

OIL CASUALTY INSURANCE, LTD.

Consolidated Financial Statements
(With Independent Auditor's Report Thereon)

Years Ended November 30, 2016 and 2015



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

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

Telephone +1 441 295 5063
Fax +1 441 295 9132
Internet www.kpmg.bm

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Oil Casualty Insurance, Ltd.

We have audited the accompanying consolidated financial statements of Oil Casualty Insurance, Ltd. and its subsidiaries, which comprise the consolidated balance sheets as of November 30, 2016 and 2015, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of Oil Casualty Insurance, Ltd. and its subsidiaries as of November 30, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG Audit Limited

Chartered Professional Accountants
Hamilton, Bermuda
February 23, 2017

OIL CASUALTY INSURANCE, LTD.

Consolidated Balance Sheets

November 30, 2016 and 2015

(Expressed in Thousands of United States Dollars)

	<u>2016</u>	<u>2015</u>
Assets		
Cash and cash equivalents (Notes 2(j) and 4(b))	\$ 93,058	\$ 106,844
Investments in marketable securities and derivatives (Notes 2(d), 2(e), 3 and 4)	765,712	698,887
Other investments (Notes 2(d) and 3)	85,203	112,738
Restricted Assets (Note 4 (e))	150,244	89,651
Investment sales pending settlement	52,882	27,708
Accrued investment income	4,132	4,339
Losses recoverable from reinsurers (Notes 5 and 9)	192,944	165,567
Accounts receivable	81,514	55,533
Funds withheld	15,822	22,757
Prepaid reinsurance premiums	17,968	20,947
Other assets (Note 2(k))	<u>14,104</u>	<u>12,927</u>
 Total assets	 \$ 1,473,583	 \$ 1,317,898
	<u>=====</u>	<u>=====</u>
Liabilities		
Outstanding losses and loss expenses (Note 5)	\$ 522,691	\$ 441,055
Unearned premiums	109,739	97,163
Securities sold short (Notes 2(i), 3 and 4)	18,022	24,284
Investment purchases pending settlement	82,691	25,578
Loan payable (Notes 2(k), 6(a) and 6(c))	141,144	145,934
Reinsurance premium payable	36,616	26,976
Amounts due to affiliates (Note 8(b))	949	1,054
Accounts payable	<u>22,610</u>	<u>18,390</u>
 Total liabilities	 934,462	 780,434
	<u>=====</u>	<u>=====</u>
Shareholders' equity		
Common shares (Note 7)	280	290
Retained earnings	<u>538,841</u>	<u>537,174</u>
 Total shareholders' equity	 539,121	 537,464
	<u>=====</u>	<u>=====</u>
 Total liabilities and shareholders' equity	 \$ 1,473,583	 \$ 1,317,898
	<u>=====</u>	<u>=====</u>

See accompanying notes to consolidated financial statements

OIL CASUALTY INSURANCE, LTD.

Consolidated Statements of Operations

Years Ended November 30, 2016 and 2015

(Expressed in Thousands of United States Dollars)

	<u>2016</u>	<u>2015</u>
Gross premiums written (Note 12)	\$ 166,566	\$ 152,684
Change in unearned premiums	<u>(12,576)</u>	<u>2,775</u>
Premiums earned (Note 12)	<u>153,990</u>	<u>155,459</u>
Premiums ceded	50,936	42,823
Change in prepaid reinsurance premiums	<u>2,979</u>	<u>1,204</u>
Premiums ceded	<u>53,915</u>	<u>44,027</u>
Net premiums earned (Note 12)	100,075	111,432
Losses and loss expenses incurred, net of reinsurance (Notes 5 and 12)	(67,662)	(57,277)
Commission and brokerage fees, net (Note 12)	<u>(19,796)</u>	<u>(19,109)</u>
Net underwriting income (Note 12)	<u>12,617</u>	<u>35,046</u>
Interest income	15,118	16,125
Net gains (losses) on investments (Note 3)	3,026	(14,209)
Dividends	1,649	1,418
Investment advisory and custodian fees	(3,589)	(4,609)
Interest and debt expense (Notes 6(a) and 6(c))	<u>(11,937)</u>	<u>(12,353)</u>
Net investment income (loss)	<u>4,267</u>	<u>(13,628)</u>
General and administrative expenses (Note 8(a))	<u>(15,217)</u>	<u>(16,670)</u>
Net income	<u>\$ 1,667</u>	<u>\$ 4,748</u>

See accompanying notes to consolidated financial statements

OIL CASUALTY INSURANCE, LTD.

