

PRIMUS GUARANTY LTD

Form 10-Q

August 08, 2008

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

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended June 30, 2008**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission File Number: 001-32307**

**Primus Guaranty, Ltd.**

(Exact name of registrant as specified in its charter)

**Bermuda**

(State or other jurisdiction of incorporation or organization)

**Not Required**

(I.R.S. Employer Identification No.)

**Clarendon House**

**2 Church Street**

**Hamilton HM 11, Bermuda**

(Address of principal executive offices, including zip code)

**441-296-0519**

(Registrant's telephone number, including area code)

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

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

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

(Do not check if a smaller reporting company)

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

As of August 1, 2008, the number of shares outstanding of the issuer's common shares, \$0.08 par value, was 45,229,069.



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**Form 10-Q**  
For the three months ended June 30, 2008  
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## Item 1. Financial Statements

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

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(unaudited)	
<b>Assets</b>		
Cash and cash equivalents	\$ 303,858	\$ 242,665
Available-for-sale investments	589,203	617,631
Accrued interest receivable	6,134	7,684
Accrued premiums and receivables on credit and other swaps	3,470	4,187
Unrealized gain on credit and other swaps, at fair value	339	606
Fixed assets and software costs, net	4,850	5,036
Debt issuance costs, net	6,809	6,965
Other assets	2,673	3,872
<b>Total assets</b>	<b>\$ 917,336</b>	<b>\$ 888,646</b>
<b>Liabilities and shareholders equity</b>		
Accounts payable and accrued expenses	\$ 2,182	\$ 2,182
Accrued compensation	4,704	5,957
Interest payable	369	831
Unrealized loss on credit and other swaps, at fair value	986,492	544,731
Accrued premiums and payables on credit and other swaps		1,770
Long-term debt	325,570	325,904
Restructuring liabilities		1,709
Other liabilities	497	503
<b>Total liabilities</b>	<b>1,319,814</b>	<b>883,587</b>
Preferred securities of subsidiary	98,521	98,521
Commitments and contingencies		
<b>Shareholders equity (deficit)</b>		
Common shares, \$0.08 par value, 62,500,000 shares authorized, 45,226,856 and 45,035,593 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively	3,618	3,603
Additional paid-in-capital	282,587	280,224
Accumulated other comprehensive loss	(7,152)	(4,712)
Retained earnings (deficit)	(780,052)	(372,577)
<b>Total shareholders equity (deficit)</b>	<b>(500,999)</b>	<b>(93,462)</b>
<b>Total liabilities, preferred securities of subsidiary and shareholders equity (deficit)</b>	<b>\$ 917,336</b>	<b>\$ 888,646</b>

*See accompanying notes.*

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	(unaudited)		(unaudited)	
<b>Revenues</b>				
Net credit swap revenue (loss)	\$ 270,990	\$ (15,995)	\$ (392,625)	\$ (20,872)
Asset management and advisory fees	1,090	625	2,180	1,286
Interest income	6,319	10,316	15,513	20,293
Other trading revenue		708		1,967
Foreign currency revaluation loss	(102)	(63)	(127)	(12)
<b>Total net revenues</b>	<b>278,297</b>	<b>(4,409)</b>	<b>(375,059)</b>	<b>2,662</b>
<b>Expenses</b>				
Compensation and employee benefits	5,964	5,972	12,155	11,976
Professional and legal fees	1,281	1,463	2,304	2,439
Depreciation and amortization	334	370	663	947
Technology and data	900	1,078	2,011	1,955
Interest expense	3,973	4,859	8,864	9,721
Other	1,300	1,410	2,623	2,945
<b>Total expenses</b>	<b>13,752</b>	<b>15,152</b>	<b>28,620</b>	<b>29,983</b>
Distributions on preferred securities of subsidiary	1,942	1,959	3,747	3,861
Income (loss) before provision for income taxes	262,603	(21,520)	(407,426)	(31,182)
Provision (benefit) for income taxes		(4)	49	52
<b>Net income (loss) available to common shares</b>	<b>\$ 262,603</b>	<b>\$ (21,516)</b>	<b>\$ (407,475)</b>	<b>\$ (31,234)</b>
Income (loss) per common share:				
Basic	\$ 5.81	\$ (0.48)	\$ (9.02)	\$ (0.70)
Diluted	\$ 5.78	\$ (0.48)	\$ (9.02)	\$ (0.70)
Average common shares outstanding:				
Basic	45,225	45,012	45,166	44,588
Diluted	45,406	45,012	45,166	44,588
<i>See accompanying notes.</i>				

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

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>
	(unaudited)	
<b>Cash flows from operating activities</b>		
Net loss	\$ (407,475)	\$ (31,234)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Non-cash items included in net loss:		
Depreciation and amortization	663	947
Share compensation	2,573	2,248
Net unrealized losses on credit and other swaps	442,028	58,996
Net amortization of premium and discount on securities	(1,128)	(4,634)
Amortization of debt issuance costs	156	156
Distributions on preferred securities of subsidiary	3,747	3,861
Increase (decrease) in cash resulting from changes in:		
Accrued interest receivable	1,550	(171)
Accrued premiums and interest receivable on credit and other swaps	717	(755)
Deposit and warehouse loan agreement		(6,022)
Warehouse loans held for securitization		(336,278)
Other assets	865	(3,459)
Trading account assets		1,334
Accounts payable and accrued expenses		(635)
Accrued compensation	(1,253)	(4,752)
Trading account liabilities		(32)
Accrued premiums and payables on credit and other swaps	(1,770)	
Interest payable	(462)	(200)
Restructuring liabilities	(1,709)	
Other liabilities	(6)	51
Net cash provided by (used in) operating activities	38,496	(320,579)
<b>Cash flows from investing activities</b>		
Fixed asset purchases and capitalized software costs	(477)	(1,064)
Payments received from CLO investments	2,063	
Purchases of available-for-sale investments	(1,059,776)	(413,731)
Maturities and sales of available-for-sale investments	1,084,890	381,499
Net cash provided by (used in) investing activities	26,700	(33,296)
<b>Cash flows from financing activities</b>		
Repurchase and retirement of common shares	(195)	(1,142)
Proceeds from exercise of options and issue of shares		557
Proceeds from exercise of warrants		7,335



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Warehouse loan payable		336,278
Net preferred distributions of subsidiary	(3,747)	(3,861)
Net cash provided by (used in) financing activities	(3,942)	339,167
Net effect of exchange rate changes on cash	(61)	(5)
Net increase (decrease) in cash	61,193	(14,713)
Cash and cash equivalents at beginning of period	242,665	204,428
Cash and cash equivalents at end of period	\$ 303,858	\$ 189,715

**Supplemental disclosures**

Cash paid for interest	\$ 9,171	\$ 9,815
Cash paid for taxes	\$ 25	\$ 22

*See accompanying notes.*

**Table of Contents****1. Organization and Basis of Presentation**

Primus Guaranty, Ltd., together with its consolidated subsidiaries ( Primus Guaranty or the Company ), is a Bermuda holding company that conducts business through its two principal operating subsidiaries, Primus Financial Products, LLC ( Primus Financial ) and Primus Asset Management, Inc. ( Primus Asset Management ).

