator of underwriting profitability and is calculated by dividing net losses and loss adjustment expenses by net premiums earned.

The current accident year loss ratio for the nine months ended September 30, 2011 increased 29.0 points from the nine months ended September 30, 2010.

The current accident year property loss ratio increased 57.3 points from 46.6% in the nine months ended September 30, 2010 to 103.9% in the nine months ended September 30, 2011. This increase was primarily due to catastrophe losses related to the Japan earthquake and tsunami, New Zealand earthquakes, Australian floods, Alabama tornadoes, Hurricane Irene, Tropical Storm Lee, and other U.S. catastrophe events. Current accident year property losses for the nine months ended September 30, 2011 and 2010 were \$27.6 million and \$12.1 million, respectively.

The current accident year casualty loss ratio increased 11.1 points from 73.0% in the nine months ended September 30, 2010 to 84.1% in the nine months ended September 30, 2011. This increase was primarily due to higher than expected reported losses on general liability treaties.

The impact of changes to prior accident years is 16.1 points resulting from an increase in net losses and loss adjustment expenses for prior accident years of \$10.6 million in the nine months ended September 30, 2011. This was compared to an increase of \$1.0 million in the nine months ended September 30, 2010, which resulted in a 1.5 point increase in net losses and loss adjustment expenses for prior accident years. When analyzing loss reserves and prior year development, we may, as necessary for each treaty, consider many factors, including the frequency and severity of claims, loss trends, case reserve settlements that may have resulted in significant development, and any other additional or pertinent factors that may impact reserve estimates.

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For the first nine months of 2011, the Company increased its prior accident year loss reserves by \$10.6 million, which consisted of a \$5.4 million increase in general liability lines, a \$3.5 million increase in auto liability lines, a \$0.8 million increase in property lines, and a \$0.8 million increase in workers' compensation lines:

General liability: The \$5.4 million increase primarily related to accident years 2009 and 2010 due to

Table of Contents

GLOBAL INDEMNITY PLC

loss emergence that was greater than expected.

Auto liability: The \$3.5 million increase is primarily related to a \$4.0 million increase to accident year 2010 resulting from further unexpected development on non-standard auto treaties which were not renewed in 2011. This was partially offset by a decrease of \$0.5 million in accident year 2009.

Property: The \$0.8 million increase primarily related to accident year 2010 and is primarily related to loss emergence on a worldwide catastrophe treaty.

Workers compensation: The \$0.8 million increase primarily related to accident years 2009 and 2010 and is the result of expected losses recorded on adjustment premiums recorded in 2011.

For the first nine months of 2010, the Company increased its prior accident year loss reserves by \$1.0 million. This increase is primarily due to a \$1.8 million increase in our commercial auto lines related to accident years 2008 and 2009 due to higher than expected reported losses on two non-standard auto treaties. This increase was partially offset by a net \$0.7 million reduction in our property lines that was driven by lower than expected loss severity on a 2009 treaty partially offset by adverse loss development on a 2008 treaty.

Net losses and loss adjustment expenses were \$71.1 million for the nine months ended September 30, 2011, compared with \$44.7 million for the nine months ended September 30, 2010, an increase of \$26.4 million or 59.2%. Excluding the \$10.6 million increase of net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2011 and the \$1.0 million increase in net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2010, the current accident year net losses and loss adjustment expenses increased from \$43.6 million for the nine months ended September 30, 2010 to \$60.5 million for the nine months ended September 30, 2011. This increase is primarily attributable to large catastrophe losses incurred during the first nine months of 2011 as discussed above. Property net premiums earned for the nine months ended September 30, 2011 and 2010 were \$26.6 million and \$26.0 million, respectively. Casualty net premiums earned for the nine months ended September 30, 2011 and 2010 were \$39.2 million and \$43.2 million, respectively.

Acquisition Costs and Other Underwriting Expenses

Acquisition costs and other underwriting expenses were \$21.1 million for the nine months ended September 30, 2011, compared with \$20.0 million for the nine months ended September 30, 2010, an increase of \$1.0 million or 5.2%. The increase is due to a \$0.6 million increase in other underwriting expenses and a \$0.4 million increase in acquisition costs:

The \$0.6 million increase in other underwriting expenses is primarily due to an increase in compensation related to the hiring of new employees within this business unit.