Consolidated Statements of Changes in Shareholders' Equity

Years Ended November 30, 2016 and 2015

(Expressed in Thousands of United States Dollars)

	<u>Common shares</u>		<u>Retained</u>	<u>Total</u>
	<u>Number of</u>		<u>earnings</u>	
	<u>shares</u>			
Balance at November 30, 2014	55	275	532,426	532,701
Shares issued in year	3	15	—	15
Shares redeemed in year	—	—	—	—
Net income	<u>—</u>	<u>—</u>	<u>4,748</u>	<u>4,748</u>
Balance at November 30, 2015	58	\$ 290	\$ 537,174	\$ 537,464
Shares issued in year	1	5	—	5
Shares redeemed in year	(3)	(15)	—	(15)
Net income	<u>—</u>	<u>—</u>	<u>1,667</u>	<u>1,667</u>
Balance at November 30, 2016	<u>56</u>	<u>\$ 280</u>	<u>\$ 538,841</u>	<u>\$ 539,121</u>

See accompanying notes to consolidated financial statements

OIL CASUALTY INSURANCE, LTD.

Consolidated Statements of Cash Flows

Years Ended November 30, 2016 and 2015
(Expressed in Thousands of United States Dollars)

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Net income	\$ 1,667	\$ 4,748
Adjustments to reconcile net income to cash (used) provided by operating activities:		
Amortization of deferred debt issuance costs	77	132
Net (gains) losses on investments	(3,026)	14,209
Proceeds from the sale of securities sold short	82,440	88,453
Purchase of securities sold short	(82,794)	(90,618)
Proceeds from the sale of investments	1,218,258	1,067,609
Purchase of investments	(1,228,204)	(1,079,899)
Changes in operating assets and liabilities:		
Accrued investment income	207	730
Losses recoverable from reinsurers	(27,377)	(5,744)
Accounts receivable	(25,981)	1,084
Funds withheld	6,935	3,881
Prepaid reinsurance premiums	2,979	1,204
Other assets	(1,177)	(932)
Outstanding losses and loss expenses	81,636	25,009
Unearned premiums	12,576	(2,775)
Reinsurance premium payable	9,640	7,572
Amounts due to affiliates	(105)	246
Accounts payable	4,220	(2,672)
Restricted assets	<u>(60,247)</u>	<u>(22,958)</u>
Net cash (used) provided by operating activities	<u>(8,276)</u>	<u>9,279</u>
Cash flows from financing activities		
Repurchase of deferrable subordinated debentures	(5,500)	—
Redemption of common shares, net	<u>(10)</u>	<u>15</u>
Net cash (used) provided by financing activities	<u>(5,510)</u>	<u>15</u>
Net (decrease) increase in cash and cash equivalents	(13,786)	9,294
Cash and cash equivalents at beginning of year	<u>106,844</u>	<u>97,550</u>
Cash and cash equivalents at end of year	\$ 93,058	\$ 106,844
Supplemental disclosure of cash flow information:		
Interest paid	<u>\$ 11,605</u>	<u>\$ 11,872</u>

See accompanying notes to consolidated financial statements

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

1. Nature of the business

Oil Casualty Insurance, Ltd. (the “Company”) was incorporated under the laws of Bermuda on May 14, 1986. The Company’s shareholders comprise companies operating in the energy industry. The Company provides property and casualty insurance and reinsurance on a global basis.

Through October 1, 2015, the Company’s insurance business insured the risks of companies operating in the energy industry while its assumed reinsurance business mainly represented the property and casualty risks of ceding companies that provide such insurance primarily to energy companies. Effective October 1, 2015, the Company expanded its operations to insure and reinsure the same risks of companies outside of the energy industry. The Company holds a Class 3B license under The Insurance Act 1978 of Bermuda and related regulations.

