Armour Residential REIT, Inc.
Form S-11/A
June 09, 2010

As filed with the Securities and Exchange Commission on June 9, 2010

Registration Statement No. 333-166847

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 2 TO

FORM S-11

FOR REGISTRATION

UNDER THE SECURITIES ACT OF 1933

OF SECURITIES OF CERTAIN REAL ESTATE COMPANIES

ARMOUR Residential REIT, Inc.

(Exact Name of Registrant as Specified in Its Charter)

956 Beachland Blvd., Suite 11

Vero Beach, FL 32963

(772) 617-4340

(Address, Including Zip Code, and Telephone Number, Including

Area Code, of Registrant's Principal Executive Offices)

Scott J. Ulm

Co-Chief Executive Officer

956 Beachland Blvd., Suite 11

Vero Beach, FL 32963

(772) 617-4340

(Name, Address, Including Zip Code, and Telephone Number,

Including Area Code, of Agent for Service)

Copies to:

Bradley D. Houser
Akerman Senterfitt
One S.E. Third Avenue, 25th Floor
Miami, Florida 33131
(305) 374-5600
Facsimile: (305) 374-5095

David Alan Miller
Brian L. Ross
Jeffrey M. Gallant
Graubard Miller
405 Lexington Avenue
New York, New York 10174
(212) 818-8800

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this registration statement.

If any of the Securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box: o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

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	o	Accelerated filer	o
Non-accelerated filer (Do not check if a smaller reporting company)	þ	Smaller reporting company	o

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the commission, acting pursuant to said Section 8(a), may determine.

The information in this preliminary prospectus is not complete and may be changed. The issuer shall not sell these securities until the registration statement filed with the Securities and Exchange Commission is declared effective. This preliminary prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion, Dated June 9, 2010

Preliminary Prospectus

7,000,000 Shares

Common Stock

We are selling 7,000,000 shares of common stock.

Our common stock and warrants are currently quoted on the Over-the-Counter Bulletin Board (OTC Bulletin Board) under the symbols AMRR and AMRRW, respectively. The closing price of our common stock on the OTC Bulletin Board on June 4, 2010 was $7.09 per share. Our common stock and warrants have been approved for listing on the NYSE Amex, LLC, or NYSE Amex, under the symbols ARR and ARR.WS, respectively, subject to official notice of issuance.

The underwriters have a 45-day option to purchase a maximum of 1,050,000 additional shares to cover over-allotments of shares, if any.

Certain of our officers, directors and employees may participate in this offering on the same terms as the public.

We intend to elect to be taxed as a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our taxable year ended December 31, 2009. To assist us in qualifying as a REIT, among other purposes, stockholders are generally restricted under our charter from beneficially owning more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock. In addition, our charter contains various other restrictions on the ownership and transfer of our common stock. See *Description of Securities Restrictions on Ownership and Transfer.*

Investing in our common stock involves risks. See Risk Factors on page 8.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Price to Public	Underwriting Discounts and Commissions	Proceeds to Us
Per Share	$	$	$
Total	$	$	$

We are offering the shares of common stock for sale on a firm commitment basis. Ladenburg Thalmann & Co. Inc., the representative of the underwriters in this offering, expects to deliver the shares of common stock to investors in the offering on or about , 2010.

Joint Bookrunning Managers

Ladenburg Thalmann & Co. Inc. **Macquarie Capital**

I-Bankers Securities, Inc. **Maxim Group LLC** **National Securities Corporation**

The date of this prospectus is , 2010.

TABLE OF CONTENTS

PROSPECTUS SUMMARY	1
RISK FACTORS	8
SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS	23
USE OF PROCEEDS	24
PUBLIC MARKET FOR OUR SECURITIES	25
DIVIDEND POLICY	26
CAPITALIZATION	27
SELECTED FINANCIAL AND OTHER DATA	28
MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	30
BUSINESS	45
MANAGEMENT	54
OUR MANAGER AND THE MANAGEMENT AGREEMENT	60
BENEFICIAL OWNERSHIP OF SECURITIES	68
CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS	71
DESCRIPTION OF SECURITIES	72
CERTAIN PROVISIONS OF THE MARYLAND GENERAL CORPORATION LAW AND OUR CHARTER AND BYLAWS	78
U.S. FEDERAL INCOME TAX CONSIDERATIONS	82
UNDERWRITING	99
LEGAL MATTERS	101
EXPERTS	101
WHERE YOU CAN FIND MORE INFORMATION	101

You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with information that is different. This document may only be used where it is legal to sell these securities. The information in this document may only be accurate on the date of this document.

PROSPECTUS SUMMARY

This summary highlights the material information contained in this prospectus. It does not contain all of the information that you should consider before investing in our common stock. You should read carefully the more detailed information set forth under Risk Factors and the other information included in this prospectus. Except where the context suggests otherwise, references to we , us , ARMOUR or the Company are to ARMOUR Residential REIT Inc. Except as otherwise indicated, the information in this prospectus assumes no exercise of the underwriters' overallotment option.

Overview

We are a Maryland corporation that intends to elect to be a real estate investment trust, or REIT, for U.S. federal income tax purposes, commencing with our fiscal year ended December 31, 2009. We are externally managed by ARMOUR Residential Management LLC, or ARRM, an entity affiliated with our executive officers. We invest primarily in hybrid adjustable rate, adjustable rate and fixed rate residential mortgage-backed securities, or RMBS, issued or guaranteed by U.S. Government-chartered entities, which we refer to as Agency Securities. The entities issuing or guaranteeing the Agency Securities include:

.

the Federal National Mortgage Association, commonly known as Fannie Mae;

.

the Federal Home Loan Mortgage Corporation, commonly known as Freddie Mac; and

.

the Government National Mortgage Administration, commonly known as Ginnie Mae.

From time to time, a portion of our portfolio may be invested in unsecured notes and bonds issued by U.S. Government-chartered entities, which we refer to as Agency Debt. Agency Debt includes:

.

U.S. Treasuries; and

.

money market instruments.

We seek attractive long-term investment returns by investing our equity capital and borrowed funds in our targeted asset class. We earn returns on the spread between the yield on our assets and our costs, including the interest cost of the funds we borrow, after giving effect to our hedges.

When acquiring Agency Securities, we typically finance our acquisitions with borrowings under a series of short-term repurchase agreements at the most competitive interest rates available to us and then cost-effectively mitigate our interest rate and other risks based on our entire portfolio of assets, liabilities and derivatives and our management's view of the market. Successful implementation of this approach requires us to address and effectively mitigate interest rate risk and maintain adequate liquidity.

Our Manager

We are externally managed by ARRM, a Delaware limited liability company, pursuant to a management agreement between us and ARRM. As an externally-managed company, we depend on the diligence, experience and skill of ARRM for the selection, acquisition, structuring, interest rate risk mitigation and monitoring of our Agency Securities, Agency Debt and associated borrowings. We do not have any employees whom we compensate directly with salaries or other compensation. ARRM currently has four full-time employees.

The management agreement requires ARRM to manage our business affairs in conformity with certain restrictions contained therein, including any material operating policies adopted by us. ARRM's role as manager is subject to the direction and oversight of our board of directors. ARRM is responsible for:

.

advising us with respect to, arranging for, and managing the acquisition, financing, management and disposition of, our investments;

.

evaluating the duration and prepayment risk of our investments and arranging borrowing and interest rate risk mitigation strategies; and

.

coordinating our capital raising activities.

In conducting these activities, ARRM also advises us on the formulation of, and implements, our operating strategies and policies, arranges for our acquisition of assets, monitors the performance of our assets, arranges for various types of financing and interest rate risk mitigation strategies, and provides administrative and managerial services in connection with our day-to-day operations, as may be required from time to time for our management and our assets (other than assets solely being managed by any other manager).

Management Agreement

Pursuant to the management agreement, as amended, ARRM is entitled to receive a monthly management fee equal to 1/12th of 1% of gross equity raised (including initial gross merger equity as well as any future gross equity raised) until gross equity raised is $50 million, inclusive of gross merger equity. Thereafter, the management fee shall be 1/12th of (a) 1.5% of gross equity raised up to $1 billion and (b) 0.75% of gross equity raised in excess of $1 billion, with a monthly minimum based on 1/12th of $900,000 (inclusive of the original gross merger equity).

We pay all of our and ARRM's costs and expenses (including for goods and services obtained from third parties) incurred solely on behalf of us or any subsidiary or in connection with the management agreement, except for expenses related to the employment of ARRM personnel, rent, telephone, utilities, equipment and other office and internal and overhead expenses of ARRM required for our day to day operations.

The management agreement became effective in November 2009 and has an initial term of five years. Following the initial term, the management agreement automatically renews for successive one-year renewal terms unless we or ARRM give notice to the other of its intent not to renew the agreement 180 days prior to the expiration of the initial term or any renewal term, as applicable.

For more information on our management agreement with ARRM, including further details on the definition of gross equity raised, please see the section of this prospectus entitled *Our Manager and the Management Agreement*.

Our Assets

Since commencing operations, our assets have been invested primarily in Agency Securities. As of March 31, 2010, our Agency Security portfolio, including both trades that had settled and forward settling trades that we had committed to settle, consisted of approximately $180.4 million, in market value, of Agency Securities with initial fixed-interest rate periods of three years, five years, seven years, ten years and 15 years.

Our Borrowings

We borrow against our Agency Securities using repurchase agreements. These borrowings generally have maturities that range from one month or less to up to one year, although occasionally we may enter into longer dated borrowing agreements to more closely match the rate adjustment period of the securities we own. Our total repurchase indebtedness was approximately $168.5 million at March 31, 2010, and had a weighted average maturity of 44 days. Depending on market conditions, we may enter into additional repurchase arrangements with similar longer-term maturities or a committed borrowing facility. Our borrowings are generally between six and ten times the amount of our stockholders' equity, but we are not limited to that range. The level of our borrowings may vary periodically depending on market conditions. Despite recent credit market developments and prevailing trends, we believe Agency Securities will continue to be eligible for financing in the repurchase agreement market.

Our Interest Rate Risk Mitigation

Our interest rate risk mitigation strategies are designed to reduce the impact on our income caused by the potential adverse effects of changes in interest rates on our assets and liabilities. Subject to complying with REIT requirements, we use derivative instruments to mitigate the risk of adverse changes in interest rates on the value of our assets as well as the differences between the interest rate adjustments on our assets and borrowings. These strategies primarily consist of purchasing or selling futures contracts and may also include entering into interest rate swap agreements, interest rate cap or floor agreements, purchasing put and call options on securities or securities underlying futures contracts, or entering into forward rate agreements. Although we are not legally bound to use interest rate risk mitigation strategies, we intend to limit our use of derivative instruments to only those techniques described above and to enter into derivative transactions only with counterparties that we believe have a strong credit rating to help mitigate the risk of counterparty default or insolvency. These transactions are entered into solely for the purpose of mitigating interest rate and prepayment risk. Since we will not qualify for hedge accounting treatment as prescribed by U.S. generally accepted accounting principles, or GAAP, our operating results may reflect greater volatility than otherwise would be the case, because gains or losses on the derivative instruments may not be offset by changes in the fair values or cash flows of the related investment or borrowing transactions within the same accounting period, or ever.

Our Strategy and Competitive Advantages

Our objective is to realize attractive risk-adjusted returns to our stockholders over the long-term through selective acquisition of Agency Securities combined with strategic applications of leverage management, risk management and interest rate management strategies. We believe we possess the core strengths that will enable us to realize our objectives and provide us with competitive advantages in the marketplace. Our core strengths include:

Significant Experience of Our Management Team

We believe that the extensive experience of our management team at ARRM provides us with significant expertise across our target assets. Scott Ulm and Jeffrey Zimmer, our Co-Chief Executive Officers, have extensive experience in favorable and unfavorable economic cycles and in securities trading, interest rate risk mitigation, asset/liability management and analysis and leveraged mortgage finance.

The senior members of our research and investment team have an aggregate of 48 years of experience in mortgage-backed securities investing, including experience in performing advisory services for investment banks, funds, other investment vehicles and other managed and discretionary accounts. Mr. Ulm has 23 years of structured finance and debt capital markets experience, including mortgage-backed securities. Mr. Ulm has advised numerous U.S., European and Asian financial institutions and corporations on balance sheet and capital raising matters. Mr. Zimmer has significant experience in the mortgage-backed securities market over a 25 year period. See the sections of this prospectus entitled *Manager* and *Business-Prior Experience of Executive Managing Agency Securities Portfolio* for more information.

Disciplined Relative Value Investment Approach

We follow a disciplined security selection process and are, in essence, a relative value investor in Agency Securities. ARRM uses a cross-product approach, conducting top-down market assessments with respect to various subsets of the Agency Securities market in order to identify the most attractive segments and investment opportunities consistent with our portfolio objectives and risk management strategy. In employing this detailed analysis, ARRM seeks to identify the best values available in Agency Securities. We select our Agency Securities based on extensive analysis including factors such as prepayment trends, average remaining life, amortization schedules, fixed versus floating interest rates, geographic concentration, property type, loan-to-value ratios and credit scores. Considering the large size of the Agency Securities market, we believe we can be very selective with our investments and buy only the securities we deem to be the most attractive.

Portfolio Construction

We anticipate that returns to our stockholders will be realized over the long-term primarily through the distribution of dividends and secondarily through capital appreciation. We intend to realize returns to our investors by constructing a well-balanced portfolio consisting primarily of shorter duration Agency Securities with a focus on managing various associated risks, including interest rate, prepayment, and financing risk. ARRM uses its fixed income expertise across the range of asset classes within the Agency Securities markets to build a portfolio that seeks to balance income, cash, capital, leverage and the aforementioned risks. Through the careful and disciplined selection of assets, and continual portfolio monitoring, we believe we can build and maintain an investment portfolio that provides value to stockholders over time, both in absolute terms and relative to other Agency Securities portfolios.

Analytical Tools, Infrastructure and Expertise

ARRM's experienced investment team constructs and manages our Agency Securities investment portfolio through the use of focused qualitative and quantitative analysis, which helps us manage risk on a security-by-security and portfolio basis. We rely on a variety of analytical tools and models to assess our investments and risk management.

We focus on in-depth analysis of the numerous factors that influence our target assets, including:

- fundamental market and sector review;
- cash flow analysis;
- controlled risk exposure; and
- prudent balance sheet management.

We also use these tools to guide the interest rate risk mitigation strategies developed by ARRM to the extent consistent with the requirements for qualification as a REIT.

Extensive Strategic Relationships and Experience of ARRM

ARRM maintains extensive relationships with financial intermediaries including prime brokers, investment banks, broker-dealers and asset custodians. We believe these relationships enhance our ability to source, finance, protect and mitigate the interest rate risk on our investments and, thus, enable us to succeed in various credit and interest rate environments. ARRM s management has many years of experience and well-established contacts within the Agency Securities, capital and financing markets, and are able to bring their personal relationships to bear for our benefit and the benefit of our stockholders.

Operating and Regulatory Structure

REIT Qualification

We intend to elect to qualify and be taxed as a REIT under the Internal Revenue Code, or the Code upon filing of our 2009 federal income tax return. We believe that we are organized in conformity with the requirements for qualification as a REIT under the Code and that following consummation of this offering our manner of operations and corporate structure and stockholder ownership will enable us to meet on a continuing basis the requirements for taxation as a REIT for federal income tax purposes. As a REIT, we will generally not be subject to federal income tax on the REIT taxable income that we distribute to our stockholders currently. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to federal income tax at regular corporate rates. Even if we qualify as a REIT for federal income tax purposes, we may still be subject to some federal, state and local taxes on our income. For more information on the consequences to us of not satisfying the requirements for taxation as a REIT, see the section titled *Risk Factors*.

1940 Act Exemption

We conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended, or the 1940 Act. If we were to fall within the definition of an investment company, we would be unable to conduct our business as described in this prospectus. See *Risk Factors Loss of our 1940 Act exemption would adversely affect us...* .

Restrictions on Ownership of our Common Stock

To assist us in complying with the REIT limitations on the concentration of ownership imposed by the Code, among other purposes, our charter prohibits, with certain exceptions, any stockholder from beneficially or constructively owning, applying certain attribution rules under the Code (including deemed ownership of shares underlying warrants or options to purchase stock), more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock, or 9.8% by value or number of shares, whichever is more restrictive, of our outstanding capital stock. Our board of directors may, in its sole discretion, waive the 9.8% ownership limit in certain circumstances. Currently, there are holders of our capital stock and/or warrants whose ownership exceeds the thresholds set forth in our charter. We have either granted waivers or currently are in the process of granting waivers from the charter requirements for such holders where, based on representations, covenants and agreements received from such holders, we determine that such waivers would not jeopardize our status as a REIT.

For more information on our operating and regulatory structure, see the section of this prospectus entitled *Business Operating and Regulatory Structure*.

Dividend Policy

In order to maintain our qualification as a REIT for U.S. federal income tax purposes, we are required to distribute at least 90% of our annual REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. Accordingly, we intend to pay regular quarterly dividends of all or substantially all of our taxable income to holders of our common stock out of assets legally available for such purposes. We are not restricted from using the proceeds of equity or debt offerings to pay dividends, but we do not intend to do so. The timing and amount of any dividends we pay to holders of our common stock will be at the discretion of our board of directors and will depend upon various factors, including our earnings and financial condition, maintenance of REIT status, applicable provisions of the Maryland General Corporation Law, or MGCL, and such other factors as our board of directors deems relevant.

Summary Risk Factors

An investment in our common stock involves various risks. You should consider carefully the risks discussed below and under the heading *Risk Factors* beginning on page 8 of this prospectus before purchasing our common stock. If any of the following risks occur, our business, financial condition or results of operations could be materially and adversely affected. In that case, the trading price of our securities could decline, and you may lose some or all of your investment.

.

We have a limited operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

.

Our failure to qualify as a REIT would subject us to federal income tax as a regular corporation and potentially increased state and local taxes, thereby reducing the amount of cash available for distribution to our stockholders.

.

Continued adverse developments in the global capital markets, including defaults, credit losses and liquidity concerns, as well as mergers, acquisitions or bankruptcies of potential repurchase agreement counterparties, could make it difficult for us to borrow money to acquire Agency Securities on a leveraged basis, on favorable terms, or at all, which could adversely affect our profitability.

.

Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency Securities in which we invest.

.

Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

.

Our use of derivative instruments may expose us to counterparty risk.

.

We may incur increased borrowing costs related to repurchase agreements which could harm our results of operations.

.

Rapid changes in the values of our target assets may make it more difficult for us to maintain our qualification as a REIT or our exemption from the 1940 Act.

.

We depend on ARRM and particularly key personnel including Messrs. Ulm and Zimmer. The loss of those key personnel could severely and detrimentally affect our operations.

.

There are conflicts of interest in our relationship with ARRM and its affiliates, which could result in decisions that are not in the best interests of our stockholders or warrant holders.

Corporate Information

We were incorporated in the state of Maryland on February 5, 2008. On November 1, 2009, we consummated a business combination with Enterprise Acquisition Corp., a publicly traded blank check company formed for the purposes of acquiring an operating business. As a result of this transaction, which we refer to as the Business Combination, we became a publicly traded company.

Our principal offices are located at 956 Beachland Blvd., Suite 11, Vero Beach, Florida 32963. Our phone number is (772) 617-4340. Our website is www.ARMOURREIT.com. The contents of our website are not a part of this prospectus. The information on our website is not intended to form a part of or be incorporated by reference into this prospectus.

The Offering

Common Stock Offered By Us

7,000,000 shares (plus up to an additional 1,050,000 shares of our common stock that we may issue and sell upon the exercise of the underwriters' over-allotment option). Certain of our officers, directors and employees may participate in the offering on the same terms as the public.

Common stock to be outstanding after this Offering

9,304,054 shares

We also have outstanding redeemable warrants to purchase an aggregate of 32,500,000 shares of our common stock that are currently exercisable through November 7, 2013 at an exercise price of $11.00 per share. These warrants likely will be exercised if the market price of the shares of our common stock equals or exceeds the warrant exercise price.

Use of Proceeds

We plan to use all of the net proceeds from this offering to acquire additional target assets, principally Agency Securities and Agency Debt, in accordance with our objectives and strategies described in this prospectus. See *Use of Proceeds.*

Dividend Policy

We intend to continue to make regular quarterly cash distributions to holders of our common stock consistent with maintaining our REIT qualification for U.S. federal income tax law purposes. On November 5, 2009, we declared a dividend of $0.13 per share of common stock to stockholders of record as of October 5, 2009 and we paid the dividend in December 2009 and January 2010. On March 5, 2010, we declared a dividend of $0.40 per share of common stock to stockholders of record as of March 15, 2010, and we paid the dividend on April 29, 2010. On May 25, 2010, we declared a dividend of $0.40 per share of common stock to stockholders of record on June 3, 2010, which we will pay on July 29, 2010. For more information, see *Dividend Policy.*

Listing

Our common stock and warrants are currently quoted on the OTC Bulletin Board under the symbols AMRR and AMRRW, respectively. Our common stock and warrants have been approved for listing on the NYSE Amex, LLC, or NYSE Amex, under the symbols ARR and ARR.WS, respectively, subject to official notice of issuance.

Ownership Restrictions

To assist us in qualifying as a REIT, ownership of shares of our common stock by any person is limited, with certain exceptions, to 9.8% by value or by number of shares, whichever is more restrictive, of our outstanding shares of

	common stock and 9.8% by value or by number of shares, whichever is more restrictive, of our outstanding capital stock. Our charter also provides for certain other ownership restrictions. For more information on our operating and regulatory structure, see the section of this prospectus entitled *Business Operating and Regulatory Structure*.
Risk Factors	Investing in our common stock involves risks. You should carefully read and consider the information set forth under the heading *Risk Factors* beginning on page 8 of this prospectus and all other information in this prospectus before investing in our common stock.

Summary Selected Financial And Other Data

The following table sets forth selected historical financial information derived from our unaudited financial statements for the quarter ended March 31, 2010 and our audited financial statements for the years ended December 31, 2009 and 2008. The following data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements including the notes thereto, included elsewhere in this prospectus. The financial data below, including the results of operations and key portfolio statistics for periods prior to the Business Combination are those of Enterprise Acquisition Corp., or Enterprise, and its investment strategy which differed significantly from our current operations.

	March 31, 2010 (unaudited)	**December 31, 2009**	**December 31, 2008**
Balance Sheet Data:			
Total Assets	$ 191,640,680	$ 126,693,608	$ 250,189,469
Repurchase Agreements	168,525,093	46,288,602	-
Payable for unsettled securities	-	58,559,479	-

	Quarter Ended **March 31, 2010** (unaudited)	**Year Ended** **December 31, 2009**	**Year Ended** **December 31, 2008**
Statement of Operations and Per Share Data:			
Interest income, net of premium amortization	$ 1,108,138	$ 446,598	$ 5,425,560
Interest expense	(120,646)	(14,153)	-
Net interest income	987,492	432,445	5,425,560
Change in fair value of interest rate contracts	(603,579)	-	-
Gain on sale of agency securities	208,199	-	-
Total net revenues	592,112	432,445	5,425,560
Operating expenses	283,879	2,026,925	2,309,375
Net income (loss)	$ 305,833	$ (1,149,427)	$ 1,074,435
Net income (loss) per share	$ 0.13	$ (0.11)	$ (0.02)
Weighted average shares outstanding	2,304,054	20,456,664	23,750,001
Cash dividends declared per share	$ 0.40	$ 0.09	$ -
Book value per share (1)	$ 9.30	$ 9.33	$ 5.32
Key Portfolio Statistics*			
Average Agency Securities (2)	$ 144,822,902	$ 10,670,293	$ -
Average Repurchase Agreements (3)	$ 132,411,377	$ 5,531,886	$ -
Average Equity (4)	$ 21,417,725	$ 21,491,094	$ -
Average Portfolio Yield (5)	3.06%	4.59%	-
Average Cost of Funds (6)	0.38%	0.72%	-
Interest Rate Spread (7)	2.68%	3.87%	-
Return on Average Equity (8)	1.43%	(0.80)%	-
Average Annual Portfolio Repayment Rate (9)	14.5%	8.6%	-
Debt to Equity *(at period end)* (10)	7:87:1	2:16:1	-
Debt to Additional Paid in Capital *(at period end) (11)*	7:44:1	2:22:1	-

* Average numbers for each period are weighted based on days on books and records. All percentages are annualized.

(1)

Book value per share was calculated by dividing total stockholders   equity by shares outstanding of 2,304,054, 2,304,054, and 31,250,000 at March 31, 2010, December 31, 2009, and December 31, 2008, respectively.

(2)

Our average investment in Agency Securities was calculated by dividing the sum of our daily Agency Securities investments during the period by the number of days in the period.

(3)

Our average balance outstanding under our repurchase agreements was calculated by dividing the sum of our daily outstanding balances under our repurchase agreements during the period by the number of days in the period.

(4)

Our average stockholders' equity was calculated by dividing the sum of our daily stockholders' equity during the year by the number of days in the period.

(5)

Our average portfolio yield was calculated by dividing our net interest income by our average Agency Securities or other investments.

(6)

Our average cost of funds was calculated by dividing our total interest expense (including interest rate risk mitigation) by our average borrowings.

(7)

Our interest rate spread was calculated by subtracting our average cost of funds from our average portfolio yield.

(8)

Our return on average equity was calculated by dividing net income by average equity.

(9)

Our average annual principal repayment rate was calculated by dividing our total principal payments received during the year (scheduled and unscheduled) by our average Agency Securities.

(10)

Our debt to equity ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by total stockholders' equity at period end.

(11)

Our debt to additional paid in capital ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by additional paid in capital at period end.

RISK FACTORS

An investment in our securities involves a high degree of risk. You should consider carefully the material risks described below, together with the other information contained in this prospectus, before making a decision to invest in our securities. If any of the following events occur, our business, financial condition and operating results may be materially adversely affected. In that event, the trading price of our securities could decline, and you could lose all or part of your investment. This prospectus also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of specific factors, including the risks described below.

Risks Related to Our Business

We have a limited operating history and may not be able to successfully operate our business or generate sufficient revenue to make or sustain distributions to our stockholders.

We were organized in 2008 and began investment activity in November 2009. We have a limited operating history on which to evaluate us and the past performance of ARRM and its key personnel should not be viewed as an indication of our future performance.

The results of our operations depend on many factors, including, without limitation:

- the availability of opportunities for the acquisition of attractively priced Agency Securities;
- the level and volatility of interest rates;
- the availability of readily accessible funding in the financial markets;
- our ability to cost-effectively hedge risks; and
- overall and general economic conditions.

We may not be able to maintain any agreements with our lenders on favorable terms or at all. Furthermore, we may not be able to operate our business successfully or implement our operating policies and strategies as described in this prospectus, which would harm our financial results and could result in the loss of some or all of your investment.

Continued adverse developments in the global capital markets, including defaults, credit losses and liquidity concerns, as well as mergers, acquisitions or bankruptcies of potential repurchase agreement counterparties, could make it difficult for us to borrow money to acquire Agency Securities on a leveraged basis, on favorable terms, or at all, which could adversely affect our profitability.

We rely on the availability of financing to acquire Agency Securities on a leveraged basis. Institutions from which we obtain financing may have invested in or financed mortgage-backed securities and other assets that have declined in value as a result of the recent downturn in the residential mortgage market, causing these institutions to suffer losses. If these conditions persist, these institutions may be forced to exit the repurchase market, become insolvent or further tighten their lending standards or increase the amount of equity capital or the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount required to obtain financing. Under such circumstances, it could be more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we were unable to obtain cost-effective financing for our investments.

While the overall financing environment has improved over the last twelve months, further credit losses or mergers, acquisitions, or bankruptcies of investment banks and commercial banks that have historically acted as repurchase agreement counterparties may occur. This would result in a fewer number of potential repurchase agreement counterparties operating in the market and could potentially impact the pricing and availability of financing for our business.

Continued adverse developments in the residential mortgage market may adversely affect the value of the Agency Securities in which we invest.

During the past few years, the residential mortgage market in the United States has experienced a variety of difficulties and changed economic conditions that have adversely affected the performance and market value of the Agency Securities in which we invest. Agency Securities originated in 2006 and 2007 have experienced a higher and earlier than expected rate of delinquencies. Additionally, other earlier vintages of Agency Securities may not be performing as expected. As a result, the market for these securities may be adversely affected for a significant period of time.

Conditions within the market are being driven primarily by:

.

Delinquencies across a broad scope of mortgage loans that include subprime mortgage loans (loans that are made to borrowers with impaired credit), Alt-A mortgage loans (loans that are made to borrowers with limited documentation), and prime mortgage loans (loans that are made to borrowers with excellent credit who provide full documentation).

.

Declining housing prices and flattening of property values,

.

Resetting adjustable rate mortgages that result in increased mortgage payments, and

.

Constrained ability by borrowers to refinance or sell their properties.

While we intend to primarily invest in Agency Securities, rising levels of delinquencies could negatively affect the value of our Agency Securities or create market uncertainty about their true value. At the same time, market uncertainty about residential mortgages in general could depress the market for Agency Securities, making it more difficult for us to sell any Agency Securities we own on favorable terms or at all.

The federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government, may adversely affect our business.

The payments we receive on the Agency Securities in which we invest depend upon a steady stream of payments by borrowers on the underlying mortgages and the fulfillment of guarantees by Ginnie Mae, Fannie Mae and Freddie Mac. Ginnie Mae is part of a U.S. Government agency and its guarantees are backed by the full faith and credit of the United States. Fannie Mae and Freddie Mac are U.S. Government-sponsored entities, but their guarantees are not backed by the full faith and credit of the United States.

Since 2007, Fannie Mae and Freddie Mac have reported substantial losses and a need for substantial amounts of additional capital. In response to the deteriorating financial condition of Fannie Mae and Freddie Mac and the credit market disruption, Congress and the U.S. Treasury undertook a series of actions to stabilize these government-sponsored entities and the financial markets generally. The Housing and Economic Recovery Act of 2008 was signed into law on July 30, 2008, and established the Federal Housing Finance Agency, or FHFA, with enhanced regulatory authority over, among other things, the business activities of Fannie Mae and Freddie Mac and the size of their portfolio holdings. On September 7, 2008, FHFA placed Fannie Mae and Freddie Mac into federal conservatorship and, together with the U.S. Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and Agency Securities. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs the operations of Fannie Mae and Freddie Mac and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of the stockholders, the directors, and the officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator.

Although the federal government has committed capital to Fannie Mae and Freddie Mac, there can be no assurance that these credit facilities and other capital infusions will be adequate for their needs. If the financial support is inadequate, these companies could continue to suffer losses and could fail to honor their guarantees and other obligations. Shortly after Fannie Mae and Freddie Mac were placed in federal conservatorship, the U.S. Treasury Secretary suggested that the guarantee payment structure of Fannie Mae and Freddie Mac should be re-examined. The future roles of Fannie Mae and Freddie Mac could be significantly reduced and the nature of their guarantees could be eliminated or considerably limited relative to historical measurements. Any changes to the nature of the guarantees provided by Fannie Mae and Freddie Mac could redefine what constitutes an Agency Security and could have broad adverse market implications.

The problems faced by Fannie Mae and Freddie Mac resulting in their being placed into federal conservatorship have stirred debate among some federal policy makers regarding the continued role of the U.S. Government in providing liquidity for the residential mortgage market. For example, in late January 2010, the Chairman of the House Financial Services Committee announced that the House Financial Services Committee will be recommending abolishing Fannie Mae and Freddie Mac in their current form and establishing a new system of providing housing finance. Following expiration of the current authorization, each of Fannie Mae and Freddie Mac could be dissolved and the U.S. Government could decide to stop providing liquidity support of any kind to the mortgage market. If Fannie Mae or Freddie Mac were eliminated, or their structures were to change radically, we would not be able to acquire Agency Securities from these companies, which would drastically reduce the amount and type of Agency Securities available for investment, which are our only targeted investments.

Our income could be negatively affected in a number of ways depending on the manner in which related events unfold. For example, the current credit support provided by the U.S. Treasury to Fannie Mae and Freddie Mac, and any additional credit support it may provide in the future, could have the effect of lowering the interest rate we expect to receive from Agency Securities that we seek to acquire, thereby tightening the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio. A reduction in the supply of Agency Securities could also negatively affect the pricing of Agency Securities we seek to acquire by reducing the spread between the interest we earn on our portfolio of targeted assets and our cost of financing that portfolio.

In February 2010, Fannie Mae and Freddie Mac announced that they will be purchasing delinquent loans from mortgage pools guaranteed by them. Delinquent loans for this program will be those that are 120 days or greater delinquent as of the measurement date. Freddie Mac stated that it will be consummating all of its purchases at once, based on the delinquencies as of February 2010, with payments to securities holders on March 15th and April 15th. Fannie Mae's repurchase program will occur over several months, the details of which are still forthcoming. These actions could decrease our income and book value. We cannot predict whether or when new actions may occur, the timing and pace of current actions already implemented, or what impact if any, such actions, or future actions, could have on our business, results of operations and financial condition.

In addition, in 2009, the U.S. Federal Reserve initiated a program to purchase $200.0 billion in direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks and $1.3 trillion in Agency Securities issued and guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. The U.S. Federal Reserve stated that its actions are intended to reduce the cost and increase the availability of credit for the purchase of houses, which in turn was expected to support housing markets and foster improved conditions in financial markets more generally.

The purchase program was completed on March 31, 2010. It is unclear the degree to which the completion of this program and withdrawal of substantial demand for Agency Securities by the Federal Reserve will affect the price and liquidity of Agency Securities. We are unable to predict whether or when the US Treasury or the Federal Reserve will make further interventions in the Agency Securities markets, or what impact, if any, such action could have on the Agency Securities market, the Agency Securities we hold, our business, results of operations and financial condition. It is unclear the timing or manner in which the Federal Reserve might dispose of the Agency Securities it has acquired and, consequently, any impact on the Agency Securities market and the Agency Securities we hold.

As indicated above, recent legislation has changed the relationship between Fannie Mae and Freddie Mac and the U.S. Government and requires Fannie Mae and Freddie Mac to reduce the amount of mortgage loans they own or for which they provide guarantees on Agency Securities. Future legislation could further change the relationship between Fannie Mae and Freddie Mac and the federal government, and could also nationalize or eliminate such entities entirely. Any law affecting these government-sponsored enterprises may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such laws could increase the risk of loss on investments in Fannie Mae and/or Freddie Mac Agency Securities. It also is possible that such laws could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially adversely affect our business, operations and financial condition.

Mortgage loan modification programs and future legislative action may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

During 2008, the U.S. Government, through the Federal Housing Authority and the Federal Deposit Insurance Corporation, commenced implementation of programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures. The programs may involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. In addition, members of the U.S. Congress have indicated support for additional legislative relief for homeowners, including an amendment of the bankruptcy laws to permit the modification of mortgage loans in bankruptcy proceedings. These loan modification programs, as well as future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans may adversely affect the value of, and the returns on, the Agency Securities in which we invest.

We may not be able to operate our business or implement our operating policies and strategies successfully.

The results of our operations depend on many factors, including, without limitation, the availability of opportunities for the acquisition of attractively priced Agency Securities, the level and volatility of interest rates, readily accessible funding in the financial markets and our ability to cost-effectively hedge risks as well as overall economic conditions. We may not be able to maintain any agreements with our lenders on favorable terms or at all. Furthermore, we may not be able to operate our business successfully or implement our operating policies and strategies as described in this prospectus, which could result in the loss of some or all of your investment.

Increased levels of prepayments from Agency Securities may decrease our net interest income or result in a net loss.

Pools of mortgage loans underlie the Agency Securities that we acquire. We generally receive payments from the payments that are made on these underlying mortgage loans. When we acquire Agency Securities, we anticipate that the underlying mortgages will prepay at a projected rate generating an expected yield. When borrowers prepay their mortgage loans faster than expected, the related prepayments on the corresponding Agency Securities will be faster than expected. Since we typically purchase Agency Securities at premium prices that reflect above market coupons, faster than expected prepayments reduce the period those above market coupons are outstanding and could potentially harm our financial position and results of operations. Furthermore, while the Agency Securities we purchase are guaranteed against principal loss by Fannie Mae, Freddie Mac, or Ginnie Mae, defaults, serious delinquencies, and loan modifications of the underlying mortgages result in prepayment of principal as well. Continuing poor credit results at Fannie Mae, Freddie Mac, and Ginnie Mae would suggest higher rates of prepayments from defaults and serious delinquencies. While we will seek to manage prepayment risk, in selecting investments, we must balance prepayment risk against other risks, the potential returns of each investment and the cost of hedging its risks. No strategy can completely insulate us from prepayment or other such risks, and we may deliberately retain exposure to prepayment or other risks.

Recent market conditions may upset the historical relationship between interest rate changes and prepayment trends, which would make it more difficult for us to analyze our portfolio.

Our success depends on our ability to analyze the relationship of changing interest rates and prepayments of the mortgages that underlie our Agency Securities. Changes in interest rates and prepayments affect the market price of the Agency Securities that we purchase and any Agency Securities that we hold at a given time. As part of our overall portfolio risk management, we analyze interest rate changes and prepayment trends separately and collectively to assess their effects on our portfolio. In conducting our analysis, we depend on industry-accepted assumptions with respect to the relationship between interest rates and prepayments under normal market conditions. If the dislocation in the residential mortgage market or other developments change the way that prepayment trends have historically responded to interest rate changes, our ability to assess the market value of our portfolio would be significantly affected and could materially adversely affect our financial position and results of operations.

Changes in interest rates may adversely affect the results of our operations and our financial position.

Interest rates are highly sensitive to many factors, including governmental, monetary and tax policies, domestic and international economic and political considerations, all of which are beyond our control. Our success depends on our ability to analyze the relationship changing interest rates may have on our results of operations and financial position in general, and the impact such rate changes may have on critical elements underlying Agency Securities and other investments' values and borrowings in particular, as follows:

.

