



AMERICAN OVERSEAS GROUP LIMITED

2017 ANNUAL REPORT



**American Overseas Group
Limited**

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Dear Shareholders,

I am pleased to report the results of American Overseas Group Limited (the “Company,” “we” or “us”) for the year ending December 31, 2017. As discussed in previous years, we manage insurance and reinsurance companies that are comprised of two general categories: (1) the active U.S. based insurance companies, which specialize in non-standard auto insurance, along with their affiliated off-shore reinsurers in Barbados; and, (2) the legacy financial guaranty reinsurance company, based in Barbados, which has been in voluntary run-off since the financial crisis in 2009.

The U.S. based non-standard auto business continued to generate moderate premium growth during 2017. Our Texas company, Old American County Mutual Fire Insurance Company (OACM), which holds a unique, Texas-only “County Mutual” license, operates through multiple MGA partners in the State. OACM continues to see steady growth, as it has over the past few years, both due to a long stretch of rate increases as well as a growing population in the customer base it serves. For the year ended 2017, OACM produced direct written premiums of approximately \$397 million. In addition, we entered into several new MGA agreements during 2017. We expect both rate increases, population growth in our customer base and new MGA partnerships to continue into the near future.

Outside of Texas at Old American Indemnity Company (OAIC), we continue to expand our footprint in the same non-standard auto insurance niche, essentially following the same fee-based business model, with the slight nuance of retaining a small portion of the underwriting risk. However, in contrast to the Texas-only County Mutual license, our licenses outside of Texas are traditional property/casualty licenses, which effectively limit us to a single MGA partner in each state. During 2017, OAIC entered Utah with an existing business partner and is engaged in identifying qualified MGAs in states outside of Texas that exhibit viable characteristics in the non-standard auto insurance space. Also, we plan to seek additional licenses and expand our writings of non-standard auto business into states where we receive inbound interest from prospective business partners.

We continue to manage the run-off of the legacy financial guaranty (FG) reinsurance business in American Overseas Reinsurance Company Ltd. (AORE). In 2017, the FG book declined by 35% from par outstanding of \$3.57 billion to \$2.32 billion. This reduction was partly due to normal attrition, and also due to the commutation of approximately \$400 million par. With this commutation, we not only reduced our risk exposure, but also benefitted from a gain to income and the release of funds held in a trust account to support the reinsurance exposure.

Our most significant risk exposure in the legacy FG business continues to be our reinsurance of Puerto Rico insured bonds. As of December 31, 2017, our total Puerto Rico par outstanding was \$132.4 million consisting primarily of bonds issued by the Puerto Rico Highway and Transportation Authority (PRHTA) and the Municipal Finance Authority (MFA) in the amount of \$91.5 million and \$36.9 million, respectively. The PRHTA exposure breaks down further into \$61.0 million and \$30.5 million of “Highway” and “Transportation” bonds, respectively, and are backed by various special revenues.

As of December 31, 2017, we had less par outstanding exposures to the Puerto Rico Electric Power Authority (PREPA) and the Commonwealth General Obligation (GO) bonds, consisting of \$3.5 million and \$0.5 million, respectively. Our total Puerto Rico par outstanding at year-end 2017 reflected a reduction during the year of \$7.8 million due to principal payments on the MFA bonds. All other Puerto Rico par amounts remained the same.

Beginning January 1, 2016, a number of Puerto Rico credits defaulted on bond payments. As a result, we have now paid claims on all of our exposures except MFA (and we have paid loss adjustment expenses (LAE) on MFA). As of December 31, 2017, we have paid cumulative claims and LAE totaling \$3.5 million on all Puerto Rico exposures. As discussed further below, PRHTA, PREPA and the Commonwealth GOs have each filed for a form of bankruptcy protection (Title III) pursuant to the legislation passed by the U.S. Congress in 2016, while our MFA exposure has not.

In last year's letter, I discussed the background and context of the financial crisis in Puerto Rico, which has its roots going back more than a decade. The causes of the Puerto Rico's crisis stem largely from fiscal mismanagement by successive governments in Puerto Rico and excessive borrowing, particularly borrowing to meet operating expenses. Instead of working to control spending to meet existing obligations, over several years, Puerto Rico's leaders created an extensive and complex debt structure to incur excessive debt, consisting of 18 different government agencies that issued different securities with different collateral and sometimes conflicting and competing revenue sources. The weakness of Puerto Rico's economy over the years was further exacerbated by the 2008 financial crisis and its aftermath, including a shrinking population, as many Puerto Rico residents, who are U.S. citizens, left the island due to high unemployment and the lack of economic growth.

To deal with the worsening debt crisis in Puerto Rico, in June 2016 the U.S. Congress passed the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA), which mandated the formation of an oversight board (Oversight Board) to attempt to work through Puerto Rico's financial situation and essentially do what Puerto Rico's governmental leaders had been unable to accomplish.

The intention of Congress, as stated by the Congressmen who enacted PROMESA, was to allow Puerto Rico to file a form of bankruptcy under Title III of the Act, but only after all consensual negotiations with creditors mandated under Title VI of the Act were pursued and failed. Title III of PROMESA provides for a process analogous to a voluntary bankruptcy process under Chapter 9 of the United States Bankruptcy Code. Unfortunately, the Oversight Board ignored the intent of Congress and filed Title III bankruptcy for the Commonwealth and other entities right after a short stay on lawsuits expired, without pursuing negotiations with creditors in any meaningful way. As mentioned, the Title III filings include our exposure to PRHTA, PREPA and the Commonwealth GOs. MFA remains outside of Title III.

In March 2017 the Oversight Board approved the original fiscal plan prepared by the Commonwealth. Shortly thereafter the Oversight Board approved original fiscal plans for other entities such as PRHTA and PREPA. The approval of these plans and the actions taken by the Commonwealth, the Oversight Board and others with respect to the obligations we reinsure (and

others) have led to extensive litigation as many of such actions have been challenged as illegal and/or unconstitutional. Many bond insurers and several creditors have taken legal action to enforce their rights with respect to these matters.

In May 2017 Judge Laura Taylor Swain of the Southern District of New York was selected by Chief Justice John Roberts of the United States Supreme Court to preside over the Title III cases and any legal proceedings under PROMESA. Judge Swain has selected a team of five federal judges to act as mediators for certain issues and disputes.

On September 20, 2017, Hurricane Maria struck Puerto Rico as a Category 4 hurricane, causing loss of life and widespread devastation. The damage to the Commonwealth's infrastructure, including the PREPA power grid, the PRHTA transportation system and other island infrastructure, was extensive, and interrupted the ongoing efforts to resolve the Commonwealth's financial issues under PROMESA. The federal government is expected to provide substantial resources for relief and rebuilding, which is expected to help economic activity and address the Commonwealth's infrastructure needs in the intermediate and longer term. Since the Hurricane, however, economic activity in general, and tourism in particular, as well as tax collections, have declined, and outbound migration to the mainland also has increased.

In early 2018, with the recovery from Hurricane Maria emerging, the Commonwealth released revised fiscal plans for itself and for a number of its entities, which were further revised and re-released in April following notices of violation from the Oversight Board and enactment of significant federal disaster relief. The Oversight Board did not agree with the Commonwealth on the final fiscal plan and, in turn, released and certified its own version of the fiscal plan in late April. More recently, additional adjustments were made to reduce the surplus to an unspecified amount, with such adjustments subject to litigation between the Commonwealth and the Oversight Board.

The Oversight Board again approved the latest fiscal plans without collaborating with creditors and in violation of many PROMESA requirements. It seems the Commonwealth and the Oversight Board have not changed their strategy regarding indebtedness. They continue to take aggressive and unjustified legal stances and to withhold financial information from creditors with the apparent goal of obtaining the largest reduction of indebtedness possible. They ignore provisions of the U.S. and Puerto Rico Constitutions, invoke arbitrary claw-back provisions and disregard the requirements of PROMESA to "respect the relative lawful priorities or lawful liens, as may be applicable, in the constitution, other laws, or agreements of a covered territory or covered territorial instrumentality in effect prior to the date of enactment."

For example, the Commonwealth, supported by the Oversight Board, has ignored provisions in the US Bankruptcy Code which were specifically included in PROMESA. Certain revenues (e.g., tolls) clearly meet the legal requirements of "special revenues" which are protected through the provisions of the Bankruptcy Code included in PROMESA. As such, special revenue liens cannot be stayed during the bankruptcy proceedings and should survive the bankruptcy. PRHTA has ignored the presence of this lien and has taken the toll revenues for its general use.

The extra-legal actions taken by the Commonwealth and the Oversight Board are likely to be subject to protracted and expensive litigation as creditors ranging from institutions to coalitions of individual investors and retirees seek to protect their lawful rights. Particularly disturbing is that the latest certified fiscal plan calls for the expenditure of over \$1.5 billion of restructuring costs through fiscal 2023, which presumably includes litigation costs. The Title III “plan of adjustment” filings are anticipated to be considered by Judge Swain in the coming months, but are not anticipated to be fair to creditors and should be rejected by the Court. If approved, further litigation is anticipated.

Thus, the future course and timing of the resolution of the Puerto Rico financial crisis remains highly uncertain largely due to a lack of collaboration and the political motivations of the Commonwealth and the Oversight Board. As long as these parties continue to take actions in conflict with PROMESA, the U.S. and Puerto Rico Constitutions, and the rule of law, the citizens of Puerto Rico will continue to bear exorbitant legal costs and an extended period of uncertainty that will limit access to the capital markets and the economic growth and prosperity of the Commonwealth. We can only hope that they will recognize the benefits of good faith negotiations and settlement efforts with creditors who stand ready to support Puerto Rico’s growth and prosperity over the long run.

In 2018, we will continue monitoring the developments in Puerto Rico, and will pursue any economically viable options to mitigate our FG exposures. We will also seek to enhance shareholder value by continuing the profitable growth of our fee-based specialty insurance business and to ensure that expenses are in line with current revenues and business needs. As part of our ongoing capital management efforts, the Company will continue to redirect excess capital within the group to debt reduction unless other compelling opportunities present themselves.

Sincerely,

A handwritten signature in cursive script that reads "Debra J. Roberts". The signature is written in black ink and is positioned to the left of the typed name.

Debra J. Roberts
President and Chief Executive Officer

Note on Forward-Looking Statements

Various statements contained in this Annual Report, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may include projections and estimates concerning the timing and success of specific projects and the Company's future production, revenues, income and capital spending. The Company's forward-looking statements are generally, but not always, accompanied by words such as "estimate," "believe," "expect," "anticipate," "would," "will," "may," "plan," "goal," "target," "could," "continue," "intend" or other words that convey the uncertainty of future events or outcomes. While the Company's management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond the Company's control.

Examples of forward-looking statements include the plans and objectives of management for future operations, including those relating to future growth of our business, and are based on current expectations that involve assumptions that are difficult or impossible to predict accurately and many of which are beyond our control. There can be no assurance that actual developments will be those anticipated by us, and therefore you are cautioned not to place undue reliance on such statements. Actual results may differ materially from those expressed or implied in these statements as a result of significant risks and uncertainties, including, but not limited to, our ability to recover from our capacity providers, the cost and availability of reinsurance coverage, challenges to our use of issuing carrier or fronting arrangements by regulators or changes in state or federal insurance or other statutes or regulations, our dependence on a limited number of business partners, our ability to compete effectively, our ability to continue to compete without a financial strength rating of our insurance subsidiaries, our ability to accurately underwrite and price our products and to maintain and establish accurate loss reserves, changes in interest rates or other changes in the financial markets, the effects of emerging claim and coverage issues, changes in the demand for our products, the effect of general economic conditions, breaches in data security or other disruptions with our technology, and changes in pricing or other competitive environments.

Forward-looking statements involve inherent risks and uncertainties and the Company cautions readers that various factors could cause its actual financial and operational results to differ materially from those indicated by forward-looking statements made from time-to-time in news releases, reports, proxy statements, registration statements, and other written communications, as well as oral statements made from time-to-time by representatives of the Company. Those and other important factors, including those contained in this Annual Report, may cause our actual results, performance or achievements to differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements. The forward-looking statements contained in this Annual Report speak only as of the date hereof, and the Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

Business

History

American Overseas Group Limited (“AOG”) was incorporated on January 28, 1998, under the laws of Bermuda. AOG was originally organized to operate a mono-line financial guaranty reinsurance subsidiary which was subsequently placed in voluntary run-off in 2009.

On May 2, 2006, AOG completed an initial public offering (“IPO”), and AOG’s common shares were thereafter traded on the NASDAQ Global Market. Effective May 14, 2009, AOG’s common shares were voluntarily delisted from the NASDAQ Global Market and thereafter have traded on the Pink Sheets. In addition, AOG obtained a primary listing on the Bermuda Stock Exchange effective May 14, 2009.

AOG and Orpheus Group Ltd. (“OGL”) came under common control on June 26, 2013 and, on October 28, 2014, AOG acquired all of the outstanding stock of OGL for a combination of Senior Notes and AOG common stock. In this Annual Report AOG, OGL and all of its subsidiaries are referred to as the “Company,” “we,” “us” or “our.”

Our Businesses

Our business group comprises the following categories:

1. U.S.-based property and casualty insurance companies that provide non-standard auto insurance through specialty managing general agents (“MGAs”)
2. Barbados-based affiliated reinsurance companies that assume a small portion of the U.S.-sourced non-standard auto business
3. U.S and Bermuda-based management services companies
4. Barbados-based legacy financial guaranty reinsurance company, in voluntary run-off since 2009

The primary source of our active property and casualty business consists of two U.S. operating subsidiaries: Old American County Mutual Fire Insurance Company (“OACM”), a Texas insurance company that is licensed to write certain property and casualty business under the unique Texas-only county mutual license, and Old American Indemnity Company (“OAIC”), an admitted carrier domiciled in Kentucky that is licensed to write property and casualty insurance in 14 states, both of which are managed exclusively by us. These companies specialize in the niche of non-standard automobile insurance sold through MGAs and operate principally on a fee-based business model.