2. Summary of significant accounting policies

The accompanying Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The following are the significant accounting policies adopted by the Company:

(a) Principles of consolidation

These Consolidated Financial Statements include the results of the Company and its wholly-owned subsidiaries, Oil Casualty Investment Corporation Ltd. (“OCICL”) and OCIL Limited. OCICL was established to hold the Company’s investment portfolios. OCIL Limited is a corporate member established during 2016 to participate in Lloyd’s business incepting in 2017. All intercompany transactions are eliminated on consolidation.

(b) Premiums and acquisition costs

Insurance and assumed reinsurance premiums earned are recognized as income in the consolidated statement of operations.

Insurance premiums are recorded as written on the inception date of the policy. Insurance premiums are recognized as income generally on a basis proportionate with the coverage period within the underlying contracts. Unearned premiums represent the portion of premiums written that relate to the unexpired terms of policies in force.

Assumed reinsurance premiums are recorded at the inception of the reinsurance contract and are estimated based upon information in underlying contracts and information provided by clients and/or brokers. Assumed reinsurance premiums written are earned generally on a basis proportionate with the coverage period. Assumed reinsurance premiums written not yet recognized as revenue are recorded on the consolidated balance sheets as unearned premiums.

Due to the nature of reinsurance, ceding companies routinely report and remit premiums to the Company subsequent to the contract coverage period. Consequently, premiums written and receivable include amounts reported and billed by the ceding companies, supplemented by estimates of premiums that are written but not reported. The Company’s premium estimation process considers the terms and conditions of the reinsurance contracts and assumes that the contracts will remain in-force until expiration.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

2. Summary of significant accounting policies (continued)

(b) Premiums and acquisition costs (continued)

The Company's estimates of written premiums may be affected by early cancellation, election of contract provisions for cut-off and return of unearned premiums or other contract disruptions. Changes in assumed reinsurance premium estimates are expected and may result in significant adjustments in any period. These estimates change over time as additional information regarding the underlying exposures insured is obtained. Any subsequent differences arising on such estimates are recorded as premiums written in the period they are determined.

In the ordinary course of business, the Company uses both treaty and facultative reinsurance to minimize its net loss exposure to any one catastrophic loss event or to an accumulation of losses from a number of smaller events. Premiums ceded are pro-rated over the period the reinsurance coverage is provided with the unearned portion being deferred as prepaid reinsurance premiums.

Reinstatement premiums ceded are recognized and accrued at the time losses are incurred and are expensed pro-rata over the reinstated coverage period. Such accruals are based upon actual contractual terms applied to the amount of losses expected to be paid. However, there is a significant amount of management judgment involved with respect to the estimated amount of loss reserves as described in Note 2(c). It is at least reasonably possible that management will revise this estimate significantly in the near term. Any changes in the assessment of the ceded reinsurance premium will be recorded in the period in which it is determined.

Acquisition costs, consisting primarily of commissions, are deferred and charged to income on a pro-rata basis over the term of each policy or reinsurance contract.

(c) Outstanding losses and loss expenses and losses recoverable from reinsurers

Outstanding losses and loss expenses include reserves for reported unpaid losses and loss expenses and for losses incurred but not reported, including an estimate of the loss adjustment expenses. The reserve for outstanding losses and loss expenses for the Company's insurance and reinsurance operations is established by management based on claims reported from insureds or amounts reported from ceding companies at or before the balance sheet date, and represent the ultimate cost of events or conditions that have been reported to or specifically identified by the Company. In addition, a provision for adverse development for reported notifications and for losses incurred but not reported ("IBNR") is estimated by management based on the recommendations of an independent actuary using the past loss history of the Company and industry data. In establishing a provision for unpaid claims and claims expenses related to environmental exposure and clean-up, management considers facts currently known and the current state of laws and litigation.

Liabilities are recognized for known claims when sufficient information has been developed to indicate the involvement of a specific policy, and management can reasonably estimate the Company's liability. A substantial degree of judgment is required in assessing the ultimate cost of outstanding losses and the related amounts recoverable from reinsurers. It is at least reasonably possible that management will revise these estimates significantly in the near term. Any changes in the assessment of the ultimate cost of claims notified to date will be recorded in the period in which they are determined.