Changes in interest rates may inversely affect the fair market value of our assets, which are primarily Agency Securities. When interest rates rise, the value of fixed-rate Agency Securities generally declines, and when interest rates fall, the value of fixed-rate Agency Securities generally increase.

.

Changes in interest rates may inversely affect levels of prepayments on mortgages. Typically, as interest rates rise, prepayments on the underlying mortgages tend to slow; conversely, as interest rates fall, prepayments on the underlying mortgages tend to accelerate. The effect that rising or falling interest rates has on these prepayments affects the price of Agency Securities, and the effect can be particularly pronounced with fixed rate Agency Securities.

.

Changes in interest rates may create mismatches between our assets, primarily Agency Securities, and our borrowings used to fund our purchases of those assets. The risk of these mismatches may be pronounced in that, should rates increase, interest rate caps on our hybrid adjustable rate and adjustable rate mortgage-backed securities would limit the income stream on these investments while our borrowings would not be subject to similar restrictions.

Interest rate fluctuations will also cause variations in the yield curve, which may reduce our net income. The relationship between short-term and longer-term interest rates is often referred to as the yield curve. If short-term interest rates rise disproportionately relative to longer-term interest rates (a flattening of the yield curve), our borrowing costs may increase more rapidly than the interest income earned on our assets. Because our assets may bear interest based on longer-term rates than our borrowings, a flattening of the yield curve would tend to decrease our net income and the market value of our Agency Security assets. Additionally, to the extent cash flows from investments that return scheduled and unscheduled principal are reinvested in Agency Securities, the spread between the yields of the new investments and available borrowing rates may decline, which would likely decrease our net income. It is also possible that short-term interest rates may exceed longer-term interest rates (a yield curve inversion) in which event our borrowing costs may exceed our interest income and we could incur significant operating losses. This risk and the variables created by changing interest rates discussed above are integral to our business and our investment strategies. We will seek to mitigate these risks to the degree achievable through the active formulation and execution of our hedging strategies.

Mitigating against interest rate exposure may adversely affect our earnings, and our interest rate risk mitigation transactions may fail to protect us from the losses that they were designed to offset.

Subject to complying with REIT tax requirements, we employ techniques that limit the adverse effects of rising interest rates on a portion of our short-term repurchase agreements and on a portion of the value of our assets. In general, our interest rate risk mitigation strategy depends on our view of our entire portfolio, consisting of assets, liabilities and derivative instruments, in light of prevailing market conditions. We could misjudge the condition of our portfolio or the market. Our interest rate risk mitigation activity will vary in scope based on the level and volatility of interest rates and principal repayments, the type of securities held and other changing market conditions. Our actual interest rate risk mitigation decisions will be determined in light of the facts and circumstances existing at the time and may differ from our currently anticipated strategy. These techniques may include purchasing or selling futures contracts, entering into interest rate swap agreements or interest rate cap or floor agreements, swaptions, purchasing put and call options on securities or securities underlying futures contracts, or entering into forward rate agreements.

Because a mortgage borrower typically has no restrictions on when a loan may be paid off either partially or in full, there are no perfect interest rate risk mitigation strategies, and interest rate risk mitigation may fail to protect us from loss. Alternatively, we may fail to properly assess a risk to our portfolio or may fail to recognize a risk entirely leaving us exposed to losses without the benefit of any offsetting interest rate risk mitigation activities. The derivative instruments we select may not have the effect of reducing our interest rate risk. The nature and timing of interest rate risk mitigation transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could actually increase our risk and losses. In addition, interest rate risk mitigation activities could result in losses if the event against which we mitigate does not occur.

We may not be able to execute desired interest risk mitigation transactions at favorable prices.

We will continue to execute derivative instrument transactions to manage many, but not all, of the risks inherent in our portfolio. This strategy will potentially help us reduce our exposure to significant changes in interest rates but entails significant costs and other risks. These derivative instruments may not be attractively priced in the marketplace and may not be available to us given our financial condition in the future or as a result of other factors. Additionally, we may not successfully implement our business strategy, we may expose ourselves to additional risks and we could suffer significant losses.

Our use of derivative instruments may expose us to counterparty risk.

We enter into transactions to mitigate interest rate risks associated with our business with counterparties that have a high-quality credit rating and with futures exchanges. If counterparties, or the exchange, cannot perform under the terms of our futures contracts, for example, we would not receive payments due under that agreement, and may lose any unrealized gain associated with the futures contract, and the mitigated liability would cease to be mitigated by the futures contract. We may also be at risk for any collateral we have pledged to secure our obligations under the futures contract if the counterparty became insolvent or filed for bankruptcy. Similarly, if a cap counterparty fails to perform under the terms of the cap agreement, in addition to not receiving payments due under that agreement that would offset our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement. Our derivative instrument agreements require our counterparties to post collateral in certain events, generally related to their credit condition, to provide us some protection against their potential failure to perform. We, in turn, are subject to similar requirements.

Competition may prevent us from acquiring Agency Securities at favorable yields and that would harm our results of operations.

Our net income largely depends on our ability to acquire Agency Securities at favorable spreads over our borrowing costs. In acquiring Agency Securities, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders and other entities that purchase Agency Securities, many of which have greater financial resources than we do. Additionally, many of our competitors are not subject to REIT tax compliance or required to maintain an exemption from the 1940 Act. As a result, we may not be able to acquire sufficient Agency Securities at favorable spreads over our borrowing costs, which would harm our results of operations.

We may be harmed by changes in various laws and regulations.

Our business may be harmed by changes in laws and regulations affecting it, including changes to securities laws and changes to the Code applicable to the taxation of REITs. In addition, proposed changes to laws and regulations that could hinder a loan servicer's ability to adjust loan interest rates upward or to foreclose promptly on defaulted mortgage loans could adversely affect the performance of the loans and the yield on and value of the mortgage securities. Any legislation requiring U.S. Government-chartered entities to reduce the amount of mortgages they own or for which they guarantee payments on Agency Securities could adversely affect the availability and pricing of Agency Securities and harm our business. New legislation may be enacted into law or new interpretations, rulings or regulations could be adopted, any of which could harm us and our stockholders, potentially with retroactive effect.

We may not be able to acquire investments at favorable prices.

We may not be able to acquire Agency Securities at favorable prices. As a result, we may not be able to acquire enough Agency Securities in order to remain fully invested, or we may have to pay more for Agency Securities than we would expect. In either case, the return that we earn on our stockholders' equity may be reduced.

Risks Related to Debt Financing

There is no assurance that our current financing arrangements will remain in place.

During the credit crisis which began in 2007 and which continues to this day, repurchase funding became increasingly more difficult to acquire. Our relationship with AVM, L.P., or AVM, a securities broker dealer which we contract for clearing and settlement services for our securities and derivative transactions, as well as assistance with financing transaction services such as repurchase financing and management of margin arrangements between us and our lenders for each of our repurchase agreements, is beneficial in addressing the potential scarcity of repurchase funding. Nonetheless we will depend on borrowings to fund our acquisitions of Agency Securities and reach our target leverage ratio. Accordingly, our ability to achieve our investment and leverage objectives depends on our ability to borrow money in sufficient amounts and on favorable terms. Currently, we have entered into several master agreements establishing the terms and conditions of borrowings, if any, made by lenders. There can be no assurance that these agreements will remain in place and, even if in place, the amount and definitive terms under which we would be able to borrow. Continued adverse developments in the residential and commercial mortgage markets could make it more difficult for us to borrow money to finance our acquisition of residential Agency Securities.

Institutions from which we seek to obtain financing may also originate and hold residential and commercial mortgage loans and may have suffered financial difficulties as a result of the market conditions described above. Further, even lenders that do not originate and hold mortgage loans may have suffered losses related to their lending and other financial relationships with the institutions that do so as part of their businesses. As a result, institutions that originate and hold loans, and other lenders that have been indirectly affected by losses in the mortgage market, may become insolvent or tighten their lending standards which could result in the following:

.

Our lenders may not be able to obtain financing to fund our borrowings,

.

Our lenders may require us to enter into restrictive covenants relating to our operations,

.

We may not be able to fund acquisitions of sufficient Agency Securities to reach our target leverage ratio,

.

We may become dependent on one or a few lenders for all of our financing, and

.

Our size may impact our ability to obtain financing on favorable terms or at all.

We may incur increased borrowing costs related to repurchase agreements which could harm our results of operations.

Our borrowing costs under repurchase agreements that we have arranged generally are adjustable and relate to short-term interest rates, such as the London Interbank Offered Rate, or LIBOR. The price of these borrowings may vary depending upon a number of factors, including, without limitation:

.

The movement of interest rates;

.

The availability of financing in the market, including the financial stability of lenders; and

.

The value and liquidity of our Agency Securities.

We expect that most of our borrowings will be collateralized borrowings in the form of repurchase agreements. If the interest rates on these repurchase agreements increase, our results of operations will be harmed and we may have losses.

Our leverage strategy increases the risks of our operations, which could reduce our net income and the amount available for distributions or cause us to suffer a loss.

We generally seek to borrow so that our debt-to-equity ratio is between 6:1 and 10:1, but we are not explicitly bound by that range. We incur this leverage by borrowing against a substantial portion of the market value of our Agency Securities. The amount of leverage, however, is not expressly limited and will depend on our and our lenders' estimate of the stability of our portfolio's cash flow and our ability to service and repay additional debt. We may not be able to meet our debt service obligations and, to the extent we cannot, we may be forced to liquidate our assets at disadvantageous prices and you could lose some or all of your investment.

This leverage, which is fundamental to our investment strategy, also creates significant risks. For example:

.

Our borrowings are secured by our Agency Securities, generally under repurchase agreements. A decline in the market value of the Agency Securities used to secure these debt obligations could limit our ability to borrow or result in lenders requiring us to pledge additional collateral to secure our borrowings. In that situation, we could be required to sell Agency Securities under adverse market conditions. If these sales are made at prices lower than the carrying value of the Agency Securities, we would experience losses.

.

Certain lenders may require us to remain in compliance with all provisions of other material contracts, including other financing agreements. As a result, a default under one financing agreement could cause us to be in default under other financing agreements. If that occurs, our access to capital would be significantly impeded, which could materially and adversely affect our ability to operate our business.

.

To the extent we are compelled to liquidate qualified REIT assets to repay debts, our compliance with the REIT rules regarding our assets and our sources of income could be negatively affected, which would jeopardize our qualification as a REIT. Losing our REIT status would cause us to lose tax advantages applicable to REITs and would decrease our overall profitability and distributions to our stockholders.

If we experience losses as a result of our leverage policy, such losses would reduce the amounts available for distribution to our stockholders. Because the assets that we expect to acquire may experience periods of illiquidity, we may be prevented from selling our Agency Securities at opportune times and prices.

We bear the risk of being unable to dispose of our Agency Securities at advantageous times and prices or in a timely manner because Agency Securities may experience periods of illiquidity. The lack of liquidity may result from the absence of a willing buyer or an established market for these assets, as well as legal or contractual restrictions on resale. As a result, the illiquidity of Agency Securities may harm our results of operations and could cause us to suffer a loss and reduce our distributions.

Risks Related to Our Corporate Structure

We have not established a minimum dividend payment level and there are no assurances of our ability to pay dividends in the future.

We intend to pay quarterly dividends and to make distributions to our stockholders in amounts such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. This, along with other factors, should enable us to qualify for the tax benefits accorded to a REIT under the Code. However, we have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected by the risk factors described in this report. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future. In addition, some of our distributions may include a return of capital.

Although we have no present intention to do so, we may use proceeds from equity and debt offerings and other financings to fund distributions, which will decrease the amount of capital available for purchasing our target assets.

We presently have no intention of using the proceeds of this offering or any offering of our equity or debt or other financings to fund distributions to stockholders. However, there are no restrictions in our charter or in any agreement to which we are a party that prohibits us from doing so. In the event that we elect to fund any distribution to our stockholders from sources other than our earnings, the amount of capital available to us to purchase our target assets would decrease, which could have an adverse effect on our overall financial results and performance.

Maintenance of our exemption from the 1940 Act will impose limits on our business.

We conduct our business so as not to become regulated as an investment company under the 1940 Act. If we were to fall within the definition of investment company, we would be unable to conduct our business as described in this prospectus. Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the 1940 Act also defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis. Excluded from the term investment securities, among other things, in Section 3(a)(1)(C) of the 1940 Act, as defined above, are U.S. Government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act.

To avoid registration as an investment company, we rely on the exclusion provided by Section 3(c)(5)(C) of the 1940 Act. To qualify for the exclusion, we intend to make investments so that at least 55% of the assets we own consist of qualifying assets and so that at least 80% of the assets we own consist of qualifying assets and real estate related assets. We generally expect that our investments in Agency Securities will be treated as either qualifying assets or real estate related assets under Section 3(c)(5)(C) of the 1940 Act in a manner consistent with the SEC staff no-action letters. Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency Securities that are considered the functional equivalent of mortgage loans for purposes of the 1940 Act. We invest at least 55% of our assets in whole pool Agency Securities that constitute qualifying assets in accordance with SEC staff guidance and at least 80% of our assets in qualifying interests plus other real estate related assets. Other real estate related assets would consist primarily of non-whole pool Agency Securities and funds awaiting investment. As a result of the foregoing restrictions, we will be limited in our ability to make or dispose of certain investments. To the extent that the SEC staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. These restrictions could also result in our holding assets we might wish to sell or selling assets we might wish to hold. Although we monitor our portfolio relying on the Section 3(c)(5)(C) exclusion periodically and prior to each acquisition and disposition, there can be no assurance that it will be able to maintain this exclusion.

To the extent that we elect in the future to conduct our operations through wholly-owned subsidiaries, such business will be conducted in such a manner as to ensure that we do not meet the definition of investment company under either Section 3(a)(1)(A) or Section 3(a)(1)(C) of the 1940 Act. All wholly-owned subsidiaries that we elect to conduct our business through would qualify for the Section 3(c)(5)(C) exclusion discussed above and we would, accordingly, qualify for the Section 3(a)(1)(C) exemption because less than 40% of the value of our total assets on an unconsolidated basis would consist of investment securities. We monitor our portfolio periodically to insure compliance with the 40% test. In such case, we would be a holding company which conducts business exclusively through wholly-owned subsidiaries and we would be engaged in the non-investment company business of our subsidiaries.

Loss of our 1940 Act exemption would adversely affect us, the market price of shares of our common stock or warrants and our ability to distribute dividends.

As described above, we conduct our operations so as not to become required to register as an investment company under the 1940 Act based on current laws, regulations and guidance. However, the laws and regulations governing REITs, including the Division of Investment Management of the SEC providing more specific or different guidance regarding the treatment of assets as qualifying real estate assets or real estate-related assets, may change in a manner that adversely affects our operations. Further, although we monitor our portfolio, we may not be able to maintain our 1940 Act exemption. If we were to fail to qualify for this exemption in the future, we could be required to restructure our activities or the activities of our subsidiaries, if any, including effecting sales of assets in a manner that, or at a time when we would not otherwise choose, which could negatively affect the value of our common stock or warrants, the sustainability of our business model, and our ability to make distributions. The sale could occur during adverse market conditions, and we could be forced to accept a price below that which we believe is appropriate.

There are significant restrictions on ownership of our stock and warrants.

In order for us to maintain our qualification as a REIT under the Code, not more than 50% in value of the issued and outstanding shares of our capital stock may be owned, actually or constructively, by five or fewer individuals (as defined in the Code to include certain entities) at any time during the last half of each taxable year (other than our first year as a REIT). This test is known as the 5/50 test. Attribution rules in the Code apply to determine if any individual actually or constructively owns our capital stock for purposes of this requirement, including, without limitation, a rule that deems a holder of a warrant or option to purchase stock as owning the shares underlying such warrant or option and a rule that treats shares owned (or treated as owned, including shares underlying warrants) by entities in which an individual has a direct or indirect interest as if they were owned by such individual. Additionally, at least 100 persons must beneficially own our capital stock during at least 335 days of each taxable year (other than our first year as a

REIT).

The 5/50 test did not apply to us for 2009 because it was our first year as a REIT. Further, the 5/50 test does not need to be satisfied before July, 1 2010 in order for us to qualify as a REIT for 2010. In order for us to qualify as a REIT going forward, we must either increase our capital and/or reduce our stockholder concentration before July 1, 2010 in order to maintain our REIT status. We believe that upon completion of this offering, we will meet the 5/50 test.

Our charter prohibits beneficial or constructive ownership by any person of more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our capital stock. Additionally, our charter prohibits beneficial or constructive ownership of our stock that would otherwise result in our failure to qualify as a REIT. In each case, such prohibition includes a prohibition on owning warrants or options to purchase stock if ownership of the underlying stock would cause the holder or beneficial owner to exceed the prohibited thresholds. The ownership rules in our charter are complex and may cause the outstanding stock would cause the holder or beneficial owner to exceed the prohibited thresholds. The ownership rules in our charter are complex and may cause the outstanding stock owned by a group of related individuals or entities to be deemed to be owned by one individual or entity. As a result, these ownership rules could cause an individual or entity to unintentionally own shares beneficially or constructively in excess of our ownership limits. Any attempt to own or transfer shares of our common or preferred stock or warrants in excess of our ownership limits without the consent of ARRM or our board of directors shall be void, and will result in the shares being transferred to a charitable trust. These provisions may inhibit market activity and the resulting opportunity for our stockholders to receive a premium for their shares that might otherwise exist if any person were to attempt to assemble a block of shares of our stock in excess of the number of shares permitted under our charter and which may be in the best interests of our stockholders. Currently, there are holders of our capital stock and/or warrants whose ownership exceeds the thresholds set forth in our charter. We have either granted waivers or currently are in the process of granting waivers from the charter requirements for such holders where, based on representations, covenants and agreements received from such holders, we determine that such waivers would not jeopardize our status as a REIT.

Provisions of Maryland law and other provisions of our organizational documents may limit the ability of a third party to acquire control of the company.

Certain provisions of the MGCL may have the effect of delaying, deferring or preventing a transaction or a change in control of the company that might involve a premium price for holders of our common stock or otherwise be in their best interests. Additionally, our charter and bylaws contain other provisions that may delay or prevent a change of control of the company.

If we have a class of equity securities registered under the Securities Exchange Act and meet certain other requirements, Title 3, Subtitle 8 of the MGCL permits ARRM without stockholder approval and regardless of what is currently provided in our charter or bylaws, to elect on behalf of the company to be subject to statutory provisions that may have the effect of delaying, deferring or preventing a transaction or a change in control of the company that might involve a premium price for holders of our common stock or otherwise be in their best interest. Pursuant to Title 3, Subtitle 8 of the MGCL, once we meet the applicable requirements, our charter provides that our board of directors will have the exclusive power to fill vacancies on our board of directors. As a result, unless all of the directorships are vacant, our stockholders will not be able to fill vacancies with nominees of their own choosing. ARRM may elect to opt in to additional provisions of Title 3, Subtitle 8 of the MGCL without stockholder approval at any time that we have a class of equity securities registered under the Securities Exchange Act and satisfy certain other requirements.

Risks Related to Our Management and Conflicts of Interest

We depend on our manager, ARRM, AVM and particularly key personnel, including Mr. Ulm and Mr. Zimmer. The loss of these relationships or key personnel could severely and detrimentally affect our operations.

As an externally-managed company, we depend on the diligence, experience and skill of our manager for the selection, acquisition, structuring, mitigation of interest rate risk and monitoring of our mortgage-backed assets and associated borrowings. We depend on the efforts and expertise of our operating officers to manage our day-to-day operations and strategic business direction. If any of our key personnel were to leave the company, locating individuals with specialized industry knowledge and skills similar to that of our key personnel may not be possible or could take months and require the retention of an executive search firm, which may be expensive. Because we are a new company with no employees, the loss of Mr. Ulm and Mr. Zimmer could harm our business, financial condition, cash flow and results of operations.

Messrs. Ulm and Zimmer have a long term relationship with AVM and we have a contract with AVM to provide clearing and settlement services for our securities and derivative transactions. We have also entered into a second contract with AVM to assist us with financing transaction services such as repurchase financings and managing the margin arrangement between us and our lenders for each of our expected repurchase agreements. We rely on AVM for these aspects of our business so our executive officers can focus on our daily operations and strategic direction. Further, as our business expands, we will be increasingly dependent on AVM to provide us with timely, effective services. In the future, as we expand our staff, we may absorb internally some or all of the services provided by AVM. Until we elect to move those services in-house, we will remain dependent on AVM or other third parties that provide similar services. If we are unable to maintain a relationship with AVM or are unable to establish a successful relationship with other third parties providing similar services at comparable pricing, we may have to reduce or delay our operations and/or increase our expenditures and undertake the repurchase agreement and trading and administrative activities on our own, which could have a material adverse effect on our business operations and financial condition. However, we believe that the breadth and scope of our manager's experience will enable them to fill any needs created by discontinuing a relationship with AVM.

There are conflicts of interest in our relationship with ARRM and its affiliates, which could result in decisions that are not in the best interests of our stockholders or warrant holders.

We are subject to conflicts of interest arising out of our relationship with ARRM and its affiliates. Each of our executive officers and certain of our non-independent directors is also an employee or partner of ARRM and they will not be exclusively dedicated to our business. Each of Mr. Ulm and Mr. Zimmer is a partner and owner of equity interests in ARRM. In addition, Daniel C. Staton and Marc H. Bell, two of our directors, are principal owners of Staton Bell Blank Check LLC, or SBBC or Sub-Manager, which, in consideration for services to be provided to ARRM under a sub-management agreement is entitled to receive a percentage of the net management fee earned by ARRM from us. As a result, the management agreement with ARRM may create a conflict of interest, and its terms, including fees payable to ARRM, may not be as favorable to us as if they had been negotiated with an unaffiliated third party. In addition, we may choose not to enforce, or to enforce less vigorously, our rights under the management agreement because of our desire to maintain our ongoing relationship with ARRM. ARRM maintains a contractual as opposed to a fiduciary relationship with us. The management agreement with ARRM does not prevent ARRM and its affiliates from engaging in additional management or investment opportunities some of which will compete with us. ARRM and its affiliates may engage in additional management or investment opportunities that have overlapping objectives with ours, and may thus face conflicts in the allocation of investment opportunities to these other investments. Such allocation is at the discretion of ARRM and there is no guarantee that this allocation would be made in the best interest of our stockholders or warrant holders. We are not entitled to receive preferential treatment as compared with the treatment given by ARRM or its affiliates to any investment company, fund or advisory account other than any fund or advisory account which contains only funds invested by ARRM (and not of any of its clients or customers) or its officers and directors. Additionally, the ability of ARRM and its respective officers and employees to engage in other business activities may reduce the time spent managing our activities.

In the future, we may enter, or ARRM may cause us to enter, into additional transactions with ARRM or its affiliates. In particular, we may purchase, or ARRM may cause us to purchase, assets from ARRM or its affiliates or make co-purchases alongside ARRM or its affiliates. These transactions may not be the result of arm's length negotiations and may involve conflicts between our interests and the interests of ARRM and/or its affiliates in obtaining favorable terms and conditions.

Members of our management team have competing duties to other entities, which could result in decisions that are not in the best interests of our stockholders or warrant holders.

Our executive officers and the employees of ARRM do not spend all of their time managing our activities and our investment portfolio. Our executive officers and the employees of ARRM allocate some, or a material portion, of their time to other businesses and activities. For example, each of our executive officers is also an employee or partner of ARRM. None of these individuals is required to devote a specific amount of time to our affairs. Accordingly, we compete with ARRM, its existing funds, investment vehicles, other ventures and possibly other entities in the future for the time and attention of these officers.

If ARRM ceases to be our investment manager, financial institutions providing any financing arrangements to us may not provide future financing to us.

Financial institutions that we seek to finance our investments may require that ARRM continue to act in such capacity. If ARRM ceases to be our manager, it may constitute an event of default and the financial institution providing the arrangement may have acceleration rights with respect to outstanding borrowings and termination rights with respect to our ability to finance our future investments with that institution. If we are unable to obtain financing for our accelerated borrowings and for our future investments under such circumstances, it is likely that we would be materially and adversely affected.

ARRM's failure to make investments on favorable terms that satisfy our investment strategy and otherwise generate attractive risk-adjusted returns initially and consistently from time to time in the future would materially and adversely affect us.

Our ability to achieve our investment objective depends on ARRM's personnel and their ability to make investments on favorable terms that satisfy our investment strategy and otherwise generate attractive risk-adjusted returns initially and consistently from time to time in the future. Accomplishing this result is also a function of ARRM's ability to execute our financing strategy on favorable terms.

The manner of determining the management fee may not provide sufficient incentive to ARRM to maximize risk-adjusted returns on our investment portfolio since it is based on our gross equity raised and not on our performance.

ARRM is entitled to receive a monthly management fee that is based on the total of all gross equity raised (as defined in the management agreement), as measured as of the date of determination (i.e., each month), regardless of our performance. Accordingly, the possibility exists that significant management fees could be payable to ARRM for a given month despite the fact that we could experience a net loss during that month. ARRM's entitlement to such significant nonperformance-based compensation may not provide sufficient incentive to ARRM to devote its time and effort to source and maximize risk-adjusted returns on our investment portfolio, which could, in turn, adversely affect our ability to pay dividends to our stockholders and the market price of our common stock or warrants. Further, the management fee structure gives ARRM the incentive to maximize gross equity raised by the issuance of new equity securities or the retention of existing equity, regardless of the effect of these actions on existing stockholders. In other words, the management fee structure will reward ARRM primarily based on the size of our equity, and not on our financial returns to stockholders.

The termination of the management agreement may be difficult and costly, which may adversely affect our inclination to end our relationship with ARRM.

Termination of the management agreement with ARRM without cause is difficult and costly. The term cause is limited to those circumstances described in the Management Agreement with ARRM. The management agreement provides that, in the absence of cause, it may be terminated by us only without cause and only during any renewal term following the initial 5-year term of the management agreement. ARRM will be provided 180 days prior notice of any such termination by us without cause. Additionally, upon a termination by us without cause, the management agreement provides that we will pay ARRM a termination payment equal to three times the sum of the base management fee (which is a minimum of $900,000) received by ARRM during the 12-month period before such termination, calculated as of the effective date of termination. This provision increases the effective cost to us of electing to terminate the management agreement, thereby adversely affecting our inclination to end our relationship with ARRM prior to the expiration of any renewal term, even if we believe ARRM's performance is not satisfactory.

ARRM may terminate the management agreement at any time and for any reason upon 180 days prior notice. If the management agreement is terminated and no suitable replacement is found to manage us, we may not be able to execute our business plan.

Additionally, following the initial 5-year term, the management agreement will automatically renew for successive one-year renewal terms unless either we or ARRM give advance notice to the other of our intent not to renew the agreement prior to the expiration of the initial term or any renewal term. However, our right to give such a notice of non-renewal is limited and requires our independent directors to agree that certain conditions are met.

ARRM's liability is limited under the management agreement and we have agreed to indemnify ARRM and its affiliates against certain liabilities. As a result, we could experience poor performance or losses for which ARRM would not be liable.

The management agreement limits the liability of ARRM and any directors and officers of ARRM for money damages, except for liability resulting from actual receipt of an improper benefit or profit in money, property or services, or a final judgment based upon a finding of active and deliberate dishonesty by the director or officer that was material to the cause of action adjudicated.

Pursuant to the management agreement, ARRM will not assume any responsibility other than to render the services called for there under and will not be responsible for any action of our board in following or declining to follow its advice or recommendations. ARRM and its affiliates, directors, officers, stockholders, equity holders, employees, representatives and agents, and any affiliates thereof, will not be liable to us, our stockholders, any subsidiary of ours, the stockholders of any subsidiary of ours, our board of directors, any issuer of mortgage securities, any credit-party, any counterparty under any agreement, or any other person for any acts or omissions, errors of judgment or mistakes of law by ARRM or its affiliates, directors, officers, stockholders, equity holders, employees, representatives or agents, or any affiliates thereof, under or in connection with the management agreement, except if ARRM was grossly negligent, acted with reckless disregard or engaged in willful misconduct or fraud while discharging its duties under the management agreement. We have agreed to indemnify ARRM and its affiliates, directors, officers, stockholders, equity holders, employees, representatives and agents, and any affiliates thereof, with respect to all expenses, losses, costs, damages, liabilities, demands, charges and claims of any nature, actual or threatened (including reasonable attorneys' fees), arising from or in respect of any acts or omissions, errors of judgment or mistakes of law (or any alleged acts or omissions, errors of judgment or mistakes of law) performed or made while acting in any capacity contemplated under the management agreement or pursuant to any underwriting or similar agreement to which ARRM is a party that is related to our activities, unless ARRM was grossly negligent, acted with reckless disregard or engaged in willful misconduct or fraud while discharging its duties under the management agreement. As a result, we could experience poor performance or losses for which ARRM would not be liable.

In addition, our articles of incorporation provide that no director or officer of ours shall be personally liable to us or our stockholders for money damages. Furthermore, our articles of incorporation permit, and our by-laws require, us to indemnify, pay or reimburse any present or former director or officer of ours who is made or threatened to be made a party to a proceeding by reason of his or her service to us in such capacity. Officers and directors of ours who are also officers and board members of ARRM will therefore benefit from the exculpation and indemnification provisions of our articles of incorporation and by-laws, and accordingly may not be liable to us in such circumstances.

Federal Income Tax Risks

Rapid changes in the values of our Agency Securities may make it more difficult for us to maintain our qualification as a REIT or our exemption from the 1940 Act.

If the market value or income potential of our Agency Securities declines as a result of increased interest rates, prepayment rates, general market conditions, government actions or other factors, we may need to increase certain types of our assets and income or liquidate our non-qualifying assets to maintain our REIT qualifications or our exemption from the 1940 Act. If the decline in real estate asset values or income occurs quickly, this may be especially difficult to accomplish. We may have to make decisions that we otherwise would not make absent the REIT and 1940 Act considerations.

Our qualification as a REIT subjects us to a broad array of financial and operating parameters that may influence our business and investment decisions and limit our flexibility in reacting to market developments.

In order to qualify and maintain our qualification as a REIT, we must insure that:

.

That at least 75% of our gross income each year is derived from certain real estate related sources,

.

That at least 75% of the value of our assets consists of cash, cash items, government securities and qualified REIT real estate assets at the end of each calendar quarter,

.

That the remainder of our investment in securities generally cannot include more than 10% of the outstanding voting securities of any one issuer, or more than 10% of the total value of the outstanding securities of any one issuer,

.

That no more than 5% of the value of our assets can consist of securities of any one issuer.

If we fail to comply with applicable REIT requirements, we must dispose of a portion of our assets within 30 days after the end of the calendar quarter in order to avoid losing our REIT status and suffering adverse tax consequences. If we fail to qualify as a REIT, we will be subject to federal income tax as a regular corporation and may face substantial tax liability.

Qualification as a REIT involves the satisfaction of numerous requirements (some on an annual or quarterly basis) established under highly technical and complex provisions of the Code for which only a limited number of judicial or administrative interpretations exist. We believe we will satisfy all the requirements to be a REIT upon consummation of this offering. However, the determination that we satisfy all REIT requirements requires an analysis of various factual matters and circumstances that may not be totally within our control. We have not requested, and do not intend to request, a ruling from the Internal Revenue Service, or IRS, that we qualify as a REIT. Accordingly, we are not certain we will be able to qualify and remain qualified as a REIT for federal income tax purposes. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress or the IRS might change tax laws or regulations and the courts might issue new rulings, in each case potentially having retroactive effect, which could make it more difficult or impossible for us to qualify as a REIT.

If we fail to qualify as a REIT in any tax year, then:

.

We would be taxed as a regular domestic corporation, which, among other things, means that we would be unable to deduct distributions to stockholders in computing taxable income and would be subject to federal income tax on our taxable income at regular corporate rates,

.

Any resulting tax liability could be substantial and would reduce the amount of cash available for distribution to stockholders, and could force us to liquidate assets at inopportune times, causing lower income or higher losses than would result if these assets were not liquidated, and

.

Unless we were entitled to relief under applicable statutory provisions, we would be disqualified from treatment as a REIT for the subsequent four taxable years following the year during which we lost our qualification, and thus, our cash available for distribution to our stockholders would be reduced for each of the years during which we do not qualify as a REIT.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow. Further, we may be subject to certain federal, state and local taxes on our income and property. Any of these taxes would decrease cash available for distribution to our stockholders. Complying with REIT requirements may limit our ability to mitigate interest rate risk effectively or may require us to execute our risk mitigation and derivative activities through a taxable REIT subsidiary, or TRS.

The existing REIT provisions of the Code may substantially limit our ability to mitigate interest rate risk on Agency Securities and related borrowings by requiring us to limit our income in each year from derivative instrument transactions, other than qualified REIT contracts, together with any other income not generated from qualified REIT real estate assets, to less than 25% of our gross income. In addition, we must generally limit our aggregate income from derivative transactions and services from all sources, other than from qualified REIT contracts, to less than 5% of our annual gross income. As a result, we may in the future need to conduct certain derivative activity through a TRS, the income from which will be fully subject to federal, state and local corporate income tax, and we may have to limit our use of interest rate risk mitigation techniques. This could result in greater risks associated with changes in interest rates than we would otherwise want to incur. If we fail to satisfy the 25% or 5% limitations, unless our failure was due to reasonable cause and not due to willful neglect and we meet certain other technical requirements, we could lose our REIT status for federal income tax purposes. Even if our failure was due to reasonable cause, we may have to pay a penalty tax equal to the amount of income in excess of certain thresholds, multiplied by a fraction intended to reflect our profitability.

Complying with REIT requirements may force us to borrow to make distributions to our stockholders.

As a REIT, we must distribute at least 90% of our annual REIT taxable income (excluding net capital gains) to our stockholders. From time to time, we may generate taxable income greater than our net income for financial reporting purposes from, among other things, the non-taxable unrealized changes in the value of our interest rate hedges, or our taxable income may be greater than our cash flow available for distribution to our stockholders. If we do not have other funds available in these situations, we may be unable to distribute 90% of our taxable income as required by the REIT rules. Thus, we could be required to borrow funds, sell a portion of our assets at disadvantageous prices or find another alternative source of funds. These alternatives could increase our costs or reduce our equity and reduce amounts available to invest in Agency Securities.

Plans should consider ERISA risks of investing in our common stock.

Investment in our common stock may not be appropriate for a pension, profit-sharing, employee benefit, or retirement plan, considering the plan's particular circumstances, under the fiduciary standards of ERISA or other applicable similar laws including standards with respect to prudence, diversification and delegation of control and the prohibited transaction provisions of the Employee Retirement Income Security Act, or ERISA, the Code and any applicable similar laws.

ERISA and Section 4975 of the Code prohibit certain transactions that involve (i) certain pension, profit-sharing, employee benefit, or retirement plans or individual retirement accounts and (ii) any person who is a party in interest or disqualified person with respect to such plan. Consequently, the fiduciary of a plan contemplating an investment in our common stock should consider whether its company, any other person associated with the issuance of its common stock or any affiliate of the foregoing is or may become a party in interest or disqualified person with respect to the plan and, if so, whether an exemption from such prohibited transaction rules is applicable.

ERISA may limit our ability to attract capital from Benefit Plan Investors.

It is unlikely that we will qualify as an operating company for purposes of ERISA. Consequently, in order to avoid our assets being deemed to include so-called plan assets under ERISA, we will initially limit equity ownership in us by Benefit Plan Investors to less than 25% of the value of each class or series of capital stock issued by us and to prohibit transfers of our common stock to Benefit Plan Investors. Our charter prohibits Benefit Plan Investors from holding any interest in any shares of our capital stock that are not publicly traded. These restrictions on investments in us by Benefit Plan Investors (and certain similar investors) may adversely affect the ability of our stockholders to transfer their shares of our common stock and our ability to attract private equity capital in the future.

Risks Related to Our Securities

The performance or our common stock correlates to the performance of our REIT investments, which may be speculative and aggressive compared to other types of investments.

The investments we make in accordance with our investment objectives may result in a greater amount of risk as compared to alternative investment options, including relatively higher risk of volatility or loss of principal. Our investments may be speculative and aggressive, and therefore an investment in our common stock may not be suitable for someone with lower risk tolerance.

Future issuances and/or sales of shares of our common stock may depress the market price of our common stock or have adverse consequences for our stockholders.

Our charter provides that we may issue up to 250,000,000 shares of common stock. As of the date of this prospectus, 2,304,054 shares of common stock were issued and outstanding and warrants to purchase up to 32,500,000 shares of common stock were issued and outstanding.

We cannot predict the effect, if any, of future issuances or sales of our common stock on the market price of our common stock. Sales of substantial amounts of common stock or the perception that such sales could occur may adversely affect the prevailing market price for our common stock. Also, we may issue additional shares in subsequent public offerings or private placements to acquire new assets or for other purposes. We are not required to offer any such shares to existing stockholders on a preemptive basis. Therefore, it may not be possible for existing stockholders to participate in such future share issuances, which may dilute the existing stockholders' interests.

Furthermore, a significant portion of our outstanding common stock is beneficially owned by only a few stockholders, including Wells Fargo and Company, which beneficially owns approximately 44% of our common stock. Any such stockholder may in the future elect to sell all or a significant portion of its common stock in one or more related transactions, which may adversely affect the prevailing market price for our common stock.

We have not established a minimum distribution payment level and we cannot assure you of our ability to pay distributions in the future.

We intend to pay quarterly cash distributions and to make distributions to our stockholders in an amount such that we distribute all or substantially all of our REIT taxable income in each year, subject to certain adjustments. We have not established a minimum distribution payment level and our ability to pay distributions may be adversely affected by a number of factors, including the risk factors described herein. All distributions will be made, subject to Maryland law, at the discretion of our board of directors and will depend on our earnings, our financial condition, any debt covenants, maintenance of our REIT qualification and other factors as our board of directors may deem relevant from time to time. We cannot assure you that we will achieve results that will allow us to make a specified level of cash distributions.

