

American Overseas Group Limited

**Consolidated Financial Statements
For the Year Ended
December 31, 2015**



INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
American Overseas Group Limited

We have audited the accompanying consolidated financial statements of American Overseas Group Limited (the "Company"), which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income (loss), equity and retained deficit and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

Auditors' 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 Company'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 Company'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 American Overseas Group Limited 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 accounting principles generally accepted in the United States of America.

Emphasis of Matter

We draw attention to Note 18 of the financial statements which describes the risks and uncertainties of the Company's exposure to the Commonwealth of Puerto Rico. Our opinion is not modified in respect of this matter.

Deloitte Ltd.

June 15, 2016

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED BALANCE SHEETS
December 31, 2015 and 2014

	2015	2014
Assets		
Fixed-maturity securities held as available for sale, at fair value	\$ 103,801,752	\$ 123,526,758
Equity investments available for sale, at fair value	6,856,397	32,212,066
Cash and cash equivalents	31,130,939	35,497,038
Restricted cash	51,403,076	46,967,926
Accrued investment income	202,864	320,185
Premiums receivable	61,877,148	57,193,847
Reinsurance balances receivable, net	277,439,278	282,979,695
Salvage and subrogation recoverable	1,213,936	2,661,560
Deferred policy acquisition costs	192,408	451,650
Intangible assets	4,800,000	7,038,166
Goodwill	33,050,000	33,050,000
Assets held in segregated accounts	-	537,310
Other assets	2,030,127	1,064,222
Total assets	\$ 573,997,925	\$ 623,500,423
Liabilities and Shareholders' Equity		
Liabilities:		
Losses and loss expense reserve	\$ 249,204,344	\$ 265,438,578
Unearned premiums	93,472,483	95,276,840
Ceded premium payable	64,380,313	56,134,928
Payable to general agents	1,193,824	355,433
Funds withheld	3,925,745	2,567,631
Accounts payable and accrued liabilities	2,315,601	4,148,676
Liabilities related to segregated accounts	-	537,310
Redeemable Series A preference shares	9,786,582	9,445,656
Derivative liabilities	16,778,892	46,696,287
Fair value adjustment	19,355,150	22,104,393
Notes payable	40,000,004	60,890,360
Non-owned interest in VIE	300,000	300,000
Interest payable	1,023,400	1,187,773
Deferred tax liability	37,625	30,625
Total liabilities	501,773,963	565,114,490
Shareholders' equity:		
Common shares	4,376,500	4,398,897
Additional paid-in capital	186,398,669	185,638,345
Accumulated other comprehensive (loss)/income	(2,214,236)	893,142
Retained deficit	(122,390,347)	(138,597,827)
Total shareholders' equity	66,170,586	52,332,557
Non-controlling interest in preferred shares in subsidiaries	6,053,376	6,053,376
Total equity	72,223,962	58,385,933
Total liabilities and equity	\$ 573,997,925	\$ 623,500,423

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS
December 31, 2015 and 2014

	2015	2014
Net premiums earned	\$ 6,424,495	\$ 36,298,263
Fee income	12,516,516	12,817,680
Net investment income	2,782,718	4,362,929
Net realized (losses) gains	(87,757)	4,843,815
Fair value adjustment	2,408,319	4,519,332
Net change in fair value of credit derivatives	30,528,630	18,760,035
Other income	253,028	-
Total revenues	54,825,949	81,602,054
Net losses and loss adjustment expenses	11,583,988	12,685,506
Acquisition costs	864,632	6,931,525
General and administrative expenses	15,927,072	16,337,008
Amortization of intangible assets	2,238,167	2,706,667
Interest expense	5,376,304	2,535,132
Other expense	280,295	499,802
Total expenses	36,270,458	41,695,640
Income before income tax expense and non-controlling interest	18,555,491	39,906,414
Income tax expense	(7,000)	(7,000)
Net income before non-controlling interest	18,548,491	39,899,414
Non-controlling interest - dividends on Class B preference shares of subsidiary	(2,341,011)	(1,476,231)
Net income attributable to common shareholders	\$ 16,207,480	\$ 38,423,183
Net income per common share:		
Basic	\$ 371.96	\$ 1,813.44
Diluted	\$ 370.36	\$ 1,797.58
Weighted-average number of common shares outstanding:		
Basic	43,573	21,188
Diluted	43,761	21,375

* Shares outstanding and net income per share as of December 31, 2014, reflect the effects of a 1 for 100 reverse stock split on October 14, 2014.

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
December 31, 2015 and 2014

	2015	2014
Net income before non-controlling interest	\$ 18,548,491	\$ 39,899,414
Other comprehensive loss		
Change in unrealized fair value of investments	(3,286,485)	(318,967)
Less: reclassification adjustment for net realized investment gains included in income	87,757	(5,010,736)
Less: Reclassification adjustment for OTTI included in net income	-	166,921
Other comprehensive loss	(3,198,728)	(5,162,782)
Comprehensive income	\$ 15,349,763	\$ 34,736,632

See Accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF EQUITY AND RETAINED DEFICIT
December 31, 2015 and 2014

	Share capital	Noncontrolling Interest	Additional paid-in-capital	Accumulated other comprehensive income (loss)	Retained deficit	Total stockholders' equity
Balance, December 31, 2013, as adjusted	\$ 1,532,979	9,053,376	233,210,892	6,055,924	(177,021,010)	72,832,161
Net income	-	-	-	-	39,899,414	39,899,414
Share issuance	29,210	-	74,840	-	-	104,050
Treasury shares sold	9,100	-	-	-	-	9,100
Share repurchase in AOG	(8,792)	-	-	-	-	(8,792)
Share based compensation - AOG	-	-	377,506	-	-	377,506
Share based compensation - OGL	-	-	420,698	-	-	420,698
Impact of amalgamation with OGL	2,836,400	-	(48,445,591)	-	-	(45,609,191)
Additional Series B preferred shares issued	-	800,000	-	-	-	800,000
Series B preferred shares redemption	-	(3,800,000)	-	-	-	(3,800,000)
Net change in unrealized gains and losses on investments	-	-	-	(5,162,782)	-	(5,162,782)
Dividends on preference shares	-	-	-	-	(1,476,231)	(1,476,231)
Balance, December 31, 2014	<u>4,398,897</u>	<u>6,053,376</u>	<u>185,638,345</u>	<u>893,142</u>	<u>(138,597,827)</u>	<u>58,385,933</u>
Net income	-	-	-	-	18,548,491	18,548,491
Share issuance	25,700	-	310,385	-	-	336,085
Share based compensation - AOG	58,900	-	434,292	-	-	493,192
Impact of amalgamation with OGL	(106,997)	-	15,647	91,350	-	-
Net change in unrealized gains and losses on investments	-	-	-	(3,198,728)	-	(3,198,728)
Dividends on preference shares	-	-	-	-	(2,341,011)	(2,341,011)
Balance, December 31, 2015	<u>\$ 4,376,500</u>	<u>\$ 6,053,376</u>	<u>\$ 186,398,669</u>	<u>\$ (2,214,236)</u>	<u>\$ (122,390,347)</u>	<u>\$ 72,223,962</u>

See Accompanying Notes to the Consolidated Financial Statements

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2015 and 2014

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income for the year	\$ 18,548,491	\$ 39,899,414
Adjustments to reconcile net loss to net cash used in operating activities:		
Net realized losses/(gains) on sale of investments	87,757	(4,843,815)
Net unrealized gains on credit derivatives	(30,528,630)	(18,760,035)
Deferred tax expense	7,000	7,000
Amortization of intangible assets	2,238,167	2,706,667
Interest expense	5,376,304	2,535,132
Share based compensation - AOG	493,192	377,506
Share based compensation - OGL	-	420,698
Amortization of fair value adjustment	(2,408,317)	(4,519,332)
Amortization of bond discount	178,705	185,548
Changes in operating assets and liabilities:		
Accrued investment income	117,321	465,170
Premiums receivable	(4,683,301)	15,387,140
Reinsurance balance receivable, net	5,540,417	47,142,338
Salvage and subrogation	1,447,624	4,022,420
Deferred acquisition costs, net	259,242	489,160
Other assets	(965,905)	(8,904)
Changes in derivative liability	611,235	482,839
Unpaid losses and loss adjustment expenses	(16,234,234)	(58,164,988)
Unearned premiums	(1,804,357)	(13,670,950)
Ceded premium payable	8,245,385	(21,615,865)
Payable to general agents	838,391	(45,533)
Funds withheld	1,358,114	(1,248,057)
Accounts payable and accrued liabilities	(1,833,075)	761,715
Net cash used in operating activities	(13,110,474)	(7,994,732)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of available for sale securities	(45,090,980)	(160,075,604)
Proceeds from sales of investments	67,992,535	78,264,276
Proceeds from maturities of investments	18,713,929	102,167,531
Proceeds from sales of equities	-	28,649,466
Change in restricted cash	(4,435,150)	(3,280,107)
Net cash provided by investing activities	37,180,334	45,725,562
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term note payable	(20,890,356)	(32,468,831)
Interest paid	(5,540,677)	(1,664,897)
Redemption of preferred shares	-	(3,000,000)
Proceeds from issuance of common shares	336,085	104,358
Dividends paid on preferred shares	(2,341,011)	(1,551,231)
Net cash used in financing activities	(28,435,959)	(38,580,601)

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2015 and 2014

	2015	2014
Net decrease in cash and cash equivalents	(4,366,099)	(849,771)
Cash and cash equivalents - Beginning of year	35,497,038	36,346,809
Cash and cash equivalents - End of year	\$ 31,130,939	\$ 35,497,038
 Net taxes (refunded)/paid	-	(17,329)

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BACKGROUND

American Overseas Group Limited (“AOG” or the “Company”) was incorporated on January 28, 1998, under the laws of Bermuda. The Company was originally organized to operate a mono-line financial guaranty reinsurance subsidiary which was placed in voluntary run-off in 2009. After substantially reducing its financial guaranty exposure, AOG entered the property and casualty reinsurance business in 2012. On June 26, 2013 the Company’s principal shareholder at that time, Orpheus Group Ltd. (“OGL”), acquired voting control of AOG. On October 28, 2014, AOG acquired OGL for a combination of common stock and senior notes. The Company is now a major writer of non-standard auto insurance through its U.S. subsidiaries. The bulk of its earned premium and fee income are related to its property and casualty book of business. The financial guaranty book of business remains in run-off.

2. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies adopted by the Company:

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ materially from those estimates.

(b) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and of its subsidiaries, as well as those of Old American County Mutual Fire Insurance Company (“OACM”), a variable interest entity (“VIE”) which the Company is required to consolidate. All significant intercompany balances have been eliminated in consolidation. Transactions with the segregated account owned by the Company have been eliminated on consolidation. For further discussion of VIEs, see Note 20.

As described in Note 1, the acquisition of OGL in 2014 represents a transaction between entities under common control and as such, in accordance with Accounting Standards Codification (“ASC”) 805-50 “Business Combinations”, the comparative financial information has been combined from the earliest date on which the entities were under common control, June 26, 2013. AOG adopted OGL’s historical basis of accounting upon acquisition of OGL on October 28, 2014. The fair value adjustments resulting from OGL’s acquisition of voting control over AOG in 2013 are therefore reflected in these consolidated financial statements.

(c) Cash and cash equivalents

The Company considers all highly liquid investments, including fixed-interest and money market fund deposits, with a maturity of 90 days or less when purchased, as cash equivalents. Cash equivalents are carried at cost which approximates fair value.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(d) Investments

The Company has classified its fixed-maturity investments as available-for-sale and held to maturity. Available-for-sale investments are carried at fair value, with unrealized appreciation or depreciation reported as a separate component of accumulated other comprehensive income. The Company's fair values of fixed-maturity investments are based on prices obtained from nationally recognized independent pricing services and represent quoted prices in active markets when available. Equity securities include investments in shares of publicly traded companies and offshore mutual funds. All investment transactions are recorded on a trade date basis. Realized gains and losses on sales of fixed-maturity investments are determined on the basis of amortized cost. Gains and losses on sale of investments are included in "net realized gains on sale of investments" when realized. The cost of securities sold is determined using the specific identification method. The Company's investment guidelines require the orderly sale of securities that do not meet investment guidelines due to a downgrade by rating agencies or other circumstances, unless otherwise authorized by management to hold.

Other-than-temporary impairments on investments

The Company reviews its investment portfolio no less than quarterly in order to determine whether an other-than-temporary impairment ("OTTI") of its fixed-maturity investments classified as available-for-sale exists. An impairment is considered to be other-than-temporary if the Company (i) intends to sell the security, (ii) more likely than not will be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). A "credit loss" is recognized when the present value of cash flows expected to be collected from the fixed-maturity investment is less than the amortized cost basis of the security. If there is an intent to sell the impaired security or it is more likely than not that the Company will be required to sell the security before recovering its cost, then the entire difference between amortized cost and the security's fair value is recognized as an OTTI charge in earnings in the period. If there is no intent to sell the impaired security and it is not more likely than not that the Company will be required to sell the security before recouping its cost but there is a credit loss, then the credit loss portion of the unrealized loss is recognized in earnings with the remainder recognized in other comprehensive income.

Factors considered when assessing impairment include: (i) securities whose market values have declined by 20% or more below amortized cost for a continuous period of at least six months; (ii) credit downgrades by rating agencies; (iii) the financial condition of the issuer; (iv) whether scheduled interest payments are past due; and (v) whether the Company has an intent to sell the security.

(e) Revenue recognition

The Company earns property casualty insurance and reinsurance premium revenue over the terms of the related policies. Unearned premiums represent the unexpired portion of premiums written. Such reserves are computed by pro rata methods. In addition, the Company earns fee income for providing insurance capacity for its nonstandard automobile liability and physical damage insurance products produced by managing general agents or other producers and ceded to reinsurers. Fee income is the excess of the ceding commission received from the reinsurers over the commission expense paid to the managing general agents or other producers.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (CONT'D)

(f) Deferred policy acquisition costs

Deferred policy acquisition costs comprise those expenses that vary with and are primarily related to the production of business, including ceding commissions paid.

When assessing the recoverability of deferred policy acquisition costs, the Company considers the future earnings of premiums and anticipated investment income and compares this to the sum of unamortized policy acquisition costs, expected loss and loss adjustment expenses and expected maintenance costs. This comparison is completed by underwriting year and risk type. If a deficiency were calculated, the unamortized acquisition costs would be reduced by a charge to expense. For the financial guaranty assessment, any deficiency driven by the maintenance costs that is greater than the balance of the deferred acquisition costs for the underwriting year and risk type is recorded as a premium deficiency.

(g) Losses and loss adjustment expenses

For its property/casualty insurance and reinsurance, unpaid losses and loss adjustment expenses include an amount determined from individual case estimates (“case basis loss reserves”), including reports received from ceding companies for reinsurance, and an amount for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed and adjustments are reflected in the period determined.

For its financial guaranty reinsurance business, the Company establishes loss reserves based on a review of reserving practices, reported reserves, surveillance reports and other data provided by its ceding companies. In addition, the Company augments the ceding company information with its own research, analysis and modeling.

The Company recognizes a claim liability on a financial guaranty insurance contract (excluding those written in derivative form) when the Company estimates that the present value of expected net cash outflows to be paid under the insurance contract will exceed the unearned premium revenue for that contract. The present value of expected net cash outflows is discounted using a current risk free rate based on the remaining period (contractual or expected as applicable) of the insurance contract. Expected net cash outflows are probability weighted cash flows that reflect the likelihood of possible outcomes, based on all information available to the Company.

The Company updates the discount rate each reporting period and revises expected net cash outflows when increases or decreases in the likelihood of a default and potential recoveries occurs. The discount of the loss and loss expense reserve is accreted through earnings and included in losses and loss adjustment expenses. Changes to the estimate of loss and loss adjustment expenses reserve after initial recognition are recognized in “loss and loss adjustment expenses” in the Consolidated Statements of Operations in the period of the change.

The Company reviews the portfolio on a continuous basis to identify problem credits. Quarterly, the Company reviews reserves. Management establishes reserves that it believes are adequate to cover the present value of the ultimate liability for claims. The reserves are based on estimates and are substantially dependent on the surveillance activities and reserving policies of the Company’s ceding companies and may vary materially from actual results. Adjustments based on actual loss experience are recorded in the Consolidated Statements of Operations in the periods in which they become known.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(h) Derivative instruments

American Overseas Reinsurance Company Limited (“AORE”) has entered into agreements to reinsure derivative instruments, consisting primarily of credit default swaps that it intends to reinsure for the full term of the contract. While management considers these agreements to be a normal extension of its financial guaranty reinsurance business and reinsurance in substance, certain of these contracts meet the definition of a derivative under Accounting Standards Codification (“ASC”) 815 “Derivatives and hedging” (“ASC 815”). ASC 815 establishes accounting and reporting standards for derivative instruments, and requires the Company to recognize the derivative instruments on the Consolidated Balance Sheets at their fair value, under “Derivative assets or liabilities,” as applicable, with changes in fair value recognized in earnings. Changes in fair value are recorded in “Net change in fair value of credit derivatives” on the Consolidated Statements of Operations. The “Realized gains (losses) and other settlements” component of this change in fair value includes (i) net premiums earned on credit derivative policies, including current premiums receivable on assumed credit derivative policies, net of ceding commissions, and (ii) loss payments to the reinsured including losses payable upon the occurrence of a credit event. The “Unrealized gains (losses)” component of the “Net change in fair value of credit derivatives” includes all other changes in fair value, including changes in instrument specific credit spreads and reduction in fair values due to commutation of credit derivative policies.

