

CATALINA HOLDINGS (BERMUDA) LTD.

**CONSOLIDATED FINANCIAL STATEMENTS
AND REPORT OF INDEPENDENT AUDITORS**

**FOR THE YEARS ENDED
DECEMBER 31, 2015 AND 2014**

CATALINA HOLDINGS (BERMUDA) LTD.

FINANCIAL STATEMENTS

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KPMG Audit Limited
Crown House
4 Par-la-Ville Road
Hamilton HM 08 Bermuda

Mailing Address:
P.O. Box HM 906
Hamilton HM DX Bermuda

Telephone +1 441 295 5063
Fax +1 441 295 8280
Internet www.kpmg.bm

Independent Auditor's Report

To the Board of Directors
Catalina Holdings (Bermuda) Ltd.

We have audited the accompanying consolidated financial statements of Catalina Holdings (Bermuda) Ltd. and its subsidiaries which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of Catalina Holdings (Bermuda) Ltd. and its subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG Audit Limited

Chartered Professional Accountants
Hamilton, Bermuda
April 13, 2016

CATALINA HOLDINGS (BERMUDA) LTD.
CONSOLIDATED BALANCE SHEETS
December 31, 2015 and 2014
(Expressed in thousands of U.S. dollars)

	2015	2014
Assets		
Investments at fair value (amortized cost December 31, 2015: \$1,594,333; December 31, 2014: \$1,508,282)	\$ 1,525,960	\$ 1,525,500
Cash and cash equivalents	324,541	170,139
Restricted cash and cash equivalents	84,557	92,982
Accrued investment income	13,131	9,352
Funds held by cedants and claims administrators.....	92,556	90,118
Outstanding losses and loss expenses recoverable	470,689	553,060
Insurance and reinsurance balances receivable	44,732	69,432
Deferred reinsurance premiums	11,429	20,989
Investments in real estate.....	134,452	60,348
Other assets	21,128	35,256
Intangible assets	16,750	19,450
Total assets	\$ 2,739,925	\$ 2,646,626
 Liabilities		
Outstanding losses and loss expenses	\$ 1,560,347	\$ 1,556,525
Unearned premiums	26,031	49,935
Insurance and reinsurance balances payable	60,947	88,493
Accounts payable, accrued expenses and other liabilities	36,355	30,430
Long term subordinated debt.....	170,725	182,125
Loans payable	351,857	341,137
Total liabilities	2,206,262	2,248,645
 Shareholders' equity		
Ordinary shares	7,711	7,693
Preference shares.....	358,403	258,761
Additional paid-in capital	26,477	15,508
Retained earnings	144,218	114,188
Accumulated other comprehensive (loss) income.....	(7,858)	184
Total Catalina Holdings (Bermuda) Ltd. shareholders' equity	528,951	396,334
Non-controlling interest.....	4,712	1,647
Total shareholders' equity	533,663	397,981
Total liabilities and shareholders' equity	\$ 2,739,925	\$ 2,646,626

The accompanying notes are an integral part of these consolidated financial statements

CATALINA HOLDINGS (BERMUDA) LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the years ended December 31, 2015 and 2014
(Expressed in thousands of U.S. dollars)

	<u>2015</u>	<u>2014</u>
Revenues		
Gross premiums written	\$ 3,206	\$ (4,128)
Premiums ceded	6,085	(3,276)
Net premiums written	9,291	(7,404)
Change in net unearned premiums	15,747	48,960
Net premiums earned	25,038	41,556
Net losses and loss expenses	60,525	15,892
Commissions	(2,251)	(6,025)
Net run-off income	<u>83,312</u>	<u>51,423</u>
Net investment income	37,432	31,998
Net (losses) gains on investments	(10,447)	17,166
Rental income.....	5,494	488
Net foreign exchange gains (losses)	6,489	(586)
Gain on acquisition	7,298	7,827
General and administrative expenses	(52,074)	(51,510)
Change in subordinated debt fair value	8,271	3,898
Interest expense	(21,076)	(16,774)
Income before income taxes	64,699	43,930
Income tax expense	(7,529)	(654)
Net income	<u>\$ 57,170</u>	<u>\$ 43,276</u>
Net (income) loss attributable to non-controlling interest.....	(121)	9
Net income attributable to Catalina Holdings (Bermuda) Ltd.	<u>\$ 57,049</u>	<u>\$ 43,285</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the years ended December 31, 2015 and 2014
(Expressed in thousands of U.S. dollars)

	<u>2015</u>	<u>2014</u>
Net income attributable to Catalina Holdings (Bermuda) Ltd.	<u>\$ 57,049</u>	<u>\$ 43,285</u>
Other comprehensive loss, before and net of tax:		
Foreign currency translation adjustments	(8,531)	(451)
Fair value of interest rate swap.....	489	-
Other comprehensive loss, before and net of tax	<u>(8,042)</u>	<u>(451)</u>
Comprehensive income	<u>\$ 49,007</u>	<u>\$ 42,834</u>

The accompanying notes are an integral part of these consolidated financial statements

CATALINA HOLDINGS (BERMUDA) LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the years ended December 31, 2015 and 2014
(Expressed in thousands of U.S. dollars except for share and per share amounts)

	<u>2015</u>	<u>2014</u>
Share capital - "A" Ordinary shares of par value \$1.00 each		
Balance at beginning and end of year	\$ 6,693	\$ 6,693
Share capital - "B" Ordinary shares of par value \$1.00 each		
Balance at beginning and end of year	600	600
Share capital - "C" Ordinary shares of par value \$1.00 each		
Balance at beginning of year	400	400
Issued during year.....	18	-
Balance at end of year	418	400
Preference share capital - Preference shares of par value \$1.00 each		
Balance at beginning of year	258,761	247,560
Issued during year.....	97,667	10,767
Change in accrued dividends during year.....	1,975	434
Balance at end of year	358,403	258,761
Additional paid-in capital		
Balance at beginning of year	15,508	6,390
Dividends on "B" and "C" Ordinary shares	(120)	-
Increase in subscription value of preference shares.....	11,089	9,118
Balance at end of year	26,477	15,508
Retained earnings		
Balance at beginning of year	114,188	93,100
Preference shares dividends and subscription value increase.....	(24,731)	(20,319)
Dividends on "B" and "C" Ordinary shares	(2,437)	(1,869)
Issued "C" Ordinary shares as stock-based compensation.....	106	-
Dividend paid to non-controlling interest.....	(78)	-
Net income	57,170	43,276
Balance at end of year	144,218	114,188
Accumulated other comprehensive (loss) income		
Balance at beginning of year	184	635
Other comprehensive loss.....	(8,042)	(451)
Balance at end of year	(7,858)	184
Total shareholders' equity	\$ 528,951	\$ 396,334

The accompanying notes are an integral part of these consolidated financial statements

CATALINA HOLDINGS (BERMUDA) LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2015 and 2014
(Expressed in thousands of U.S. dollars)

	2015	2014
Cash flows from operating activities		
Net income	\$ 57,049	\$ 43,285
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Gain on acquisitions	(7,298)	(7,827)
Gain on disposal of intangible assets	(256)	-
Depreciation of property and equipment	653	242
Amortization of net discounts on investments	4,139	(3,161)
Write-off of intangible asset	-	1,000
Net losses(gains) on investments	10,447	(17,166)
Net income (loss) attributable to non-controlling interest.....	121	(9)
Change in subordinated debt fair value.....	(8,271)	(3,898)
"C" shares issued as stock-based compensation.....	124	-
Changes in assets and liabilities:		
Restricted cash and cash equivalents	(15,699)	(9,774)
Accrued investment income	(3,685)	1,135
Funds held by cedants and claims administrators.....	24,245	44,588
Outstanding losses and loss expenses recoverable	84,389	56,201
Insurance and reinsurance balance receivable	26,393	12,917
Deferred reinsurance premiums	9,560	21,454
Other assets	18,192	(23,917)
Outstanding losses and loss expenses	(9,244)	(107,297)
Unearned premiums	(23,904)	(41,433)
Deposit liabilities	-	(30,180)
Accounts payable, accrued expenses and other liabilities	2,133	(10,951)
Insurance and reinsurance balances payable	(27,365)	(2,791)
Net cash provided by (used in) operating activities	141,723	(77,582)
Cash flows used in investing activities		
Payment for acquisitions, net of cash acquired	(53,771)	(105,520)
Proceeds from sale of intangible assets	2,956	-
Securities transferred from novation	(60,064)	-
Purchases of investments	(868,548)	(1,264,046)
Proceeds from sale or maturity of investments.....	975,865	1,377,587
Investment in real estate.....	(74,104)	(60,436)
Net cash used in investing activities	(77,666)	(52,415)
Cash flows provided by financing activities		
Proceeds from issuance of preference shares	86,000	-
Capital contributions for non-controlling interest.....	3,231	1,656
"B" and "C" Ordinary shares dividend	(2,557)	(1,869)
Proceeds from issuance of loans payable.....	107,820	332,037
Non-controlling interest dividend.....	(78)	-
Repayment of loans	(97,100)	(225,866)
Net cash provided by financing activities.....	97,316	105,958
Effect of exchange rate changes.....	(6,971)	3,734
Increase (decrease) in cash and cash equivalents	154,402	(20,304)
Cash and cash equivalents at beginning of year	170,139	190,443
Cash and cash equivalents at end of year	\$ 324,541	\$ 170,139
Supplemental information:		
Interest paid	\$ 18,595	\$ 17,503
Income taxes paid	\$ 17	\$ 766

The accompanying notes are an integral part of these consolidated financial statements

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of U.S dollars except for share amounts, or as otherwise stated)

1. Description of business

Catalina Holdings (Bermuda) Ltd. (“Catalina” or the “Company”), incorporated on June 25, 2007, is a holding company organized under the laws of Bermuda. Catalina, through its subsidiaries located in Bermuda, the United States, the United Kingdom, Ireland and Switzerland, was formed to acquire and manage non-life insurance and reinsurance companies and portfolios of insurance and reinsurance business in run-off. Since October 2008 Catalina has completed the acquisition of insurance and reinsurance companies and portfolios of insurance and reinsurance business. The acquisitions are:

• Quanta Capital Holdings Ltd. (“Quanta”)	October 2008
• Alea Holdings UK Limited	October 2009
• Western General Insurance Ltd. (“WestGen”)	July 2010
• Glacier Reinsurance AG (“Glacier Re”)	April 2011
• Residential Loss Control Holdings, LLC (“RLCH”)	October 2011
• HSBC Reinsurance Limited and HSBC Insurance (Ireland) Limited	October 2012
• KX Reinsurance Company Ltd.	April 2013
• American Safety Reinsurance Ltd. (“Catalina Safety”)	October 2013
• Alea Group Holdings (Bermuda) Ltd. (“AGHBL”)	March 2014
• SPARTA Insurance Holdings, Inc.,	September 2014
• Danielson Indemnity Company (“Danielson”)	November 2014
• PXRE Reinsurance Company (“PXRE”)	May 2015
• Papiro AG (“Papiro”)	October 2015
• Allianz Suisse Ruckversicherungs-Gessellschaft AG (“Allianz Suisse Re”)	December 2015

The portfolio transfers are:

• Contractors wrap-up policies from Renaissance Reinsurance Ltd.	November 2012
• Marine insurance liabilities from the Delta Lloyd Group	June 2014
• Residential construction liabilities from NationsBuilders Insurance Company	February 2015
• UK and EU insurance liabilities from Quinn Insurance Limited	June 2015

Catalina has renamed many of the entities acquired and simplified the group structure by merging and amalgamating entities where possible. As at December 31, 2015 Catalina had fourteen regulated entities of which the most significant are Catalina General Insurance Ltd. (“CatGen”), SPARTA Insurance Company (“SIC”), Catalina London Limited, Glacier Re and Catalina Insurance Ireland Limited (“CIIL”).