We are not be currently eligible to use Form S-3 registration statements, which could hamper our ability to timely raise capital if and as needed.

A Form S-3 registration statement is often used by a registrant to establish a shelf registration because, once effective, such form incorporates by reference to the registrant s subsequent Exchange Act filings and therefore remains current and effective without the need for filing amendments to the registration statement from time to time. Once effective, the shelf registration allows the registrant to quickly access capital by drawing down securities covered by the registration statement when market conditions are favorable for an offering. A Form S-3 also can be utilized by a registrant to register securities in a manner that is typically quicker and more cost efficient than using a Form S-11 which is a longer, more detailed registration statement. We will not be able to utilize Form S-3 until November 6, 2010, the first anniversary of our merger with Enterprise. Therefore, our ability to raise capital as and when needed could be materially adversely effected and we could be required to utilize registration forms and processes that may cause delay in our capital raising activities, which delay could, in turn, ultimately, result in the failure of such activities.

Our warrants may be exercised in the future, which would increase the number of shares eligible for future resale in the public market.

Outstanding redeemable warrants to purchase an aggregate of 32,500,000 shares of our common stock are currently exercisable at an exercise price of $11.00 per share. These warrants likely will be exercised if the market price of the shares of our common stock equals or exceeds the warrant exercise price. Therefore, as long as warrants remain outstanding, there will be a drag on any increase in the price of our common stock in excess of the warrant exercise price. To the extent such warrants are exercised, additional shares of our common stock will be issued, which would dilute the ownership of existing stockholders. Further, if these warrants are exercised at any time in the future at a price lower than the book value per share of our common stock, existing stockholders could suffer substantial dilution of their investment, which dilution could increase in the event the warrant exercise price is lowered.

Our stock price could fluctuate and could cause you to lose a significant part of your investment.

The market price of our securities may be influenced by many factors, some of which are beyond our control, including those described above and the following:

.

changes in financial estimates by analysts;

.

fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us; general economic conditions;

.

changes in market valuations of similar companies;

.

regulatory developments in the United States; and

.

additions or departures of key personnel at ARRM.

Resulting fluctuations in our stock price could cause you to lose a significant part of your investment.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus contains various forward-looking statements. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. In some cases, you can identify forward-looking statements by the use of forward-looking terminology such as believes, expects, may, will, would, could, should, seeks, appro intends, plans, projects, estimates or anticipates or the negative of these words and phrases or similar words or phrases. All forward-looking statements may be impacted by a number of risks and uncertainties, including statements regarding the following subjects:

.

our business and investment strategy;

.

our anticipated results of operations;

.

statements about future dividends;

.

our ability to obtain financing arrangements;

.

our understanding of our competition and ability to compete effectively;

.

market, industry and economic trends; and

.

interest rates.

The forward-looking statements in this prospectus are based on our beliefs, assumptions and expectations of our future performance, taking into account all information currently available to us. These beliefs, assumptions and expectations are subject to risks and uncertainties and can change as a result of many possible events or factors, not all of which are known to us. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. You should carefully consider these risks before you make an investment decision with respect to our common stock, along with the following factors that could cause actual results to vary from our forward-looking statements:

(1)

the factors referenced in this report, including those set forth under the sections captioned Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations;

(2)

the federal conservatorship of Fannie Mae and Freddie Mac and related efforts, along with any changes in laws and regulations affecting the relationship between Fannie Mae and Freddie Mac and the federal government;

(3)

mortgage loan modification programs and future legislative action;

(4)

availability, terms and deployment of capital;

(5)

changes in economic conditions generally;

(6)

changes in interest rates, interest rate spreads, the yield curve or prepayment rates;

(7)

general volatility of the financial markets, including markets for mortgage securities;

(8)

inflation or deflation;

(9)

availability of suitable investment opportunities;

(10)

the degree and nature of our competition, including competition for agency securities from the U.S. Treasury;

(11)

changes in our business and investment strategy;

(12)

our limited operating history;

(13)

our dependence on our manager and ability to find a suitable replacement if our manager were to terminate its management relationship with us;

(14)

the existence of conflicts of interest in our relationship with our manager, certain of our directors and our officers, which could result in decisions that are not in the best interest of our stockholders;

(15)

changes in personnel at our manager or the availability of qualified personnel at our manager;

(16)

limitations imposed on our business by our status as a REIT;

(17)

changes in GAAP, including interpretations thereof; and

(18)

changes in applicable laws and regulations.

We cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on forward-looking statements, which apply only as of the date of this report. We do not intend and disclaim any duty or obligation to update or revise any industry information or forward-looking statements set forth in this report to reflect new information, future events or otherwise, except as required under the U.S. federal securities laws.

USE OF PROCEEDS

We are offering 7,000,000 shares of our common stock at the assumed public offering price of $7.09 per share (based on our last reported sales price on June 4, 2010). We estimate that the net proceeds we will receive from selling common stock in this offering will be approximately $46,728,500, after deducting assumed underwriting discounts and commissions payable by us and estimated offering expenses of approximately $2,901,500 (or, if the underwriters exercise their over-allotment option in full, approximately $53,800,775, after deducting the portion of the assumed underwriting discounts and commissions payable by us and estimated offering expenses of approximately $3,273,725.

We plan to use all the net proceeds from this offering above to acquire additional target assets in accordance with our objectives and strategies described in this prospectus. See *Business - Strategies.* Our focus will be on purchasing Agency Securities and Agency Debt and other assets, subject to our investment guidelines and REIT qualification requirements. ARRM will make determinations as to the percentage of our assets that will be invested in each of our target assets. Its decisions will depend on prevailing market conditions and may change over time in response to opportunities available in different interest rate, economic and credit environments. Until appropriate assets can be identified, ARRM may invest the net proceeds from this offering in interest-bearing short-term investments, including funds that are consistent with our qualification as a REIT. These investments are expected to provide a lower net return than we will seek to achieve from our target assets. Prior to the time we have fully used the net proceeds of this offering to acquire our target assets, we may fund our quarterly cash distributions out of such net proceeds.

PUBLIC MARKET FOR OUR SECURITIES

Our common stock and warrants are currently quoted on the OTC Bulletin Board under the symbols AMRR and AMRRW, respectively. Prior to trading on the OTC Bulletin Board, from November 5, 2009 to February 1, 2010, our common stock and warrants were traded on the NYSE Amex under the symbols ARR and ARR.WS, respectively. The following table sets forth the range of high and low closing prices or bid information, as applicable, for the common stock and warrants for the periods indicated since the consummation of the business combination with Enterprise on November 5, 2009. Over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

	Common Stock		Warrants	
	High	Low	High	Low
Fourth Quarter 2009 (from November 6, 2009)	$ 9.00	$ 7.35	$ 0.25	$ 0.12
First Quarter 2010	$ 8.45	$ 6.30	$ 0.20	$ 0.10
Second Quarter 2010 (through June 4, 2010)	$ 8.50	$ 6.81	$ 0.18	$ 0.05

Our common stock and warrants have been approved for listing on the NYSE Amex under the symbols ARR and ARR.WS, respectively, subject to official notice of issuance.

Holders of Common Equity

As of June 4, 2010, we had one stockholder of record of our outstanding common stock, and two holders of record of our outstanding warrants. We believe that upon consummation of this offering there will be in excess of 400 beneficial owners of our common stock and warrants.

Dividends

On November 5, 2009, we declared a dividend of $0.13 per share of common stock, which we paid in December 2009 and January 2010 to stockholders of record on October 5, 2009. On March 5, 2010, we declared a first quarter 2010 dividend of $0.40, which we paid on April 29, 2010 to stockholders of record on March 15, 2010. On May 25, 2010, we declared a second quarter 2010 dividend of $0.40 to stockholders of record on June 3, 2010, which we will pay on July 29, 2010.

DIVIDEND POLICY

We intend to elect to be taxed as a REIT for U.S. federal income tax purposes commencing with our taxable year ended December 31, 2009. U.S. federal income tax law requires that a REIT distribute with respect to each year at least 90% of its REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. If our cash available for distribution is less than 90% of our REIT taxable income, we could be required to sell assets or borrow funds to pay cash dividends or we may make a portion of the required dividend in the form of a taxable stock dividend or dividend of debt securities. We will generally not be required to pay dividends with respect to activities conducted through any domestic TRS. For more information, see *U.S. Federal Income Tax Considerations U.S. Federal Income Tax Considerations of ARMOUR as a REIT Taxation of ARMOUR General.*

In order to maintain our qualification as a REIT for U.S. federal income tax purposes, we are required to distribute at least 90% of our annual REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. Accordingly, we intend to pay regular quarterly dividends of all or substantially all of our taxable income to holders of our common stock out of assets legally available for such purposes.

The timing and amount of any dividends we pay to holders of our common stock will be at the discretion of our board of directors and will depend upon various factors, including our earnings and financial condition, maintenance of REIT status, applicable provisions of the MGCL and such other factors as our board of directors deems relevant.

We presently have no intention of using the proceeds of this offering or any offering of our equity or debt or other financings to fund distributions to stockholders. However, there are no restrictions in our charter or in any agreement to which we are a party that prohibits us from doing so. In the event that we elect to fund any distribution to our stockholders from sources other than our earnings, the amount of capital available to us to purchase our target assets would decrease, which could have an adverse effect on our overall financial results and performance.

Our results of operations, financial condition, cash flows and liquidity will, in turn, be affected by various factors, including the net interest and other income from our portfolio, our operating expenses and any other expenditures. For more information regarding risk factors that could materially adversely affect our results of operations, financial condition, cash flows, liquidity, business and prospects, see *Risk Factors.*

We anticipate that our dividends generally will be taxable as ordinary income to our stockholders, although a portion of the dividends may be designated by us as qualified dividend income or capital gain or may constitute a return of capital. We will furnish annually to each of our stockholders a statement setting forth dividends paid during the preceding year and their characterization as ordinary income, return of capital, qualified dividend income or capital gain. For more information, see *U.S. Federal Income Tax Considerations Taxation of Taxable U.S. Stockholders.*

CAPITALIZATION

The following table sets forth (1) our actual capitalization at March 31, 2010 and (2) our capitalization as adjusted to reflect the effect of the sale of our common stock in this offering at an assumed offering price of $7.09 per share (based on the last reported sales price on June 4, 2010), after deducting the underwriting discount and estimated offering expenses payable by us. You should read this table together with our consolidated financial statements and the accompanying notes, and *Management's Discussion and Analysis of Financial Condition and Results of Operations* and *Use of Proceeds* included elsewhere in this prospectus.

	At March 31, 2010	
	Actual	**As Adjusted**
	(Unaudited)	
Cash	$ 2,781,756	$ 49,510,256
Stockholders' equity		
Common stock, $0.0001 par value; 250,000,000 shares authorized; 2,304,054 shares outstanding; 9,304,054 shares outstanding, as adjusted for the sale of the 7,000,000 shares in this offering	230	930
Additional paid-in capital	22,647,201	69,375,001
Accumulated deficit	(1,812,963)	(1,812,963)
Accumulated other comprehensive income	583,257	583,257
Total capitalization	$ 21,417,725	$ 68,146,225

SELECTED FINANCIAL AND OTHER DATA

The following table sets forth selected historical financial information derived from our unaudited financial statements for the quarter ended March 31, 2010 and our audited financial statements for the years ended December 31, 2009, 2008 and the period from July 9, 2007 (inception) to December 31, 2007. The following data should be read in conjunction with *Management's Discussion and Analysis of Financial Condition and Results of Operations* and our financial statements including the notes thereto, included elsewhere in this prospectus. The financial data below, including the results of operations and key portfolio statistics for periods prior to the Business Combination are those of Enterprise Acquisition Corp. and its investment strategy which differed significantly from our current operations.

	March 31, 2010 (unaudited)	**December 31, 2009**	**December 31, 2008**	**December 31, 2007**
Balance Sheet Data				
Total Assets	$ 191,640,680	$ 126,693,608	$ 250,189,469	$ 249,200,417
Repurchase Agreements	168,525,093	46,388,602	-	-
Payable for unsettled securities	-	58,559,479	-	-

	Quarter Ended March 31, 2010 (unaudited)	**Year Ended December 31, 2009**	**Year Ended December 31, 2008**	**Period from July 9, 2007 to December 31, 2007**
Statement of Operations and Per Share Data:				
Interest income, net of premium amortization	$ 1,108,138	$ 446,598	$ 5,425,560	$ 1,652,252
Interest expense	(120,646)	(14,153)	-	-
Net interest income	987,492	432,445	5,425,560	1,652,252
Change in fair value of interest rate contracts	(603,579)	-	-	-
Gain on sale of agency securities	208,199	-	-	-
Total net revenues	592,112	432,445	5,425,560	1,652,252
Operating expenses	$ 283,879	$ 2,026,925	$ 2,309,375	$ 163,275
Net income (loss)	$ 305,833	$ (1,149,427)	$ 1,074,435	$ 1,867,315
Net income (loss) per share	0.13	(0.11)	(0.02)	0.07
Weighted average shares outstanding	2,304,054	20,456,664	23,750,001	16,129,865
Cash dividends declared per share	0.40	0.09	-	-
Key Portfolio Statistics*	$ 144,822,902	$ 10,670,293	-	-
Average Agency Securities (2)	$ 132,411,377	$ 5,531,886	-	-
Average Repurchase Agreements (3)	$ 21,417,725	$ 21,491,094	-	-
Average Equity (4)	3.06%	4.59%	-	-
Average Portfolio Yield (5)	0.38%	0.72%	-	-

Average Cost of Funds (6)	2.67%	3.87%	-	-
Interest Rate Spread (7)	1.43%	(0.80)%	-	-
Return on Average Equity (8)	14.5%	8.6%	-	-
Average Annual Portfolio Repayment Rate (9)	7:87:1	2:16:1	-	-
Debt to Equity *(at period end)* (10)	7:44:1	2:22:1	-	-

* Average numbers for each period are weighted based on days on books and records. All percentages are annualized.

(1)

Our average investment in Agency Securities was calculated by dividing the sum of our daily Agency Securities investments during the period by the number of days in the period.

(2)

Our average balance outstanding under our repurchase agreements was calculated by dividing the sum of our daily outstanding balances under our repurchase agreements during the period by the number of days in the period.

(3)

Our average stockholders' equity was calculated by dividing the sum of our daily stockholders' equity during the year by the number of days in the period.

(4)

Our average portfolio yield was calculated by dividing our net interest income by our average Agency Securities or other investments.

(5)

Our average cost of funds was calculated by dividing our total interest expense (including interest rate risk mitigation) by our average borrowings.

(6)

Our interest rate spread was calculated by subtracting our average cost of funds from our average portfolio yield.

(7)

Our return on average equity was calculated by dividing net incme by average equity.o

(8)

Our average annual principal repayment rate was calculated by dividing our total principal payments received during the year (scheduled and unscheduled) by our average Agency Securities.

(9)

Our debt to equity ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by total stockholders' equity at period end.

(10)

Our debt to additional paid in capital ratio was calculated by dividing the amount outstanding under our repurchase agreements at period end by additional paid in capital at period end.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations together with Selected Financial and Other Data and our consolidated financial statements and notes thereto that appear elsewhere in this prospectus. This discussion and analysis contains forward-looking statements that involve risks, uncertainties, and assumptions. Actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including, but not limited to, those presented under Risk Factors included in this prospectus.

Overview

As of March 31, 2010, our Agency Security portfolio, including both trades that had settled and forward settling trades that we had committed to settle, consisted of approximately $180.4 million, in market value, of Agency Securities with initial fixed-interest rate periods of three years, five years, seven years, ten years and 15 years.

The following table represents key data regarding our company since the beginning of operations on November 6, 2009:

						Quarterly
					Book	**Diluted**
	Agency	**Repurchase**		**Shares**	**Value**	**Earnings**
As of	**Securities**	**Agreements**	**Equity**	**Outstanding**	**Per Share**	**Per Share**
March 31, 2010	$ 180,364,369	$ 168,525,093	$21,417,725	2,304,504	$ 9.30	$ 0.13
December 31, 2009	$ 118,648,724	$ 46,388,602	$21,491,096	2,304,054	$ 9.33	$ (0.08)

Factors that Affect our Results of Operations and Financial Condition

Our results of operations and financial condition, including, among other things, our net interest income, the market value of our assets and the supply of and demand for such assets, are affected by various factors, many of which are beyond our control. We invest in financial assets and markets, and recent events, such as those discussed below, can affect our business in ways that are difficult to predict, and can produce results outside of typical operating variances. Our net interest income varies primarily as a result of changes in interest rates, borrowing costs and prepayment rates. Prepayment rates, as reflected by the rate of principal pay downs, and interest rates vary according to the type of investment, conditions in financial markets, government actions, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment rates on our Agency Securities purchased at a premium increase, related purchase premium amortization increases, thereby reducing the net yield on such assets. Because changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT.

We anticipate that during any period where changes in the interest rates earned on our assets do not coincide with interest rate changes on our borrowings, such assets will reprice more slowly than the corresponding liabilities. Consequently, changes in interest rates, particularly short-term interest rates, may significantly influence our net interest income. With the maturities of our assets generally of longer term than those of our liabilities, interest rate increases will tend to decrease our net interest income and the market value of our assets (and therefore our book value). Such rate increases could possibly result in operating losses or adversely affect our ability to make distributions to our stockholders.

Prepayments on Agency Securities and the underlying mortgage loans may be influenced by changes in market interest rates and a variety of economic, geographic and other factors beyond our control; and consequently such prepayment rates cannot be predicted with certainty. To the extent we have acquired Agency Securities at a premium or discount to par, or face value, changes in prepayment rates may impact our anticipated yield. In periods of declining interest rates, prepayments on our Agency Securities will likely increase. If we are unable to reinvest the proceeds of such prepayments at comparable yields, our net interest income may suffer. The current climate of government intervention in the mortgage markets significantly increases the risk associated with prepayments.

While we have tried to mitigate some of our interest rate risk, we do not intend to mitigate all of our exposure to changes in interest rates and prepayment rates, as there are practical limitations on our ability to insulate our portfolio from all potential negative consequences associated with changes in short-term interest rates in a manner that will allow us to seek attractive net spreads on our portfolio.

In addition, a variety of other factors relating to our business may also impact our financial condition and operating performance. These factors include:

.

our degree of leverage;

.

our access to funding and borrowing capacity;

.

our interest rate risk mitigation activities; and

.

the REIT requirements, the requirements to qualify for an exemption under the 1940 Act and other regulatory and accounting policies related to our business.

ARRM, our manager, is entitled to receive a management fee that is based on our equity (as defined in our management agreement), regardless of the performance of our portfolio. Accordingly, the payment of our management fee may not decline in the event of a decline in our profitability and may cause us to incur losses.

Market and Interest Rate Trends and the Effect on our Portfolio

Credit Market Disruption

During the past three years, the residential housing and mortgage markets in the United States have experienced a variety of difficulties and changed economic conditions including loan defaults, credit losses and decreased liquidity. These conditions have resulted in volatility in the value of the Agency Securities we purchase and an increase in the average collateral requirements under our repurchase agreements. Liquidating sales by several large institutions have increased the volatility of many financial assets, including Agency Securities and other high-quality Residential Mortgage Backed Securities, or RMBS. As a result, values for RMBS, including some Agency Securities, have been negatively impacted. Further increased volatility and deterioration in the broader RMBS markets may adversely affect the performance and market value of the Agency Securities in which we invest. In addition, we rely on the availability of financing to acquire Agency Securities on a leveraged basis. As values for certain types of Agency Securities declined many lenders in the Agency Securities market tightened their lending standards, and in some cases, withdrew financing of residential mortgage assets and Agency Securities. Our lenders may have owned or financed RMBS that have declined in value and caused them to incur losses. If these market conditions persist, our lenders may be forced to exit the repurchase market, become insolvent or further tighten lending standards or increase the amount of equity capital or the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount required to obtain financing, any of which could make it more difficult or costly for us to obtain financing.

Developments at Fannie Mae and Freddie Mac

Payments on the Agency Securities in which we invest are guaranteed by Fannie Mae and Freddie Mac. Because of the guarantee and the underwriting standards associated with mortgages underlying Agency Securities, Agency Securities historically have had high stability in value and been considered to present low credit risk. In 2008, Fannie Mae and Freddie Mac were placed under the conservatorship of the U.S. government due to the significant weakness of their financial condition. The turmoil in the residential mortgage sector and concern over the future role of Fannie Mae and Freddie Mac have generally increased credit spreads and decreased price stability of Agency Securities.

In response to the credit market disruption and the deteriorating financial condition of Fannie Mae and Freddie Mac, Congress and the U.S. Treasury undertook a series of actions in 2008 aimed at stabilizing the financial markets in general, and the mortgage market in particular. These actions include the large-scale buying of mortgage backed securities, significant equity infusions into banks and aggressive monetary policy.

In addition, the U.S. Federal Reserve initiated a program in 2008 to purchase $200.0 billion in direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks and $1.3 trillion in Agency Securities issued and guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. The U.S. Federal Reserve stated that its actions were intended to reduce the cost and increase the availability of credit for the purchase of houses, which in turn was expected to support housing markets and foster improved conditions in financial markets more generally.

The purchase program was completed on March 31, 2010. It is unclear the degree to which the completion of this program and withdrawal of substantial demand for Agency Securities by the Federal Reserve will affect the price and liquidity of Agency Securities. We are unable to predict whether or when the US Treasury or the Federal Reserve will make further interventions in the Agency Securities markets, or what impact, if any; such action could have on the Agency Securities market, the Agency Securities we hold, our business, results of operations and financial condition. It is unclear the timing or manner in which the Federal Reserve might dispose of the Agency Securities it has acquired and, consequently, any impact on the Agency Securities market and the Agency Securities we hold.

In February of 2010, Fannie Mae and Freddie Mac announced that they would execute wholesale repurchases of loans which they considered seriously delinquent from existing mortgage pools. This action temporarily decreased the value of these securities until complete details of the programs and the timing were announced, and have or will reduce the yield and our book value in the months of repayment. Freddie Mac implemented its purchase program in February 2010 with actual purchases beginning in March 2010. Fannie Mae began their process in March 2010 and announced it would implement the initial purchases over a period of three months, beginning in April 2010. Further, both agencies announced that on an ongoing basis they would purchase loans from the pools of mortgage loans underlying their mortgage pass-through certificates that became 120 days delinquent.

These actions by Fannie Mae, Freddie Mac, the U.S. Treasury, Federal Reserve and Congress could decrease our income and book value. We cannot predict whether or when new actions may occur, the timing and place of current actions already implemented, or what impact if any, such actions, or future actions could have on our business, results of operations and financial condition.

Interest Rates

The overall credit market deterioration since August 2007 has also affected prevailing interest rates. For example, interest rates have been unusually volatile since the third quarter of 2007. Since September 18, 2007, the U.S. Federal Reserve has lowered the target for the Federal Funds Rate nine times from 4.75% to 1.0% in October 2008. In December 2008, the Federal Reserve stated that it was adopting a policy of quantitative easing and would target keeping the Federal Funds Rate between 0 and 0.25%. Our funding costs, which traditionally have tracked the 30 day LIBOR have generally benefited by this easing of monetary policy, although to a somewhat lesser extent. Because of continued uncertainty in the credit markets and U.S. economic conditions, we expect that interest rates are likely to experience continued volatility, which will likely affect our financial results since our cost of funds is largely dependent on short-term rates.

Historically, 30-day LIBOR has closely tracked movements in the Federal Funds Rate. Our borrowings in the repurchase market have also historically closely tracked LIBOR. So traditionally, a lower Federal Funds rate has indicated a time of increased net interest margin and higher asset values. However, since July 2007 (prior to our commencement of operations) LIBOR and repurchase market rates have varied greatly, and often have been significantly higher than the target Federal Funds Rate. The difference between 30-day LIBOR and the Federal Funds rate has also been quite volatile, with the spread alternately returning to more normal levels and then widening out again. Towards the end of the third quarter of 2008 this difference increased to historically high levels. Although this difference had returned to more normal levels by the end of December 2008, the volatility in these rates and divergence from the historical relationship among these rates could negatively impact our ability to manage our portfolio. If this were to occur, our net interest margin and the value of our portfolio might suffer as a result. The following table shows the 30-day LIBOR as compared to the Federal Funds rate at each period end:

As of	**30-Day LIBOR**	**Federal Funds**
March 31, 2010	0.25%	0.09%
December 31, 2009	0.23%	0.05%

Principal Repayment Rate

Our net income is primarily a function of the difference between the yield on our assets and the financing cost of owning those assets. Since we tend to purchase assets at a premium to par, the main item that can affect the yield on our assets after they are purchased is the rate at which the mortgage borrowers repay the loan. While the scheduled repayments, which are the principal portion of the homeowners' regular monthly payments, are fairly predictable, the unscheduled repayments, which are generally refinancing of the mortgage but can also result from repurchases of delinquent, defaulted, or modified loans, are less so. Being able to accurately estimate and manage these repayment rates is a critical portion of the management of our portfolio, not only for estimating current yield but also to consider the rate of reinvestment of those proceeds into new securities and the yields which those new securities may add to our portfolio. The following table shows the average principal repayment rate for those securities which have settled for each quarter since our commencement of operations (as our operations commenced in November 2009, there is only one month of prepayment data for our portfolio of settled Agency Securities):

Quarter ended	Average Quarterly Principal Repayment Rate	Average Principal Repayment Rate Annualized
March 31, 2010	14.5%	14.5%
December 31, 2009	8.6%	8.6%

Book Value per Share

As of March 31, 2010, our book value per share of common stock (total shareholders' equity divided by shares of common stock outstanding) was $9.30, a decrease of $0.03 from $9.33 at December 31, 2009. U.S. Government actions, particularly the large-scale purchasing of Agency Securities, the availability of historically low funding rates to fund asset purchases and decreasing turmoil in the financial markets increased values on our securities modestly between our commencement of operations and December 31, 2009. Our interest rate contracts, which consist of using Eurodollar futures to replicate a pay fixed and receive floating swap format, act to fix the borrowing cost on a portion of our financing and generally help to mitigate some of the change in our book value. Generally, the value of our interest rate contracts move in the opposite direction of the value of our Agency Securities. During the first quarter of 2010, our Eurodollar futures positions declined by $0.6 million and our Agency Securities increased by $0.6 million in value.

Investments

Agency Securities

As of March 31, 2010, our Agency Securities portfolio was purchased at a net premium to par value with a weighted average amortized cost, including settled and forward settled securities, of 104.03%, due to the average interest rates on these securities being higher than prevailing market rates. As of March 31, 2010, we had approximately $7.0 million of unamortized premium included in the cost basis of our investments, inclusive of both settled and forward settled securities. The table below includes $15.8 million of current carrying value of forward settle security sales.

Adjustable Rate Securities

Months to Reset	Percentage of Portfolio	Weighted Average Months to Reset	Current Face Value(1)	Weighted Average Coupon(2)	Weighted Average Amortized Purchase Price(3)	Amortized Cost(4)	Weighted Average Market Price(5)	Current Market Value(6)
0-18	11.17%	7.3	$ 19,439,658	4.57%	$ 103.92	$ 20,202,643	$ 103.67	$ 20,153,538
19-36	1.13	29.0	1,945,399	5.17	102.55	1,994,986	104.77	2,038,138
37-60	46.99	55.3	81,327,867	4.56	103.71	84,347,347	104.21	84,749,203
61-80	17.37	64.0	30,059,610	4.79	103.94	31,245,203	104.22	31,327,076
Totals/Averages	76.66%	49.9	$132,772,534	4.62%	$ 103.78	$137,790,179	$ 104.14	$138,267,955

Fixed Rate Securities

Weighted Average Months to Maturity	**Percentage of Portfolio**	**Weighted Average Months to Reset**	**Current Face Value(1)**	**Weighted Average Coupon(2)**	**Weighted Average Amortized Purchase Price(3)**	**Amortized Cost(4)**	**Weighted Average Market Price(5)**	**Current Market Value(6)**
0-90	0.92%	72.7	$ 1,540,539	6.18%	$ 107.15	$ 1,650,615	$ 107.86	$ 1,661,619
91-180	22.42	168.1	38,501,116	4.90	104.78	40,340,317	105.02	40,434,795
Totals/Averages	23.34%	164.4	$40,041,655	4.95%	$ 104.87	$41,990,932	$ 105.13	$42,096,414

All Securities

	Percentage of Portfolio	**Current Face Value(1)**	**Weighted Average Coupon(2)**	**Weighted Average Amortized Purchase Price(3)**	**Amortized Cost(4)**	**Weighted Average Market Price(5)**	**Current Market Value(6)**
Totals/Averages	100.00%	$172,814,189	4.70%	$ 104.03	$179,781,111	$ 104.37	$180,364,369

(1)

The current face is the current monthly remaining dollar amount of principal of an Agency Security. We compute current face by multiplying the original face value of the security by the current principal balance factor. The current principal balance factor is a fraction, where the numerator is the current outstanding balance and the denominator is the original principal balance.

(2)

For a pass-through certificate, the coupon reflects the weighted average nominal rate of interest paid on the underlying mortgage loans, net of fees paid to the servicer and the agency. The coupon for a pass-through certificate may change as the underlying mortgage loans are prepaid.

(3)

Amortized purchase price is the dollar amount, per $100 of current face, of our purchase price for the security, adjusted for amortization as a result of scheduled and unscheduled principal repayments.

(4)

Amortized cost is our total purchase price for the Agency Security, adjusted for amortization as a result of scheduled and unscheduled principal repayments.

(5)

Market price is the dollar amount of market value, per $100 of nominal, or face value, of the Agency Security. We utilize a third party pricing service to determine pricing for our portfolio. In certain circumstances, we may disagree with the pricing service analysis and we will request a price from third party broker dealers who actively trade in the specific securities. We may seek one or more prices from broker dealers to assess fair market value. Generally, the securities we purchase can be fully analyzed using software available from Bloomberg L.P. This software is utilized by the counterparties with whom we trade.

(6)

Market value is the total market value for the security.

As of December 31, 2009, our Agency Securities portfolio was purchased at a net premium to par value with a weighted average amortized cost, including settled and forward settles securities, of 104.07%, due to the average interest rates on these securities being higher than prevailing market rates. As of December 31, 2009, we had approximately $4.6 million of unamortized premium included in the cost basis of our investments, inclusive of both settled and forward settle securities. All unsettled purchases of securities as of December 31, 2009 were settled in January and February 2010. As of December 31, 2009, our investment portfolio of settled securities consisted of Agency Securities as follows:

Adjustable Rate Settled Securities

Months to Reset	Percentage of Portfolio	Weighted Average Months to Reset	Current Face Value(1)	Weighted Average Coupon(2)	Weighted Average Amortized Purchase Price(3)	Amortized Cost(4)	Weighted Average Market Price(5)	Current Market Value(6)
0-18	9.48%	1.6	$ 5,568,961	2.79	$ 102.03	$ 5,681,963	$ 102.34	$ 5,699,059
19-36	2.65	30.4	1,512,149	5.38	102.60	1,551,508	105.27	1,591,791
37-60	39.12	54.5	22,268,269	5.50	105.18	23,421,507	105.64	23,523,759
61-80	17.95	66.4	10,214,641	5.43	105.61	10,787,220	105.64	10,790,323
Totals/Averages	69.20%	49.4	$ 39,564,020	5.11	$ 104.76	$ 41,442,198	$ 105.17	$ 41,604,932

Fixed Rate Settled Securities

Weighted Average Months to Maturity	Percentage of Portfolio	Weighted Average Months to Reset	Current Face Value(1)	Weighted Average Coupon(2)	Weighted Average Amortized Purchase Price(3)	Amortized Cost(4)	Weighted Average Market Price(5)	Current Market Value(6)
0-90	2.89%	73.3	$ 1,628,086	6.18%	$ 107.11	$ 1,743,902	$ 106.87	$ 1,739,867
91-180	27.91	167.2	16,026,317	4.97	106.18	17,016,808	104.72	16,782,673
Totals/Averages	30.80%	158.4	$ 17,654,403	5.08%	$ 106.27	$ 18,760,710	$ 104.92	$ 18,522,540

All Settled Securities

	Percentage of Portfolio	Current Face Value(1)	Weighted Average Coupon(2)	Weighted Average Amortized Purchase Price(3)	Amortized Cost(4)	Weighted Average Market Price(5)	Current Market Value(6)
Totals/Averages	100.00%	$ 57,218,423	5.10%	$ 105.23	$ 60,202,908	$ 105.10	$ 60,127,472

As of December 31, 2009, we had committed to purchase securities for settlements in January and February of 2010. The information below is accurate as of December 31, 2009, but subject to change due to amortization prior to settlement. In addition, some forward trades of new issue securities are subject to modest changes in delivery size and coupon. All, but one, of the forward settling Agency Securities are adjustable rate with a minimum expected months to reset of eleven months and a maximum expected months to reset of 71 months.

Adjustable Rate Forward Settled Securities

	Percentage of Forward Settle Portfolio	**Weighted Average Months to Reset**	**Current Face Value(1)**	**Weighted Average Coupon(2)**	**Weighted Average Amortized Purchase Price(3)**	**Expected Amortized Cost(4)**	**Weighted Average Market Price(5)**	**Current Market Value(6)**
Totals/Averages	91.0%	59.0	$51,636,165	4.29%	$ 102.89	$53,126,166	$ 103.19	$53,282,749

Fixed Rate Forward Settled Securities

	Percentage of Forward Settle Portfolio	**Weighted Average Months to Reset**	**Current Face Value(1)**	**Weighted Average Coupon(2)**	**Weighted Average Amortized Purchase Price(3)**	**Expected Amortized Cost(4)**	**Weighted Average Market Price(5)**	**Current Market Value(6)**
Totals/Averages	9.0%	163.0	$ 5,132,846	4.50%	$ 102.84	$ 5,278,811	$ 102.06	$5,238,503

All Forward Settled Securities

Percentage of Forward Settle	**Current Face Value(1)**	**Weighted Average Coupon(2)**	**Weighted Average Amortized Purchase**	**Expected Amortized Cost(4)**	**Weighted Average Market Price(5)**	**Current Market Value(6)**

	Portfolio			Price(3)			
Totals/Averages	100.00%	$ 56,769,011	4.31%	$ 102.89	$58,404,977	$ 103.09	$58,521,252

All Settled and Forward Settled Securities

	Percentage			**Weighted**			
	of			**Average**		**Weighted**	
	Forward		**Weighted**	**Amortized**	**Expected**	**Average**	**Current**
		Current					
	Settle	**Face**	**Average**	**Purchase**	**Amortized**	**Market**	**Market**
	Portfolio	**Value(1)**	**Coupon(2)**	**Price(3)**	**Cost(4)**	**Price(5)**	**Value(6)**
Totals/Averages	100.00%	$113,987,434	4.71%	$ 104.07	$118,607,885	$ 104.10	$118,648,724

(1) The current face is the current monthly remaining dollar amount of principal of an Agency Security. We compute current face by multiplying the original face value of the security by the current principal balance factor. The current principal balance factor is a fraction, where the numerator is the current outstanding balance and the denominator is the original principal balance.

(2) For a pass-through certificate, the coupon reflects the weighted average nominal rate of interest paid on the underlying mortgage loans, net of fees paid to the servicer and the agency. The coupon for a pass-through certificate may change as the underlying mortgage loans are prepaid.

(3) Amortized purchase price is the dollar amount, per $100 of current face, of our purchase price for the security, adjusted for amortization as a result of scheduled and unscheduled principal repayments.

(4) Amortized cost is our total purchase price for the Agency Security, adjusted for amortization as a result of scheduled and unscheduled principal repayments.

(5) Market price is the dollar amount of market value, per $100 of nominal, or face value, of the Agency Security. We utilize a third party pricing service to determine pricing for our portfolio. In certain circumstances, we may disagree with the pricing service analysis and we will request a price from third party broker dealers who actively trade in the specific securities. We may seek one or more prices from broker dealers to assess fair market value. Generally, the securities we purchase can be fully analyzed using software available from Bloomberg L.P. This software is utilized by the counterparties with whom we trade.

(6) Market value is the total market value for the security.

Our investment portfolio consisted of the following breakdown between Fannie Mae, Freddie Mac and Ginnie Mae at March 31, 2010. The table below includes $15.8 million of current carrying value of forward settled security sales.

Agency Securities	March 31, 2010	
	Estimated Fair Value	Percentage of Total
Settled Securities		
Fannie Mae Certificates	$ 87,774,493	48.7%
Freddie Mac Certificates	78,809,270	43.7
Ginnie Mae	13,780,606	7.6
Total Securities	$ 180,364,369	100.0%

Our investment portfolio consisted of the following breakdown between Fannie Mae, Freddie Mac and Ginnie Mae at December 31, 2009:

Agency Securities	December 31, 2009	
	Estimated Fair Value	Percentage of Total
Settled Securities		
Fannie Mae Certificates	$ 32,500,935	27.3%
Freddie Mac Certificates	27,372,349	23.1
Ginnie Mae	254,188	0.2
Forward Settle Securities		
Fannie Mae Certificates	8,378,168	7.1
Freddie Mac Certificates	34,993,084	29.5
Ginnie Mae	15,150,000	12.8
Total Securities	$ 118,648,724	100.0%

As of March 31, 2010 and December 31, 2009, the adjustable and hybrid adjustable rate mortgage loans underlying our Agency Securities had fixed interest rates for an average period of approximately 50 and 49 months, respectively, after which time the interest rates reset and become adjustable. After a reset date, interest rates on our adjustable and hybrid adjustable Agency Securities float based on spreads over various indices, typically LIBOR or the one-year Constant Maturity Treasury, or CMT, rate. These interest rates are subject to caps that limit the amount the applicable interest rate can increase during any year, known as an annual cap, and through the maturity of the security, known as a lifetime cap. Most of our adjustable and hybrid adjustable Agency Securities, but not all, have an initial 5% adjustment cap after the fixed period ends. The average annual cap, after the initial adjustment cap, on increases (or decreases) to the interest rates on our Agency Securities is typically, but not always, 2% per year. The typical average lifetime cap on increases to the interest rates on our Agency Securities is 5% from the initial stated rate, although in some cases it may be 6%.