Management uses, as a key input to the estimation of the fair value of our derivatives, the mark-to-market valuation information provided to us by our ceding companies (“the mark”). The Company participates in credit default swaps through a reinsurance treaty with a ceding company and therefore the contract to be valued is a reinsurance contract on a derivative. This contract is not identical to the underlying credit default swaps. In particular, although the Company’s contract allows it to share in the economic results of the underlying contracts, it does not provide rights to the same information to which the ceding companies have access. Under ASC 820, “Fair value measurements and disclosures” (“ASC 820”), the fair value of the Company’s contract represents the exit price that would be paid to a market participant to assume the reinsurance contract as written; that is, the amount the market participant would require to assume the Company’s potential obligations under the contract with the same contractual rights and obligations, including those which limit the information about the ceding companies’ underlying contracts that are being reinsured. Given the contractual terms that exist, the Company believes that an exit market participant would look to the information that is available from the ceding companies to determine the exit value of the Company’s reinsurance contract. The primary insurers underwrite each of the transactions underlying the reinsurance contract and they have access to all the underlying data related to the transactions. The ceding companies use their own internal valuation models where market prices are not available. The Company employs procedures to test the reasonableness of the mark both in process and absolute terms because we believe that an exit market participant would perform similar procedures when determining an exit price for our reinsurance contract. If it appears that the fair values generated by the ceding companies internal models and reported to the Company are consistent with macro spread movements and general market trends, and the Company believes that the modeling and assumptions that drive the modeling are reasonable (based on the Company’s ceding company reviews and review of publicly available information), the Company will use the mark provided by the ceding company as a key input in the determination of the fair value of the reinsurance contract. There is no single accepted model for fair valuing credit default swaps and there is generally not an active market for the type of credit default swaps insured by ceding companies and reinsured by us. Therefore, due to the limited availability of quoted market prices for these derivative contracts and the inherent uncertainties in the assumptions used in models, different valuation models may produce materially different results and be materially different from actual experience. In addition, due to the complexity of fair value accounting in particular on accounting for derivatives, future amendments or interpretations of these standards may cause us to modify our accounting methodology in a manner which may have an adverse impact on our financial results.

The use of valuation information provided to us by our ceding companies remains appropriate for the reasons described above, as well as the fact that the credit default swaps we reinsure are the same as those valued by our primaries, and the Company views its hypothetical principal market to be the same as that of our primaries,

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(h) Derivative instruments (cont'd)

being the financial guaranty insurance and reinsurance market. The Company's fair value on credit derivatives is adjusted for the Company's own non-performance risk in accordance with ASC 820.

(i) Fair Value Measurements

ASC 820 provides guidance for fair value measurement of assets and liabilities and associated disclosures about fair value measurement. Under this standard, the definition of fair value focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). ASC 820 clarifies that fair value is a market-based measurement, not an entity-specific measurement. ASC 820 establishes a fair value hierarchy of inputs in measuring fair value, with the highest level being observable inputs and the lowest being unobservable data as follows:

- Level 1 inputs – valuations based on quoted prices in active markets for identical assets or liabilities. Valuations in this level do not entail a significant degree of judgment.
- Level 2 inputs – valuations based on quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active and model derived valuations where all significant inputs are observable in active markets.
- Level 3 inputs – valuations based on significant inputs that are unobservable.

Disclosures relating to fair value measurements are included in Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives and Note 7 – Fair Value of Financial Instruments.

(j) Goodwill and Intangible Assets

The Company tests for impairment of goodwill and indefinite-lived intangible assets on an annual basis, or more frequently if events or changes in circumstances indicate that impairment exists.

The Company amortizes finite-lived intangible assets over the respective useful lives of the assets. If events or changes in circumstances indicate that impairment of these assets exists, the Company will test for impairment.

If, as a result of the evaluation, the Company determines that the value of the goodwill or intangible assets is impaired, then the value of the assets will be written-down through net income in the period in which the determination of the impairment is made.

(k) Acquisitions

The Company uses the purchase method in accounting for acquisitions and business combinations except for transactions between entities under common control. The difference between the fair value of net assets acquired and purchase price is recorded as goodwill or negative goodwill.

Due to OGL's consolidation of AOG effective June 26, 2013, certain adjustments were required under the purchase method of accounting. As further described in Note 2 (b), AOG adopted OGL's historical basis of accounting on acquisition of OGL on October 28, 2014. The fair value adjustments resulting from OGL's acquisition of voting control over AOG in 2013 are therefore reflected in these consolidated financial statements.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(k) Acquisitions (cont'd)

The purchase method of accounting requires that the acquirer record the assets and liabilities acquired at their estimated fair value. The fair values of each of the reinsurance assets and liabilities acquired are derived from probability-weighted ranges of the associated projected cash flows, based on actuarially prepared information and management's strategy. It is assumed that a hypothetical market participant would incorporate the runoff of the AORE financial guaranty business into existing insurance operations. The key assumptions used by OGL and, it believes, by other run-off market participants in the fair valuation in a business combination are (i) the projected payout, timing and amount of claims liabilities; (ii) a risk-free discount rate, which is applied to determine the present value of the future cash flows; (iii) the estimated unallocated loss adjustment expenses to be incurred over the life of the run-off; (iv) the impact of any accelerated run-off strategy; (v) an appropriate risk margin; and (vi) the non-performance risk of the AOG as it relates to its own liabilities.

The difference between the original carrying values of the liability recorded for the Redeemable Series A preference shares, as well as that of certain reinsurance assets and liabilities, including unearned premium reserves, loss and loss adjustment expenses and deferred acquisition costs, acquired at the date of acquisition and their fair values are recorded as an adjustment to those assets and liabilities, with the remainder recognized as an other liability. The other liability, related to the costs related to the financial guaranty business, is referred to in the Consolidated Balance Sheet as the Fair Value Adjustment ("FVA"). The FVA, along with adjustments to certain assets and liabilities, are amortized over the estimated payout period of outstanding losses and loss expenses acquired and accreted over the period to maturity of the Redeemable Series A preference shares; such adjustments are referred to as Fair Value Adjustment on the Consolidated Statements of Operations. To the extent the actual payout experience after the acquisition is materially faster or slower than anticipated at the time of the acquisition, there is an adjustment to the estimated ultimate loss reserves, or there are changes in bad debt provisions or in estimates of future run-off costs following accelerated payouts, then the amortization of the purchase adjustments is adjusted to reflect such changes.

(l) Assets Held and Liabilities Related to Segregated Accounts

A subsidiary of the Company is licensed to maintain segregated accounts relating to third party entities. The assets related to these programs (which include cash and accounts receivable) represent funds under management as the participants retain the risk and rewards of ownership. In the case where the Company is the beneficiary of the segregated accounts, the segregated accounts have been consolidated in the accompanying financial statements. For those segregated accounts owned by unrelated parties, the assets and liabilities are captioned as "Assets held in segregated accounts" and "Liabilities related to segregated accounts" in the consolidated balance sheet.

(m) Taxation

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the difference is reversed. A valuation allowance is recorded against gross deferred tax assets if it is more likely than not that all or some portion of the benefits related to the deferred tax assets will not be realized.

(n) Share-based Compensation

The Company measures and records compensation costs for all share-based payment awards based on grant-date fair value over the requisite service period. This includes consideration of expected forfeitures in determining share based-based employee compensation expenses.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(o) Treasury Shares

Common shares of AOG held by the Company and its subsidiaries are accounted for similar to share cancellations with the excess of the par value reflected in additional paid in capital.

(p) Recent accounting pronouncements

Financial Instruments

In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-01, *Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities*. The amendments in this ASU are intended to make targeted improvements to US GAAP by addressing certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. One of the amendments pertains to liabilities that an entity has elected to measure at fair value in accordance with the fair value option for financial instruments. For these liabilities, the portion of fair value change related to credit risk will be separately presented in other comprehensive income. Currently, the entire change in the fair value of these liabilities is reflected in the income statement.

The ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the fiscal year in which the guidance is adopted. For the Company, this would be as of January 1, 2018. Early adoption is permitted only for the amendment related to the change in presentation of financial liabilities that are fair valued using the fair value option. The Company is currently evaluating the effect of adopting this ASU on its Consolidated Financial Statements.

Insurance Contracts

In May 2015, the FASB issued ASU 2015-09, *Financial Services - Insurance (Topic 944) - Disclosures about Short-Duration Contracts*. The primary objective of this ASU is to improve disclosures for insurance entities which issue short-duration contracts. The Company is currently evaluating the effect of adopting this ASU on its Consolidated Financial Statements. The ASU is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

3. PLEDGED ASSETS

As of December 31, 2015 and 2014, there were investments of \$1.6 million, for both years respectively, on deposit with state insurance department regulators related to a U.S. subsidiary.

As of December 31, 2015, and 2014, the Company had restricted cash of \$51.4 million and \$47.0 million, respectively, and investments at fair value of \$70.8 million and \$90.8 million, respectively, in trust and escrow accounts for the benefit of ceding companies. Pursuant to the terms of the reinsurance agreements with ceding companies regulated in the United States, the Company is required to secure its obligations to these ceding companies in accordance with applicable state statutes governing credit for reinsurance, and may not withdraw funds from these trust accounts without the ceding companies' express permission. The trust accounts are required to hold cash and investments equivalent to unearned premiums, case-basis and incurred but not reported loss reserves, credit impairments (a non GAAP measure representing losses expected to be paid on insured credit derivative policies), and a contingency reserve calculated by the ceding companies. Management reviews these balances for reasonableness quarterly.

On February 19, 2014 AOG established an irrevocable trust (the "Series A Security Trust") for the benefit of the holders of the Series A Preference Shares. As of December 31, 2015 and 2014, the asset value of the Series A Security Trust was \$3.1 million and \$3.2 million, respectively, included within investments. Butterfield Trust Company has been appointed as its trustee. The Company has been authorized to redeem Series A Shares at any time for the amount that is not in excess of the Holder's pro-rata share of the assets in the Series A Security Trust.

On July 21, 2014 AORE established an irrevocable trust (the "Class B Security Trust") for the benefit of the holders of its Class B Preference Shares. As of December 31, 2015 and 2014, the asset value of the Class B Security Trust was \$1.9 million and \$2.0 million, respectively, included within investments. Butterfield Trust Company has been appointed as its trustee. The Company has been authorized to redeem Class B Shares at any time for the amount that is not in excess of the Holder's pro-rata share of the assets in the Class B Security Trust.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS

The amortized cost, gross unrealized gains, gross unrealized losses, OTTI and estimated fair value recorded in accumulated other comprehensive income of the Company's available for sale investments at December 31, 2015 and 2014, were as follows:

	<u>Amortized Cost</u>	<u>Included in Accumulated Other Comprehensive Income ("AOCI")</u>		<u>Estimated Fair Value</u>
		<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses Related to Changes in Estimated Fair Value</u>	
2015				
US Treasuries and government agencies ⁽²⁾	\$ 24,708,169	\$ 245,987	\$ (21,575)	\$ 24,932,581
Corporate debt securities	13,594,812	-	(1,744,427)	11,850,385
Mortgage-backed securities	22,612,687	345,469	(253,803)	22,704,353
Asset-backed securities	44,727,077	10,683	(423,327)	44,314,433
Total available for sale fixed-maturity investments	<u>\$ 105,642,745</u>	<u>\$ 602,139</u>	<u>\$(2,443,132)</u>	<u>\$ 103,801,752</u>
Equity securities available for sale	7,229,640	60,432	(433,675)	6,856,397
Total investment portfolio	<u><u>\$ 112,872,385</u></u>	<u><u>\$ 662,571</u></u>	<u><u>\$(2,876,807)</u></u>	<u><u>\$ 110,658,149</u></u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

	Included in Accumulated Other Comprehensive Income ("AOCI")				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Estimated Fair Value
Related to Changes in Estimated Fair Value			OTTI Included in Other Comprehensive Income ⁽¹⁾		
2014					
US Treasuries and government agencies (2)	\$ 30,674,762	\$ 591,549	\$ (2,315)	\$ -	\$ 31,263,996
Corporate debt securities	13,653,354	233	(291,418)	-	13,362,169
Mortgage-backed securities	33,711,597	646,394	(192,513)	-	34,165,478
Asset-backed securities	44,771,828	124,872	(161,585)	-	44,735,115
Total available for sale fixed-maturity investments	<u>\$ 122,811,541</u>	<u>\$ 1,363,048</u>	<u>\$ (647,831)</u>	<u>\$ -</u>	<u>\$ 123,526,758</u>
Equity securities available for sale	31,942,789	437,553	(168,276)	-	32,212,066
Total investment portfolio	<u><u>\$ 154,754,330</u></u>	<u><u>\$ 1,800,601</u></u>	<u><u>\$ (816,107)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 155,738,824</u></u>

(1) Represents the amount of OTTI losses in accumulated other comprehensive income ("AOCI"), since adoption of the accounting guidance for OTTI.

(2) Including US Government temporary liquidity guarantee program securities.

The Company did not have an aggregate investment in a single entity, other than U.S. Treasury securities, in excess of 10% of total investments at December 31, 2015 and 2014. The Company had no material investments in securities guaranteed by third parties and had no direct investments in financial guarantors as at December 31, 2015 and 2014.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

The amortized cost and estimated fair value of fixed-maturity securities classified as available-for-sale, as of December 31, 2015 and 2014, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

	December 31, 2015		December 31, 2014	
	Amortized	Estimated	Amortized	Estimated
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Less than one year	\$ 20,274,043	\$ 20,258,250	\$ 26,314,084	\$ 26,479,841
One through five years	18,553,866	17,060,423	18,314,770	18,446,771
Greater than five years	1,160,156	1,147,093	1,368,498	1,361,850
Mortgage-backed securities:				
RMBS	20,927,603	21,021,554	26,475,034	26,818,328
CMBS	-	-	5,567,327	5,684,853
Asset-backed securities	44,727,077	44,314,432	44,771,828	44,735,115
Total	<u>\$ 105,642,745</u>	<u>\$103,801,752</u>	<u>\$ 122,811,541</u>	<u>\$ 123,526,758</u>

The investments that have unrealized loss positions as of December 31, 2015 and 2014, aggregated by investment category and the length of time they have been in a continuous unrealized loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	<u>Fair Value</u>	Unrealized <u>Loss</u>	<u>Fair Value</u>	Unrealized <u>Loss</u>	<u>Fair Value</u>	Unrealized <u>Loss</u>
2015:						
Fixed-maturity investments:						
US Treasuries and government agencies	\$ 8,728,075	\$ (21,184)	\$ -	\$ -	\$ 8,728,075	\$ (21,184)
Corporate debt securities	10,584,422	(1,727,900)	1,004,315	(6,364)	11,588,737	(1,734,264)
Mortgage-backed securities	14,959,251	(262,345)	296,117	(2,012)	15,255,368	(264,357)
Asset-backed securities	18,925,068	(77,040)	21,369,565	(346,287)	40,294,633	(423,327)
Total temporarily impaired securities	<u>\$ 53,196,816</u>	<u>\$(2,088,469)</u>	<u>\$ 22,669,997</u>	<u>\$ (354,663)</u>	<u>\$ 75,866,813</u>	<u>\$(2,443,132)</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
2014:						
Fixed-maturity investments:						
US Treasuries and government agencies	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Corporate debt securities	14,933,367	(292,901)	84,147	(827)	15,017,514	(293,728)
Mortgage-backed securities	300,306	(296)	16,597,179	(192,222)	16,897,485	(192,518)
Asset-backed securities	17,920,355	(53,809)	16,852,300	(107,776)	34,772,655	(161,585)
Total temporarily impaired securities	<u>\$ 33,154,028</u>	<u>\$ (347,006)</u>	<u>\$ 33,533,626</u>	<u>\$ (300,825)</u>	<u>\$ 66,687,654</u>	<u>\$ (647,831)</u>

The following table sets forth the investment ratings of the Company's available-for-sale corporate fixed income securities as at December 31, 2015 and 2014. Ratings are assigned by Standard & Poor's or AM Best in instances where Standard & Poor's do not issue a rating.

2015	<u>Amortized Cost</u>	<u>%</u>
AAA	\$ 59,135,445	56.0%
AA	32,737,406	31.0%
A	2,001,262	1.9%
BBB and below	11,768,632	11.1%
	<u>\$ 105,642,745</u>	<u>100%</u>

2014	<u>Amortized Cost</u>	<u>%</u>
AAA	\$ 66,614,013	54.2%
AA	42,544,039	34.6%
A	2,402,572	2.0%
BBB and below	11,250,917	9.2%
	<u>\$ 122,811,542</u>	<u>100%</u>

As of December 31, 2015, 38 out of 70 fixed maturity securities were in unrealized loss positions compared to 33 out of 75 as of December 31, 2014. As at December 31, 2015, the Company's gross unrealized loss position for fixed maturity securities was \$1.5 million compared to \$0.7 million at December 31, 2014. Management does not believe these investments to be other than temporarily impaired, and has no intention to sell the securities. Unrealized gains and losses relating to fixed maturity investments, excluding any credit loss portion, are currently recorded in accumulated other comprehensive income in shareholders' equity as the Company generally holds these investments to maturity. The unrealized gains and losses are expected to decrease as the investment approaches maturity and the Company expects to realize a value substantially equal to amortized cost. Eight of the securities have been in an unrealized loss position of \$0.4 million for 12 months or more as of December 31, 2015 and there were nine securities in an unrealized loss position \$0.3 million for 12 months or more as of December 31, 2014.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

During the years ended December 31, 2015 and 2014, the Company recognized nil and \$0.17 million, respectively on other than temporary impairments. There was no movement in the amount of OTTI recognized in other comprehensive income during such years.