2. Significant accounting policies

Basis of presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities reported at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. While management believes the amounts included in the consolidated financial statements reflect management’s best estimates and assumptions, the actual results could ultimately be materially different from the amounts currently provided for in the consolidated financial statements. The Company’s principal estimates relate to the development or determination of the following:

- valuation of outstanding losses and loss expenses;
- valuation of investments and determination of hierarchical inputs used to measure fair value of investments;
- valuation of assets and liabilities under business combination accounting;
- valuation of long term subordinated debt;
- provisions for litigation and other contingent liabilities;
- provision for non-collectible reinsurance balances recoverable;

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

- recoverability of insurance and reinsurance balances receivable; and
- valuation of intangible assets.

The Company's consolidated financial statements include the financial statements of the Company and all of its subsidiaries in which it owns, directly or indirectly through subsidiaries, over fifty percent of the voting rights or is in a position to govern the financial and operating policies of the entity. All significant balances and transactions among related companies have been eliminated on consolidation. The results of subsidiaries acquired are included from the dates of their acquisition by the Company.

Premiums

The Company's insurance and reinsurance subsidiaries wrote insurance policies and reinsurance contracts prior to entering into run-off. These subsidiaries no longer write new policies or contracts but premiums continue to be earned over the terms of the associated insurance policies and reinsurance contracts in proportion to the amount of insurance protection provided. The term of the insurance or reinsurance coverage provided may be cancelled by the insured or ceding company resulting in a return of written premium.

Profit commission accruals are recorded as commission expenses and are adjusted at the end of each year based on the experience of the underlying contract. Such adjustments related to profit commissions may be significant.

Ceded reinsurance or retrocessional coverage was used to limit the Company's insurance and reinsurance subsidiaries' individual and aggregate exposures to risks of losses arising from contracts of insurance or reinsurance. Reinsurance premiums ceded to reinsurers are recorded and earned in a manner consistent with that of the original contracts or policies written and the terms of the reinsurance agreements.

Premiums written and ceded relating to the unexpired periods of coverage or policy terms are recorded on the consolidated balance sheet as unearned premiums and deferred reinsurance premiums, respectively. Unearned premiums and deferred reinsurance premiums are recorded at fair value at the date that they were acquired. The fair value of the unearned premiums reserve was based on the estimated timing of reserve settlements discounted at a risk free rate.

Assumed premiums on life insurance contracts are recognized as revenue when payable by the policyholder on underlying reinsurance policies. Premiums collected by intermediaries but not yet received are assessed based on estimates from underwriting or past experience and are included in premium revenue.

Retroactive reinsurance

Consideration received in excess of estimated liabilities assumed with respect to retroactive reinsurance contracts is recognized as deferred income at inception of such contracts. Deferred income is subsequently amortized using the interest method over the expected claims settlement periods. Changes to the estimated timing or amount of loss payments produce changes in periodic amortization. Changes in such estimates are applied retrospectively and are included within net income in the year in which such changes are made. Deferred income is reported within outstanding losses and loss expenses in the consolidated balance sheets and deferred income amortization is recognized within net losses and loss expenses in the consolidated statements of operations.

Outstanding losses and loss expenses

The Company establishes reserves for outstanding losses and loss expenses for estimates of future amounts to be paid in settlement of its ultimate liabilities for claims arising under its contracts of insurance and reinsurance that have occurred at or before the consolidated balance sheet date. The estimation of ultimate loss and loss expense liabilities is a significant judgment made by management and is inherently subject to significant uncertainties.

The Company's loss reserves fall into two categories; case reserves for reported losses and loss expenses ("case reserves") and reserves for losses and loss expenses incurred but not reported ("IBNR reserves"). Case reserves are based initially on claim reports received from insureds, brokers or ceding companies, and may be supplemented by the Company's claims professionals with estimates of additional ultimate settlement costs. IBNR reserves are estimated by management

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

using generally accepted statistical and actuarial techniques and are reviewed by independent actuaries. In applying these techniques, management uses estimates as to ultimate loss emergence, severity, frequency, settlement periods and settlement costs. In making these estimates, the Company relies on the most recent information available, including industry information, and on its own historical loss and loss expense experience.

On periodic payment order claims (“PPO’s”), due to the long delay from when the claim was settled and when the final payment will be made, the outstanding claims are discounted to take account of investment income receivable to the final payment date. The Company discount its PPO’s at a real discount rate of 0%, assuming a long term care index inflation rate of 2.5% per annum, offset by expected investment returns of 2.5%. For known PPO’s, cash flows were projected in accordance with the claimants’ life expectancy. Annual cash flows were increased in line with an assumed inflation rate of 2.5% per annum. These cash flows are then discounted to the valuation date at an assumed discount rate of 2.5% per annum. The Company has discounted the cash flows as it is of the opinion that estimating undiscounted reserve for PPO’s is neither reliable nor representative of the underlying value of the losses. The unreliability stems from the significant uncertainty involved in estimating an absolute level of indexation. Discounting cash flows using a real yield assumption based on the relationship of investment returns relative to inflation indices is more reliable in the long term.

Management believes the Company’s reserving techniques represent a reasonable basis for estimating ultimate claim costs and that the outstanding losses and loss expenses are sufficient to cover claims from losses occurring up to the consolidated balance sheet date; however, ultimate losses and loss expenses may be subject to significant volatility as a result of significant uncertainties. These uncertainties are driven by many variables that are difficult to quantify. These uncertainties include, for example, the period of time between the occurrence of an insured loss and actual settlement, fluctuations in inflation, prevailing economic, social and judicial trends, legislative changes, internal and third party claims handling procedures and the lack of complete historical data on which to base loss expectations. Accordingly, ultimate liabilities may differ materially from the amounts recorded in the consolidated financial statements.

The Company regularly reviews and adjusts its reserve estimates and reserving methodologies taking into account current information. Outstanding losses and loss expenses are adjusted as claim experience develops and new information becomes available. Any adjustments to previously established reserves may significantly impact net income.

Reinsurance recoverable

Reinsurance recoverables are recorded at fair value at the date that the subsidiary owning the assets is acquired. The fair value of the recoverable from reinsurers is based on the estimated timing of reserve settlements discounted at a risk adjusted rate determined by management.

The Company estimates outstanding loss and loss expenses recoverable using methodologies and assumptions consistent with those used in estimating reserves for losses and loss expenses. The estimation of outstanding loss and loss expenses recoverable is a significant judgment made by management and is inherently subject to significant uncertainties. The Company establishes allowances for amounts recoverable that are considered potentially uncollectible from its reinsurers. The valuation of this allowance for uncollectible reinsurance recoverable includes a review of the credit ratings of the reinsurance recoverables by reinsurer, an analysis of default probabilities as well as identifying whether or not coverage issues exist. These factors require management judgment and the impact of any adjustments to those factors is reflected in net income in the year that the adjustment is determined. The Company is subject to credit risk with respect to the reinsurance ceded because the ceding of risk does not relieve the Company from its original obligations to its insureds.

Life contracts

Life contracts comprise of traditional life savings business assumed through coinsurance and modified coinsurance reinsurance contracts. They have all been in run-off for several years although many have recurring premiums. Liabilities for life reinsurance contracts are booked at the amounts reported by the ceding companies. The Company estimates the policy benefits for the life and annuity contracts using standard actuarial techniques and cash flow models. Policy benefits are reviewed annually and the Company performs a liability adequacy test based on cash flow projections. Since estimating the policy benefits depends on cash flow projection, the Company makes assumptions based on experience and industry mortality tables, longevity, morbidity rates, lapse rates, expenses and investment experience including provision for adverse deviation. The assumptions used are determined at the acquisition of the Company that wrote the contract and

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

locked in throughout the life of the contract unless a premium deficiency develops. The assumptions are reviewed at acquisition and annually and unlocked if it results in material adverse development. The estimates are established based on information provided by the ceding companies, contract specific historical experience and industry experience.

The policy benefits are maintained at a level that, when taken together with future premium payments and investment income, are expected to be sufficient to cover policyholder obligations as they fall due. Provision is made where current best estimates of future contractual cash flows arising from the contracts are expected to exceed the policy obligations net of premiums receivable. Investment income from the assets backing the liabilities is taken into account when calculating such provision. The assessment of whether an additional provision needs to be booked is based on information available after offsetting the surpluses and deficits arising on contracts within the life portfolio. Any deficiency is charged to the statement of operations by establishing a provision for losses arising from the liability adequacy test for the unexpired risk portion. The amount of the provision depends on the risk adjusted returns available on assets designated to support life contract liabilities.

Structured settlements

Included within outstanding losses and loss expenses and outstanding losses and loss expenses recoverable in the consolidated balance sheets are amounts related to structured settlements. CatGen through its Canadian branch, has assumed ownership of certain structured settlements and has purchased annuities from life insurance companies to provide fixed and recurring payments to the claimants. CatGen remains responsible to the claimant in the case of non-performance by the life insurance companies. The assets and liabilities for the structured settlement contracts are booked at the amounts reported by the life insurance companies as management believes this to be the best available estimate of the obligations under these contracts.

Cash and cash equivalents

Cash equivalents include highly liquid instruments such as liquidity funds, money market funds and other time deposits with commercial banks and financial institutions which have maturities of less than three months from the date of purchase. See Note 12(a) in relation to concentrations of credit risk. Restricted cash and cash equivalents are separately reported in the consolidated balance sheets at December 31, 2015 and 2014. Changes in restricted cash and cash equivalents are reported as an operating activity in the statements of cash flows for the years ended December 31, 2015 and 2014.