The \$0.4 million increase in acquisition costs is primarily due to a premium deficiency charge of \$3.3 million, offset partially by a decrease in contingent commissions resulting from higher than expected current accident year losses discussed above.

Expense and Combined Ratios

The expense ratio for our Reinsurance Operations was 32.0% for the nine months ended September 30, 2011, compared with 29.0% for the nine months ended September 30, 2010. The expense ratio is a non-GAAP financial measure that is calculated by dividing the sum of acquisition costs and other underwriting expenses by net premiums earned. The increase in the expense ratio is primarily due to an increase in compensation related to the hiring of new employees within this business unit and a premium deficiency charge, offset partially by a decrease in contingent commissions resulting from higher than expected current accident year losses. Excluding the impact of the premium deficiency charge, the expense ratio for our Reinsurance Operations was 26.9% for the nine months ended September 30, 2011.

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The combined ratio for our Reinsurance Operations was 140.2% for the nine months ended September 30, 2011, compared with 93.6% for the nine months ended September 30, 2010. The combined ratio is a non-GAAP financial measure and is the sum of our loss and expense ratios. Excluding the impact of a \$10.6 million increase of net losses and loss adjustment expenses for prior accident years in the nine months ended September 30, 2011 and a \$1.0 million increase of net losses and loss adjustment expenses for prior accident years in the nine months ended

Table of Contents**GLOBAL INDEMNITY PLC**

September 30, 2010, the combined ratio increased from 92.1% for the nine months ended September 30, 2010 to 124.1% for the nine months ended September 30, 2011. Excluding the impact of the premium deficiency charge, the current accident year combined ratio was 119.0% for the nine months ended September 30, 2011. See discussion of loss ratio included in *Net Losses and Loss Adjustment Expenses* above and discussion of expense ratio in the preceding paragraph above for an explanation of this increase.

Income (loss) from segment

The factors described above resulted in a loss from our Reinsurance Operations of \$26.4 million for the nine months ended September 30, 2011 compared to income of \$4.5 million for the nine months ended September 30, 2010.

Unallocated Corporate Items

The following items are not allocated to our Insurance Operations or Reinsurance Operations segments:

| (Dollars in thousands) | Nine Months Ended | | Increase / (Decrease) | |
|--|---------------------------|---------------------------|------------------------------|----------|
| | September 30, 2011 | September 30, 2010 | \$ | % |
| Net investment income | \$ 41,224 | \$ 42,609 | \$ (1,385) | (3.3%) |
| Net realized investment gains | 21,671 | 21,619 | 52 | 0.2% |
| Corporate and other operating expenses | (10,329) | (15,065) | (4,736) | (31.4%) |
| Interest expense | (5,020) | (5,397) | (377) | (7.0%) |
| Income tax expense | (5,758) | (4,706) | 1,052 | 22.4% |
| Equity in net income (loss) of partnership, net of tax | 53 | (29) | 82 | N/M |

N/M - Not meaningful

Net Investment Income

Net investment income, which is gross investment income less investment expenses, was \$41.2 million for the nine months ended September 30, 2011, compared with \$42.6 million for the nine months ended September 30, 2010, a decrease of \$1.4 million or 3.3%.

Gross investment income, excluding realized gains and losses, was \$44.7 million for the nine months ended September 30, 2011, compared with \$47.2 million for the nine months ended September 30, 2010, a decrease of \$2.5 million or 5.2%. The decrease was primarily due to lower yields on fixed maturities when compared to the corresponding period in 2010.

Investment expenses were \$3.5 million for the nine months ended September 30, 2011, compared with \$4.6 million for the nine months ended September 30, 2010, a decrease of \$1.1 million or 22.9%. The decrease is primarily due to trust fee reductions in the current period.

Please see the discussion of Net Investment Income in the quarter to quarter comparison above for a discussion of our average duration and embedded book yield.

Net Realized Investment Gains

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Net realized investment gains were \$21.7 million and \$21.6 million for the nine months ended September 30, 2011 and 2010, respectively. The net realized investment gains for the nine months ended September 30, 2011 and 2010 consist entirely of net gains relative to our fixed maturities and equity portfolios.

See Note 5 of the notes to the consolidated financial statements in Item 1 of Part I of this report for an analysis of total investment return on an after-tax basis for the nine months ended September 30, 2011 and 2010.