As of December 31, 2015 and 2014, an immaterial amount of net unrealized gains were recorded in accumulated other comprehensive income on securities which have previously had a credit loss written off to earnings, respectively.

Proceeds from maturities and sales of investments in fixed-maturity securities available for sale during 2015 and 2014 were \$86.7 million and \$180.4 million, respectively. Gross gains of \$0.05 million and \$2.2 million in 2015 and 2014, respectively, and gross losses of \$0.14 million and \$0.04 million in 2015 and 2014, respectively, were realized on those sales. The Company did not sell any equity investments in 2015 however in 2014, the Company sold equity investments in the amount of \$28.7 million which resulting in a gain \$2.7 million.

Major categories of net investment income are summarized as follows for the years ended December 31, 2015 and 2014:

	2015	2014
Interest from fixed-maturity securities	\$ 3,100,233	\$ 4,412,427
Interest from cash equivalents	9,272	121,136
Dividend income	-	245,738
Investment expense	(361,620)	(442,358)
Interest on funds held	<u>34,833</u>	<u>25,986</u>
Net Investment income	<u>\$ 2,782,718</u>	<u>\$ 4,362,929</u>

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE

The underwriting of insured risks and the reporting of underwriting results to AORE are the responsibility of the primary insurers under the treaties. AORE does not “re-underwrite” the transactions ceded under the treaties. AORE’s business model has always been that of a reinsurer in which it leverages and relies on the operations and reporting of the primary insurers. As a result of this model, AORE is highly dependent on the operating and reporting of the ceding companies. As the result of commutations in previous years, AORE is only assuming from ceding companies owned by a common group. AORE assesses the reasonableness of the ceding companies’ reporting by i) discussing with primary insurers their earnings methodology, ii) reviewing the primaries’ publicly available information regarding their accounting policies and methodologies, iii) comparing the primary reported information to the results of AORE’s own basic model and iv) performing analytical reviews on AORE’s underwriting results.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE (Cont'd)

The following tables present a roll forward of AORE's premiums receivable on installment policies for the years ended December 31, 2015 and 2014:

(dollars in thousands)	Years ended December 31,	
	2015	2014
Premiums receivable beginning balance	\$ 10,904	\$ 13,608
Change in premiums receivable discount	1	507
Adjustments for changes in expected term of policies (including early terminations)	25	(675)
Foreign exchange movement	(479)	(630)
Premiums received	(1,225)	(1,906)
Premiums receivable ending balance	<u>\$ 9,226</u>	<u>\$ 10,904</u>

As of December 31, 2015 and 2014, AORE had \$9.2 million and \$10.9 million, respectively, of premiums receivable, which represents the present value of future expected premiums on contracts where installments are collected over the term of the policy. This amount is included within "Reinsurance balances receivable, net" on the Consolidated Balance Sheets, net of the related ceding commissions payable as of December 31, 2015 and 2014 of \$3.9 million and \$4.6 million, respectively. As of December 31, 2015 and 2014, \$0.4 million and \$0.6 million, respectively, of paid losses (recoverable)/due to ceding companies was netted off "Reinsurance balances receivable, net" on the Consolidated Balance Sheets where the right of offset with a ceding company exists.

AORE experienced a number of downgrades, commencing in the middle of 2008, by both Moody's and S&P. On May 19, 2009, Moody's downgraded AORE to Ba3 and, at the same time, withdrew the rating at AORE's request. On August 31, 2009, S&P downgraded AORE's financial strength rating to BB with negative outlook and, at the same time, withdrew the rating at AORE's request. As a result of these downgrades, since 2008 certain of the ceding companies have a right under some of our treaty agreements to increase the ceding commission charged to AORE on the U.S. statutory unearned premium balance, as well as premiums payable after the downgrade. This increase applies to all financial guaranty and derivative policies covered by the relevant treaties. The additional ceding commissions charged to AORE have been paid or accrued and deferred and are being expensed in proportion to the earning of the remaining unearned premium, except for credit derivative policies where they are expensed as incurred. As of December 31, 2015 and 2014, additional ceding commissions due on the present value of premiums receivable on installment policies are netted off the premiums receivable within "Reinsurance balances receivable, net".

The accretion of premiums receivable discount is included in earned premiums in the Company's consolidated statements of operations. As of December 31, 2015 and 2014, the weighted average risk-free rate used to discount the premiums receivable was 3.29% and 3.39%, respectively. The weighted average expected period of future premiums used to estimate the premiums receivable was 8.8 years as of such dates, respectively. This information is presented excluding the impact of the amortization of fair value adjustments recorded in the conjunction with the change in voting control of AOG in 2013, discussed further in Note 19.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE (Cont'd)

The following table presents the future amount of undiscounted premiums expected to be collected on installment policies and the period in which those collections are expected to occur. These amounts are based on AORE's estimates as of December 31, 2015, utilizing information as reported by the ceding companies, and any changes to the underlying information on insured obligations could cause actual results to be materially different from the amounts below:

		Premiums Expected to be collected
(dollars in thousands)		
<u>Three Months Ended:</u>		
March 31, 2016	\$	373
June 30, 2016		329
September 30, 2016		335
December 31, 2016		280
 <u>Twelve Months Ended:</u>		
December 31, 2017		1,200
December 31, 2018		1,003
December 31, 2019		905
December 31, 2020		812
 <u>Five Years Ended:</u>		
December 31, 2025		2,839
December 31, 2030		1,441
December 31, 2035		769
December 31, 2040		497
December 31, 2045		365
December 31, 2050		222
After 2050		180

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE (Cont'd)

The estimated premiums written for the years ended December 31, 2015 and 2014, were \$0.1 million and \$(0.2) million, respectively; see Note 10 – Commutations and Other Settlements for details of commutations in the period included within these numbers. Included in premiums written in 2015 and 2014 was estimated accretion of the premiums receivable of \$0.1 million and \$(0.2) million, respectively. Accretion of the ceding commissions payable of \$0.1 million and \$(0.1) million, respectively, was included in acquisition expenses for such years.

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES

AORE has entered into agreements to reinsure derivative instruments, consisting primarily of credit default swaps (“CDS”), that it intends to reinsure for the full term of the contract, unless commuted early in the normal course of business. While management considers these agreements to be a normal extension of its financial guaranty reinsurance business and reinsurance in substance, these transactions reinsured by AORE meet the definition of a derivative under ASC 815. The Company is required to recognize all derivatives as either assets or liabilities in the Consolidated Balance Sheets and measure those instruments at fair value. The gain or loss on credit derivatives will change at each measurement date based on the underlying assumptions and information used in the estimate of fair value. Such fair value changes may not be indicative of ultimate claims. The credit derivative contracts AORE has reinsured require it to make payments upon the occurrence of certain defined credit events relating to an underlying obligation. Credit derivative exposures are substantially similar to financial guaranty insurance contracts and provide for credit protection against payment default, are generally held to maturity, and the unrealized gains and losses on derivative financial instruments will approach zero as the exposure approaches its maturity date, unless there is a credit impairment. Since these derivative instruments are considered a normal extension of the AORE’s financial guaranty business, AORE monitors the risks associated with these policies in accordance with its normal risk management activities as discussed in Note 8 - Losses and Loss Expense Reserve.

The following table provides the components of “Net change in fair value of credit derivatives” included in the Company’s Consolidated Statements of Operations related to our credit derivative policies:

	Years ended December 31,	
	2015	2014
Change in fair value of credit derivatives:		
Credit derivative premiums earned and receivable	\$ 1,388,781	\$ 1,788,930
Expenses on credit derivatives	(502,990)	(648,956)
Losses and loss adjustment expenses ⁽¹⁾	(427,240)	(553,372)
Realized gains and other settlements	<u>458,551</u>	<u>586,602</u>
Unrealized gain	<u>30,070,079</u>	<u>18,173,433</u>
Net change in fair value of credit derivatives	<u>\$ 30,528,630</u>	<u>\$ 18,760,035</u>

⁽¹⁾ See Note 10 – Commutations and Other Settlements, for details of the effect of the commutations on the above balances.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

Determining Fair Value

In accordance with ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is determined based on quoted market prices, if available. Financial guarantors sell credit protection in CDS form to financial institutions in a principal-to-principal market in which transactions are highly customized and negotiated independently. A CDS contract written by a financial guarantor differs from typical CDS contracts entered into by parties that are not financial guarantors because:

- CDS contracts written by financial guarantors are neither held for trading purposes (i.e., a short-term duration contract written for the purpose of generating trading gains) nor used as hedging instruments. Instead they are written with the intent to provide protection for the stated duration of the contract, similar to the financial guarantor's intent with regard to a financial guaranty contract.
- Financial guarantors are not entitled to terminate a CDS contract they write that is "in-the-money" and realize a profit on such a position.
- The liquidity risk present in most CDS contracts sold outside the financial guaranty industry, i.e., the risk that the CDS writer would be required to make cash payments, is typically not present in a CDS contract written by a financial guarantor. Terms are designed to replicate the payment provisions of financial guaranty contracts in that (a) losses, if any, are generally paid over time, and (b) the financial guarantor is generally not required to post collateral to secure its obligation under the CDS contract (the financial guarantor may be required to post collateral on their downgrade).

As a result of these differences, we believe there have been few, if any, relevant third-party exit transactions for CDS contracts written by financial guarantors. In the absence of a principal exit market, a financial guarantor determines the fair value of a CDS contract it writes by using internally developed models, as more fully discussed below.

Fair Value Modeling

AORE's CDS policies are not readily tradable as there is no active market for them. Therefore, AORE views its principal market as the financial guaranty insurance and reinsurance market, whose participants would hypothetically be able to assume this business if AORE were to hypothetically transfer a policy.

Each ceding company uses its own internal valuation models where market prices are not available. The primary insurers underwrite each of the transactions underlying the reinsurance contract and they have access to all the underlying data related to the transactions. In addition, they have sophisticated modeling capabilities and services (i.e. Loan Performance and Intex) that allow them to evaluate the performance of all of the underlying credits in a transaction. Given the contractual terms of AORE's reinsurance that limit its access to the terms of the underlying credit derivatives, which are highly individualized, and the underlying loan level data, AORE believes that an exit market participant would look to the information that is available from the ceding companies to determine the exit value of AORE's reinsurance contract, as discussed above. Therefore, AORE, in determining the fair value of derivative instruments, uses credit derivative contract valuations from its ceding companies as a key input. Management then assesses the reasonableness of the ceding companies' valuations by i) discussing with primary insurers their mark-to-market valuation methodology including the nature of changes in key assumptions, ii) reviewing the primaries' publicly available information regarding their mark-to-market process, including methodology and key assumptions, and iii) analyzing the movement of individual derivative policies compared to observable market data, including credit spread movements. Spreads and the related movements, quarter to quarter, are identified from observable market information such as indices, including the CDX, ABX,

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

CMBX and LCDX indices, as related to specific types of derivative contracts. Overall, the relationship between the widening of credit spreads and fair value is not a linear one due to the mix of policy types (duration, rating, and maturities) within the portfolio. Therefore, it is difficult to calculate the actual magnitude of any increase/decrease in the unrealized gain/(loss) with the movement of spreads alone. Additionally, there are many other assumptions that drive the ceding companies' ultimate fair value assessment namely asset recovery assumptions, correlation across asset assumptions, discount rate used, time to maturity, timing of default assumptions, and collateral posting requirements, where applicable. So while spreads are a significant driving factor in models of fair value, they are not the only variables. Changes in correlation and recovery assumptions can result in valuations moving more or less than the absolute movement of spreads. If it appears that the marks are consistent with macro spread movements, and general market trends and AORE believes that the modeling and assumptions that drive the modeling are reasonable (based on AORE's ceding company reviews and review of publicly available information), AORE will use the mark provided by the ceding company as a key input in the determination of the fair value of its reinsurance contracts on credit derivatives. These fair values are based on estimates and are sensitive to selected assumptions and changes to assumptions could lead to materially different results.

Fair values from the ceding companies' models may differ from values calculated by companies outside of the financial guaranty industry because, according to the ceding companies, the terms of the CDS contracts insured generally differ from other non-insured CDS contracts. Because of these terms and conditions, the fair value of the ceding companies' credit derivatives may not reflect the same prices observed in an actively traded market of CDS that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the related assumptions are continuously reevaluated by the ceding companies and enhanced, as appropriate, based upon improvements in modeling techniques and availability of market information.

As of December 31, 2015 and 2014, included in AORE's outstanding par exposure was \$750.4 million and \$1.0 billion, respectively, of CDS that have been fair valued. These derivative instruments had a remaining average legal term to maturity of 16.2 years and 16.1 years as of December 31, 2015 and 2014, respectively.

The following tables set forth AORE's exposure to credit derivatives by major asset type as at December 31, 2015 and 2014:

December 31, 2015:

Asset Type ⁽¹⁾	Net Par Outstanding (\$ in millions)	Weighted Average Credit Rating ⁽²⁾	Remaining Weighted Average Legal Contract Term ⁽³⁾
HY	466.4	AA	10.67
IG	44.6	AAA	0.96
Other CDO	149.5	A	39.64
Total CDO	660.5		
RMBS	21.3	BIG ⁽⁴⁾	20.96
Other	108.9	A	6.96
Grand Total	\$ 790.7		

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

December 31, 2014:	Net Par	Weighted	Remaining
Asset Type ⁽¹⁾	Outstanding	Average	Weighted Average
	(\$ in millions)	Credit Rating ⁽²⁾	Legal Contract Term ⁽³⁾
HY	662.1	AA	11.38
IG	52.3	AAA	2.69
Other CDO	166.9	A	40.35
Total CDO	881.3		
RMBS	42.4	BIG ⁽⁴⁾	26.41
Other	104.9	A	10.21
Grand Total	<u>\$ 1,028.6</u>		

(1) The definitions of the CDO types in the above table are as follows:

HY – Non-investment grade corporates, predominantly Collateralized Loan Obligations (“CLOs”) backed by corporate loans.

IG – Investment grade corporate securities (predominantly corporate, may include limited asset-backed securities (“ABS”)).

Other CDO – includes Double-Wrap CDO’s, Emerging markets sovereign debt obligations and Multi-sector collateral, primarily CMBS.

(2) For the year ending December 31, 2015, these ratings are current as of March 7, 2016 (for the year ending December 31, 2014, ratings were as of February 20, 2015). These ratings are assigned by AORE based on management’s judgment and take into consideration the ratings assigned by the ceding companies and the rating agencies. AORE undertakes no obligation to update its ratings, and such ratings do not constitute investment advice.

(3) Actual maturity of CDS is generally expected to be significantly less than the legal term.

(4) BIG – Below Investment Grade.

In compliance with the requirements of ASC 820, AORE considers its own non-performance risk when measuring the fair value of a liability.

There is no observable credit spread for AORE or AOG, and as such there is inherently a significant amount of judgment, subjectivity and uncertainty involved in the estimation of the adjustment for AORE’s non-performance risk. Management has used inputs that reflect assumptions market participants may use in pricing AORE’s creditworthiness. In determining AORE’s own non-performance risk when measuring the fair value of a liability, AORE uses an implied market price for buying credit protection on AORE and a cash flow model, which models a CDS contract, to calculate a price based on those spreads and cash flows. AORE identifies comparable entities with active CDS markets to estimate credit spreads for AORE. Such identification focuses on the nature of risk positions

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

(primarily public finance and structured products), ratings and approximate capital adequacy as depicted by publicly available information. Based on this information, as at December 31, 2015 and 2014, AORE estimated its credit spread to be approximately 2,316 and 1,120 basis points, respectively. An approximation of a CDS contract is made based on a 5-year insured CDS contract, an assumption of a 8 year weighted average life (7.5 years in 2014), and an assumption for par, coupon, duration and the appropriate discount rate based on a 5-year swap rate. AORE believes that these data points may be considered by hypothetical market participants in determining AORE's creditworthiness. AORE also considers other data points that may be relevant. These data points include transactions involving AORE's debt or preferred shares, if any, during the financial statement period. AORE assesses the interrelationship of market prices for these transactions with the results of applying the implied credit spreads described above. Furthermore, AORE considers the interrelationship between observed market prices for similar buyback transactions of other industry participants and their credit spreads and non-performance risk adjustments. These interrelationships are not always intuitive, nor are they necessarily consistent across all observed market participants. As a result, AORE has not directly incorporated these data points into the calculation of the non-performance risk adjustment, but rather has utilized them as a point of reference in assessing the reasonableness of the results of AORE's estimate of the non-performance risk adjustment. AORE will continue to evaluate the significance of any future transactions in the determination of our own credit worthiness.

The effect of applying this requirement of ASC 820 was a reduction in AORE's derivative liability at December 31, 2015 and 2014, of approximately \$34.6 million and \$27.5 million, respectively. As noted above, this calculation is based on estimates, involves a significant degree of management judgment and is sensitive to selected assumptions. Changes to the assumptions used in this valuation could lead to materially different results. For example, a change in AORE's estimated spread would have a significant impact on the amount of the adjustment for AORE's own non-performance risk. Adjustments to AORE's non-performance risk will be recorded in the periods in which they become known or estimable by AORE.