Unidentified events or conditions may have occurred which may be validly notified to the Company in subsequent periods and result in losses. Any such losses will be subject to the limits and conditions of the related policies in force at the time of notification.

Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

2. **Summary of significant accounting policies** (continued)

(d) *Investments in marketable securities, other investments and investment income*

Investments are classified as trading and are carried in the Consolidated Balance Sheet at fair value. Realized and unrealized gains and losses are included in the Consolidated Statement of Operations. Security transactions are accounted for on a trade date basis with investment purchases and sales pending settlement accrued in the Consolidated Balance Sheet.

Other investments consist of investments in hedge funds and fund of funds and are carried at fair value. The units of account that are valued by the Company are its interest in the funds and not the underlying holdings of such funds. Thus, the inputs used by the Company to value its investments in each of the funds may differ from the inputs used to value the underlying holdings of such funds. These funds are stated at fair value, which ordinarily will be the most recently reported net asset value ("NAV") as reported by their investment managers or third party administrators. The use of net asset value as an estimate of the fair value for investments in certain entities that calculate the net asset value is a permitted practical expedient. The change in the fair value of hedge fund investments is included in the Consolidated Statement of Operations.

Restricted assets are carried in the Consolidated Balance Sheet at fair value. Realized and unrealized gains and losses are included in the Consolidated Statement of Operations.

Investment gains and losses are computed using the average cost of securities sold and are recorded in the Consolidated Statement of Operations. Dividend income, net of withholding tax, is recorded when declared. Interest income is accrued to the balance sheet date.

Short term investments comprise securities due to mature within one year of the balance sheet date.

(e) *Derivative financial instruments*

The Company recognizes all derivatives as either assets or liabilities in the Consolidated Balance Sheet and measures those instruments at fair value. All changes in the fair value of derivatives are recorded in the Consolidated Statement of Operations. None of the derivatives used by the Company are designated as accounting hedges. Derivatives are used by the Company to mitigate certain risks inherent in holding the underlying debt or equity securities, or are designed to provide exposure to certain sectors or markets and to enhance investment returns. The unrealized gains or losses arising from derivative financial instruments are not separately classified as assets or liabilities in the Consolidated Balance Sheet; they are classified with the underlying debt and equity securities they are designed to hedge or enhance (see Notes 3 and 4).

(f) *Deferred debt issuance costs*

The Company defers costs directly associated with the issuance of debt instruments and amortizes such costs on a straight-line basis over the term of the debt agreements. The amortization is reported within interest and debt expense in the Consolidated Statement of Operations.

(g) *Translation of foreign currency investments and losses*

The costs of foreign currency investments are translated at exchange rates in effect on the date of purchase; fair values are translated at year end exchange rates. Reserves for outstanding losses, accounts receivable and payable and investments in trust which are denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Realized and unrealized exchange gains and losses are included in the Consolidated Statement of Operations.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

2. Summary of significant accounting policies (continued)

(h) Fair value of financial instruments

The following methods and assumptions are used by the Company in estimating the fair values of its financial instruments:

Cash and cash equivalents: The carrying amounts reported in the Consolidated Balance Sheet for these instruments approximate their fair values.

Investments in marketable securities: Fair values of fixed maturity securities, long and short positions in equity securities and short term investments are based on market prices quoted by broker dealers in that market or quoted on the relevant exchange.

Other investments: Hedge fund investments, which are investments in fund of funds and investments in other hedge funds, are valued using the net asset values obtained from the investment managers or the administrators of the respective investment funds. These investment entities generally carry their investments at fair value.

Derivatives: The fair value of these instruments are based upon quoted market prices. Where quoted market prices are not available, fair value is based upon prices provided by the counterparty.

Loan payable: The fair value of the outstanding debentures approximate their carrying value as the Company pays interest at market rates.

Other assets and liabilities: The fair values of restricted assets, investment purchases and sales pending settlement, amounts due to affiliates, reinsurance premiums payable, accounts receivable, funds withheld and accounts payable approximate their carrying value due to the immediate or short term maturity of these financial instruments.