Investments and net investment income

Investments are recognized and measured at fair value with subsequent changes to the fair value recorded within net gains (losses) on investments in the consolidated statements of operations. The Company holds trading portfolios of fixed maturities, short-term investments and equities which are recorded at fair value.

Purchases and sales of investments are recorded on a trade date basis. Realized gains and losses on sales of investments are determined on a first-in, first-out basis and are shown within net gains (losses) on investments in the consolidated statements of operations. Net investment income is recognized when earned and includes interest and dividend income, together with amortization of market premiums and discounts using the effective yield method and is net of investment management fees.

Other investments are recognized and measured at fair value with subsequent changes to the fair value, income distributions and realized gains and losses reported within net investment income in the consolidated statements of operations.

Derivatives

The Company's derivative instruments are recorded in the consolidated balance sheets at fair value, with changes in fair value recognized in the consolidated statements of operations.

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

Fair Value Measurements

Fair value is defined as the price to sell an asset or transfer a liability (i.e. the “exit price”) in an orderly transaction between market participants. Assets and liabilities recorded at fair value in the consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. An asset or a liability’s categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. The hierarchy is broken down into three levels as follows:

- Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2 – Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. These are generally company generated inputs and are not market based inputs.

The Company used the following valuation techniques and assumptions in estimating the fair value of financial instruments as well as the general classification of such financial instruments pursuant to the above fair value hierarchy:

Fixed maturities

At each valuation date, the Company uses a market approach technique to estimate the fair value of the fixed maturities portfolios, where possible. This market approach includes, but is not limited to, prices obtained from third party pricing services and broker-dealers for identical or comparable securities. The pricing services use market quotations for securities that have quoted prices in active markets.

When quoted market prices are unavailable, the pricing service prepares estimates of fair value measurements with its proprietary pricing applications, using observable market inputs such as yield curves, credit risks and spreads, measures of volatility, and expected cash flows including prepayment speeds.

The following describes the significant inputs generally used to determine the fair value of fixed maturities by asset class:

- U.S. government and agency securities consist of securities issued by the U.S. Treasury and mortgage passthrough agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other agencies. The significant inputs include the spread above the risk-free yield curve, reported trades and broker-dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.
- Non-U.S. government securities consist of bonds issued by non-U.S. governments and agencies along with supranational organizations. The significant inputs include the spread above the risk-free yield curve, reported trades and broker-dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.
- Corporate securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker-dealer quotes, benchmark yields, and industry and market indicators. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2. Private debt has been classified under Level 3 as the inputs used to determine the fair value of this are not considered to be observable.

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

- Municipal securities consist primarily of bonds issued by U.S.-domiciled state and municipal entities. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker-dealer quotes and benchmark yields. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2.
- Asset-backed securities consist primarily of investment-grade bonds backed by pools of loans with a variety of underlying collateral. The significant inputs used to determine the fair value of these securities includes the spread above the risk-free yield curve, reported trades, benchmark yields, broker-dealer quotes, expected cash flows including prepayment speeds, and default rates. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2. Student loans asset-backed securities have been classified under Level 3 as the inputs used to determine the fair value of these securities are not considered to be observable.
- Mortgage-backed securities include both agency and non-agency originated securities. The significant inputs used to determine the fair value of these securities include the spread above the risk-free yield curve, reported trades, benchmark yields, broker-dealer quotes, expected cash flows including prepayment speeds, and default rates. These are considered observable market inputs and, therefore, the fair values of these securities are classified within Level 2.

Equity securities

Equity securities include exchange traded funds, mutual funds, common stocks and preferred stocks. Exchange traded debt and equity funds, common stocks and preferred stocks are classified within Level 1 as the fair values are based on quoted market prices in active markets. Certain convertible bond and multi-asset funds with daily liquidity and redemption based on the net asset value of the fund are classified within Level 2. The policy for all equity securities classified under Level 3 has been described under alternative investments below.

Alternative Investments

Alternative Investments consist of non-traditional, not readily marketable investments, some of which may be structured as offshore limited partnerships, hedge funds, private equity, private equity funds, private debt funds, debt funds, commercial real estate funds, common trust funds and venture capital funds. The underlying investments of such funds, whether invested in stock or other securities, are generally not currently traded in a public market and typically are subject to restrictions on resale. Values determined by investment managers and general partners of underlying securities that are thinly traded or not traded in an active market may be based on historical cost, appraisals, a review of the investees' financial results, financial condition and prospects, together with comparisons to similar companies for which quoted market prices are available or other estimates that require varying degrees of judgment. Because of the inherent uncertainty of valuations, the estimated fair values may differ significantly from the values that would have been used had a ready market for such investments existed or had such investments been liquidated, and those differences could be material.

The fair values of alternative investments have been estimated using the Net Asset Value ("NAV") of the funds reported by the management responsible for administering the funds, where possible. In the absence of such information the assets are valued based on management's review and judgement of such assets. FASB guidance provides for the use of NAV as a 'Practical Expedient' for estimating fair value for alternative investments. NAV reported by each alternative investment fund is used as a practical expedient to estimate the fair value of the fund's interest therein and their classification within level 2 or 3 is based on the funds ability to redeem its interest in the near term as well as availability of observable inputs for similar assets.

Long term subordinated debt

Glacier Re:

Long term subordinated debt was issued by Glacier Re in 2005 (see note 11). The Company classified its subordinated debt within Level 3 because similar debt trades infrequently and therefore there have been few observable inputs in terms of valuation benchmarks. Using judgement, the Company has therefore determined certain inputs in its valuation model

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

which are not readily observable. Such inputs incorporate the counterparty risk of non-performance for Glacier Re's debt.

Accordingly, the fair value of the long-term subordinated debt reflects the risk of non-performance of Glacier Re, captured by incorporating Glacier Re's credit spread derived from the USD and Euro Composite yields to determine an appropriate discount rate which is applied to the nominal value of the debt at each measurement date. The discount rate is adjusted by an additional factor which reflects the implicit value, determined using judgement, of the value of Glacier Re's options for early repayment of the debt.

Alea Holdings US Company ("AHUSCO"):

AHUSCO issued \$100 million of trust preferred securities ("TruPS") in December 2004 and an additional \$20 million of TruPS in January 2005 which are classified within Level 3. The TruPS were issued by three Delaware trusts established by AHUSCO and provide for a preferred dividend at a rate of 3-month LIBOR plus 285 basis points. AGHBL gave a guarantee to the holders of the TruPS. The TruPS do not carry financial covenants or cross default covenants, have a fixed maturity of 30 years, and are callable. AHUSCO may optionally redeem the debentures and thereby retire the TruPS but the holders of the debentures may not call the debentures prior to their maturity dates.

The fair value of the TruPS is calculated through an internal valuation model. Similar debt trades infrequently and therefore the Company has determined certain inputs in its valuation model which are not readily observable. Such inputs incorporate the counterparty risk of non-performance for AGHBL's debt. Accordingly, the fair value of the long-term subordinated debt reflects the risk of non-performance of the Company, captured by incorporating the Company's credit spread derived from the USD composite yields to determine an appropriate discount rate which is applied to the nominal value of the debt at each measurement date. The discount rate is further adjusted by an additional factor to reflect the assumption that the subdebt's credit risks are below BBB level. The Company classified this debt within Level 3.

Derivative instruments

Interest rate swaps are customized to the Company's risk management strategy. The Company estimates the fair value of these derivatives from significant observable inputs such as non-binding broker-dealer quotes and foreign exchange rates. Accordingly, the Company classified these derivatives within Level 2.

Investments in real estate

The Company invests in real estate to generate returns via rental income and capital appreciation. The income from the operating leases is recognized as rental income as per the terms of the leases.

The real estate acquired is recorded at cost less accumulated depreciation for the depreciable assets. The cost includes all acquisition costs directly identifiable with the purchase of the real estate. The Company splits the acquisition cost of each real estate asset between land and buildings based on management's judgement. The buildings comprise primarily of warehouses used to store goods. These buildings are depreciated over an estimated useful life of 40 years on a straight-line basis.

The Company will assess for impairment when circumstances indicate the carrying value of the property may not be recoverable. The review will be based on the estimate of future undiscounted cash flows excluding interest charges expected to result from the use and eventual disposal.

Property and equipment

Property and equipment, which consist of furniture, equipment, and leasehold improvements, are stated at cost less accumulated depreciation. Depreciation is computed using an accelerated method over the estimated useful lives of the related assets, ranging from three to seven years. Property and equipment are included in the other assets line item in the balance sheet.

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

Intangible assets

Intangible assets with indefinite useful lives are not amortized but are tested annually for impairment by a comparison to estimated realizable value. If the carrying amounts of intangible assets are greater than their fair values established during impairment testing, the carrying value is written-down to the fair value with a corresponding impairment loss recognized in the consolidated statements of operations.

Foreign currency translation

The U.S. dollar is the functional currency of the Company and most of its subsidiaries. All foreign currency asset and liability amounts are translated into U.S. dollars at end-of-period exchange rates. Foreign currency income and expenses are translated at average exchange rates in effect during the period. Exchange gains and losses arising from the translation of foreign currency-denominated monetary assets and liabilities are included in the consolidated statements of operations. The effects of the currency translation adjustments for entities whose functional currency is not the U.S. dollar are included within foreign currency translation adjustments in the consolidated statements of comprehensive income.

Income taxes

Income taxes have been recognized in accordance with current standards, on those operations that are subject to income taxes. Deferred tax assets and liabilities result from net operating loss carryforwards and temporary differences between the carrying amounts of existing assets and liabilities recorded in the consolidated financial statements and their respective tax bases. A valuation allowance for a portion or all of deferred tax assets is recorded as a reduction to deferred tax assets if it is more likely than not that such portion or all of such deferred tax assets will not be realized.

Legal expenses

In the event of a dispute in the ordinary course of business, the Company expenses legal costs on an accrual basis. In the event of a specific litigation, when it is reasonably probable that the legal costs are going to be incurred, the Company accrues legal costs in line with the estimated incurred expenses.

Commutations

As the Company actively runs off its insurance and reinsurance subsidiaries it seeks to mitigate its exposures through early settlement of its obligations to policyholders or ceding companies by entering into commutations or other arrangements.

These negotiated commutation agreements eliminate the risk of adverse claim experience as they provide for full and final settlement of all current and future policy obligations with respect to the transaction to which they relate. Gains and losses on commutations are recorded as either a decrease or an increase in incurred claims.

Acquisitions

The Company accounts for acquisitions using the acquisition method of accounting, which requires that the acquirer recognize and measure the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. The fair values of each of the acquired reinsurance assets and liabilities are derived from probability-weighted ranges of the associated projected cash flows, based on actuarially prepared information and management's run-off strategy.