Liabilities

We have entered into repurchase agreements to finance most of our Agency Securities. Our repurchase agreements are secured by our Agency Securities and bear interest at rates that have historically moved in close relationship to LIBOR. We had established borrowing relationships with several investment banking firms and other lenders, five of which we had done repurchase trades with as of March 31, 2010 and three of which we had done repurchases trades with as of December 31, 2009. We had outstanding balances under our repurchase agreements at March 31, 2010 and

December 31, 2009 of $168.5 million and $46.4 million, respectively.

Derivative Instruments

We generally intend to mitigate as much of our interest rate risk as our manager deems prudent in light of market conditions and the associated costs. No assurance can be given that our interest rate contracts will have the desired beneficial impact on our results of operations or financial condition. We do not qualify for, and have not elected hedge accounting treatment under the authoritative guidance. Our policies do not contain specific requirements as to the percentages or amount of interest rate risk that our manager is required to mitigate.

Use of derivative instruments may fail to protect or could adversely affect us because, among other things:

.

available interest rate contracts may not correspond directly with the interest rate risk for which protection is sought;

.

the duration of the interest rate contracts may not match the duration of the related liability;

.

the party owing money on the interest rate contracts may default on its obligation to pay;

.

the credit quality of the party owing money on interest rate contracts may be downgraded to such an extent that it impairs our ability to sell or assign our side of the hedging transaction; and

.

the value of interest rate contracts may be adjusted from time to time in accordance with accounting rules to reflect changes in fair value. Downward adjustments, or mark-to-market losses, would reduce our net income.

As of March 31, 2010 and December 31, 2009, we had entered into $60.0 million and $21.0 million, respectively, Eurodollar Futures swap equivalents traded in 716 and 292 individual contract transactions, respectively, designed to lock in some funding costs for financing activities associated with our assets in such a way as to help assure the realization of attractive net interest margins. Such hedges are based on assumptions about prepayments which, if not realized, will cause hedge results to differ from expectations. Eurodollar Futures are traded on the Chicago Mercantile Exchange (CME) and have limited counterparty risk because of daily mark-to-market and collateral requirements. In addition, substantial credit support for the futures contracts is provided by the CME.

Results of Operations

We commenced our operations in November 2009 upon completion of the merger with Enterprise Acquisition Corp. Our investment strategy requires a period of time to deploy investment capital. Consequently, comparison of quarter over quarter data, especially of gross numbers, may not be meaningful, or useful in predicting future results.

Three Months Ended March 31, 2010 Compared to Three Months Ended March 31, 2009

Our primary source of income is the interest income we earn on our investment portfolio. Our net income attributable to stockholders for the quarter ended March 31, 2010 was $0.3 million, or $0.13 per weighted average share. This was a significant increase from the quarter ended March 31, 2009 of net loss of $(9,000) million or $0.00 per weighted average share. The main drivers of the difference were the implementation of ARMOUR s investment strategy and the expenses related to the merger of Enterprise and ARMOUR.

Our net interest income for the quarter ended March 31, 2010 was $1.0 million compared to $0.1 million for the quarter ended March 31, 2009. As of March 31, 2010, our Agency Securities portfolio consisted of $180.4 million of securities, including $15.8 million of current carrying value of forward settle security sales. Our securities had an average yield of 3.06% and a cost of funds (including the effect of derivative instruments) of 0.38%. This resulted in a net interest margin (or spread) of 2.68% for the quarter ended March 31, 2010. The average yield of 3.06% and the net interest margin were significantly higher than the quarter ended March 31, 2009 because we implemented our investment strategy in Agency Securities on a leveraged basis. The average cost of funds incorporates repurchase placement fees as well as certain losses on derivative instruments incurred during the quarter ended March 31, 2010. The weighted average repurchase rate alone, excluding fees and interest rate risk mitigation was 27.4 basis points. For the quarter ended March 31, 2009 our investments were short term government bonds and had a yield of 0.06%. We had no borrowings and no hedging costs. As a result, our net interest margin equaled our yield of 0.06%.

The yield on our assets is most significantly affected by the rate of repayments on our Agency Securities. Our rate of portfolio repayment for the quarter ended March 31, 2010 was 14.5% on a Constant Prepayment Basis (CPR). Our portfolio was not fully invested until January 26, 2010, so this represents less than a full quarter of prepayment reports on the entire invested portfolio. We did not own Agency Securities as of the quarter ended March 31, 2009. Our prepayment rates were significantly faster in March at 20.7% CPR versus 10.0% CPR in February principally due to Freddie Mac s repurchase of all 120 day or more delinquent loans from its pools. We expect that prepayment rates will be elevated over the next several months as Fannie Mae repurchases its 120 day or more delinquent loans. Over the longer term, prepayment rates will likely be higher than recent history due to repurchases of loans that reach 120 day or more delinquency by Freddie Mac and Fannie Mae on a continuing basis.

As of March 31, 2010, our Agency Securities portfolio was purchased at a net premium to par value with a weighted average amortized cost, including settled and forward settled securities, of 104.03%, due to the average interest rates on these securities being higher than prevailing market rates.

The main indicator of our borrowing costs is 30-day LIBOR, which generally closely parallels the rates we pay on our repurchase agreements. LIBOR was 0.25% at March 31, 2010. During the quarter ended March 31, 2010, we realized expense related to our interest rate contracts of $6,654, as compared to no expense for the quarter ended March 31, 2009. We increased our total Eurodollar future swap equivalent notional amount from no amount during the quarter ended March 31, 2009 to $60.0 million at March 31, 2010 with a weighted average swap equivalent average rate of 1.79% and weighted average term of 35 months.

Our total operating expenses for the quarter ended March 31, 2010 were $0.3 million as compared to $0.2 million for the quarter ended March 31, 2009.

Fiscal Year Ended December 31, 2009 Compared to Fiscal Year Ended December 31, 2008

Our net loss attributable to stockholders not subject to possible conversion for the year ended December 31, 2009 was $(2.3) million, or $(0.11) per weighted average share. This was a significant decrease from the year ended December 31, 2008 of net income $0.6 million, or $0.02 per weighted average share. The main drivers of the difference were additional interest income attributable to a large number of stockholders that had their shares redeemed and the expenses related to the merger of Enterprise and ARMOUR.

Our net interest income for the year ended December 31, 2009 was $0.4 million compared to $5.4 million for the year ended December 31, 2008. As of December 31, 2009, our Agency Securities portfolio consisted of $60.1 million of settled securities and $58.5 million of unsettled securities, or commitments we had to buy securities for future settle dates. Our settled securities had an average yield of 4.59% and a cost of funds (including hedges) of 0.72%. This resulted in a net interest margin (or spread) of 3.86% for the year ended December 31, 2009. The average yield of 4.59% and the net interest margin are significantly higher than we estimate will be the case in the future as the securities that we owned as of December 31, 2009 had limited amortization expense during the average 18 day holding period in which we owned Agency Securities during 2009. The average cost of funds incorporates repurchase placement fees as well as certain hedging expenses incurred during the year ended December 31, 2009. The weighted average repurchase rate alone, excluding fees and hedges, was 26 basis points. For the year ended December 31, 2008, our investments had a yield of 2.17% and we had no borrowings. As a result, our net interest margin equaled our yield of 2.17%.

While the relative difference between our interest income and interest expense is more important to our performance than the absolute level of rates, the yield on our assets is a significant indicator of performance. Our gross yield in 2009, as stated above, is estimated to be lower in 2010 as we own securities over a longer period of time and normal amortization expense occurs. At the end of 2009, we had invested in Agency Securities with a weighted average coupon of 5.10% for those Agency Securities which had settled as of December 31, 2009. As of December 31, 2008, we primarily held cash for our investments.

After coupon rate, the yield on our assets is most directly affected by the rate of repayments on our Agency Securities. Our rate of portfolio repayment for the year ended December 31, 2009 was 8.6%. This represents just one month of prepayment reports the Agency Securities we owned in 2009. We did not own Agency Securities as of the year ended December 31, 2008. Low overall mortgage rates combined with U.S. government intervention in the mortgage market created a significant increase in residential mortgage refinancing, and is a risk to earnings in the future. At December 31, 2009, our portfolio of settled securities had an average dollar price of $105.23 per $100 of face value and an average dollar price of $104.07 for all securities, settled or not settled.

Our weighted average cost of funds (not including interest rate contracts and fees to AVM) for the year ended December 31, 2009 was 0.26%. There were no borrowings as of December 31, 2008. The main indicator of our borrowing costs is 30-day LIBOR, which generally closely parallels the rates we pay on our repurchase agreements. This rate (LIBOR) dropped throughout 2009, ending 2009 at 0.23%. In 2009, we realized expense related to our interest rate hedges of $720, as compared to no expense for the preceding year. We increased our total Eurodollar future swap equivalent notional amount from no amount at December 31, 2008 to $21.0 million at December 31, 2009 with a weighted average swap equivalent average rate of 2.22% and weighted average term of 42 months.

Our total operating expenses for the year ended December 31, 2009 were $2.0 million as compared to the previous year s total expenses of $2.3 million.

We incurred substantial non-recurring expenses of $1.6 million in 2009 related to the merger of Enterprise and ARMOUR.

Fiscal Year Ended December 31, 2008 Compared to the Period from July 9, 2007 (inception) to December 31, 2007

Our net income attributable to stockholders not subject to possible conversion for the year ended December 31, 2008 was $0.5 million, or $0.02 per weighted average share. This was a significant decrease from the year ended December 31, 2007 of net income of $0.9 million, or $0.05 per weighted average share. The main driver of the difference was interest income attributable to a large number of stockholders that could possibly convert their shares being present in 2008 that was not present in 2007.

Our net interest income for the year ended December 31, 2008 was $5.4 million compared to $1.7 million for the year ended December 31, 2007. As of December 31, 2008, we did not own any Agency Securities. Our cash held in trust had an average yield of 2.18%. We did not have any borrowings or cost of funds. Therefore, out net interest margin (or spread) was also 2.18% for the year ended December 31, 2008. The average yield of 2.18% and the net interest margin are significantly lower than we estimate will be the case in the future as Enterprise only invested in short term government bonds and going forward we will implement our investment strategy in Agency Securities on a leveraged basis.

Our total operating expenses for the year ended December 31, 2008 were $2.3 million as compared to the previous year s total expenses of $0.2 million. The significant difference between these two figures is due to the fact that Enterprise was formed in 2007 and did begin to incur significant expenses to consummate a merger transaction until 2008.

Liquidity and Capital Resources

Our primary sources of funds are borrowings under repurchase arrangements, monthly principal and interest payments on our investments, and cash generated from our operating results. Other sources of funds may include proceeds from equity and debt offerings and asset sales. We generally maintain liquidity to pay down borrowings under repurchase arrangements to reduce borrowing costs and otherwise efficiently manage our long-term investment capital. Because the level of these borrowings can be adjusted on a daily basis, the level of cash and cash equivalents carried on the balance sheet is significantly less important than our potential liquidity available under our borrowing arrangements. We currently believe that we have sufficient liquidity and capital resources available for the acquisition of additional investments, repayments on borrowings and the payment of cash dividends as required for continued qualification as a REIT.

Based on our current portfolio, leverage rate and available borrowing arrangements, we believe that our common equity, combined with cash flow from operations and available borrowing capacity, will be sufficient to enable us to meet anticipated short-term (one year or less) liquidity requirements such as to fund our investment activities, pay fees under our management agreement, fund our distributions to shareholders and general corporate expenses.

Our ability to meet our long-term (greater than one year) liquidity and capital resource requirements will be subject to obtaining additional debt financing and/or equity capital. We may increase our capital resources by obtaining long-term credit facilities or making public or private offerings of equity or debt securities, possibly including classes of preferred stock, common stock, and senior or subordinated notes. Such financing will depend on market conditions for capital raises and for the investment of any proceeds. If we are unable to renew, replace or expand our sources of financing on substantially similar terms, it may have an adverse effect on our business and results of operations.

We generally seek to borrow (on a recourse basis) between six and ten times the amount of our shareholders' equity, although we are not limited to that range. At March 31, 2010 and December 31, 2009, our total borrowings were approximately $168.5 million and $46.4 million (excluding accrued interest), respectively, which represented a leverage ratio of approximately 7.9:1 and 2.16:1, respectively. The March 31, 2010 leverage ratio was approximately our target level of leverage in current market conditions.

Our primary uses of cash are to purchase Agency Securities, pay interest and principal on our borrowings, fund our operations, and pay dividends. During the first quarter of 2010, we purchased for settlement in the first quarter $7.7 million of Agency Securities using proceeds from the merger transaction, repurchase agreements and cash. During the first quarter of 2010, we received cash of $6.6 million from prepayments and scheduled amortization on our investment securities. We had a net cash increase from our repurchase agreements of $45.9 million. We made cash interest payments of $0.09 on our borrowings in the first quarter as well. Part of funding our operations includes providing cash margin to offset liability balances on our interest rate contracts. This required $0.7 million of cash to be placed in a restricted account with our counterparty as of the end of the first quarter 2010. As the long term outlook for rates increases, and as time passes, we expect to receive this cash back.

During 2009, we purchased for either settlement in 2009 or for settlement in 2010 $118.6 million of Agency Securities using proceeds from the merger transaction, repurchase agreements and cash. During 2009, we received cash of $0.2 million from prepayments and scheduled amortization on our investment securities. We had a net cash increase from our repurchase agreements of $46.4 million. We did not make any cash interest payments on our borrowings in 2009. Part of funding our operations includes providing cash margin to offset liability balances on our interest rate mitigation. This required $0.3 million of cash to be placed in a restricted account with our counterparty as of the end of 2009. As the long term outlook for rates increases, and as time passes, we expect to receive this cash back.

In response to the growth of our Agency Securities portfolio and to the relatively weak financing market, we have continued to pursue additional lending counterparties in order to help increase our financial flexibility and ability to withstand periods of contracting liquidity in the credit markets. Currently, we have Master Repurchase Agreements, which are uncommitted repurchase facilities with nine lending counterparties to finance this portfolio, subject to certain conditions, and have borrowings outstanding with five of these counterparties.

On April 29, 2010, we paid a first quarter 2010 cash dividend of $0.40, or $0.9 million in the aggregate, per common share to holders of record on March 15, 2010.

Our board of directors will continue to evaluate our dividend policy each quarter and will make adjustments as necessary, based on a variety of factors, including, among other things, the need to maintain our REIT status, our financial condition, liquidity, earnings projections and business prospects. Our dividend policy does not constitute an obligation to pay dividends, which only occurs when our board of directors declares a dividend.

We intend to make distributions to our stockholders to comply with the various requirements to maintain our REIT status and to minimize or avoid corporate income tax and the nondeductible excise tax. However, REIT taxable income is calculated according to the requirements of the Code rather than GAAP which can cause differences between GAAP income reported by us and taxable income calculated to determine distribution requirements to stockholders. These differences are primarily due to non-taxable unrealized changes in the value of our interest rate risk mitigation. These differences may be large and can be either positive or negative variances from GAAP income. In addition, differences in timing between the recognition of REIT taxable income and the actual receipt of cash could require us to sell assets or to borrow funds on a short-term basis to meet the REIT distribution requirements and to avoid corporate income tax and the nondeductible excise tax.

We entered into a consulting agreement with I-Bankers Securities Incorporated (IBS) on November 30, 2009, pursuant to which IBS agreed to assist us in expanding our shareholder base and listing our securities on NASDAQ. If we become listed on NASDAQ, IBS has the right to act as a manager and co-underwriter on any underwritten public offering of equity securities undertaken by us during the 18-month period following such listing. In addition, we entered into a letter agreement with Deutsche Bank Securities Inc. (Deutsche Bank) on September 29, 2009, pursuant to which Deutsche Bank agreed to provide investment banking services to us with respect to the after-market in our securities in connection with our merger with Enterprise. As compensation, we granted Deutsche Bank a right of first refusal as left bookrunner on all capital offerings by us through December 31, 2011. Deutsche Bank declined to exercise its right in connection with this offering.

Off-Balance Sheet Arrangements

As of March 31, 2010 and December 31, 2009, we did not maintain any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, or special purpose or variable interest entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, as of March 31, 2010 and December 31, 2009, we had not guaranteed any obligations of any unconsolidated entities or entered into any commitment or intent to provide funding to any such entities.

Liquidity Sources Repurchase Facilities

The following table presents certain information regarding our risk exposure on our repurchase agreements as of March 31, 2010:

Repurchase Agreement Counterparties	Amount Outstanding	Amount at Risk(1)	Weighted Average Maturity of Repurchase Agreements in Days	Percent of Total Amount Outstanding
MF Global	$ 66,434,000	$ 3,425,353	55	39.4%
Goldman Sachs	43,508,000	2,091,153	26	25.8
Nomura	26,340,093	1,199,539	26	15.6
South Street Securities	25,957,000	1,483,654	72	15.4
Jefferies	6,286,000	327,100	23	3.8
Total	$ 168,525,093	$ 8,526,799		100.0%

(1) Equal to the fair value of securities sold, plus accrued interest income, minus the sum of repurchase agreement liabilities, plus accrued interest expense.

The following table presents certain information regarding our risk exposure on our repurchase agreements as of December 31, 2009:

Repurchase Agreement Counterparties	Amount Outstanding	Amount at Risk(1)	Weighted Average Maturity of Repurchase Agreements in Days	Percent of Total Amount Outstanding
Goldman Sachs	$ 31,692,000	$ 1,683,203	81	68.3%
MF Global	10,730,188	385,340	22	23.1
South Street Securities	3,966,414	131,489	25	8.6
Total	$ 46,388,602	$ 2,200,032		100.0%

(1) Equal to the fair value of securities sold, plus accrued interest income, minus the sum of repurchase agreement liabilities, plus accrued interest expense.

As of March 31, 2010, the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount under all our repurchase agreements was approximately 5.2% (weighted by borrowing amount). As of December 31, 2009, the weighted average margin requirement, under all our repurchase agreements was approximately 5.4%. Declines in the value of our Agency Securities portfolio can trigger margin calls by our lenders under our repurchase agreements. An event of default or termination event under the standard master repurchase agreement would give our counterparty the option to terminate all repurchase transactions existing with us and require any amount due by us to the counterparty to be payable immediately.

The residential mortgage market in the United States has recently experienced difficult economic conditions including:

.

increased volatility of many financial assets, including Agency Securities and other high-quality RMBS assets;

.

increased volatility and deterioration in the broader residential mortgage and RMBS markets; and

.

significant disruption in financing of RMBS.

If these conditions persist, our lenders may be forced to exit the repurchase market, become insolvent or further tighten lending standards or increase the amount of required equity capital or the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount, any of which could make it more difficult or costly for us to obtain financing.

Effects of Margin Requirements, Leverage and Credit Spreads

Our Agency Securities have values that fluctuate according to market conditions and, as discussed above, the market value of our Agency Securities will decrease as prevailing interest rates or credit spreads increase. When the value of the securities pledged to secure a repurchase loan decreases to the point where the positive difference between the collateral value and the loan amount is less than the weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount, our lenders may issue a margin call, which means that the lender will require us to pay the margin call in cash or pledge additional collateral to meet that margin call. Under our repurchase facilities, our lenders have full discretion to determine the value of the Agency Securities we pledge to them. Most of our lenders will value securities based on recent trades in the market. Lenders also issue margin calls as the published current principal balance factors change on the pool of mortgages underlying the securities pledged as collateral when scheduled and unscheduled pay downs are announced monthly.

We experience margin calls in the ordinary course of our business, and under certain conditions, such as during a period of declining market value for Agency Securities, we may experience margin calls monthly or more frequently. In seeking to manage effectively the margin requirements established by our lenders, we maintain a position of cash and unpledged securities. We refer to this position as our liquidity. The level of liquidity we have available to meet margin calls is directly affected by our leverage levels, our weighted average margin requirement, or the percentage amount by which the collateral value must exceed the loan amount, and the price changes on our securities. If interest rates increase as a result of a yield curve shift or for another reason or if credit spreads widen, the prices of our collateral (and our unpledged assets that constitute our liquidity) will decline, we will experience margin calls, and we will use our liquidity to meet the margin calls. There can be no assurance that we will maintain sufficient levels of liquidity to meet any margin calls. If the percentage amount by which the collateral value must exceed the loan amount increase, our liquidity will proportionately decrease. In addition, if we increase our borrowings, our liquidity will decrease by the amount of additional percentage amount on the increased level of indebtedness.

We intend to maintain a level of liquidity in relation to our assets that enables us to meet reasonably anticipated margin calls but that also allows us to be substantially invested in Agency Securities. We may misjudge the appropriate amount of our liquidity by maintaining excessive liquidity, which would lower our investment returns, or by maintaining insufficient liquidity, which would force us to liquidate assets into unfavorable market conditions and harm our results of operations and financial condition.

Critical Accounting Policies

A summary of our critical accounting policies is included in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2009. There have been no significant changes to those policies during 2010.

Inflation

Virtually all of our assets and liabilities are interest rate sensitive in nature. As a result, interest rates and other factors influence our performance far more than inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and any distributions we may make will be determined by our Board based in part on our REIT taxable income as calculated according to the requirements of the Code; in each case, our activities and balance sheet are measured with reference to fair value without considering inflation.

Quantitative and Qualitative Disclosures About Market Risk

We seek to manage our risks related to the credit quality of our assets, interest rates, liquidity, prepayment speeds and market value while, at the same time, seeking to provide an opportunity to shareholders to realize attractive risk-adjusted returns through ownership of our capital stock. While we do not seek to avoid risk completely, we believe the risk can be quantified from historical experience and seek to actively manage that risk, to earn sufficient compensation to justify taking those risks and to maintain capital levels consistent with the risks we undertake.

Interest Rate, Cap, and Mismatch Risk

We invest in adjustable rate, hybrid and fixed rate Agency Securities. Hybrid mortgages are adjustable rate mortgages, or ARMs, that have a fixed interest rate for an initial period of time (typically three years or greater) and then convert to an adjustable rate for the remaining loan term. Our debt obligations are generally repurchase agreements of limited duration that are periodically refinanced at current market rates.

ARM-related assets are typically subject to periodic and lifetime interest rate caps that limit the amount an ARM-related asset's interest rate can change during any given period. ARM securities are also typically subject to a minimum interest rate payable. Our borrowings are not subject to similar restrictions. Hence, in a period of increasing interest rates, interest rates on our borrowings could increase without limitation, while the interest rates on our mortgage-related assets could be limited. This problem would be magnified to the extent we acquire Agency Securities that are not fully indexed. Further, some ARM-related assets may be subject to periodic payment caps that result in some portion of the interest being deferred and added to the principal outstanding. These factors could lower our net interest income or cause a net loss during periods of rising interest rates, which would negatively impact our liquidity, net income and our ability to make distributions to stockholders.

We fund the purchase of a substantial portion of our ARM-related assets with borrowings that have interest rates based on indices and repricing terms similar to, but of shorter maturities than, the interest rate indices and repricing terms of our mortgage assets. Thus, we anticipate that in most cases the interest rate indices and repricing terms of our mortgage assets and our funding sources will not be identical, thereby creating an interest rate mismatch between assets and liabilities. During periods of changing interest rates, such interest rate mismatches could negatively impact our net interest income, dividend yield and the market price of our common stock. Most of our adjustable rate assets are based on the one-year constant maturity treasury rate and the one-year LIBOR rate and our debt obligations are generally based on LIBOR. These indices generally move in the same direction, but there can be no assurance that this will continue to occur.

Our ARM-related assets and borrowings reset at various different dates for the specific asset or obligation. In general, the repricing of our debt obligations occurs more quickly than on our assets. Therefore, on average, our cost of funds may rise or fall more quickly than does our earnings rate on the assets.

Further, our net income may vary somewhat as the spread between one-month interest rates, the typical term for our repurchase agreements and six- and twelve-month interest rates, the typical reset term of adjustable rate Agency Securities, varies.

Prepayment Risk

As we receive repayments of principal on our Agency Securities from prepayments and scheduled payments, premiums paid on such securities are amortized against interest income and discounts are accreted to interest income as realized. Premiums arise when we acquire Agency Securities at prices in excess of the principal balance of the mortgage loans underlying such Agency Securities. Conversely, discounts arise when we acquire Agency Securities at prices below the principal balance of the mortgage loans underlying such Agency Securities. To date, all of our Agency Securities have been purchased at a premium.

Interest Rate Risk and Effect on Market Value Risk

Another component of interest rate risk is the effect changes in interest rates will have on the market value of our Agency Securities. We face the risk that the market value of our Agency Securities will increase or decrease at different rates than that of our liabilities, including our derivative instruments.

We primarily assess our interest rate risk by estimating the effective duration of our assets and the effective duration of our liabilities and by estimating the time difference between the interest rate adjustment of our assets and the interest rate adjustment of our liabilities. Effective duration essentially measures the market price volatility of financial instruments as interest rates change. We generally estimate effective duration using various financial models and empirical data. Different models and methodologies can produce different effective duration estimates for the same securities.

The sensitivity analysis tables presented below show the estimated impact of an instantaneous parallel shift in the yield curve, up and down 50 and 100 basis points, on the market value of our interest rate-sensitive investments and net interest income, at March 31, 2010 and December 31, 2009, assuming a static portfolio. When evaluating the impact of changes in interest rates, prepayment assumptions and principal reinvestment rates are adjusted based on our manager's expectations. The analysis presented utilized assumptions, models and estimates of the manager based on the manager's judgment and experience.

As of March 31, 2010

		Percentage Change
	Percentage Change	**in Projected Portfolio**
	in Projected Net	**Value Including Interest Rate Risk**
Change in Interest rates	**Interest Income**	**Mitigaton**
1.00%	(12.96)%	(1.79)%
0.50%	(5.81)%	(0.79)%
(0.50)%	(0.36)%	0.38%
(1.00)%	(4.34)%	0.28%

As of December 31, 2009

Change in Interest rate	Percentage Change in Projected Net Interest Income	Percentage Change in Projected Portfolio Value Including Interest Rate Risk Mitigation
1.00%	(6.09)%	(1.12)%
0.50%	(2.73)%	(0.55)%
(0.50)%	(1.12)%	0.78%
(1.00)%	(3.89)%	0.99%

While the table above reflects the estimated immediate impact of interest rate increases and decreases on a static portfolio, we rebalance our portfolio from time to time either to seek to take advantage of or reduce the impact of changes in interest rates. It is important to note that the impact of changing interest rates on market value and net interest income can change significantly when interest rates change beyond 100 basis points from current levels. Therefore, the volatility in the market value of our assets could increase significantly when interest rates change beyond amounts shown in the table above. In addition, other factors impact the market value of and net interest income from our interest rate-sensitive investments and derivative instruments, such as the shape of the yield curve, market expectations as to future interest rate changes and other market conditions. Accordingly, interest income would likely differ from that shown above, and such difference might be material and adverse to our shareholders.

The above table quantifies the potential changes in net interest income and portfolio value, which includes the value of our interest rate risk mitigation, should interest rates immediately change. Given the low level of interest rates at March 31, 2010 and December 31, 2009, we applied a floor of 0% for all anticipated interest rates included in our assumptions. Due to presence of this floor, it is anticipated that any hypothetical interest rate decrease would have a limited positive impact on our funding costs beyond a certain level; however, because prepayments speeds are unaffected by this floor, it is expected that any increase in our prepayment speeds (occurring as a result of any interest rate decrease or otherwise) could result in an acceleration of our premium amortization and the reinvestment of such prepaid principal in lower yielding assets. As a result, the presence of this floor limits the positive impact of any interest rate decrease on our funding costs. Therefore, at some point hypothetical interest rate decreases could cause the fair value of our financial instruments and our net interest income to decline.

Market Value Risk

All of our Agency Securities are classified as available for sale assets. As such, they are reflected at fair value (i.e., market value) with the periodic adjustment to fair value (that is not considered to be an other than temporary impairment) reflected as part of Accumulated other comprehensive income that is included in the equity section of our balance sheet. The market value of our assets can fluctuate due to changes in interest rates and other factors.

Liquidity Risk

Our primary liquidity risk arises from financing long-maturity Agency Securities with short-term debt. The interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable rate Agency Securities. Accordingly, in a period of rising interest rates, our borrowing costs will usually increase faster than our interest earnings from Agency Securities.

BUSINESS

Overview

We are a Maryland corporation that intends to elect to be a REIT for U.S. federal tax purposes, commencing with our fiscal year ended December 31, 2009. We are externally managed by ARRM, an entity affiliated with our executive officers. We invest primarily in hybrid adjustable rate, adjustable rate and fixed rate RMBS issued or guaranteed by U.S. Government-chartered entities. The entities issuing or guaranteeing the Agency Securities include:

- Fannie Mae;
- Freddie Mac; or
- Ginnie Mae.

From time to time, a portion of our portfolio may be invested in Agency Debt. Agency Debt includes:

- U.S. Treasuries; and
- money market instruments.

We seek attractive long-term investment returns by investing our equity capital and borrowed funds in our targeted asset class. We earn returns on the spread between the yield on our assets and our costs, including the interest cost of the funds we borrow, after giving effect to our interest rate risk mitigation.

When acquiring Agency Securities, we often finance our acquisitions with borrowings under a series of short-term repurchase agreements at the most competitive interest rates available to us and then cost-effectively mitigate our interest rate risk and other risks based on our entire portfolio of assets, liabilities and derivatives and our management's view of the market. Successful implementation of this approach requires us to address interest rate risk, maintain adequate liquidity and mitigate effectively.

Our Manager

We are managed by ARRM, a Delaware limited liability company, pursuant to a management agreement between us and ARRM. As an externally-managed company, we depend on the diligence, experience and skill of ARRM for the selection, acquisition, structuring, interest rate risk mitigation and monitoring of our Agency Securities and Agency Debt and associated borrowings. We do not have any employees whom we compensate directly with salaries or other compensation. ARRM currently has four full-time employees.

The management agreement requires ARRM to manage our business affairs in conformity with certain restrictions contained therein, including any material operating policies adopted by us. ARRM's role as manager is subject to the direction and oversight of our board of directors.   ARRM is responsible for:

.

advising us with respect to, arranging for, and managing the acquisition, financing, management and disposition of, our investments;

.

evaluating the duration risk and prepayment risk of our investments and arranging borrowing and interest rate risk mitigation strategies; and

.

coordinating our capital raising activities.

In conducting these activities, ARRM also advises us on the formulation of, and implements, our operating strategies and policies, arranges for our acquisition of assets, monitors the performance of our assets, arranges for various types of financing and interest rate risk mitigation strategies, and provides administrative and managerial services in connection with our day-to-day operations, as may be required from time to time for our management and our assets (other than assets solely being managed by any other manager).

Our Assets

Since commencing operations, our assets have been invested primarily in Agency Securities. As of March 31, 2010, our Agency Security portfolio, including both trades that had settled and forward settling trades that we had committed to settle, consisted of approximately $180.4 million, in market value, of Agency Securities with initial fixed-interest rate periods of three years, five years, seven years, ten years and 15 years.

Our Borrowings

We borrow against our Agency Securities using repurchase agreements. These borrowings generally have maturities that may range from one month or less to up to one year, although occasionally we may enter into longer dated borrowing agreements to more closely match the rate adjustment period of the securities we own. Our total repurchase indebtedness was approximately $168.5 million at March 31, 2010, and had a weighted average maturity of 44 days. Depending on market conditions, we may enter into additional repurchase arrangements with similar longer-term maturities or a committed borrowing facility. Our borrowings are generally between six and ten times the amount of our stockholders' equity, but we are not limited to that range. The level of our borrowings may vary periodically depending on market conditions. Despite recent credit market developments and prevailing trends, we believe Agency Securities will continue to be eligible for financing in the repurchase agreement market.

Our Interest Rate Risk Mitigation

Our interest rate risk mitigation strategies are designed to reduce the impact on our income caused by the potential adverse effects of changes in interest rates on our assets and liabilities. Subject to complying with REIT requirements, we use derivative instruments to mitigate the risk of adverse changes in interest rates on the value of our assets as well as the differences between the interest rate adjustments on our assets and borrowings. These strategies primarily consist of purchasing or selling futures contracts and may also include entering into interest rate swap agreements, interest rate cap or floor agreements, purchasing put and call options on securities or securities underlying futures contracts, or entering into forward rate agreements. Although we are not legally bound to use interest rate risk mitigation strategies, we intend to limit our use of derivative instruments to only those techniques described above and to enter into derivative instrument transactions only with counterparties that we believe have a strong credit rating to help mitigate the risk of counterparty default or insolvency. These transactions are entered into solely for the purpose of mitigating interest rate risk and prepayment risk and not for speculative purposes. Since we will not qualify for hedge accounting treatment as prescribed by GAAP, our operating results may reflect greater volatility than otherwise would be the case, because gains or losses on the derivative instrument transactions may not be offset by changes in the fair values or cash flows of the related investment or borrowing transactions within the same accounting period, or ever.

Our Strategy and Competitive Advantages

Our objective is to realize attractive risk-adjusted returns to our stockholders over the long-term through selective acquisition of Agency Securities combined with strategic applications of leverage management, risk management and interest rate management strategies. We believe we possess the core strengths that will enable us to realize our objectives and provide us with competitive advantages in the marketplace. Our core strengths include:

Significant Experience of Our Management Team

We believe that the extensive experience of our management team at ARRM provides us with significant expertise across our target assets. Messrs. Ulm and Zimmer have extensive experience in favorable and unfavorable economic cycles and in securities trading, interest rate risk mitigation, asset/liability management and analysis and leveraged mortgage finance.

The senior members of our research and investment team have an aggregate of 48 years of experience in mortgage-backed securities investing, including experience in performing advisory services for investment banks, funds, other investment vehicles and other managed and discretionary accounts. Mr. Ulm has 23 years of structured finance and debt capital markets experience, including mortgage-backed securities. Mr. Ulm has advised numerous U.S., European and Asian financial institutions and corporations on balance sheet and capital raising matters. Mr. Zimmer has significant experience in the mortgage-backed securities market over a 25 year period.

Disciplined Relative Value Investment Approach

We follow a disciplined security selection process and are, in essence, a relative value investor in Agency Securities. ARRM uses a cross-product approach, conducting top-down market assessments with respect to various subsets of the Agency Securities market in order to identify the most attractive segments and investment opportunities consistent with our portfolio objectives and risk management strategy. In employing this detailed analysis, ARRM seeks to identify the best values available in Agency Securities. We select our Agency Securities based on extensive analysis including factors such as prepayment trends, average remaining life, amortization schedules, fixed versus floating interest rates, geographic concentration, property type, loan-to-value ratios and credit scores. Considering the large size of the Agency Securities market, we believe we can be very selective with our investments and buy only the securities we deem to be the most attractive.

Portfolio Construction

We anticipate that returns to our stockholders will be realized over the long-term primarily through the distribution of dividends and secondarily through capital appreciation. We intend to realize returns to our investors by constructing a well-balanced portfolio consisting primarily of shorter duration Agency Securities with a focus on managing various associated risks, including interest rate, prepayment, and financing risk. ARRM uses its fixed income expertise across the range of asset classes within the Agency Securities markets to build a portfolio that seeks to balance income, cash, capital, leverage and the aforementioned risks. Through the careful and disciplined selection of assets, and continual portfolio monitoring, we believe we can build and maintain an investment portfolio that provides value to stockholders over time, both in absolute terms and relative to other Agency Securities portfolios.

Analytical Tools, Infrastructure and Expertise

ARRM's experienced investment team constructs and manages our Agency Securities investment portfolio through the use of focused qualitative and quantitative analysis, which helps us manage risk on a security-by-security and portfolio basis. We rely on a variety of analytical tools and models to assess our investments and risk management. We focus on in-depth analysis of the numerous factors that influence our target assets, including:

- fundamental market and sector review;
- cash flow analysis;
- controlled risk exposure; and
- prudent balance sheet management.

We also use these tools to guide the interest rate risk mitigation strategies developed by ARRM to the extent consistent with the requirements for qualification as a REIT.

Extensive Relationships and Experience of ARRM

ARRM maintains extensive relationships with financial intermediaries including prime brokers, investment banks, broker-dealers and asset custodians. We believe these relationships enhance our ability to source, finance, protect and mitigate our investments, interest rate risk and, thus, enable us to succeed in various credit and interest rate environments. ARRM s management has many years of experience and well-established contacts within the Agency Securities, capital and financing markets, and are able to bring their personal relationships to bear for our benefit and the benefit of our stockholders.

Operating and Regulatory Structure

REIT Qualification

We intend to elect to qualify and be taxed as a REIT under the Code, commencing with our taxable year ended December 31, 2009. Our qualification as a REIT depends upon our ability to meet on a continuing basis, through actual investment and operating results, various complex requirements under the Code relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels and the diversity of ownership of our shares. We believe that we have been organized in conformity with the requirements for qualification and taxation as a REIT under the Code, and that following consummation of this offering, our intended manner of operation and corporate structure and stockholder ownership will enable us to meet the requirements for qualification and taxation as a REIT.

So long as we qualify as a REIT, we generally will not be subject to U.S. federal income tax on our net taxable income that we distribute currently to our stockholders. If we fail to qualify as a REIT in any taxable year and do not qualify for certain statutory relief provisions, we will be subject to U.S. federal income tax at regular corporate rates and may be precluded from qualifying as a REIT for the subsequent four taxable years following the year during which we lost our REIT qualification. Even if we qualify for taxation as a REIT, we may be subject to certain U.S. federal, state and local taxes on our income or property.

1940 Act Exemption

We conduct our business so as not to become regulated as an investment company under the 1940 Act. If we were to fall within the definition of an investment company, we would be unable to conduct our business as described in this prospectus.