Our fee-based model means that, unlike traditional insurance companies, we generate the majority of our income from fees, not underwriting profits. Our business generates fee income based upon underwriting volume, by offering issuing carrier capacity to specialty MGAs who sell, control, and administer books of insurance business that are supported by reinsurance. At OACM, we do not retain any underwriting risk, which means that we cede 100% of the business written into the reinsurance market. At OAIC, we retain a small portion of the underwriting risk, and then cede half of that retention to one of our affiliated reinsurers.

Our affiliated reinsurers provide reinsurance capacity primarily to OAIC, and on a very limited basis to certain MGA programs written by OACM. Such reinsurance is provided through our Barbados-based reinsurance subsidiary as well as through segregated accounts of our Barbados segregated account reinsurer.

Our management services subsidiaries provide services to OACM, OAIC, and American Overseas Reinsurance Company Limited (“AORE”). Our management companies are based in the U.S. and Bermuda. While the fees for providing services to our regulated subsidiaries are eliminated from income in our GAAP consolidation, they represent a substantial stream of cash flow that is available within the Company outside of the normal dividend restrictions imposed by local regulation.

Our legacy financial guaranty reinsurance company, AORE is based in Barbados and has been in voluntary run-off since 2009.

U.S. Property and Casualty Insurance Companies

The Role of MGAs:

We provide access to U.S. property and casualty insurance underwriting capacity in the specialty niche of non-standard auto insurance through MGAs for a fee. This fee is generally based upon underwriting volume (gross written premium plus policy fees). MGAs who specialize in non-standard auto insurance and seek our fee-based underwriting capacity are generally in one of the following categories:

- MGAs writing specialized books of business supported by reinsurers; or
- MGAs affiliated with insurance companies seeking a fronting arrangement for the following reasons:
 - Their insurers have access to origination but require access to licensing in our states;
 - Their insurers wish to utilize OACM’s county mutual licensed authority to impose rating surcharges for insureds’ driving violations and other undesirable risk characteristics.

Our business model relies on our MGAs to provide the infrastructure associated with providing underwriting policy administration, claims handling, cash management and other services traditionally associated with insurance companies. As a result, our gross written premiums and fees are scalable. Significant additional premium volume can be generated with minimal incremental expense.

Our business model also relies upon significant risk mitigation practices. We cede substantially all of the underwriting risk at OACM and retain a small percentage of the underwriting risk at OAIC. We remain exposed to the credit risk of the reinsurers, including the risk that one of our reinsurers becomes insolvent or otherwise unable or unwilling to pay claims. To mitigate this credit risk, we have established financial criteria for selecting reinsurers as well as comprehensive methodologies, collateral arrangements and monitoring systems. To mitigate the financial and operational risks associated with MGAs, we have several risk mitigation procedures and requirements in place.

Business Philosophy:

We recognize that there are significant potential risks associated with a business model that relies upon third parties to underwrite, administer and handle claims on the insurance policies we provide. However, we approach this business opportunity with the fundamental goal of building long term partnerships with both our MGAs and third party reinsurers. We strive to avoid any MGA or reinsurer who is aiming for rapid growth based solely on generating premium volume because of the obvious pitfalls, such as problems with policy service, claims handling and customer service that can occur from that type of approach. We believe that it is critically important to select MGAs and reinsurers who have a long-term commitment to this product niche and who adhere to our standards of managing their business.

As part of our MGA selection process, we perform extensive due diligence on our prospects. Once selected, we perform regular audits to ensure that the MGAs are managing their programs in accordance with our MGA agreements and expectations. We emphasize to our MGAs the importance of producing a profitable book of business that will garner and retain support from the reinsurance market.

We also cultivate long-standing relationships with our reinsurance partners, and meet directly with senior management on a regular basis to ensure clear and direct communication between our reinsurance partners and our executive team. We share the results of our regular MGA audits with both the MGAs and the reinsurers, so that there is regular and consistent communication between all business partners involved.

Our experienced professional management team offers substantial resources to our MGAs in the form of value-added services, such as: advice and assistance with general business expertise and the necessary IT system requirements, support with product design and rate filings, review and approval of reinsurance submissions, and monitoring of regulatory compliance matters. Our senior management team has substantial experience in the specialized niche of non-standard auto business as well as the broader property and casualty insurance and reinsurance industry. Biographies of the senior executive team can be found under “Directors and Executive Officers Information.”

Contractual Relationships with MGAs and Reinsurers:

In connection with writing non-standard auto business, we enter into agency and reinsurance agreements with the MGAs and the reinsurers. In some cases, the MGAs and the reinsurers for a program are part of the same organization or are otherwise affiliated. The MGA generally is the party that will handle the marketing and underwriting of the policies (subject to certain limitations), the overall administration of the business, including preparing reports and fiduciary responsibilities (e.g. collecting premiums, paying commissions, losses and loss adjustment expenses, assessments) required pursuant to the applicable agreements, and handling of claims (up to certain limits as set forth in the specific program).

As a result of our contract design, substantially all of the underwriting risk and business risk inherent in the arrangement is borne by the reinsurers. We have residual exposure to Extra Contractual Obligations and Excess of Policy Limits Losses (ECO and XPL), when such amounts exceed the limits stated in our program reinsurance contracts, and we have purchased additional reinsurance coverage for such exposure.

We regularly review and update the minimum capital and ratings requirements for our reinsurers. We also review historical financial results of proposed reinsurers to assess financial stability. Some MGAs have affiliated insurance carriers that serve as reinsurers on the programs fronted by us. If such a reinsurer does not meet our standard selection criteria, we can engineer adequate security through a number of risk mitigating requirements, such as letters of credit and trust agreements. We monitor our collateral on a regular basis and set our collateral requirements to limit our credit exposure.

Our contracts relating to collateral typically provide for changes in the level of collateral required based on estimates of reinsurance recoverables. As of December 31, 2017, we held \$226.6 million in collateral against \$250.1 million in total reinsurance recoverable, which includes recoverables from highly-rated domestic reinsurers that are not required to provide collateral.

Geographic Distribution and Licensing:

To date, we have predominantly written our business through OACM in the state of Texas. In 2017 OACM was the twelfth largest auto insurer in the state¹. OACM is only licensed to write business in Texas, and possesses a unique and valuable license which allows it to submit multiple rate filings to the Texas Department of Insurance, its regulator. This allows OACM to appoint multiple MGAs, each of which can submit one or more rate filings through OACM. This enables each of the MGAs to produce business through their own distribution channel in the name of OACM, but each MGA program remains independent to all of the other business written by other MGA producers. In addition, county mutual licenses have certain competitive advantages which include surcharge rating flexibility and effective exemption from Texas Automobile Insurance Plan Association (TAIPA) assignments for assigned risk auto business via earned credits for the non-standard auto policies written.

OAIC operates outside of Texas, and is currently writing non-standard auto business in Georgia, Oklahoma, and Utah. OAIC is licensed in fourteen states, and is expected to continue to add new MGA programs each year as part of its growth strategy. Unlike the unique license held by OACM, the license of OAIC only allows one rate filing per state, therefore OAIC writes through a single MGA in each state.

Affiliated Reinsurance Business

Our affiliated reinsurance companies provide reinsurance capacity for a portion of the retained underwriting risk of OAIC and to a small number of selected MGA programs of our U.S.-based non-standard auto insurance business. Such reinsurance is provided through our Barbados-based reinsurance subsidiary as well as through segregated accounts of our Barbados segregated account reinsurer.

We have assessed our overall risk appetite for underwriting risk, and have determined to participate in the U.S.-sourced non-standard auto risk on a limited basis for the foreseeable future.

Management Services Business

Business Overview:

We own management services companies in the U.S. and Bermuda, which comprise our Management Services business. The Management Services business operates our own regulated subsidiaries based in the U.S. and Barbados.

Management Contracts With Regulated Affiliates:

The Management Services business has an exclusive management contract with OACM which expires on January 1, 2036. The OACM management contract is transferable, subject to regulatory approval. The OACM management contract provides that the fee earned by the Management Services business is calculated and settled on a monthly basis. Besides the management fee paid to the Management Services business, OACM generally incurs direct expenses for actuarial, audit and legal fees.

The Management Services business is also party to a management contract for OAIC. The fee earned by the Management Services business under the OAIC management contract is settled quarterly.

¹ Source: SNL Financial and NAIC Annual Statements

The Management Services business has also provided services to our financial guaranty reinsurer since 2010. The contract with AORE provides that AORE will pay an arms-length fee using hourly rates that are comparable to other sophisticated captive managers based in Bermuda.

Financial Guaranty Reinsurance Business

AORE was formed by the Company in Bermuda on January 28, 1998 and initially operated as a mono-line financial guaranty reinsurer. In 2009, AORE was placed in voluntary run-off. AORE re-domesticated from Bermuda to Barbados on December 7, 2012 after substantially reducing its financial guaranty exposure. In connection with the re-domestication, AORE received approval of the Barbados Financial Services Commission (“the Barbados FSC”) for licensing as an Exempt Insurance Company in accordance with the provisions of the Barbados Exempt Insurance Act 1983. Prior to the re-domestication, AORE received confirmation of a no objection from the Bermuda Monetary Authority’s Insurance Division in accordance with the Insurance Act 1978 and filed a notice of discontinuance under the Companies Act 1981, which was approved by the Bermuda Minister of Finance.

AORE no longer writes financial guaranty business and its legacy book of financial guaranty exposure remains in run-off, which will likely take many years to complete. AORE assumed financial guaranty reinsurance through both quota share and facultative reinsurance agreements. The financial guaranty business assumed by AORE generally provided for guarantees of scheduled principal and interest payments on an issuer’s obligations in accordance with the obligations’ original payment schedule. All of AORE’s remaining exposure was assumed from a single group of companies, Assured Guaranty Ltd. (“Assured”). During 2017, insured par (net of escrowed transactions) decreased 30% from \$3.0 billion to \$2.1 billion. This compares to outstanding par of approximately \$50 billion when AORE entered voluntary run-off in 2009.

While AORE still has significant exposure to several troubled credits, its below investment grade exposure declined 26% in 2017, from \$283 million to \$209 million. Various bonds issued by Puerto Rico totaling \$132.4 million represent 61.2% of our remaining below investment grade exposure. The situation in Puerto Rico became more severe during 2016, when the commonwealth publicly announced it was unable to meet its financial obligations. In June 2016, the U.S. Congress passed the PROMESA Act to address the worsening debt crisis in Puerto Rico. An important feature of this legislation was the formation of an oversight board of qualified individuals to formulate a solution to the growing financial crisis in Puerto Rico. Ultimately, in May and July of 2017, most of the entities that had issued bonds filed for legal protection under Title III of PROMESA, which is similar to bankruptcy, even though technically territories of the U.S. are not allowed to file for bankruptcy. Both the Commonwealth of Puerto Rico and the oversight board have released various fiscal plans. Legal challenges have ensued regarding the implementation of those plans, as well as creditor’s rights related to Title III protections. Litigation and mediation related to these matters has been delayed by the impacts of Hurricane Maria, and the final forms of resolution for these matters, and the ultimate impact on obligations reinsured by the Company, are uncertain.

Capital Resources

AOG had \$6.0 million of Senior Notes outstanding as of December 31, 2017. In addition, the U.S. property and casualty business had \$10.5 million of Senior Secured Notes outstanding at our U.S. holding company. The Company believes that its existing resources will be sufficient to service these obligations for the foreseeable future.

The Company also had \$58.6 million par of Series A Preference Shares and AORE had \$37.3 million liquidation value of Class B Preference Shares outstanding as of December 31, 2017. We have reduced the carrying values of both of these classes of preferred stock in our financial statements in accordance with U.S. GAAP. We have also established a separate trust for each of these classes of preferred stock with assets that we believe will be sufficient to repay the par (or liquidation value as the case may be) in accordance with the terms of these securities.

The highlights of the above securities are as follows:

AOG Senior Notes:

The Company had \$6.0 million of Senior Notes outstanding at December 31, 2017. These notes bear interest at 9.0% per annum which is payable quarterly. No principal is due until maturity on October 28, 2039. Principal can be prepaid at any time without penalty.

U.S. Property and Casualty Senior Secured Notes:

Our U.S. holding company subsidiary had \$10.5 million of Senior Secured Notes outstanding at December 31, 2017. These notes bear interest at 12.0% per annum which is payable quarterly. No principal is due until maturity on January 1, 2040. Principal can be prepaid at any time without penalty.

AOG Series A Preference Shares:

AOG had 58,600 Series A Preference shares (the "Series A shares") outstanding as of December 31, 2017. The Series A shares have a liquidation preference of \$1,000 per share and mature on December 15, 2066. Dividends have not been paid on the Series A shares since 2008. Unpaid dividends are not cumulative. The Series A shares were valued at \$150 per share by an independent third party as of June 26, 2013 and our carrying value of the Series A shares was adjusted to that valuation as of that date. The \$850 per share valuation adjustment will be accreted at 3.61% through maturity for accounting purposes. The carrying value of the Series A shares was \$175.98 per share at December 31, 2017.

The Company established an irrevocable trust for the benefit of the holders of the Series A shares on February 14, 2014 (the "Series A Trust"). An initial contribution of \$3.0 million was made to the Series A Trust on that date. This contribution assumes a 5.8% return compounded annually until the mandatory redemption date. The assets of the Series A Trust were invested in a global equity index fund. The Company expects that the assets in the Series A Trust will be sufficient to meet its obligation to the holders of the Series A shares at the mandatory redemption date, December 15, 2066. The Company is authorized to use assets in the Series A Trust to redeem Series A shares at any time for an amount not in excess of a holder's pro-rata share of the assets in the Series A Trust as of the date of any such redemption. The value of the assets held in the Series A Trust was \$68.72 per Series A share at December 31, 2017.