The key assumptions used in the fair valuation of acquired companies are the projected payout, timing and amount of claims liabilities, the related projected timing and amount of reinsurance collections, a risk-free discount rate, which is applied to determine the present value of the future cash flows, the estimated unallocated loss adjustment expenses to be incurred over the life of the run-off, the impact of any accelerated run-off strategy, and an appropriate risk margin.

The difference between the original carrying value of assets acquired and liabilities assumed at the date of acquisition and their fair value is recorded as an intangible asset or liability, which we refer to as the fair value adjustment. The fair value adjustment is amortized over the estimated payout period of outstanding losses and loss expenses acquired. To the extent the actual payout experience after the acquisition is materially faster or slower than anticipated at the time of the

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

2. Significant accounting policies – (continued)

acquisition or there is an adjustment to the estimated ultimate loss reserves, then the amortization of the fair value adjustment is adjusted to reflect such changes.

Any excess between the fair value of net assets acquired and the purchase price is recorded as a gain on bargain purchase in the consolidated statements of operations.

Share-based compensation

The Company has issued Class C ordinary shares to management as share-based compensation. The fair value of the compensation cost is measured at the grant date and is expensed over the service period of the award.

3. Acquisitions

The Company accounts for acquisitions using the acquisition method of accounting, which requires that the acquirer recognize and measure the identifiable assets acquired and liabilities assumed at their acquisition-date fair values.

PXRE Reinsurance Company (“PXRE”)

On May 27, 2015, the Company, through its wholly-owned subsidiary, AHUSCO, completed the acquisition of PXRE. PXRE wrote reinsurance business, primarily commercial and catastrophe focused property and marine and aerospace risks plus some casualty and finite business. PXRE ceased to write new business in 2006.

The purchase price of \$9.9 million, and acquisition costs were financed from cash in hand.

The acquisition resulted in a gain of \$3.6 million included within gain on acquisition in the consolidated statement of operations. Management believes that the reason for the transaction gain related mainly to the seller’s requirement to generate cash in a short timeframe.

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	2015
Investments, at fair value	\$ 18,238
Cash and cash equivalents	4,657
Accrued investment income	93
Outstanding losses and loss expenses recoverable	2,018
Insurance and reinsurance balances receivable	1,693
Other assets	427
Total assets.....	<u>\$ 27,126</u>
Liabilities	
Outstanding losses and loss expenses	\$ 13,069
Insurance and reinsurance balances payable	567
Accounts payable and other liabilities	5
Total liabilities	<u>13,641</u>
Net assets acquired at fair value	<u>\$ 13,485</u>

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

3. Acquisitions (continued)

Quinn Insurance Limited (“QIL”)

On June 30, 2015 the Company, through its wholly-owned subsidiary, CIIL, completed a portfolio transfer of £237 million of legacy insurance liabilities from QIL (under administration). The insurance liabilities are predominantly UK and Northern Ireland motor insurance and professional indemnity (UK solicitors) with some employer’s liability and public liability business. The business has been in run-off since December 31, 2012. The portfolio transfer has been accounted for as a business combination as the Company has acquired control of the business of QIL. As a result of the portfolio transfer, the Company acquired all assets and liabilities of QIL. The business combination has been accounted for using the acquisition method of accounting.

As part of the transfer process the Company injected £103 million of capital into CIIL. The capital injection of £103 million was financed through a £60 million drawdown on the Revolving Credit Facility and the issuance of \$63 million of preference shares.

The acquisition resulted in no pre-tax gain or loss in 2015.

The following summarises the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition which is converted at the USD exchange rate of \$1.5726:

Assets	2015
Cash and cash equivalents	\$ 373,025
Outstanding losses and loss expenses recoverable	6,369
Total assets.....	<u>\$ 379,394</u>
Liabilities	
Outstanding losses and loss expenses	\$ 378,358
Unearned premiums	1,036
Total liabilities	<u>379,394</u>
Net assets acquired at fair value	<u>\$ -</u>

Papiro AG

On October 8, 2015, the Company, through its wholly-owned subsidiary, Glacier Re, completed the acquisition of Papiro. Papiro insured its former owner’s environmental, transport and key man risks. The purchase price of Euro 53.0 million, was financed from a loan note from the vendor and the Company’s effective purchase price was therefore nil.

The acquisition resulted in a gain of \$3.7 million included within gain on acquisition in the consolidated statement of operations. Management believes that the reason for the transaction gain related mainly to the transaction allowing the vendor to share the benefit of the tax savings arising from using Glacier Re’s brought forward tax losses.

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	2015
Cash and cash equivalents	\$ 4,039
Total assets.....	<u>\$ 4,039</u>
Liabilities and Shareholder's Equity	
Accounts payable and other.....	\$ 329
Total liabilities	<u>329</u>
Net assets acquired at fair value	<u>\$ 3,710</u>

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

3. Acquisitions (continued)

Allianz Suisse Ruckversicherungs-Gesellschaft AG (“Allianz Suisse Re”)

On December 11, 2015, the Company, through its wholly-owned subsidiary, Glacier Re, completed the acquisition of Allianz Suisse Re. Allianz Suisse Re has never written live business but received approximately CHF 400 million of run-off liabilities via a portfolio transfer from Allianz Suisse Versicherungs AG on January 1, 2008. At acquisition Allianz Suisse Re had \$29.1 million of loss reserves remaining including asbestos, health, non-proportional liability and proportional liability exposure.

The purchase price of \$55.7 million, and acquisition costs were financed from the issuance of \$23 million of preference shares, the drawdown of \$9 million from Catalina’s Revolving Credit Facility and available cash on hand.

The acquisition resulted in no pre-tax gain or loss during 2015.

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	2015
Investments, at fair value	\$ 59,199
Cash and cash equivalents	17,057
Accrued investment income	747
Funds held by cedants and claims administrators.....	8,440
Insurance and reinsurance balances receivable	940
Other assets	346
Total assets	\$ 86,729
Liabilities	
Outstanding losses and loss expenses	\$ 29,145
Insurance and reinsurance balances payable	1,695
Accounts payable and other liabilities	196
Total liabilities	31,036
Net assets acquired at fair value	\$ 55,693

Danielson Indemnity Company (“Danielson”)

On November 14, 2014, the Company, through its wholly-owned subsidiary AHUSCO, completed the acquisition of Danielson, which included its wholly-owned subsidiaries, National American Insurance Company of California (“NAICC”) and Danielson National Insurance Company (“DNIC”). NAICC and DNIC wrote private passenger auto, contract surety, bail bond, workers’ compensation and general liability business. The reserves primarily consist of workers’ compensation and asbestos and environmental business. Liability and workers’ compensation business has been in run-off since 1995 and 2002, respectively. The rest of the business went into run-off in 2012.

The purchase price of \$4.6 million was financed through cash on hand.

The acquisition resulted in a pre-tax gain of \$7.8 million included in the consolidated statements of operations. Management believes the reason for the transaction gain related mainly to the seller’s requirement to dispose of a non-core operation and to retain the ability to use the associated tax losses. As a result of the necessary filing of a Section 338 (h) (10) election under the Inland Revenue Code the Company recorded a deferred tax liability of \$2.7 million.

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

3. Acquisitions (continued)

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	2014
Investments, at fair value	\$ 35,331
Cash and cash equivalents	6,684
Accrued investment income	309
Outstanding losses and loss expenses recoverable	13,413
Insurance and reinsurance balances receivable	291
Other assets	360
Total assets	<u>\$ 56,388</u>
Liabilities	
Outstanding losses and loss expenses	\$ 39,260
Unearned premiums	73
Insurance and reinsurance balances payable	4,102
Deferred tax liability	2,661
Accounts payable and other liabilities	526
Total liabilities	<u>46,622</u>
Net assets acquired at fair value	<u>\$ 9,766</u>

SPARTA Insurance Holdings, Inc.

On September 15, 2014, the Company, through its wholly-owned subsidiary, AHUSCO, completed the acquisition of the SPARTA Companies. The SPARTA Companies wrote commercial auto, general liability, workers' compensation and property business. The SPARTA Companies were put into run-off during 2014, with the last policies written effective September 30, 2014.

The purchase price of \$156.5 million and acquisition costs of \$0.6 million, were financed through cash on hand, as well as an \$80 million loan obtained by AHUSCO as part of the Revolving Credit Facility (see note 11).

The acquisition resulted in no pre-tax gain or loss during 2014.

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	2014
Investments, at fair value	\$ 437,337
Cash and cash equivalents	16,832
Accrued investment income	2,003
Outstanding losses and loss expenses recoverable	170,017
Insurance and reinsurance balances receivable	21,681
Other assets	56,601
Total assets	<u>\$ 704,471</u>
Liabilities	
Outstanding losses and loss expenses	\$ 491,903
Unearned premiums	19,951
Insurance and reinsurance balances payable	14,725
Accounts payable and other liabilities	21,378
Total liabilities	<u>547,957</u>
Net assets acquired at fair value	<u>\$ 156,514</u>

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

3. Acquisitions (continued)

Alea Group Holdings (Bermuda) Ltd. (“AGHBL”)

On March 27, 2014, Catalina completed the acquisition of AGHBL. AGHBL through its two regulated entities, Alea North America Insurance Company (“ANAIC”) and Alea (Bermuda) Ltd. (“ABL”) wrote life and non-life business in the US, Canada, Continental Europe, Singapore and Bermuda. AGHBL went into run-off in 2005.

The purchase price of \$124.6 million and acquisition costs were financed through a loan facility of \$38.0 million provided by Royal Bank of Scotland Plc. (“RBS”), and \$86.6 million of cash on hand. Acquisition costs of \$1.0 million were expensed and recognized within the general and administrative expenses in the consolidated statements of operations during the year ended December 31, 2014 and \$1.2 million during the year ended December 31, 2013.

The acquisition resulted in no pre-tax gain or loss during 2014.