Section 3(a)(1)(A) of the 1940 Act defines an investment company as any issuer that is or holds itself out as being engaged primarily in the business of investing, reinvesting or trading in securities. Section 3(a)(1)(C) of the 1940 Act also defines an investment company as any issuer that is engaged or proposes to engage in the business of investing, reinvesting, owning, holding or trading in securities and owns or proposes to acquire investment securities having a value exceeding 40% of the value of the issuer's total assets (exclusive of U.S. Government securities and cash items) on an unconsolidated basis. Excluded from the term investment securities, among other things, in Section 3(a)(1)(C) of the 1940 Act, as defined above, are U.S. Government securities and securities issued by majority-owned subsidiaries that are not themselves investment companies and are not relying on the exception from the definition of investment company set forth in Section 3(c)(1) or Section 3(c)(7) of the 1940 Act.

To avoid registration as an investment company, we rely on the exclusion provided by Section 3(c)(5)(C) of the 1940 Act. To qualify for the exclusion, we intend to make investments so that at least 55% of the assets we own consist of qualifying assets and so that at least 80% of the assets we own consist of qualifying assets and real estate related assets. We generally expect that our investments in Agency Securities will be treated as either qualifying assets or real estate related assets under Section 3(c)(5)(C) of the 1940 Act in a manner consistent with the SEC staff no-action letters. Qualifying assets for this purpose include mortgage loans and other assets, such as whole pool Agency Securities that are considered the functional equivalent of mortgage loans for the purposes of the 1940 Act. We invest at least 55% of our assets in whole pool Agency Securities that constitute qualifying assets in accordance with SEC staff guidance and at least 80% of our assets in qualifying interests plus other real estate related assets. Other real estate related assets would consist primarily of non-whole pool Agency Securities and funds awaiting investment. As a result of the foregoing restrictions, we are limited in our ability to make or dispose of certain investments. To the extent that the SEC staff publishes new or different guidance with respect to these matters, we may be required to adjust our strategy accordingly. These restrictions could also result in us holding assets we might wish to sell or selling assets we might wish to hold. Although we intend to monitor our portfolio relying on the Section 3(c)(5)(C) exclusion periodically and prior to each acquisition and disposition, there can be no assurance that we will be able to maintain this exclusion.

To the extent that we elect in the future to conduct our operations through wholly-owned subsidiaries, such business will be conducted in such a manner as to ensure that we do not meet the definition of investment company under either Section 3(a)(1)(A) or Section 3(a)(1)(C) of the 1940 Act. All wholly-owned subsidiaries that we elect to conduct our business through would qualify for the Section 3(c)(5)(C) exclusion discussed above and we would, accordingly, qualify for the Section 3(a)(1)(C) exemption because less than 40% of the value of our total assets on an unconsolidated basis would consist of investment securities. We intend to monitor our portfolio periodically to insure compliance with the 40% test. In such case, we would be a holding company which conducts business exclusively through wholly-owned subsidiaries and we would be engaged in the non-investment company business of our subsidiaries.

Restrictions on Ownership of our Common Stock

To assist us in complying with the REIT limitations on the concentration of ownership imposed by the Code, among other purposes, our charter prohibits, with certain exceptions, any stockholder from beneficially or constructively owning, applying certain attribution rules under the Code (including deemed ownership of shares underlying warrants or options to purchase sotck), more than 9.8% by value or number of shares, whichever is more restrictive, of our outstanding shares of common stock, or 9.8% by value or number of shares, whichever is more restrictive, of our outstanding capital stock. Our board of directors may, in its sole discretion, waive the 9.8% ownership limit with respect to a particular stockholder if it is presented with certain representations and undertakings required by our charter and other evidence satisfactory to it that such ownership will not then or in the future jeopardize our qualification as a REIT. Our charter also prohibits any person from, among other things: (1) beneficially or constructively owning shares of our capital stock that would result in our being closely held under Section 856(h) of the Code, or otherwise cause us to fail to qualify as a REIT; and (2) transferring shares of our capital stock if such transfer would result in our capital stock being beneficially owned by fewer than 100 persons.

We believe that, based on our current stockholder concentration, upon completion of this offering, the 5/50 test will be met. If we fail to maintain qualification as a REIT, we would be exposed to additional risks, including those risks described in the section of this prospectus entitled *Risks--Federal Income Tax Risks* .

Our board may exempt a person from our charter s restrictions on ownership of stock or warrants. Currently, there are holders of our capital stock and/or warrants whose ownership exceeds the thresholds set forth in our charter. We currently are in the process of granting waivers from the charter requirements for such holders where, based on representations, covenants and agreements received from such holders, we determine that such waivers would not jeopardize our status as a REIT.

Policy With Respect to Dividends and Distributions

As required in order to maintain our qualification as a REIT for U.S. federal income tax purposes, we intend to distribute with respect to each year at least 90% of our REIT taxable income, determined without regard to the deduction for dividends paid and excluding any net capital gain. To satisfy the requirements to qualify as a REIT and generally not be subject to U.S. federal income and excise tax, we intend to pay regular quarterly dividends of all or substantially all of our taxable income to holders of our common stock out of assets legally available for such purposes. We are not restricted from using the proceeds of equity or debt offerings to pay dividends, but we do not intend to do so. The timing and amount of any dividends we pay to holders of our common stock will be at the discretion of our Board and will depend upon various factors, including our earnings and financial condition, maintenance of REIT status, applicable provisions of the Maryland General Corporation Law, or MGCL, and such other factors as our Board deems relevant.

Policies With Respect To Certain Other Activities

If, when applicable, we determine that additional funding is required, we may raise such funds through equity offerings (including preferred equity), unsecured debt securities, convertible securities (including warrants, preferred equity and debt) or the retention of cash flow (subject to provisions in the Code concerning taxability of undistributed REIT taxable income) or a combination of these methods.

In the event that we determine to raise additional equity capital, we have the authority, without stockholder approval, to issue additional common stock or preferred stock in any manner and on such terms and for such consideration as we deem appropriate, at any time.

Competition

Our success depends, in large part, on our ability to acquire assets at favorable spreads over our borrowing costs. In acquiring Agency Securities, we compete with mortgage REITs, mortgage finance and specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investment banking firms, other lenders, governmental bodies and other entities. Many of these organizations have greater financial resources and access to lower costs of capital than we do. In addition, there are numerous mortgage REITs with similar asset acquisition objectives, including Agency Securities, and others may be organized in the future. The effect of the existence of additional REITs may be to increase competition for the available supply of mortgage assets suitable for purchase.

In addition, the U.S. Federal Reserve had initiated a program to purchase $200.0 billion in direct obligations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks and $1.3 trillion in Agency Securities issued and guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae. The U.S. Federal Reserve stated that its actions were intended to reduce the cost and increase the availability of credit for the purchase of houses, which in turn was expected to support housing markets and foster improved conditions in financial markets more generally.

The purchase program was completed on March 31, 2010. It is unclear the degree to which the completion of this program and withdrawal of substantial demand for Agency Securities by the Federal Reserve will affect the price and liquidity of Agency Securities. We are unable to predict whether or when the US Treasury or the Federal Reserve will make further interventions in the Agency Securities markets, or what impact, if any; such action could have on the

Agency Securities market, the Agency Securities we hold, our business, results of operations and financial condition. It is unclear the timing or manner in which the Federal Reserve might dispose of the Agency Securities it has acquired and, consequently, any impact on the Agency Securities market and the Agency Securities we hold.

Corporate Background

We were incorporated in the state of Maryland on February 5, 2008.

On July 29, 2009, we and ARMOUR Merger Sub Corp., a Delaware corporation and our wholly-owned subsidiary, which we refer to as Merger Sub Corp., entered into a merger agreement with Enterprise Acquisition Corp., a Delaware blank check company, which we refer to as Enterprise. The merger agreement provided for two primary transactions: (i) the merger of Merger Sub Corp. with and into Enterprise with Enterprise surviving the merger and becoming a wholly-owned subsidiary of ARMOUR, and (ii) ARMOUR becoming the new publicly-traded corporation of which the holders of Enterprise securities would be security holders.

Enterprise was incorporated on July 9, 2007 in order to serve as a vehicle for the acquisition of one or more operating businesses.

In July 2007, Enterprise issued an aggregate of 7,187,500 shares of common stock, which we refer to as the Initial Shares, to SBBC, an affiliate of Messrs. Bell and Stanton, two of our directors, and three of Enterprise's directors, who together with SBBC we refer to as the Founders.

On November 6, 2007, SBBC purchased an aggregate of 7,500,000 warrants, which we refer to as Insider Warrants, from Enterprise in a private placement transaction at a purchase price of $1.00 per Insider Warrant, which we refer to as the Private Placement.

On November 14, 2007, Enterprise completed its initial public offering, which we refer to as the IPO, of 25,000,000 units pursuant to a registration statement (File No. 333-145154), resulting in total gross proceeds of $250,000,000. Each unit sold in the IPO consisted of one share of common stock, par value $0.0001 per share, and one warrant exercisable for an additional share of common stock. The managing underwriters for the IPO were UBS Securities LLC and Ladenburg Thalmann & Co. Inc., the representative of the underwriters in this offering. The net proceeds after offering expenses of the IPO and the Private Placement was $247,575,000, which was placed in a trust account maintained at Continental Stock Transfer & Trust Company.

In connection with the IPO, the Founders placed the Initial Shares into an escrow account maintained by Continental Stock Transfer & Trust Company, acting as escrow agent. The Initial Shares were not to be released from escrow until one year after the consummation of a Business Combination, or earlier if, following a Business Combination, the company consummated a subsequent liquidation, merger, stock exchange or other similar transaction which results in stockholders having the right to exchange their shares for cash, securities or other property.

On November 28, 2007, the underwriters in the IPO decided not to exercise its over-allotment option to purchase an additional 3,000,000 units. Pursuant to the escrow agreement, SBBC forfeited an aggregate of 937,500 shares of common stock. Accordingly, the Founders collectively held 6,250,000 shares of common stock.

On November 5, 2009, the stockholders of Enterprise approved certain proposals to: (i) amend Enterprise's amended and restated certificate of incorporation to allow for the Business Combination and (ii) adopt the merger agreement and approve the Business Combination.

On November 6, 2009, Merger Sub Corp. merged with and into Enterprise pursuant to the merger agreement. As a result of the Business Combination, we became a public company. In connection with the closing, the holders of Enterprise common stock and warrants became holders of the securities of ARMOUR after the Business Combination in the same proportion as their holdings in Enterprise immediately before the Business Combination, except as (i) increased by (A) the cancellation of an aggregate of 6,150,000 Initial Shares by the Founders, (B) conversion of 11,890,903 shares of Enterprise common stock by holders thereof who exercised the right to have their shares converted into funds held in the trust account at a value of $9.98 per share and (C) the purchase of 13,209,097 shares pursuant to forward contract arrangements that provided for Enterprise to purchase such shares after the closing of the Business Combination at a price of $9.98 per share. The remaining 100,000 Initial Shares that were not cancelled continue to be held in escrow pursuant to the escrow agreement with Continental Stock Transfer & Trust Company. Upon completion of the merger, we now have 2,304,054 shares of common stock outstanding.

At the closing of the IPO, Enterprise had paid an underwriting fee of $9.1 million to the underwriters, including Ladenburg Thalmann & Co, and committed to pay a deferred fee of $8.4 million to the underwriters upon the completion of the Business Combination. However, upon the completion of the Business Combination, the $8.4 million of deferred underwriting fees were settled for a cash payment of $300,000 and the balance was waived by the underwriters.

In addition, in connection with the closing of the merger, Enterprise and ARMOUR entered into a supplement and amendment to the agreement that governs the public warrants, the terms of which, among other things, (i) increased the exercise price of the warrants from $7.50 per share to $11.00 per share, (ii) extended the expiration date of the warrants from November 7, 2012 to November 7, 2013 and (iii) limited a holder's ability to exercise warrants to ensure that such holder's Beneficial Ownership or Constructive Ownership (each term as defined in our charter) do not exceed the restrictions contained in the charter limiting the ownership of shares of our common stock.

At the closing of the merger with Enterprise, Enterprise had $249.5 million in cash. Of such amount, $226.5 million was used to pay stockholders who elected to exercise their conversion rights into a pro rata portion of the trust account or who sold their shares to Enterprise pursuant to forward contract arrangements. The remaining funds have been invested by us in either Agency Securities or money market instruments (primarily deposits at federally chartered banks).

Prior Experience of Mr. Zimmer in Managing Agency Securities Portfolios

Scott J. Ulm and Jeffrey J. Zimmer currently manage the business of ARRM. In September of 2003, Mr. Zimmer and partners (not including Mr. Ulm) formed Bimini Mortgage Management, Inc. (Bimini) to manage a leveraged investment portfolio of Agency Securities. Bimini conducted private placements of its Class A common stock in which it raised aggregate net proceeds (after commissions and expenses) of approximately $141.7 million between December 2003 and February 2004. In September 2004, Bimini completed the initial public offering of shares of its Class A common stock, in which it raised approximately $75.9 million in net proceeds. In December 2004, Bimini completed a follow-on public offering of its Class A common stock, in which is raised approximately $66.7 million in net proceeds.

From December 2003 through November 2, 2005 Bimini operated solely as a REIT and invested only in Agency Securities. As of early November 2005, Bimini had approximately 10 employees operating from one office in Vero Beach, Florida, managing more than $4 billion in Agency Securities and cash assets.

On November 3, 2005, Bimini acquired Opteum Financial Services, LLC (Opteum), a mortgage company focused on origination of ALT-A mortgages. At that time, Opteum had more than 35 offices nationwide and approximately 1,000 employees. In the first quarter of 2006, Bimini changed its name to Opteum to reflect the new nature of its business under a known enterprise name in the mortgage origination field. Although the company continued to manage a leveraged portfolio of Agency Securities, from closing of the acquisition of Opteum in November 2005 until the mortgage company was closed in the spring of 2007, the mortgage origination business was the primary user of cash flow of the company. The company had GAAP losses from the time Opteum was acquired until the mortgage company was closed, during which period most of the equity of the company was lost. At the same time, through the end of 2008, little cash was reinvested into the Agency Securities business and the portfolio declined from approximately $4 billion to approximately $600 million in assets. On September 28, 2007, Opteum changed its name to Bimini Capital Management, Inc. (Bimini Capital).

Set forth below is a table showing the performance of Bimini Capital during the period in which Mr. Zimmer was associated with the company. Additional information regarding Bimini Capital is set forth in the most recent Annual Report on Form 10-K of Bimini Capital. ARMOUR will provide upon request, for no fee, the Annual Report on Form 10-K of Bimini Capital, and, for a reasonable fee, the exhibits to such Form 10-K.

	BIMINI AS AN AGENCY ONLY REIT						
	2004				2005		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Revenue and Income							
Interest Income (in millions)	$ 7.19	$ 10.96	$ 11.02	$ 20.46	$ 31.07	$ 36.75	$ 43.57
Interest Expense (in millions)	$ (2.74)	$ (4.34)	$ (4.25)	$ (10.83)	$ (19.84)	$ (26.45)	$ (33.51)
Trading Account Profit or (Loss) (in millions)	$ -	$ -	$ 0.12	$ (0.03)	$ 1.98	$ -	$ 0.01
Net Revenue (in millions)	$ 4.46	$ 6.62	$ 6.89	$ 9.61	$ 13.21	$ 10.30	$ 10.08
Non-Interest Expense (in millions)	$ (0.51)	$ (1.05)	$ (1.14)	$ (2.01)	$ (2.30)	$ (2.08)	$ (2.20)
Operating Income (in millions)	$ 3.94	$ 5.57	$ 5.75	$ 7.60	$ 10.91	$ 8.22	$ 7.88

Net Income (in millions)	$	3.94	$	5.57	$	5.75	$	7.60	$	10.91	$	8.22	$	7.88
Net Income Available to Common Shareholders (in millions)	$	3.94	$	5.57	$	5.75	$	7.60	$	10.91	$	8.22	$	7.88
Per Share Income														
Diluted Earnings Per Share	$	0.39	$	0.52	$	0.51	$	0.44	$	0.52	$	0.39	$	0.37
Dividends Paid Per Share (1)	$	0.39	$	0.52	$	0.52	$	0.54	$	0.53	$	0.40	$	0.38
Portfolio and Liability Information														
Average Investment Securities Held During Quarter (in billions)	$	0.87	$	1.51	$	1.57	$	2.31	$	3.14	$	3.59	$	3.87
Average Balance of Repurchase Agreements During Quarter (in billions)	$	0.82	$	1.45	$	1.50	$	2.16	$	2.98	$	$3.45	$	$3.72
Annualized Average Cost of Funds		1.34%		1.20%		1.13%		2.00%		2.65%		3.02%		3.48
Net Interest Spread		1.96%		1.70%		1.67%		1.55%		1.31%		1.07%		1.03

BIMINI AS AN AGENCY ONLY REIT

	2004				2005		
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Assets and Liabilities							
Total Assets (in millions)	$1,593.64	$1,603.71	$1,779.53	$3,128.42	$3,469.96	$4,071.49	$4,042.42
Total Debt (in millions)	$1,442.79	$1,461.22	$1,548.62	$2,771.16	$3,181.66	$3,769.38	$3,780.92
Net Trust Preferred Outstanding (in millions) (2)	$ -	$ -	$ -	$ -	$ -	$ 50.00	$ 50.00
Total Debt *less* Net Trust Preferred (in millions)	$1,442.79	$1,461.22	$1,548.62	$2,771.16	$3,181.66	$3,719.38	$3,730.92
Shareholders Equity							
Shareholder's Equity (in millions)	$ 144.67	$ 132.70	$ 218.55	$ 282.96	$ 261.62	$ 261.54	$ 232.60
Shareholders Equity + Net Trust Preferred (in millions)	$ 144.67	$ 132.70	$ 218.55	$ 282.96	$ 261.62	$ 311.54	$ 282.60
Debt to Equity Ratios							
Total Debt to Shareholder's Equity	9.97	11.01	7.09	9.79	12.16	14.41	16.26
Total Debt *less* Net Trust Preferred to Shareholders Equity + Net Trust Preferred	9.97	11.01	7.09	9.79	12.16	11.94	13.20
Per Share Book Value and Stock Price Information							
Beginning Book Value Per Share	$ 14.04	$ 13.85	$ 13.25	$ 13.32	$ 13.47	$ 12.45	$ 12.44
Ending Book Value Per Share	$ 13.85	$ 13.25	$ 13.32	$ 13.47	$ 12.45	$ 12.44	$ 11.06
Stock Price (3)	$ N/A	$ N/A	$ 15.76	$ 16.06	$ 13.85	$ 14.10	$ 11.30

The information above is from Bloomberg L.P. and Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K filed by Bimini.

(1) GAAP earnings and dividends can differ as a REIT pays out TAXABLE REIT income which can be different than GAAP income.

(2) The Trust Preferred referenced herein is reported as Junior Subordinated Notes due to Bimini Capital Trust I.

(3) There is no public stock price for Q1 and Q2 2004 as Bimini was a private company.

Bimini with an ALT-A Mortgage Company

2005	2006	2007	2008

	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue and Income										
Interest Income (in millions)	$ 49.25	$ 60.69	$ 75.29	$ 43.05	$ 31.84	$ 53.88	$ 27.52	$ 24.63	$ 11.71	$ 10.11
Interest Expense (in millions)	$(44.95)	$(57.94)	$(62.47)	$(44.92)	$(41.69)	$(54.11)	$ (35.68)	$(23.23)	$(12.71)	$(9.20)
Trading Account Profit or (Loss) (in millions)	$ -	$ 7.08	$ -	$ -	$ -	$(18.78)	$ (73.82)	$ (2.53)	$ -	$ 0.93
Net Revenue (in millions)	$ 6.62	$ 17.88	$ 20.73	$ (1.87)	$ (9.84)	$(10.06)	$ (81.97)	$ (1.13)	$ 3.11	$ 1.32
Non-Interest Expense (in millions)	$(13.56)	$(26.76)	$(32.96)	$ (2.07)	$ (9.26)	$(30.73)	$ (2.09)	$ (2.10)	$ (2.18)	$ 2.09
Operating Income (in millions)	$ (6.94)	$ (8.88)	$(12.23)	$ (3.94)	$(19.10)	$(40.79)	$ (84.06)	$ (3.23)	$ 3.02	$(0.77)
Net Income (in millions)	$ (2.72)	$ (5.09)	$ (3.69)	$ (6.26)	$(33.92)	$(78.07)	$(162.47)	$ (4.72)	$ (2.39)	$(5.10)
Net Income Available to Common Shareholders (in millions)	$ (2.72)	$ (5.09)	$ (3.69)	$ (6.26)	$(33.92)	$(78.07)	$(162.47)	$ (4.72)	$ (2.39)	$(5.10)

100.0 — 100.0 -

Industrial	97.4	—	97.4	—
Energy	62.6	—	62.6	—
Basic materials	55.6	—	55.6	—
Utilities	43.1	—	43.1	—
Technology	29.0	—	29.0	—
Debt securities issued by corporations	755.7	—	755.7	—
Mortgage-backed and asset-backed securities	881.3	—	862.9	18.4
Preferred stocks	84.3	—	13.0	71.3
Municipal obligations	32.1	—	32.1	—
Foreign government obligations	2.3	1.6	0.7	—
Fixed maturity investments	1,965.8	211.7	1,664.4	89.7
Short-term investments	152.7	152.7	—	—
Common equity securities:				

Consumer	123.3	123.3	—	—
Financials	83.0	82.9	—	0.1
Energy	35.9	35.9	—	—
Basic Materials	20.9	20.9	—	—
Utilities	9.6	9.6	—	—
Other	74.4	74.4	—	—
Common equity securities	347.1	347.0	—	0.1
Convertible fixed maturity investments	29.3	—	29.3	—
Other investments[1]	123.7	—	—	123.7
Total[1]	$ 2,618.6	$ 711.4	$ 1,693.7	$ 213.5

[1] Excludes the carrying value of $19.3 million associated with a tax advantaged federal affordable housing development fund accounted for using the equity method as of March 31, 2014.

[2] Fair value includes $222.2 million of fixed maturity investments reclassified to assets held for sale in the March 31, 2014 consolidated balance sheets as part of the Runoff Transaction.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

	Fair value at December 31, 2013[2] ($ in millions)	Level 1	Level 2	Level 3
Fixed maturity investments:				
U.S. Government and agency obligations	$131.1	$131.1	$—	$—
Debt securities issued by corporations:				
Consumer	239.6	—	239.6	—
Financial	145.5	—	145.5	—
Industrial	106.0	—	106.0	—
Communications	91.5	—	91.5	—
Basic materials	64.4	—	64.4	—
Energy	40.5	—	40.5	—
Utilities	38.0	—	38.0	—
Technology	29.0	—	29.0	—
Debt securities issued by corporations	754.5	—	754.5	—
Mortgage-backed and asset-backed securities	949.5	—	938.6	10.9
Preferred stocks	83.3	—	12.3	71.0
Municipal obligations	16.5	—	16.5	—
Foreign government obligations	2.3	1.6	0.7	—
Fixed maturity investments	1,937.2	132.7	1,722.6	81.9
Short-term investments	157.0	155.9	1.1	—
Common equity securities:				
Consumer	122.6	122.6	—	—
Financials	83.3	83.2	—	0.1
Energy	34.7	34.7	—	—
Basic Materials	20.3	20.3	—	—
Utilities	8.3	8.3	—	—
Other	67.7	67.7	—	—
Common equity securities	336.9	336.8	—	0.1
Convertible fixed maturity investments	30.5	—	30.5	—
Other investments[1]	119.9	—	—	119.9
Total[1]	$2,581.5	$625.4	$1,754.2	$201.9

[1] Excludes the carrying value of $19.7 million associated with a tax advantaged federal affordable housing development fund accounted for using the equity method as of December 31, 2013.

[2] Fair value includes $236.3 million of fixed maturity investments reclassified to assets held for sale in the December 31, 2013 consolidated balance sheets as part of the Runoff Transaction.

At both March 31, 2014 and December 31, 2013, OneBeacon held one private preferred stock that represented approximately 85% of its preferred stock portfolio. OneBeacon calculated its fair value using projected discounted cash flows based on a discount yield. The discounted yield was determined with inputs from quoted market yields for similar securities and adjusted for liquidity based on management's best estimate of market conditions; this security is classified as a Level 3 measurement.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

The following table summarizes the ratings of OneBeacon's corporate debt securities as of March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	($ in millions)	
AA	$47.1	$51.2
A	352.2	357.9
BBB	355.6	345.4
BB	—	—
Other	0.8	—
Debt securities issued by corporations[1]	$755.7	$754.5

[1] Credit ratings are assigned based on the following hierarchy: 1) Standard and Poor's Financial Services LLC ("Standard and Poor's") and 2) Moody's Investor Service ("Moody's").

Rollforwards of Fair Value Measurements by Level

The changes in Level 1 fair value measurements for the three months ended March 31, 2014 are as follows:

	Fixed maturity investments	Common equity securities	Convertible fixed maturity investments	Other investments	Total[1]
	($ in millions)				
Balance at January 1, 2014	$132.7	$336.8	$—	$—	$469.5
Amortization/accretion	—	—	—	—	—
Net realized and unrealized gains (losses)	0.1	8.5	—	—	8.6
Purchases	114.6	26.0	—	—	140.6
Sales	(35.7)	(24.3)	—	—	(60.0)
Transfers in	—	—	—	—	—
Transfers out	—	—	—	—	—
Balance at March 31, 2014	$211.7	$347.0	$—	$—	$558.7

[1] Excludes short-term investments which are deemed to have a Level 1 designation.

The changes in Level 2 fair value measurements for the three months ended March 31, 2014 are as follows:

	Fixed maturity investments	Common equity securities	Convertible fixed maturity investments	Other investments	Total
	($ in millions)				
Balance at January 1, 2014	$1,722.6	$—	$30.5	$—	$1,753.1
Amortization/accretion	(2.6)	—	(0.1)	—	(2.7)
Net realized and unrealized gains (losses)	5.0	—	1.9	—	6.9
Purchases	344.0	—	3.8	—	347.8
Sales	(404.6)	—	(6.8)	—	(411.4)
Transfers in	—	—	—	—	—
Transfer out	—	—	—	—	—
Balance at March 31, 2014	$1,664.4	$—	$29.3	$—	$1,693.7

16

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

The changes in Level 3 fair value measurements for the three months ended March 31, 2014 and 2013 are as follows:

	Fixed maturity investments	Common equity securities	Convertible fixed maturity investments	Other investments[1]	Total[1]
	($ in millions)				
Balance at January 1, 2014	$81.9	$0.1	$—	$ 119.9	$201.9
Amortization/accretion	—	—	—	—	—
Net realized and unrealized gains (losses)	0.3	—	—	3.1	3.4
Purchases	7.5	—	—	2.3	9.8
Sales	—	—	—	(1.6)	(1.6)
Transfers in	—	—	—	—	—
Transfers out	—	—	—	—	—
Balance at March 31, 2014	$89.7	$0.1	$—	$ 123.7	$213.5

	Fixed maturity investments	Common equity securities	Convertible fixed maturity investments	Other investments[1]	Total[1]
	($ in millions)				
Balance at January 1, 2013	$76.1	$0.1	$—	$ 122.7	$198.9
Amortization/accretion	—	—	—	—	—
Net realized and unrealized gains (losses)	0.1	—	—	3.7	3.8
Purchases	1.8	—	—	1.8	3.6
Sales	—	—	—	(4.5)	(4.5)
Transfers in	—	—	—	—	—
Transfers out	—	—	—	—	—
Balance at March 31, 2013	$78.0	$0.1	$—	$ 123.7	$201.8

[1] Excludes the carrying value of $19.3 million and $20.6 million associated with a tax advantaged federal affordable housing development fund accounted for using the equity method as of March 31, 2014 and 2013, respectively.

There were no “Transfers in” to Level 3 or "Transfers out" of Level 3 for the three months ended March 31, 2014 and 2013.

Significant Unobservable Inputs

As previously described, in certain circumstances, OneBeacon estimates the fair value of investments using industry standard pricing models and both observable and unobservable inputs.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

The following summarizes significant unobservable inputs used in estimating the fair value of investment securities classified within Level 3, other than hedge funds and private equity funds, at March 31, 2014. The fair value of investments in hedge funds and private equity funds, which are classified within Level 3, are estimated using the net asset value of the funds.

Description[1]	Fair Value	Rating[2]	Valuation Technique	Unobservable Inputs	Range
Non-agency commercial mortgage-backed securities	$6.4	AAA	Broker indication	Prepayment/Default Rate Discount Spread over Swap	0 CPY/0 CDR 0.8%
Non-agency commercial mortgage-backed securities	$1.1	BBB-	Broker pricing	Broker quote	N/A
Other asset-backed securities	$10.9	AA+	Broker pricing	Broker quote	N/A
Preferred stock	$71.3	N/R	Discounted cash flow	Discount yield	6.9%

[1] As of March 31, 2014, each asset type consists of one security.

[2] Credit ratings are assigned based on the following hierarchy: 1) Standard & Poor's and 2) Moody's

The assumed prepayment rate is a significant unobservable input used to estimate the fair value of investments in agency commercial mortgage-backed securities. Generally for bonds priced at a premium, increases in prepayment speeds will result in a lower fair value, while decreases in prepayment speed may result in a higher fair value, with the inverse for bonds priced at a discount.

The following table summarizes the change in net unrealized gains or losses for assets designated as Level 3 for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Fixed maturity investments	$0.3	$0.1
Short-term investments	—	—
Common equity securities	—	—
Convertible fixed maturity investments	—	—
Other investments	3.1	1.9
Total	$3.4	$2.0

Mortgage-backed Securities

OneBeacon purchases commercial mortgage-backed securities ("CMBS") and residential mortgage-backed securities ("RMBS") to maximize its risk adjusted returns in the context of a diversified portfolio. OneBeacon's non-agency CMBS are generally short tenor and structurally senior, with approximately 30 points of subordination on average for fixed rate and floating rate CMBS as of March 31, 2014. In general, subordination represents the percentage of principal loss on the underlying collateral that would have to occur before the security incurs a loss. These collateral losses, instead, are first absorbed by other securities lower in the capital structure. OneBeacon believes this structural protection mitigates the risk of loss tied to refinancing challenges facing the commercial real estate market. As of March 31, 2014, on average less than 1% of the underlying loans were reported as non-performing for both agency and non-agency CMBS held by OneBeacon. OneBeacon is not an originator of residential mortgage loans. OneBeacon did not hold any RMBS categorized as sub-prime as of March 31, 2014. OneBeacon's investments in hedge funds and private equity funds contain negligible amounts of sub-prime mortgage-backed securities as of

March 31, 2014. OneBeacon considers sub-prime mortgage-backed securities to be those that have underlying loan pools that exhibit weak credit characteristics or are issued from dedicated sub-prime shelves or dedicated second-lien shelf registrations (i.e., OneBeacon considers investments backed primarily by second-liens to be sub-prime risks regardless of credit scores or other metrics).

There are also mortgage-backed securities that OneBeacon categorizes as "non-prime" (also called "Alt A" or "A-") that are backed by collateral that has overall credit quality between prime and sub-prime, as determined based on OneBeacon's review of the characteristics of their underlying mortgage loan pools, such as credit scores and financial ratios. As of March 31, 2014, OneBeacon held one mortgage-backed security with a market value of $6.4 million that was classified as non-prime.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

OneBeacon's non-agency residential mortgage-backed portfolio is generally of moderate average life, fixed rate and structurally senior. OneBeacon does not own any collateralized debt obligations, including residential mortgage-backed collateralized debt obligations.

The following table summarizes the carrying value of OneBeacon's mortgage-backed and asset-backed securities as of March 31, 2014 and December 31, 2013:

	March 31, 2014			December 31, 2013		
	Fair Value	Level 2	Level 3	Fair Value	Level 2	Level 3
	($ in millions)					
Mortgage-backed securities:						
Agency:						
GNMA	$305.9	$305.9	$—	$321.8	$321.8	$—
FNMA	64.8	64.8	—	36.5	36.5	—
FHLMC	23.0	23.0	—	24.3	24.3	—
Total agency[1]	393.7	393.7	—	382.6	382.6	—
Non-agency:						
Residential	54.0	54.0	—	51.5	51.5	—
Commercial	169.2	161.7	7.5	155.0	155.0	—
Total Non-agency	223.2	215.7	7.5	206.5	206.5	—
Total mortgage-backed securities	616.9	609.4	7.5	589.1	589.1	—
Other asset-backed securities:						
Credit card receivables	101.8	90.9	10.9	124.2	113.3	10.9
Vehicle receivables	115.8	115.8	—	189.3	189.3	—
Other	46.8	46.8	—	46.9	46.9	—
Total other asset-backed securities	264.4	253.5	10.9	360.4	349.5	10.9
Total mortgage-backed and asset-backed securities	$881.3	$862.9	$18.4	$949.5	$938.6	$10.9

[1] Represents publicly traded mortgage-backed securities which carry the full faith and credit guaranty of the U.S. government (i.e., GNMA) or are guaranteed by a government sponsored entity (i.e., FNMA, FHLMC).

Non-agency Mortgage-backed Securities

The security issuance years of OneBeacon's investments in non-agency RMBS and non-agency CMBS securities as of March 31, 2014 are as follows:

	Fair	Security Issuance Year										
	Value	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	($ in millions)											
Total non-agency RMBS	$54.0	$6.5	$5.7	$5.5	$—	$6.5	$—	$6.4	$—	$—	$17.4	$6.0
Total non-agency CMBS	169.2	—	—	—	1.3	15.0	—	7.2	13.1	86.3	38.8	7.5

Total non-agency	$223.2	$6.5	$5.7	$5.5	$1.3	$21.5	$—	$13.6	$13.1	$86.3	$56.2	$13.5

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Non-agency Residential Mortgage-backed Securities
The classification of the underlying collateral quality and the tranche levels of OneBeacon's non-agency RMBS securities are as follows as of March 31, 2014:

	Fair Value	Super Senior[1]	Senior[2]	Subordinate[3]
	($ in millions)			
Prime	$47.6	$24.9	$22.7	$—
Non-prime	6.4	—	6.4	—
Total non-agency RMBS	$54.0	$24.9	$29.1	$—

[1] At issuance, Super Senior, or in the case of resecuritization, the underlying securities, were rated AAA by Standard & Poor's, Aaa by Moody's, or AAA by Fitch Ratings ("Fitch") and were senior to other AAA or Aaa bonds.

[2] At issuance, Senior, or in the case of resecuritization, the underlying securities, were rated AAA by Standard & Poor's, Aaa by Moody's, or AAA by Fitch and were senior to non-AAA or non-Aaa bonds.

[3] At issuance, Subordinate were not rated AAA by Standard & Poor's, Aaa by Moody's, or AAA by Fitch and were junior to other bonds.

Non-agency Commercial Mortgage-backed Securities
The amount of fixed and floating rate securities and their tranche levels are as follows as of March 31, 2014:

	Fair Value	Super Senior[1]	Senior[2]	Subordinate[3]
	($ in millions)			
Fixed rate CMBS	$127.9	$86.4	$32.6	$8.9
Floating rate CMBS	41.3	1.3	15.0	25.0
Total non-agency CMBS	$169.2	$87.7	$47.6	$33.9

[1] At issuance, Super Senior, or in the case of resecuritization, the underlying securities, were rated AAA by Standard & Poor's, Aaa by Moody's or AAA by Fitch and were senior to other AAA or Aaa bonds.

[2] At issuance, Senior, or in the case of resecuritization, the underlying securities, were rated AAA by Standard & Poor's, Aaa by Moody's, or AAA by Fitch and were senior to non-AAA or non-Aaa bonds.

[3] At issuance, Subordinate were not rated AAA by Standard & Poor's, Aaa by Moody's, or AAA by Fitch and were junior to other bonds.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Other Investments

OneBeacon holds investments in hedge funds and private equity funds which are included in other investments. The fair value of these investments has been estimated using the net asset value of the funds. The following table summarizes investments in hedge funds and private equity funds at March 31, 2014 and December 31, 2013:

	March 31, 2014		December 31, 2013	
	Fair Value	Unfunded Commitments	Fair Value	Unfunded Commitments
	($ in millions)			
Hedge funds				
Long/short equity	$41.3	$—	$39.1	$—
Long/short credit and distressed	8.3	—	8.1	—
Long/short equity activist	2.2	—	2.1	—
Long bank loan	0.1	—	0.1	—
Total hedge funds	51.9	—	49.4	—
Private equity funds				
Energy infrastructure and services	26.3	5.7	26.0	5.9
Multi-sector	14.9	2.5	14.5	2.5
Private equity secondaries	6.2	2.1	6.4	2.1
Healthcare	3.9	1.4	2.8	1.4
Real estate	3.5	0.1	3.9	0.1
Insurance	2.4	0.1	2.3	0.1
Distressed residential real estate	—	—	0.2	—
Total private equity funds	57.2	11.9	56.1	12.1
Total hedge funds and private equity funds[1]	$109.1	$11.9	$105.5	$12.1

[1] Excluded from the above table as of March 31, 2014 and December 31, 2013 are other investments, which include an investment in a community reinvestment vehicle of $14.4 million for both periods and an investment in a tax advantaged federal affordable housing development fund of $19.3 million and $19.7 million, respectively. Additionally, other investments includes trust certificates issued upon dissolution of a private equity fund of $0.2 million as of March 31, 2014, with no such investment held as of December 31, 2013.