On February 1, 2018 AOG completed a private repurchase of \$20M liquidation value of 20,000 of its Series A Preference Shares from an undisclosed holder.

AORE Class B Preference Shares:

AORE had 373.01 Class B Preference shares (the "Class B shares") outstanding as of December 31, 2017. The

Class B shares carry a 6.276% dividend, have a liquidation preference of \$100,000 per share and are perpetual. Dividends on the Class B shares, which had been suspended between mid-2009 and mid-2014, were reinstated in 2014 through December 15, 2015. On February 23, 2016, AORE announced that it had suspended the dividend on the Class B shares to ensure liquidity to meet its operational needs. Unpaid dividends are not cumulative. The Class B shares were valued at \$16,228.46 per share when they were issued in 2009. The \$16,228.46 per share value is reflected as non-controlling interest in preferred shares of subsidiary in the financial statements.

AORE established an irrevocable trust for the benefit of the holders of the Class B shares on July 15, 2014 (the "Class B Trust"). An initial contribution of \$2.0 million was made to the Class B Trust on that date. The assets of the Class B Trust were invested in a global equity index fund. The Company is authorized to use assets in the Class B Trust to redeem Class B shares at any time for an amount not in excess of a holder's pro-rata share of the assets in the Class B Trust as of the date of any such redemption. The value of the assets held in the Class B Trust was \$6,921.01 per Class B share at December 31, 2017.

The Company considers the Class B shares as part of the permanent capital of AORE and intends to use this capital to support the business of AORE.

Selected Five Year Financial Data

The following tables set forth our selected historical consolidated financial information for the periods ended and as of the dates indicated. These selected historical consolidated results are not necessarily indicative of results to be expected in any future period. You should read the following selected financial information together with the other information contained in this report, including the consolidated financial statements and related notes included herein.

Selected Five Year Financial Data

(\$ in millions, except for share information)	For The Years Ended				
	2017	2016	December 31 2015	2014	2013
OPERATING RESULTS					
Gross written premium	\$ 422.0	\$ 426.3	\$ 385.0	\$ 418.3	\$ 224.9
Net written premium	7.0	9.3	15.4	30.6	36.1
Fee income	11.5	12.1	12.5	12.8	6.3
Premiums earned	\$ 1.9	\$ 3.1	\$ 6.4	\$ 36.3	\$ 35.8
Net loss and loss adjustment expenses	(19.8)	(14.3)	(11.6)	(12.7)	(31.2)
Acquisition costs	(0.4)	(0.7)	(0.9)	(6.9)	(9.3)
Underwriting gain (loss)	<u>\$ (18.3)</u>	<u>\$ (11.9)</u>	<u>\$ (6.1)</u>	<u>\$ 16.7</u>	<u>\$ (4.7)</u>
Net par outstanding, net of escrowed transactions	2,132	3,007	4,680	6,169	7,615
Net debt service outstanding	3,451	4,668	7,065	9,242	11,355
Reconciliation of operating income:					
Net income attributable to common shareholders	\$ (10.6)	\$ (7.5)	\$ 16.2	\$ 38.4	\$ (0.3)
Reconciling adjustments:					
Dividends on preference shares	-	-	2.3	1.5	-
Net change in fair value of credit derivatives	(8.1)	(8.2)	(30.1)	(18.2)	(1.9)
Net realized investment losses (gains)	(0.2)	1.9	0.1	(4.8)	(2.3)
Fair value adjustments	(1.0)	(0.8)	(5.5)	(22.8)	3.7
Amortization of intangibles	-	-	2.2	2.7	2.3
Operating income (loss)	<u>\$ (19.9)</u>	<u>\$ (14.6)</u>	<u>\$ (14.8)</u>	<u>\$ (3.2)</u>	<u>\$ 1.5</u>
SELECTED BALANCE SHEET DATA					
Investments and cash	\$ 194.2	\$ 206.6	\$ 193.2	\$ 238.2	\$ 285.3
Premiums receivable	81.3	69.4	61.9	57.2	72.6
Reinsurance balances receivable, net	340.7	310.4	277.4	283.0	330.1
Deferred acquisition costs	0.1	0.2	0.2	0.5	0.9
Goodwill and intangible assets	37.9	37.9	37.9	40.1	42.8
Total assets	658.0	627.8	574.0	623.5	742.6
Loss and LAE reserve	304.8	276.7	249.2	265.4	323.6
Unearned premium reserve	105.7	101.2	93.5	95.2	108.9
Ceded premium payable	95.2	77.2	64.4	56.1	77.8
Derivative liabilities	0.3	8.4	16.8	46.7	65.0
Notes payable	16.5	19.6	40.0	60.9	47.8
Redeemable Series A preference shares	10.3	9.9	9.8	9.4	9.4
Fair value adjustment	15.2	17.0	19.4	22.1	26.6
Total liabilities	598.3	559.6	501.8	565.1	669.8
Shareholders equity	53.5	62.1	66.1	52.3	63.8
Non-controlling interest	6.1	6.1	6.1	6.1	9.1
Total equity	59.6	68.2	72.2	58.4	72.8
SHARE INFORMATION					
Basic earnings per share	\$ (233.62)	\$ (169.18)	\$ 371.96	\$ 1,813.44	\$ (16.62)
Diluted earnings per share	(233.62)	(169.14)	370.36	1,797.58	(16.39)

American Overseas Group Limited

**Consolidated Financial Statements
For the Year Ended
December 31, 2017**



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 and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive loss, changes in 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 audits 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 and its subsidiaries as of December 31, 2017 and 2016, and the results of their operations and 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.

Other Matter

Accounting principles generally accepted in the United States of America require that the disclosure of short-duration contracts included in Note 8 be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Deloitte Ltd.

June 6, 2018

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED BALANCE SHEETS
December 31, 2017 and 2016

	2017	2016
Assets		
Fixed-maturity securities held as available for sale, at fair value	\$ 81,028,049	\$ 80,525,286
Equity investments available for sale, at fair value	6,436,614	6,652,662
Cash and cash equivalents	40,173,162	71,130,790
Restricted cash	66,534,599	48,306,033
Accrued investment income	256,153	219,113
Premiums receivable	81,264,067	69,418,710
Reinsurance balances receivable, net	340,700,321	310,350,944
Salvage and subrogation recoverable	1,707,921	1,896,077
Deferred policy acquisition costs	100,548	157,575
Intangible assets	4,800,000	4,800,000
Goodwill	33,050,000	33,050,000
Other assets	1,899,547	1,300,784
Total assets	\$ 657,950,981	\$ 627,807,974
Liabilities and Shareholders' Equity		
Liabilities:		
Losses and loss expense reserve	\$ 304,772,603	\$ 276,687,908
Unearned premiums	105,689,737	101,198,347
Ceded premium payable	95,195,311	77,178,341
Payable to general agents	1,478,955	1,334,422
Funds withheld	44,985,364	43,333,864
Accounts payable and accrued liabilities	3,057,300	4,174,205
Redeemable Series A preference shares	10,312,218	9,919,812
Derivative liabilities	341,843	8,357,625
Fair value adjustment	15,198,761	17,043,678
Notes payable	16,520,907	19,526,293
Non-owned interest in VIE	300,000	300,000
Interest payable	450,770	515,873
Deferred tax liability	30,975	44,625
Total liabilities	598,334,744	559,614,993
Shareholders' equity:		
Common shares	4,555,800	4,454,200
Additional paid-in capital	188,331,207	187,281,343
Accumulated other comprehensive income	1,189,495	300,986
Retained deficit	(140,513,641)	(129,896,924)
Total shareholders' equity	53,562,861	62,139,605
Non-controlling interest in preferred shares in subsidiaries	6,053,376	6,053,376
Total equity	59,616,237	68,192,981
Total liabilities and equity	\$ 657,950,981	\$ 627,807,974

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS

December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Net premiums earned	\$ 1,946,640	\$ 3,093,640
Fee income	11,530,571	12,090,941
Net investment income	1,761,994	1,762,777
Net realized gain (losses)	154,488	(1,904,798)
Fair value adjustment	1,452,511	1,958,241
Net change in fair value of credit derivatives	8,237,732	10,542,346
Other income	591,157	7,424
Total revenues	<u>25,675,093</u>	<u>27,550,571</u>
Net losses and loss adjustment expenses	19,782,700	14,278,541
Acquisition costs	447,129	652,196
General and administrative expenses	13,771,938	16,456,105
Interest expense	2,303,693	3,265,315
Other expense	-	397,991
Total expenses	<u>36,305,460</u>	<u>35,050,148</u>
Loss before income tax expense	(10,630,367)	(7,499,577)
Income tax benefit/(expense)	13,650	(7,000)
Loss before non-controlling interest	<u>\$ (10,616,717)</u>	<u>\$ (7,506,577)</u>
Net loss per common share:		
Basic	\$ (233.62)	\$ (169.18)
Diluted	\$ (233.62)	\$ (169.14)
Weighted-average number of common shares outstanding:		
Basic	45,444	44,371
Diluted	45,444	44,381

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
December 31, 2017 and 2016

	2017	2016
Net loss before non-controlling interest	\$ (10,616,717)	\$ (7,506,577)
Other comprehensive gain		
Change in unrealized fair value of investments	1,042,997	610,424
Reclassification adjustment for net realized investment (losses) gains included in income	(375,498)	1,904,798
Reclassification adjustment for OTTI included in net income	221,010	-
Other comprehensive gain	888,509	2,515,222
Comprehensive loss	\$ (9,728,208)	\$ (4,991,355)

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF EQUITY AND RETAINED DEFICIT
December 31, 2017 and 2016

	Share capital	Noncontrolling Interest	Additional paid-in-capital	Accumulated other comprehensive (loss) income	Retained deficit	Total stockholders' equity
Balance, December 31, 2015	4,376,500	6,053,376	186,398,669	(2,214,236)	(122,390,347)	72,223,962
Net loss	-	-	-	-	(7,506,577)	(7,506,577)
Share based compensation	77,700	-	882,674	-	-	960,374
Net change in unrealized gains and losses on investments	-	-	-	2,515,222	-	2,515,222
Balance, December 31, 2016	4,454,200	6,053,376	187,281,343	300,986	(129,896,924)	68,192,981
Net loss	-	-	-	-	(10,616,717)	(10,616,717)
Share based compensation	101,600	-	1,049,864	-	-	1,151,464
Net change in unrealized gains and losses on investments	-	-	-	888,509	-	888,509
Balance, December 31, 2017	\$ 4,555,800	\$ 6,053,376	\$ 188,331,207	\$ 1,189,495	\$ (140,513,641)	\$ 59,616,237

See Accompanying Notes to the Consolidated Financial Statements

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2017 and 2016

	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss for the year	\$ (10,616,717)	\$ (7,506,577)
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Net realized losses on sale of investments	(154,488)	1,904,798
Net unrealized gains on credit derivatives	(8,237,732)	(10,542,346)
Deferred tax expense	(13,650)	7,000
Interest expense	2,303,693	3,265,315
Share based compensation	1,151,464	960,374
Amortization of fair value adjustment	(1,452,511)	(1,958,242)
Amortization of bond discount	43,281	119,285
Changes in operating assets and liabilities:		
Accrued investment income	(37,040)	(16,249)
Premiums receivable	(11,845,357)	(7,541,562)
Reinsurance balance receivable, net	(30,349,377)	(32,911,666)
Salvage and subrogation	188,156	(682,141)
Deferred acquisition costs, net	57,027	34,833
Other assets	(598,763)	729,343
Changes in derivative liability	221,950	2,121,079
Unpaid losses and loss adjustment expenses	28,084,695	27,483,564
Unearned premiums	4,491,390	7,725,864
Ceded premium payable	18,016,970	12,798,028
Payable to general agents	144,533	140,598
Funds withheld	1,651,500	39,408,119
Accounts payable and accrued liabilities	(1,116,905)	1,858,604
Net cash (used in) provided by operating activities	(8,067,881)	37,398,021
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of available for sale securities	(72,085,851)	(49,835,222)
Proceeds from sales of investments	27,161,779	65,123,431
Proceeds from maturities of investments	45,637,073	8,683,131
Change in restricted cash	(18,228,566)	3,097,043
Net cash (used in) provided by investing activities	(17,515,565)	27,068,383
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term note payable	(3,005,386)	(20,473,711)
Interest paid	(2,368,796)	(3,772,842)
Payment on preferred shares	-	(220,000)
Net cash used in financing activities	(5,374,182)	(24,466,553)

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2017 and 2016

	2017	2016
Net (decrease)/increase in cash and cash equivalents	(30,957,628)	39,999,851
Cash and cash equivalents - Beginning of year	71,130,790	31,130,939
Cash and cash equivalents - End of year	\$ 40,173,163	\$ 71,130,790
 Net taxes refunded	 (1,018)	 (6,981)

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.

(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 and equity investments as available-for-sale. 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 and equity 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 recognizes financial guaranty reinsurance contract revenue over the period of the contract in proportion to the amount of insurance protection provided. The Company recognizes a liability for unearned premium revenue at the inception of a financial guaranty insurance contract equal to the present value of the premiums due or expected to be collected over the period of the contract. 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. 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. 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”) 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. Therefore there are two components to the fair value process of the Company's derivatives. The first component is the fair value assessment performed by the primary on each derivative instrument ceded to the Company. The second component is the Company's own non-performance risk adjustment that is applied to the total fair valued derivatives obtained by the primary.

(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.

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

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(k) 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.

(l) 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.