The estimates of fair value presented herein are subjective in nature and are not necessarily indicative of the amounts that the Company could realize in a current market exchange. Any differences are not expected to be material. All non-financial instruments such as unearned premiums, prepaid reinsurance premiums, other assets and financial instruments related to insurance contracts such as outstanding losses and loss expenses and losses recoverable from reinsurers are excluded from fair value disclosure. Thus the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

(i) Short selling

The Company may sell a security it does not own in anticipation of a decline in the fair value of that security. The Company must borrow the security or enter into an arrangement to borrow the security before the Company sells a security short. The Company is required to maintain collateral with the broker-dealer from which the security was borrowed. A gain, limited to the price at which the Company sold the security short, or a loss, unlimited in size, will be recognized upon the termination of a short sale. The Company is also subject to the risk that it may be unable to reacquire a security to close a short position except at a price substantially in excess of the last quoted price. Realized and unrealized gains and losses arising from short sales are recorded within net gains on investments in the Consolidated Statement of Operations. Securities sold short are recorded as liabilities in the Consolidated Balance Sheet at fair value.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

2. Summary of significant accounting policies (continued)

(j) Cash and cash equivalents

For the purposes of the Consolidated Statement of Cash Flows, cash equivalents include time deposits with an original maturity period of ninety days or less.

As at November 30, 2016, cash in the amount of \$26.0 million (2015: \$36.9 million) was on deposit with counterparties as collateral for securities sold short and positions held in derivative financial instruments (Note 4).

(k) Recently adopted accounting pronouncements

During the year ended November 30, 2015, the Company elected to early adopt the guidance issued in ASU No. 2015-7, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or its Equivalent)", which removed the requirement to categorize within the fair value hierarchy all investments measured using the net asset value per share practical expedient in all periods presented. The adoption of this accounting guidance did not have a material impact on the Company's financial statements.

During the year ended November 30, 2016, the Company retrospectively adopted guidance issued in ASU No. 2015-03 "Simplifying the Presentation of Debt Issuance Costs". ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the associated debt liability. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in ASU 2015-03. The impact on the Company's consolidated balance sheet at November 30, 2015, was to reduce each of other assets and loan payable by \$2.5 million, respectively, which represented the deferred debt issuance costs previously recorded in other assets and reclassified as an offset to loan payable. There was no net impact on the Company's Consolidated Statements of Operations, Consolidated Statement of Cash Flows or Consolidated Statement of Changes in Shareholders' Equity as a result of the retrospective adoption of ASU 2015-03.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

3. Investments

The fair values of investments as at November 30, 2016 and 2015 are as follows:

	<u>2016</u> (\$'000)	<u>2015</u> (\$'000)
<u>Short Term Investments</u>	\$ <u>142,085</u>	\$ <u>108,042</u>
<u>Derivatives, net</u>	<u>5,416</u>	<u>(116)</u>
<u>Equity Securities</u>	<u>87,417</u>	<u>124,276</u>
<u>Fixed Maturities</u>		
US Treasury and Government Agency	143,007	80,192
State and Municipal Bonds	12,542	14,578
Non-US Government Bonds	90,885	105,531
Supranationals	3,774	7,709
Corporate Bonds	170,940	161,610
Asset-Backed Securities	41,810	37,360
Mortgage-Backed Securities	<u>67,836</u>	<u>59,705</u>
Total Fixed Maturities	<u>530,794</u>	<u>466,685</u>
Total Investments in Marketable Securities and Derivatives	\$ <u>765,712</u>	\$ <u>698,887</u>
Other Investments	\$ <u>85,203</u>	\$ <u>112,738</u>

In the table above, mortgage-backed securities issued by US government agencies are combined with other mortgage-backed securities held and are included in the category "Mortgage-Backed Securities". At November 30, 2016, approximately 66% (2015: 43%) of the total mortgage-backed holdings are represented by investments in GNMA, FNMA and FHLMC securities. The remainder of the mortgage exposure consists of collateralized mortgage obligations and non-government issued securities, the majority of which have investment grade credit ratings.