Primus Financial, incorporated in Delaware, is a credit derivatives product company ( CDPC ), which has AAA/Aaa counterparty ratings by Standard & Poor's Rating Group ( S&P ), and Moody's Investors Service, Inc. ( Moody's ), respectively. Primus Financial is a seller of credit swaps to banks and credit swap dealers, referred to as counterparties, against primarily investment grade credit obligations of corporate and sovereign issuers. In exchange for a fixed quarterly premium, Primus Financial agrees, upon the occurrence of a defined credit event (e.g., bankruptcy, failure to pay or restructuring) affecting a designated issuer, referred to as a Reference Entity, to pay its counterparty an agreed upon notional amount against delivery to Primus Financial of the Reference Entity's debt obligation in the same notional amount. Credit swaps related to a single specified Reference Entity are referred to as single name credit swaps. Primus Financial seeks to minimize the risk inherent in its credit swap portfolio by maintaining a high quality, diversified credit swap portfolio across Reference Entities, industries, countries and rating grades. Primus Financial also sells credit swaps referencing portfolios containing obligations of multiple Reference Entities, which are referred to as tranches, and sells credit swaps referencing residential mortgage-backed securities, which are referred to as ABS. Defined credit events related to ABS may include any or all of the following: failure to pay principal, write-down in the reference obligation and downgrades to CCC/Caa2 (S&P/Moody's) or below of the reference obligation.

Primus Asset Management, a Delaware services company, acts as an investment manager to affiliated companies and third party entities. It currently manages the credit swap and cash investment portfolios of its affiliate, Primus Financial. Primus Asset Management also manages two collateralized loan obligations ( CLOs ). A CLO issues securities backed by a diversified pool of primarily below investment grade rated senior secured loans of corporations. Additionally, Primus Asset Management manages three investment grade collateralized swap obligations ( CSOs ) on behalf of third parties. A CSO issues securities backed by one or more credit swaps sold against a diversified pool of investment grade corporate or sovereign reference entities. Primus Asset Management receives fees for its investment management services on the five investment vehicles. In general, such management fees are calculated based on percentage of assets under management, subject to applicable contractual terms. As of June 30, 2008, CLO and CSO assets under management were approximately \$1.5 billion. Primus Asset Management has entered into a Services Agreement with its affiliates, whereby it provides services to its affiliates including management, consulting and information technology.

Primus Re, Ltd. ( Primus Re ), another subsidiary, is a Bermuda company that operates as a financial guaranty insurance company and is licensed as a Class 3 Insurer under the Bermuda Insurance Act of 1978. Primus Re's business is to act as a conduit, or transformer, between parties interested in buying or selling protection in insurance form and other parties interested in assuming the opposite risk position in the form of credit swaps. Primus Re was inactive during the six months ended June 30, 2008.

As of March 31, 2008, Harrier Credit Strategies Master Fund, LP ( Harrier ) ceased trading activities and closed all of its trading positions. As of December 31, 2007, PRS Trading Strategies, LLC ( PRS Trading Strategies ) was inactive.

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The accompanying unaudited condensed consolidated financial statements of Primus Guaranty, Ltd. have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of the results for a full year. The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances have been eliminated.

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

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

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

**2. Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 157, *Fair Value Measurements* ( SFAS No. 157 ). SFAS No.157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157. For additional information and discussion, see note 5 of notes to the condensed consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* ( SFAS No. 159 ). SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Effective January 1, 2008, the Company adopted the provisions of SFAS No. 159. The adoption of SFAS No. 159 did not have a material impact on the Company's condensed consolidated financial statements. For additional information and discussion, see note 5 of notes to the condensed consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an Amendment of FASB Statement No. 133* ( SFAS No. 161 ). SFAS No. 161 is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS No.161 applies to all derivative instruments within the scope of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ( SFAS No. 133 ). It also applies to non-derivative hedging instruments and all hedged items designated and qualifying as hedges under SFAS No. 133. SFAS No. 161 is effective prospectively for financial statements issued for fiscal years beginning after November 15, 2008. The Company will adopt SFAS No. 161 in the first quarter of 2009. The Company is currently evaluating the disclosure requirements that adoption of SFAS No. 161 will have on its condensed consolidated financial statements. However, since SFAS No. 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS No. 161 will not affect the Company's financial condition, results of operations or cash flows.

**Table of Contents****3. Available-for-sale Investments**

Available-for-sale investments include U.S. government agency obligations (including government-sponsored enterprises) rated AAA and Aaa by the respective rating agencies, commercial paper rated A-1 and P-1 by the respective rating agencies and the Company's CLO investments. The Company accounts for its CLO investments as debt securities and fixed maturity securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ( *SFAS 115* ) and Emerging Issues Task Force ( *EITF* ) Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets* ( *EITF 99-20* ). Accordingly, the CLO investments are classified as available-for-sale investments.

Available-for-sale investments are carried at fair value with the unrealized gains or losses reported in accumulated other comprehensive loss as a separate component of shareholders' equity. Available-for-sale investments have maturities at time of purchase greater than 90 days.