The following table summarizes the estimated changes in fair value of our credit derivatives assuming immediate changes in AORE's non-performance credit risk at specified levels at December 31, 2015:

Change in Credit Spreads	Estimated Net Fair Value of Derivative Liability	Impact of Change on Net Income
	(\$ in millions)	
1000 basis point narrowing	\$ (35.1)	\$ (14.0)
500 basis point narrowing	(26.9)	(5.9)
100 basis point narrowing	(22.0)	(1.0)
Base scenario	(21.0)	-
100 basis point widening	(20.0)	1.0
500 basis point widening	(16.8)	4.2
1000 basis point widening	(13.6)	7.4

AORE believes that the above hypothetical spread movements used in the sensitivity analysis of 100, 500, and 1000 basis points are supported by previous large spread changes that have occurred during 2015 and 2014 in our primaries' spreads. Therefore, AORE believes it is not unreasonable for AORE to use these spread movements in the sensitivity analysis. This calculation is based on estimates, involves a significant degree of management judgment and is sensitive to selected assumptions. Changes to assumptions used in this valuation could lead to materially different results.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

Our credit derivative policies are classified as Level 3 in the fair value hierarchy in Note 7 since the inputs provided to us by our ceding companies and our own non-performance risk adjustments are from valuation models which place reliance on at least one significant unobservable input. Consistent with the requirements of ASC 820, we believe these models use observable market data when available.

The following table presents changes in the net credit derivative liabilities balance for which fair value was measured under Level 3 for the years ended December 31, 2015 and 2014:

Fair value measurement using significant unobservable inputs (Level 3)

	Years ended December 31,	
	2015	2014
Balance, beginning of period	\$ (46,696,287)	\$ (64,973,483)
Total unrealized gains included in earnings ⁽¹⁾	30,070,079	18,173,433
Total realized gains included in earnings ⁽²⁾	458,551	586,602
Net Cash Receipts ⁽³⁾	(611,235)	(482,839)
Transfers in and/or out of Level 3	-	-
Balance, end of period	\$ (16,778,892)	\$ (46,696,287)
Change in unrealized gains and losses relating to assets held at the reporting date	\$ 27,267,265	\$ 13,797,953

(1) Included within "Net change in fair value of credit derivatives".

(2) Included in "Realized gains and other settlements" within "Net change in fair value of credit derivatives".

(3) Net Cash Payments/ (Receipts) includes all ongoing contractual cash payments inclusive of payments to commute credit derivatives (see Note 10 – Commutations and Other Settlements for details of commutations in the years ended December 31, 2015 and 2014)

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value Measurements

The Company follows the guidance of ASC 820 for fair value measurement of financial instruments. ASC 820 establishes a hierarchy of inputs in measuring fair value, with the highest level being observable inputs and the lowest being unobservable data, with the standard requiring that the use of observable inputs is maximized (see Note 2(i) - Significant Accounting Policies – Fair Value Measurements for a description of each of the three levels).

The following table presents the fair value measurement levels for assets and liabilities, which the Company has recorded at fair value as of December 31, 2015 and 2014. As required by ASC 820, items are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Fair Value Measurements at Reporting Date Using			
	Balance as of December 31, <u>2015</u>	Quoted Prices in Active Markets for Identical <u>Assets (Level 1)</u>	Significant Other Observable <u>Inputs (Level 2)</u>	Significant Unobservable <u>Inputs (Level 3)</u>
Financial Assets:				
U.S. treasuries and government agencies	\$ 24,932,582	\$ 18,421,460	\$ 6,511,122	\$ -
Corporate debt securities	11,850,384	-	2,554,135	9,296,249
Mortgage-backed securities	22,704,353	-	22,704,353	-
Asset-back securities	44,314,433	-	44,314,433	-
Investments available for sale fixed maturity investments	103,801,752	18,421,460	76,084,043	9,296,249
Equity investments available for sale	6,856,397	1,749,271	5,107,126	-
Cash and Cash Equivalents	31,130,939	31,130,939		
Restricted Cash	51,403,076	51,403,076		
Financial Liabilities:				
Derivative Liabilities ⁽¹⁾	\$ 16,778,892	\$ -	\$ -	\$ 16,778,892

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (cont'd)

	Balance as of December 31, <u>2014</u>	Quoted Prices in Active Markets for Identical <u>Assets (Level 1)</u>	Significant Other Observable <u>Inputs (Level 2)</u>	Significant Unobservable <u>Inputs (Level 3)</u>
Financial Assets:				
U.S. treasuries and government agencies	\$ 31,263,996	\$ 26,527,396	\$ 4,736,600	\$ -
Corporate debt securities	13,362,169	-	2,632,169	10,730,000
Mortgage-backed securities	34,165,478	-	34,165,478	-
Asset-back securities	44,735,115	-	44,735,115	-
Investments available for sale fixed maturity investments	123,526,758	26,527,396	86,269,362	10,730,000
Equity investments available for sale	32,212,066	15,060,105	17,151,961	-
Cash and Cash Equivalents	35,497,038	35,497,038		
Restricted Cash	46,967,926	46,967,926		
Financial Liabilities:				
Derivative Liabilities (1)	\$ 46,696,287	\$ -	\$ -	\$ 46,696,287

⁽¹⁾ See Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives for further disclosure on the application of ASC 820 to the Company's derivative liabilities.

Fixed-maturity investments

The Company's fair values of fixed-maturity and short-term investments are based on prices obtained from nationally recognized independent pricing services. Where available, the prices are obtained from market quotations in active markets. Where there is no quoted price for an identical security, then the pricing service may use matrix pricing or model processes, such as the option adjusted spread model, to estimate the fair value of a security. The matrix pricing or model processes consist primarily of observable inputs, which may include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. The Company receives at least one fair value price for each of its investment securities and has not adjusted any of the prices received from the pricing services. At December 31, 2015 and 2014, all but one security was valued using the independent pricing services.

There were no transfers into or out of Level 1 or 2 during the years ended December 31, 2015 and 2014.

As management is ultimately responsible for determining the fair value measurements for all securities, the Company assesses the reasonableness of the fair values received by comparing them to other pricing information readily available and management's knowledge of the current markets. The Company also assesses the pricing methodologies and related inputs used by the pricing services to estimate fair value. Any prices that, in management's opinion, may not be representative of fair value are challenged with the pricing service. Based on the information obtained from the above reviews, the Company evaluated the fixed-maturity securities in the investment portfolio to determine the appropriate fair value hierarchy level in accordance with ASC 820. Based on the Company's evaluation, each security was classified as Level 1, 2, or 3. Prices with observable market inputs were

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (cont'd)

classified as Level 2, prices on money market funds and US treasuries were classified as Level 1, and valuations with no significant observable inputs were classified as Level 3 as of December 31, 2015 and 2014. The Company holds an investment in a capital trust, classified as a corporate debt security available for sale, which was valued using an analysis to comparable securities, incorporating a spread to the yields on the comparable securities to derive the fair value. Because the investment in this security was valued using significant unobservable inputs, it is classified as Level 3 in the fair value hierarchy. There were no liabilities measured at fair value on a recurring basis using unobservable measurements other than those dealt with in Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives.

The following table presents changes in the fixed maturity investment balance for which fair value was measured under Level 3 for the years ended December 31, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
	<u>Fixed maturity investments</u>	<u>Fixed maturity investments</u>
Balance beginning of period	\$ 10,730,000	\$ 10,475,625
Unrealized (losses) gains included in OCI	(1,433,751)	254,375
Sales	-	-
Balance, end of period	<u>\$ 9,296,249</u>	<u>\$ 10,730,000</u>
Change in unrealized gains relating to assets held at the reporting date	<u>\$ (1,688,126)</u>	<u>\$ 254,375</u>

Equity investments

The Company's equity investments are comprised of funds invested in a range of diversified strategies. In accordance with U.S. GAAP, the fair values of the funds are based on the unadjusted net asset value of the funds as reported by the fund manager. As such, the fair values of those funds are included in the Level 1 and Level 2 fair value hierarchy. The Company validates these prices through agreeing net asset values to audited financial statements where available, in conjunction with regular discussion and analysis of the investment portfolio's structure.

Other fair value disclosures

Management has estimated the fair value of certain financial instruments based upon market information using appropriate valuation methodologies. Fair value estimates are not necessarily indicative of the amount the Company could realize in a current market exchange.

The Company considers carrying amounts of cash and cash equivalents, interest, other assets, accounts payable and accrued liabilities to be reasonable estimates of their fair values.

As of December 31, 2015 and 2014, the fair value of the Company's \$59.7 million redeemable Series A Preference Shares was approximately \$9.8 million and \$9.4 million, respectively. These fair value estimates are based on the present value of expected cashflows, together with the Company's best estimate of fair value of this instrument. The fair value measurement was classified as Level 3 in the fair value hierarchy.

The carrying amounts of certain assets and liabilities were adjusted to their respective fair value as of June 26, 2013 in conjunction with OGL's acquisition of voting control of AOG. See Note 19 for further information.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (cont'd)

The following table sets out the carrying amounts and the estimated fair values of the Company's financial instruments at December 31, 2015 and 2014:

	Years Ended December 31,			
	2015		2014	
	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Carrying Amount</u>	<u>Fair Value</u>
Financial Assets:				
Fixed-maturity investments	\$ 103,801,752	\$ 103,801,752	\$ 123,526,758	\$ 123,526,758
Equity investments	6,856,397	6,856,397	32,212,066	32,212,066
Cash and cash equivalents	31,130,939	31,130,939	35,497,038	35,497,038
Restricted cash	51,403,076	51,403,076	46,967,926	46,967,926
Accrued investment income	202,864	202,864	320,185	320,185
Financial Liabilities:				
Derivative liabilities	16,778,892	16,778,892	46,696,287	46,696,287
Redeemable preference shares	9,786,582	9,786,582	9,445,656	9,445,656

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE

The Company's loss and loss expense reserve as of December 31, 2015, represented case basis loss reserves and incurred but not reported reserves, or claim liability which includes a fair value adjustment of the financial guaranty reserves. Refer to Note 2 - Significant Accounting Policies for a description of the Company's accounting policy for insurance losses.

A summary of the movement in the provision for losses and LAE for the years ended December 31, 2015 and 2014 is presented in the following table:

	2015	2014
Losses and loss expense reserve		
Balance - Beginning of year	\$ 265,438,578	\$ 323,603,567
Less: reinsurance recoverable	(185,076,937)	(218,714,980)
Net Balance - Beginning of year	<u>80,361,641</u>	<u>104,888,587</u>
Reserves transferred in through loss portfolio transfer	5,632,352	-
Incurred related to:		
Current year	7,787,102	31,655,312
Prior Years	3,796,886	(18,969,806)
Total incurred	<u>11,583,988</u>	<u>12,685,506</u>
Net losses paid related to:		
Current year	(11,043,915)	(17,559,322)
Prior Years	(11,941,748)	(19,653,130)
Total Paid	<u>(22,985,663)</u>	<u>(37,212,452)</u>
Net balance - End of year	74,592,318	80,361,641
Add: reinsurance recoverable	174,612,026	185,076,937
Balance - End of year	<u><u>\$ 249,204,344</u></u>	<u><u>\$ 265,438,578</u></u>

For the year ended December 31, 2015, the Company incurred loss and LAE of \$11.6 million. Incurred losses related to the Company's short-tailed property casualty business were \$4.0 million. The majority of the losses from the property casualty business are from the prior year, with only \$1.7 million development on the current accident year. The financial guaranty reinsurance business generated positive net incurred losses of \$7.6 million in 2015 including fair value adjustments.

For the year ended December 31, 2014, the Company incurred loss and LAE of \$12.7 million. Incurred losses related to the Company's short-tailed property casualty business were \$35.9 million. The majority of the losses from the property casualty business are from the current year, with only \$4.2 million development on the prior accident year. The financial guaranty reinsurance business generated negative net incurred losses of \$23.2 million in 2014 including fair value adjustments.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

The Company's US RMBS exposure includes obligations backed by Alt-A, subprime, closed-end second mortgage loans and home equity lines of credit. Alt-A and subprime mortgage loans tend to be first lien products, while closed-end second and home equity lines of credit mortgages tend to be second lien products. The Company's estimate of loss reserves related to US RMBS exposure represents management's best estimate of total future losses for these exposures, but actual losses may differ materially from these estimates. The Company continues to monitor the performance of these exposures and will update estimates of loss as new information reflecting future performance is available and any changes will be recorded in the period in which they occur.

As of December 31, 2015 and 2014, the Company gave credit of \$2.8 million and \$3.0 million, respectively, in its case reserves for the benefit of expected recoveries in US RMBS transactions resulting from required repurchases by the originators due to contractual breaches of representations and warranties in the RMBS securitization agreements. The credit given for such repurchase recoveries at year-end 2015 and 2014 approximates the credit reported to the Company by the ceding companies in their ceded reserves, as that is the Company's best estimate of the remediation benefit at this time. The ceding companies performed detailed examinations of sampled RMBS loan files to determine whether the loans conformed to the representations and warranties made by the sponsors of the RMBS. The sampled loans were either in later stages of delinquency or had been charged off. Those loans that showed a material breach of representations and warranties and were put back to the sponsors for repurchase. Through December 31, 2015 the ceding companies have caused sponsors providing representations and warranties to pay, or agree to pay, or to terminate or agree to terminate insurance protection on future projected losses in respect of their representation and warranty liabilities for transactions in which the Company has provided reinsurance. The ceding companies are no longer actively pursuing sponsors where they do not have such an agreement. Most of the amount projected to be received pursuant to existing agreements with sponsors benefits from eligible assets placed in trusts to collateralize the sponsor's future reimbursement obligation. Thus, the Company views the inclusion of the credit taken by the primaries in its own case reserves to be appropriate and generally assumes its proportionate share of the credit given by the ceding companies when establishing its case reserves as of year-end 2015 and 2014.

To determine the adequacy of its aggregate reserves, the Company considers the loss reserves established by its ceding companies for the exposures it has reinsured as well as the methodologies used by the ceding companies to calculate such ceded loss reserves. To further evaluate the ceded reserve amounts established by the ceding companies, the Company uses its own expected loss forecasting methodologies. Ultimately, the Company decides on an individual credit-by-credit basis whether to establish the ceding company's reserve as its own or to use its own forecast methodology to determine the reserve for such credit. Specifically regarding RMBS, we established a maximum threshold amount between the reserve calculated using our model and the primaries' ceded reserve. If our calculated reserve was less than the primaries' reserve plus the threshold, we used the primaries' reserve as our reserve for each RMBS deal as of Q4 15. If the threshold was exceeded, then we used our reserve. As of December 31, 2015 and 2014, the Company's recorded loss and LAE reserves for financial guaranty contracts are \$3.4 million (2014: \$5.7 million) higher than the reserves reported by the primaries.

The Company uses one of two approaches to perform its own forecast of expected losses. The first approach is a statistical expected loss approach, which considers the likelihood of alternative outcomes. The statistical expected loss is a function of: (i) the net par outstanding on the credit; (ii) internally developed historical default assumptions (taking into consideration internal ratings and remaining term to maturity of an obligation); (iii) internally developed loss severities; and (iv) a discount factor. This approach is referred to by the Company as the probabilistic expected loss ("PEL") modeling approach. The loss severities and default assumptions are based on rating agency information, are specific to each bond type and are established and approved by management. For certain credit exposures, the Company's surveillance activities may provide information relevant to adjust the estimate of the statistical expected losses. As such, the default probability or loss severity for such exposures under certain probabilistic scenarios may be adjusted based on the judgment of senior management.

The second approach entails the use of more precise estimates of expected net cash outflows (future claim payments, net of potential recoveries, expected to be paid to the holder of the insured financial obligation). The Company's risk management staff considers the likelihood of alternative possible outcomes and develops alternative loss

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

scenarios, in conjunction with a review of historical performance data of the collateral pools. In this approach, a probability-weighted expected loss estimate is developed based on assigning probabilities to multiple net claim payment scenarios and applying an appropriate discount factor. For RMBS, the Company takes into account the first loss protective features inherent in the structure of the insured exposure, collateral losses to date, current delinquency rates and loan product characteristics such as loan-to-value ratio and credit score. The first loss protection in most of the Company's RMBS transactions is provided by excess spread, overcollateralization, subordination, and in some cases mortgage pool insurance.

A loss reserve is recorded for the excess, if any, of estimated expected losses (net cash outflows) over unearned premium reserve ("UPR"). For certain policies, estimated potential recoveries exceed estimated future claim payments because all or a portion of such recoveries relate to claims previously paid. The expected net cash inflows for these policies are recorded as a recoverable asset.

The discount factor applied is based on a risk-free discount rate corresponding to the remaining expected weighted-average life of the exposure or based on multiple risk-free discount rates related to the timing of individual claims payments. The discount factors are updated for the current risk-free rates each reporting period. As of December 31, 2015, the Company used risk free rates ranging from 0.63% to 3.29% to discount reserves for loss and loss adjustment expenses. As of December 31, 2014, the Company used risk free rates ranging from 0.24% to 2.95% to discount reserves for loss and loss adjustment expenses.

The Company establishes reserves that it believes are adequate to cover the present value of ultimate liability for losses and loss adjustment expenses, net of UPR. These reserves are based on estimates and may vary materially from actual results.

The Company also identifies problem credits through information provided by the ceding companies at least on a quarterly basis. Such information generally consists of surveillance and underwriting reports and quarterly correspondence and/or conference calls with the ceding companies' analysts. The Company supplements this input with their own research to identify and assess the status of individual credits. Research performed includes reviews of rating agency and fixed income research publications and analysis of historical performance data. Each of the ceding companies maintains a "watch list" for credits that have been identified as requiring a greater than usual level of ongoing scrutiny and/or intervention. The ceding companies notify the Company when any ceded exposure has been placed on such a watch list.