The credit quality of fixed maturities and short term investments as at November 30, 2016 and 2015, are as follows:

	<u>2016</u> (\$'000)	<u>2015</u> (\$'000)
US Government and Agency	\$ 213,459	\$ 142,743
AAA	116,761	94,150
AA	69,055	78,956
A	104,985	94,621
BBB	105,865	100,906
Below BBB	<u>62,754</u>	<u>63,351</u>
Total fixed maturities and short term investments	\$ <u>672,879</u>	\$ <u>574,727</u>

The Company's methodology for assigning credit ratings to fixed maturities and short term investments uses the lower rating as determined by Standard & Poor's and Moody's Investors Services. Securities with a credit rating below investment grade as at November 30, 2016, had an unrealized loss of \$1.6 million (2015: \$3.0 million loss) at the same date, which has been recorded in the Consolidated Statement of Operations.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

3. Investments (continued)

At November 30, 2016, \$66.9 million (2015: \$90.4 million) of investments are held in joint custody accounts with Oil Investment Corporation Ltd., a company affiliated through common shareholders. Under the terms of the joint custody agreement the Company owns 4.0% (2015: 5.5%) of each security held in these joint custody accounts. The Company records its proportionate share of the investment assets, liabilities, income, net realized and unrealized gains and losses within these Consolidated Financial Statements.

The contractual maturities of fixed maturities and short term investments as at November 30, 2016 and 2015 are as follows:

	<u>2016</u> (\$'000)	<u>2015</u> (\$'000)
Due in one year or less	\$ 142,085	\$ 108,042
Due after one year through five years	193,898	145,496
Due after five years through ten years	112,084	123,019
Due after ten years	<u>115,166</u>	<u>101,105</u>
	563,233	477,662
Asset-Backed Securities	41,810	37,360
Mortgage-Backed Securities	<u>67,836</u>	<u>59,705</u>
Total Fixed Maturities and short term investments	\$ 672,879	\$ 574,727

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties and the lenders may have the right to put or sell the securities back to the borrower.

The gross realized gains and losses on investments and the change in unrealized gains and losses for the years ended November 30, 2016 and 2015 are as follows:

	<u>2016</u> (\$'000)	<u>2015</u> (\$'000)
Gross realized gains on investments	\$ 100,297	\$ 102,460
Gross realized losses on investments	(106,197)	(109,544)
Gross realized gains on derivative instruments	48,968	72,450
Gross realized losses on derivative instruments	(51,404)	(49,650)
Gross realized gains on other investments	129	5,324
Gross realized losses on other investments	(583)	(16)
Change in net unrealized gains and losses during the year on investments	6,313	(33,459)
Change in net unrealized gains and losses during the year on other investments	(375)	(3,115)
Change in net unrealized gains and losses during the year on derivative instruments	5,532	1,326
Change in net unrealized gains and losses during the year on restricted assets	<u>346</u>	<u>15</u>
Net gains (losses) on investments	\$ 3,026	\$ (14,209)

During the year ended November 30, 2016, the change in net unrealized gains and losses on investments was attributable to movements in the fair value of the Company's fixed maturities and short term investments of a \$4.6 million gain (2015: \$31.6 million loss) and equity securities of a \$1.7 million gain (2015: \$1.9 million loss).

3. **Investments** (continued)

Under U.S. GAAP the Company is required to determine the appropriate level in the fair value hierarchy for each fair value measurement. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Level 1 financial instruments include certain short duration instruments such as money market funds, short term investments, U.S. treasury securities and exchange traded equities.

Level 2 inputs are those which are observable for the asset or liability, either directly or indirectly. These inputs may include quoted prices for similar instruments, interest rates, prepayment speeds, credit risk, yield curves, default rates and similar observable market data. Level 2 financial instruments include sovereign debt, corporate debt, U.S. agency and non-agency mortgage and asset-backed securities and derivatives.

Level 3 includes financial instruments whose value is based on valuation techniques that use significant inputs which are unobservable. These measurements include circumstances in which there is little, if any, market activity for the asset or liability. In making the assessment, the Company considers factors specific to the asset or liability and such an assessment will involve significant management judgment. Because of the inherent uncertainty in the valuation of these Level 3 investments, fair values of such investments may differ from the values that would have been used had a ready market for these investments existed, and the differences could be material.