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	2014
Investments, at fair value	\$ 276,986
Cash and cash equivalents	161,763
Accrued investment income	3,043
Outstanding losses and loss expenses recoverable	303,763
Insurance and reinsurance balances receivable	3,834
Funds held by cedants and claims administrators	61,737
Other assets	8,495
Total assets	\$ 819,621
Liabilities	
Outstanding losses and loss expenses	\$ 566,435
Insurance and reinsurance balances payable	20,920
Accounts payable and other liabilities	8,307
Long-term subordinated debt	99,377
Total liabilities	695,039
Net assets acquired at fair value	\$ 124,582

4. Significant new business

NationsBuilders Insurance Company (“NBIC”)

On February 1, 2015, Catalina through its wholly owned subsidiary CatGen entered into a Reinsurance Novation Agreement with NBIC. This agreement resulted in CatGen replacing NBIC as reinsurer on 16 Quota-Share contracts and a Loss Portfolio Transfer. NBIC reinsures residential construction policies written over the period 2002 to 2010 issued by the Risk Retention Group, ProBuilders Specialty Insurance Company (“PBSIC”). PBSIC is an association captive insurance company domiciled in the District of Columbia. PBSIC provided construction liability coverages for contractors, subcontractors and artisans associated with the residential construction industry, mainly within the western United States. PBSIC ceded various portions of its business via quota share to NBIC. Following the downturn in the residential construction market, PBSIC went into run-off in 2009. Consequently, NBIC assumed the remaining net assets via a Loss Portfolio Transfer as at December 31, 2009. NBIC is a fully owned subsidiary of NationsBuilders Insurance Services, Inc. (“NBIS”), a privately owned specialty property and casualty insurance coverage and service provider. Catalina also took over the entire management of PBSIC from NBIS including management of all its claims.

As of February 1, 2015, CatGen assumed gross reserves of \$63.56 million for a total consideration of \$65.77 million, net of Federal Excise Tax of \$0.64 million.

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

5. Investments

The fair value of fixed maturity, equity and other investments as of December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Fixed maturities:		
Corporate	\$ 606,691	\$ 372,839
Asset-backed securities	250,158	352,248
Mortgage-backed securities	117,026	275,392
U.S. government and agency	78,807	102,795
Non-U.S. government	104,171	46,565
Municipals	81,689	103,639
Total fixed maturities	<u>1,238,542</u>	<u>1,253,478</u>
Equities:		
Debt funds	150,514	190,224
Preferred and common stocks	85,486	54,736
Equity funds	957	3,113
Fund of funds	50,646	24,142
Total equities	<u>287,603</u>	<u>272,215</u>
Other investments:		
Interest rate swap	(185)	(193)
Total other investments	<u>(185)</u>	<u>(193)</u>
Total investments	<u>\$ 1,525,960</u>	<u>\$ 1,525,500</u>

Contractual maturities of the Company's fixed maturities as of December 31, 2015 are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Fixed maturities:	
Due in one year or less	\$ 171,756
Due after one year through five years	476,070
Due after five years through 10 years	199,492
Due after 10 years	24,040
Total fixed maturities	<u>871,358</u>
Mortgage and asset-backed securities	367,184
Total	<u>\$ 1,238,542</u>

The components of net investment income for the years ended December 31, 2015 and 2014 were derived from the following sources:

	<u>2015</u>	<u>2014</u>
Fixed maturities, including mortgage and asset-backed securities	\$ 36,709	\$ 33,821
Equities	3,525	1,199
Other investments	1,312	353
Cash and cash equivalents	262	56
Gross investment income	<u>41,808</u>	<u>35,429</u>
Investment expenses	(4,376)	(3,431)
Net investment income	<u>\$ 37,432</u>	<u>\$ 31,998</u>

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

5. Investments (continued)

Net (losses) gains on investments within the consolidated statements of operations for the years ended December 31, 2015 and 2014 consisted of the following:

	<u>2015</u>	<u>2014</u>
Net realized gains on investments	\$ 5,813	\$ 18,174
Net change in fair market value of investments	(16,268)	(971)
Net change in fair market value of derivative instruments	8	(37)
Net (losses) gains on investments	<u>\$ (10,447)</u>	<u>\$ 17,166</u>

6. Fair Value Measurements

At December 31, 2015 and 2014, the Company's financial instruments measured at fair value were categorized between Levels 1, 2 and 3 as follows:

At December 31, 2015	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total Fair Value</u>
Assets				
Fixed maturities:				
Corporate	\$ -	\$ 531,744	\$ 74,947	\$ 606,691
Asset-backed securities	-	241,239	8,919	250,158
Mortgage-backed securities	-	117,026	-	117,026
U.S. government and agency	-	78,807	-	78,807
Non U.S. government	-	104,171	-	104,171
Municipals	-	81,689	-	81,689
Total fixed maturities	-	<u>1,154,676</u>	<u>83,866</u>	<u>1,238,542</u>
Equity securities:				
Debt funds	36,086	88,241	26,187	150,514
Preferred and common stocks	71,596	1,998	11,892	85,486
Equity funds	957	-	-	957
Fund of funds.....	<u>14,351</u>	<u>13,375</u>	<u>22,920</u>	<u>50,646</u>
Total equity securities	<u>122,990</u>	<u>103,614</u>	<u>60,999</u>	<u>287,603</u>
Other investments:				
Interest rate swap	-	(185)	-	(185)
Total assets	<u>\$ 122,990</u>	<u>\$ 1,258,105</u>	<u>\$ 144,865</u>	<u>\$ 1,525,960</u>
Liabilities				
Long term subordinated debt	\$ -	\$ -	\$ 170,725	\$ 170,725
Total liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 170,725</u>	<u>\$ 170,725</u>

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

6. Fair Value Measurements (continued)

At December 31, 2014	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Fixed maturities:				
Corporate	\$ -	\$ 340,943	\$ 31,896	\$ 372,839
Asset-backed securities	-	346,143	6,105	352,248
Mortgage-backed securities	-	275,392	-	275,392
U.S. government and agency	-	102,795	-	102,795
Non U.S. government	-	46,565	-	46,565
Municipals	-	103,639	-	103,639
Total fixed maturities	-	1,215,477	38,001	1,253,478
Equity securities:				
Debt funds	61,401	41,586	87,237	190,224
Preferred and common stocks	42,123	-	12,613	54,736
Equity funds	1,445	1,668	-	3,113
Fund of funds	-	24,142	-	24,142
Total equity securities	104,969	67,396	99,850	272,215
Interest rate swap	-	(193)	-	(193)
Total assets	<u>\$ 104,969</u>	<u>\$ 1,282,680</u>	<u>\$ 137,851</u>	<u>\$ 1,525,500</u>
Liabilities				
Long term subordinated debt	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 182,125</u>	<u>\$ 182,125</u>
Total liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 182,125</u>	<u>\$ 182,125</u>

The following table presents a reconciliation of the beginning and ending balances for all financial instruments measured at fair value on a recurring basis using the Level 3 inputs for the years ended December 31, 2015 and 2014:

	Fixed maturities and Equity securities	Long term subordinated debt	Subordinated Loan Note
Balance at beginning of year, January 1, 2014.....	\$ -	\$ (90,507)	\$ (110,000)
Amortization.....	-	-	(4,500)
Purchases	136,623	-	-
Debt acquired in acquisition.....	-	(99,377)	-
Repayment of loan.....	-	-	114,500
Net gains(*).....	1,228	3,898	-
Foreign exchange gains.....	-	3,861	-
Balance at end of year, December 31, 2014.....	<u>\$ 137,851</u>	<u>\$ (182,125)</u>	<u>\$ -</u>
Purchases	87,441	-	-
Transferred between levels.....	(81,209)	-	-
Net gains (*).....	782	8,271	-
Foreign exchange gains.....	-	3,129	-
Balance at end of year, December 31, 2015.....	<u>\$ 144,865</u>	<u>\$ (170,725)</u>	<u>\$ -</u>
(*) Level 3 gains (losses) included in earnings attributable to the change in unrealized gains and losses relating to financial instruments held at the reporting date	<u>\$ 782</u>	<u>\$ 8,271</u>	<u>\$ -</u>

(*) Net gains (losses) on long term subordinated debt are included within change in subordinated debt fair value in the consolidated statements of operations.

During the year ended December 31, 2015, there was a transfer of \$81.2 million from Level 3 to Level 2. This relates to Debt Fund securities of \$63.6 million for which the underlying securities are valued using market observable information and the redemption notice period and frequency is considered to be in the near term and corporate bonds of \$17.6 million where market pricing was available at December 31, 2015. During the year ended December 31, 2014 there were no transfers in or out of Levels 1, 2 or 3.

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

6. Fair Value Measurements (continued)

The carrying amount of financial assets and liabilities presented on the consolidated balance sheet as at December 31, 2015 and 2014 approximate their fair values. Transfers into and out of level 3 are recorded as of the end of the reporting period consistent with the date of determination of fair value.

7. Derivative instruments

The following table summarizes information on the location and amounts of derivative fair values on the consolidated balance sheets:

	<u>Nominal amount</u>	<u>Balance Sheet Location</u>	<u>Fair Value</u>
At December 31, 2015			
Interest rate swap.....	\$ 2,125	Investments at fair value	\$ (185)
Interest rate swap.....	<u>125,000</u>	Other Assets	<u>\$ 489</u>
Total	<u>\$ 127,125</u>		<u>\$ 304</u>
At December 31, 2014			
Interest rate swap.....	\$ 2,125	Investments at fair value	\$ (193)
Total	<u>\$ 2,125</u>		<u>\$ (193)</u>

On July 26, 2010, the Company entered into an interest rate swap to exchange fixed interest received on a Non U.S. government bond for floating interest rate. The interest rate swap matures on July 20, 2020.

This derivative has not been designated as a hedging instrument for financial reporting purposes.

The following table provides the total gains and losses recorded in earnings for the years ended December 31, 2015 and 2014:

	<u>Gain (loss)</u>	<u>Statement of operations Location</u>
Year ending December 31, 2015		
Interest rate swap	\$ 8	Net investment income
Total	<u>\$ 8</u>	
Year ending December 31, 2014		
Interest rate swap	\$ (37)	Net investment income
Total	<u>\$ (37)</u>	

On August 24, 2015, the Company entered into a \$125 million interest rate swap with ING Bank N.V. to exchange floating rate interest paid on the Revolving Credit Facility for fixed interest of 1.38%. This interest rate swap matures on September 12, 2019.

This derivative has been designated as a hedging instrument for financial reporting purposes. The fair value of \$489k is included in other comprehensive income for the year ended December 31, 2015.

8. Investments in real estate

The Company acquired three properties during 2015 and two properties during 2014 through its subsidiaries, Oxenwood Catalina Ltd. and Oxenwood Catalina II Ltd., both being Guernsey incorporated Companies, to generate returns via rental income and capital appreciation. On February 13, 2015, a property was purchased in Biggleswade, United Kingdom at a cost of \$22.1 million including acquisition related expenses of \$1.1 million. On September 25, 2015, a property was purchased in Immingham, United Kingdom, at a cost of \$22.2 million including acquisition related expenses of \$0.7 million. On December 21, 2015, a property was purchased in Newport Pagnell, United Kingdom at a cost of \$30.2 million including acquisition related expenses of \$1.4 million.

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

8. Investments in real estate (continued)

On October 7, 2014, a property was purchased in Rotherham, United Kingdom at a cost of \$25.7 million including acquisition related expenses of \$1.4 million. On December 19, 2014, a property was purchased in Runcorn, United Kingdom at a cost of \$34.7 million including acquisition related expenses of \$1.6 million. Company formation costs of \$0.5 million were expensed and recognized within the general and administrative expenses in the consolidated statements of operations during the year ended December 31, 2014.