The following table summarizes the composition of the Company's available-for-sale investments at June 30, 2008 and December 31, 2007 (in thousands):

	<b>June 30, 2008</b>			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. government agency obligations	\$ 565,741	\$ 304	\$ (219)	\$ 565,826
Collateralized loan obligations	13,616		(6,878)	6,738
Corporate debt securities	17,024		(429)	16,595
ABS bond	61		(17)	44
<b>Total</b>	<b>\$ 596,442</b>	<b>\$ 304</b>	<b>\$ (7,543)</b>	<b>\$ 589,203</b>
	<b>December 31, 2007</b>			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
U.S. government agency obligations	\$ 607,663	\$ 480	\$ (169)	\$ 607,974
Collateralized loan obligations	14,880		(5,223)	9,657
<b>Total</b>	<b>\$ 622,543</b>	<b>\$ 480</b>	<b>\$ (5,392)</b>	<b>\$ 617,631</b>

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The following table summarizes the fair value of investments that have been in a continuous unrealized loss position for less than 12 months and for 12 months or more at June 30, 2008 and December 31, 2007 (in thousands):

	<b>June 30, 2008</b>					
	Securities with Unrealized Losses					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency obligations	\$ 418,954	\$ (219)	\$	\$	\$ 418,954	\$ (219)
Collateralized loan obligations	3,553	(4,451)	3,185	(2,427)	6,738	(6,878)
Corporate debt securities	16,595	(429)			16,595	(429)
ABS bond	44	(17)			44	(17)
<b>Total</b>	<b>\$ 439,146</b>	<b>\$ (5,116)</b>	<b>\$ 3,185</b>	<b>\$ (2,427)</b>	<b>\$ 442,331</b>	<b>\$ (7,543)</b>

	<b>December 31, 2007</b>					
	Securities with Unrealized Losses					
	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government agency obligations	\$ 127,139	\$ (59)	\$ 104,600	\$ (110)	\$ 231,739	\$ (169)
Collateralized loan obligations	5,302	(3,065)	4,355	(2,158)	9,657	(5,223)
<b>Total</b>	<b>\$ 132,441</b>	<b>\$ (3,124)</b>	<b>\$ 108,955</b>	<b>\$ (2,268)</b>	<b>\$ 241,396</b>	<b>\$ (5,392)</b>

The Company makes an assessment to determine whether unrealized losses reflect declines in value of securities that are other-than-temporarily impaired. The Company considers many factors, including the length of time and significance of the decline in fair value; the Company's intent and ability to hold the investment for a sufficient period of time for a recovery in fair value; recent events specific to the issuer or industry; credit ratings and asset quality of collateral structure; and any significant changes in estimated cash flows. If the Company, based on its evaluation of the above factors, determines that the impairment is other-than-temporary, the carrying value of the security is written down to fair value and the unrealized loss is recognized through a charge to earnings in the condensed consolidated statements of operations. Based on the Company's evaluation, it does not consider these investments to be other-than-temporarily impaired at June 30, 2008 and December 31, 2007.

The U.S. government agency obligations mature before November 2009. The two CLO investments are scheduled to mature in 2019 and 2021, respectively, although the actual maturity of each may be sooner.

**Table of Contents****4. Net Credit Swap Revenues and Portfolio*****Overview***

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

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

All credit swap transactions entered into between the Buyer and the Seller are subject to an International Swaps and Derivatives Association, Inc. Master Agreement (ISDA Master Agreement) executed by both parties. The ISDA Master Agreement allows for the aggregation of the market exposures and termination of all transactions between the Buyer and Seller in the event a default (as defined by the ISDA Master Agreement) occurs in respect of either party. The primary risks inherent in the Company's activities are (a) where the Company is a Seller that Reference Entities specified in its credit swap transactions will experience credit events that will require the Company to make payments to the Buyers of the transactions. Defined credit events may include any or all of the following: bankruptcy, failure to pay, repudiation or moratorium, and modified or original restructuring, (b) where the Company is a Buyer of a credit swap and a defined credit event occurs, the Seller fails to make payment to the Company, and (c) that Buyers of the transactions from the Company will default on their required premium payments. Defined credit events related to the Company's credit swaps against ABS may include any or all of the following: failure to pay principal, write-down in the reference obligation and downgrades to CCC/Caa2 (S&P/Moody's) or below of the reference obligation. See note 6 of notes to condensed consolidated financial statements for further discussion.

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

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In accordance with U.S. GAAP, the Company carries its credit swaps on its consolidated statements of financial condition at their fair value. Changes in the fair value of the Company's credit swap portfolio are recorded as unrealized gains or losses as a component of net credit swap revenue (loss) in the Company's consolidated statements of operations. If a credit swap has an increase or decline in fair value during a period, the increase will add to the Company's net credit swap revenue and the decline will subtract from the Company's net credit swap revenue for that period, respectively. Changes in the fair value of the Company's credit swap portfolio are a function of the notional amount and composition of the portfolio and prevailing market credit swap premiums for comparable credit swaps. The Company generally holds the credit swaps it sells to maturity, at which point, assuming no defined credit event has occurred, the cumulative unrealized gains and losses on each credit swap would equal zero.

Primus Financial enters into ISDA Master Agreements with its counterparties and aggregates its respective transactions on a counterparty basis for presentation on the Company's condensed consolidated statements of financial condition. If the aggregate total of fair values with a counterparty is a net gain, the total is recorded as a component of unrealized gains on credit swaps, at fair value in the condensed consolidated statements of financial condition. If the aggregate total of fair values with a counterparty is a net loss, the total is recorded as a component of unrealized losses on credit and other swaps, at fair value in the condensed consolidated statements of financial condition.

***Primus Financial***

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

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

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

***Harrier/PRS Trading Strategies***

At December 31, 2007, PRS Trading Strategies was inactive. At March 31, 2008, Harrier had closed its remaining credit swap positions.

**Table of Contents****Consolidated Net Credit Swap Revenue (Loss) and Credit Swap Portfolio Information**

The table below presents the components of consolidated net credit swap revenue (loss) for the three and six months ended June 30, 2008 and 2007 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Net premium income	\$ 27,239	\$ 20,304	\$ 54,550	\$ 38,826
Realized gains		4,893	1,033	7,688
Realized losses	(898)	(5,385)	(6,084)	(8,552)
Net change in unrealized gains (losses)	244,649	(35,807)	(442,124)	(58,834)
Net credit swap revenue (loss)	\$ 270,990	\$ (15,995)	\$ (392,625)	\$ (20,872)

The table below, represents the Company's consolidated notional amount, fair value and average fair value of open credit swap transactions entered into with third parties at June 30, 2008 and December 31, 2007 are as follows (in thousands):