Redemptions of investments in certain funds are subject to restrictions including "lock-up" periods where no redemptions or withdrawals are allowed, restrictions on redemption frequency and advance notice periods for redemptions. Amounts requested for redemptions remain subject to market fluctuations until the redemption effective date, which generally falls at the end of the defined redemption period. The following summarizes the March 31, 2014 fair value of hedge funds subject to restrictions on redemption frequency and advance notice period requirements for investments in active hedge funds:

	Hedge Funds—Active Funds				
	30 - 59 days notice	60 - 89 days notice	90 - 119 days notice	120+ days notice	Total
	($ in millions)				
Redemption frequency					
Monthly	$2.0	$—	$—	$5.5	$7.5
Quarterly	27.5	8.3	6.4	—	42.2
Annual	—	—	2.1	0.1	2.2
Total hedge funds	$29.5	$8.3	$8.5	$5.6	$51.9

Certain hedge fund investments are no longer active and are in the process of disposing of their underlying investments. Distributions from such funds are remitted to investors as the fund's underlying investments are liquidated. At March 31, 2014, $0.9 million of hedge funds were in liquidation. The actual amount of the final distribution is subject to market fluctuations. The date at which such distributions will be received is not determinable at March 31, 2014.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

OneBeacon has also submitted redemption requests for certain of its investments in active hedge funds. At March 31, 2014, redemptions of $2.2 million were outstanding. The date at which all these redemptions will be received is not determinable at March 31, 2014. Redemptions are recorded as receivables when the investment is no longer subject to market fluctuations.

Investments in private equity funds are generally subject to lock-up periods during which investors may not request a redemption. Distributions prior to the expected termination date of the fund may be limited to dividends or proceeds arising from the liquidation of the fund's underlying investment. In addition, certain private equity funds provide an option to extend the lock-up period at either the sole discretion of the fund manager or upon agreement between the fund and the investors. At March 31, 2014, investments in private equity funds were subject to lock-up periods as follows:

	1 - 3 years	3 - 5 years	5 - 10 years	>10 years	Total
	($ in millions)				
Private Equity Funds—expected lock-up period remaining	$2.4	$19.3	$35.5	$—	$57.2

NOTE 6. Debt

OneBeacon's debt outstanding as of March 31, 2014 and December 31, 2013 consisted of the following:

	March 31, 2014	December 31, 2013
	($ in millions)	
Senior unsecured notes, at face value	$275.0	$ 275.0
Unamortized original issue discount	(0.3)	(0.3)
Senior unsecured notes, carrying value	$274.7	$ 274.7

2012 Senior Notes

In November 2012, OneBeacon U.S. Holdings, Inc. ("OBH") issued $275.0 million face value of senior unsecured notes ("2012 Senior Notes") through a public offering, at an issue price of 99.9% and received $272.9 million of proceeds. The 2012 Senior Notes bear an annual interest rate of 4.6% payable semi-annually in arrears on May 9 and November 9, until maturity on November 9, 2022, and are fully and unconditionally guaranteed as to the payment of principal and interest by the Company. OBH incurred $2.8 million in expenses related to the issuance of the 2012 Senior Notes (including the $1.8 million underwriting discount), which were deferred and are being recognized into interest expense over the life of the 2012 Senior Notes. Taking into effect the amortization of the original issue discount and all underwriting and issuance expenses, the 2012 Senior Notes have an effective yield to maturity of approximately 4.7% per annum.

Debt Covenants

At March 31, 2014, OneBeacon was in compliance with all of the covenants under the 2012 Senior Notes.

NOTE 7. Segment Information

The Company has fourteen underwriting operating segments, including two that were exited in 2013, which are managed by the chief operating decision maker and are aggregated into two underwriting reportable segments. The two underwriting reportable segments were determined based on the nature of products or services, the production process, the method of distribution and the nature of the regulatory environment. The principal difference between the reportable segments is the type or class of customer.

The Specialty Products segment is comprised of eight operating segments, including a new Crop underwriting operating segment, as well as the Collector Cars and Boats underwriting operating segment that was exited in the first quarter of 2013 (see Note 2—"Acquisitions and Dispositions"), representing an aggregation based on those that offer distinct products and tailored coverages and services to a broad customer base across the United States. In addition to Crop and Collector Cars and Boats, the Specialty Products segment includes the Professional Insurance, Specialty Property, Environmental, Tuition Reimbursement, Programs, and Surety underwriting operating segments. During

2013, the Company received approval to provide multiple peril crop insurance through the federal crop insurance program administered by the U.S. Department of Agriculture's Risk Management Agency. The Company has entered into an exclusive agreement with a managing general

NOTE 7. Segment Information

agency, The Climate Corporation, to provide coverages through the federal program and other supplemental coverages, including crop-hail. The Company began writing crop business in the fourth quarter of 2013.

The Specialty Industries segment is comprised of six underwriting operating segments, including the Energy underwriting operating segment that was exited in the first quarter of 2013, representing an aggregation based on those that focus on solving the unique needs of a particular customer or industry group. The Specialty Industries segment includes the International Marine Underwriters, Technology, Accident, Government Risks, and Entertainment underwriting operating segments.

The Investing, Financing and Corporate segment includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and its intermediate subsidiaries. Invested assets are not allocated to the Specialty Products and Specialty Industries segments since OneBeacon does not manage them by segment. Invested assets, net investment income and net realized and change in unrealized investment gains related to OneBeacon's Specialty Products and Specialty Industries segments are included in the Investing, Financing and Corporate segment since these assets are available for payment of losses and expenses for all segments. Debt and the related interest expense on debt also are not allocated to or managed by segment and are also included in the Investing, Financing and Corporate segment.

Substantially all of the Company's revenue is generated from customers located in the United States.

Financial information for OneBeacon's reportable segments is as follows:

	Insurance Operations		Investing, Financing and Corporate	Consolidated
	Specialty Products	Specialty Industries		
	($ in millions)			
Three months ended March 31, 2014				
Earned premiums	$135.4	$141.1	$—	$276.5
Loss and loss adjustment expense	(78.0)	(71.4)	—	(149.4)
Policy acquisition expenses	(21.4)	(25.3)	—	(46.7)
Other underwriting expenses	(22.2)	(27.2)	—	(49.4)
Total underwriting income	13.8	17.2	—	31.0
Net investment income	—	—	10.0	10.0
Net realized and change in unrealized investment gains	—	—	18.9	18.9
Net other revenues	0.1	0.1	0.8	1.0
General and administrative expenses	0.1	(0.5)	(2.9)	(3.3)
Interest expense	—	—	(3.2)	(3.2)
Pre-tax income from continuing operations	$14.0	$16.8	$23.6	$54.4
Three months ended March 31, 2013				
Earned premiums	$153.7	$132.8	$—	$286.5
Loss and loss adjustment expense	(78.6)	(70.3)	—	(148.9)
Policy acquisition expenses	(30.4)	(24.4)	—	(54.8)
Other underwriting expenses	(24.3)	(25.0)	—	(49.3)
Total underwriting income	20.4	13.1	—	33.5
Net investment income	—	—	9.4	9.4
Net realized and change in unrealized investment gains	—	—	28.4	28.4
Net other revenues	0.3	0.2	23.5	24.0
General and administrative expenses	—	(0.6)	(3.4)	(4.0)
Interest expense	—	—	(3.2)	(3.2)

Pre-tax income from continuing operations	$20.7	$12.7	$54.7	$88.1

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 7. Segment Information

	Insurance Operations		Investing, Financing and Corporate[1]	Consolidated
	Specialty Products	Specialty Industries		
	($ in millions)			
March 31, 2014				
Total investment securities	$—	$—	$2,415.7	$2,415.7
Reinsurance recoverables	56.2	26.9	—	83.1
Deferred acquisition costs	55.4	50.5	—	105.9
Unpaid loss and loss adjustment expense reserves	617.6	452.2	—	1,069.8
Unearned premiums	303.8	278.4	—	582.2
Debt	—	—	274.7	274.7
December 31, 2013				
Total investment securities	$—	$—	$2,364.9	$2,364.9
Reinsurance recoverables	60.2	29.7	—	89.9
Deferred acquisition costs	53.6	50.1	—	103.7
Unpaid loss and loss adjustment expense reserves	607.8	446.5	—	1,054.3
Unearned premiums	275.4	269.5	—	544.9
Debt	—	—	274.7	274.7

[1] As described in Note 2, balances related to the the Runoff Business are presented as held for sale. Total investment securities excludes $222.2 million and $236.3 million of fixed maturity investments reclassified to assets held for sale as of March 31, 2014 and December 31, 2013, respectively.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 7. Segment Information

The following tables provide net written premiums, earned premiums and underwriting ratios for OneBeacon's insurance operations by reportable segment and in total, for the three months ended March 31, 2014, and 2013:

	Insurance Operations					
($ in millions)	Specialty Products		Specialty Industries		Consolidated	
Three months ended March 31, 2014						
Net written premiums	$160.8		$150.3		$311.1	
Earned premiums	135.4		141.1		276.5	
Underwriting ratios:[1]						
Loss and LAE	57.6	%	50.6	%	54.0	%
Expense	32.2		37.2		34.8	
Total combined ratio	89.8	%	87.8	%	88.8	%
Three months ended March 31, 2013						
Net written premiums	$123.9		$141.2		$265.1	
Earned premiums	153.7		132.8		286.5	
Underwriting ratios:[1]						
Loss and LAE	51.2	%	52.9	%	52.0	%
Expense	35.5		37.2		36.3	
Total combined ratio	86.7	%	90.1	%	88.3	%

[1] Underwriting ratios are used to measure the components of underwriting profitability and include: The loss and LAE ratio, calculated by dividing loss and LAE by earned premiums; the expense ratio, calculated by dividing policy acquisition and other underwriting expenses by earned premiums; and the combined ratio, the sum of the loss and LAE ratio and the expense ratio.

NOTE 8. Retirement Plans

OneBeacon sponsors qualified and non-qualified, non-contributory, defined benefit pension plans covering substantially all employees who were employed as of December 31, 2001 and former employees who had met the eligibility requirements, as well as retirees. Current plans include the OneBeacon qualified pension plan (the "Qualified Plan") and the OneBeacon non-qualified pension plan (the "Non-qualified Plan") (collectively the "Plans"). OneBeacon's Plans were frozen and curtailed in 2002 and, as a result, the projected benefit obligation is equal to the accumulated benefit obligation.

The benefits for the Plans are based primarily on years of service and employees’ compensation through December 31, 2002. OneBeacon’s funding policy is consistent with the funding requirements of U.S. federal laws and regulations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 8. Retirement Plans

The components of net periodic benefit cost for the three months ended March 31, 2014 and 2013 were as follows:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Service cost	$0.1	$0.2
Interest cost	1.2	1.1
Expected return on plan assets	(2.1)	(1.8)
Amortization of unrecognized loss	0.1	0.2
Net periodic pension income before special termination benefits	(0.7)	(0.3)
Special termination benefits expense[1]	0.3	0.2
Total net periodic benefit income	$(0.4)	$(0.1)

[1] Special termination benefits represent additional payments made from the Qualified Plan to certain vested participants when their employment was terminated due to a reduction in force.

OneBeacon does not expect to make a contribution to its Qualified Plan in 2014. OneBeacon anticipates contributing $2.2 million to the Non-qualified Plan in 2014, for which OneBeacon has assets held in a rabbi trust. During the three months ended March 31, 2014, the Company contributed $0.5 million to the Non-qualified Plan.

NOTE 9. Employee Share-Based Incentive Compensation Plans

OneBeacon's share-based compensation plans include performance shares and restricted shares, which are designed to maximize shareholder value over long periods of time by aligning the financial interests of its management with those of its owners. Performance shares are payable only upon achievement of pre-defined business goals and are valued based on the market value of OneBeacon's common shares at the time awards are earned. Performance shares are typically paid in cash, though, in some instances, they may be paid in common shares or may be deferred in accordance with the terms of OneBeacon's deferred compensation plan. OneBeacon expenses the full cost of all its share-based compensation over the requisite service period. For the three months ended March 31, 2014 and 2013, the Company recognized expense of $1.4 million and $1.2 million, respectively, related to its share-based compensation plans.

Performance Shares

The following summarizes performance share activity for OB Performance Shares for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,			
	2014		2013	
	Target OB Performance Shares outstanding	Accrued expense	Target OB Performance Shares outstanding	Accrued expense
	($ in millions)			
Beginning of period	493,421	$4.0	563,190	$1.2
Payments and deferrals[1]	(142,138)	(1.0)	(238,658)	—
New awards	165,800	—	179,000	—
Forfeitures and net change in assumed forfeitures	(4,145)	—	(13,665)	—
Expense recognized	—	0.6	—	0.4
End of period	512,938	$3.6	489,867	$1.6

[1]

Performance share payments in 2014 for the 2011-2013 performance cycle were based upon a performance factor of 37.1%. No payments were made in 2013 for the 2010-2012 performance cycle as the performance factor was zero.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 9. Employee Share-Based Incentive Compensation Plans

The following summarizes performance shares outstanding and accrued performance share expense at March 31, 2014 for each performance cycle:

	Target OB Performance Shares outstanding	Accrued expense
	($ in millions)	
Performance cycle:		
2012 - 2014	181,290	$2.3
2013 - 2015	179,000	1.2
2014 - 2016	165,800	0.2
Subtotal	526,090	3.7
Assumed forfeitures	(13,152)	(0.1)
Total at March 31, 2014	512,938	$3.6

If 100% of the outstanding performance shares had been vested on March 31, 2014, the total additional compensation cost to be recognized would have been $4.7 million, based on current accrual factors (common share price, accumulated dividends and payout assumptions) at March 31, 2014.

All performance shares earned and paid were settled in cash or by deferral into OneBeacon's deferred compensation plan.

Restricted Shares

On March 1, 2012, OneBeacon issued shares of restricted stock to certain employees, of which 142,500 shares vested on February 28, 2014, with the remaining 140,000 shares outstanding as of March 31, 2014 scheduled to vest on February 28, 2015. On May 25, 2011, OneBeacon issued 630,000 shares of restricted stock to its CEO, of which 157,500 shares vested on February 22, 2014, with the remaining 472,500 shares scheduled to vest in equal installments on February 22, 2015, 2016 and 2017. The restricted shares contain dividend participation features and therefore are considered participating securities.

The following summarizes restricted shares activity for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,			
	2014		2013	
	Restricted Shares	Unamortized Issue Date Fair Value	Restricted Shares	Unamortized Issue Date Fair Value
	($ in millions)			
Beginning of period	915,000	$6.5	927,000	$9.6
New awards	—	—	—	—
Forfeitures	(2,500)	—	—	—
Vested	(300,000)	—	(9,000)	—
Expense recognized	—	(0.8)	—	(0.8)
End of period	612,500	$5.7	918,000	$8.8

Restricted shares that vested during the three months ended March 31, 2014 and 2013 had a grant date fair value of $4.3 million and $0.1 million, respectively. As of March 31, 2014, unrecognized compensation expense of $5.7 million related to restricted stock awards is expected to be recognized over a weighted-average period of 2.5 years.

NOTE 10. Income Taxes

OneBeacon and its Bermuda-domiciled subsidiaries are not subject to Bermuda income tax under current Bermuda law. In the event that there is a change in the current law such that taxes are imposed, OneBeacon and its Bermuda-domiciled subsidiaries would be exempt from such tax until March 31, 2035, pursuant to the Bermuda

Exempted Undertakings Tax Protection Act of 1966. OneBeacon also has subsidiaries that operate in Gibraltar, Luxembourg and the United States. U.S.

operations are financed with a combination of debt and equity and the financing income currently accounts for the majority of non-U.S. earnings.

OneBeacon's income tax expense related to pre-tax income from continuing operations for the three months ended March 31, 2014 and 2013, represented net effective tax rates of 11.9% and 22.5% respectively. The effective tax rate for the three months ended March 31, 2014, was lower than the U.S. statutory rate of 35% due to income generated in jurisdictions other than the United States, principally representing interest income taxed in a jurisdiction with a lower effective tax rate and the settlement of the 2005-2006 IRS exam. The effective tax rate for the three months ended March 31, 2013, was lower than the U.S. statutory rate of 35% due to income generated in jurisdictions other than the United States, principally representing interest income taxed in a jurisdiction with a lower effective tax rate. For the three months ended March 31, 2014 and 2013, the effective tax rate on non-U.S. income was 1.3% and (0.1)%, respectively, and the effective tax rate on U.S. income was 16.0% and 29.4%, respectively.

In arriving at the effective tax rate for the three months months ended March 31, 2014 and 2013, OneBeacon forecasted all income and expense items including the realized and change in unrealized investment gains for the years ending December 31, 2014 and 2013, and included these gains in the effective tax rate calculation.

OneBeacon classifies all interest and penalties on unrecognized tax benefits as part of income tax expense. With few exceptions, OneBeacon is no longer subject to U.S. federal, state or non-U.S. income tax examinations by tax authorities for years before 2005. On February 14, 2014, OneBeacon received Form 870-AD (Offer to Waive Restrictions on Assessment and Collection Tax Deficiency and to Accept Over assessment) from the IRS Appeals Office relating to the examination of tax years 2005 and 2006. All disputed items have now been agreed and resolved with the Joint Committee. OneBeacon recorded a tax benefit of $5.0 million in the first quarter of 2014 relating to the settlement of the IRS examination for tax years 2005 and 2006.

On July 28, 2011, the IRS commenced an examination of OneBeacon's U.S. income tax returns for 2007, 2008 and 2009. On July 17, 2013, OneBeacon received a revised Form 4549-A (Income Tax Discrepancy Adjustments) from the IRS relating to the examination of tax years 2007, 2008 and 2009. The estimated total assessment, including interest, utilization of alternative minimum and foreign tax credit carryovers and capital loss carrybacks, is $69.3 million. However, $60.2 million of the proposed adjustments relate to items for which the expense deduction has been disallowed in a year being examined, but ultimate deductibility is highly certain to occur in a later period. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the deduction in the exam period would not affect the effective tax rate but would accelerate the payment of cash to the taxing authority. OneBeacon disagrees with the adjustments proposed by the IRS and is defending its position. Although the timing of the resolution of these issues is uncertain, it is reasonably possible that the resolution could occur within the next twelve months. An estimate of the range of potential outcomes cannot be made at this time. OneBeacon does not expect the resolution of this examination to result in a material change to its financial position.

On September 2, 2013, the IRS commenced an examination of OneBeacon's U.S. income tax returns for 2010, 2011 and 2012. OneBeacon does not expect the resolution of this examination to result in a material change to its financial position.

NOTE 11. Fair Value of Financial Instruments

OneBeacon carries its financial instruments on its balance sheet at fair value with the exception of its equity method investments and fixed-rate, long-term indebtedness. For certain financial instruments where quoted market prices are not available, other independent valuation techniques and assumptions are used. Because considerable judgment is used, these estimates are not necessarily indicative of amounts that could be realized in a current market exchange. Certain financial instruments are excluded from disclosure, including insurance contracts, other than financial guarantees, and investment contracts.

At March 31, 2014 and December 31, 2013, the fair value of OneBeacon's 2012 Senior Notes (its fixed-rate, long-term indebtedness) was $275.1 million and $269.8 million, respectively, which compared to a carrying value of $274.7 million as of both March 31, 2014 and December 31, 2013. The fair value measurement of the Senior Notes is classified as Level 2 in the valuation hierarchy.

NOTE 12. Legal Contingencies

OneBeacon, and the insurance and reinsurance industry in general, is routinely subject to claims related litigation and arbitration in the normal course of business, as well as litigation and arbitration that do not arise from, or directly relate to, claims activity. OneBeacon's estimates of the costs of settling matters routinely encountered in claims activity are reflected in the reserves for unpaid loss and LAE. See Note 3—"Unpaid Loss and Loss Adjustment Expense (LAE) Reserves."

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 12. Legal Contingencies

OneBeacon evaluates its exposure to non-claims related litigation and arbitration and establishes accruals for litigation and arbitration if it is probable that a loss has been incurred and it can be reasonably estimated. Disclosure of litigation and arbitration is made if it is probable that a loss has been incurred or if there is a reasonable possibility that a loss may have been incurred. Although the ultimate outcome of claims and non-claims related litigation and arbitration, and the amount or range of potential loss at any particular time, is often inherently uncertain, management does not believe that the ultimate outcome of such claims and non-claims related litigation and arbitration will have a material adverse effect on OneBeacon's financial condition, full year results of operations, or cash flows.

The following summarizes significant ongoing non-claims related litigation or arbitration as of March 31, 2014:

Deutsche Bank Litigation

In June 2011, Deutsche Bank Trust Company Americas, Law Debenture Company of New York and Wilmington Trust Company (collectively referred to as “Plaintiffs”), in their capacity as trustees for certain senior notes issued by the Tribune Company (“Tribune”), filed lawsuits in various jurisdictions (the “Noteholder Actions”) against numerous defendants including OneBeacon, OneBeacon-sponsored benefit plans and other affiliates of White Mountains in their capacity as former shareholders of Tribune seeking recovery of the proceeds from the sale of common stock of Tribune in connection with Tribune's leveraged buyout in 2007 (the “LBO”). Tribune filed for bankruptcy in 2008 in the Delaware bankruptcy court (the “Bankruptcy Court”). The Bankruptcy Court granted Plaintiffs permission to commence these LBO-related actions, and in 2011, the Judicial Panel on Multidistrict Litigation granted a motion to consolidate the actions for pretrial matters and transferred all such proceedings to the United States District Court for the Southern District of New York. Plaintiffs seek recovery of the proceeds received by the former Tribune shareholders on a theory of constructive fraudulent transfer asserting that Tribune purchased or repurchased its common shares without receiving fair consideration at a time when it was, or as a result of the purchases of shares, was rendered, insolvent. OneBeacon has entered into a joint defense agreement with other affiliates of White Mountains that are defendants in the action. OneBeacon and OneBeacon-sponsored benefit plans received approximately $32 million for Tribune common stock tendered in connection with the LBO.

The Court granted an omnibus motion to dismiss the Noteholder Actions in September 2013 and Plaintiffs have filed a notice of appeal.

In addition, OneBeacon, OneBeacon-sponsored benefit plans and other affiliates of White Mountains in their capacity as former shareholders of Tribune, along with thousands of former Tribune shareholders, have been named as defendants in an adversary proceeding brought by the Official Committee of Unsecured Creditors of the Tribune Company (the “Committee”), on behalf of the Tribune Company, which seeks to avoid the repurchase of shares by Tribune in the LBO on a theory of intentional fraudulent transfer (the “Committee Action”). Tribune emerged from bankruptcy in 2012, and a litigation trustee replaced the Committee as plaintiff in the Committee Action. This matter was consolidated for pretrial matters with the Noteholder Actions in the United States District Court for the Southern District of New York and was stayed pending the motion to dismiss in the Noteholder Action. The Committee Action will proceed upon the lifting of the stay and a scheduling order.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 13. Earnings per Share

Basic and diluted earnings per share amounts are based on the weighted average number of common shares outstanding, including unvested restricted shares that are considered participating securities. Diluted earnings per share amounts are based on the weighted average number of common shares including unvested restricted shares and the net effect of potentially dilutive common shares outstanding.

The following table outlines the Company's computation of earnings per share for net income from continuing operations attributable to OneBeacon's common shareholders for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,	
	2014	2013
Earnings attributable to OneBeacon's common shareholders—basic and diluted (in millions):		
Net income from continuing operations attributable to OneBeacon's common shareholders	$47.5	$67.9
Allocation of income for participating unvested restricted common shares	(0.4)	(0.7)
Dividends paid on participating restricted common shares	(0.1)	(0.2)
Total allocation to restricted common shares	(0.5)	(0.9)
Net income from continuing operations attributable to OneBeacon's common shareholders, net of restricted common share amounts	$47.0	$67.0
Undistributed net earnings (in millions):		
Net income from continuing operations attributable to OneBeacon's common shareholders, net of restricted common share amounts	$47.0	$67.0
Dividends paid, net of restricted common share amounts	(19.9)	(19.8)
Total undistributed net earnings, net of restricted common share amounts	$27.1	$47.2
Earnings per share denominator—basic and diluted (in millions):		
Total weighted average common shares outstanding	95.4	95.4
Weighted average unvested restricted common shares[1]	(0.8)	(0.9)
Basic and diluted earnings per share denominator	94.6	94.5
Earnings per share attributable to OneBeacon's common shareholders—basic and diluted (in dollars):		
Net income from continuing operations attributable to OneBeacon's common shareholders	$0.50	$0.71
Dividends declared and paid	(0.21)	(0.21)
Undistributed earnings	$0.29	$0.50

[1] Restricted shares outstanding vest in equal installments upon a stated date or upon the occurrence of a specified event.

Basic and diluted income (loss) per share amounts for discontinued operations are included in Note 15—"Discontinued Operations."

Table of Contents

NOTE 14. Common Shareholders' Equity

Common Shares Repurchased and Retired

On August 22, 2007, the Company's Board authorized the repurchase of up to $200.0 million of its Class A common shares from time to time, subject to market conditions. Shares may be repurchased on the open market or through privately negotiated transactions. This authorization does not have a stated expiration date. During the three months ended March 31, 2014 and 2013, no shares were repurchased under the share repurchase authorization. The amount of authorization remaining is $87.7 million as of March 31, 2014.

During the three months ended March 31, 2014 and 2013, the Company repurchased 106,366 and 3,300 common shares, respectively, to satisfy employee income tax withholding, pursuant to employee benefit plans. Shares repurchased pursuant to employee benefit plans do not fall under the board authorization referred to above.

Dividends on Common Shares

During the three months ended March 31, 2014 and 2013, the Company declared and paid cash dividends totaling $20.0 million, or $0.21 per common share, for each period.

Accumulated Other Comprehensive Income

For the three months ended March 31, 2014 and 2013, OneBeacon recorded pre-tax changes to accumulated other comprehensive income for net increases in net benefit plan assets and obligations of $0.1 million (no after tax change) and $0.2 million ($0.1 million after tax change), respectively.

NOTE 15. Discontinued Operations

Runoff Business

As described in Note 1 and Note 2, in October 2012, OneBeacon entered into the Stock Purchase Agreement with respect to the sale of its Runoff Business to Armour. Pursuant to the terms of the Stock Purchase Agreement, at closing, OneBeacon will transfer to Armour all of the issued and outstanding shares of common stock of certain legal entities that will contain the assets, liabilities (including gross and ceded loss reserves) and capital supporting the business as well as certain elements of the Runoff Business infrastructure, including staff and office space. Additionally, as part of the Runoff Transaction, OneBeacon may provide, under certain scenarios, financing in the form of surplus notes.

In anticipation of the Runoff Transaction, OneBeacon received regulatory approval as required from various state departments of insurance effective October 1, 2012 to terminate the then-existing pooling agreement and intercompany 100% quota share reinsurance agreements and to enter into new 100% quota share reinsurance agreements. The result is that the Runoff Business is assumed and retained by OBIC, one of the legal entities that will be transferred to Armour at closing, and that the ongoing specialty business is assumed and retained by Atlantic Specialty Insurance Company ("ASIC"), one of the entities that OneBeacon will continue to own post-closing.

The Pennsylvania Insurance Department is currently conducting a required examination of the Runoff Business as part of its regulatory review of the Runoff Transaction. The Company expects the Runoff Transaction to close in the second half of 2014.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 15. Discontinued Operations

Summary of Reclassified Balances and Related Items
As of March 31, 2014 and December 31, 2013, the Runoff Transaction met the criteria for held for sale accounting. As a result, the assets and liabilities associated with the businesses being sold, after effecting the various steps contemplated by the Stock Purchase Agreement, are presented separately as single line items in the asset and liability sections of the consolidated balance sheets as of March 31, 2014 and December 31, 2013, respectively. The following summarizes the major categories of assets and liabilities associated with the business classified as held for sale:

	March 31, 2014	December 31, 2013
	($ in millions)	
Assets:		
Investments	$222.2	$236.3
Premiums receivable	12.8	9.1
Reinsurance recoverable on unpaid losses[1]	1,540.0	1,604.7
Reinsurance recoverable on paid losses	9.5	10.7
Net deferred tax asset	3.2	3.3
Other assets	15.4	16.0
Total assets held for sale	$1,803.1	$1,880.1
Liabilities:		
Unpaid loss and loss adjustment expense reserves[1]	$1,717.3	$1,793.1
Unearned premiums	0.2	0.2
Ceded reinsurance payable	12.1	12.3
Other liabilities[2]	73.5	74.5
Total liabilities held for sale	$1,803.1	$1,880.1

[1] The March 31, 2014 and December 31, 2013 balances include the remaining purchase accounting fair value adjustments of $133.6 million and $136.9 million, respectively, relating to the OneBeacon Acquisition. As of March 31, 2014 and December 31, 2013, reinsurance recoverable on unpaid losses, gross of purchase accounting adjustments, were $1,673.6 million and $1,741.6 million, respectively, and unpaid loss and LAE reserves, gross of purchase accounting adjustments, were $1,850.9 million and $1,930.0 million for each period.

[2] Other liabilities as of March 31, 2014 and December 31, 2013 include the accrual related to the pre-tax loss on sale of the Runoff Business of $69.0 million for both periods.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 15. Discontinued Operations

As described in Note 1 and Note 2, the results of operations for the Runoff Business have been classified as discontinued operations and are presented as such, net of related income taxes, in the statements of operations and comprehensive income and cash flows for all periods. Investing and financing activities for OneBeacon are managed on a consolidated basis reported within the Investing, Financing and Corporate segment. Therefore, no investment or financing activity is included in discontinued operations.

The following summarizes the results of operations, including related income taxes associated with the business classified as discontinued operations:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Net written premiums	$(0.1)	$0.8
Revenues		
Earned premiums	$(0.1)	$0.9
Total revenues	(0.1)	0.9
Expenses		
Loss and loss adjustment expenses	—	—
Policy acquisition expenses	—	0.1
Other underwriting expenses	0.7	0.1
Total expenses	0.7	0.2
Pre-tax income (loss)	(0.8)	0.7
Income tax benefit (expense)	0.3	(0.2)
Income (loss) from discontinued operations, net of tax	$(0.5)	$0.5

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 15. Discontinued Operations

Income (Loss) per Share Related to Discontinued Operations

Basic income (loss) per share amounts are based on the weighted average number of common shares outstanding including unvested restricted shares that are considered participating securities. Diluted earnings per share amounts are based on the weighted average number of common shares including unvested restricted shares and the net effect of potentially dilutive common shares outstanding.

The following table outlines the computation of income (loss) per share for discontinued operations attributable to OneBeacon's common shareholders for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,	
	2014	2013
Income (loss) attributable to OneBeacon's common shareholders—basic and diluted (in millions):		
Net income (loss) from discontinued operations attributable to OneBeacon's common shareholders	$(0.5)	$0.5
Allocation of loss for participating unvested restricted common shares	—	—
Net income (loss) from discontinued operations attributable to OneBeacon's common shareholders, net of restricted common share amounts	$(0.5)	$0.5
Income (loss) per share denominator—basic and diluted (in millions):		
Total weighted average common shares outstanding	95.4	95.4
Weighted average unvested restricted common shares[1]	(0.8)	(0.9)
Basic and diluted income (loss) per share denominator	94.6	94.5
Income (loss) per share attributable to OneBeacon's common shareholders—basic and diluted (in dollars):		
Net income (loss) from discontinued operations attributable to OneBeacon's common shareholders per share	$(0.01)	$—

[1] Restricted shares outstanding vest in equal installments upon a stated date or upon the occurrence of a specified event.

Additional Disclosures

Due to the relative significance of the transactions described above, OneBeacon has expanded the disclosures herein to provide additional insight into the balances and related activity reclassified to held for sale and discontinued operations.

Results of Discontinued Operations

The loss from discontinued operations, net of tax, was $0.5 million for the three months ended March 31, 2014, compared to income of $0.5 million for the three months ended March 31, 2013. The loss for the three months ended March 31, 2014 was substantially a result of non-claims expenses related to the Runoff Business, including dedicated staff. The income for the three months ended March 31, 2013 primarily related to earned premiums from involuntary pools in our Runoff Business.

For the three months ended March 31, 2014 and 2013, the Company recorded no incurred loss and LAE for the Runoff Business. As of March 31, 2014, the recorded net unpaid loss and LAE reserves associated with the Runoff Business totaled $177.3 million. Management believes that the recorded net loss and LAE reserves reflect a reasonable provision for expected future loss and LAE payments and represent management’s best estimate within a range of reasonable estimates.

Fair Value Adjustment

In connection with purchase accounting for the OneBeacon Acquisition, the Company was required to adjust to fair value the loss and LAE reserves and the related reinsurance recoverables. Loss and LAE reserves and the related reinsurance recoverable presented in the summary of reclassified balances within assets and liabilities held for sale as of March 31, 2014 and December 31, 2013, are net of $133.6 million and $136.9 million, respectively, related to the outstanding pre-tax unaccreted adjustment.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 15. Discontinued Operations

Reinsurance

As described in Note 4—"Reinsurance," in the normal course of business, OneBeacon's insurance subsidiaries seek to limit losses that may arise from catastrophes or other events by reinsuring with third-party reinsurers. OneBeacon remains liable for risks reinsured even if the reinsurer does not honor its obligations under reinsurance contracts.

In connection with the OneBeacon Acquisition, Aviva caused OneBeacon to purchase two reinsurance contracts from subsidiaries of Berkshire Hathaway Inc.: a reinsurance contract with National Indemnity Company (“NICO”) for up to $2.5 billion in old asbestos and environmental ("A&E") claims and certain other exposures (the “NICO Cover”) and an adverse loss reserve development cover from General Reinsurance Corporation (“GRC”) for up to $570.0 million, comprised of $400.0 million of adverse loss reserve development occurring in years 2000 and prior (the “GRC Cover”) in addition to $170.0 million of reserves ceded as of the date of the OneBeacon Acquisition. The NICO Cover and GRC Cover, which were contingent on and occurred contemporaneously with the OneBeacon Acquisition, were put in place in lieu of a seller guarantee of loss and LAE reserves and are therefore accounted for under GAAP as a seller guarantee.

NICO Cover

Under the terms of the NICO Cover, NICO receives the economic benefit of reinsurance recoverables from certain of OneBeacon’s third party reinsurers (“Third Party Reinsurers”) in existence at the time the NICO Cover was executed (“Third Party Recoverables”). As a result, the underlying Third Party Recoverables serve to protect the $2.5 billion limit of NICO coverage for the benefit of OneBeacon. OneBeacon estimates that on an incurred basis it has used approximately $2.3 billion of the coverage provided by NICO at March 31, 2014. Net losses paid totaled approximately $1.7 billion as of March 31, 2014. To the extent that actual experience differs from OneBeacon’s estimate of ultimate A&E losses and Third-Party Recoverables, future losses could exceed the $198.3 million of protection remaining under the NICO Cover at March 31, 2014.

GRC Cover

Pursuant to the GRC Cover, OneBeacon is not entitled to recover losses to the full contract limit if such losses are reimbursed by GRC more quickly than anticipated at the time the contract was signed. OneBeacon intends to seek reimbursement from GRC only for claims which result in payment patterns similar to those supporting its recoverables recorded pursuant to the GRC Cover. The economic cost of not submitting certain other eligible claims to GRC is primarily the investment spread between the rate credited by GRC and the rate achieved by OneBeacon on its own investments. This cost, if any, is expected to be nominal. As of March 31, 2014, OneBeacon has ceded estimated incurred losses of $562.0 million to GRC under the GRC Cover. As of March 31, 2014, OneBeacon has $359.7 million of reinsurance recoverable on unpaid losses outstanding under the GRC Cover.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 15. Discontinued Operations

At March 31, 2014, OneBeacon had $9.5 million of reinsurance recoverable on paid losses and $1,673.6 million (gross of $133.6 million in purchase accounting adjustments, as described above) that will become recoverable if claims are paid in accordance with current reserve estimates, related to the Runoff Business that have been reclassified to assets held for sale. Reinsurance contracts do not relieve OneBeacon of its obligations. Therefore, collectibility of balances due from reinsurers is critical to OneBeacon's financial strength. The following table provides a listing of the top reinsurers related to the Runoff Business reported in assets held for sale, excluding industry pools and associations, based on reinsurance recoverable amounts on paid and unpaid losses, the percentage of the total reported as held for sale (gross of the $133.6 million in purchase accounting adjustment), and the reinsurers' A.M. Best ratings.

($ in millions)	Balance at March 31, 2014	% of total		A.M. Best Rating[1]
National Indemnity Company ("NICO") and General Reinsurance Corporation[2]	$1,188.8	71	%	A++
Hanover Insurance Company	38.7	2	%	A
Tokio Marine and Nichido Fire[3]	26.1	2	%	A++
Munich Reinsurance America	14.1	1	%	A+
Tower Insurance Company	9.9	1	%	B[4]

[1] A.M. Best ratings as detailed above are: “A++” (Superior, which is the highest of sixteen financial strength ratings), “A+” (Superior, which is the second highest of sixteen financial strength ratings), “A” (Excellent, which is the third highest of sixteen financial strength ratings) and “B” (Fair, which is the seventh highest of sixteen financial strength ratings).

[2] Includes $198.3 million of Third Party Recoverables, which NICO would pay under the terms of the NICO Cover if they are unable to collect from third party reinsurers.

[3] Excludes $21.4 million of reinsurance recoverables from the various reinsurers that are guaranteed by Tokio Marine and Nichido Fire.

[4] Under review with developing implications.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 16. Consolidating Financial Information

The Company has fully and unconditionally guaranteed the 2012 Senior Notes issued by its 100% owned subsidiary, OBH. The following tables present OneBeacon's consolidating balance sheets as of March 31, 2014 and December 31, 2013 and statements of operations and comprehensive income and cash flows for the three months ended March 31, 2014 and 2013. These financial statements reflect the Company's ("guarantor") financial position, results of operations and cash flows on a stand-alone basis, that of OBH ("the issuer") and of the Company's other entities ("non-guarantor subsidiaries") as well as the necessary consolidating adjustments to eliminate intercompany balances and transactions.