The cost of each property is split between land and buildings. The cost of the buildings is depreciated over a period of 40 years on a straight-line basis. Income from these real estate investments is recognized as per the terms of the lease agreements.

	<u>2015</u>	<u>2014</u>
Land, at cost.....	\$ 67,743	\$ 30,218
Buildings, at cost.....	67,743	30,218
Accumulated depreciation.....	(1,034)	(88)
Buildings, net of accumulated depreciation.....	<u>66,709</u>	<u>30,130</u>
Total	<u>\$ 134,452</u>	<u>\$ 60,348</u>

9. Intangible assets

On the acquisition of Quanta, the Company determined that the US insurance licenses held by Quanta Indemnity Company had an indefinite useful life. The Company determined that the value of the licenses acquired was their estimated net realizable value of \$5.0 million. During 2014 the Company reviewed the carrying value of this asset and, based on a current offer for the licenses, assessed that the asset should be written down to \$4.0 million.

On the acquisition of AGHBL, the Company acquired U.S. insurance licenses on all 50 states plus a Washington D.C. admitted insurance license for ANAIC. These licenses were valued at \$6.4 million as of the date of acquisition.

Through the acquisition of the SPARTA Companies, AHUSCO has acquired licenses to operate in various states. The Company determined the value of the SPARTA Companies licenses at \$9.0 million as of the date of acquisition.

On December 4, 2015, SIC sold Sparta Specialty Insurance Company. SIC received \$2.9 million of cash, net of costs, for licenses with a book value of \$2.7 million.

10. Outstanding losses and loss expenses

Outstanding losses and loss expenses as of December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Case reserves.....	\$ 680,136	\$ 662,113
Incurred but not reported	589,741	575,820
Structured settlements.....	258,119	291,899
Life reserves.....	33,494	40,779
Unamortized fair value adjustment	(20,668)	(29,207)
Deferred income.....	19,525	15,121
	<u>\$ 1,560,347</u>	<u>\$ 1,556,525</u>

Outstanding losses and loss expenses recoverable as of December 31, 2015 and 2014 are as follows:

<u>Recoverables</u>	<u>2015</u>	<u>2014</u>
Case reserves.....	\$ 104,988	\$ 142,242
Incurred but not reported	123,984	142,580
Structured settlements.....	258,119	291,899
Unamortized fair value adjustment	(16,402)	(23,661)
	<u>\$ 470,689</u>	<u>\$ 553,060</u>

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

10. Outstanding losses and loss expenses (continued)

The fair value adjustments represent the unamortized difference between the carrying value of reserves of acquired companies at the date of acquisition and the fair value of the reserves. The fair value of the outstanding losses and loss expenses was based on the estimated timing of reserve settlements discounted at a risk free rate and a risk margin determined by management. The fair value of the outstanding losses and loss expenses recoverable was based on the estimated timing of reserve settlements discounted at a risk adjusted rate determined by management reflecting credit risk and duration. The fair value adjustments are amortized over the estimated payout period using the constant yield method.

The deferred income relates to the Reinsurance Novation Agreement of CatGen with NBIC in 2015, 100% Quota-Share Reinsurance Agreement assumed by CatGen from Glencoe Insurance Ltd., a subsidiary of Renaissance Re Holdings Ltd in 2012 and the loss portfolio transfer assumed by Glacier Re from the Delta Lloyd Group in 2014.

CatGen, through its Canadian branch (formerly ABL Canadian branch), has assumed ownership of certain structured settlements and has purchased annuities from life insurance companies to provide fixed and recurring payments to the claimants. The gross liability for the structured settlements is fully recoverable from the life insurance companies resulting in no net liability to the Company. These annuities are fully funded and were purchased from Canadian life insurance companies with a Standard and Poor's Financial Strength Rating of A+ and higher. In the event of the life insurance companies being unable to meet their obligations under the structured settlements to the Company, 85% of the total exposure is recoverable from the Compensation Corporation of Canada leaving a net credit risk exposure of less than \$40 million.

The following table represents the activity in outstanding losses and loss expenses for the years ended December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Gross outstanding losses and loss expenses, beginning of year	\$ 1,556,525	\$ 578,652
Less reinsurance recoverable, beginning of year	<u>(553,060)</u>	<u>(126,663)</u>
Net losses and loss expenses, beginning of year	1,003,465	451,989
Net losses and loss expenses acquired	456,283	816,524
Net incurred losses related to:		
Current year	7,275	24,766
Prior years	<u>(67,800)</u>	<u>(40,658)</u>
	(60,525)	(15,892)
Net paid losses related to:		
Current year	(1,825)	(90,824)
Prior years	<u>(298,747)</u>	<u>(136,355)</u>
	(300,572)	(227,179)
Foreign exchange gains	(8,993)	(21,977)
Net losses and loss expenses, end of year	<u>1,089,658</u>	<u>1,003,465</u>
Reinsurance recoverable, end of year	<u>470,689</u>	<u>553,060</u>
Gross outstanding losses and loss expenses, end of year	<u>\$ 1,560,347</u>	<u>\$ 1,556,525</u>

During the year ended December 31, 2015 the Company experienced net favorable loss development of \$67.8 million primarily due to a reduction in the estimates of ultimate incurred losses in the Company's UK motor insurance run-off business and the marine reinsurance run-off business, offset by adverse development of \$19 million at SIC.

During the year ended December 31, 2014 the Company experienced favorable loss development of \$40.7 million primarily due to a reduction in the estimates of ultimate incurred losses in the Company's Home Buyers' Warranty insurance run-off business and the marine, property and general liability reinsurance run-off business.

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

10. Outstanding losses and loss expenses (continued)

Net losses incurred of \$(60.5) million (2014: \$(15.9) million) are net of \$21.1 million (2014: \$(4.1) million) of loss and loss expenses recovered from reinsurers. Included within net losses incurred is a positive effect from the net amortization of fair value adjustments of \$5.6 million (2014: \$3.2 million).

Management believes that the assumptions used represent a realistic and appropriate basis for estimating the outstanding losses and loss expenses as of December 31, 2015 and 2014. However, these assumptions are subject to change and the Company regularly reviews and adjusts its reserve estimates and reserving methodologies taking into account all currently known information and updated assumptions related to unknown information.

11. Loans payable

Catalina Revolving Credit Facility

On August 12, 2014, Catalina entered into a \$225 million Revolving Credit Facility Agreement with Royal Bank of Scotland plc (“RBS”) and other banks. The agreement was amended on October 28, 2014 to increase the amount to \$250 million. The agreement was further amended on May 13, 2015 to increase the amount to \$300 million. The facility is split between Catalina (\$235 million) and AHUSCO (\$65 million). The interest rate is based on LIBOR plus the applicable margin percentage based on gearing. Total outstanding loan as of December 31, 2015 was \$289.4 million. During the year, the interest rates were between 3.40% to 3.84% which included a margin of 3.25%. As at December 31, 2015 the Catalina loans were comprised of a loan of \$136 million and a loan of £60 million (\$88.4 million).

Catalina.....	\$ 224,401
AHUSCO.....	65,000
Balance at December 31, 2015	<u>\$ 289,401</u>

Catalina’s Revolving Credit Facility Agreement has financial covenants in relation to maximum gearing ratios and minimum aggregate group regulatory capital. At December 31, 2015 and 2014, Catalina was in compliance with all covenants under the Revolving Credit Facility Agreement.

Oxenwood Loan Facility

On November 10, 2014 OXW Catalina (Logistics) Limited (“OXW”) entered into a £7.55 million Term Loan Facility Agreement with RBS in order to partially fund its purchase of a real estate investment in Rotherham, United Kingdom. Interest periods are of three months and the interest rate is based on LIBOR plus a margin of 1.5%. On December 18, 2014 the loan was increased by £10.49 million in order to partially fund the purchase of a real estate investment in Runcorn, United Kingdom. The interest rate for the additional £10.49 million is based on LIBOR plus a margin of 1.6%. The loan is secured by a first ranking legal charge over the properties. The loan expires on May 10, 2018. On February 13, 2015 the loan was increased by £6.845 million in order to partially fund the purchase of a real estate investment in Biggleswade, United Kingdom. On August 19, 2015 OXW Catalina (Immingham) Limited (“OXWCI”) entered into a £10.375 million Term Loan Facility Agreement with RBS in order to partially fund its purchase of a real estate investment in Immingham, United Kingdom. As of December 31, 2015, £7.573 million of this Term Loan Facility had been drawn down. Interest periods are of three months and the interest rate is based on LIBOR plus a margin of 1.6%. The loan is secured by a first ranking legal charge over the property. The loan expires on May 10, 2018.

On December 18, 2015 OXW Catalina (NPP) Limited (“OXWCNPP”) entered into a £9.675 million Term Loan Facility Agreement with Wells Fargo Bank International in order to partially fund its purchased of a real estate investment in Newport Pagnell, United Kingdom. Interest periods are of three months and the interest rate is based on LIBOR plus a margin of 1.7%. The loan is secured by a first ranking legal charge over the property. The loan expires on June 18, 2018.

Each of OXW, OXWCI and OXWCNPP’s Term Loan Facility Agreement has financial covenants in relation to net rental income interest cover and loan to value. During 2015 and 2014 each of OXW, OXWCI and OXWCNPP was in compliance with all covenants under their respective Term Loan Facility Agreements.

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

11. Loans payable (continued)

Long term subordinated debt

Prior to the acquisition by Catalina, Glacier Re issued a total of \$68.0 million and Euro 26.0 million of floating rate unsecured subordinated notes to support its underwriting activities. The notes are due in 2035 and include options for Glacier Re for partial or full early repayment, respectively, and to defer interest for up to 20 consecutive quarters but not beyond the maturity date of the respective notes. The notes rank pari passu without any preference among themselves and do not contain any covenants concerning financial ratios or specified levels of net worth or liquidity.

Interest on the subordinated debt is based on LIBOR or EURIBOR plus a margin between 3.25% and 3.70%. Interest expense in connection with these notes was \$3.6 million for the year ended December 31, 2015 (2014: \$3.9 million) and is included within interest expense in the consolidated statements of operations.

Prior to acquisition by Catalina, AHUSCO issued a total of \$120 million of TruPS. The TruPS were issued by three Delaware trusts established by AHUSCO and provide for a preferred dividend at a rate of 3-month LIBOR plus margin of 2.85%. These securities allow for the postponement of preferred dividends under certain circumstances for up to five years. The TruPS carry no financial covenants or cross default covenants, have a fixed maturity in 2034 / 2035 and are callable. The holders of the TruPS may not call the securities prior to their maturity dates. Interest expense on the TruPS in 2015 is \$3.8 million and in 2014 was \$2.9 million and is included within interest expense in the consolidated statement of operations.