Corporate and Other Operating Expenses

Table of Contents

GLOBAL INDEMNITY PLC

Corporate and other operating expenses consist of outside legal fees, other professional fees, directors' fees, management fees, salaries and benefits for holding company personnel, development costs for new products, and taxes incurred which are not directly related to operations. Corporate and other operating expenses were \$10.3 million for the nine months ended September 30, 2011, compared with \$15.1 million for the nine months ended September 30, 2010, a decrease of \$4.7 million or 31.4%. The decrease is primarily due to cost savings resulting from our previously disclosed Profit Enhancement Initiative and a decrease in share-based compensation related to the forfeiture of unvested restricted shares and options, offset partially by an increase in outside legal fees.

Interest Expense

Interest expense was \$5.0 million and \$5.4 million for the nine months ended September 30, 2011 and 2010, respectively. On July 20, 2011, the Company made a principal payment of \$18.0 million on our \$90.0 million Guaranteed Senior Notes. We are required to prepay \$18.0 million of the principal amount on July 20th of each year through July 20, 2015, when we will be required to pay any outstanding remaining principal amount on the notes. These notes are guaranteed by Global Indemnity (Cayman), Ltd and United America Indemnity, Ltd. The decrease in interest expense was primarily due to the payment of principal on the Guaranteed Senior Notes. See Note 11 of the notes to the consolidated financial statements in Item 8 of Part II of our 2010 Annual Report on Form 10-K for details on our debt.

Income Tax Expense

Income tax expense was \$5.8 million and \$4.7 million for the nine months ended September 30, 2011 and 2010, respectively. See Note 8 of the notes to the consolidated financial statements in Item 1 of Part I of this report for a comparison of income tax expense between periods.

Equity in Net Income (Loss) of Partnerships

Equity in net income (loss) of partnerships, net of tax was income of \$0.05 million and a loss of \$0.03 million for the nine months ended September 30, 2011 and 2010, respectively, an increase of \$0.08 million.

Net Income (Loss)

The factors described above resulted in a net loss of \$16.0 million and net income of \$63.2 million for the nine months ended September 30, 2011 and 2010, respectively, a decrease of \$79.2 million or 125.4%.

Table of Contents

GLOBAL INDEMNITY PLC

Liquidity and Capital Resources

Sources and Uses of Funds

Global Indemnity is a holding company. Its principal asset is its ownership of the shares of its direct and indirect subsidiaries, including those of its Insurance Operations: United National Insurance Company, Diamond State Insurance Company, United National Specialty Insurance Company, United National Casualty Insurance Company, Penn-America Insurance Company, Penn-Star Insurance Company, and Penn-Patriot Insurance Company; and its Reinsurance Operations: Wind River Reinsurance.

The principal source of cash that Global Indemnity, Global Indemnity Group, Inc. and AIS need to meet their short term and long term liquidity needs, including the payment of corporate expenses, includes dividends and other permitted disbursements from their direct and indirect subsidiaries and reimbursement for equity awards granted to employees. The principal sources of funds at these direct and indirect subsidiaries include underwriting operations, investment income, and proceeds from sales and redemptions of investments. Funds are used principally by these operating subsidiaries to pay claims and operating expenses, to make debt payments, to purchase investments, and to make dividend payments. The future liquidity of Global Indemnity, Global Indemnity Group, Inc. and AIS is dependent on the ability of their subsidiaries to pay dividends. Currently, Global Indemnity, Global Indemnity Group, Inc. and AIS have no planned capital expenditures that could have a material impact on their short-term or long-term liquidity needs; however, the Company's Board of Directors has authorized the repurchase of up to \$100 million of the Company's Class A ordinary shares. Stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of derivative contracts, structured share repurchase agreements and Rule 10b5-1 trading plans. The timing and amount of any repurchase transactions, if any, under this program will depend upon market conditions as well as other factors. We may decide to buy or not buy any of our ordinary shares or discontinue our share repurchase program at any time, any of which may impact our stock price. Important factors that could cause us to discontinue our share repurchases include, among others, market conditions, increases in the market price of our ordinary shares, the nature of other investment opportunities presented to us from time to time, and the availability of funds necessary to continue purchasing common stock. There have been no share repurchases under this program to date.