(m) 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

Statement of Cash Flows

In November 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* (a consensus of the Emerging Issues Task Force), which addresses the presentation of changes in restricted cash and restricted cash equivalents in the statement of cash flows with the objective of reducing the existing diversity in practice. Under the ASU, entities are required to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the ASU requires a reconciliation be presented either on the face of the statement of cash flows or in the notes to the financial statements showing the totals in the statement of cash flows to the related captions in the balance sheet. The ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If the ASU is adopted in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company is currently evaluating the effect on its Consolidated Statements of Cash Flows of adopting this ASU.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* (a consensus of the Emerging Issues Task Force), which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The issues addressed in the new guidance include debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, distributions received from equity method investments, beneficial interests in securitization transactions and separately identifiable cash flows and application of the predominance principle. The amendments in this ASU are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. This ASU is not expected to have a material impact on the Company's Consolidated Statements of Cash Flows.

Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will use forward-looking information to better inform their credit loss estimates as a result of the ASU. While many of the loss estimation techniques applied today will still be permitted, the inputs to those techniques will change to reflect the full amount of expected credit losses. The ASU requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as credit quality and underwriting standards of an organization's portfolio.

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

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(p) Recent accounting pronouncements (cont'd)

In addition, the ASU amends the accounting for credit losses on available-for-sale securities and purchased financial assets with credit deterioration. The ASU also eliminates the concept of "other than temporary" from the impairment model for certain available-for-sale securities. Accordingly, the ASU states that an entity must use an allowance approach, must limit the allowance to an amount at which the security's fair value is less than its amortized cost basis, may not consider the length of time fair value has been less than amortized cost, and may not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists. For purchased financial assets with credit deterioration, the ASU requires an entity's method for measuring credit losses to be consistent with its method for measuring expected losses for originated and purchased non-credit-deteriorated assets.

The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For most debt instruments, entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted. The changes to the impairment model for available-for-sale securities and changes to purchased financial assets with credit deterioration are to be applied prospectively. For the Company, this would be as of January 1, 2020. Early adoption is permitted for fiscal years, and interim periods with those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the effect on its Consolidated Financial Statements of adopting this ASU.

Revenue

In May 2014, the FASB issued guidance which revises the criteria for revenue recognition. Insurance contracts are excluded from the scope of the new guidance. Under the guidance, the transaction price is attributed to underlying performance obligations in the contract and revenue is recognized as the entity satisfies the performance obligations and transfers control of a good or service to the customer. Incremental costs of obtaining a contract may be capitalized to the extent the entity expects to recover those costs. The guidance is effective for reporting periods beginning after December 15, 2017 and is to be applied retrospectively. The Company is in the process of evaluating the impact of adoption, which is not expected to be material to our consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to present right-of-use assets and lease liabilities on the balance sheet. ASU 2016-02 is to be applied using a modified retrospective approach at the beginning of the earliest comparative period in the financial statements. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is evaluating the impact that this ASU will have on its Consolidated Financial Statements.

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.

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

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(p) Recent accounting pronouncements (cont'd)

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.

3. PLEDGED ASSETS

As of December 31, 2017 and 2016, there were investments of \$1.5 million and \$1.6 million, respectively, on deposit with state insurance department regulators related to a U.S. subsidiary.

As of December 31, 2017, and 2016, the Company had restricted cash of \$66.5 million and \$48.3 million, respectively, and investments at fair value of \$29.0 million and \$67.2 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.

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, 2017 and 2016, the asset value of the Series A Security Trust was \$2.7 million and \$3.3 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.

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, 2017 and 2016, the asset value of the Class B Security Trust was \$2.6 million and \$2.1 million, respectively, included within investments. Butterfield Trust Company has been appointed as its trustee. AORE 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, 2017 and 2016, were as follows:

	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⁾	
2017					
US Treasuries and government agencies ⁽²⁾	\$ 31,050,746	\$ -	\$ (106,562)	\$ -	\$ 30,944,184
Corporate debt securities	3,015,554	2,009	(14,183)	-	3,003,380
Mortgage-backed securities	33,336,356	176,887	(251,360)	-	33,261,883
Asset-backed securities	13,782,820	35,782	-	-	13,818,602
Total available for sale fixed-maturity investments	<u>\$ 81,185,476</u>	<u>\$ 214,678</u>	<u>\$ (372,105)</u>	<u>\$ -</u>	<u>\$ 81,028,049</u>
Equity securities available for sale	5,089,692	1,346,922	-	-	6,436,614
Total investment portfolio	<u><u>\$ 86,275,168</u></u>	<u><u>\$ 1,561,600</u></u>	<u><u>\$ (372,105)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 87,464,663</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⁾		
2016					
US Treasuries and government agencies (2)	\$ 18,949,528	\$ 79,709	\$ (21,259)	\$ -	\$ 19,007,978
Corporate debt securities	3,304,031	369	(10,943)	-	3,293,457
Mortgage-backed securities	17,523,170	252,342	(243,773)	-	17,531,739
Asset-backed securities	40,737,368	21,387	(66,643)	-	40,692,112
Total available for sale fixed-maturity investments	<u>\$ 80,514,097</u>	<u>\$ 353,807</u>	<u>\$ (342,618)</u>	<u>\$ -</u>	<u>\$ 80,525,286</u>
Equity securities available for sale	6,362,865	510,807	(221,010)	-	6,652,662
Total investment portfolio	<u><u>\$ 86,876,962</u></u>	<u><u>\$ 864,614</u></u>	<u><u>\$ (563,628)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 87,177,948</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, 2017 and 2016. The Company had no material investments in securities guaranteed by third parties and had no direct investments in financial guarantors as at December 31, 2017 and 2016.

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, 2017 and 2016, 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, 2017		December 31, 2016	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Less than one year	\$ 18,175,944	\$ 18,160,069	\$ 15,826,921	\$ 15,904,961
One through five years	31,125,106	31,023,454	6,499,362	6,470,548
Greater than five years	4,855,746	4,858,384	824,593	816,045
Mortgage-backed securities:				
RMBS	13,245,860	13,167,540	16,625,853	16,641,620
CMBS	-	-	-	-
Asset-backed securities	13,782,820	13,818,602	40,737,368	40,692,112
Total	\$ 81,185,476	\$ 81,028,049	\$ 80,514,097	\$ 80,525,286

The investments that have unrealized loss positions as of December 31, 2017 and 2016, 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	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2017:						
Fixed-maturity investments:						
US Treasuries and government agencies	\$ 23,047,462	\$ (87,948)	\$ 4,648,475	\$ (18,613)	\$ 27,695,937	\$ (106,561)
Corporate debt securities	1,104,757	(7,033)	1,195,706	(7,149)	2,300,463	(14,182)
Mortgage-backed securities	3,907,870	(17,438)	9,432,260	(233,924)	13,340,130	(251,362)
Total temporarily impaired securities	<u>\$ 28,060,089</u>	<u>\$ (112,419)</u>	<u>\$ 15,276,441</u>	<u>\$ (259,686)</u>	<u>\$ 43,336,530</u>	<u>\$ (372,105)</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>
2016:						
Fixed-maturity investments:						
US Treasuries and government agencies	\$ 7,801,224	\$ (12,673)	\$ -	\$ -	\$ 7,801,224	\$ (12,673)
Corporate debt securities	3,669,484	(17,698)	746,160	(1,831)	4,415,644	(19,529)
Mortgage-backed securities	11,701,471	(243,773)	-	-	11,701,471	(243,773)
Asset-backed securities	-	-	21,172,780	(66,643)	21,172,780	(66,643)
Total temporarily impaired securities	<u>\$ 23,172,179</u>	<u>\$ (274,144)</u>	<u>\$ 21,918,940</u>	<u>\$ (68,474)</u>	<u>\$ 45,091,119</u>	<u>\$ (342,618)</u>

The following table sets forth the investment ratings of the Company's available-for-sale corporate fixed income securities as at December 31, 2017 and 2016. Ratings are assigned by Standard & Poor's or AM Best in instances where Standard & Poor's do not issue a rating.

	<u>Amortized Cost</u>	<u>%</u>
2017		
AAA	\$ 36,563,391	45.0%
AA	41,756,637	51.4%
A	2,564,237	3.2%
BBB and below	301,211	0.4%
	<u>\$ 81,185,476</u>	<u>100%</u>

	<u>Amortized Cost</u>	<u>%</u>
2016		
AAA	\$ 46,638,526	57.9%
AA	30,771,541	38.2%
A	1,904,348	2.4%
BBB and below	1,199,682	1.5%
	<u>\$ 80,514,097</u>	<u>100%</u>

As of December 31, 2017, 48 out of 104 fixed maturity securities were in unrealized loss positions compared to 33 out of 80 as of December 31, 2016. As at December 31, 2017, the Company's unrealized loss position for fixed maturity securities was \$0.4 million compared to \$0.3 million at December 31, 2016. 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. Sixteen of the securities have been in an unrealized loss position of \$0.3 million for 12 months or more as of December 31, 2017 and there were eight securities in an unrealized loss position \$0.1 million for 12 months or more as of December 31, 2016.

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

4. INVESTMENTS (Cont'd)

During the years ended December 31, 2017 and 2016, the Company recognized losses on other than temporary impairments in the amount of \$ 0.2 million and nil, respectively. There was a \$ 0.2 movement in the amount of OTTI recognized in other comprehensive income during such years and the closing balance of OTTI was \$0.2 million, as of December 31, 2017 and 2016.

As of December 31, 2017 and 2016, an immaterial amount of net unrealized gains was 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 2017 and 2016 were \$71.4 million and \$73.8 million, respectively. Gross gains of nil and \$0.01 million in 2017 and 2016, respectively, and gross losses of nil million and \$1.9 million in 2017 and 2016, respectively, were realized on those sales. Proceeds from the sale of equities were \$1.4 million and nil in 2017 and 2016, respectively. Gross gains from those 2017 sales were \$0.4 million.

Major categories of net investment income are summarized as follows for the years ended December 31, 2017 and 2016:

	2017	2016
Interest from fixed-maturity securities	\$ 1,969,058	\$ 2,024,810
Interest from cash equivalents	372,404	82,996
Dividend Income	97,592	-
Amortization	25,347	12,911
Investment expense	(709,158)	(392,173)
Interest on funds held	<u>6,751</u>	<u>34,233</u>
Net Investment income	<u>\$ 1,761,994</u>	<u>\$ 1,762,777</u>

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

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.

The following tables present a roll forward of AORE’s premiums receivable on installment policies for the years ended December 31, 2017 and 2016:

(dollars in thousands)	Years ended December 31,	
	2017	2016
Premiums receivable beginning balance	\$ 6,600	\$ 9,226
Change in premiums receivable discount	649	348
Adjustments for changes in expected term of policies (including early terminations)	19	(854)
Other Adjustment - Commutation	(1,202)	
Foreign exchange movement	460	(855)
Premiums received	(1,173)	(1,265)
Premiums receivable ending balance	\$ 5,353	\$ 6,600

As of December 31, 2017 and 2016, AORE had \$5.3 million and \$6.6 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, 2017 and 2016 of \$2.4 million and \$2.8 million, respectively. As of December 31, 2017 and 2016, \$0.2 million and \$(0.1) 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, 2017 and 2016, 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.”

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

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

The accretion of premiums receivable discount is included in earned premiums in the Company's consolidated statements of operations. As of December 31, 2017 and 2016, the weighted average risk-free rate used to discount the premiums receivable was 2.07% and 3.31%, respectively. The weighted average expected period of future premiums used to estimate the premiums receivable was 10.1 and 7.1 years for December 31, 2017 and 2016 respectively. As of December 31, 2017 and 2016, the unearned premiums on these installment policies were \$6.9 million and \$8.4 million, respectively, and were included in "Unearned premiums" on the Consolidated Balance Sheets.

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, 2017, 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, 2018	\$ 133
June 30, 2018	213
September 30, 2018	97
December 31, 2018	168
 <u>Twelve Months Ended:</u>	
December 31, 2019	583
December 31, 2020	550
December 31, 2021	515
December 31, 2022	460
 <u>Five Years Ended:</u>	
December 31, 2027	1,645
December 31, 2032	951
December 31, 2037	582
December 31, 2042	419
December 31, 2047	281
After 2047	277

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 expected unearned premium revenue and the schedule of total expected future premium earnings revenue on upfront and installment policies. These amounts are based on the Company's estimates as of December 31, 2017, 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:

	<u>Change in Unearned Premiums</u>	<u>Accretion</u>	<u>Total Expected Future Earned Premiums</u>
(dollars in thousands)			
<u>Three Months Ended:</u>			
March 31, 2018	\$ 542	\$ 27	\$ 569
June 30, 2018	526	26	552
September 30, 2018	509	25	534
December 31, 2018	502	25	527
<u>Twelve Months Ended:</u>			
December 31, 2019	1,948	94	2,042
December 31, 2020	1,838	89	1,927
December 31, 2021	1,744	81	1,825
December 31, 2022	1,577	73	1,650
<u>Five Years Ended:</u>			
December 31, 2027	6,173	277	6,450
December 31, 2032	4,095	178	4,273
December 31, 2037	2,390	117	2,507
December 31, 2042	1,430	84	1,514
December 31, 2047	1,045	56	1,101
After 2047	1,162	40	1,202

Accelerated premium revenue for refunded obligations for the years ended December 31, 2017 and 2016, was approximately \$2.1 million and \$3.8 million, respectively, and represents the earning of the unearned premiums associated with the unscheduled prepayment of the underlying obligations.

The estimated premiums written for the years ended December 31, 2017 and 2016, were \$1.5 million and \$(0.5) 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 2017 and 2016 was estimated accretion of the premiums receivable of \$0.6 million and \$0.6 million, respectively. Accretion of the ceding commissions payable of \$(0.1) million and \$0.6 million, respectively, was included in acquisition expenses for such years.