Catalina Bravo debt facility agreement

On April 17, 2013 Catalina Bravo Ltd. (“Catalina Bravo”) borrowed \$41.8 million under its Term Facility Agreement in order to fund the payment by the Company for the acquisition of KX Re. The interest rate reset at intervals of one, three or six months at the Company’s pre-selection and is based on LIBOR plus a margin of 3.50%. During the year, the interest rates ranged from 3.65% to 3.67%. On April 17, 2014 Catalina Bravo repaid \$18.7 million of the outstanding balance. On March 13, 2015 Catalina Bravo repaid \$14.3 million. On April 9, 2015 another payment of \$1.8 million was made and on December 21, 2015, final payment of \$7.0 million was made.

Catalina Bravo’s loan facility had financial covenants in relation to maximum gearing ratios and minimum capital requirements. During 2014 and 2015, Catalina Bravo was in compliance with all covenants under the loan facility.

Catalina Charlie debt facility agreement

On July 18, 2013 Catalina Charlie Ltd. (“Catalina Charlie”) borrowed \$15 million under its Term Facility Agreement in order to fund a distribution to the Company. The interest rate reset at intervals of any duration of up to three months at the Company’s pre-selection and is based on LIBOR plus a margin of 3.50%. During the year, the interest rates ranged from 3.73% to 3.74%. On July 18, 2014 Catalina Charlie repaid \$6.0 million of the outstanding balance. On February 10, 2015, the Company repaid the \$9 million outstanding balance.

Catalina Charlie’s loan facility had financial covenants in relation to maximum gearing ratios and minimum capital requirements. During 2014 and 2015, Catalina Charlie was in compliance with all covenants under the loan facility.

Catalina Echo debt facility agreement

On July 8, 2013 Catalina Echo Ltd. (“Catalina Echo”) borrowed \$90 million under its Term Facility Agreement in order to fund the payment to Catalina Delta Ltd. of the purchase price of Glacier Re. The loan had two Facilities under the agreement, i.e. Facility A and Facility B having total commitments of \$40 million and \$50 million respectively. The loan was secured by a stock pledge agreement in respect of 100% of the issued share capital of Glacier Re. Catalina Echo could select an interest period of one or three months or any other period agreed with the lending banks. The interest rate for Facility A was based on LIBOR plus a margin of 3.35%. Facility B was based on a margin of 3.9% per annum until Facility A was repaid in full and subsequently a margin of 3.5%. During the year, the interest rates were 3.67% to 3.68%.

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

11. Loans payable (continued)

Catalina Echo had the right, giving prior notice, to prepay the whole or any part of the loan prior to the termination date. During 2013 Catalina Echo repaid Facility A. Catalina Echo repaid \$10 million of Facility B on January 21, 2015, \$5 million on April 9, 2015, \$10 million on June 8, 2015 and the final payment of \$25 million on June 12, 2015.

Catalina Echo's loan facility had financial covenants in relation to maximum gearing ratios, the minimum net worth of Glacier Re and minimum debt service cover. During 2014 and 2015, Catalina Echo was in compliance with all covenants under the loan facility.

Catalina Foxtrot debt facility

On October 15, 2012, Catalina Foxtrot Holdings Limited ("Catalina Foxtrot") borrowed GBP 32.8 million from RBS under its Term Facility Agreement in order to partially fund its purchase of Catalina Reinsurance Ireland Limited ("CRIL") and CIIL. The loan was secured by a stock pledge agreement in respect of 100% of the issued share capital of Catalina Foxtrot Limited (a wholly-owned subsidiary of Catalina Foxtrot and the parent company of CRIL and CIIL). Catalina Foxtrot could select an interest period of one, three or six months or any other period agreed with RBS, and the interest rate was based on LIBOR plus a margin of 3.50%. Catalina Foxtrot repaid GBP 21.8 million on July 11, 2013. The remaining balance was repaid on June 19, 2014.

Catalina Foxtrot's Term Facility Agreement had financial covenants in relation to maximum gearing ratios and minimum debt service cover. During 2014, Catalina Foxtrot was in compliance with all covenants under the Term Facility Agreement.

CHBL subordinated loan notes

CHBL issued four senior zero coupon loan notes with an aggregate value of \$114.5 million to NFF L.P Inc. in December 2013 as consideration for common and preference shares repurchased and extinguished. Terms of the loan note included that no interest shall accrue on the unpaid principal balance of the note and only a final payment shall be made at the end of the term, i.e. December 31, 2014.

The fair value of the loan note was calculated using an effective discount rate of 4.09%. The discount rate was calculated based on Catalina's current borrowing rate for existing debt facilities. Therefore at the date of issuance the fair value of the loan note was \$110.0 million giving rise to a discount of \$4.5 million to be amortized using the effective interest method over the life of the loan note. The note was fully paid on December 30, 2014.

Interest expense in connection with the Company's debt facilities, long term subordinated debt and subordinated loan notes was \$21.1 million for the year ended December 31, 2015 (2014: \$16.8 million) and is included within interest expense in the consolidated statements of operations.

12. Concentrations, commitments and contingencies

a) Concentrations of credit risk

As of December 31, 2015 and 2014 substantially all of the Company's cash and cash equivalents, and investments were held by eight custodians. Management monitors the credit ratings of these custodians and believes them to be of high credit quality. The Company's investment portfolio is primarily managed by external investment advisors in accordance with the Company's investment guidelines. The Company limits its exposure to any single issuer to 5% or less of the total portfolio's market value at the time of purchase, with the exception of U.S. government and agency securities. As of December 31, 2015 the largest single non-U.S. government and agency issuer accounted for 3.4% (2014: 3.7%) of the aggregate market value of the Company's invested assets. As of December 31, 2015, the Company's fixed maturity investments had a weighted average Standard & Poor's credit rating of BBB+.

At December 31, 2015 the Company had a provision for uncollectible premiums receivable of \$5.9 million (2014: \$2.4 million).

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

12. Concentrations, commitments and contingencies (continued)

Reinsurance assets due from reinsurers include outstanding losses and loss expenses recoverable and deferred reinsurance premiums. The Company is subject to credit risk with respect to reinsurance ceded because the ceding of risk does not relieve the Company from its primary obligations to its policyholders. The concentration of credit risks relating to the structured settlements is explained in Note 10. Failure of the Company's reinsurers to honor their obligations could result in credit losses. As of December 31, 2015 the Company has recorded a provision for credit losses relating to outstanding losses and loss expenses recoverable of \$24.4 million (2014: \$25.8 million). During the year ended December 31, 2015 outstanding loss and loss expenses recoverable of \$0.5 million were written off (2014: \$0.2 million).

Two reinsurers each accounted for more than 10% of the outstanding losses and loss expenses recoverable balance as of December 31, 2015. These reinsurers were rated A+ and AA- by S&P as at December 31, 2015. The Company's reinsurers had a weighted average credit rating of A+ as of December 31, 2015.

b) Restricted assets

The Company is required to maintain assets on deposit with various regulatory authorities to support its insurance and reinsurance operations. These requirements are generally promulgated by the regulations of the individual locations within which the Company operates. These funds on deposit are available to settle insurance and reinsurance liabilities.

The Company has also issued letters of credit ("LOC") under its credit agreements (for which cash and cash equivalents and investments are pledged as security) and in favor of certain ceding companies to collateralize its obligations under contracts of insurance and reinsurance (see Note 15).

The Company also utilizes trust funds where the trust funds are set up for the benefit of the ceding companies, and generally take the place of LOC requirements.

The fair values of these restricted assets by category at December 31, 2015 and 2014 are as follows:

	<u>2015</u>		<u>2014</u>	
	<u>Cash and cash equivalents</u>	<u>Investments</u>	<u>Cash and cash equivalents</u>	<u>Investments</u>
Deposits with U.S. insurance regulatory authorities	\$ 3,480	\$ 151,162	\$ 1,600	\$ 163,963
LOC pledged assets	30,245	116,674	39,164	104,232
Trust funds	50,254	332,361	52,218	189,602
Amounts held in trust funds related to deposit liabilities	578	-	-	-
Total	<u>\$ 84,557</u>	<u>\$ 600,197</u>	<u>\$ 92,982</u>	<u>\$ 457,797</u>

c) Fund commitments

As of December 31, 2015 the Company has unfunded capital commitments for fund investments of \$16.8 million.

d) Lease commitments

The Company leases office space and furniture and equipment under operating lease agreements. Rent expenses are being recognized on a straight-line basis over the respective lease terms. Future annual minimum payments under non-cancelable operating leases are as follows:

Year ending December 31,

2016.....	\$ 374
2017.....	452
2018.....	175
2019.....	45
2020.....	11
Total	<u>\$ 1,057</u>

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

12. Concentrations, commitments and contingencies (continued)

Total rent expense under operating leases for the year ended December 31, 2015 was approximately \$1.3 million (2014: \$1.4 million).

e) Contingent liabilities

The Company and/or its subsidiaries, from time to time, are a party to litigation and/or arbitration that arises in the normal course of its business operations. The Company and/or its subsidiaries are also subject to other potential litigation, disputes and regulatory or governmental inquiries.

13. Taxation

Under current Bermuda law, the Company and its Bermuda subsidiaries are not required to pay any taxes in Bermuda on income including realized capital gains. The Company has received an undertaking from the Minister of Finance of Bermuda that, in the event of any taxes being imposed, the Company will be exempt from taxation in Bermuda until March 2035.

The Company has operating subsidiaries in the United States, United Kingdom, Switzerland and Ireland and is subject to the relevant taxes in those jurisdictions. The Company is not subject to taxation other than as stated above. There can be no assurance that there will not be changes in applicable laws, regulations or treaties, which might require the Company to become subject to additional taxation.

During 2015 withholding tax of \$41,884 was paid by SIC. During 2014 withholding tax of \$17,000 was paid on a distribution from RLCH to Catalina Echo. No U.S. Federal tax was paid during 2015 and 2014.

During 2015, there was a non U.S. tax refund of \$25,351. During 2014, non U.S. tax of \$29,570 was paid.