The Company maintains its own Watch List to identify those transactions requiring increased monitoring. The Company typically places a transaction on the Watch List if the ceding company places a transaction on its watch list, and the Company generally employs a mapping of each watch list category of each ceding company to the Company's own Watch List categories. The Company also surveys market segments on an as-needed basis based on market trends, and may add transactions to the Watch List as a result of such survey even if the ceding company has not added the transaction to its watch list.

As of December 31, 2015, the Company revised its Watch List definitions to more closely align them with its ceding companies. As of December 31, 2014 the Company's Watch List was divided into four categories generally based upon the following definitions:

- Category 1 includes transactions for which performance of the issue or that of an issuance participant is sufficiently below expectations where increased monitoring is required; however, the risk of loss remains remote.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

- Category 2 transactions include those for which performance of an issue or that of an issuance participant is sufficiently below expectations where increased monitoring is required and remedial intervention by the ceding company is either planned or already in progress. Performance issues occur when the performance of an issue does not stabilize or improve over the intermediate term and concerns about the transaction's ability to meet its debt service obligations may arise.
- Category 3 includes transactions where performance has deteriorated to the point where concerns about continued ability to meet debt service requirements on a timely basis are substantial. Also included are transactions where claims have been paid but recoveries are forecast for the claims.
- Category 4 transactions include those for which ultimate net loss (net of recoveries and premium receivable) is expected in the most-probable scenarios.

As of December 31, 2015, the Company's revised its Watch List definitions as follows:

- Category 1: Transactions that are investment grade and for which future losses still seem unlikely, but with a material deterioration in some aspect. Transactions may be in Category 1 where, for example, there has been a;
 - Breach of a material performance trigger or covenant
 - Material deterioration in the financial health of the issuer, servicer, collateral manager or other important party
 - Material downgrade of internal or external credit ratings from their original level
 - Material deterioration in macroeconomic factors (such as industry trends or asset values)Investment grade transactions on which liquidity claims have been paid are in this category. Active monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.
- Category 2: Below investment grade transactions showing sufficient deterioration to make future losses possible, but for which none are currently expected. Intense monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.
- Category 3: Below investment grade transactions for which future losses are expected but for which no claims (other than liquidity claims) have yet been paid. Intense monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.
- Category 4: Below investment grade transactions for which future losses are expected and on which claims (other than liquidity claims) have been paid. Intense monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.

The Company generally expects "future losses" on a transaction when the Company believes there is more than a 50% chance that, on a present value basis, it will pay more claims over the remaining life of that transaction than it will ultimately have reimbursed. A "liquidity claim" is a claim that the Company expects to be reimbursed within one year. (Excluded from consideration are small, immaterial losses or claims not indicative of the performance of the transaction generally.)

Each transaction in Category 3 or 4 of the Watch List is generally reviewed quarterly to determine whether material changes are noted by the ceding company or by the Company. If material adverse changes are identified, surveillance reports are requested from the ceding company and discussions are held to assess the deterioration and outlook for the credit.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

The Company may have transactions in Categories 1 or 2 on the Watch List or transactions not on the Watch List for which the Company has established loss reserves based on its Probabilistic Expected Loss (“PEL”) modeling analysis. These transactions are typically not on the ceding primary’s watch list and are assigned reserves in the Company’s PEL modeling primarily due to low premium pricing, not due to poor transaction performance. Further surveillance and modeling may result in the Company placing these transactions on the Watch List or downgrading the assigned category. In addition, the Company may have transactions for which it projects prior claim recoveries that are not on the Watch List because they have no remaining par outstanding. Such transactions are reflected in the tables below.

The Company does not perform loss mitigation activities and instead relies on the loss mitigation efforts of the ceding companies that report the Company’s proportionate share of the expenses incurred and liability arising from such activities. The Company pays the ceding companies a ceding commission for all policies reinsured. The ceding commission represents the Company’s portion of the cost to the ceding companies to write the transaction, perform ongoing surveillance and to undertake loss mitigation activities. Ceding commissions are deferred and expensed as each policy’s exposure matures and are included as an asset in deferred policy acquisition costs and as acquisition expenses in the statement of operations. The Company reports loss expenses associated with claims as a liability in losses and loss expense reserves on the Consolidated Balance Sheets and in loss and loss adjustment expenses in the Consolidated Statements of Operations.

The following table provides information about the financial guaranty policies and related loss reserves in each of the Company’s Watch List categories as of December 31, 2015:

(dollars in millions)	Deals not on watch List	Surveillance Categories				Total
		Category 1	Category 2	Category 3	Category 4	
Number of policies	25	18	30	11	36	120
Remaining weighted average contract period (in yrs)	23	17	17	20	21	
Insured contractual payments outstanding:						
Principal	\$ 27.5	\$ 102.8	\$ 274.0	\$ 52.4	\$ 41.5	\$ 498.2
Interest	13.3	70.5	145.2	36.6	11.6	277.2
Total	\$ 40.8	\$ 173.3	\$ 419.2	\$ 89.0	\$ 53.1	\$ 775.4
Gross Claim Liability	\$ 1.4	\$ 1.3	\$ 9.4	\$ 17.7	\$ 10.0	\$ 39.8
Less:						
Gross potential recoveries	(1.3)	-	(1.3)	(1.3)	(2.7)	(6.6)
Discount, net	(0.1)	(0.2)	(0.6)	(0.8)	(1.1)	(2.8)
Net Claim Liability	\$ (0.0)	\$ 1.1	\$ 7.5	\$ 15.6	\$ 6.2	\$ 30.4
Unearned premium revenue ⁽¹⁾	0.7	1.0	2.0	0.4	0.2	\$ 4.3
Net Claim liability reported in the Balance Sheet related to financial guarantee						\$ 26.1
Reinsurance recoverables	-	-	-	-	-	-

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

The following table provides information about the financial guaranty policies and related loss reserves in each of the Company's Watch List categories as of December 31, 2014:

(dollars in millions)	Deals not on watch List	Surveillance Categories				Total
		Category 1	Category 2	Category 3	Category 4	
Number of policies	21	25	14	13	51	124
Remaining weighted average contract period (in yrs)	17	21	13	12	19	17
Insured contractual payments outstanding:						
Principal	\$ 67.6	\$ 283.9	\$ 167.0	\$ 141.7	\$ 128.2	\$ 788.4
Interest	17.1	160.1	44.2	60.2	67.3	348.9
Total	<u>\$ 84.7</u>	<u>\$ 444.0</u>	<u>\$ 211.2</u>	<u>\$ 201.9</u>	<u>\$ 195.5</u>	<u>\$ 1,137.3</u>
Gross Claim Liability	\$ (0.1)	\$ 2.3	\$ 1.3	\$ 3.3	\$ 19.8	\$ 26.6
Less:						
Gross potential recoveries	(0.6)	(0.4)	-	(0.3)	(3.6)	(4.9)
Discount, net	(0.1)	(0.3)	(0.1)	(0.2)	(2.4)	(3.1)
Net Claim Liability	<u>\$ (0.8)</u>	<u>\$ 1.6</u>	<u>\$ 1.2</u>	<u>\$ 2.8</u>	<u>\$ 13.8</u>	<u>\$ 18.6</u>
Unearned premium revenue ⁽¹⁾	0.8	1.5	0.7	2.0	0.8	<u>\$ 5.8</u>
Net Claim liability reported in the Balance Sheet related to financial guarantee						<u>\$ 12.8</u>
Reinsurance recoverables	-	-	-	-	-	<u>-</u>

⁽¹⁾ On policies with a loss reserve but excluding those policies with a recoverable as of December 31, 2015 and 2014, respectively.

Categories 1 to 4 in the above table include all financial guaranty contracts on the Company's Watch List at December 31, 2015 and 2014, whether or not they have reserves on them. The column entitled "Deals not on Watch List" includes only financial guaranty exposures for which the Company has established reserves. Policies written in credit derivative form are not included in the above tables. Due to rounding, the numbers in the above tables may not add up to the totals.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

9. OUTSTANDING FINANCIAL GUARANTY EXPOSURE

A portion of the Company's business consists of financial guaranty reinsurance, the purpose of which is to indemnify a primary financial guarantor, referred to as the "primary insurer" or "ceding company," against the portion of any loss it may sustain under financial guaranty policies it has ceded to the Company. The Company reinsures policies covering both U.S. and international exposures. The Company's portfolio as of December 31, 2015 was diversified by geographic and bond market sector, with no single obligor representing more than 2.2% of the Company's total outstanding ("OS") par insured.

The following table presents the Company's net par outstanding by credit sector and type of guaranty as of December 31, 2015 and 2014:

(dollars in millions)	2015		2014	
	Total OS Par	% of Total	Total OS Par	% of Total
US Public Finance				
General Obligation and Lease	\$ 1,402	26.8	\$ 1,962	29.1
Tax backed	208	4.0	268	4.0
Transportation	515	9.9	580	8.6
Healthcare	340	6.5	365	5.4
Utility	372	7.1	555	8.3
Higher Education	42	0.8	176	2.6
Other	67	1.3	76	1.1
Escrowed	546	10.4	563	8.4
Total US Public Finance	\$ 3,492	66.8%	\$ 4,545	67.5%
US Structured Finance				
Commercial ABS and CDOs	\$ 470	9.0	\$ 645	9.6
RMBS	118	2.2	147	2.2
Other Structured Finance & Corporate	50	1.0	50	0.7
Total US Structured Finance	\$ 638	12.2%	\$ 842	12.5%
International				
Asset-backed	\$ 338	6.5	\$ 475	7.1
Public Finance	361	6.9	406	6.0
Investor Owned Utilities and Other	397	7.6	464	6.9
Total International	\$ 1,096	21.0%	\$ 1,345	20.0%
Total	\$ 5,226	100.0%	\$ 6,732	100.0%

Due to rounding the numbers in the above tables may not add up to the totals.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

9. OUTSTANDING FINANCIAL GUARANTY EXPOSURE (cont'd)

Net outstanding par reinsured at December 31, 2015 and 2014, by geographic location was as follows:

(dollars in millions)	2015		2014	
	<u>OS Par</u>	<u>%</u>	<u>OS Par</u>	<u>%</u>
International	\$ 1,096	21.0	\$ 1,345	20.0
Multi-state	629	12.0	831	12.3
California	704	13.5	983	14.6
New York	324	6.2	450	6.7
Illinois	347	6.6	446	6.6
Massachusetts	298	5.7	321	4.8
Other U.S. States	1,828	35.0	2,356	35.0
Total	\$ 5,226	100.0%	\$ 6,732	100.0%

The above outstanding par amounts do not include interest, which is an additional exposure to the company and could be significant. The above outstanding par amounts are also inclusive of outstanding par on credit derivative policies. See Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives for further information on the outstanding par relating to credit derivative policies.

10. COMMUTATIONS AND OTHER SETTLEMENTS

Effective October 17, 2014, AORE entered into a Commutation, Reassumption and Release Agreement with one of its financial guaranty ceding companies. This agreement provided, among other things, for AORE to make a \$1,054 net commutation payment to terminate the reinsurance with respect to a certain policy previously assumed, with par in-force of \$76.0 million (the “Released Risks”). In return, each party was released from all liabilities and obligations with respect to the Released Risks. The effect of this agreement on the Company’s results of operations was to increase the gain in the net change in fair value of derivatives by \$3.9 million, as this policy was classified as a derivative liability.

The Company did not enter into any commutations in 2015.

11. SEGMENT INFORMATION

The determination of reportable segments is based on how management monitors the Company’s underwriting operations. Management monitors the performance of its underwriting operations based on the markets and customers served and the type of accounts written. The Company is currently organized into three operating segments: property/casualty insurance and reinsurance, financial guaranty and corporate/other. All product lines fall within these classifications. The property/casualty segment provides insurance and reinsurance primarily related to US short-tail personal lines. The financial guaranty segment includes AORE’s financial guaranty operations which are in run-off and which the Company has no plans to re-enter. During the year ended December 31, 2015, our major customers were the following primary monoline financial guaranty insurers: Assured Guaranty Corp., or “Assured Guaranty”, Assured Guaranty Municipal Corp. (formerly Financial Security Assurance Inc.), or “AGM”, Assured Guaranty (Europe) Ltd., or “AGE” (formerly Financial Security Assurance (U.K.) Limited) and together with AGM, “FSA”. As the Company does not manage its assets by segment, investment income, interest expense and total assets are not allocated to individual reportable segments.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

11. SEGMENT INFORMATION (cont'd)

The following tables provide a summary of the segment results.

(dollars in thousands)	December 31, 2015			
	<u>Property/Casualty</u>	Financial		<u>Total</u>
		<u>Guaranty</u>	<u>Corporate</u>	
Net premiums earned	\$ 6,399	\$ 25	\$ -	\$ 6,424
Net change in fair value of credit derivatives	-	30,529	-	30,529
Losses and loss adjustment expenses	(3,991)	(7,593)	-	(11,584)
Acquisition expenses	(901)	36	-	(865)
Underwriting gain (loss)	1,507	22,997	-	24,504
Fee income	12,517	-	-	12,517
Net investment income	-	-	2,783	2,783
Other income	-	-	253	253
Net realized gains on sales of investments	-	-	(88)	(88)
Fair value adjustment	-	-	2,408	2,408
Operating expenses	(9,075)	(5,983)	(869)	(15,927)
Interest expense	-	-	(5,376)	(5,376)
Amortization expense	(2,238)	-	-	(2,238)
Other expense	-	-	(280)	(280)
Income tax	(7)	-	-	(7)
Net income (loss) before non controlling interest	\$ 2,704	\$ 17,014	\$ (1,169)	\$ 18,549

(dollars in thousands)	December 31, 2014			
	<u>Property/Casualty</u>	Financial		<u>Total</u>
		<u>Guaranty</u>	<u>Corporate</u>	
Net premiums earned	\$ 36,466	\$ (168)	\$ -	\$ 36,298
Net change in fair value of credit derivatives	-	18,760	-	18,760
Losses and loss adjustment expenses	(35,897)	23,211	-	(12,686)
Acquisition expenses	(7,107)	175	-	(6,932)
Underwriting gain (loss)	(6,538)	41,978	-	35,440
Fee income	12,818	-	-	12,818
Net investment income	-	-	4,363	4,363
Net realized gains on sales of investments	-	-	4,844	4,844
Fair value adjustment	-	-	4,520	4,520
Operating expenses	(8,614)	(7,019)	(704)	(16,337)
Interest expense	-	-	(2,535)	(2,535)
Amortization expense	(2,707)	-	-	(2,707)
Other income	-	-	(500)	(500)
Income tax	(7)	-	-	(7)
Net income (loss) before non controlling interest	\$ (5,048)	\$ 34,959	\$ 9,988	\$ 39,899

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

12. COMMITMENTS AND CONTINGENCIES

The insurance and reinsurance subsidiaries of the Company are involved in various claims and legal actions arising in the ordinary course of business. Some claims allege breach of good faith and fair dealing; however, those entities are vigorously defending their position, and in the opinion of management, the ultimate outcome of these matters will not have a material adverse effect on the Company's financial position, results of operations or cashflows.

Future minimum lease payments as of December 31, 2015 are as follows:

2016	\$	253,412
2017	\$	258,514
2018	\$	193,885

No lease commitments for 2019 and beyond.

13. REDEEMABLE SERIES A PREFERENCE SHARES

On December 14, 2006, AOG issued 75,000 Series A Preference Shares at \$1,000 per share for total consideration of \$75.0 million. The Series A Preference Shares have a par value of \$0.10 per share and a redemption value of \$1,000 per share. Until December 15, 2016, the Series A Preference Shares bear a non-cumulative, non mandatory dividend rate of 7.50%, which is payable semi-annually on June 15 and December 15 each year upon declaration by the Board of Directors. After December 15, 2016, if the Series A Preference Shares have not been redeemed or repurchased, they bear a non-cumulative, non-mandatory dividend rate of Three-Month LIBOR (as defined in the Series A Certificate of Designations) plus 3.557%, which is payable quarterly on the 15th day of March, June, September and December of each year, beginning on March 15, 2017, upon declaration by the Board of Directors. Unless previously redeemed, the Series A Preference Shares have a mandatory redemption date of December 15, 2066. AOG can redeem the Series A Preference Shares at any time from December 15, 2016 with no penalty to AOG. Prior to December 15, 2016, AOG can redeem the preference shares at the redemption price and a make-whole amount, amounting to dividends for the remainder of the period to December 15, 2016.

On May 12, 2009, the Board determined to suspend payment of dividends on the Series A Preference Shares; therefore, during the years ended December 31, 2015 and 2014, there were no dividends declared or paid. The payment of preference share dividends is classified as interest expense. On March 10, 2010, AOG completed a tender offer for the Series A Preference Shares, pursuant to which 15,300 shares, or 20.40% of the 75,000 shares previously outstanding were validly tendered. The Company accepted for purchase all such Series A Preference Shares that were validly tendered as of the applicable expiration date and paid \$3.8 million for all such Series A Preference Shares realizing a gain of \$11.5 million. Following the settlement of the tender offer and as of December 31, 2015 and 2014, 59,700 shares of AOG's Series A Preference Shares remain outstanding.

The Company is not permitted under the terms of the Series A Preference Shares to pay common share dividends or repurchase common shares unless full dividends for the latest completed dividend period on all Series A Preference Shares have been paid. The Company has no plans to liquidate, pay common share dividends or to repurchase any of its common shares.