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

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES

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,	
	2017	2016
	<hr/>	<hr/>
Change in fair value of credit derivatives:		
Credit derivative premiums earned and receivable	\$ 221,826	\$ 3,240,906
Expenses on credit derivatives	(30,150)	(1,284,680)
Losses and loss adjustment expenses ⁽¹⁾	(79,211)	423,925
Realized gains and other settlements	<hr/> 112,465	<hr/> 2,380,151
Unrealized gain	<hr/> 8,125,267	<hr/> 8,162,195
Net change in fair value of credit derivatives	<hr/> <u>\$ 8,237,732</u>	<hr/> <u>\$ 10,542,346</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

The Company's CDS policies are not readily tradable as there is no active market for them. Therefore, the Company views its principal market as the financial guaranty insurance and reinsurance market, whose participants would hypothetically be able to assume this business if the Company 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 the Company's reinsurance that limit its access to the terms of the underlying credit derivatives, which are highly individualized, and the underlying loan level data, 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, as discussed above. Therefore, the Company, 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 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 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.

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, 2017 and 2016:

Fair value measurement using significant unobservable inputs (Level 3)

	Years ended December 31,	
	2017	2016
Balance, beginning of period	\$ (8,357,625)	\$ (16,778,892)
Total unrealized gains included in earnings ⁽¹⁾	8,125,267	8,162,195
Total realized gains included in earnings ⁽²⁾	112,465	2,380,151
Net Cash Receipts ⁽³⁾	(221,950)	(2,121,079)
Transfers in and/or out of Level 3	-	-
Balance, end of period	\$ (341,843)	\$ (8,357,625)
Change in unrealized gains and losses relating to assets held at the reporting date	\$ 183,144	\$ (6,021,303)

(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, 2017 and 2016

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, 2017 and 2016. 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>2017</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	\$ 30,944,184	\$ 30,944,184	\$ -	\$ -
Corporate debt securities	3,003,380	-	3,003,380	-
Municipal securities	-	-	-	-
Mortgage-backed securities	33,261,883	-	33,261,883	-
Asset-back securities	<u>13,818,602</u>	<u>-</u>	<u>13,818,602</u>	<u>-</u>
Investments available for sale fixed maturity investments	81,028,049	30,944,184	50,083,865	-
Equity investments available for sale	6,436,614	1,202,555	5,234,059	-
Cash and Cash Equivalents	40,173,162	40,173,162		
Restricted Cash	66,534,599	66,534,599		
Financial Liabilities:				
Derivative Liabilities ⁽¹⁾	\$ 341,843	\$ -	\$ -	\$ 341,843

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

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

	Fair Value Measurements at Reporting Date Using			
	Balance as of December 31, <u>2016</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	\$ 19,007,978	\$ 14,847,386	\$ 4,160,592	\$ -
Corporate debt securities	3,293,457	-	3,293,457	-
Mortgage-backed securities	17,531,739	-	17,531,739	-
Asset-back securities	<u>40,692,112</u>	<u>-</u>	<u>40,692,112</u>	<u>-</u>
Investments available for sale fixed maturity investments	80,525,286	14,847,386	65,677,900	-
Equity investments available for sale	6,652,662	1,275,209	5,377,453	-
Cash and Cash Equivalents	71,130,790	71,130,790		
Restricted Cash	48,306,033	48,306,033		
Financial Liabilities:				
Derivative Liabilities ⁽¹⁾	\$ 8,357,625	\$ -	\$ -	\$ 8,357,625

⁽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, 2017 and 2016, 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, 2017 and 2016.

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, 2017 and 2016. 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, 2017 and 2016:

	2017	2016
	Fixed maturity investments	Fixed maturity investments
Balance beginning of period	\$ -	\$ 9,296,249
Unrealized (losses) gains included in OCI	-	-
Sales	-	(9,296,249)
	\$ -	\$ -
Balance, end of period	-	-
Change in unrealized gains relating to assets held at the reporting date	\$ -	\$ -

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, 2017 and 2016, the fair value of the Company's \$58.6 million and \$59.5 million, respectively redeemable Series A Preference Shares was approximately \$10.3 million and \$9.9 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.

Carrying value of all financial assets and liabilities is equivalent to fair value.

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, 2017, 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, 2017 and 2016 is presented in the following table:

	2017	2016
Losses and loss expense reserve		
Balance - Beginning of year	\$ 276,687,908	\$ 249,204,344
Less: reinsurance recoverable	(196,596,105)	(174,612,026)
Net Balance - Beginning of year	<u>80,091,803</u>	<u>74,592,318</u>
Incurred related to:		
Current year	2,857,832	3,071,565
Prior Years	16,924,868	11,206,976
Total incurred	<u>19,782,700</u>	<u>14,278,541</u>
Net losses paid related to:		
Current year	(1,965,523)	(1,578,829)
Prior Years	(10,008,431)	(7,200,227)
Total Paid	<u>(11,973,954)</u>	<u>(8,779,056)</u>
Net balance - End of year	87,900,549	80,091,803
Add: reinsurance recoverable	216,872,054	196,596,105
Balance - End of year	<u><u>\$ 304,772,603</u></u>	<u><u>\$ 276,687,908</u></u>

For the year ended December 31, 2017, the Company incurred loss and LAE of \$19.8 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 current year, with \$2.9 million development on the current accident year. The financial guaranty reinsurance business generated net incurred losses of \$15.8 million in 2017 including fair value adjustments, primarily related to its reinsurance of obligations of Commonwealth of Puerto Rico (See note 18).

For the year ended December 31, 2016, the Company incurred loss and LAE of \$14.3 million. Incurred losses related to the Company's short-tailed property casualty business were \$2.0 million. The majority of the losses from the property casualty business are from the 2016 accident year, with \$3.1 million development on the that year. The financial guaranty reinsurance business generated net incurred losses of \$12.3 million in 2016 including fair value adjustments, primarily related to its reinsurance of obligations of Commonwealth of Puerto Rico (See note 18).

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

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

Financial guaranty

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, 2017 and 2016, the Company gave credit of \$0.1 million and \$0.1 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 2017 and 2016 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, 2017 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 2017 and 2016.

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 17. If the threshold was exceeded, then we used our reserve. As of December 31, 2017 and 2016, the Company's recorded loss and LAE reserves for financial guaranty contracts are \$19.3 million (2016: \$16.3 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, 2017, the Company used risk free rates ranging from 1.28% to 2.74% to discount reserves for loss and loss adjustment expenses. As of December 31, 2016, the Company used risk free rates ranging from 0.44% to 3.06% 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.

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

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

As of December 31, 2017 and 2016, the Company's Watch List definitions are 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.

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

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

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

losses and loss expense reserves on the Consolidated Balance Sheets and in loss and loss adjustment expenses in the Consolidated Statements of Operations.

Categories 1 to 4 in the below table include all financial guaranty contracts on the Company's Watch List at December 31, 2017 and 2016, 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 below tables may not add up to the totals.

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, 2017:

2017

(dollars in millions)	Deals not on watch List	Surveillance Categories				Total
		Category 1	Category 2	Category 3	Category 4	
Number of policies	19	6	19	4	37	85
Remaining weighted average contract period (in yrs)	23	19	13	19	15	
Insured contractual payments outstanding:						
Principal	\$ 20.8	\$ 64.1	\$ 77.5	\$ 7.8	\$ 122.6	\$ 292.8
Interest	11.3	30.8	37.1	1.2	64.3	144.7
Total	<u>\$ 32.1</u>	<u>\$ 94.9</u>	<u>\$ 114.6</u>	<u>\$ 9.0</u>	<u>\$ 186.9</u>	<u>\$ 437.5</u>
Gross claim liability	\$ 0.6	\$ 0.1	\$ 3.9	\$ 1.3	\$ 58.7	\$ 64.6
Less:						
Gross potential recoveries	(0.9)	-	(0.8)	(0.1)	-	(1.8)
Discount, net	-	-	(0.7)	-	(3.3)	(4.0)
Net claim liability	<u>\$ (0.3)</u>	<u>\$ 0.1</u>	<u>\$ 2.4</u>	<u>\$ 1.2</u>	<u>\$ 55.4</u>	<u>\$ 58.8</u>
Unearned premium revenue ⁽¹⁾	0.4	0.1	0.5	-	1.3	<u>\$ 2.3</u>
Premium deficiency						\$ 1.0
Net claim liability reported in the Balance Sheet related to financial guaranty						<u>\$ 57.5</u>

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, 2016:

2016

(dollars in millions)	Deals not on watch List	Surveillance Categories				Total
		Category 1	Category 2	Category 3	Category 4	
Number of policies	18	12	22	8	35	95
Remaining weighted average contract period (in yrs)	23	21	13	16	19	
Insured contractual payments outstanding:						
Principal	\$ 21.7	\$ 134.0	\$ 103.2	\$ 115.1	\$ 44.1	\$ 418.1
Interest	12.0	75.5	55.6	71.1	11.8	226.0
Total	<u>\$ 33.7</u>	<u>\$ 209.5</u>	<u>\$ 158.8</u>	<u>\$ 186.2</u>	<u>\$ 55.9</u>	<u>\$ 644.1</u>
Gross claim liability	\$ 1.0	\$ 0.7	\$ 5.5	\$ 38.1	\$ 9.3	\$ 54.6
Less:						
Gross potential recoveries	(1.0)	-	(2.0)	(0.2)	(0.8)	(4.0)
Discount, net	(0.1)	(0.1)	(0.5)	(1.2)	(1.5)	(3.4)
Net claim liability	<u>\$ (0.1)</u>	<u>\$ 0.6</u>	<u>\$ 3.0</u>	<u>\$ 36.7</u>	<u>\$ 7.0</u>	<u>\$ 47.2</u>
Unearned premium revenue ⁽¹⁾	0.6	0.7	1.1	1.4	0.2	<u>\$ 4.0</u>
Premium deficiency						\$ 0.7
Net claim liability reported in the Balance Sheet related to financial guaranty						<u>\$ 43.9</u>

⁽¹⁾ On policies with a loss reserve but excluding those policies with a recoverable as of December 31, 2017 and 2016, respectively.

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

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

Property and casualty

The following presents information about incurred and paid claims development for the short term duration contracts as of December 31, 2017, net of reinsurance. The information about incurred and paid claims development for the 2013 to 2016 years, and the average annual percentage payout of incurred claims by age as of December 31, 2017, is presented as required supplementary information. The below tables begin at June 26, 2013. This was the date AOG became part of OGL, whose U.S. subsidiaries write short duration property and casualty business. Claims count information is not reflected in the below tables. Due to the role of the U.S subsidiaries in the non standard auto and the reinsurance business this information is not available.

Incurred loss and allocated loss adjustment expenses, net of reinsurance For the Years Ended December 31,							Total of incurred- but-not-reported liabilities plus expected development on reported claims
(dollars in thousands)	(unaudited)	(unaudited)	(unaudited)				
Accident Year	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>		
2013	\$ 37,936	\$ 41,996	\$ 41,382	\$ 41,151	\$ 41,413	\$ 128	
2014	-	34,792	35,215	34,577	34,960	285	
2015	-	-	5,182	5,076	5,480	94	
2016	-	-	-	3,072	3,390	264	
2017	-	-	-	-	2,491	789	
				\$ 83,876	\$ 87,734		

Cumulative paid claims and allocated loss adjustment expenses, net of reinsurance For the Years Ended December 31,						
(dollars in thousands)	(unaudited)	(unaudited)	(unaudited)			
Accident Year	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	
2013	\$ 15,872	\$ 30,676	\$ 35,199	\$ 37,208	\$ 37,919	
2014	-	21,080	28,728	32,052	33,420	
2015	-	-	3,392	4,708	5,332	
2016	-	-	-	1,980	2,794	
2017	-	-	-	-	1,810	
				\$ 75,947	\$ 81,275	

All outstanding liabilities before 2013, net of reinsurance 72

Liabilities for claims and claims adjustment expense, net of reinsurance \$ 6,531

Average annual percentage payout of incurred claims by age, net of reinsurance

Years	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
	58%	26%	11%	4%	2%

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

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

**Reconciliation of the disclosure of incurred and paid claims development to the liability
for unpaid claims and claims adjustment expenses**

(dollars in thousands)	<u>2017</u>
<u>Net Outstanding Liabilities</u>	
Liabilities for unpaid claims and claim adjustment expenses, net of reinsurance	\$ 6,531
Total reinsurance recoverable on unpaid claims	211,975
Insurance lines other than short-duration	86,267
Unallocated claims adjustment expenses	-
Other	-
	304,773
	\$ 304,773
Total gross liability for unpaid claims and claims adjustment expense	\$ 304,773

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, 2017 was diversified by geographic and bond market sector, with no single obligor representing more than 3.9% of the Company's total outstanding ("OS") par insured.