Deferred income taxes reflect net operating loss carryforwards and the tax impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and those for income tax purposes. The significant components of the net deferred tax assets and liabilities as of December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Deferred tax assets:		
Investments	\$ 2,808	\$ 2,669
Outstanding losses and loss expenses	9,508	11,136
Unearned premiums	1,786	2,736
Net operating loss carry forwards	117,975	108,512
Capital loss carry forwards	3,220	2,165
Other	3,706	1,346
Total deferred tax assets	<u>139,003</u>	<u>128,564</u>
Valuation allowance	<u>(112,565)</u>	<u>(99,713)</u>
Total deferred tax assets net of valuation allowance	<u>26,438</u>	<u>28,851</u>
Deferred tax liabilities:		
Investments	(5,194)	(8,547)
Goodwill	(2,898)	(5,462)
Outstanding losses and loss expenses	(6,312)	(2,357)
Subordinated debt	(1,341)	(1,348)
Underwriting results subject to timing differences for taxation	(1,303)	(482)
Other	(8,203)	(7,655)
Total deferred tax liabilities	<u>(25,251)</u>	<u>(25,851)</u>
Net deferred tax asset	<u>\$ 1,187</u>	<u>\$ 3,000</u>

**CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)**

13. Taxation (continued)

The deferred tax asset and liability balances presented above represent the gross deferred tax asset and liability balances across each tax jurisdiction. The net deferred tax asset balance of \$1.2 million (2014: \$3.0 million) includes deferred tax assets of \$2.0 million within other assets and \$0.8 million deferred tax liability within accounts payable, accrued expenses and other liabilities in the consolidated balance sheet as of December 31, 2015. The net deferred tax asset balance of \$2.0 million included within other assets, includes netting of certain deferred tax assets and liabilities within a tax jurisdiction to the extent such netting is consistent with the regulations of the tax authorities in those jurisdictions.

As of December 31, 2015, the Company has a deferred tax asset of \$118.0 million (2014: \$108.5 million) generated by net operating loss carry forwards (“NOL”) of approximately \$492.8 million (2014: \$462.3 million), of which \$234.2 million (2014: \$192.1 million) relates to NOL in the United States (“U.S. NOL”), \$142.0 million (2014: \$146.0 million) relates to NOL in the United Kingdom (“UK NOL”), \$77.5 million (2014: \$79.8 million) relates to NOL in Switzerland (“Swiss NOL”) and \$39.1 million (2014: \$44.3 million) relates to NOL in Ireland (“Irish NOL”).

During 2015 the Company released the \$3.4 million valuation allowance relating to the deferred tax asset for the net operating loss carry forwards of Glacier Re. This deferred tax asset was offset against the deferred tax liabilities of Papiro at acquisition and resulted, together with Papiro’s assets, in a gain of \$3.7 million included within gain on acquisition in the consolidated statement of operations.

In relation to the U.S. NOL, UK NOL and the Irish NOL the Company believes that it is more likely than not that the deferred tax asset will not be recognized. Accordingly, the Company has recorded a full valuation allowance against these net deferred tax assets as of December 31, 2015 and 2014.

14. Shareholders' equity

a) Preference share capital

As at December 31, 2015, the Company has authorized preference share capital of 488,000,000 8% non-convertible, cumulative, redeemable, preference shares of \$1.00 each.

During 2015 the Company issued 97,667,349 (2014: 10,767,837) preference shares at par. In accordance with the terms of the preference shares, a return of 8% per annum accrues on the subscription price.

The Company has the right to redeem all or any of the preference shares, at par, at any date. However, U.S. preference shareholders shall have the right to decline in whole or in part the redemption of the shares.

During the year ended December 31, 2015, dividends of \$13.6 million (2014: \$11.2 million) have been accrued and are included in preference shares. On June 30 each year the unpaid preference share dividends are converted to preference shares. For U.S. shareholders, \$11.1 million has been accrued for the year ended December 31, 2015 (2014: \$9.1 million) as an increase in the subscription value of preference shares held. This amount is included within additional paid-in capital in the consolidated statements of changes in shareholders’ equity.

b) Ordinary share capital

The authorized and issued and authorized ordinary share capital of the Company, all with a par value of \$1.00, consists of the following for the years ending December 31, 2015 and 2014:

	Class “A”	Class “B”	Class “C”
Authorized, issued and outstanding ordinary shares at January 1, 2014 and December 31, 2014	6,692,308	600,000	400,000
Shares authorized and issued.....	-	-	18,100
Authorized, issued and outstanding ordinary shares at December 31, 2015	6,692,308	600,000	418,100

CATALINA HOLDINGS (BERMUDA) LTD.
NOTES TO THE CONSOLIDATED
FINANCIAL STATEMENTS (continued)

14. Shareholders' equity (continued)

During the year ended December 31, 2015, 18,100 Class C ordinary shares were issued to management for no consideration. The estimated value of the shares of \$0.12 million has been included in the General and administrative expenses.

The holders of all classes of the Ordinary shares shall have one vote for every Ordinary share held.

Except with the consent or sanction of all of the Preference shareholders, no dividend shall be declared or paid by the Company on the Ordinary shares unless and until all arrears and accruals of the Preference shares have been satisfied.

During the year ended December 31, 2015 dividends of \$2.6 million (2014: \$1.9 million) were paid to the holders of the Class "B" and Class "C" shares. Class "B" and Class "C" shares are owned by management.

The Company also has 162,896 authorized but unissued ordinary shares. These shares are currently not assigned to Class "A", "B" or "C".

On March 17, 2016 the Company declared dividends of \$2.8 million to the holders of the Class "B" and Class "C" shares.

15. Credit agreements

Two of Catalina Alpha's subsidiaries have a discretionary collateralized LOC agreement with Comerica Bank. The aggregate commitment under this agreement is currently up to \$93 million. Availability for issuances of LOCs on account of any borrower is based on the amount of eligible investments pledged by the applicable borrower(s). The agreements contain financial and other covenants, among them a requirement to maintain a minimum statutory capital and surplus value. At December 31, 2015, the outstanding LOC issued under the facility were \$60.9 million (2014: \$82.2 million). During the year ended December 31, 2015, the Company was in compliance with the covenants under the facility. As of December 31, 2014, Catalina Safety had \$8.8 million of outstanding LOC with Coutts Bank. On July 24, 2015, the Coutts LOC was replaced through an uncommitted LOC facility agreement with ING Bank N.V. At December 31, 2015, the outstanding LOC issued under this facility was \$7.4 million.

Prior to the acquisition of AGHBL by the Company, AGHBL entered into discretionary collateralized LOC agreement with Citibank N.A. ("Citibank"). Availability for issuances of LOCs is based on the amount of eligible investments pledged. At December 31, 2015, the outstanding LOCs issued under the Citibank LOC agreement were \$12.5 million (2014: \$16.5 million). Catalina acquired a LOC agreement with Citibank Europe Plc following the acquisition of Catalina UK. At December 31, 2015, the outstanding LOCs issued under the facility were \$20.8 million (2014: \$22.7 million).

Prior to the acquisition of WestGen by Catalina, WestGen entered into a discretionary collateralized LOC agreement with Citibank. Availability for issuances of LOCs is based on the amount of eligible investments pledged. At December 31, 2015, the outstanding LOCs issued under the facility were \$6.3 million (2014: \$7.0 million).

Prior to the acquisition of Glacier Re by Catalina, Glacier Re entered into a collateralized LOC agreement with UBS AG. The aggregate commitment under this agreement is \$30.0 million at December 31, 2015 and the outstanding LOCs issued under the facility were \$19.1 million (2014: \$24.5 million).

Prior to the acquisition of PXRE by Catalina, PXRE entered into a collateralized LOC agreement with Merrill Lynch. At December 31, 2015, the outstanding LOCs issued under the facility were \$3.5 million.

16. Statutory financial information and dividend restrictions

The Company is subject to a 30% withholding tax on certain dividends received from its U.S. subsidiaries.

The Company's insurance and reinsurance subsidiaries are subject to insurance laws and regulations in the jurisdictions in which they operate, which are Bermuda, the United States, the United Kingdom, Switzerland and Ireland. The regulations in these jurisdictions include restrictions that limit the amount of dividends or other distributions available to shareholders without prior approval of the insurance regulatory authorities. Typically, these restrictions relate to minimum levels of solvency, capital and liquidity as defined by the relevant insurance laws and regulations.

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16. Statutory financial information and dividend restrictions (continued)

Statutory capital and surplus for the principal operating subsidiaries of the Company in these jurisdictions as of December 31, 2015 was:

	<u>Required minimum</u>	<u>Actual</u>
Bermuda	\$ 46,332	\$ 164,432
United States	60,565	259,727
UK	17,132	68,485
Switzerland (*)	77,800	184,700
Ireland	4,028	195,303

The statutory capital and surplus required by the relevant regulatory authorities in any jurisdiction may be significantly in excess of the minimum required statutory capital and surplus and, as a result, the maximum surplus available for distribution may be significantly lower than shown in the table above.

(*) Annually, Glacier Re calculates Risk Bearing Capital and Target Capital pursuant to the Swiss Solvency Test rules and regulations. Risk Bearing Capital is defined as the difference between the market consistent value of assets less the best estimate value of liabilities. The long term subordinated debt is considered to be supplementary capital and is therefore included in the Risk Bearing Capital. As at December 31, 2015 Glacier Re had Risk Bearing Capital of approximately \$255 million. Target Capital as of December 31, 2015 was approximately \$95 million. As such, Glacier Re has significant excess capital as at December 31, 2015.

The Company's U.S. subsidiaries required statutory capital and surplus is determined using various criteria, including risk based capital tests. If a company falls below certain levels of risk based capital, and dependent upon the degree to which the company falls below, the commissioner of insurance with jurisdiction of the company is authorized to take certain regulatory actions to protect policyholders and creditors.

As at December 31, 2015 and 2014, there are statutory restrictions on the payment of dividends from retained earnings or the return of capital from some of the Company's subsidiaries. All of the Company's regulated reinsurance and insurance subsidiaries require regulatory approval before paying a dividend from retained earnings or returning capital.

At December 31, 2015 and 2014, the Company met the minimum levels of solvency and liquidity in all jurisdictions in which the Company operates.

17. Subsequent Events

On March 29, 2016, the Company through its wholly owned subsidiary Catalina Holdings UK Limited signed a definitive agreement to acquire AGF Insurance Limited ("AGF") from AGF Holdings (UK) Limited, a subsidiary of Allianz SE.

AGF is a UK regulated insurance company incorporated in 1960. It wrote predominantly direct Employers and Public liability insurance in the UK. It ceased writing new business and went into run-off in 1999. At December 31, 2015, AGF had total assets of £270 million (\$389 million), undiscounted gross reserves of £185 million (\$266 million), and pro-forma shareholder's equity of £79 million (\$113 million).

The transaction is subject to approval by the Prudential Regulation Authority, the UK insurance regulator and is expected to close in the 3rd quarter of 2016.

In preparing the consolidated financial statements, the Company has evaluated subsequent events through April 13, 2016, which is the date that these financial statements were issued, and concluded that there are no other items requiring disclosure, other than those disclosed in Note 14(b).