The U.S. Insurance Companies are restricted by statute as to the amount of dividends that they may pay without the prior approval of regulatory authorities. The U.S. Insurance Companies may pay dividends without advance regulatory approval only out of unassigned surplus. For 2011, the maximum amount of distributions that could be paid as dividends under applicable laws and regulations without regulatory approval is approximately \$63.8 million. The limitation includes \$7.0 million that would be distributed to United National Insurance Company or its subsidiary Penn Independent Corporation based on the December 31, 2010 ownership percentages. The U.S. Insurance Companies did not pay any dividends during the quarter or nine months ended September 30, 2011. During the quarter and nine months ended September 30, 2011, the U.S. Insurance Companies declared dividends of \$63.7 million to be paid during the fourth quarter of 2011.

For 2011, we believe that Wind River Reinsurance, including distributions it could receive from its subsidiaries, should have sufficient liquidity and solvency to pay dividends. Wind River Reinsurance is prohibited, without the approval of the Bermuda Monetary Authority (BMA), from reducing by 15% or more its total statutory capital as set out in its previous year's statutory financial statements, and any application for such approval must include such information as the BMA may require. Based upon the total statutory capital plus the statutory surplus as set out in its 2010 statutory financial statements that were filed with the BMA in 2011, we believe Wind River Reinsurance could pay a dividend in 2011 of up to \$248.5 million without requesting BMA approval.

Cash Flows

Sources of operating funds consist primarily of net premiums written and investment income. Funds are used primarily to pay claims and operating expenses and to purchase investments.

Our reconciliation of net income to cash provided from operations is generally influenced by the following:

the fact that we collect premiums, net of commissions, in advance of losses paid;

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the timing of our settlements with our reinsurers; and

the timing of our loss payments.

Net cash provided by (used for) operating activities was \$1.4 million and (\$15.9) million for the nine months ended September 30, 2011 and 2010, respectively. The increase in operating cash flows of approximately \$17.3 million

Table of Contents**GLOBAL INDEMNITY PLC**

from the prior year was primarily a net result of the following items:

| (Dollars in thousands) | Nine Months Ended September 30, | | |
|--|---------------------------------|-------------|-----------|
| | 2011 | 2010 | Change |
| Net premiums collected | \$ 228,949 | \$ 223,012 | \$ 5,937 |
| Net losses paid | (168,957) | (161,291) | (7,666) |
| Underwriting and corporate expenses | (95,022) | (112,304) | 17,282 |
| Net investment income | 46,408 | 46,746 | (338) |
| Net federal income taxes paid | (4,160) | (5,410) | 1,250 |
| Interest paid | (6,578) | (6,625) | 47 |
| Other | 800 | (20) | 820 |
| Net cash provided by (used for) operating activities | \$ 1,440 | \$ (15,892) | \$ 17,332 |

See the consolidated statement of cash flows in the consolidated financial statements in Item 1 of Part I of this report for details concerning our investing and financing activities.

Liquidity

On September 15, 2011, the Company's Board of Directors authorized the repurchase of up to \$100 million of the Company's Class A ordinary shares. Stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of derivative contracts, structured share repurchase agreements and Rule 10b5-1 trading plans. The timing and amount of any repurchase transactions, if any, under this program will depend upon market conditions as well as other factors. We may decide to buy or not buy any of our ordinary shares or discontinue our share repurchase program at any time, any of which may impact our stock price. Important factors that could cause us to discontinue our share repurchases include, among others, market conditions, increases in the market price of our ordinary shares, the nature of other investment opportunities presented to us from time to time, and the availability of funds necessary to continue purchasing common stock. There have been no share repurchases under this program to date.

Other than the items noted above, there have been no significant changes to our liquidity during the quarter or nine months ended September 30, 2011. Please see Item 7 of Part II in our 2010 Annual Report on Form 10-K for information regarding our liquidity.

Capital Resources

On July 20, 2011, the Company made a principal payment of \$18.0 million on our \$90.0 million Guaranteed Senior Notes. We are required to prepay \$18.0 million of the principal amount on July 20th of each year through July 20, 2015, when we will be required to pay any outstanding remaining principal amount on the notes. These notes are guaranteed by Global Indemnity (Cayman), Ltd and United America Indemnity, Ltd.

There have been no other significant changes to our capital resources during the quarter or nine months ended September 30, 2011. Please see Item 7 of Part II in our 2010 Annual Report on Form 10-K for information regarding our capital resources.