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

9. OUTSTANDING FINANCIAL GUARANTY EXPOSURE (cont'd)

The following table presents the Company's net par outstanding by credit sector and type of guaranty as of December 31, 2017 and 2016:

(dollars in millions)	2017		2016	
	Total OS Par	% of Total	Total OS Par	% of Total
US Public Finance				
General Obligation and Lease	\$ 696	30.0	\$ 887	24.8
Tax backed	165	7.1	191	5.3
Transportation	140	6.0	269	7.5
Healthcare	178	7.7	244	6.8
Utility	180	7.8	261	7.3
Higher Education	16	0.7	24	0.7
Other	38	1.6	62	1.7
Escrowed	188	8.1	564	15.8
Total US Public Finance	\$ 1,601	69.0%	\$ 2,502	70.1%
US Structured Finance				
Commercial ABS and CDOs	\$ 5	0.2	\$ 122	3.4
RMBS	50	2.1	82	2.2
Other Structured Finance & Corporate	-	-	50	1.4
Total US Structured Finance	\$ 55	2.3%	\$ 254	7.0%
International				
Asset-backed	\$ 7	0.3	\$ 167	4.7
Public Finance	306	13.2	309	8.7
Investor Owned Utilities and Other	351	15.1	339	9.5
Total International	\$ 664	28.7%	\$ 815	22.9%
Total	\$ 2,320	100.0%	\$ 3,571	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, 2017 and 2016, by geographic location was as follows:

(dollars in millions)	2017		2016	
	OS Par	%	OS Par	%
International	\$ 664	28.6	\$ 815	22.8
Multi-state	48	2.1	246	6.9
California	275	11.9	533	14.9
New York	84	3.6	181	5.1
Illinois	126	5.4	175	4.9
Massachusetts	222	9.6	272	7.6
Puerto Rico	139	6.0	148	4.2
Other U.S. States	762	32.8	1,201	33.6
Total	\$ 2,320	100.0%	\$ 3,571	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

AORE entered into a Commutation Agreement, effective June 30, 2017, to commute the entire portfolio of financial guaranty reinsurance business it had assumed from Assured Guaranty Corporation (“AGC”), effective upon receipt of a commutation payment to AGC (the “AGC Commutation”). The aggregate outstanding par value of the reinsurance portfolio being commuted was \$402 million as of June 30, 2017, bringing total par outstanding down to \$2,345 million as of June 30, 2017, a reduction of 17% from Q1 2017. The effect of this agreement on the Company’s results of operations was an overall gain to net income at the time of termination of \$1.6 million.

Effective September 30, 2016, 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 receive a \$978,046 net commutation payment to terminate the reinsurance with respect to a certain policy previously assumed, with par in-force of \$4.5 million (the “Released Risks”). In return, each party was released from all liabilities and obligations with respect to the Released Risks. There was no effect of this agreement on AORE’s results of operations as there was no net change in fair value of derivatives, as this policy is classified as derivative liability in AORE and was carried at a \$nil value.

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

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, 2017, our major customers were the following primary monoline financial guaranty insurers all owned by a common group: 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, 2017			
	<u>Property/Casualty</u>	Financial		<u>Total</u>
		<u>Guaranty</u>	<u>Corporate</u>	
Net premiums earned	\$ 3,497	\$ (1,550)	\$ -	\$ 1,947
Net change in fair value of credit derivatives	-	8,238	-	8,238
Losses and loss adjustment expenses	(3,960)	(15,823)	-	(19,783)
Acquisition expenses	(430)	(17)	-	(447)
Underwriting gain (loss)	(893)	(9,152)	-	(10,045)
Fee income	11,531	-	-	11,531
Net investment income	-	-	1,762	1,762
Other income	-	-	591	591
Net realized gain on sales of investments	-	-	154	154
Fair value adjustment	-	-	1,453	1,453
Operating expenses	(9,593)	(6,415)	2,235	(13,773)
Interest expense	-	-	(2,304)	(2,304)
Amortization expense	-	-	-	-
Other expense	-	-	-	-
Income tax	14	-	-	14
Net income (loss) before non controlling interest	<u>\$ 1,059</u>	<u>\$ (15,567)</u>	<u>\$ 3,891</u>	<u>\$ (10,617)</u>

(dollars in thousands)	December 31, 2016			
	<u>Property/Casualty</u>	Financial		<u>Total</u>
		<u>Guaranty</u>	<u>Corporate</u>	
Net premiums earned	\$ 3,600	\$ (506)	\$ -	\$ 3,094
Net change in fair value of credit derivatives	-	10,542	-	10,542
Losses and loss adjustment expenses	(2,037)	(12,242)	-	(14,279)
Acquisition expenses	(896)	244	-	(652)
Underwriting gain (loss)	667	(1,962)	-	(1,295)
Fee income	12,091	-	-	12,091
Net investment income	-	-	1,763	1,763
Other income	-	-	7	7
Net realized loss on sales of investments	-	-	(1,905)	(1,905)
Fair value adjustment	-	-	1,958	1,958
Operating expenses	(9,740)	(7,236)	520	(16,456)
Interest expense	-	-	(3,265)	(3,265)
Amortization expense	-	-	-	-
Other expense	-	-	(398)	(398)
Income tax	(7)	-	-	(7)
Net income (loss) before non controlling interest	<u>\$ 3,011</u>	<u>\$ (9,198)</u>	<u>\$ (1,320)</u>	<u>\$ (7,507)</u>

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, 2017 are as follows:

2018	\$	329,998
2019	\$	298,655
2020	\$	302,922
2021	\$	307,188
2022	\$	311,455
Thereafter	\$	1,611,578

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.

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, 2017 and 2016, 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. On August 8, 2016, American Overseas Group commenced a tender offer for any and all of its outstanding Series A Non-Cumulative Preference Shares for cash at a price not to exceed \$200 for each \$1,000 principal liquidation amount of the Series A Shares validly tendered and accepted by the Company. In order to be purchased in the tender offer, Series A Shares were to be tendered on or before September 2, 2016, and accepted by the Company. Of the 59,700 outstanding shares, 1,100 shares were tendered for a redemption value of \$220,000. After expiration of the tender, 58,600 Series A Non –Cumulative Preference Shares remain outstanding as of December 31, 2017.

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.

Following the settlement of previous repurchases, 373.01 shares of Class B Preference Shares remained outstanding at December 31, 2017 and 2016. 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, 2017 and 2016.

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.

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. In 2017 and 2016 there were no dividends declared or paid to the Class B preference shareholders. As a dividend had not been paid for 18 months, pursuant to the Articles of Continuance of the Company, the number of directors on the Board automatically increased by two and the holders of the Class B shares are entitled to elect directors to serve. The Company thus called a Special Meeting of the Class B shareholders for July 14, 2017. As a quorum of holders of Class B Preference Shares was not present for the meeting, no meeting was held.

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

15. SHARE CAPITAL

As at December 31, 2017 and 2016, authorized common share capital was \$9,000,000. As at December 31, 2017 and 2016, 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.

The following table shows a roll forward of the issued, outstanding and unissued common shares for the years ended December 31, 2016 and 2017:

	Outstanding share capital	Outstanding Shares	Treasury Shares	Issued Shares	Unissued Shares
As at December 31, 2015	\$ 4,376,500	43,765	42	43,807	46,193
Issued restricted share units during the year	26,300	263	-	263	(263)
Shares issued in lieu of cash for director's fees	51,400	514	-	514	(514)
As at December 31, 2016	\$ 4,454,200	44,542	42	44,584	45,416
Issued restricted stock awards during the year	65,900	659	-	659	(659)
Shares issued in lieu of cash for director's fees	21,400	214	-	214	(214)
Shares issued in lieu of cash for consultant's fees	14,300	143	-	143	(143)
As at December 31, 2017	\$ 4,555,800	45,558	42	45,600	44,400

16. SHARE BASED COMPENSATION

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 4,500. 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, 2017, outstanding awards under the AOG Plan consisting of 1,851 share options and 631 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 tenth 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, 2017 ranges from \$675 to \$1,520. Restricted share units vest in equal annual installments over a four-year period.

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

16. SHARE BASED COMPENSATION (cont'd)

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, 2017. In 2016 there were no stock options awarded:

	<u>2017</u>
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	\$ 700.00

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, 2017, the weighted average grant date fair value for options issued subsequent to January 1, 2006 was \$800.46. The Company expensed \$0.3 million and \$0.2 million in compensation expense related to the stock options for each of the years ended December 31, 2017 and 2016 respectively. As at December 31, 2017, there was \$0.7 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 2.53 years. For both the twelve month periods ended December 31, 2017 and 2016, 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.

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, 2017 and 2016:

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, 2017				
Options				
Outstanding - beginning of year	1,226	\$ 876.74		
Granted	625	700.00		
Exercised	-	-		
Forfeited	-	-		
Outstanding - end of year	<u>1,851</u>	817.06	7.88	\$ -
Exercisable - end of year	726	\$ 895.16	6.67	\$ -
	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value ⁽¹⁾
Year ended December 31, 2016				
Options				
Outstanding - beginning of year	1,226	\$ 876.74		
Granted	-	-		
Exercised	-	-		
Forfeited	-	-		
Outstanding - end of year	<u>1,226</u>	876.74	8.19	\$ 870
Exercisable - end of year	474	\$ 919.17	6.99	\$ 870

- 1) The aggregate intrinsic value was calculated based on the market value of \$263.00 and \$702.00 as at December 31, 2017 and 2016, respectively, and is calculated as the difference between the market value and the exercise price of the underlying options.

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

16. SHARE BASED COMPENSATION (cont'd)

Restricted Share Units

The following table summarizes the restricted share unit activity for the years ended December 31, 2017 and 2016:

Restricted Share Units

	<u>Number of share units</u>	<u>Weighted average grant date fair value per share</u>
Year ended December 31, 2017		
Restricted Share Units		
Non-vested - beginning of year	391	\$ 1,561.97
Granted	450	700.00
Vested	(210)	1,631.91
Forfeited	-	-
Non-vested - End of year	631	\$ 925.08

	<u>Number of share units</u>	<u>Weighted average grant date fair value per share</u>
Year ended December 31, 2016		
Restricted Share Units		
Non-vested - beginning of year	672	\$ 1,586.03
Granted	20	700.00
Vested	(226)	1,564.56
Forfeited	(75)	1,538.00
Non-vested - End of year	391	\$ 1,561.97

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, 2017 and 2016 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, 2017, there is unrecognized compensation expense related to the non-vested restricted share units under the AOG Plan of \$0.4 million, which will be recognized over the weighted average remaining service period of 2.45 years.

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 of December 31, 2017 and 2016, there were 1,851 and 1,166, 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, 2017 and 2016:

	2017	2016
Net loss available to common shareholders	\$ (10,612,517)	\$ (7,506,577)
Basic weighted-average shares	45,444	44,371
Effect of stock options	-	9
Effect of restricted share units	-	1
Diluted weighted-average shares	45,444	44,381
Basic loss earnings per share	\$ (233.53)	\$ (169.18)
Diluted loss earnings per share	\$ (233.53)	\$ (169.14)

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, 2017, AOG has \$2.5 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)

AOG's property/casualty segment 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 \$226.4 million of collateral compared to \$194.5 million of balances at December 31, 2016 and such amounts are included in reinsurance balances received net on the consolidated balance sheet.

At December 31, 2017, the Company had \$194.2 million of cash and investments of which \$123.5 million was held in trust for the benefit of our ceding companies, leaving \$70.7 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 25 – Statutory Requirements, for further information regarding AORE's ability to pay dividends.

As at December 31, 2017, the Company has reinsured \$23 million of par exposures that have been written by ceding companies as credit default 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 \$132.4 million and \$140.3 million par outstanding as of December 31, 2017 and 2016 respectively, all of which are rated below investment grade (“BIG”). The Company believes its exposure to Puerto Rico entities represents the largest risk the Company faces for the next several years. The Company’s largest Puerto Rico exposures are to bonds issued by Puerto Rico Highway and Transportation Authority (“PRHTA”) and Municipal Finance Authority (“MFA”) in the amounts of \$91.5 million and \$36.9 million, respectively, at December 31, 2017. Beginning on January 1, 2016, a number of Puerto Rico credits have defaulted on bond payments.

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.

On November 30, 2015, and December 8, 2015, Governor Garcia Padilla (“the Former 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”), the entities ceding Puerto Rico exposures to the Company, 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 reinsured by the Company impacted by the Clawback Orders are shown in the table “Puerto Rico Par Outstanding” below.

On June 30, 2016, PROMESA was signed into law by the President of the United States. PROMESA establishes a seven-member federal financial oversight board (“Oversight Board”) with authority to require that balanced budgets and fiscal plans be adopted and implemented by Puerto Rico. PROMESA provides a legal framework under which the debt of the Commonwealth and its related authorities and public corporations may be voluntarily restructured, and grants the Oversight Board the sole authority to file restructuring petitions in a federal court to restructure the debt of the Commonwealth and its related authorities and public corporations if voluntary negotiations fail, provided that any such restructuring must be in accordance with an Oversight Board approved fiscal plan that respects the liens and priorities provided under Puerto Rico law. PROMESA also appears to preempt at least portions of the Moratorium Act and to stay debt-related litigation, including Assured’s litigation regarding the Clawback Orders.

In May and July 2017 the Oversight Board filed petitions under Title III of PROMESA with the Federal District Court of Puerto Rico for the Commonwealth, the Puerto Rico Sales Tax Financing Corporation (COFINA), PRHTA, and Puerto Rico Electric Power Authority (PREPA). Title III of PROMESA provides for a process analogous to a voluntary bankruptcy process under chapter 9 of the United States Bankruptcy Code (Bankruptcy Code).

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

18. RISKS AND UNCERTAINTIES (cont'd)

Judge Laura Taylor Swain of the Southern District of New York was selected by Chief Justice John Roberts of the United States Supreme Court to preside over any legal proceedings under PROMESA. Judge Swain has selected a team of five federal judges to act as mediators for certain issues and disputes.

On September 20, 2017, Hurricane Maria made landfall in Puerto Rico as a Category 4 hurricane on the Saffir-Simpson scale, causing loss of life and widespread devastation in the Commonwealth. Damage to the Commonwealth's infrastructure, including the power grid, water system and transportation system, was extensive, and rebuilding and economic recovery are expected to take years. While the federal government is expected to provide substantial resources for relief and rebuilding -- which is expected to help economic activity and address the Commonwealth's infrastructure needs in the intermediate and longer term -- economic activity in general and tourism in particular, as well as tax collections, have declined in the aftermath of the storm, and emigration to the U.S. mainland also has increased.

In December 2017, U.S. legislation known as the 2017 Tax Cuts and Jobs Act (Tax Act) was enacted. Many of the provisions under the new law are geared toward increasing production in the U.S. and discouraging companies from having operations or intangibles off-shore. Since Puerto Rico is considered a foreign territory under the U.S. tax system, it is possible the new law may have adverse consequences to Puerto Rico's economy. However, the Company and Assured are unable to predict the full impact of the new law on Puerto Rico.