	June 30, 2008	December 31, 2007
<b>Gross Notional Amounts:</b>		
Credit swaps sold-single name	\$ 19,116,761	\$ 18,260,653
Credit swaps sold-tranche	5,000,000	4,700,000
Credit swaps sold-ABS	75,000	80,000
Credit swaps purchased-single name	(16,610)	(25,410)
<b>Fair value:</b>		
Asset	339	606
Liability	986,492	544,731
<b>Average fair value:</b>		
Asset	720	33,217
Liability	1,058,532	165,087

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



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The tables that follow summarize in thousands, by credit rating of Reference Entities and of counterparties, the notional amounts and fair values of credit swap transactions outstanding for the Company as of June 30, 2008 and December 31, 2007:

Moody's Rating Category By Single Name Reference Entity/Tranche	June 30, 2008		December 31, 2007	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Credit Swaps Sold-Single Name:				
Aaa	\$ 593,163	\$ (7,390)	\$ 828,504	\$ (3,953)
Aa	3,507,683	(70,496)	3,832,904	(91,863)
A	6,464,057	(114,745)	6,047,762	(36,544)
Baa	7,507,104	(153,903)	6,882,813	(22,162)
Ba	691,871	(27,376)	570,090	(17,235)
B	352,883	(69,525)	71,080	(2,390)
Caa			27,500	(2,791)
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)
Credit Swaps Sold-Tranche:				
Aaa	\$ 4,050,000	\$ (344,347)	\$ 3,450,000	\$ (172,175)
Aa	500,000	(58,048)	950,000	(94,312)
A	300,000	(55,391)	300,000	(53,569)
Baa	150,000	(31,259)		
Total	\$ 5,000,000	\$ (489,045)	\$ 4,700,000	\$ (320,056)
Credit Swaps Sold-ABS (1):				
A	\$ 15,000	\$ (9,867)	\$ 25,000	\$ (12,821)
Baa	10,000	(7,951)	35,000	(20,470)
Ba			15,000	(11,353)
B	10,000	(8,196)	5,000	(4,038)
Caa	40,000	(31,169)		
Total	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)
Credit Swaps Purchased-Single Name:				
Aa	\$	\$	\$ (8,160)	\$ 403
A	(8,160)	2,112	(12,380)	335
Baa	(8,450)	1,398	(4,870)	813
Total	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551

(1) See note 6  
Credit Events

CDS on ABS  
for further  
discussion.

**Table of Contents****By Counterparty Buyer / (Seller)**

## Credit Swaps Sold-Single Name:

Aaa	\$ 1,619,949	\$ (38,454)	\$ 3,625,845	\$ (34,091)
Aa	14,662,076	(343,095)	12,153,764	(118,109)
A	1,804,254	(42,816)	2,481,044	(24,738)
Baa	1,030,482	(19,070)		
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)

## Credit Swaps Sold-Tranche:

Aaa	\$	\$	\$ 400,000	\$ (33,706)
Aa	4,550,000	(429,906)	3,850,000	(246,490)
A	450,000	(59,139)	450,000	(39,860)
Total	\$ 5,000,000	\$ (489,045)	\$ 4,700,000	\$ (320,056)

## Credit Swaps Sold-ABS (1):

Aaa	\$	\$	\$ 15,000	\$ (10,241)
Aa	50,000	(37,587)	40,000	(21,969)
A	25,000	(19,596)	25,000	(16,472)
Total	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)

## Credit Swaps Purchased-Single Name:

Aaa	\$	\$	\$ (5,000)	\$ 383
Aa	(16,610)	3,510	(20,410)	1,168
Total	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551

(1) See note 6  
Credit Events  
CDS on ABS  
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S&P Rating Category By Single Name Reference Entity/Tranche	June 30, 2008		December 31, 2007	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Credit Swaps Sold-Single Name:				
AAA	\$ 697,408	\$ (19,726)	\$ 1,071,504	\$ (32,181)
AA	3,487,028	(49,162)	3,704,784	(56,437)
A	7,150,876	(113,735)	6,550,733	(42,398)
BBB	6,887,034	(173,322)	6,326,638	(20,200)
BB	650,032	(66,818)	478,820	(14,583)
B	212,326	(19,098)	128,174	(11,139)
CCC	32,057	(1,574)		
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)
Credit Swaps Sold-Tranche:				
AAA	\$ 4,150,000	\$ (352,689)	\$ 3,800,000	\$ (212,582)
AA	250,000	(37,005)	700,000	(67,998)
A	450,000	(68,092)	100,000	(21,880)
BBB	150,000	(31,259)	100,000	(17,596)
Total	\$ 5,000,000	\$ (489,045)	\$ 4,700,000	\$ (320,056)
Credit Swaps Sold-ABS (1):				
A	\$ 5,000	\$ (2,668)	\$ 50,000	\$ (29,921)
BBB	10,000	(7,740)	15,000	(7,242)
BB	20,000	(15,395)	15,000	(11,519)
CCC	40,000	(31,380)		
Total	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)
Credit Swaps Purchased-Single Name:				
AA	\$	\$	\$ (8,160)	\$ 403
A	(11,740)	2,647	(12,250)	765
BBB	(4,870)	863	(5,000)	383
Total	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551

(1) See note 6  
Credit Events  
CDS on ABS  
for further  
discussion.



**Table of Contents****By Counterparty Buyer / (Seller)**

## Credit Swaps Sold-Single Name:

AAA	\$	\$	\$ 5,000	\$ 3
AA	14,072,545	(287,293)	14,367,841	(131,277)
A	5,044,216	(156,142)	3,887,812	(45,664)
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)

## Credit Swaps Sold-Tranche:

AA	\$ 4,550,000	\$ (429,906)	\$ 4,250,000	\$ (280,196)
A	450,000	(59,139)	450,000	(39,860)
Total	\$ 5,000,000	\$ (489,045)	\$ 4,700,000	\$ (320,056)

## Credit Swaps Sold-ABS (1):

AA	\$ 50,000	\$ (37,587)	\$ 55,000	\$ (32,210)
A	25,000	(19,596)	25,000	(16,472)
Total	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)

## Credit Swaps Purchased-Single Name:

AA	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551
Total	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551

(1) See note 6  
Credit Events  
CDS on ABS  
for further  
discussion.

Primus Financial's counterparties are generally financial institutions with whom it has entered into ISDA Master Agreements. For the six months ended June 30, 2008, no individual counterparty generated greater than ten percent of the Company's consolidated net premium revenue. For the six months ended June 30, 2007, one counterparty generated greater than ten percent of the Company's consolidated net premium revenue.