See Note 3 for discussion of the establishment of an irrevocable trust for the benefit of holders of the Series A Preference Shares.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

14. NONCONTROLLING INTEREST

On December 23, 2003, AORE entered into a \$50.0 million soft capital facility whereby it was granted the right to exercise perpetual put options in respect of its Class B Preference Shares against the counterparty to the option agreement, in return for which it paid the counterparty a floating put option fee through February 17, 2009. The counterparty was a trust established by an investment bank. The trust was created as a vehicle for providing capital support to AORE by allowing it to obtain, at its discretion and subject to the terms of the option agreement, access to new capital through the exercise of a put option and the subsequent purchase by the trust of AORE's Class B Preference Shares. On February 17, 2009, AORE exercised the put option in the soft capital facility and issued 500.01 Class B Preference Shares to the trust in exchange for \$50,001,000 of proceeds. On March 16, 2009, AORE elected to pay a fixed rate dividend on the Class B Preference Shares, as a result of which the Class B Preference Shares were distributed to the holders of the trust's securities. As a result of the fixed rate election, if declared by the board, dividends are payable on the Class B Preference Shares every 90 days at a rate of 6.276%. The Class B Preference Shares give investors the rights of a preferred equity investor in AORE. Such rights are subordinate to insurance claims, as well as the general unsecured creditors of AORE. The Class B Preference Shares are not rated by S&P since AORE requested the withdrawal of its ratings during 2009 and have not been rated by Moody's. AORE has the option to redeem the Class B Preference Shares, subject to certain specified terms and conditions.

The fair value of the put option at the exercise date was \$41.9 million and therefore the value of the Class B Preference Shares on that date was \$8.1 million, being the difference between the proceeds received and the fair value of the put option on the date of exercise. On March 9, 2010, AORE completed a tender offer for the Class B Preference Shares, pursuant to which 68.00 shares, or 13.60%, were tendered out of the 500.01 shares outstanding. AORE accepted for purchase all such Class B Preference Shares that were validly tendered as of the applicable expiration date and paid \$1.7 million for all such Class B Preference Shares on March 10, 2010.

On July 16, 2013, AORE completed a private repurchase of its Class B Preference Shares from an unrelated holder. Under the terms of the repurchase agreement, AORE repurchased 9 of the Class B Preference Shares at a price of \$25,000 per share from the Holder, for an aggregate repurchase price of \$225,000. This resulted in a reduction of \$146,056 of "Class B Preference Shares" in AORE's Consolidated Balance Sheets.

On December 27, 2013, AORE completed a private repurchase of its Class B Preference Shares from an unrelated holder. Under the terms of the repurchase agreement, AORE repurchased 50 of the Class B Preference Shares at a price of \$25,000 per share from the Holder, for an aggregate repurchase price of \$1,250,000. This resulted in a reduction of \$811,423 of "Class B Preference Shares" in AORE's Consolidated Balance Sheets.

Following the settlement of these repurchases, 373.01 shares of Class B Preference Shares remained outstanding at December 31, 2015 and 2014. The remaining value of the Class B Preference Shares of \$6.1 million is included as a "Noncontrolling Interest" in the Company's Consolidated Balance Sheets as of December 31, 2015 and 2014.

On July 21, 2014 AORE established an irrevocable trust (the "Class B Security Trust") for the benefit of the holders of its Class B Preference Shares. The Company deposited assets valued at \$2.050 million in the Class B Security Trust. Butterfield Trust Company has been appointed as its trustee. The Company has been authorized to redeem Class B Shares at any time for the amount that is not in excess of the Holder's pro-rata share of the assets in the Class B Security Trust.

If declared by the board, dividends are payable on the Class B Preference Shares every 90 days at a rate of 6.276%. Dividends on the Class B Preference Shares are currently non-cumulative. The terms of AORE's Class B Preference Shares restrict AORE's ability to pay dividends on its common shares unless all accrued and unpaid dividends on the Class B Preference Shares for the then current dividend period have been declared and paid or a sum sufficient for payment thereof set apart, except that AORE may to declare dividends on its common shares in such amounts as are necessary for AOG (i) to service indebtedness for borrowed money as such payments become due (or to satisfy any of its guaranty obligations made in respect of AORE or AOG) or (ii) to pay its operating expenses.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

14. NONCONTROLLING INTEREST (cont'd)

If AORE fails to pay dividends in full on the Class B Preference Shares for eighteen consecutive months then the number of members on the Board of Directors of AORE is automatically increased by two with the holders of the Class B Preference Shares having the ability to elect the two additional directors. On August 12, 2014 AORE reinstated the dividends on its Class B preference shares and the board seats available to the Class B Preference Shares were eliminated.

In 2015, the Company paid \$2,341,011 in dividends to the Class B preference shareholders.

A U.S. subsidiary of the Company issued 800 shares of Series B Preferred Stock ("Series B Shares") in 2014. The Series B Shares were perpetual, had a par value of \$1,000 per share and paid cumulative dividends of 10% per annum. All of the Series B Shares were redeemed in 2014. The Company paid dividends of \$305,726 in 2014 dividends on the Series B Shares.

15. SHARE CAPITAL

As at December 31, 2015 and 2014, authorized common share capital was \$9,000,000. As at December 31, 2015 and 2014, there were 10,000,000 authorized undesignated preference shares with a par value of \$0.10 each. Common shares and additional paid in capital are presented net of treasury shares held by the company and its subsidiaries.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

15. SHARE CAPITAL (cont'd)

The following table shows a roll forward of the issued, outstanding and unissued common shares for the years ended December 31, 2014 and 2015:

	Outstanding share capital	Outstanding Shares	Treasury Shares	Issued Shares	Unissued Shares
Par Value per share prior to reverse stock split		\$1.00	\$1.00	\$1.00	\$1.00
As at January 1, 2014	1,532,979	1,532,979	1,237,142	2,770,121	6,229,879
Issued restricted share units during the year prior to reverse stock split	16,710	16,710	-	16,710	(16,710)
Shares purchased pre split	(8,792)	(8,792)	-	(8,792)	8,792
Treasury shares cancelled pre split	-	-	(39)	(39)	39
Number of shares prior to reverse stock split	\$1,540,897	1,540,897	1,237,103	2,778,000	6,222,000
Reverse stock split of issued shares on 1 for 100 basis ⁽¹⁾					
Par value per share subsequent to reverse stock split		\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00
Number of shares subsequent to reverse stock split	1,540,897	15,409	12,371	27,780	62,220
Issued restricted share units during the year after the reverse stock split	1,500	15	-	15	(15)
Share options exercised during the year after the reverse stock split	11,000	110	-	110	(110)
Treasury shares sold to Calliope	9,100	91	(91)	-	-
Shares issued to OGL shareholders for purchase of OGL	2,836,400	28,364	-	28,364	(28,364)
As at December 31, 2014 and January 1, 2015	4,398,897	43,989	12,280	56,269	33,731
Issued restricted share units during the year	24,300	243	-	243	(243)
Share options exercised during the year	25,700	257	-	257	(257)
Impact of amalgamation with OGL	(106,997)	(1,070)	1,070	-	-
Shares issued in lieu of cash for director's fees	34,600	346	(346)	-	-
Treasury shares cancelled			(12,962)	(12,962)	12,962
As at December 31, 2015	4,376,500	43,765	42	43,807	46,193

⁽¹⁾ Reverse Stock Split

On October 14, 2014, as previously approved by AOG's shareholders, AOG effected a reverse stock split of its issued common shares (the "Consolidation"). AOG's issued common shares of par value US\$1.00 each were consolidated into common shares of par value US\$100.00 each on a 1 for 100 basis. No fractional shares were issued in the Reverse Stock Split. In lieu thereof, any holder of pre-split shares who was otherwise entitled to receive fractional shares was paid an amount based on market value at close of business on October 13, 2014. A total of 8,792 common shares were purchased by AOG to effect this payout of fractional shares.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION

In accordance with ASC 718, the Company recognizes compensation costs based on the estimated fair value at the grant date of the award. For both the twelve month periods ended December 31, 2015 and 2014, the Company recognized no compensation expense for share options with an exercise price less than the market value of the underlying common shares on the date of the grant.

As of April 26, 2006, AOG adopted the 2006 Equity Plan (the "AOG Plan"). The number of common shares that may be issued under the AOG Plan may not exceed 247,000 adjusted to 2,470 with share split, and then increased to 4,500 by official vote of the shareholders at the 2015 Annual General Meeting. In the event of certain transactions affecting the common shares of the Company, the number or type of shares subject to the AOG Plan, the number and type of shares subject to outstanding awards under the Plan, and the exercise price of awards under the AOG Plan will be adjusted in accordance with the terms of the AOG Plan. The AOG Plan authorizes the grant of share options, share appreciation rights, share awards, restricted share units, performance units, or other awards that are based on AOG's common shares. The awards granted are contingent on the achievement of service conditions during a specified period, and may be subject to a risk of forfeiture or other restrictions that will lapse upon the achievement of one or more goals relating to completion of service by the participant. Awards under the AOG Plan may accelerate and become vested upon a change in control of the Company. The AOG Plan is administered by the Board of Directors. The AOG Plan is subject to amendment or termination by the board.

As at December 31, 2015, outstanding awards under the AOG Plan consisting of 1,226 share options and 672 restricted share units had been granted to the Company's directors, officers, employees and consultants. Each of the options vest in equal annual installments over a four-year period and will expire at the earlier of the seventh anniversary of the date of grant or the expiration of the AOG Plan. The grant price is the average of the highest and lowest quoted selling price on the grant date. The exercise price of the options at December 31, 2015 ranges from \$675 to \$1,520. Restricted share units vest in equal annual installments over a four-year period.

Stock Options

The Company has used the Black-Scholes option pricing model to estimate the fair value of stock options using the following weighted average assumptions during the period ending December 31, 2015. In 2014 there were no stock options awarded:

	2015
Dividend yield	0%
Expected volatility	346.00%
Risk-free interest rate	1.50%
Expected life of options (in years)	4.0
Weight-average grant-date fair value	\$ 850.00

Compensation cost is recognized on a straight-line basis over the vesting period and is net of estimated pre-vesting forfeitures of 10% for both periods. The estimated forfeiture rate is based on future forfeiture expectations. At December 31, 2015, the weighted average grant date fair value for options issued subsequent to January 1, 2006 was \$892.17. The Company expensed \$0.1 million in compensation expense related to the stock options for each of the years ended December 31, 2015 and 2014. As at December 31, 2015, there was \$0.9 million of unrecognized compensation expense related to the stock options granted subsequent to January 1, 2006, which is expected to be recognized over the weighted average remaining service period of 3.39 years.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION (cont'd)

The following tables summarize the stock option activity for the years ended December 31, 2015 and 2014:

Stock option activity

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value ⁽¹⁾
Year ended December 31, 2015				
Options				
Outstanding - beginning of year	647	\$ 4,924.31		
Granted	1,000	850.00		
Exercised	(256)	893.32		
Forfeited	(165)	12,056.46		
Outstanding - end of year	<u>1,226</u>	928.44	6.20	\$ 36,250
Exercisable - end of year	176	\$ 1,388.86	2.82	\$ 9,650

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value ⁽¹⁾
Year ended December 31, 2014				
Options				
Outstanding - beginning of year	86,982	\$ 49.16		
Granted	-	-		
Exercised	(110)	904.47		
Forfeited	(11,132)	145.66		
Subtotal prior to Consolidation ⁽²⁾	<u>75,740</u>			
Reverse stock split 1 for 100 basis	(75,093)	N/A		
Outstanding - end of year	647	4,924.31	1.98	\$ 248,730
Exercisable - end of year	535	\$ 7,778.77	3.41	\$ 180,119

- 1) The aggregate intrinsic value was calculated based on the market value of \$875.00 and \$1,600.00 as at December 31, 2015 and 2014, respectively, and is calculated as the difference between the market value and the exercise price of the underlying options.
- 2) Amounts and prices prior to the Consolidation effective date discussed above are not adjusted for the effects of the Consolidation.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION (cont'd)

Restricted Share Units

AOG has granted restricted share units to directors, employees and consultants of the Company. Restricted share units vest annually over a four-year period.

The following table summarizes the restricted share unit activity for the years ended December 31, 2015 and 2014:

	<u>Number of share units</u>	<u>Weighted average grant date fair value per share</u>
Year ended December 31, 2015		
Restricted Share Units		
Non-vested - beginning of year	758	\$ 1,600.91
Granted	180	1,495.00
Vested	(266)	1,564.30
Forfeited	-	
Non-vested - End of year	<u>672</u>	<u>\$ 1,585.68</u>
	<u>Number of share units</u>	<u>Weighted average grant date fair value per share</u>
Year ended December 31, 2014		
Restricted Share Units		
Non-vested - beginning of year	51,718	\$ 15.12
Granted	42,350	16.01
Vested	(15,833)	11.71
Forfeited	-	
Subtotal prior to Consolidation ⁽¹⁾	<u>78,235</u>	
Reverse stock split 1 for 100 basis	(77,462)	N/A
Vested post split	(15)	1,074.28
Non-vested - End of year	<u>758</u>	<u>\$ 1,600.91</u>

1) Number and prices prior to the Consolidation discussed above are not adjusted for the effects of the Consolidation.

The Company expensed \$0.4 million and \$0.3 million in compensation expense related to the restricted share units for the years ended December 31, 2015 and 2014 respectively under the AOG Plan. The compensation expense for restricted share units is expensed on a prorated basis over the vesting period. At December 31, 2015, there is unrecognized compensation expense related to the non-vested restricted share units under the AOG Plan of \$0.9 million, which will be recognized over the weighted average remaining service period of 2.36 years.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION (cont'd)

OGL had a separate equity plan. As of September 20, 2012, OGL adopted the 2012 Equity Plan (the "OGL Plan"). The number of common shares that may be issued under the OGL Plan may not exceed 1,100. In the event of certain transactions affecting the common shares of the Company, the number or type of shares subject to the OGL Plan, the number and type of shares subject to outstanding awards under the OGL Plan, and the exercise price of awards under the OGL Plan will be adjusted in accordance with the terms of the OGL Plan. The OGL Plan authorizes the grant of share options, share appreciation rights, share awards, restricted share units, performance units, or other awards that are based on the Company's common shares. The awards granted are contingent on the achievement of service conditions during a specified period, and may be subject to a risk of forfeiture or other restrictions that will lapse upon the achievement of one or more goals relating to completion of service by the participant. Awards under the OGL Plan may accelerate and become vested upon a change in control of the Company. The OGL Plan is administered by the Board of Directors. The OGL Plan is subject to amendment or termination by the Board. The OGL plan was terminated in March 2015.

Restricted Share Units

OGL had granted restricted share units to employees and a consultant. Restricted share units vest annually over a four-year period.

The Company expensed \$0.4 million in compensation expense related to the restricted share units for the years ended December 31, 2014 under the OGL Plan. There was no compensation expense under the OGL Plan in 2015. The compensation expense for restricted share units is expensed on a prorated basis over the vesting period. At December 31, 2015, there is no unrecognized compensation expense related to the non-vested restricted share units under the OGL Plan, as the outstanding non-vested RSUs vested with the change in control of OGL which occurred with its acquisition by AOG.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

17. EARNINGS (LOSS) PER SHARE

Basic earnings per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share shows the dilutive effect of all stock options and restricted share units outstanding during the period that could potentially result in the issuance of common shares. The calculation of diluted loss per share excludes the dilutive effect of stock options and restricted share awards outstanding because it would otherwise have an anti-dilutive effect on net loss per share. The weighted average number of common and common share equivalents outstanding is calculated using the treasury stock method for all potentially dilutive securities.

As discussed in Note 15 – Share Capital, the Company effected a Consolidation of its issued common shares on October 14, 2014. All comparative figures in this earnings per share note are adjusted for the Consolidation as if it had occurred in prior year.

As of December 31, 2015 and 2014, there were 1,696 and 766, respectively, of stock options excluded from the diluted earnings per share calculation because they were anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2015 and 2014:

	2015	2014
Net income (loss) available to common shareholders	\$ 16,207,480	\$ 38,423,183
Basic weighted-average shares	43,573	21,188
Effect of stock options	172	102
Effect of restricted share units	16	85
Diluted weighted-average shares	43,761	21,375
Basic income (loss) earnings per share	\$ 371.96	\$ 1,813.44
Diluted income (loss) earnings per share	\$ 370.36	\$ 1,797.58

18. RISKS AND UNCERTAINTIES

The Company continues to evaluate its financial condition and capital adequacy and may pursue a different set of strategies in the future. There can be no assurance that the strategies that have been implemented or that will be pursued in the future in connection with this evaluation will improve the Company's business, financial condition, liquidity or results of operations or will not have a material adverse effect on the Company. Management believes that the Company has sufficient capital resources and liquidity to meet its obligations for at least the next twelve months and therefore that the Company remains a "going concern."

AOG is a holding company and therefore its liquidity, both on a short-term basis (for the next twelve months) and a long-term basis (beyond the twelve months), is largely dependent upon (1) the ability of its subsidiaries to pay dividends or make other payments to AOG and (2) its ability to access debt and equity markets, which is unlikely in the near term given current market conditions and AOG's current share valuation. AOG's principal uses of liquidity are for payment of operating expenses, debt service on the senior notes payable and capital investments in its subsidiaries. As of December 31, 2015, AOG has \$10.1 million of cash and investments and believes that it will have sufficient liquidity to meet its requirements over at least the next twelve months. The subsidiaries' ability to declare and pay dividends to AOG may be influenced by a variety of factors such as adverse loss development, amount and timing of claims payments, the amounts required to be held in trust for the benefit of its ceding companies, adverse market changes, insurance regulatory changes, changes in general economic conditions beyond the next twelve months and law. The Company believes that AOG's expected liquidity needs can be funded from its operating and investing cash flows for the next twelve months.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

OGL generates substantial cash flows from its fee-based model. The principal uses of liquidity for those entities are the payment of operating expenses, debt service on subsidiary notes and capital investment in property/casualty subsidiaries. The property/casualty subsidiaries are highly leveraged through their reinsurance arrangements, and disputes with reinsurers could severely impact the liquidity of these subsidiaries. The property/casualty subsidiaries attempt to mitigate this exposure by holding collateral from their reinsurers. The subsidiaries held \$171.6 million of collateral compared to \$225.2 million of balances at December 31, 2015 and such amounts are included in reinsurance balances received net on the consolidated balance sheet.