The Commonwealth released fiscal plans for itself and for a number of its authorities and public corporations, and in response to notices of violation from the Oversight Board and the enactment of a significant federal disaster relief package by the U.S. Congress, Puerto Rico released one or more revised fiscal plans for the Commonwealth and a number of its authorities and public corporations. The most recent fiscal plans submitted by the Commonwealth for the Commonwealth, PRHTA and PREPA were released on April 5, 2018. The Commonwealth and the Oversight Board did not agree on final fiscal plans, and on April 18 and April 19, 2018, the Oversight Board released its own versions of fiscal plans for the Commonwealth, PRHTA and PREPA, which it certified on April 19 or 20, 2018. The current governor of Puerto Rico (Governor) has announced that he will refuse to implement certain aspects of the fiscal plans certified by the Oversight Board, and there has been speculation in the press that the differences between the Governor and the Oversight Board will be litigated.

The certified Commonwealth fiscal plan (which the Company and Assured believes covers its general obligations as well as obligations of certain of its other authorities and public corporations) indicates a primary budget surplus of \$6.7 billion that could be available for debt service over the six-year forecast period (as compared to contractual debt service of approximately \$15.5 billion over the same period). The certified PRHTA fiscal plan projects very limited capacity to pay debt service over the six-year forecast period, as the Commonwealth anticipates continuing to retain approximately three-fourths of PRHTA's total revenues. The certified PREPA fiscal plan indicates that no funds will be available for legacy debt service payments over the six-year forecast period unless rates are adjusted. Additionally, the Governor has announced an intention to privatize PREPA. Assured does not believe the certified fiscal plans for the Commonwealth, PRHTA or PREPA comply with certain mandatory requirements of PROMESA.

Litigation and mediation related to the Commonwealth's debt have been delayed by Hurricane Maria. The final form and timing of responses to Puerto Rico's financial distress and the devastation of Hurricane Maria eventually taken by the federal government or implemented under the auspices of PROMESA and the Oversight Board or otherwise, and the final impact, after resolution of legal challenges, of any such responses on obligations reinsured by the Company, are uncertain.

The Company's Puerto Rico exposure is through bonds issued by PRHTA, MFA, PREPA, and general obligation ("GO").

PRHTA

As of December 31, 2017 and 2016, the Company had \$30.5 million reinsured net par outstanding of PRHTA (Transportation revenue) bonds and \$61.0 million net par of PRHTA (Highway revenue) bonds. The Company has recorded reserves of \$47.5 million as of December 31, 2017 related to this exposure. As of December 31, 2016, the recorded reserves for PRHTA exposures were \$34.1 million. 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)

The Transportation revenue bonds are secured by a subordinate gross pledge of gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to \$120 million annually of taxes on crude oil, unfinished oil and derivative products. The Highway revenue bonds are secured by a gross pledge of gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The Clawback Orders cover Commonwealth-derived taxes that are allocated to PRHTA. The PRHTA bonds are subject to executive orders issued pursuant to the Moratorium Act.

Despite the presence of funds in relevant debt service reserve accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company has been making claim payments on these bonds since that date. The Oversight Board filed a petition under Title III of PROMESA with respect to PRHTA.

MFA

As of December 31, 2017 and 2016, the Company had \$36.9 million and \$44.8 million, respectively, net par outstanding of bonds issued by MFA and secured by a pledge of local property tax revenues. The Company has recorded reserves of \$1.5 million as of December 31, 2017 related to this exposure. As of December 31, 2016, the recorded reserves for MFA exposures were \$1.8 million.

The MFA is a public corporation and governmental instrumentality of the Commonwealth, created to allow the municipalities of Puerto Rico to access the capital markets so they can finance public improvement programs more effectively. The MFA bonds are payable from the MFA's revenues and any money appropriated or transferred to the MFA by the Commonwealth. Revenues are derived mainly from payments on municipal bonds purchased by the MFA from PR municipalities. The municipal bonds are primarily backed by a statutory first lien on property taxes collected, without limitation as to rate or amount, on all taxable property within the issuing municipalities. The good faith, credit and unlimited taxing power of each issuing municipality is pledged for the payment of its general obligation municipal bonds and notes. Property taxes are collected directly in a lock-box by a separate municipal agency called the Municipal Revenue Collection Center created on behalf of the Commonwealth's municipalities.

In addition to the property tax revenue, the bonds are supported by Commonwealth appropriations of matching equalization funds. The bondholders are also protected by a reserve fund that is funded through revenue collections up to a formula-based amount. The MFA's Enabling Act provides that the Commonwealth shall annually apportion and pay to the Agency such sum as shall be necessary to maintain the reserve account in the required amount. The payment of such sum by the Commonwealth is subject to appropriation by the Legislature of Puerto Rico, which appropriation is authorized but not legally required to be made (the "Moral Obligation Pledge"). The Moral Obligation Pledge has never been drawn upon.

PREPA

As of December 31, 2017 and 2016, the Company had \$3.5 million reinsured net par outstanding of PREPA obligations which are payable from a pledge of net revenues of the electric system. The Company has recorded reserves of \$1.1 million as of December 31, 2017 related to this exposure. As of December 31, 2016, the recorded reserves for PREPA exposures were \$0.5 million.

On December 24, 2015, PREPA, Assured, an ad hoc group of uninsured bondholders and a group of fuel-line lenders entered into a Restructuring Support Agreement (RSA) with PREPA that would, subject to certain conditions, result in, among other things, modernization of the utility and a restructuring of current debt. Upon finalization of the contemplated restructuring transaction, insured PREPA revenue bonds (with no reduction to par or stated interest rate or extension of maturity) will be supported by securitization bonds issued by a special purpose corporation and secured by a transition charge assessed on ratepayers. Legislation meeting the requirements of the original RSA was enacted on February 16, 2016, and a transition charge to be paid by PREPA rate payers for debt service on the securitization bonds as contemplated by the RSA was approved by the Puerto Rico Energy Commission on June 20, 2016.

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

18. RISKS AND UNCERTAINTIES (cont'd)

The Oversight Board did not certify the RSA under Title VI of PROMESA as the Company believes was required by PROMESA, but rather, on July 2, 2017, commenced proceedings for PREPA under Title III of PROMESA. The Company has been making claim payments on these bonds since July 1, 2017.

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.

Puerto Rico		Par Outstanding	
	As of December 31, 2017	As of December 31, 2016	
	(in millions)		
PRHTA (Highway revenue)	\$ 61.0	\$ 61.0	
PRHTA (Transportation revenue)	30.5	30.5	
PRHTA Total - subject to potential Clawback	<u>91.5</u>	<u>91.5</u>	
MFA	36.9	44.8	
PREPA	3.5	3.5	
GO	0.5	0.5	
Total exposure to Puerto Rico	<u>\$ 132.4</u>	<u>\$ 140.3</u>	

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.

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

18. RISKS AND UNCERTAINTIES (cont'd)

**Amortization Schedule of Puerto Rico Par Outstanding
and Debt Service Outstanding
As of December 31, 2017**

	<u>Scheduled Par Amortization</u>	<u>Scheduled Debt Service Amortization</u>
	(in millions)	
2018 (January 1 - March 31)	\$ -	\$ 2.6
2018 (April 1 - June 30)	-	-
2018 (July 1 - September 30)	6.2	9.5
2018 (October 1 - December 31)	-	-
Subtotal 2018	<u>6.2</u>	<u>12.1</u>
2019	8.4	14.8
2020	4.4	10.4
2021	3.4	9.2
2022	37.0	42.6
2023-2027	9.3	26.9
2028-2032	25.7	39.3
2033-2038	<u>38.0</u>	<u>43.9</u>
Total	<u>\$ 132.4</u>	<u>\$ 199.2</u>

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

19. 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, 2017 and December 31, 2016.

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, 2017 and 2016 with appropriate eliminations being made for intercompany balances:

	<u>2017</u>	<u>2016</u>
ASSETS:		
Cash	\$ 8,779,511	\$ 48,092,286
Investments	40,030,018	-
Premiums receivable	77,530,371	63,858,698
Reinsurance balances receivable	340,059,082	307,500,995
Other assets	317,474	236,693
	<u>\$ 466,716,456</u>	<u>\$ 419,688,672</u>
LIABILITIES:		
Unpaid losses and loss adjustment expenses	\$ 215,252,570	\$ 193,402,840
Unearned premium	104,849,493	99,743,743
Ceded premium payable	94,343,312	75,627,770
Payable to general agents	936,824	181,911
Funds withheld	44,857,396	43,281,485
Accounts payable and accrued expenses	739,267	1,756,358
Due to parent and affiliates	803,540	694,565
	<u>\$ 461,782,402</u>	<u>\$ 414,688,672</u>
EQUITY:		
Policyholders' surplus	\$ 300,000	\$ 300,000
Surplus debenture	4,700,000	4,700,000
Accumulated other comprehensive income	(65,946)	
Total equity	<u>\$ 4,934,054</u>	<u>\$ 5,000,000</u>
Total Liabilities and Equity	<u>\$ 466,716,456</u>	<u>\$ 419,688,672</u>

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

20. BUSINESS CONCENTRATION

The Company's property casualty insurance subsidiaries, OACM and Old American Indemnity Company ("OA Indemnity"), produce business through unrelated managing general agencies. In 2017, four of these managing general agencies produced approximately 56.6% of OACM's gross premium writings and 57.4% of the Company's property casualty gross written premiums. In 2017, one managing general agent produced approximately 52.4% of OA Indemnity's gross premium writings and less than 1% of the Company's property casualty gross written premiums.

21. 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, the Company 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, 2017.

In conjunction with the acquisition of OACM in 2012, the Company 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, 2017.

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, 2017.

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

21. GOODWILL AND INTANGIBLE ASSETS (cont'd)

The gross and net carrying amounts of intangible assets by major category as of December 31, 2017 and 2016 are as follows:

	<u>Gross</u>	<u>Accumulated Amortization</u>	<u>Net</u>
As of December 31, 2017			
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, 2016			
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>

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.

22. 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

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 superseded 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 nil and \$5.9 million were made in 2017 and 2016, respectively, to the 2015 OACC Notes. The 2016 repayments were to Directors and members of their respective families. As of December 31, 2017, \$0.3 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. Principal repayments of \$3.0 million and \$14.6 million were made in 2017 and

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

22. NOTES PAYABLE (cont'd)

2016, respectively, on the AOG Notes. Of the 2017 repayments, \$2.5 million were to Directors and members of their respective families. As of December 31, 2017, \$0.1 million in interest was accrued and unpaid on the remaining balance of the AOG Notes.

Directors and members of their respective families held notes payable in the aggregate principal amount of approximately \$8.6 million at December 31, 2017.

23. 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:

	2017	2016
Current tax expense	\$ -	\$ -
Deferred tax expense	(13,650)	7,000
Net income tax expense	<u>\$ (13,650)</u>	<u>\$ 7,000</u>

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

23. TAXATION (cont'd)

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 21% for 2017 and 35% for 2016.

	2017	2016
Net (loss) income before income tax	(10,630,365)	(7,499,577)
Adjustment for non-taxable entities	<u>12,668,268</u>	<u>10,679,522</u>
Taxable income before income tax expense	\$ 2,037,903	\$ 3,179,945
Expected tax benefit at statutory rates in taxable jurisdictions	427,960	1,112,981
Increases (reductions) in taxes resulting from:		
Exclusion of profit from VIE not included in consolidated		
Valuation allowance	(5,721,726)	(101,382)
Other	<u>5,280,116</u>	<u>(1,004,599)</u>
Income tax (benefit)/expense	<u>\$ (13,650)</u>	<u>\$ 7,000</u>
Effective tax rate	<u>0%</u>	<u>0%</u>

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

23. 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, 2017 and 2016 were as follows:

	2017	2016
Deferred tax assets:		
Net operating loss carryforward	\$ 3,848,400	\$ 8,131,259
Unearned premium reserves	(5,110)	50,196
Discounted unpaid losses and loss adjustment expenses	19,893	28,805
Goodwill and other intangible assets	<u>-</u>	<u>-</u>
 Total deferred tax assets	 <u>3,863,183</u>	 <u>8,210,260</u>
 Deferred tax liabilities:		
Deferred acquisition costs	21,115	39,466
Intangible Assets with permanent differences	<u>1,441,475</u>	<u>62,125</u>
	1,462,590	101,591
 Deferred tax assets, net, before valuation allowance	 2,400,593	 8,108,669
Valuation allowance	<u>(2,431,568)</u>	<u>(8,153,294)</u>
 Deferred tax liabilities, net	 <u>\$ (30,975)</u>	 <u>\$ (44,625)</u>

As of December 31, 2017, the Company had net operating loss carry forwards of \$18,325,713 the expiration of which is as follows:

2032	\$ 1,495,114
2033	\$ 8,173,931
2034	\$ 8,257,850
2035	\$ 206,117
2036	\$ 192,701

As of December 31, 2017 and 2016, 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)

24. 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 2017. These four reinsurers account for approximately 91% of the total net recoverable from reinsurers, and 90% for 2016. 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. 76% of the reinsurance balances OACM ceded as of December 31, 2017 were to reinsurers rated A or better. Substantially all of the balances ceded to reinsurers rated less than A are collateralized. During 2017 and 2016, OACM obtained collateral totaling \$219.3 million and \$187.0 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 \$86.0 million as of December 31, 2017 as compared to \$83.2 million for 2016.

With OA Indemnity's reinsurance programs, a concentration of credit risk exists with three reinsurers that have net balances due in excess of 5% of OA Indemnity's total receivable balances in 2017. These three reinsurers account for approximately 100% of the total net recoverable from reinsurers, and 100% for 2016. During 2017, OA Indemnity obtained collateral and letters of credit totaling \$7.3 million 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 \$877 thousand as of December 31, 2017 as compared to \$347 thousand for 2016.