The table below shows the geographical distribution of the Company's credit swap portfolio by domicile of the Reference Entity and domicile of the counterparty as of June 30, 2008 and December 31, 2007 (in thousands):

Country of Domicile	June 30, 2008		December 31, 2007	
	Notional Amount	Fair Value	Notional Amount	Fair Value
<b>Credit Swaps Sold-Single Name</b>				
By Reference Entity:				
North America	\$ 9,603,795	\$ (333,787)	\$ 9,531,846	\$ (149,169)
Europe	8,616,966	(92,147)	7,837,807	(21,719)

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Asia-Pacific	717,000	(13,134)	712,000	(4,791)
Others	179,000	(4,367)	179,000	(1,259)
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)
By Counterparty:				
North America	\$ 9,605,502	\$ (233,046)	\$ 9,431,827	\$ (100,747)
Europe	9,369,259	(208,790)	8,686,826	(75,709)
Asia-Pacific	132,000	(1,623)	132,000	(534)
Others	10,000	24	10,000	52
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)

**Table of Contents****Credit Swaps Sold-Tranche**

By Counterparty:

North America	\$ 600,000	\$ (54,693)	\$	\$
Europe	4,400,000	(434,352)	4,700,000	(320,056)
Total	\$ 5,000,000	\$ (489,045)	\$ 4,700,000	\$ (320,056)

**Credit Swaps Sold-ABS (1)**

By Reference Entity:

North America	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)
Total	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)

By Counterparty:

North America	\$ 45,000	\$ (34,096)	\$ 45,000	\$ (24,418)
Europe	30,000	(23,087)	35,000	(24,264)
Total	\$ 75,000	\$ (57,183)	\$ 80,000	\$ (48,682)

**Credit Swaps Purchased-Single Name**

By Reference Entity:

North America	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551
Total	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551

By Counterparty:

Europe	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551
Total	\$ (16,610)	\$ 3,510	\$ (25,410)	\$ 1,551

(1) See note 6  
Credit Events  
CDS on ABS  
for further  
discussion.



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The table below shows the distribution of the Company's credit swap portfolio by year of maturity as of June 30, 2008 and December 31, 2007 (in thousands). With respect to the credit swaps sold-ABS caption below, the actual maturity date for any contract will vary depending on the level of voluntary prepayments, defaults and interest rates with respect to the underlying mortgage loans. As a result, the actual maturity date for any such contract may be earlier or later than the estimated maturity indicated.

	June 30, 2008		December 31, 2007	
	Notional Amount	Fair Value	Notional Amount	Fair Value
<b>Credit Swaps Sold-Single Name</b>				
Year of Maturity				
2008	\$ 390,032	\$ (1,010)	\$ 1,180,401	\$ (302)
2009	2,801,191	(21,587)	2,723,618	(6,449)
2010	6,158,004	(129,693)	6,052,998	(56,037)
2011	3,043,533	(140,841)	2,953,911	(53,905)
2012	5,529,271	(142,100)	5,309,725	(60,119)
2013	1,194,730	(8,204)	40,000	(126)
Total	\$ 19,116,761	\$ (443,435)	\$ 18,260,653	\$ (176,938)
<b>Credit Swaps Sold-Tranche</b>				
Year of Maturity				
2012	\$ 1,000,000	\$ (27,704)	\$ 1,000,000	\$ (6,204)
2013	350,000	(64,685)	350,000	(58,715)
2014	3,650,000	(396,656)	3,350,000	(255,137)
Total	\$ 5,000,000	\$ (489,045)	\$ 4,700,000	\$ (320,056)
<b>Credit Swaps Sold-ABS (1)</b>				
Year of Maturity				
2010	\$ 10,000	\$ (7,198)	\$ 10,000	\$ (4,632)
2011	5,000	(3,535)	10,000	(6,368)
2012	15,000	(11,578)	15,000	(9,322)
2013	15,000	(10,261)	15,000	(9,443)
2014	20,000	(16,059)	20,000	(12,438)
2016	10,000	(8,552)	10,000	(6,479)

(1) See note 6  
Credit Events  
CDS on ABS  
for further  
discussion.

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**5. Financial Instruments and Fair Value Disclosures**

A significant number of the Company's financial instruments are carried at fair value with changes in fair value recognized in earnings each period. Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157. Under this standard, 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 (an exit price). In determining fair value, the Company uses various valuation techniques. SFAS No. 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

The fair value hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to valuation techniques using unobservable inputs (Level 3). Observable inputs are inputs that market participants would use in pricing the asset or liability that are based on market data obtained from sources independent of the Company. Unobservable inputs reflect the Company's estimates of the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances. These valuation techniques involve some level of management estimation and judgment. The degree to which management's estimation and judgment is required is generally dependent upon the market price transparency for the instruments, the availability of observable inputs, frequency of trading in the instruments and the instrument's complexity.

In measuring the fair market values of its financial instruments, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs based on the fair value hierarchy established in SFAS No. 157. The hierarchy is categorized into three levels based on the reliability of inputs as follows:

Level 1 Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities.

The Company's cash and cash equivalents, which include deposits in banks and money market accounts, are categorized within Level 1. The Company does not adjust the quoted prices for such financial instruments.

Level 2 Valuations based on quoted prices in markets that are not considered to be active; or valuations for which all significant inputs are observable or can be corroborated by observable market data, either directly or indirectly.

The Company's U.S. government agency obligations, commercial paper, single name credit swaps and interest rate swap are categorized within Level 2 of the fair value hierarchy. The interest rate swap is included in other assets in the condensed consolidated statements of financial condition.

Level 3 Valuations based on significant unobservable inputs that are supported by little or no market activity.

The Company's CLO investments, ABS bond, credit swaps sold on ABS and credit swaps - tranches are categorized within Level 3 of the fair value hierarchy.

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***Valuation Techniques Credit Swaps***

The Company's fair value of its portfolio of single name, tranches and ABS credit swaps, depends upon a number of factors, including:

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

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

Valuation models, which are used to derive a fair value of credit swaps. Our valuation models have been internally developed but are benchmarked against market-standard models.

Consideration of the credit risk of our counterparties, as well as our own nonperformance risk. SFAS No. 157 requires that our own nonperformance risk be considered when determining the fair value of our liabilities, which include credit swaps.