At December 31, 2015, the Company had \$194.1 million of cash and investments of which \$128.3 million was held in trust for the benefit of our ceding companies and \$0.7 million in escrow accounts, leaving \$65.1 million cash and investments available to support ongoing business. See Note 3 – Pledged Assets, for further information regarding these trust accounts. Currently, losses are paid out of AORE's unrestricted cash rather than AORE's trust accounts which reduces available cash until the trust accounts are adjusted. AORE is not permitted to withdraw funds from these trust accounts without the ceding companies' express permission. The ceding companies are allowed to withdraw funds from the trust account under certain conditions as specified in the trust agreements.

Further increases in loss reserves and credit impairments would require AORE to deposit additional collateral in the applicable trust account(s) and resulting claims payments in respect of those losses and impairments would increase cash outflows and could decrease the size of AORE's investment portfolio, in turn decreasing income from investments.

The principal sources of AORE's liquidity are premiums net of acquisition expenses, scheduled investment maturities, and net investment income. The principal uses of AORE's liquidity are for the payment of operating expenses, claims, ceding commissions, and for purchases of new investments and more recently funding commutation agreements. The Company believes that AORE's expected operating liquidity needs can be funded from its operating and investing cash flows for the next twelve months. See Note 14 – Noncontrolling Interest and Note 27 – Statutory Requirements, for further information regarding AORE's ability to pay dividends.

Some of the exposures the Company reinsures have been written by ceding companies as credit derivative contracts rather than financial guaranty insurance policies. Traditional financial guaranty insurance provides an unconditional and irrevocable guaranty of payment to the holder of a municipal finance or structured finance obligation of principal and interest on that obligation in the event of a non-payment by the issuer. In contrast, credit derivatives provide protection from the occurrence of specified credit events, which frequently include non-payment of principal and interest ("failure to pay"), but may also include other terms such as settlement of individual referenced collateral losses in excess of policy specific deductibles or subordination amounts. The credit derivatives that protect against failure to pay usually have settlement terms that require the ceding company to pay interest and principal shortfalls as they occur (referred to as "pay-as-you-go"). The Company may be deemed to have assumed reinsurance on credit derivative exposures that have other than "pay-as-you-go" terms. Although the Company considers the occurrence of such payments to be unlikely, the Company is at risk of unanticipated loss payments under insured credit derivative policies that could have an adverse effect on the Company's liquidity. Further, the ceding companies write credit derivatives that are governed by standard International Swaps and Derivatives Association ("ISDA") documentation which can include various events of default related to the primary insurer itself, such as insolvency of or a failure to pay by the primary insurer on any credit derivative with a particular counterparty, which would not typically trigger a payment obligation under traditional financial guaranty. If a credit derivative (or group of credit derivatives) is terminated upon an event of default, the primary could be required to make a mark-to-market payment(s) as determined under the ISDA documentation. While the Company does not believe that its reinsurance contracts obligate it to indemnify the primary insurers for mark-to-market payments resulting from their default under the ISDA documentation, the primary insurer or its regulator may allege that the Company is liable for its pro rata share of such payments and withdraw funds to pay such claims from the trust account for the benefit of that primary insurer.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

The underwriting of insured risks and the reporting of underwriting results to the Company are the responsibility of the primary insurers under the treaties. The Company leverages and relies on the operations and reporting of the primary insurers. As a result of this model, the Company is highly dependent on the operating and reporting of the ceding companies. The ceding companies often use complex financial models, which have been internally developed, to produce their results. The Company performs its own assessment of the reasonableness of the information provided by ceding companies (See Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives, Note 5 - Financial Guaranty Policies Accounted for as Reinsurance and Note 8 – Losses and Loss Expense Reserve, for details of the work completed by the Company on this information). However, depending on the nature of the information provided by the ceding company, the Company may not be able to identify errors in the reported information in the period in which it is reported, which may be material, as indicated by corrections of errors in primary reported information in prior period financial statements.

Exposure to Puerto Rico

The Company has reinsured exposure to general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$146.2 million net par as of December 31, 2015, all of which are rated BIG.

Puerto Rico has experienced significant general fund budget deficits in recent years. These deficits, until recently, were covered primarily with the net proceeds of bond issuances, interim financings provided by Government Development Bank for Puerto Rico (“GDB”) and, in some cases, one-time revenue measures or expense adjustment measures. In addition to high debt levels, Puerto Rico faces a challenging economic environment.

In June 2014, the Puerto Rico legislature passed the Puerto Rico Public Corporation Debt Enforcement and Recovery Act (the "Recovery Act") in order to provide a legislative framework for certain public corporations experiencing severe financial stress to restructure their debt, including Puerto Rico Highway and Transportation Authority ("PRHTA") and Puerto Rico Electric Power Authority ("PREPA"). Subsequently, the Commonwealth stated PREPA might need to seek relief under the Recovery Act due to liquidity constraints. Investors in bonds issued by PREPA filed suit in the United States District Court for the District of Puerto Rico challenging the Recovery Act. On February 6, 2015, the U.S. District Court for the District of Puerto Rico ruled the Recovery Act is preempted by the U.S. Bankruptcy Code and is therefore void. On July 6, 2015, the U.S. Court of Appeals for the First Circuit upheld that ruling, and on December 4, 2015, the U.S. Supreme Court granted petitions for writs of certiorari relating to that ruling. Oral arguments were heard on March 22, 2016. Typical Supreme Court practice suggests a decision could be announced in June 2016, but there is no assurance that an opinion will be announced at such time, especially in light of the recent Supreme Court vacancy.

On June 28, 2015, Governor García Padilla of Puerto Rico (the "Governor") publicly stated that the Commonwealth's public debt, considering the current level of economic activity, is unpayable and that a comprehensive debt restructuring may be necessary, and he has made similar statements since then. On June 29, 2015 a report commissioned by the Commonwealth and authored by former World Bank Chief Economist and former Deputy Director of the International Monetary Fund Dr. Anne Krueger and economists Dr. Ranjit Teja and Dr. Andrew Wolfe and calling for debt restructuring of all Puerto Rico bonds was released ("Krueger Report").

On September 9, 2015, the Working Group for the Fiscal and Economic Recovery of Puerto Rico (“Working Group”) established by the Governor published its “Puerto Rico Fiscal and Economic Growth Plan” (the “FEGP”). The FEGP projected that the Commonwealth would face a cumulative financing gap of \$27.8 billion from fiscal year 2016 to fiscal year 2020 without corrective action. Various stakeholders and analysts have publicly questioned the accuracy of the \$27.8 billion gap projected by the Working Group. The FEGP recommended economic development, structural, fiscal and institutional reform measures that it projects would reduce that gap to \$14.0 billion. The Working Group asserts that the Commonwealth's debt, including debt with a constitutional priority, is not sustainable. The FEGP included a recommendation that the Commonwealth's advisors begin to work on a voluntary exchange offer to its creditors as part of the FEGP. The FEGP does not have the force of law and implementation of its recommendations would require actions by the governments of the Commonwealth and of the United States as well as the cooperation and agreement of various creditors.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

On November 30, 2015, and December 8, 2015, the Governor issued executive orders (“Clawback Orders”) directing the Puerto Rico Department of Treasury and the Puerto Rico Tourism Company to retain or transfer certain taxes and revenues pledged to secure the payment of bonds issued by PRHTA, Puerto Rico Infrastructure Financing Authority (“PRIFA”) and Puerto Rico Convention Center District Authority (“PRCCDA”). On January 7, 2016 Assured Guaranty Ltd. and subsidiaries (“Assured”) sued various Puerto Rico governmental officials in the United States District Court, District of Puerto Rico asserting that this attempt to “claw back” pledged taxes and revenues is unconstitutional, and demanding declaratory and injunctive relief. The Puerto Rico credits insured by the Company impacted by the Clawback Orders are shown in the table “AORE Puerto Rico Portofolio” below.

On January 18, 2016 the Working Group published an updated FEGP that projected the cumulative financing gap beyond 2020 would continue to increase to \$63.4 billion without corrective action. The Working Group followed that up with the publication on February 1, 2016, of a proposal for a voluntary exchange of \$49.2 billion of tax supported debt into \$26.5 billion of new mandatorily payable base bonds and \$22.7 billion of growth bonds.

There have been a number of other proposals, plans and legislative initiatives offered in Puerto Rico and in the United States Congress aimed at addressing Puerto Rico’s fiscal issues. Among the responses proposed is a federal financial control board and access to bankruptcy courts or another restructuring mechanism. A draft of this response has been presented to the U.S. House of Representatives. The final shape and timing of responses to Puerto Rico’s distress eventually enacted or implemented by Puerto Rico or the United States, if any, and the impact of any such actions on obligations insured by the Company, is uncertain and may differ substantially from the recommendations of the Working Group or any other proposals or plans described in the press or offered to date or in the future.

S&P, Moody’s and Fitch Ratings have lowered the credit rating of the Commonwealth’s bonds and on its public corporations several times over the past approximately two years, and the Commonwealth has disclosed its liquidity has been adversely affected by rating agency downgrades and by the limited market access for its debt, and also noted it has relied on short-term financings and interim loans from the GDB and other private lenders, which reliance has constrained its liquidity and increased its near-term refinancing risk.

PREPA

As of December 31, 2015, the Company had \$3.5 million reinsured net par outstanding of PREPA obligations. In August 2014, PREPA entered into forbearance agreements with the GDB, its bank lenders, and bondholders and financial guaranty insurers (including Assured) that hold or guarantee more than 60% of PREPA’s outstanding bonds, in order to address its near-term liquidity issues. Creditors agreed not to exercise available rights and remedies until March 31, 2015, and the bank lenders agreed to extend the maturity of two revolving lines of credit to the same date. PREPA agreed it would continue to make principal and interest payments on its outstanding bonds, and interest payments on its lines of credit. It also agreed it would develop a five year business plan and a recovery program in respect of its operations. Subsequently, most of the parties extended these forbearance agreements several times.

On July 1, 2015, PREPA made full payment of the \$416 million of principal and interest due on its bonds, including bonds insured by Assured. However, that payment was conditioned on and facilitated by AGM and AGC agreeing, also on July 1, to purchase a portion of \$131 million of interest-bearing bonds to help replenish certain of the operating funds PREPA used to make the \$416 million of principal and interest payments. On July 31, 2015, Assured purchased \$74 million aggregate principal amount of those bonds; the bonds were repaid in full in 2016.

PRHTA

As of December 31, 2015, the Company had \$27.0 million reinsured net par outstanding of PRHTA (Transportation revenue) bonds and \$61.0 million net par of PRHTA (Highway revenue) bonds. In March 2015, legislation was passed in the Commonwealth that would have supported proposals involving the GDB and PRIFA and would have, among other things, strengthened PRHTA. The proposals involved the issuance of up to \$2.95 billion of bonds by PRIFA, but the Company believes the Commonwealth is no longer pursuing those proposals. In addition, PRHTA is one of the public corporations affected by the Clawback Orders.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

Municipal Finance Agency

As of December 31, 2015, the Company had \$54.2 million net par outstanding of bonds issued by the Puerto Rico Municipal Finance Agency (“MFA”) secured by a pledge of local property tax revenues. On October 13, 2015, Assured filed a motion to intervene in litigation between Centro de Recaudación de Ingresos Municipales (“CRIM”) and the GDB in which CRIM was seeking to ensure that the pledged tax revenues are, and will continue to be, available to support the MFA bonds. While Assured’s motion to intervene was denied, the GDB and CRIM have reported that they executed a new deed of trust that requires the GDB, as fiduciary, to keep the pledged tax revenues separate from any other GDB monies or accounts and that govern the manner in which the pledged revenues may be invested and dispersed.

The following table shows the Company’s insured exposure to general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations.

AORE Puerto Rico Portfolio

AORE Obligor Name	OS Par (\$ mm)
Puerto Rico Commonwealth	0.5
Puerto Rico Electric Power Authority	3.5
Puerto Rico Transportation	27.0
Puerto Rico Highway	61.0
Puerto Rico Highway and Transportation Authority Total	88.0
Puerto Rico Municipal Finance Agency	54.2
Grand Total	146.2

* Exposures subject to potential clawback by the Commonwealth.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

The following table shows the scheduled amortization of the AORE insured general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations. AORE reinsures payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. In the event that obligors default on their obligations, the Company would only be required to pay the shortfall between the principal and interest due in any given period and the amount paid by the obligors.

**Amortization Schedule of Puerto Rico Net Par Outstanding
and Net Debt Service Outstanding
As of December 31, 2015**

	Scheduled Net Par Amortization		Scheduled Net Debt Service Amortization
2016	\$ 9.4	\$	16.1
2017	7.8		14.7
2018	6.2		12.6
2019	8.4		14.5
2020	4.6		10.4
2021	3.4		9.0
2022	37.0		41.6
2023	1.1		4.6
2024	1.1		4.6
2025	0.9		4.2
2026-2030	20.2		34.8
2031-2035	31.6		39.7
2036-2040	14.3		15.2
Total	\$ 146.0	\$	222.0

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

19. BUSINESS COMBINATIONS

On June 26, 2013, OGL acquired voting control of AOG. This was accounted for as a business combination by OGL effective this date, and AOG's net identifiable assets acquired and liabilities assumed were restated to fair value. As further discussed in Note 2 (b), AOG adopted OGL's historical basis of accounting on acquisition of OGL on October 28, 2014. As a result the fair value adjustments related to OGL's acquisition of AOG are reflected in these consolidated financial statements. The fair value of identifiable assets acquired and liabilities assumed consisted of the following:

AOG Fair Value Estimates

As of June 30, 2013

(in \$'000s)

	<u>Historical Cost</u>	<u>Fair Value</u>
Cash and investments	240,966	240,966
Reinsurance balances	18,906	18,906
Deferred acquisition costs	27,020	-
Other Assets	7,138	7,138
Value of acquired business	-	(28,766)
Total assets	<u>294,030</u>	<u>238,244</u>
Loss reserves		
Unearned premium	22,316	85,604
Derivative liabilities	68,109	-
Series A preference shares	72,584	72,584
Other liabilities	59,700	8,955
Total liabilities	<u>717</u>	<u>717</u>
	<u>223,426</u>	<u>167,860</u>
Net assets	<u>70,604</u>	<u>70,384</u>
Non-controlling interest - preferred shares	<u>7,011</u>	<u>7,011</u>
Net assets attributable to common shareholders	<u>63,593</u>	<u>63,373</u>

AOG acquired OGL on October 28, 2014 by acquiring 100% of the outstanding common shares of that entity for total consideration valued at \$87.9 million, consisting of \$43.95 million in senior notes and the issuance of 28,364 common shares valued at \$43.95 million. In accordance with ASC 805-50, the excess of the purchase price over OGL's assets and liabilities of \$38.9 million has been recorded as a reduction of additional paid-in capital in equity in AOG's consolidated balance sheet.

As a results of this transaction, certain adjustments were made to shareholders' equity including an increase to noncontrolling interest, representing OACC Preference Shares, as the shares held by OGL in AOG as at the date of the change in control.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

20. VARIABLE INTEREST ENTITIES

OACM is a mutual insurance company that is owned by its policyholders; however, the Company effectively has complete control over OACM through the management contract in place between the two entities, and is therefore the primary beneficiary. The Company has determined that OACM is a variable interest entity and is included in these consolidated financial statements. The interests that OACM's policyholders have in its financial position are included as non-owned interest in VIE totaling \$0.3 million at December 31, 2014 and December 31, 2015.

Creditors have no recourse against the Company in the event of default by OACM nor does the Company have any implied or unfunded commitments to OACM. The Company's financial or other support provided to OACM is limited to its management services and original investment.

The following OACM balances have been included in the Company's consolidated financial statements at December 31, 2015 and 2014 with appropriate eliminations being made for intercompany balances:

	<u>2015</u>	<u>2014</u>
ASSETS:		
Cash	\$ 7,645,920	\$ 8,659,610
Premiums receivable	52,535,993	48,749,968
Reinsurance balances receivable	278,847,999	302,585,801
Other assets	175,125	48,169
Total assets	<u>\$ 339,205,037</u>	<u>\$ 360,043,548</u>
LIABILITIES:		
Unpaid losses and loss adjustment expenses	\$ 178,821,216	\$ 201,839,754
Unearned premium	91,643,999	92,990,750
Ceded premium payable	58,282,313	54,574,234
Payable to general agents	465,840	7,120
Funds withheld	3,709,119	3,589,986
Accounts payable and accrued expenses	658,870	1,460,887
Due to parent and affiliates	623,680	580,817
Total liabilities	<u>\$ 334,205,037</u>	<u>\$ 355,043,548</u>
EQUITY:		
Policyholders' surplus	\$ 300,000	\$ 300,000
Surplus debenture	4,700,000	4,700,000
Total equity	<u>\$ 5,000,000</u>	<u>\$ 5,000,000</u>
Total Liabilities and Equity	<u>\$ 339,205,037</u>	<u>\$ 360,043,548</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

21. ASSETS HELD IN, AND LIABILITIES RELATED TO, SEGREGATED ACCOUNTS

The Company through certain of its Bermuda and Barbados subsidiaries, maintained segregated accounts on behalf of certain clients. The business written through these segregated accounts is non standard auto quota share retrocessional business from other subsidiaries. The segregated accounts' assets and liabilities owned by an unrelated party are shown separately on the statements of financial position as assets held in, and liabilities related to, segregated accounts as of December 31, 2015 and 2014.