Off Balance Sheet Arrangements

We have no off balance sheet arrangements other than the Trust Preferred Securities and floating rate common securities discussed in the Liquidity and Capital Resources sections in Item 7 of Part II of our 2010 Annual Report on Form 10-K.

Cautionary Note Regarding Forward-Looking Statements

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Some of the statements under Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report may include forward-looking statements that reflect our current views with respect to future events and financial performance that are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that are not historical facts. These statements can be identified by the use of forward-looking terminology such as believe, expect, may, will, should, project, plan, seek, intend, or anticipate or the negative thereof or comparable terminology, and include discussions of strategy, financial projections and estimates and their underlying assumptions, statements regarding plans, objectives, expectations or consequences of identified transactions, and statements about the future performance, operations, products and services of the companies, including statements regarding projected annual savings and costs resulting from the Profit Enhancement Initiative.

Table of Contents**GLOBAL INDEMNITY PLC**

Our business and operations are and will be subject to a variety of risks, uncertainties and other factors. Consequently, actual results and experience may materially differ from those contained in any forward-looking statements. Such risks, uncertainties and other factors that could cause actual results and experience to differ from those projected include, but are not limited to, the following: (1) the ineffectiveness of our business strategy due to changes in current or future market conditions; (2) the effects of competitors' pricing policies, and of changes in laws and regulations on competition, including industry consolidation and development of competing financial products; (3) greater frequency or severity of claims and loss activity than our underwriting, reserving or investment practices have anticipated; (4) decreased level of demand for our insurance products or increased competition due to an increase in capacity of property and casualty insurers; (5) risks inherent in establishing loss and loss adjustment expense reserves; (6) uncertainties relating to the financial ratings of our insurance subsidiaries; (7) uncertainties arising from the cyclical nature of our business; (8) changes in our relationships with, and the capacity of, our general agents, brokers, insurance companies and reinsurance companies from which we derive our business; (9) the risk that our reinsurers may not be able to fulfill obligations; (10) investment performance and credit risk; (11) risks associated with our completed re-domestication to Ireland, which may include encountering difficulties moving jurisdictions and opening new offices and functions, tax and financial expectations and advantages not materializing or changing, our stock price could decline, and Irish corporate governance and regulatory schemes could prove different or more challenging than currently expected; (12) new tax legislation or interpretations that could lead to an increase in our tax burden; (13) uncertainties relating to governmental and regulatory policies, both domestically and internationally; (14) foreign currency fluctuations; (15) impact of catastrophic events; (16) estimates of the projected annual savings and costs for the Profit Enhancement Initiative, which we made based on information available at the time the charges were recorded; (17) our subsidiaries' ability to pay dividends; and (18) uncertainties relating to ongoing or future litigation matters.

The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are set forth in "Risk Factors" in Item 1A and elsewhere in our 2010 Annual Report on Form 10-K. Our forward-looking statements speak only as of the date of this report or as of the date they were made. We undertake no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the third quarter of 2011, the US Federal Reserve made two announcements with important implications for fixed income investors. The first, within a week of Standard & Poor's decision to downgrade the credit rating of U.S. Treasury and agency debt on August 5, 2011, was that federal funds would be kept exceptionally low through at least mid-2013. The second was the central bank's statement on September 21, 2011 that it planned to extend the average maturity of its Treasury holdings and resume purchasing agency mortgage-backed securities (MBS). As a result, the third quarter was a challenging period for credit investors. The dramatic widening of credit spreads erased not only the excess returns over duration-equivalent government bonds that had been generated in the year to date, but also all of the excess returns generated in 2010.

The investment grade fixed income portfolio continues to maintain high quality investments. The overall credit rating dropped from AA to AA- as a result of the downgrade of U.S. Treasury and agency debt. During the quarter, the effective duration of the portfolio decreased from 2.4 to 2.2 years, whereby reducing interest rate sensitivity. Portfolio purchases were focused on high quality government, corporate credit and shorter duration U.S. mortgage backed securities. These purchases were funded primarily through portfolio sales consisting of longer duration corporate credit and MBS.

During the quarter, the large cap value equity portfolio received an additional \$25 million in funding from the sale of investment grade bonds. Other than this change, there were no significant changes to asset allocation for the total investment portfolio. The investment grade fixed income portfolio continues to be defensively positioned in the event that interest rates rise. Allocations to corporate floating rate loans and a small allocation to Asian Consumption oriented equity fund remain unchanged.