Consolidating Balance Sheet	The Company (guarantor)	Non-guarantor subsidiaries	OBH (issuer)	Consolidating adjustments	Consolidated
as of March 31, 2014		(in millions)			
Assets					
Investment Securities:					
Fixed maturity investments, at fair value	$ —	$ 1,765.7	$ 2.9	$ (25.0)	$ 1,743.6
Short-term investments, at amortized cost (which approximates fair value)	2.0	143.3	7.4	—	152.7
Common equity securities, at fair value	—	347.1	—	—	347.1
Convertible fixed maturity investments, at fair value	—	29.3	—	—	29.3
Other investments	—	143.0	—	—	143.0
Total investment securities	2.0	2,428.4	10.3	(25.0)	2,415.7
Cash	—	138.6	—	—	138.6
Reinsurance recoverables	—	83.1	—	—	83.1
Premiums receivable	—	249.2	—	—	249.2
Deferred acquisition costs	—	105.9	—	—	105.9
Net deferred tax asset	—	82.1	(2.4)	0.1	79.8
Investment income accrued	—	9.6	—	(0.5)	9.1
Accounts receivable on unsettled investment sales	—	6.7	—	—	6.7
Investments in subsidiaries	1,130.5	—	1,071.0	(2,201.5)	—
Other assets	(2.3)	289.5	2.7	—	289.9
Assets held for sale	—	1,803.1	—	—	1,803.1
Total assets	$ 1,130.2	$ 5,196.2	$ 1,081.6	$ (2,226.9)	$ 5,181.1
Liabilities					
Unpaid loss and loss adjustment expense reserves	$ —	$ 1,069.8	$—	$ —	$ 1,069.8
Unearned premiums	—	582.2	—	—	582.2
Debt	—	—	299.7	(25.0)	274.7
Accounts payable on unsettled investment purchases	—	25.6	—	—	25.6
Other liabilities	(0.1)	285.9	7.3	(0.5)	292.6
Liabilities held for sale	—	1,803.1	—	—	1,803.1
Total liabilities	(0.1)	3,766.6	307.0	(25.5)	4,048.0
OneBeacon's common shareholders' equity and noncontrolling interests					
Total OneBeacon's common shareholders' equity	1,130.3	1,426.8	774.6	(2,201.4)	1,130.3
Total noncontrolling interests	—	2.8	—	—	2.8
	1,130.3	1,429.6	774.6	(2,201.4)	1,133.1

Total OneBeacon's common shareholders' equity and noncontrolling interests					
Total liabilities, OneBeacon's common shareholders' equity and noncontrolling interests	$ 1,130.2	$ 5,196.2	$ 1,081.6	$ (2,226.9)	$ 5,181.1

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 16. Consolidating Financial Information

Consolidating Balance Sheet	The Company (guarantor)	Non-guarantor subsidiaries	OBH (issuer)	Consolidating adjustments	Consolidated
as of December 31, 2013		(in millions)			
Assets					
Investment Securities:					
Fixed maturity investments, at fair value	$ —	$ 1,725.4	$—	$ (24.5)	$ 1,700.9
Short-term investments, at amortized cost (which approximates fair value)	13.0	140.0	4.0	—	157.0
Common equity securities, at fair value	—	336.9	—	—	336.9
Convertible fixed maturity investments, at fair value	—	30.5	—	—	30.5
Other investments	—	139.6	—	—	139.6
Total investment securities	13.0	2,372.4	4.0	(24.5)	2,364.9
Cash	—	166.6	1.5	—	168.1
Reinsurance recoverables	—	89.9	—	—	89.9
Premiums receivable	—	228.2	—	—	228.2
Deferred acquisition costs	—	103.7	—	—	103.7
Net deferred tax asset	—	93.1	(2.4)	(0.1)	90.6
Investment income accrued	—	10.3	—	(0.2)	10.1
Accounts receivable on unsettled investment sales	—	3.3	—	—	3.3
Investments in subsidiaries	1,092.0	—	1,034.9	(2,126.9)	—
Other assets	(0.8)	272.4	1.1	—	272.7
Assets held for sale	—	1,880.1	—	—	1,880.1
Total assets	$ 1,104.2	$ 5,220.0	$ 1,039.1	$ (2,151.7)	$ 5,211.6
Liabilities					
Unpaid loss and loss adjustment expense reserves	$ —	$ 1,054.3	$—	$ —	$ 1,054.3
Unearned premiums	—	544.9	—	—	544.9
Debt	—	—	299.7	(25.0)	274.7
Accounts payable on unsettled investment purchases	—	11.6	—	—	11.6
Other liabilities	(0.1)	335.0	3.9	(0.2)	338.6
Liabilities held for sale	—	1,880.1	—	—	1,880.1
Total liabilities	(0.1)	3,825.9	303.6	(25.2)	4,104.2
OneBeacon's common shareholders' equity and noncontrolling interests					
Total OneBeacon's common shareholders' equity	1,104.3	1,391.0	735.5	(2,126.5)	1,104.3
Total noncontrolling interests	—	3.1	—	—	3.1
Total OneBeacon's common shareholders' equity and noncontrolling interests	1,104.3	1,394.1	735.5	(2,126.5)	1,107.4
Total liabilities, OneBeacon's common shareholders' equity and noncontrolling interests	$ 1,104.2	$ 5,220.0	$ 1,039.1	$ (2,151.7)	$ 5,211.6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 16. Consolidating Financial Information

Consolidating Statement of Operations and Comprehensive Income	The Company (guarantor)	Non-guarantor subsidiaries	OBH (issuer)	Consolidating adjustments	Consolidated
Three months ended March 31, 2014	(in millions)				
Revenues					
Earned premiums	$—	$ 276.5	$—	$—	$276.5
Net investment income	—	10.3	—	(0.3)	10.0
Net realized and change in unrealized investment gains	—	19.4	—	(0.5)	18.9
Net other revenues	—	1.0	—	—	1.0
Total revenues	—	307.2	—	(0.8)	306.4
Expenses					
Loss and loss adjustment expenses	—	149.4	—	—	149.4
Policy acquisition expenses	—	46.7	—	—	46.7
Other underwriting expenses	—	49.4	—	—	49.4
General and administrative expenses	1.6	1.6	0.1	—	3.3
Interest expense	—	—	3.5	(0.3)	3.2
Total expenses	1.6	247.1	3.6	(0.3)	252.0
Pre-tax (loss) income from continuing operations	(1.6)	60.1	(3.6)	(0.5)	54.4
Income tax (expense) benefit	—	(8.3)	1.6	0.2	(6.5)
Net (loss) income from continuing operations	(1.6)	51.8	(2.0)	(0.3)	47.9
Loss from discontinued operations, net of tax	—	(0.5)	—	—	(0.5)
(Loss) income before equity in earnings of unconsolidated affiliates	(1.6)	51.3	(2.0)	(0.3)	47.4
Equity in earnings of subsidiaries, net of tax	48.6	—	41.1	(89.7)	—
Net income including noncontrolling interests	47.0	51.3	39.1	(90.0)	47.4
Less: Net income attributable to noncontrolling interests	—	(0.4)	—	—	(0.4)
Net income attributable to OneBeacon's common shareholders	47.0	50.9	39.1	(90.0)	47.0
Other comprehensive income, net of tax	—	—	—	—	—
Comprehensive income attributable to OneBeacon's common shareholders	$47.0	$ 50.9	$39.1	$(90.0)	$47.0

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 16. Consolidating Financial Information

Consolidating Statement of Operations and Comprehensive Income	The Company (guarantor)	Non-guarantor subsidiaries	OBH (issuer)	Consolidating adjustments	Consolidated
Three months ended March 31, 2013	(in millions)				
Revenues					
Earned premiums	$—	$ 286.5	$—	$—	$286.5
Net investment income	—	10.3	(0.6)	(0.3)	9.4
Net realized and change in unrealized investment gains	—	28.7	0.1	(0.4)	28.4
Net other revenues	—	24.0	—	—	24.0
Total revenues	—	349.5	(0.5)	(0.7)	348.3
Expenses					
Loss and loss adjustment expenses	—	148.9	—	—	148.9
Policy acquisition expenses	—	54.8	—	—	54.8
Other underwriting expenses	—	49.3	—	—	49.3
General and administrative expenses	1.0	3.2	(0.2)	—	4.0
Interest expense	—	—	3.5	(0.3)	3.2
Total expenses	1.0	256.2	3.3	(0.3)	260.2
Pre-tax (loss) income from continuing operations	(1.0)	93.3	(3.8)	(0.4)	88.1
Income tax (expense) benefit	0.1	(22.9)	2.8	0.2	(19.8)
Net (loss) income from continuing operations	(0.9)	70.4	(1.0)	(0.2)	68.3
Income from discontinued operations, net of tax	—	0.5	—	—	0.5
Net (loss) income before equity in earnings of unconsolidated affiliates	(0.9)	70.9	(1.0)	(0.2)	68.8
Equity in earnings of subsidiaries, net of tax	69.3	—	58.5	(127.8)	—
Net income including noncontrolling interests	68.4	70.9	57.5	(128.0)	68.8
Less: Net income attributable to noncontrolling interests	—	(0.4)	—	—	(0.4)
Net income attributable to OneBeacon's common shareholders	68.4	70.5	57.5	(128.0)	68.4
Other comprehensive income, net of tax	0.1	—	0.1	(0.1)	0.1
Comprehensive income attributable to OneBeacon's common shareholders	$68.5	$ 70.5	$57.6	$(128.1)	$68.5

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 16. Consolidating Financial Information

Consolidating Statement of Cash Flows	The Company (guarantor)	Non-guarantor subsidiaries	OBH (issuer)	Consolidating adjustments	Consolidated
Three months ended March 31, 2014	($ in millions)				
Cash flows from operations:					
Net income including noncontrolling interests	$47.0	$ 51.3	$39.1	$ (90.0)	$ 47.4
Charges (credits) to reconcile net income to cash flows provided from (used for) operations:					
Undistributed earnings from subsidiaries	(48.6)	—	(41.1)	89.7	—
Net loss from discontinued operations	—	0.5	—	—	0.5
Net realized and change in unrealized investment gains	—	(19.4)	—	0.5	(18.9)
Deferred income tax expense	—	11.1	—	(0.2)	10.9
Dividends received from subsidiaries	10.0	—	5.0	(15.0)	—
Other operating items:					
Net change in loss and LAE reserves	—	15.5	—	—	15.5
Net change in unearned premiums	—	37.3	—	—	37.3
Net change in premiums receivable	—	(21.0)	—	—	(21.0)
Net change in reinsurance recoverable on paid and unpaid losses	—	6.8	—	—	6.8
Net change in other assets and liabilities	2.4	(63.7)	1.8	—	(59.5)
Net cash provided from operations—continuing operations	10.8	18.4	4.8	(15.0)	19.0
Net cash used for operations—discontinued operations	—	(14.6)	—	—	(14.6)
Net cash provided from operations	10.8	3.8	4.8	(15.0)	4.4
Cash flows from investing activities:					
Net maturities, purchases and sales of short-term investments	11.0	(3.3)	(3.4)	—	4.3
Maturities of fixed maturity investments	—	115.7	—	—	115.7
Sales of fixed maturity investments	—	324.5	0.1	—	324.6
Sales of common equity securities	—	24.3	—	—	24.3
Sales of convertible fixed maturity investments	—	9.8	(3.0)	—	6.8
Return of capital and distributions of other investments	—	1.6	—	—	1.6
Purchases of fixed maturity investments	—	(466.0)	—	—	(466.0)
Purchases of common equity securities	—	(26.0)	—	—	(26.0)
Purchases of convertible fixed maturity investments	—	(3.8)	—	—	(3.8)
Contributions for other investments	—	(2.3)	—	—	(2.3)
Net change in unsettled investment purchases and sales	—	10.6	—	—	10.6
Net acquisitions of property and equipment	—	(0.6)	—	—	(0.6)
Net cash provided from (used for) investing activities—continuing operations	11.0	(15.5)	(6.3)	—	(10.8)
	—	—	—	—	—

Net cash provided from investing activities—discontinued operations					
Net cash provided from (used for) investing activities	11.0	(15.5)	(6.3)	—	(10.8)
Cash flows from financing activities:					
Cash dividends paid to common shareholders	(20.0)	—	—	—	(20.0)
Cash dividends paid to parent	—	(15.0)	—	15.0	—
Repurchases and retirements of common stock	(1.8)	—	—	—	(1.8)
Payments on capital lease obligation	—	(1.3)	—	—	(1.3)
Net cash used for financing activities—continuing operations	(21.8)	(16.3)	—	15.0	(23.1)
Net cash used for financing activities—discontinued operations	—	—	—	—	—
Net cash used for financing activities	(21.8)	(16.3)	—	15.0	(23.1)
Net decrease in cash during period	—	(28.0)	(1.5)	—	(29.5)
Cash balance at beginning of period	—	166.6	1.5	—	168.1
Cash balance at end of period	$—	$ 138.6	$—	$—	$ 138.6

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 16. Consolidating Financial Information

Consolidating Statement of Cash Flows	The Company (guarantor)	Non-guarantor subsidiaries	OBH (issuer)	Consolidating adjustments	Consolidated
Three months ended March 31, 2013	($ in millions)				
Cash flows from operations:					
Net income including noncontrolling interests	$68.4	$ 70.9	$57.5	$(128.0)	$ 68.8
Charges (credits) to reconcile net income to cash flows provided from (used for) operations:					
Undistributed earnings from subsidiaries	(69.3)	—	(58.5)	127.8	—
Net income from discontinued operations	—	(0.5)	—	—	(0.5)
Net realized and change in unrealized investment gains	—	(28.7)	(0.1)	0.4	(28.4)
Net realized gain on sale of business	—	(23.0)	—	—	(23.0)
Deferred income tax expense	—	22.4	0.2	(0.2)	22.4
Dividends received from subsidiaries	22.0	—	23.0	(45.0)	—
Other operating items:					
Net change in loss and LAE reserves	—	10.3	—	—	10.3
Net change in unearned premiums	—	(22.8)	—	—	(22.8)
Net change in premiums receivable	—	(1.8)	—	—	(1.8)
Net change in reinsurance recoverable on paid and unpaid losses	—	2.4	—	—	2.4
Net change in other assets and liabilities	1.1	(17.1)	5.0	—	(11.0)
Net cash provided from operations—continuing operations	22.2	12.1	27.1	(45.0)	16.4
Net cash used for operations—discontinued operations	—	(40.7)	—	—	(40.7)
Net cash provided from (used for) operations	22.2	(28.6)	27.1	(45.0)	(24.3)
Cash flows from investing activities:					
Net maturities, purchases and sales of short-term investments	(2.2)	(17.8)	34.8	—	14.8
Maturities of fixed maturity investments	—	103.1	0.6	—	103.7
Sales of fixed maturity investments	—	567.0	101.4	(35.7)	632.7
Sales of common equity securities	—	89.7	—	—	89.7
Sales of convertible fixed maturity investments	—	29.6	—	—	29.6
Return of capital and distributions of other investments	—	18.6	—	—	18.6
Purchases of fixed maturity investments	—	(576.1)	(133.8)	35.7	(674.2)
Purchases of common equity securities	—	(102.3)	—	—	(102.3)
Purchases of convertible fixed maturity investments	—	(5.0)	—	—	(5.0)
Contributions for other investments	—	(16.0)	—	—	(16.0)
Proceeds from sale of business	—	31.3	—	—	31.3
Net change in unsettled investment purchases and sales	—	(18.3)	—	—	(18.3)
Net acquisitions of property and equipment	—	(3.0)	—	—	(3.0)
	—	30.0	—	(30.0)	—

Return of capital to OneBeacon U.S. Enterprises Holdings, Inc.					
Net cash (used for) provided from investing activities—continuing operations	(2.2)	130.8	3.0	(30.0)	101.6
Net cash provided from investing activities—discontinued operations	—	—	—	—	—
Net cash (used for) provided from investing activities	(2.2)	130.8	3.0	(30.0)	101.6
Cash flows from financing activities:					
Cash dividends paid to common shareholders	(20.0)	—	—	—	(20.0)
Cash dividends paid to parent	—	(45.0)	—	45.0	—
Return of capital to OneBeacon U.S. Enterprises Holdings, Inc.	—	—	(30.0)	30.0	—
Payments on capital lease obligation	—	(1.8)	—	—	(1.8)
Net cash used for financing activities—continuing operations	(20.0)	(46.8)	(30.0)	75.0	(21.8)
Net cash used for financing activities—discontinued operations	—	—	—	—	—
Net cash used for financing activities	(20.0)	(46.8)	(30.0)	75.0	(21.8)
Net increase in cash during period	—	55.4	0.1	—	55.5
Cash balance at beginning of period	—	43.9	—	—	43.9
Cash balance at end of period	$—	$ 99.3	$0.1	$—	$ 99.4

Table of Contents

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

The following discussion contains "forward-looking statements." Statements that are not historical in nature are forward-looking statements. OneBeacon cannot promise that its expectations in such forward-looking statements will turn out to be correct. OneBeacon's actual results could be materially different from and worse than its expectations. See "Forward-Looking Statements" on page 59 for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements.

Book Value Per Share

The following table presents our book value per share:

	March 31, 2014	December 31, 2013	March 31, 2013
	(in millions except per share amounts)		
Numerator			
OneBeacon's common shareholders' equity	$1,130.3	$1,104.3	$1,063.8
Denominator			
Common shares outstanding[1]	95.3	95.4	95.4
Book value per share	$11.86	$11.58	$11.15
Dividends paid per share	$0.21	$0.84	$0.21

[1] Common shares outstanding includes unvested restricted shares.

We ended the first quarter of 2014 with a book value per share of $11.86, reflecting an increase of 4.2%, including quarterly dividends of $0.21 per share, for the three months ended March 31, 2014. The growth in book value per share was driven by $47.9 million of net income from continuing operations, which included pre-tax underwriting results of $31.0 million, reflecting a combined ratio of 88.8%, and pre-tax net investment results of $28.9 million, reflecting a 1.2% total return on average invested assets, as well as a $5.0 million tax benefit resulting from the settlement of an IRS examination for tax years 2005 and 2006.

For the quarter ended March 31, 2014, we reported comprehensive income attributable to OneBeacon’s common shareholders of $47.0 million, compared to comprehensive income for the same period in 2013 of $68.5 million, which included a $23.0 million pre-tax gain ($15.0 million after tax) from the sale of Essentia Insurance Company (Essentia).

Significant Transactions

Dispositions

Runoff Business

As described in Note 1—"Nature of Operations and Summary of Significant Accounting Policies" and Note 2—"Acquisitions and Dispositions" of the accompanying consolidated financial statements, in October 2012, we entered into the Stock Purchase Agreement with respect to the sale of our Runoff Business to Armour. Pursuant to the terms of the Stock Purchase Agreement, at closing, we will transfer to Armour all of the issued and outstanding shares of common stock of certain legal entities that will contain the assets, liabilities (including gross and ceded loss reserves) and capital supporting the business as well as certain elements of the Runoff Business infrastructure, including staff and office space. Additionally, as part of the Runoff Transaction, we may provide, under certain scenarios, financing in the form of surplus notes.

The Runoff Transaction is subject to various closing conditions, primarily the receipt of regulatory approvals. The regulatory review process has included a third party actuarial review of the Runoff Business loss and LAE reserves, completed in September of 2013; in addition, an independent stochastic modeling of the future cash flows of the Runoff Business was subsequently required. At closing, Armour and/or OneBeacon Insurance Company (OBIC) and certain legal entities within the ongoing OneBeacon structure will enter into various ancillary agreements, including the amendment of existing reinsurance agreements and administrative services agreements, to support the separation of the Runoff Business and subsequent transfer to Armour. Also as part of the Runoff Transaction, at closing, OneBeacon and Armour will enter into a Transition Services Agreement (TSA), pursuant to which we will provide certain transition services to Armour during the term of the TSA, which has an initial term of one year. We have concluded that continuing involvement after the closing of the transaction is insignificant relative to the business being sold.

The Pennsylvania Insurance Department is currently conducting a required examination of the Runoff Business as part of its regulatory review of the Runoff Transaction. We expect the Runoff Transaction to close in the second half of 2014.

Essentia

Effective January 1, 2013, OneBeacon completed the sale of Essentia, an indirect wholly-owned subsidiary which wrote the Collector Cars and Boats business, to Markel Corporation. Concurrently, OneBeacon and Hagerty Insurance Agency (Hagerty) terminated their underwriting arrangement with respect to the Collector Cars and Boats business, and we recognized a pre-tax gain on sale of $23.0 million ($15.0 million after tax) in 2013. We had negligible earned premiums for the three months ended March 31, 2014 and earned premiums of $40.6 million for the three months ended March 31, 2013 related to the Collector Cars and Boats underwriting operating segment.

Results of Operations

Review of Consolidated Results

A summary of our consolidated financial results for the three months ended March 31, 2014 and 2013, is as follows:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Net written premiums	$311.1	$265.1
Revenues		
Earned premiums	$276.5	$286.5
Net investment income	10.0	9.4
Net realized and change in unrealized investment gains	18.9	28.4
Net other revenues	1.0	24.0
Total revenues	306.4	348.3
Expenses		
Loss and loss adjustment expense	149.4	148.9
Policy acquisition expenses	46.7	54.8
Other underwriting expenses	49.4	49.3
General and administrative expenses	3.3	4.0
Interest expense	3.2	3.2
Total expenses	252.0	260.2
Pre-tax income from continuing operations	54.4	88.1
Income tax expense	(6.5)	(19.8)
Net income from continuing operations	47.9	68.3
Income (loss) from discontinued operations, net of tax	(0.5)	0.5
Net income including noncontrolling interests	47.4	68.8
Less: Net income attributable to noncontrolling interests	(0.4)	(0.4)
Net income attributable to OneBeacon's common shareholders	47.0	68.4
Other comprehensive income, net of tax	—	0.1
Comprehensive income attributable to OneBeacon's common shareholders	$47.0	$68.5

The following table provides our consolidated underwriting ratios for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,	
	2014	2013
Underwriting ratios:		
Loss and loss adjustment expense (LAE)	54.0 %	52.0 %
Expense	34.8	36.3
Total combined ratio	88.8 %	88.3 %

The impact of certain items to our underwriting ratios was as follows:

	(Favorable) unfavorable impact Three months ended March 31,	
	2014	2013
Point impact on loss and LAE ratio and combined ratio:		
Catastrophe losses, net of reinsurance	1.0 pts	1.1 pts
Prior year loss reserve development	(0.6) pts	(1.0) pts

Consolidated Results—Three months ended March 31, 2014 versus three months ended March 31, 2013

Our comprehensive income attributable to OneBeacon's common shareholders was $47.0 million for the three months ended March 31, 2014, compared to comprehensive income of $68.5 million for the three months ended March 31, 2013. Net income attributable to OneBeacon's common shareholders was $47.0 million for the three months ended March 31, 2014, compared to net income of $68.4 million for the same period in 2013. The decrease in net income compared to the prior year period was primarily due to a $23.0 million pre-tax ($15.0 million after tax) gain from the sale of Essentia in the three months ended March 31, 2013, as well as an $8.9 million decrease in net investment results for the three months ended March 31, 2014, compared to the same period in 2013, driven by lower net realized and change in unrealized gains in our common equities securities portfolio resulting from lower equity market performance in the current year period compared to the prior year period. These decreases in pre-tax income were offset in part by lower tax expense which included a $5.0 million favorable settlement of an IRS examination during the three months ended March 31, 2014.

Consolidated net written premiums increased to $311.1 million in the three months ended March 31, 2014, compared to $265.1 million for the three months ended March 31, 2013, resulting primarily from increases in net written premiums from our newer businesses, particularly Programs, Crop, and Surety, as well as the Technology underwriting operating segment.

Our total revenues of $306.4 million for the three months ended March 31, 2014 decreased $41.9 million compared to $348.3 million for the prior year period, due primarily to the gain from the sale of Essentia in 2013 and the decrease in net investment results. Additionally, earned premiums decreased $10.0 million for the three months ended March 31, 2014, compared to the same period in 2013, as our exit from the Collector Cars and Boats business more than offset increased earned premium in our other underwriting operating segments. Net investment income increased slightly to $10.0 million for the three months ended March 31, 2014, compared to $9.4 million for the three months ended March 31, 2013, primarily due to increased dividend income and higher yields on new fixed maturity purchases. Net realized and change in unrealized investment gains decreased to $18.9 million, compared to $28.4 million in the three months ended March 31, 2013, driven by modest results in the equity market compared to large gains in 2013. Net other revenues declined to $1.0 million in the three months ended March 31, 2014, compared to $24.0 million of other revenues in the three months ended March 31, 2013, due to the $23.0 million pre-tax ($15.0 million after tax) gain from the sale of Essentia.

Total expenses decreased to $252.0 million for the three months ended March 31, 2014, compared to $260.2 million for the three months ended March 31, 2013, resulting primarily from decreased policy acquisition expenses. Net loss and LAE increased slightly to $149.4 million for the three months ended March 31, 2014, compared to $148.9 million for the same period in 2013. Policy acquisition expenses were $46.7 million for the three months ended March 31, 2014, representing a decrease of $8.1 million from the prior year period, driven primarily by our exited Collector Cars and Boats underwriting operating segment in 2013, which carried a high acquisition expense. Other underwriting expenses were $49.4 million for the three months ended March 31, 2014, compared to $49.3 million for the three months ended March 31, 2013, due primarily to increased incentive compensation and fringe expenses that were mostly offset by decreased expenses for non-claims litigation and costs related to our migration of certain corporate functions to Minnesota incurred in the prior year period. Interest expense was unchanged at $3.2 million for the each of the three month periods ended March 31, 2014 and 2013.

Our income tax expense related to pre-tax income from continuing operations for the three months ended March 31, 2014 and 2013 represented net effective tax rates of 11.9% and 22.5%, respectively. The effective tax rate for the three months ended March 31, 2014, was lower than the U.S. statutory rate of 35% due to income generated in jurisdictions other than the United States, principally representing interest income taxed in a jurisdiction with a lower effective tax rate and the settlement of the 2005-2006 IRS exam. The effective tax rate for the three months ended March 31, 2013, was lower than the U.S. statutory rate of 35% due to income generated in jurisdictions other than the United States, principally representing interest income taxed in a jurisdiction with a lower effective tax rate. The effective tax rate on non-U.S. income for the three months ended March 31, 2014 and 2013 was 1.3% and (0.1)%, respectively, and the effective tax rate on U.S. income was 16.0% and 29.4%, respectively.

Our combined ratio for the three months ended March 31, 2014 was 88.8%, reflecting a 54.0% loss and LAE ratio and a 34.8% expense ratio, which compared to a combined ratio reported for the three months ended March 31, 2013 of 88.3%, consisting of a 52.0% loss and LAE ratio and a 36.3% expense ratio. The 2.0 point increase in the loss and LAE ratio was due to a 1.7 point increase in current accident year non-catastrophe losses and a 0.4 point decrease in favorable prior year loss reserve development, offset in part by a 0.1 point decrease in catastrophe losses. Catastrophe losses were $2.8 million, or 1.0 point, for the three months ended March 31, 2014, primarily resulting from ice and snow storms in the midwestern and northeastern United States, as well as storms in Oklahoma, compared to $3.0 million, or 1.1 points, for the same period in 2013. Net favorable loss reserve development was $1.4 million, or 0.6 points, for the three months ended March 31, 2014, driven by favorable development in Technology and International Marine Underwriters (IMU). This compared to favorable loss reserve development of $2.9 million, or 1.0 point, for the three months ended March 31, 2013, primarily driven by our medical facilities and managed care errors and omissions lines in our healthcare business, which is included in Professional Insurance. The expense ratio improved 1.5 points to 34.8% for the three months ended March 31, 2014, due primarily to a 2.2 point decrease in policy acquisition expenses for the three months ended March 31, 2014, compared to the same period in 2013, driven by our exit of the Collector Cars and Boats business, which carried a high acquisition expense ratio. Other underwriting expense increased 0.7 points due to increased incentive compensation and fringe expenses that were partially reduced by decreased expenses for non-claims litigation and costs related to our migration of certain corporate functions to Minnesota.

Reinsurance protection. We purchase reinsurance in order to minimize loss from large risks or catastrophic events. We also purchase individual property reinsurance coverage for certain risks to reduce large loss volatility through property-per-risk excess of loss reinsurance programs and individual risk facultative reinsurance. We also maintain excess of loss casualty reinsurance programs that provide protection for individual risk or catastrophe losses involving workers compensation, general liability, automobile liability, professional liability or umbrella liability. The availability and cost of reinsurance protection is subject to market conditions, which are outside of our control. Limiting our risk of loss through reinsurance arrangements serves to mitigate the impact of large losses; however, the cost of this protection in an individual period may exceed the benefit.

For the three months ended March 31, 2014 and 2013, our net combined ratio was higher than our gross combined ratio by 4.0 point and 0.6 points as a result of the cost of the reinsurance programs more than offsetting the benefits from ceded losses.

Summary of Operations By Segment

Our reportable segments are Specialty Products, Specialty Industries, and Investing, Financing and Corporate.

The Specialty Products segment is comprised of eight operating segments, including the Collector Cars and Boats underwriting operating segment that was exited in the first quarter of 2013 (see Note 2—"Acquisitions and Dispositions" of the accompanying consolidated financial statements), representing an aggregation based on those that offer distinct products and tailored coverages and services to a broad customer base across the United States. In addition to Collector Cars and Boats, the Specialty Products segment includes the Professional Insurance, Specialty Property, Environmental, Tuition Reimbursement, Programs, Surety, and Crop underwriting operating segments.

The Specialty Industries segment is comprised of six underwriting operating segments, representing an aggregation based on those that focus on solving the unique needs of a particular customer or industry group. The Specialty Industries segment includes the IMU, Technology, Accident, Government Risks, Entertainment, and Energy (which has been exited) underwriting operating segments.

The Investing, Financing and Corporate segment includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and our intermediate subsidiaries.

Specialty Products

Financial results for our Specialty Products reportable segment for the three months ended March 31, 2014 and 2013 were as follows:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Net written premiums	$160.8	$123.9
Earned premiums	$135.4	$153.7
Loss and LAE	(78.0)	(78.6)
Policy acquisition expenses	(21.4)	(30.4)
Other underwriting expenses	(22.2)	(24.3)
Total underwriting income	13.8	20.4
Net other revenues	0.1	0.3
General and administrative expenses	0.1	—
Pre-tax income from continuing operations	$14.0	$20.7

The following table provides underwriting ratios for Specialty Products for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,	
	2014	2013
Underwriting ratios:		
Loss and LAE	57.6 %	51.2 %
Expense	32.2	35.5
Total combined ratio	89.8 %	86.7 %

The impact of certain items to our underwriting ratios was as follows:

	(Favorable) unfavorable impact Three months ended March 31,	
	2014	2013
Point impact on loss and LAE ratio and combined ratio:		
Catastrophe losses, net of reinsurance	0.8 pts	1.0 pts
Prior year loss reserve development	0.5 pts	(0.3) pts

Specialty Products—Three months ended March 31, 2014 versus three months ended March 31, 2013

Net written premiums for Specialty Products increased to $160.8 million for the three months ended March 31, 2014 from $123.9 million for the three months ended March 31, 2013. The increase was primarily due to increases in net written premiums of $12.7 million from Programs and $5.2 million from Surety, two of our newer underwriting operating segments. Also driving the increase was $11.3 million of net written premiums from our new Crop business, estimated based on spring planting applications that were processed during the quarter, with the balance of the spring planting applications to be processed, and associated estimated written premiums to be recorded, in the second quarter of 2014.

The Specialty Products combined ratio for the three months ended March 31, 2014 increased to 89.8% from 86.7% for the three months ended March 31, 2013. The loss and LAE ratio increased by 6.4 points to 57.6% and the expense ratio decreased by 3.3 points to 32.2%. The increase in the loss and LAE ratio was due to a 5.8 point increase in current accident year non-catastrophe losses, driven in part by the current year period no longer benefiting from the low loss and LAE ratio experienced in the Collector Cars and Boats business, which had a significant runoff of earned premium in the prior year period. In addition, there was a 0.8 point unfavorable change in prior year loss reserve development, offset in part by a 0.2 point decrease in catastrophe losses. The three months ended March 31, 2014 included 0.5 points of net unfavorable loss reserve development, primarily related to our Tuition Reimbursement underwriting operating segment. This compared to 0.3 points of favorable loss reserve development in the three months ended March 31, 2013, primarily related to Professional Insurance, offset in part by unfavorable loss reserve development for Specialty Property and Collector Cars and Boats. The three months ended March 31, 2014 included 0.8 points of catastrophe losses, primarily related to ice and snow storms in the midwestern and northeastern United States impacting the financial services business within Professional Insurance, compared with 1.0 point of catastrophe losses in the three months ended March 31, 2013, primarily related to storms impacting Specialty Property. The decrease in the expense ratio for the three months ended March 31, 2014, compared to the three months ended March 31, 2013, was primarily driven by a 4.0 point decrease in policy acquisition expenses, due significantly to our exited Collector Cars and Boats underwriting operating segment in 2013, which carried a high acquisition expense. This decrease in policy acquisition expense was partially offset by a 0.7 point increase in other underwriting expense due to increased incentive compensation and fringe expenses that were partially reduced by decreased expenses for non-claims litigation and costs related to our migration of certain corporate functions to Minnesota.

Specialty Industries

Financial results for our Specialty Industries reportable segment for the three months ended March 31, 2014 and 2013 were as follows:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Net written premiums	$150.3	$141.2
Earned premiums	$141.1	$132.8
Loss and LAE	(71.4)	(70.3)
Policy acquisition expenses	(25.3)	(24.4)
Other underwriting expenses	(27.2)	(25.0)
Total underwriting income	17.2	13.1
Net other revenues	0.1	0.2
General and administrative expenses	(0.5)	(0.6)
Pre-tax income from continuing operations	$16.8	$12.7

The following table provides underwriting ratios for Specialty Industries for the three months ended March 31, 2014 and 2013:

	Three months ended March 31,	
	2014	2013
Underwriting ratios:		
Loss and LAE	50.6 %	52.9 %
Expense	37.2	37.2
Total combined ratio	87.8 %	90.1 %

The impact of certain items to our underwriting ratios was as follows:

	(Favorable) unfavorable impact Three months ended March 31,	
	2014	2013
Point impact on loss and LAE ratio and combined ratio:		
Catastrophe losses, net of reinsurance	1.2 pts	1.2 pts
Prior year loss reserve development	(1.6) pts	(1.8) pts

Specialty Industries—Three months ended March 31, 2014 versus three months ended March 31, 2013

Net written premiums for Specialty Industries increased to $150.3 million for the three months ended March 31, 2014 from $141.2 million in the three months ended March 31, 2013. The increase in the three months ended March 31, 2014 was primarily due to increases in net written premiums of $5.8 million from our Technology underwriting operating segment, $3.2 million from IMU, and $2.3 million from Entertainment, which were primarily due to rate increases and new business, offset in part by a decrease of $2.9 million from Government Risks.

The Specialty Industries combined ratio for the three months ended March 31, 2014 decreased to 87.8% from 90.1% for the three months ended March 31, 2013, as the loss and LAE ratio decreased by 2.3 points to 50.6% and the expense ratio remained flat at 37.2%. The 2.3 point decrease in the loss and LAE ratio for the three months ended March 31, 2014, compared to the same period in 2013, was primarily driven by a 2.5 point decrease in current accident year non-catastrophe losses, offset by a 0.2 point decrease in favorable loss reserve development, while catastrophe losses were unchanged. The three months ended March 31, 2014 included 1.6 points of favorable loss reserve development primarily related to Technology and IMU, compared to 1.8 points of favorable loss reserve development in the three months ended March 31, 2013 primarily related to Technology. The three months ended March 31, 2014 included 1.2 points of catastrophe losses, primarily related to ice and snow storms in the midwestern United States, as well as Oklahoma storms, impacting Technology, IMU and Government Risks. This compared to 1.2 points of catastrophe losses in the three months ended March 31, 2013, primarily related to storms impacting IMU and Government Risks. The change in the expense ratio included a 0.4 point increase in other underwriting expenses in 2014, compared to the same period in 2013, which was offset by a 0.4 point decrease in policy acquisition expenses, driven by lower premium taxes. The increase in other underwriting expense was due to increased incentive compensation and fringe expenses that were partially reduced by decreased expenses related to our migration of certain corporate functions to Minnesota.

Crop Insurance

Beginning in 2013, we received approval to provide multiple peril crop insurance (MPCI) through the federal crop insurance program administered by the Risk Management Agency (RMA), which is a division of the U.S. Department of Agriculture. We entered into an exclusive agreement with a managing general agency, The Climate Corporation, to provide coverages through the federal program and other supplemental coverages, including crop-hail (a separate, non-federally subsidized product that is regulated by each state). In the federal crop insurance program, the RMA sets the policy terms and conditions, rates and forms, and is also responsible for setting compliance standards. As a participating company, we report all details of underwritten policies to the RMA and are party to a Standard Reinsurance Agreement (SRA). The SRA defines the relationship between participating companies and the Federal Crop Insurance Corporation.

MPCI net written premiums are estimated based on processed applications, which are typically received around the sales closing date, with necessary adjustments made as we receive acreage reports from the policyholders. Premiums written are recognized as revenues and are earned ratably over the period of risk commencing with the sales closing date, which approximates the inception of the planting season, and ending with the estimated crop harvest date. All of the written premium in our Crop business was related to the MPCI program.