The segregated account owners are required to capitalize their accounts with cash. All retrocessions are done on a funds withheld basis, and the segregated accounts are credited with interest on the funds withheld. The owners of the segregated accounts are not permitted to withdraw funds from their accounts until all of the business written in their respective accounts has fully run off.

The operations of the sole segregated account owned by an unrelated party from its inception in May 2012 to its liquidation in September 2015 were as follows:

Net equity due to segregated account participants:

Net equity due to segregated account participants as of December 31, 2012	<u>\$ 752,920</u>
Net Loss	<u>(930,805)</u>
Net equity due from segregated account participants as of December 31, 2013	<u>\$ (177,885)</u>
Net Loss	(515,793)
Additional contributions	<u>860,192</u>
Net equity due to segregated account participants as of December 31, 2014	<u>\$ 166,514</u>
Return of contributed surplus	(166,514)
Net equity due to segregated account participants as of December 31, 2015	<u>\$ -</u>

	<u>2015</u>	<u>2014</u>
Reinsurance premiums earned	\$ -	\$ 2,067,540
Losses incurred	-	(2,069,241)
Acquisition costs	-	(479,100)
Investment income, net	-	3,257
Management fees	-	<u>(38,249)</u>
Total net income (loss)	<u>\$ -</u>	<u>\$ (515,793)</u>

During the year ended December 31, 2013, the Company commuted its reinsurance contracts and redeemed the underlying segregated cell owners. On June 26, 2013, the Board of Directors of the Company approved the deregistration of one of its segregated accounts companies and placed it in member's voluntary liquidation.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

22. BUSINESS CONCENTRATION

The Company's property casualty insurance subsidiaries, OACM and OA Indemnity, produce business through unrelated managing general agencies. In 2015, four of these managing general agencies produced approximately 59% of OACM's gross premium writings and 56% of the Company's property casualty gross written premiums. In 2015, one managing general agent produced approximately 90% of OAIC's gross premium writings and 3% of the Company's property casualty gross written premiums.

23. GOODWILL AND INTANGIBLE ASSETS

The Company performs its impairment analysis of goodwill and indefinite-lived intangible assets annually as of December 31.

In conjunction with the acquisition of OA Indemnity in 2010, OGL recorded intangible assets of \$300,000, representing the fair value of six insurance licenses acquired. The impairment analysis for this indefinite-lived intangible asset is performed on the licenses aggregated as a single unit of accounting. The fair value is determined by comparing the fair value of insurance company licenses based on observable inputs. Based upon the results of the assessment, the Company concluded that the carrying value of this intangible asset was not impaired as of December 31, 2015.

In conjunction with the acquisition of OACM in 2012, OGL recorded intangible assets and goodwill. The impairment analysis for the indefinite-lived asset of \$4,500,000 associated with the insurance license acquired was performed on this license as a unit of accounting separate from the insurance licenses of OA Indemnity. The fair value is determined by comparing the fair value of insurance company licenses, with the underlying assumption that OACM's license continues to represent the value of multiple insurance licenses due to its unique ability to operate under multiple rate filing structures within a single state. Based on the number of active managing agencies using multiple rate filings in OACM, the Company concluded that the carrying value of this intangible asset was not impaired as of December 31, 2015.

The impairment analysis was performed on OACM as the reporting unit. The fair value was determined using a discounted cash flow analysis for the revenues and operating expenses associated with this reporting unit. The fair value was compared to the carrying value of the goodwill and intangible assets net of accumulated amortization, and the fair value exceeded the carrying value of those items. Accordingly, it was determined that the carrying value of goodwill was not impaired as of December 31, 2015.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

23. GOODWILL AND INTANGIBLE ASSETS (cont'd)

The gross and net carrying amounts of intangible assets by major category as of December 31, 2015 and 2014 are as follows:

	<u>Gross</u>	<u>Accumulated Amortization</u>	<u>Net</u>
As of December 31, 2015			
Insurance licenses	\$ 4,800,000	\$ -	\$ 4,800,000
Customer relationships	12,100,000	12,100,000	-
Internally developed software	<u>350,000</u>	<u>350,000</u>	<u>-</u>
Intangible assets	<u>\$ 17,250,000</u>	<u>\$ 12,450,000</u>	<u>\$ 4,800,000</u>
As of December 31, 2014			
Insurance licenses	\$ 4,800,000	\$ -	\$ 4,800,000
Customer relationships	12,100,000	9,891,000	2,209,000
Internally developed software	<u>350,000</u>	<u>320,834</u>	<u>29,166</u>
Intangible assets	<u>\$ 17,250,000</u>	<u>\$ 10,211,834</u>	<u>\$ 7,038,166</u>

Insurance licenses are not amortized because they have an indefinite life. Finite-lived intangible assets are amortized over their respective useful lives. Customer relationships are amortized to align with the expected economic benefit of the income associated with those relationships, through 2015. Internally developed software is amortized on a straight-line basis over its useful life of 3 years. The management contract will expire on January 1, 2036. Unless renewed, the Company will not own the rights to manage OACM after that date.

24. NOTES PAYABLE

Prior to the amalgamation a subsidiary of OGL had outstanding debt (the "OACC Notes") which was renegotiated in connection therewith. The subsidiary issued a Senior Secured Note in the amount of \$20 million, which was to mature on October 28, 2039 (the "2014 OACC Notes"). Interest on the 2014 OACC Notes was payable in quarterly installments at a fixed rate of 12.0% per annum. Principal repayments of \$17.3 million were made in 2015 on the AOG Notes, of this repayment, \$15.7 million was to Directors and members of their respective families.

In 2015, a partial repayment of \$1.6 million of principal was made on the 2014 OACC Notes and a series of new Series A Secured Senior Notes (the "2015 OACC Notes") were issued to replace and supersede the note that had been previously issued. The aggregate principal amount of the 2015 OACC Notes after this payment was \$18.4 million. The notes will mature on January 1, 2040 and pay interest in quarterly installments at a fixed rate of 12.0% per annum. Principal repayments of \$1.9 million were made in 2015 OACC Notes. As of December 31, \$ 0.5 million in interest was accrued and unpaid on the remaining balance of the 2015 OACC Notes.

In connection with the acquisition of OGL, AOG issued \$43.9 million of Senior Notes (the "AOG Notes") to the former shareholders of OGL that mature on October 28, 2039. Interest on the AOG notes is payable in quarterly installments at a fixed rate of 9.0% per annum. As of December 31, 2015, \$0.5 million in interest was accrued and unpaid on the remaining balance.

Directors and members of their respective families held notes payable in the aggregate principal amount of approximately \$29.9 million at December 31, 2015.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

25. TAXATION

The Company has received an undertaking from the Bermuda government exempting it from all local income, withholding and capital gains taxes until March 31, 2035. At the present time, no such taxes are levied in Bermuda.

In September 2014, AOG and OGL each became tax resident in the U.K., although they will both remain Bermuda-based companies. As companies that are not incorporated in the U.K., each intends to manage their affairs in such a way as to establish and maintain status as tax resident in the U.K. As U.K. tax resident companies, both AOG and OGL are required to file corporation tax returns with Her Majesty's Revenue & Customs ("HMRC"). Each is subject to U.K. corporation tax in respect of its worldwide profits (both income and capital gains), subject to any applicable exemptions. The main rate of corporation tax is 20% currently; such rate fell from 21% as of April 1, 2015. The Company does not expect that AOG's or OGL's becoming U.K. tax resident will result in any material change in the group's overall tax charge. The Company expects that the dividends received by AOG or OGL from their direct subsidiaries will be exempt from U.K. corporation tax due to the exemption in section 931D of the U.K. Corporation Tax Act 2009. In addition, any dividends paid by AOG to its shareholders should not be subject to any withholding tax in the U.K. The U.K. government implemented a new tax regime for "controlled foreign companies" ("CFC regime") effective January 1, 2013. The Company does not expect any profits of non-U.K. resident members of the group to be taxed under the CFC regime.

AORE is registered as an Exempt Insurance Company carrying on general insurance business in accordance with the provisions of the Barbados Exempt Insurance Act 1983 ("Exempt Insurance Act"). AORE, as an Exempt Insurance Company, has received an undertaking exempting it from corporate taxation for the first fifteen financial years, commencing with 2013. After the first fifteen financial years AORE will be subject to corporate tax of 2% on the first \$0.13 million of its profits and 0% on any excess. AORE is further exempt from all other direct or indirect Barbados taxes on its profits and transfers of assets and securities, withholding taxes on dividends, interest or other returns payable to its shareholders.

We believe that our non-US companies are not engaged in trade or business in the U.S. and, accordingly, we do not expect those companies to be subject to U.S. taxation; however, certain of its subsidiaries are subject to U.S. taxation. Certain of its subsidiaries file a consolidated U.S. federal income tax return.

The provision for income taxes for the years ended December 31, consisted of the following:

	2015	2014
Current tax expense	\$ -	\$ -
Deferred tax expense	7,000	7,000
Net income tax expense	<u>\$ 7,000</u>	<u>\$ 7,000</u>

The expected tax provisions in taxable jurisdictions is calculated as the sum of pretax income in those jurisdictions multiplied by the statutory tax rate of the jurisdiction by which it will be taxed. Pretax income of the Company's subsidiaries which are not U.S. domiciled but are subject to U.S. tax by election are included at the U.S. statutory tax rate of 35%.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

25. TAXATION (cont'd)

	2015	2014
Net income before income tax expense	\$ 18,555,491	\$ 39,906,414
Adjustment for entities not subject to income tax	<u>(17,474,791)</u>	<u>(46,850,981)</u>
Net income (loss) subject to US income tax	\$ 1,080,700	\$ (6,944,567)
Taxes computed at the US federal statutory income tax rate	378,245	(2,430,598)
Changes in taxes resulting from:		
Valuation allowance	(396,216)	2,473,245
Other	<u>24,971</u>	<u>(35,647)</u>
Income tax expense	\$ 7,000	\$ 7,000
Effective tax rate	0%	0%

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

25. TAXATION (cont'd)

Tax effects of temporary differences that give rise to significant portions of the Company's deferred tax assets and deferred tax liabilities at December 31, 2015 and 2014 were as follows:

	2015	2014
Deferred tax assets:		
Net operating loss carryforward	\$ 8,147,855	\$ 8,039,167
Unearned premium reserves	48,135	1,182,670
Discounted unpaid losses and loss adjustment expenses	109,723	222,330
Goodwill and other intangible assets	<u>-</u>	<u>1,532,475</u>
Total deferred tax assets	<u>8,305,713</u>	<u>10,976,642</u>
Deferred tax liabilities:		
Deferred acquisition costs	33,537	30,502
Intangible Assets with permanent differences	<u>55,125</u>	<u>30,625</u>
	88,662	61,127
Deferred tax assets, net, before valuation allowance	8,217,051	10,915,515
Valuation allowance	<u>(8,254,676)</u>	<u>(10,946,140)</u>
Deferred tax liabilities, net	<u>\$ (37,625)</u>	<u>\$ (30,625)</u>

As of December 31, 2015, the Company had net operating loss carry forwards of \$23,279,585 the expiration of which is as follows:

2030	\$ 234,288
2031	\$ 103,767
2032	\$ 6,256,216
2033	\$ 8,173,931
2034	\$ 8,257,850
2035	\$ 253,533

As of December 31, 2015 and 2014, the Company has no tax positions for which management believes a provision for uncertainty is necessary. The Company's U.S. federal income tax returns for all tax years are subject to examination by the Internal Revenue Service.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

26. REINSURANCE

The Company has various quota share reinsurance agreements with reinsurers. The Company remains liable to its policyholders for all of its policy obligations and the reinsuring companies are obligated to the Company to the extent of the reinsured portion of the risks. Balances are presented gross of the reinsurance agreements in the accompanying consolidated financial statements.

Due to the nature of the OACM's reinsurance programs, a concentration of credit risk exists with four reinsurers that have net balances due in excess of 5% of OACM's total receivable balances in 2015. These four reinsurers account for approximately 40% of the total net recoverable from reinsurers, and 44% for 2014. OACM reinsures substantially all of its business, and monitors the credit quality of its reinsurers to ensure that its cessions are to financially sound reinsurers. Collateral which includes funds held in trust and letters of credit are obtained both to satisfy regulatory requirements for reinsurers not authorized, and to address the Company's credit concerns related to less highly rated reinsurers. 47% of the reinsurance balances OACM ceded as of December 31, 2015 were to reinsurers rated A or better. Substantially all of the balances ceded to reinsurers rated less than A are collateralized. During 2015 and 2014, OACM obtained collateral totaling \$165.4 million and \$173.0 million respectively, to offset the overall reinsurance credit risk. If the counterparties to these reinsurance contracts completely failed to perform under these contracts, which management believes is a remote possibility, the potential loss to the Company is the amount of the uncollateralized reserves for losses and loss adjustment expenses, reinsurance recoverable, and unearned premium net of reinsurance payable, which is approximately \$85.2 million as of December 31, 2015 as compared to \$94.2 million for 2014.

27. STATUTORY REQUIREMENTS

Each of the Company's insurance companies' ability to pay dividends depends, among other things, upon their financial condition, results of operations, cash requirements, compliance with rating agency requirements, and is also subject to restrictions contained in the insurance laws and related regulations of their state of domicile and other states. Financial statements prepared in accordance with accounting practices prescribed or permitted by local insurance regulatory authorities differ in certain respects from GAAP.

The Company's U.S. domiciled insurance companies are subject to risk-based capital standards and other minimum and capital and surplus requirements. The Company's U.S. domiciled insurance companies prepare statutory financial statements in accordance with accounting practices prescribed or permitted by the National Association of Insurance Commissioners ("NAIC") and their respective insurance departments. Prescribed statutory accounting practices are set forth in the NAIC Accounting Practices and Procedures Manual. The Company has no permitted accounting practices on a statutory basis. OA Indemnity is subject to NAIC risk based capital standards and other minimum capital and surplus requirements, including the laws of Kentucky. Kentucky laws provide that without prior approval of its domiciliary commissioner, dividends to shareholders may not be paid except out of the part of surplus funds which is derived from realized net profits. Surplus funds for the purposes of this calculation are defined as the excess of assets over liabilities, including capital stock as a liability. There are no other restrictions placed on the portion of OA Indemnity's profits that may be paid as ordinary dividends to its shareholder. As of December 31, 2015, OA Indemnity had statutory capital and surplus of \$9.7 million, which was in excess of any risk-based capital levels that would require corrective actions. As a Texas county mutual, OACM is not subject to NAIC risk based capital provisions. The minimum required capital and surplus of OACM is \$5 million as provided by Texas insurance law, which is the amount of capital and surplus of the entity as of December 31, 2015.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

27. STATUTORY REQUIREMENTS (cont'd)

The Company's Barbados domiciled insurance companies are required to maintain a minimum level of solvency under the Barbados Exempt Insurance Act 1983 (the "Exempt Insurance Act"). For the purpose of compliance with the solvency criteria under the Exempt Insurance Act, assets and liabilities are calculated in accordance with US GAAP. The Barbados domiciled insurance companies also must comply with the provisions of the Barbados Companies Act regulating the payment of dividends and making of distributions from contributed surplus. A company is prohibited from declaring or paying a dividend, if there are reasonable grounds for believing that: (a) the company is, or would after the payment be, unable to pay its liabilities as they become due or (b) the realizable value of the Company's assets would thereby be less than the aggregate of its liabilities and stated capital. The excess of AORE's assets over the aggregate of its liabilities and stated capital at December 31, 2015 was \$59.2 million. The minimum required solvency margin for AORE was \$2.5 million at December 31, 2015. The excess of the Company's other Barbados domiciled insurance companies' assets over the aggregate of their liabilities and stated capital was \$6.9 million. The minimum required solvency margin for those entities was \$2.0 million.

The Bermuda domiciled insurance companies are required to prepare statutory financial statements and to file statutory financial returns annually under The Bermuda Insurance Act of 1978, amendments thereto and regulated regulations (the "Act"). The Act also requires the companies to meet certain measures of solvency and liquidity during the year or period. The statutory capital and surplus for the Company's Bermuda domiciled insurance companies was \$3.2 million as of December 31, 2015, and its minimum required statutory capital and surplus under the Act was \$0.9 million.

AOG must comply with the provisions of the Bermuda Companies Act regulating the payment of dividends and making of distributions from contributed surplus. A company is prohibited from declaring or paying a dividend, or making a distribution out of contributed surplus, if there are reasonable grounds for believing that: (a) the company is, or would after the payment, be unable to pay its liabilities as they become due or (b) the realizable value of the company's assets would thereby be less than its liabilities. The Board of Directors of AOG will evaluate any dividends in accordance with this test (and any other restrictions as discussed in Note 14 – Non-controlling interest) at the time such dividends are declared.

28. SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 15, 2016, which is the date the financial statements were issued.

Subsequent to year end there have been ongoing developments related to Puerto Rico's ability to meet its future debt obligations. Through the date of the financial statements, AORE has been notified by its cedant, Assured, of an increase of approximately 10%, or \$1.6 million, in the Puerto Rico-related reserves ceded to AORE. The potential for significant volatility due to future events continues to exist in Puerto Rico exposures reinsured by AORE.