25. 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, 2017, OA Indemnity had statutory capital and surplus of \$9.5 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, 2017.

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

25. 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, 2017 was \$44.5 million. The minimum required solvency margin for AORE was \$1.4 million at December 31, 2017. The excess of the Company's other Barbados domiciled insurance companies' assets over the aggregate of their liabilities and stated capital was \$3.3 million. The minimum required solvency margin for those entities was \$0.1 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.

26. SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 6, 2018, which is the date the financial statements were issued.

On February 1, 2018 AOG completed a private repurchase of \$20M liquidation value of 20,000 of its Series A Preference Shares from an undisclosed holder.

Director Biographies

Set forth below is biographical information concerning each current director and director nominee of AOG, AORE and OGL including each such individual's principal occupation and the period during which such person has served as a director of AOG, AORE, or OGL if applicable. Information about share ownership of certain directors and executive officers as of December 31, 2017, can be found under "Directors and Executive Officers—Security Ownership of Executive Officers and Directors" in our 2017 Annual Report delivered herewith.

Clement S. Dwyer, Jr.

Age 69

Director since 2010

Mr. Dwyer is Chairman of AOG and OGL and a director of AORE. He is also Managing Member of Snow Squall, LLC of Portsmouth, New Hampshire, a provider of insurance and reinsurance consulting services, and former President of URSA Advisors, Inc., of Las Vegas, Nevada. Previously he served as President of Signet Star Holdings, Inc., a reinsurance subsidiary of W.R. Berkeley Corp in 1996. From 1970 until 1996 he held various positions at Guy Carpenter & Company, including most recently Executive Vice President. Mr. Dwyer is also a Director of Vanbridge Holdings LLC of New York, New York, Dowling & Partners of Farmington, Connecticut, Grandparents.com Inc. of New York, New York, and ProSight Specialty Holdings Inc. of Morristown, New Jersey. He received a BA degree from Tufts University and completed the Executive Program at Stanford University Graduate School of Business.

Andrew J. Kirkpatrick

Age 44

President of Old American
County Mutual Fire
Insurance Company and Old
American Indemnity
Company

Director since 2018

Mr. Kirkpatrick is a Director of AOG. Mr. Kirkpatrick is President and Director of subsidiaries, Old American County Mutual Fire Insurance Company and Old American Indemnity Company. Mr. Kirkpatrick received a BBA in Finance and a BA in Psychology from Southern Methodist University. Mr. Kirkpatrick also holds an Associate in Reinsurance and an associate in Risk Management designation.

Jose O. Montemayor

Age 67

Director since 2016

Mr. Montemayor is a Director of AOG and OGL. Mr. Montemayor is a principal of Black Diamond Capital Partners, a member of Black Diamond Advisory Services, LLC and the Principal at J. Montemayor and Associates, LLC, where he serves as an advisor to the Board of Directors of several insurance companies. From 1999 through 2005, Mr. Montemayor was Insurance Commissioner of the State of Texas. Mr. Montemayor is currently a Director of CNA Financial Corp. (NYSE: CNA), as well as a Director of Prosperity Life Insurance Group, Ascension Texas, as well as a member of the Financial Council to the Austin, Texas Diocese. Mr. Montemayor received a BA in Management from St. Edwards University and holds advanced degrees in Management (MA Management) from Webster University; Logistics (MS Logistics) from the Air Force Institute of Technology; and Accounting (Masters of Accountancy) from Texas State University and is a Certified Public Accountant.

Debra J. Roberts

Age 64

Chief Executive Officer,

Director since 2011

Ms. Roberts is the President, Chief Executive Officer and a Director of AOG and OGL. She also serves as Chairperson of the Board of AORE and as Chairperson and Chief Executive Officer of several of OGL's subsidiaries in Bermuda, Barbados and the United States. Since 1993, Ms. Roberts has served as the Chief Executive Officer of Debra Roberts & Associates, Inc. which provides risk transfer consulting and arbitration-related services to the domestic and international reinsurance industries. From 1981 through 1993, Ms. Roberts held various senior positions at three companies within the Swiss Reinsurance Group. She holds an MBA from

Fordham University Graduate School of Business and is a Chartered Financial Analyst.

James L. Zech

Age 61

Director since 2012

Mr. Zech is a Director and Deputy Chairman of AOG and OGL, as well as a Director of Old American County Mutual Fire Insurance Company. Mr. Zech co-founded and served as President of High Ridge Capital since its formation in 1995. From 2005 through 2009, Mr. Zech was a partner in Northaven Management, Inc., a private investment firm focused on the financial services industry. From 1992 to 1995, Mr. Zech was an investment banker at S.G. Warburg & Co., Inc., where he was responsible for forming the U.S. Insurance Group as part of S.G. Warburg & Co., Inc.'s worldwide financial institutions practice. From 1988 to 1992, Mr. Zech was a member of the Insurance Investment Banking Group of Donaldson, Lufkin & Jenrette Securities Corporation. Mr. Zech is a former Director of Acordia, Inc., Alterra Capital Holdings Ltd., Eastern Insurance Holdings, Inc., Front Royal Group, Inc., and James River Group, Inc. He holds a BS from the University of Pennsylvania and a JD from the New York University School of Law.

Sir Trevor Carmichael

Age 73

Director of AORE since 2014

Sir Trevor Carmichael, KA, LVO, QC, is a Director of AORE. Sir Trevor is the founder of Chancery Chambers, a Barbados law firm engaged primarily in international business law, environmental law and law related to charities. He is a member of the Middle Temple in London and the Barbados Bar. He is also a member of the International Bar Association, the Inter-American Bar Association and a Committee member of the Inter-American Bar Foundation as well as an associate member of the Canadian Bar Association. Sir Trevor holds memberships in the International Tax Planning Association, the International Fiscal Association, and is Charter President of the Barbados Chapter of the International Fiscal Association. He is a Life Fellow of the Institute for Advanced Legal Studies in the United Kingdom, a Life Member of the Commonwealth Magistrates and Judges Association and a member of the International Law Association. Sir Trevor was the recipient on the National Honors List for his contribution to the law, financial services and the preservation of national heritage. In 2012, he was awarded the Governor of Canada's Medallion. In 2013, he was appointed by the Governor General of Barbados as an Independent Senator to Barbados' Upper Chamber. In June of 2013, he was appointed as a Lieutenant of the Royal Victorian Order in the Queen's Birthday Honours List, and was awarded the Knight of St. Andrew in the 2013 Barbados Independent Honours.

David K. Steel

Age 60

Director of AORE since 2016

Mr. Steel is a Director of AORE and has previously served in various capacities for AORE since 2005 including Chief Risk Manager, Chief Executive Officer and consultant. Currently, Mr. Steel is Chief Risk Officer for Alesia Re, SPC, a Cayman Islands-based life and annuity reinsurance company. Prior to joining AORE, Mr. Steel was head of the Domestic Mortgage Insurance and Reinsurance business at ACE Capital Re, Inc. Prior to ACE, he held various positions at GE Capital's Financial Guaranty Insurance Company from 1990 to 2002, where he was a member of the corporate leadership team and headed the Mortgage-Backed Securities and Investments business. From 1984 to 1990, Mr. Steel was an investment banker in the Financial Institutions and Mortgage Finance groups at Lehman Brothers. Mr. Steel has served as a director of the Association of Financial Guaranty Insurers since 2010. He holds an MBA from the University of California,

Los Angeles and a BS from California State University, Sacramento.

Conrad P. Voldstad

Age 67

Director AORE since 2014

Mr. Conrad P. Voldstad is a Director of AORE. Mr. Voldstad has over forty (40) years of experience in the financial services industry. Mr. Voldstad was Chief Executive Officer of International Swaps and Derivatives Association and was founder and Senior Principal of Arlington Hill Investment Management, LLC. Mr. Voldstad also held senior positions with Merrill Lynch and JP Morgan. Mr. Voldstad was a member of the Board of Directors of AOG from 2006 through 2009 and has acted as a consultant to AOG since 2012. Mr. Voldstad has a BA from Boston College and a law degree from Fordham University School of Law and an MBA from the Tuck School at Dartmouth College.

Executive Biographies

For biographical information regarding our executive officers, Debra J. Roberts, the President and Chief Executive Officer of AOG, please refer to the “Director Biographies” section of this Proxy Statement. Ms. Fyfe resigned as Executive Vice President and Chief Financial Officer of the Company effective January 12, 2018. Mr. Ballard was appointed Executive Vice President and Chief Financial Officer of the Company effective June 21, 2018.

Ronald J. Ballard

Age 50

Mr. Ballard is Chief Financial Officer of AOG. Mr. Ballard has over 25 years of experience in the property and casualty insurance industry. Mr. Ballard was most recently CFO of the non-standard automobile and commercial vehicle business for Kemper Corp, and has held a variety of financial and business leadership roles across the property and casualty spectrum at Kemper Corp, f/k/a Unitrin, Inc. Mr. Ballard has a BA in Economics from The University of Texas and a BBA in Accounting from Texas A&M University.

Security Ownership of Executive Officers and Directors

Pursuant to Regulation 6.9(2)(x)(a) and (b) of Section IIA of the Bermuda Stock Exchange Listing Regulations, the total interests of all directors and executive officers of the Company in the common shares of the Company as at December 31, 2017, was 2383 shares or 5.23% of the common shares outstanding, net of treasury shares.¹

Equity Compensation of Directors

The table below sets forth the aggregate number of shares underlying option awards and restricted stock unit (“RSU”) awards outstanding at fiscal year-end 2017 for each director as of December 31, 2017, (other than Ms. Roberts and Ms. Fyfe, whose equity awards are set forth in “Equity Compensation of Executive Officers” below).

¹ This includes Shelley P. Fyfe but does not include the shares held by Conrad P. Voldstad, who served as a director of the Company from September 22, 2015 through November 11, 2015 and is currently a director of AORE.

Equity Compensation of Directors

Name	Shares Underlying	Shares Underlying	RSUs: That Have Not Vested
	Options at Dec 31, 2017 (Outstanding)	Options at Dec 31, 2017 (Vested and Exercisable)	
James Zech	29.53	29.53	6.70
Clement S. Dwyer	7.15	7.15	6.70
Jose O. Montemayor	-	-	-

Share options granted to the directors under our 2001 Stock Option Plan prior to 2006 vested quarterly over a three year period. Share Options granted to directors beginning in 2006 under the 2006 Equity Plan vest in four equal annual installments on the first four anniversaries of the date of grant. RSUs vest annually in equal installments over a four-year period.

Equity Compensation of Executive Officers

The following table shows equity awards granted to officers of the Company outstanding at December 31, 2017:

Name	Option Awards				RSU Awards		Restricted Stock Awards Subject to Forfeiture	
	Number of Common Shares Underlying Unexercised Options	Number of Common Shares Underlying Unexercised Options	Option	Option	Number of Shares that Have Not Vested	Market Value of Shares That Have Not Vested ⁽¹⁾	Number of Shares that Have Not Vested	Market Value of Shares That Have Not Vested ⁽¹⁾
	Exercisable	Unexercisable	Exercise Price	Date				
Debra J. Roberts	26.15	—	\$915.00	4/26/2019	—	—	—	—
	250.00	250.00	\$850.00	12/15/2025	—	—	—	—
	—	175.00	\$700.00	3/21/2027	—	—	—	—
	—	—	—	—	6.70	\$1,762	100.00	\$26,300
Rochelle P. Fyfe	75.00	75.00	\$850.00	12/15/2025	—	—	—	—
	—	200.00	\$700.00	3/21/2027	—	—	—	—
	—	—	—	—	31.70	\$8,337	100.00	\$26,300

(1) Based on the closing price of \$263.00 per share on December 29, 2017, the last business day of 2017.

Options granted prior to May 2006 were awarded under our 2001 Stock Option Plan and vest in 8.33% increments at the end of each quarter, beginning with the quarter in which the grant occurred. Our 2001 Stock Option Plan was terminated in May 2006, except as to awards that were already outstanding at that date. No further awards will be granted under our 2001 Stock Option Plan.

Options granted beginning in May 2006 were awarded under our 2006 Equity Plan, and vest in four equal installments on the first four anniversaries of the date of grant. RSUs vest annually in equal installments over a four-year period.

The following table shows options exercised and RSUs vested during 2017:

<u>Name</u>	Option Awards		RSU Awards	
	Number of Shares Acquired on Exercise	Value Realized on Exercise	Number of Shares Acquired on Vesting	Value Realized on Vesting
Debra J. Roberts	—	—	6.00	\$3,594.00 ⁽²⁾
	—	—	63.00	\$21,477.96 ⁽⁴⁾
	—	—	6.00	\$3,594.00 ⁽³⁾
Rochelle P. Fyfe	—	—	4.00	\$1,363.68 ⁽⁴⁾
	—	—	6.00	\$3,594.00 ⁽³⁾
	—	—	25.00	\$14,975.00 ⁽³⁾

(2) Based on the closing price of \$599.00 per share on April 25, 2017, the day of vesting.

(3) Based on the closing price of \$599.00 per share on May 15, 2017, the day of vesting

(4) Based on the closing price of \$340.92 per share on October 2, 2017, the day of vesting

Director Service Contracts and Other Contracts of Significance

Effective April 1, 2016, Old American Capital Corporation entered into Consultancy Agreement with Clement S. Dwyer, Jr. and James L. Zech for Mr. Dwyer and Mr. Zech to assist with general corporate issues, as well as loss mitigation strategies for the Company. Under the terms of the Consultancy Agreement, Mr. Dwyer and Mr. Zech each receive a fee of \$300,000 per contract year, as well as a car allowance of \$3,000 per month for the lease of a vehicle.