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

For the single-name credit swaps, our valuation model uses mid-market credit swap premium data obtained from an independent pricing service. The independent pricing service obtains mid-market credit swap premium quotes from a number of dealers in the credit swap market across a range of standard maturities and restructuring terms, and derives average credit swap premium quotes on specific Reference Entities. We adjust the independent mid-market credit swap premium quotes to derive exit price valuations.

For tranche transactions, we obtain a mid-market valuation for each tranche transaction using our tranche valuation model. The inputs to our valuation model include: current credit swap premium quotes obtained from an independent pricing service on the Reference Entities within the tranche, our trader's estimate of correlation levels derived from credit swap indices, current interest rates and estimated recovery values on the securities issued by the underlying Reference Entities. We adjust the mid-market valuations obtained from our model to exit price valuations, using quotes obtained from our tranche counterparties.

For credit swaps on ABS, we obtain mid-market valuations from an independent valuation service and quotes from our counterparty. We adjust the mid-market valuations to obtain exit price valuations.

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***Valuation Techniques Other Financial Instruments***

The Company uses the following valuation techniques to determine the fair value of its other financial instruments:

For cash and cash equivalents, which include deposits in banks and money market accounts, the fair value of these instruments is based upon quoted market prices. The Company does not adjust the quoted price for such instruments.

For U.S. government agency obligations and commercial paper, the fair value is based upon observable quoted market prices and benchmarked to third party quotes.

For the interest rate swap, the fair value is based upon observable market data including contractual terms, market prices and interest rates and is benchmarked to multiple third party quotes.

For the ABS bond, the fair value is based upon a valuation from an independent valuation service, which estimates the value of the bond by utilizing a valuation model. This model incorporates projected cash flows, including default, prepayment, recovery and interest rate data.

For the two CLO investments, the fair value is based upon a valuation model which includes observable inputs, where available. The model calculates the present value of expected cash flows using our best estimates of the key assumptions, including forecasted credit losses, prepayment rates, forward yield curves and discount rates commensurate with the risk involved. The valuation is benchmarked to third party quotes.

***Fair Value Measurements***

The Company's assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with SFAS No. 157.

As required under SFAS No. 157, the Company considers the effect of its nonperformance risk in determining the fair value of its liabilities. The consideration of nonperformance risk resulted in an adjustment of \$369.4 million as of June 30, 2008, which reduced the fair value of the Company's credit swap liabilities in the condensed consolidated statements of financial condition and increased net credit swap revenue in the condensed consolidated statements of operations.

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The following fair value hierarchy table presents information about the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2008 (in thousands):

	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Counter- party Netting (*)</b>	<b>Assets / Liabilities at Fair Value</b>
<b>Assets</b>					
Cash and cash equivalents	\$ 80,383	\$ 223,475	\$	\$	\$ 303,858
Available-for-sale investments		582,421	6,782		589,203
Unrealized gain on credit swaps		2,999		(2,660)	339
Other assets		570			570
<b>Total Assets</b>	<b>\$ 80,383</b>	<b>\$ 809,465</b>	<b>\$ 6,782</b>	<b>\$ (2,660)</b>	<b>\$ 893,970</b>
<b>Liabilities</b>					
Unrealized loss on credit swaps	\$	\$ 442,924	\$ 546,228	\$ (2,660)	\$ 986,492
<b>Total Liabilities</b>	<b>\$</b>	<b>\$ 442,924</b>	<b>\$ 546,228</b>	<b>\$ (2,660)</b>	<b>\$ 986,492</b>

(\*) Represents the impact of counterparty netting across the levels of the fair value hierarchy. Counterparty netting among positions classified within the same level is included in that level.

The following table below provides a reconciliation for the Company's assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2008 (in thousands):

<b>Three Months Ended June 30, 2008</b>	<b>Six Months Ended June 30, 2008</b>
<b>Available-for- Unrealized Loss</b>	<b>Available-for-</b>

	<b>Sale</b>	<b>on Credit</b>	<b>Sale</b>	<b>Unrealized Loss</b>
	<b>Investments</b>	<b>Swaps</b>	<b>Investments</b>	<b>on Credit</b>
				<b>Swaps</b>
Balance, beginning of period	\$ 7,021	\$ (713,613)	\$ 9,657	\$ (368,739)
Realized losses				4,876
Unrealized gains (losses)	(239)	167,385	(2,999)	(182,365)
Purchases, sales, issuances and settlements			124	
Transfers in and/or out of Level 3, net				
Balance, end of period	\$ 6,782	\$ (546,228)	\$ 6,782	\$ (546,228)

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Realized and unrealized gains and losses on Level 3 liabilities (unrealized loss on credit swaps) are included in net credit swap revenue (loss) in the condensed consolidated statements of operations. The above reconciliation does not include credit swap premiums collected during the period. Unrealized gains and losses on Level 3 assets (available-for-sale investments) are recorded in accumulated other comprehensive loss, which is a component of shareholders' equity on the condensed consolidated statements of financial condition.

***Fair Value Option***

Effective January 1, 2008, SFAS No. 159 provides a fair value option election that allows companies to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and liabilities, with changes in fair value recognized in earnings as they occur. SFAS No. 159 permits the fair value option election on an instrument by instrument basis at initial recognition of an eligible asset or eligible liability, that otherwise not accounted for at fair value under other accounting standards. Upon adoption of SFAS No. 159, the Company did not elect the fair value option on any of its existing eligible financial assets and liabilities. Subsequent to the adoption of SFAS No. 159, the Company will consider and may elect fair value option for eligible items that arise from new transactions or events.

**6. Credit Events CDS on ABS**

On January 30, 2008, S&P announced a change in their ratings methodology and assumptions relating to CDOs and other structured products, including certain asset backed securities (ABS). As a result of these changes, the S&P ratings on six residential mortgage backed securities referenced by credit default swaps written by Primus Financial were downgraded to CCC (S&P) or below.

Under the terms of our agreements governing the credit swaps on ABS, a downgrade of the underlying ABS securities to CCC/Caa2 (S&P/Moody's) or below is considered a defined credit event. Upon the occurrence of a defined credit event, a counterparty to the credit swap has the right to present the underlying ABS, in whole or in part, to Primus Financial in exchange for the cash notional value of the credit swap corresponding to the face amount of the securities presented (Physical Settlement). If, following a defined credit event, no Physical Settlement occurs, a counterparty may make a loss claim up to the cash notional value of the credit swap, in the event of a principal write-down event, if any (Pay-As-You-Go). A principal write-down event occurs when the ABS servicer determines that there is insufficient collateral to pay a portion or all of the face value of the underlying securities. Any principal write-down claims by a counterparty will be paid by Primus Financial up to the notional amount of the credit default swap.