There have been no other significant changes to our market risk since December 31, 2010. Please see Item 7A of Part II in our 2010 Annual Report on Form 10-K for information regarding our market risk.

Table of Contents

GLOBAL INDEMNITY PLC

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. Any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of September 30, 2011. Based upon that evaluation and subject to the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that, as of September 30, 2011, the design and operation of the Company's disclosure controls and procedures were effective to accomplish their objectives at the reasonable assurance level.

Changes in Internal Controls

During the quarter ended September 30, 2011 there have been no changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) under the Exchange Act) that occurred that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents**GLOBAL INDEMNITY PLC****PART II-OTHER INFORMATION****Item 1. Legal Proceedings**

We are, from time to time, involved in various legal proceedings in the ordinary course of business, including litigation regarding claims. There is a greater potential for disputes with reinsurers who are in a runoff of their reinsurance operations. Some of our reinsurers are in a runoff of their reinsurance operations, and therefore, we closely monitor those relationships. We do not believe that the resolution of any currently pending legal proceedings, either individually or taken as a whole, will have a material adverse effect on our business, consolidated financial position or results of operations. We anticipate that, similar to the rest of the insurance and reinsurance industry, we will continue to be subject to litigation and arbitration proceedings in the ordinary course of business.

Item 1A. Risk Factors

Our results of operations and financial condition are subject to numerous risks and uncertainties described in Item 1A of Part I in our 2010 Annual Report on Form 10-K, filed with the SEC on March 16, 2011. The risk factors identified therein have not materially changed.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On September 15, 2011, the Company's Board of Directors authorized the repurchase of up to \$100 million of the Company's Class A ordinary shares. Stock repurchases may be made in both open market and privately negotiated transactions, and may include the use of derivative contracts, structured share repurchase agreements and Rule 10b5-1 trading plans. The timing and amount of any repurchase transactions, if any, under this program will depend upon market conditions as well as other factors. We may decide to buy or not buy any of our ordinary shares or discontinue our share repurchase program at any time, any of which may impact our stock price. Important factors that could cause us to discontinue our share repurchases include, among others, market conditions, increases in the market price of our ordinary shares, the nature of other investment opportunities presented to us from time to time, and the availability of funds necessary to continue purchasing common stock. There have been no share repurchases under this program to date.

Our Share Incentive Plan allows employees to surrender our Class A ordinary shares as payment for the tax liability incurred upon the vesting of restricted stock that was issued under the Plan. There were -0- shares purchased from our employees during the quarter ended September 30, 2011. All Class A ordinary shares purchased from employees by us are held as treasury stock and recorded at cost.

The following table provides information with respect to the Class A ordinary shares that were surrendered or repurchased during the quarter ended September 30, 2011:

| Period ⁽¹⁾ | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plan or Program | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plan or Program |
|-----------------------|--|--|--|---|
| July 1-31, 2011 | | \$ | | \$ |
| August 1-31, 2011 | | \$ | | \$ |
| September 1-30, 2011 | | \$ | | \$ 100,000,000 |

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Total

\$

N/A

(1) Based on settlement date.

Item 5. Other Information

None.

Item 6. Exhibits

31.1+ Certification of Chief Executive Officer pursuant to Rule 13a-14 (a) / 15d-14 (a) of the Securities Exchange of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Table of Contents

GLOBAL INDEMNITY PLC

- 31.2+ Certification of Chief Financial Officer pursuant to Rule 13a-14 (a) / 15d-14 (a) of the Securities Exchange of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1+ Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2+ Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.1+ The following financial information from Global Indemnity plc's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 formatted in XBRL: (i) Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010; (ii) Consolidated Statements of Operations for the quarters and nine months ended September 30, 2011 and 2010; (iii) Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2011 and 2010; (iv) Consolidated Statements of Changes in Shareholders' Equity as of September 30, 2011 and December 31, 2010; (v) Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010; and (vi) Notes to Consolidated Financial Statements.

+ Filed or furnished herewith, as applicable.

Table of Contents

GLOBAL INDEMNITY PLC

SIGNATURE

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.

GLOBAL INDEMNITY PLC

Registrant

November 9, 2011
Date: November 9, 2011

By: /s/ Thomas M. McGeehan
Thomas M. McGeehan
Chief Financial Officer
(Authorized Signatory and Principal Financial and Accounting
Officer)