Investing, Financing and Corporate

A summary of results from our Investing, Financing and Corporate reportable segment for the three months ended March 31, 2014 and 2013 is as follows:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Net investment income	$10.0	$9.4
Net realized and change in unrealized investment gains	18.9	28.4
Pre-tax investment results	28.9	37.8
Net other revenues	0.8	23.5
General and administrative expenses	(2.9)	(3.4)
Interest expense	(3.2)	(3.2)
Pre-tax income from continuing operations	$23.6	$54.7

Investing, Financing and Corporate—Three months ended March 31, 2014 versus three months ended March 31, 2013

Investing, Financing and Corporate reported pre-tax income from continuing operations of $23.6 million for the three months ended March 31, 2014, compared to $54.7 million for the three months ended March 31, 2013. The decrease was primarily related to a $23.0 million pre-tax ($15.0 million after tax) gain from the sale of Essentia in 2013 and a decrease in investment returns. As described in greater detail in "Summary of Investment Results" below, net investment income increased to $10.0 million for the three months ended March 31, 2014, compared to $9.4 million for the same period in 2013, and net realized and change in unrealized investment gains decreased to $18.9 million for the three months ended March 31, 2014, compared to $28.4 million for the three months ended March 31, 2013. Interest expense was unchanged at $3.2 million for the three months ended March 31, 2014, compared to the same period in 2013.

Discontinued Operations

The following summarizes the results of operations, including related income taxes associated with the business classified as discontinued operations:

	Three months ended March 31,	
	2014	2013
	($ in millions)	
Net written premiums	$(0.1)	$0.8
Revenues		
Earned premiums	$(0.1)	$0.9
Total revenues	(0.1)	0.9
Expenses		
Loss and loss adjustment expenses	—	—
Policy acquisition expenses	—	0.1
Other underwriting expenses	0.7	0.1
Total expenses	0.7	0.2
Pre-tax income (loss)	(0.8)	0.7
Income tax benefit (expense)	0.3	(0.2)
Income (loss) from discontinued operations, net of tax	$(0.5)	$0.5

Discontinued Operations Results—Three months ended March 31, 2014 versus three months ended March 31, 2013

Our loss from discontinued operations, net of tax, was $0.5 million for the three months ended March 31, 2014, compared to income of $0.5 million for the three months ended March 31, 2013. The loss for the three months ended March 31, 2014 was substantially a result of non-claims expenses related to the Runoff Business, including dedicated staff. The income for the three months ended March 31, 2013 primarily related to earned premiums from involuntary pools in our Runoff Business.

For the three months ended March 31, 2014 and 2013, we recorded no incurred loss and LAE for the Runoff Business. As of March 31, 2014, the recorded net unpaid loss and LAE reserves associated with the Runoff Business totaled $177.3 million. Management believes that the recorded net loss and LAE reserves reflect a reasonable provision for expected future loss and LAE payments and represent management's best estimate within a range of reasonable estimates.

Loss and LAE reserve fair value adjustment

In connection with purchase accounting for the OneBeacon Acquisition, we were required to adjust to fair value our loss and LAE reserves and the related reinsurance recoverables. Loss and LAE reserves and the related reinsurance recoverable presented in the summary of reclassified balances within assets and liabilities held for sale as March 31, 2014 and December 31, 2013 are net of $133.6 million and $136.9 million, respectively, related to the outstanding pre-tax unaccreted adjustment.

Table of Contents

Summary of Investment Results

Investment Returns

A summary of our consolidated pre-tax investment results for the three months ended March 31, 2014 and 2013 is as follows:

	Three months ended March 31,	
Components of Investment Results	2014	2013
	($ in millions)	
Net investment income	$10.0	$9.4
Net realized investment gains	7.3	23.9
Change in net unrealized investment gains	11.6	4.5
Total pre-tax investment results	$28.9	$37.8

Gross investment returns versus typical benchmarks for the three months ended March 31, 2014 and 2013 are as follows:

	Three months ended March 31,[1]			
	2014		2013	
Fixed maturity investments	0.8	%	0.5	%
Short-term investments:	—	%	—	%
Total fixed income	0.7	%	0.4	%
Barclays U.S. Intermediate Aggregate Index	1.2	%	0.2	%
Common equity securities	3.0	%	9.3	%
Convertible fixed maturity investments	6.0	%	2.0	%
Total common equity securities and convertible fixed maturity investments	3.2	%	8.2	%
Other investments	2.0	%	2.4	%
Total common equity securities, convertible fixed maturity and other investments	2.9	%	6.4	%
S&P 500 Index	1.8	%	10.6	%
Total consolidated portfolio	1.2	%	1.5	%

[1] Gross investment returns exclude investment expenses of $1.7 million and $1.9 million for the three months ended March 31, 2014 and 2013, respectively.

Investment Returns—Three months ended March 31, 2014 versus three months ended March 31, 2013

Overview

Our total pre-tax investment results were $28.9 million, a return on average invested assets of 1.2% for the three months ended March 31, 2014, compared to $37.8 million, a return of 1.5% for the three months ended March 31, 2013. Net investment income for the three months ended March 31, 2014 was $10.0 million, an increase of $0.6 million, compared to $9.4 million for the three months ended March 31, 2013. Net realized investment gains were $7.3 million for the three months ended March 31, 2014, a decrease of $16.6 million compared to $23.9 million for the three months ended March 31, 2013. The change in net unrealized investment gains was an increase of $11.6 million for the three months ended March 31, 2014, compared to an increase in change in net unrealized investment gains of $4.5 million for the three months ended March 31, 2013.

Fixed income

Our fixed income portfolio, which includes fixed maturity and short-term investments, returned 0.7% for the three months ended March 31, 2014, compared to 0.4% for the three months ended March 31, 2013, and underperformed the longer-duration Barclays U.S. Intermediate Aggregate Index benchmark by 50 basis points for the three months ended March 31, 2014 as a result of higher yields on a longer duration portfolio. We maintained a high quality fixed maturity portfolio with a relatively short duration of approximately 2.5 years excluding short-term investments and approximately 2.3 years including short-term investments at March 31, 2014.

Common equity securities, convertible fixed maturity and other investments

Our total common equity securities, convertible fixed maturity and other investments portfolio returned 2.9% for the three months ended March 31, 2014, compared to 6.4% for the three months ended March 31, 2013. Our total common equity securities portfolio returned 3.0% and 9.3% for the three months ended March 31, 2014 and 2013, respectively, or outperformed by 120 basis points and underperformed by 130 basis points, respectively, the S&P 500 Index benchmark. Our total common equity securities portfolio has overweight exposure to financial, energy, materials and consumer staples sectors and underweight exposure to information technology, industrials and consumer discretionary sectors compared to the S&P 500 Index. Our convertible fixed maturity investments portfolio, which returns typically lag in a strong equity market, returned 6.0% and 2.0% for the three months ended March 31, 2014 and 2013, respectively. Other investments, which are composed principally of hedge funds and private equities, returned 2.0% and 2.4% for the three months ended March 31, 2014 and 2013, respectively.

Fair Value Measurements

We measure certain assets at estimated fair value in our consolidated financial statements, with changes therein recognized in current period earnings. In addition, we disclose estimated fair value for certain assets and liabilities measured at historical or amortized cost. 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 (an exit price). Fair value measurements are categorized into a hierarchy that distinguishes between inputs based on market data from independent sources (observable inputs) and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable (unobservable inputs). Quoted prices in active markets for identical assets or liabilities have the highest priority (Level 1), followed by observable inputs other than quoted prices, including prices for similar but not identical assets or liabilities (Level 2) and unobservable inputs, including the reporting entity's estimates of the assumptions that market participants would use, having the lowest priority (Level 3).

Assets carried at fair value include fixed maturity investments, common equity securities, convertible fixed maturity investments and interests in hedge funds and private equity funds. Valuation of assets measured at fair value requires us to make estimates and apply judgment to matters that may carry a significant degree of uncertainty. In determining our estimates of fair value, we use a variety of valuation approaches and inputs. Whenever possible, we estimate fair value using valuation methods that maximize the use of observable prices and other inputs.

For investments in active markets, we use quoted market prices to determine fair value. In circumstances where quoted market prices are unavailable, we utilize fair value estimates based upon reference to other observable inputs other than quoted prices, including matrix pricing, benchmark interest rates, market comparables, broker quotes and other relevant observable inputs. Where observable inputs are not available, the estimated fair value is based upon internal pricing models using assumptions that include inputs that may not be observable in the marketplace but which reflect our best judgment given the circumstances and consistent with what other market participants would use when pricing such instruments.

As of both March 31, 2014 and December 31, 2013, approximately 92% of the investment portfolio recorded at fair value was priced based upon quoted market prices or other observable inputs. Investments valued using Level 1 inputs include fixed maturity investments, primarily investments in U.S. Treasuries, common equities and short-term investments, which include U.S. Treasury Bills. Investments valued using Level 2 inputs comprise fixed maturity investments including corporate debt, state and other governmental debt, convertible fixed maturity investments and mortgage-backed and asset-backed securities. Fair value estimates for investments that trade infrequently and have few or no observable market prices are classified as Level 3 measurements. Level 3 fair value estimates based upon unobservable inputs include our investments in hedge funds and private equity funds, as well as certain investments in debt and equity securities, including mortgage-backed and asset-backed securities, where quoted market prices are unavailable. We determine when transfers between levels have occurred as of the beginning of the period.

We use brokers and outside pricing services to assist in determining fair values. The outside pricing services we use have indicated that they will only provide prices where observable inputs are available. If no observable inputs are available for a security, the pricing services will not provide a price. In those circumstances, we estimate the fair value using industry standard pricing models and observable inputs such as benchmark interest rates, matrix pricing, market comparables, broker quotes, issuer spreads, bids, offers, credit rating prepayment speeds and other relevant inputs.

Our process to assess the reasonableness of the market prices obtained from the outside pricing sources covers substantially all of our fixed maturity investments and includes, but is not limited to, evaluation of model pricing methodologies, review of the pricing services' quality control processes and procedures on at least an annual basis, comparison of market prices to prices obtained from different independent pricing vendors on at least an annual basis, monthly analytical reviews of certain prices and review of assumptions utilized by the pricing service for selected measurements on an ad hoc basis throughout the year. We also perform back-testing of selected purchases and sales activity to determine whether there are any significant differences between the market price used to value the security prior to purchase or sale and the actual purchase or sale price on at least an annual basis. Prices provided by the pricing services that vary by more than 5% and $1.0 million from the expected price based on the procedures are considered outliers. In circumstances where the results of our review process does not appear to support the market price provided by the pricing services, we challenge the price. If we cannot gain satisfactory evidence to support the challenged price, we rely upon our own pricing methodologies to estimate the fair value of the security in question.

Other investments, which are primarily comprised of hedge funds and private equity funds for which the fair value option has been elected, are carried at fair value based upon our proportionate interest in the underlying fund's net asset value, which is deemed to approximate fair value. The fair value of our investments in hedge funds and private equity funds has been estimated using net asset value because it reflects the fair value of the funds' underlying investments. We employ a number of procedures to assess the reasonableness of the fair value measurements, including obtaining and reviewing each fund's audited financial statements and discussing each fund's pricing with the fund's manager. The fair values of our investments in hedge funds and private equity funds have been classified as Level 3 under the fair value hierarchy since the fund managers do not provide sufficient information to independently evaluate the pricing inputs and methods for each underlying investment, and therefore the inputs are considered to be unobservable.

In circumstances where the underlying investments are publicly traded, such as the investments made by hedge funds, the fair value of the underlying investments is determined using current market prices. In circumstances where the underlying investments are not publicly traded, such as the investments made by private equity funds, the private equity fund managers have considered the need for a liquidity discount on each of the underlying investments when determining the fund's net asset value. In circumstances where our portion of a fund's net asset value is deemed to differ from fair value due to illiquidity or other factors associated with our investment in the fund, including counterparty credit risk, the net asset value is adjusted accordingly. At March 31, 2014 and December 31, 2013, we did not record a liquidity adjustment to the net asset value related to our investments in hedge funds or private equity funds.

As of both March 31, 2014 and December 31, 2013, other investments reported at fair value represented approximately 5% of the investment portfolio recorded at fair value. Other investments accounted for at fair value as of March 31, 2014 and December 31, 2013 were comprised of $51.9 million and $49.4 million, respectively, in hedge funds, $57.2 million and $56.1 million, respectively, in private equity funds, and $14.4 million for both periods in an investment in a community reinvestment vehicle. Additionally, other investments accounted for at fair value as of March 31, 2014 included $0.2 million in trust certificates issued upon dissolution of a private equity fund, with no such investments held as of December 31, 2013. As of March 31, 2014 and December 31, 2013, OneBeacon held investments in 9 and 8 hedge funds, respectively, and 18 and 19 private equity funds, respectively. The largest investment in a single fund was $15.1 million and $14.9 million at March 31, 2014 and December 31, 2013, respectively. As of March 31, 2014 and December 31, 2013, other investments also included $19.3 million and $19.7 million, respectively, of an investment in a tax advantaged federal affordable housing development fund which is accounted for using the equity method.

Table of Contents

The fair values at March 31, 2014 and December 31, 2013 for assets measured using Level 3 inputs are as follows:

	Fair value at March 31, 2014[1] ($ in millions)	Level 3 Value	Level 3 Percentage	
Fixed maturity investments:				
U.S. Government and agency obligations	$210.1	$—	—	%
Debt securities issued by corporations	755.7	—	—	
Municipal obligations	32.1	—	—	
Mortgage-backed and asset-backed securities	881.3	18.4	2.1	
Foreign government obligations	2.3	—	—	
Preferred stocks	84.3	71.3	84.6	
Fixed maturity investments	1,965.8	89.7	4.6	
Short-term investments	152.7	—	—	
Common equity securities	347.1	0.1	—	
Convertible fixed maturity investments	29.3	—	—	
Other investments[2]	123.7	123.7	100.0	
Total investments[2]	$2,618.6	$213.5	8.2	%

	Fair value at December 31, 2013[1] ($ in millions)	Level 3 Value	Level 3 Percentage	
Fixed maturity investments:				
U.S. Government and agency obligations	$131.1	$—	—	%
Debt securities issued by corporations	754.5	—	—	
Municipal obligations	16.5	—	—	
Mortgage-backed and asset-backed securities	949.5	10.9	1.1	
Foreign government obligations	2.3	—	—	
Preferred stocks	83.3	71.0	85.2	
Fixed maturity investments	1,937.2	81.9	4.2	
Short-term investments	157.0	—	—	
Common equity securities	336.9	0.1	—	
Convertible fixed maturity investments	30.5	—	—	
Other investments[2]	119.9	119.9	100.0	
Total investments[2]	$2,581.5	$201.9	7.8	%

[1] Includes $222.2 million and $236.3 million of fixed maturity investments reclassified to assets held for sale in the March 31, 2014 and December 31, 2013 consolidated balance sheets, respectively, as part of the Runoff Transaction.

[2] Excludes the carrying value of $19.3 million and $19.7 million as of March 31, 2014 and December 31, 2013, respectively, associated with a tax advantaged federal affordable housing development fund accounted for using the equity method.

At March 31, 2014 and December 31, 2013, we held one private preferred stock that represented approximately 85% of our preferred stock portfolio for both periods. We used quoted market prices for similar securities that were adjusted to reflect management's best estimate of fair value; this security is classified as a Level 3 measurement.

The changes in Level 3 fair value measurements for the three months ended March 31, 2014 are as follows:

	Fixed maturity investments	Common equity securities	Convertible fixed maturity investments	Other investments[1]	Total[1]
	($ in millions)				
Balance at January 1, 2014	$81.9	$0.1	$—	$119.9	$201.9
Amortization/accretion	—	—	—	—	—
Net realized and unrealized gains (losses)	0.3	—	—	3.1	3.4
Purchases	7.5	—	—	2.3	9.8
Sales	—	—	—	(1.6)	(1.6)
Transfers in	—	—	—	—	—
Transfers out	—	—	—	—	—
Balance at March 31, 2014	$89.7	$0.1	$—	$123.7	$213.5

	Fixed maturity investments	Common equity securities	Convertible fixed maturity investments	Other investments[1]	Total[1]
	($ in millions)				
Balance at January 1, 2013	$76.1	$0.1	$—	$ 122.7	$198.9
Amortization/accretion	—	—	—	—	—
Net realized and unrealized gains (losses)	0.1	—	—	3.7	3.8
Purchases	1.8	—	—	1.8	3.6
Sales	—	—	—	(4.5)	(4.5)
Transfers in	—	—	—	—	—
Transfers out	—	—	—	—	—
Balance at March 31, 2013	$78.0	$0.1	$—	$ 123.7	$201.8

[1] Excludes the carrying value of $19.3 million and $20.6 million associated with a tax advantaged federal affordable housing development fund accounted for using the equity method as of March 31, 2014 and 2013, respectively.

Liquidity and Capital Resources

Operating cash and short-term investments

Our sources and uses of cash are as follows:

Holding company level. The primary sources of cash for OneBeacon Insurance Group, Ltd. (OneBeacon Ltd.) and certain of our intermediate holding companies are expected to be distributions and tax sharing payments received from our insurance operating subsidiaries, capital raising activities, net investment income, and proceeds from sales and maturities of holding company investments. The primary uses of cash are expected to be interest payments on our debt obligations, repurchases and retirements of our debt obligations, dividend payments on our common shares, common share repurchases, purchases of investments, payments made to tax authorities, contributions to our operating subsidiaries, and holding company operating expenses.

Operating subsidiary level. The primary sources of cash for our operating subsidiaries are expected to be premium collections, net investment income, capital raising activities, contributions from our holding companies, and proceeds from sales and maturities of investments. The primary uses of cash are expected to be claim payments, policy acquisition and other underwriting expenses, interest payments on internal debt obligations, repurchases and retirements of debt obligations, purchases of investments, and distributions and tax sharing payments made to parent holding companies.

Insurance companies typically collect premiums on policies that they write prior to paying claims made under those policies. During periods of premium growth, insurance companies typically experience positive cash flow from operations, as premium receipts typically exceed claim payments. When this happens, positive cash flow from operations is usually offset by negative cash flow from investing activities, as the positive operating cash flow is used to purchase investments. Conversely, during periods of premium decline, insurance companies typically experience negative cash flow from operations, even during periods in which they report net income, as the claims that they pay exceed the premiums that they collect. When this happens, negative cash flow from operations is typically offset by positive cash flow from investing activities, as invested assets are sold to fund current claim payments. For businesses that are in run-off, cash flow should be neutral as held investments are sold to pay claims, loss adjusting, and other operating expenses.

Both internal and external forces influence our financial condition, results of operations and cash flows. Claim settlements, premium levels and investment returns may be impacted by changing rates of inflation and other economic conditions. In many cases, significant periods of time, ranging up to several years or more, may lapse between the occurrence of an insured loss, the reporting of the loss to us and the settlement of the liability for that loss. The exact timing of the payment of claims and benefits cannot be predicted with certainty. Our operating subsidiaries maintain portfolios of invested assets with varying maturities and a substantial amount of cash and short-term investments to provide adequate liquidity for the payment of claims.

Management believes that our cash balances, cash flows from operations and cash flows from investments are adequate to meet expected cash requirements for the foreseeable future on both a holding company and operating subsidiary level.

Dividend Capacity

Under the insurance laws of the jurisdictions under which our insurance operating subsidiaries are domiciled, an insurer is restricted with respect to the timing or the amount of dividends it may pay without prior approval by regulatory authorities. Accordingly, there can be no assurance regarding the amount of such dividends that may be paid by such subsidiaries in the future.

Generally, our top tier regulated U.S. insurance operating subsidiaries have the ability to pay dividends during any 12-month period without the prior approval of regulatory authorities in an amount set by formula based on the greater of prior year statutory net income or 10% of prior year end statutory surplus, subject to the availability of unassigned funds. Based on prior year end statutory surplus, OBIC, our primary top tier regulated insurance operating subsidiary, has the ability to pay $86.6 million of dividends during 2014 without prior approval of regulatory authorities, subject to the availability of unassigned funds. The amount of dividends available to be paid by OBIC in any given year is also subject to cash flow and earnings generated by OBIC's business, which now only comprises the Runoff Business, as well as to dividends received from its subsidiaries, including ASIC, the lead U.S. insurance operating subsidiary for the ongoing specialty business. At December 31, 2013, OBIC had $0.6 billion of unassigned funds and $0.9 billion of statutory surplus.

As disclosed in Note 2—"Acquisitions and Dispositions" of the accompanying consolidated financial statements, during the fourth quarter of 2012, we executed various intercompany reinsurance agreements which, along with other internal capital transactions among our regulated U.S. insurance operating subsidiaries, resulted in ASIC becoming the lead insurance company for the ongoing specialty business and OBIC becoming the lead insurance company for the Runoff Business. Notwithstanding these restructuring transactions, we continue to manage our statutory capital on a combined basis. Although OBIC remains the primary top tier regulated U.S. insurance operating subsidiary and maintains sufficient statutory capital to support the Runoff Business, the majority of the group's statutory capital is now included in ASIC, which is currently a subsidiary of OBIC, to support the ongoing specialty business. Prior to the closing of the Runoff Transaction, and subject to regulatory approval, OBIC will distribute its investment in ASIC to its immediate parent, OneBeacon Insurance Group, LLC.

ASIC has the ability to pay dividends during any 12-month period without the prior approval of regulatory authorities in an amount set by formula based on the lesser of net investment income, as defined by statute, or 10% of statutory surplus, in both cases as most recently reported to regulatory authorities, subject to the availability of earned surplus, and subject to dividends paid in prior periods. Based on net investment income, as defined by statute, ASIC has the ability to pay $23.9 million of dividends during 2014 without prior approval of regulatory authorities, subject to the availability of earned surplus. Given the changes in structure noted above, and in order for ASIC to pay dividends consistent with being the lead insurance company for our ongoing specialty business, ASIC may require prior approval by regulatory authorities in order to make additional distributions until it builds up a historical net investment income stream and earned surplus balance under its new structure. At December 31, 2013, ASIC had $94.6 million of earned surplus and $0.7 billion of statutory surplus.

Split Rock has the ability to declare or pay dividends during any 12-month period without the prior approval of Bermuda regulatory authorities on condition that any such declaration or payment of such dividend does not cause a breach of any of its regulatory solvency and liquidity requirements. During 2014, Split Rock has the ability to make capital distributions without the prior approval of regulatory authorities, subject to meeting all appropriate liquidity and solvency requirements, of $20.3 million, which is equal to 15% of its December 31, 2013 statutory capital, excluding earned surplus. During the first quarter of 2014, Split Rock paid no dividends or distributions to its immediate parent.

During the three months ended March 31, 2014, there were no distributions from our top tier regulated U.S. insurance operating subsidiaries to their immediate parent. During the three months ended March 31, 2013, our top tier regulated U.S. insurance operating subsidiaries distributed $9.8 million to their immediate parent.

During the three months ended March 31, 2014 and 2013, our unregulated insurance operating subsidiaries paid $4.1 million and $4.2 million, respectively, of dividends to their immediate parent. At March 31, 2014, our unregulated insurance operating subsidiaries had $70.9 million of net unrestricted cash, short-term investments and fixed maturity investments.

As described in Note 14—"Common Shareholders' Equity" of the accompanying consolidated financial statements, during both the three months ended March 31, 2014 and 2013, we declared and paid regular dividends totaling $20.0 million to our common shareholders.

At March 31, 2014, OneBeacon Ltd. and its intermediate holding companies held $198.8 million of net unrestricted cash, short-term investments and fixed maturity investments and $94.4 million of common equity securities, convertible fixed maturity and other long-term investments outside of its regulated and unregulated insurance operating subsidiaries.

Insurance Float

Insurance float is an important aspect of our insurance operations. Insurance float represents funds that an insurance company holds for a limited time. In an insurance operation, float arises because premiums are collected before losses are paid. This interval can extend over many years. During that time, the insurer invests the funds. When the premiums that an insurer collects do not cover the losses and expenses it eventually must pay, the result is an underwriting loss, which is considered to be the cost of insurance float. One manner in which we calculate our insurance float is by taking our net invested assets and subtracting our total capital. Although insurance float can be calculated using numbers determined under GAAP, insurance float is not a GAAP concept and, therefore, there is no comparable GAAP measure.

Insurance float can increase in a number of ways, including through acquisitions of insurance operations, organic growth in existing insurance operations and recognition of losses that do not cause a corresponding reduction in investment assets. Conversely, insurance float can decrease in a number of other ways, including sales of insurance operations, shrinking or run-off of existing insurance operations, the acquisition of operations that do not have substantial investment assets (e.g., an agency) and the recognition of gains that do not cause a corresponding increase in investment assets. We have historically obtained our insurance float through both acquisitions and organic growth. We intend to generate low-cost float over time through a combination of acquisitions and organic growth in our ongoing insurance operations. However, we will seek to increase our insurance float organically only when market conditions allow for an expectation of generating underwriting profits.

Certain operational leverage metrics can be measured with ratios that are calculated using insurance float. There are many activities that do not change the amount of insurance float at an insurance company but can have a significant impact on the company's operational leverage metrics. For example, investment gains and losses, debt issuances and repurchases/repayments, common share issuances and repurchases and dividends paid to shareholders are all activities that do not change insurance float but that can meaningfully impact operational leverage metrics.

The following table illustrates our consolidated insurance float position and four operational leverage ratios based on insurance float and net invested assets at March 31, 2014 and December 31, 2013, and include invested assets that are included in assets held for sale of $222.2 million and $236.3 million, respectively.

	March 31, 2014	December 31, 2013
	($ in millions)	
Total investment securities	$2,415.7	$2,364.9
Cash	138.6	168.1
Cash and investments classified within assets held for sale	222.2	236.3
Accounts receivable on unsettled investment sales	6.7	3.3
Accounts payable on unsettled investment purchases	(25.6)	(11.6)
Invested assets, including unsettled transactions	$2,757.6	$2,761.0
OneBeacon's common shareholders' equity	$1,130.3	$1,104.3
Debt	274.7	274.7
Total capital	$1,405.0	$1,379.0

Insurance float	$1,352.6		$1,382.0	
Insurance float as a multiple of total capital	1.0	x	1.0	x
Invested assets as a multiple of total capital	2.0	x	2.0	x
Insurance float as a multiple of OneBeacon's common shareholders' equity	1.2	x	1.3	x
Invested assets as a multiple of OneBeacon's common shareholders' equity	2.4	x	2.5	x

Table of Contents

Based on March 31, 2014 balances, insurance float is expected to decrease by approximately $222.2 million as a result of the sale of the Runoff business.

Financing

Debt

The following table summarizes our debt to capital ratio at March 31, 2014 and December 31, 2013:

	March 31, 2014	December 31, 2013
	($ in millions)	
Senior Notes, carrying value	$274.7	$274.7
OneBeacon's common shareholders' equity	1,130.3	1,104.3
Total capital	$1,405.0	$1,379.0
Ratio of debt to total capital	19.6 %	19.9 %

We believe that we have the flexibility and capacity to obtain funds externally as needed through debt or equity financing on both a short-term and long-term basis. However, we can provide no assurance that, if needed, we would be able to obtain additional debt or equity financing on satisfactory terms, if at all.

In November 2012, OneBeacon U.S. Holdings, Inc. (OBH) issued $275.0 million face value of senior unsecured notes (2012 Senior Notes) through a public offering, at an issue price of 99.9% and received $272.9 million of proceeds. The 2012 Senior Notes bear an annual interest rate of 4.6% payable semi-annually in arrears on May 9 and November 9, until maturity on November 9, 2022, and are fully and unconditionally guaranteed as to the payment of principal and interest by OneBeacon Insurance Group Ltd. OBH incurred $2.8 million in expenses related to the issuance of the 2012 Senior Notes (including the $1.8 million underwriting discount), which have been deferred and are being recognized into interest expense over the life of the 2012 Senior Notes. Taking into effect the amortization of the original issue discount and all underwriting and issuance expenses, the 2012 Senior Notes have an effective yield to maturity of approximately 4.7% per annum.

The 2012 Senior Notes were issued under indentures that contain restrictive covenants which, among other things, limit the ability of OneBeacon Ltd., OBH and their respective subsidiaries to consolidate, merge or transfer their properties and assets. The indentures do not contain any financial ratios or specified levels of net worth or liquidity to which OneBeacon Ltd. or OBH must adhere. At March 31, 2014, OneBeacon Ltd. and OBH were in compliance with all of the covenants under the 2012 Senior Notes and anticipate they will continue to remain in compliance with these covenants for the foreseeable future. In addition, a failure by OneBeacon Ltd. subsidiaries to pay principal and interest on covered debt, where such failure results in the acceleration of at least $75 million of the principal amount of covered debt, could trigger the acceleration of the 2012 Senior Notes.

No interest was paid or scheduled to be paid on the 2012 Senior Notes during the three months ended March 31, 2014 or 2013.

Capital Lease

In December 2011, we sold the majority of our fixed assets and capitalized software. We entered into lease financing arrangements with US Bancorp and Fifth Third whereby we sold furniture and equipment and capitalized software, respectively, at a cost equal to net book value. We then leased the fixed assets back from US Bancorp for a lease term of five years and leased the capitalized software back from Fifth Third for a lease term of four years. We received cash proceeds of $23.1 million as a result of entering into the sale-leaseback transactions. At the end of the lease terms, we will have the obligation to purchase the leased assets for a nominal fee, after which all rights, title and interest would transfer back to us. As of March 31, 2014 and December 31, 2013, we had a capital lease obligation of $11.1 million and $12.5 million, respectively, included within other liabilities and a capital lease asset of $9.9 million and $10.9 million, respectively, included within other assets.

Share Repurchase Authorization

On August 22, 2007, our Board authorized us to repurchase up to $200.0 million of OneBeacon's Class A common shares from time to time, subject to market conditions. Shares may be repurchased on the open market or through privately negotiated transactions. This authorization does not have a stated expiration date. Since the inception of this authorization, the Company has repurchased and retired 5.6 million of its Class A common shares. During the three months ended March 31, 2014 and 2013, no shares were repurchased under the share repurchase authorization. The amount of authorization remaining as of March 31, 2014 is $87.7 million.

Cash Flows

Detailed information concerning our cash flows during the three months ended March 31, 2014 and 2013 follows:

Cash flows from operations for the three months ended March 31, 2014 and 2013

For the three months ended March 31, 2014, net cash flows provided from operations were $4.4 million, consisting of $19.0 million provided from continuing operations and $14.6 million used for discontinued operations. For the three months ended March 31, 2013, net cash flows used for operations was $24.3 million, consisting of $16.4 million provided from continuing operations and $40.7 million used for discontinued operations. Net cash flows for operations for the three months ended March 31, 2014 and 2013 were reduced by the run-off of reserves related to the Runoff Business. Net cash flows relating to continuing operations in 2014 increased primarily due to net cash flows driven by new business.

Other Liquidity and Capital Resource Activities

During the three months ended March 31, 2014 and 2013, we repurchased 106,366 and 3,300 common shares, respectively, to satisfy employee income tax withholding, pursuant to employee benefit plans. Shares repurchased pursuant to employee benefit plans do not fall under the board authorizations referred to above.

During the three months ended March 31, 2014, we made payments with respect to our long-term incentive compensation plans totaling $10.8 million, in cash or by deferral into certain of our non-qualified compensation plans. These payments were made primarily with respect to 142,138 performance shares, 106,225 performance units, and 2,757,500 long-term cash awards for the 2011-2013 performance cycle.

During the three months ended March 31, 2013, we made payments with respect to our long-term incentive compensation plans totaling $3.9 million, in cash or by deferral into certain of our non-qualified compensation plans. These payments were made primarily with respect to 158,890 performance units for the 2010-2012 performance cycle.

Cash flows from investing and financing activities for the three months ended March 31, 2014 and 2013

Financing and Other Capital Activities

During the three months ended March 31, 2014 and 2013, we declared and paid $20.0 million of regular quarterly cash dividends to holders of OneBeacon's common shares.

Acquisitions and Dispositions

During the three months ended March 31, 2013, we completed the sale of Essentia Insurance Company and received $31.3 million as consideration.

Critical Accounting Estimates

Refer to the Company's 2013 Annual Report on Form 10-K for a complete discussion regarding our critical accounting estimates. As of March 31, 2014, there were no material changes to our critical accounting estimates.

FORWARD-LOOKING STATEMENTS

The information contained in this report may contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements, other than statements of historical facts, included or referenced in this report that address activities, events or developments which we expect will or may occur in the future are forward-looking statements. The words "will," "believe," "intend," "expect," "anticipate," "project," "estimate," "predict," “anticipate” and similar expressions are also intended to identify forward-looking statements. These forward-looking statements include, among others, statements with respect to our:

- change in book value per share or return on equity;
- business strategy;
- financial and operating targets or plans;
- incurred loss and loss adjustment expenses and the adequacy of our loss and loss adjustment expense reserves and related reinsurance;
- projections of revenues, income (or loss), earnings (or loss) per share, dividends, market share or other financial forecasts;
- expansion and growth of our business and operations;
- future capital expenditures; and

- pending transactions.

These statements are based on certain assumptions and analyses made by us in light of our experience and judgments about historical trends, current conditions and expected future developments, as well as other factors believed to be appropriate in the circumstances. However, whether actual results and developments will conform to our expectations is subject to a number of risks, uncertainties or other factors which are described in more detail beginning on page 19 of the Company's 2013 Annual Report on Form 10-K, that could cause actual results to differ materially from expectations, including:

- claims arising from catastrophic events, such as hurricanes, windstorms, earthquakes, floods or terrorist attacks;
- recorded loss and loss adjustment expense reserves subsequently proving to have been inadequate;
- exposure to asbestos or environmental claims;
- changes in interest rates, debt or equity markets or other market volatility that negatively impact our investment portfolio;
- competitive forces and the cyclicality of the property and casualty insurance industry;
- actions taken by rating agencies from time to time with respect to us, such as financial strength or credit rating downgrades or placing our ratings on negative watch;
- the continued availability of capital and financing;
- the outcome of litigation and other legal or regulatory proceedings;
- our ability to retain key personnel;
- our ability to continue meeting our debt and related service obligations or to pay dividends;
- the continued availability and cost of reinsurance coverage and our ability to collect reinsurance recoverables;
- the ability of our technology resources to prevent a data breach and the ability of our internal controls to ensure compliance with legal and regulatory policies;
- our ability to successfully develop new specialty businesses;
- changes in laws or regulations, or their interpretations, which are applicable to us, our competitors, our agents or our customers;
- participation in guaranty funds and mandatory market mechanisms;
- the impact of new theories of liability;
- changes to current shareholder dividend practice and regulatory restrictions on dividends;
- our status as a subsidiary of White Mountains, including potential conflicts of interest;
- whether the Runoff Transaction closes; and
- other factors, most of which are beyond our control.

Consequently, all of the forward-looking statements made in this report are qualified by these cautionary statements, and there can be no assurance that the anticipated results or developments will be realized or, even if substantially realized, that they will have the expected consequences. We assume no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Refer to our 2013 Annual Report on Form 10-K and in particular Item 7A — "Quantitative and Qualitative Disclosures About Market Risk." As of March 31, 2014, there were no material changes to the market risks described in our most recent Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

Management’s Quarterly Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required financial disclosure.

The CEO and CFO of OneBeacon (the principal executive officer and principal financial officer, respectively) have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, the CEO and CFO have concluded that as of March 31, 2014, our disclosure controls and procedures are adequate and effective to provide reasonable assurance that material information required to be included in our periodic SEC reports is recorded, processed, summarized and reported within the time periods specified in rules and forms. During the quarter ended March 31, 2014, there were no changes with respect to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

OneBeacon, and the insurance and reinsurance industry in general, is routinely subject to claims-related litigation and arbitration in the normal course of business, as well as litigation and arbitration that do not arise from, or directly relate to, claims activity. We believe that the outcome of these proceedings, even if determined adversely, would not have a material adverse effect on our business, financial condition and results of operations. As of March 31, 2014, there were no material changes in the legal proceedings as described in Item 3 - "Legal Proceedings" of our 2013 Annual Report on Form 10-K.

ITEM 1A. RISK FACTORS

Our business is subject to a number of risks, including those identified in Item 1A — "Risk Factors" of our 2013 Annual Report on Form 10-K, that could have a material effect on our business, results of operations, financial condition and/or liquidity and that could cause our operating results to vary significantly from period to period. As of March 31, 2014, there have been no material changes to the risk factors disclosed in our most recent Annual Report on Form 10-K. We may disclose changes to any risk factors presented or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On August 22, 2007, the Company's Board authorized the repurchase of up to $200.0 million of its Class A common shares from time to time, subject to market conditions. Shares may be repurchased on the open market or through privately negotiated transactions. This authorization does not have a stated expiration date. During the three months ended March 31, 2014, no shares were repurchased under the share repurchase authorization. As of March 31, 2014, an aggregate of 5.6 million Class A common shares were repurchased for $112.3 million under this authorization and retired.

	Total Number of Shares Purchased[1]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plan (in millions)[2]
January 1-31, 2014	—	$—	—	$87.7
February 1-28, 2014	106,366	$15.93	—	$87.7
March 1-31, 2014	—	$—	—	$87.7
Total	106,366	$15.93	—	$87.7

[1] Amounts shown represent Class A common shares repurchased to satisfy employee income tax withholding obligations pursuant to OneBeacon's employee benefit plans. These repurchases do not fall under the 2007 share repurchase authorization.

[2] Represents the amount available under the 2007 share repurchase authorization.

ITEM 6. EXHIBITS

(a) Exhibits

31.1*	Certification of T. Michael Miller pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Paul H. McDonough pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of T. Michael Miller 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 Paul H. McDonough 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 OneBeacon Insurance Group, Ltd.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 formatted in XBRL: (i) Consolidated Balance Sheets, March 31, 2014 and December 31, 2013; (ii) Consolidated Statements of Operations and Comprehensive Income, Three Months Ended March 31, 2014 and 2013; (iii) Consolidated Statements of Common Shareholders' Equity, Three Months Ended March 31, 2014 and 2013; (iv) Consolidated Statements of Cash Flows, Three Months Ended March 31, 2014 and 2013; and (v) Notes to Consolidated Financial Statements.

* Filed Herewith

** Furnished Herewith

SIGNATURES

Pursuant to the requirements of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereto duly authorized.

OneBeacon Insurance Group, Ltd.
By: /s/ JOHN C. TREACY
John C. Treacy
Chief Accounting Officer*

Date: April 28, 2014

*Executing as both the Chief Accounting Officer and a duly authorized officer of the Company