During the six months ended June 30, 2008, of the six ABS credit swaps which were downgraded to CCC (S&P) or below, one counterparty has physically settled by delivering to Primus Financial an ABS with \$5.0 million face amount and Primus Financial paid \$5.0 million to the counterparty. That swap was terminated as a result of the Physical Settlement and Primus Financial will no longer receive swap premiums from the counterparty. As the owner of the ABS, Primus Financial is entitled to receive payments of principal and interest thereon. At June 30, 2008, the notional principal amount and the fair values of the remaining five credit swaps, which were downgraded to CCC (S&P) were \$40.0 million and \$(31.4) million, respectively. At June 30, 2008, the notional principal amount and the fair values on credit swaps sold on ABS, which had not been downgraded to CCC/Caa2 (S&P/Moody's) or below was \$35.0 million and \$(25.8) million, respectively. During the second quarter of 2008, there were no further credit events or payments made related to any principal write-down claims on credit swaps sold on ABS.

**Table of Contents****7. Restructuring**

During the fourth quarter of 2007, the Company decided to discontinue Harrier, due in part to Harrier's performance and difficulty in raising third-party capital, given the market environment at that time. As a result of this decision, in the fourth quarter of 2007, the Company recorded restructuring costs of \$3.0 million. Of the total restructuring costs, approximately \$2.2 million was in connection with the write-off of certain software and technology assets and approximately \$0.8 million related to net costs of employee termination benefits.

At December 31, 2007, the balance of restructuring liabilities was approximately \$1.7 million, which consisted entirely of payments for employee termination benefits. All employee termination benefits were paid by the end of the first quarter of 2008.

**8. Earnings (Loss) per Share**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Net earnings (loss) available to common shareholders	\$ 262,603	\$ (21,516)	\$ (407,475)	\$ (31,234)
Weighted-average basic shares outstanding	45,225	45,012	45,166	44,588
<b>Effect of dilutive instruments</b>				
Share options				
Restricted share units		181		
Warrants				
Dilutive potential shares		181		
Weighted-average diluted shares	45,406	45,012	45,166	44,588
Basic EPS	\$ 5.81	\$ (0.48)	\$ (9.02)	\$ (0.70)
Diluted EPS	\$ 5.78	\$ (0.48)	\$ (9.02)	\$ (0.70)



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For the three months ended June 30, 2008 and 2007, approximately 1.6 million shares and 1.9 million shares, respectively, were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented.

For the six months ended June 30, 2008 and 2007, approximately 2.7 million shares and 1.3 million shares, respectively, were not included in the computation of diluted EPS because to do so would have been anti-dilutive for the periods presented.

**9. Share-Based Compensation**

The Company accounts for share-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment* ( SFAS No. 123(R) ). SFAS No. 123(R) requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including share options and other forms of equity compensation based on estimated fair values.

Compensation expense is recognized based on the fair value of share options, performance shares, restricted shares and restricted share units ( RSU ) as determined on the date of grant and is being expensed over the related vesting periods. The fair value of the share options granted is determined using the Black-Scholes option-pricing model. Upon the adoption of SFAS No. 123(R), the Company continues to apply the Black-Scholes option-pricing model for determining the estimated fair value for share-based payment awards as it deems it to be the most appropriate model. The use of the Black-Scholes option-pricing model requires certain estimates for values of variables used in the model. The fair value of each share option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The Company did not grant any share options during the three and six months ended June 30, 2008.

The following table is a summary of share options activity for the six months ended June 30, 2008:

	<b>June 30, 2008</b>	
	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding at December 31, 2007	1,311,624	\$ 11.61
Granted		\$
Exercised		\$
Forfeited	(63,725)	\$ 11.87
Outstanding at June 30, 2008	1,247,899	\$ 11.60
Exercisable at June 30, 2008	602,700	\$ 11.23

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The following table summarizes the status of the Company's share options as of June 30, 2008:

Range of Exercise Prices	Share Options Outstanding			Share Options Exercisable	
	Number of Shares	Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$0.00 - \$6.94	65,625	4.6	\$ 6.94	65,625	\$ 6.94
\$6.95 - \$9.76	113,125	5.6	\$ 9.76	113,125	\$ 9.76
\$9.77 - \$13.50	1,069,149	5.0	\$ 12.08	423,950	\$ 12.29
Total	1,247,899			602,700	

The Company recorded share compensation expense, which includes share options and RSUs, of approximately \$2.6 million and \$2.2 million during the six months ended June 30, 2008 and 2007, respectively. Share compensation expense is included in compensation and employee benefits in the condensed consolidated statements of operations. As of June 30, 2008, total unrecognized share-based compensation expense related to nonvested share awards was \$8.8 million. This expense is expected to be recognized over a weighted average period of 1.4 years.

**10. Comprehensive Income (Loss) and Accumulated Other Comprehensive Loss**

Comprehensive income (loss) for the three and six months ended June 30, 2008 and 2007 is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Net income (loss)	\$ 262,603	\$ (21,516)	\$ (407,475)	\$ (31,234)
Foreign currency translation adjustments	(15)	(10)	(61)	(5)
Change in net unrealized gains (losses) on available-for-sale investments	(1,103)	(438)	(2,379)	208
Total comprehensive income (loss)	\$ 261,485	\$ (21,964)	\$ (409,915)	\$ (31,031)

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The following table summarizes the components of accumulated other comprehensive loss at June 30, 2008 and December 31, 2007 (in thousands):

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
Balance at beginning of period	\$ (4,712)	\$ (2,375)
Foreign currency translation adjustments	(61)	(18)
Change in net unrealized losses on available-for-sale investments	(2,379)	(2,319)
Balance at end of period	\$ (7,152)	\$ (4,712)

**Table of Contents****Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

**Business Overview**

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

*Primus Financial*

Primus Financial is a CDPC with AAA/Aaa (S&P/Moody's) ratings. It is a seller of credit swaps to banks and credit swap dealers, referred to as counterparties, against primarily investment grade credit obligations of corporate and sovereign issuers. In exchange for a fixed quarterly premium, Primus Financial agrees, upon the occurrence of a default or other defined credit event (e.g., bankruptcy, failure to pay or restructuring) affecting a designated issuer, referred to as a Reference Entity, to pay its counterparty an agreed upon notional amount against delivery to Primus Financial of the Reference Entity's debt obligation in the same notional amount. Credit swaps related to a single specified Reference Entity are referred to as single name credit swaps. Primus Financial seeks to minimize the risk inherent in its credit swap portfolio by maintaining a high quality, highly diversified credit swap portfolio across Reference Entities, industries, countries and rating grades. Primus Financial monitors the credit worthiness of Reference Entities in its credit swap portfolio on an ongoing basis. As part of the risk management process, Primus Financial strives to take pro-active risk mitigation actions.

In establishing business relationships, Primus Financial's swap counterparties prior to entering into a credit swap, generally analyze our financial condition and establish credit limits. Counterparties monitor the appropriateness of these limits on an ongoing basis in order to limit their risk that Primus Financial will not be able to meet its obligations. In turn, Primus Financial manages its counterparty credit risk by selecting counterparties we believe to be financially strong, by performing ongoing assessment of their credit worthiness and by establishing and managing to prudent credit limits.

Primus Financial also sells credit swaps referencing portfolios containing obligations of multiple Reference Entities, which are referred to as tranches and sells credit swaps referencing residential mortgage-backed securities, which are referred to as ABS. Defined credit events related to ABS may include any or all of the following: failure to pay principal, write-down in the reference obligation and downgrades to CCC/Caa2 (S&P/Moody's) or below of the reference obligation.

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At June 30, 2008, Primus Financial's credit swap portfolio was \$24.2 billion, which includes \$19.1 billion of single name credit swaps, \$5.0 billion of tranches and \$75.0 million of credit swaps on ABS.

*Primus Asset Management*

Primus Asset Management acts as an investment manager to affiliated companies and third party entities. It currently manages the credit swap and cash investment portfolios of its affiliate, Primus Financial. Primus Asset Management currently manages two CLOs. A CLO issues securities backed by a diversified pool of primarily below investment grade rated senior secured loans of corporations. Additionally, Primus Asset Management manages three investment grade collateralized swap obligations (CSOs), on behalf of third parties. A CSO issues securities backed by one or more credit swaps sold against a diversified pool of investment grade corporate or sovereign reference entities. Primus Asset Management receives fees for its investment management services on the five investment vehicles. In general, such management fees are calculated based on percentage of assets under management, subject to applicable contractual terms. As of June 30, 2008, CLO and CSO assets under management were approximately \$1.5 billion. Primus Asset Management has entered into a Services Agreement with its affiliates, whereby it provides services to its affiliates including management, consulting and information technology.

*PRS Trading Strategies/Harrier*

As of December 31, 2007, PRS Trading was inactive, therefore, comparisons from the prior year are not meaningful. As of March 31, 2008, Harrier ceased trading activities and closed all of its remaining trading positions.

***Net Credit Swap Revenue (Loss)***

During the second quarter of 2008, we recorded net credit swap revenue of \$271.0 million. This was the result of a slight tightening of market credit swap premium levels and a favorable nonperformance risk adjustment under SFAS No. 157. Changes in the fair value of our credit swap portfolio are a function of the notional amount and composition of the portfolio and prevailing market credit swap premiums for comparable credit swaps. In our experience, considerable fluctuations may occur in the fair values of credit swaps from period to period and, as a result, the reader of our financial statements should not infer future results from historical net credit swap revenues or losses.

Net credit swap revenue (loss) in our condensed consolidated statements of operations, comprises the premiums earned and expensed on credit swaps, gains or losses realized as a result of the termination of credit swaps and changes in the fair value of our credit swaps. Primus Financial generally sells credit swaps in order to earn premium income over the tenor of the contract, generally five years. We receive premium income from the credit swaps we sell. In general, premiums are received quarterly in arrears and are accrued daily into income.

In accordance with GAAP, we carry our credit swaps on our consolidated statements of financial condition at their fair value. Changes in the fair value of our credit swap portfolio are included as a component of net credit swap revenue in our condensed consolidated statements of operations. If a credit swap has an increase or decline in fair value during a period, the increase will add to our net credit swap revenue and the decline will subtract from our net credit swap revenue for that period.

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Primus Financial enters into ISDA Master Agreements with its counterparties and aggregates its transactions on a counterparty basis for presentation in our condensed consolidated statements of financial condition. If the aggregate total of fair values for a counterparty is a net gain, the total is recorded as a component of unrealized gains on credit swaps, at fair value, in our condensed consolidated statements of financial condition. If the aggregate total of fair values for a counterparty is a net loss, the total is recorded as a component of unrealized losses on credit swaps, at fair value, in our condensed consolidated statements of financial condition.

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

Terminations of credit swaps prior to maturity may generate realized gains or losses.

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

Second, we may elect to terminate a transaction for reasons other than credit considerations. Terminations of this type may generate realized gains or losses. In making a decision to terminate a transaction for reasons other than credit considerations, we consider a number of different factors, including our view as to whether the capital dedicated to the position could be profitably reallocated to other opportunities over a short time horizon, the total size of our portfolio in relation to our capital and the total size of our swap positions and exposures with a particular counterparty. We refer to terminations effected under these circumstances as *resizing* or *rebalancing*. Since inception, we have terminated less than 9% of the notional amount of credit swaps sold, based on resizing or rebalancing considerations.

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

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

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**Credit Event CDS on ABS**

On January 30, 2008, S&P announced a change in their ratings methodology and assumptions relating to CDOs and other structured products, including certain asset backed securities (ABS). As a result of these changes, the S&P ratings on six residential mortgage backed securities referenced by credit default swaps written by Primus Financial were downgraded to CCC (S&P) or below.

Under the terms of our agreements governing the credit swaps on ABS, a downgrade of the underlying ABS securities to CCC/Caa2 (S&P/Moody s) or below is considered a defined credit event. Upon the occurrence of a defined credit event, a counterparty to the credit swap has the right to present the underlying ABS, in whole or in part, to Primus Financial in exchange for the cash notional value of the credit swap corresponding to the face amount of the securities presented ( Physical Settlement ). If, following a defined credit event, no Physical Settlement occurs, a counterparty may make a loss claim up to the cash notional value of the credit swap, in the event of a principal write-down event, if any ( Pay-As-You-Go ). A principal write-down event occurs when the