When the inputs used to measure fair value fall within different levels of the hierarchy, the level within which the fair value measurement is categorized is based on the lowest level input that is significant to the fair value measurement in its entirety. Thus, a Level 3 fair value measurement may include inputs that are observable (Level 1 and 2) and unobservable (Level 3).

Fair value prices for all securities in the fixed maturities portfolio are independently provided by the investment custodian and the investment managers, which each utilize internationally recognized independent pricing services. The Company records the unadjusted price provided by the investment custodian or the investment accounting service provider and validates this price through a process that includes, but is not limited to: (i) comparison to the price provided by the investment manager, with significant differences investigated; (ii) quantitative analysis (e.g. comparing the quarterly return for each managed portfolio to its target benchmark, with significant differences identified and investigated); (iii) evaluation of methodologies used by external pricing sources to calculate fair value; and (iv) comparing the price to the Company's knowledge of the current investment market.

The independent pricing services used by the investment custodian, investment accounting service provider and investment managers obtain actual transaction prices for securities that have quoted prices in active markets. Each pricing service has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of "matrix pricing" in which the independent pricing service uses observable market inputs including, but not limited to, reported trades, benchmark yields, broker/dealer quotes, interest rates, prepayment speeds, default rates and such other inputs as are available from market sources to determine a reasonable fair value. In addition, pricing services use valuation models to develop prepayment and interest rate scenarios.

The fair values of short-term investments are determined based on observable inputs that may include the spread above the risk-free yield curve, reported trades and broker-dealer quotes.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

3. **Investments** (continued)

For all assets classified as Level 2, the market approach is utilized. The significant inputs used to determine the fair value of those assets classified as Level 2 are as follows:

- US government agency securities fair values were based on observable inputs that may include the spread above the risk-free yield curve, reported trades and broker/dealer quotes. These are considered observable market inputs and, therefore, the fair value of these securities are classified within Level 2.
- Non-U.S. government securities consist of bonds issued by non-U.S. governments and agencies along with supranational organizations. The significant inputs include the spread above the risk-free yield curve, reported trades and broker/ dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified within Level 2.
- Corporate securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker/ dealer quotes, benchmark yields, and industry and market indicators. These are considered observable market inputs and, therefore, the fair value of these securities are classified within Level 2.
- Municipal securities consist primarily of bonds issued by U.S. domiciled state and municipality entities. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker/ dealer quotes and benchmark yields. These are considered observable market inputs and, therefore, the fair value of these securities are classified within Level 2.
- Asset-backed securities consist primarily of investment-grade bonds backed by pools of loans with a variety of underlying collateral. The significant inputs used to determine the fair value of these securities include the spread above the risk-free yield curve, reported trades, benchmark yields, broker/dealer quotes, prepayment speeds, and default rates. These are considered observable market inputs and, therefore, the fair value of these securities are classified within Level 2.
- Residential and commercial mortgage-backed securities include both agency and non-agency originated securities. Agency originated securities include securities issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and other U.S. government agencies. The significant inputs used to determine the fair value of these securities include the spread above the risk-free yield curve, reported trades, benchmark yields, broker/dealer quotes, prepayment speeds, and default rates. These are considered observable market inputs and, therefore, the fair value of these securities are classified within Level 2.

The ability to obtain quoted market prices is reduced in periods of decreasing liquidity, which generally increases the use of matrix pricing methods and generally increases the uncertainty surrounding the fair value estimates. This could result in the reclassification of a security between levels of the fair value hierarchy.

The Company invests in hedge “fund of funds” which invest in a number of underlying funds, following different investment strategies. As of November 30, 2016, the “fund of funds” portfolio was invested in a variety of strategies, with the common strategies being long / short equity, global macro, event driven, fundamental equity and commodities. In general, the fund of funds in which the Company is invested require at least 91 days’ notice of redemption, and may be redeemed on a quarterly or semi-annual basis, depending on the fund of fund. Certain fund of funds have a lock-up period. A lock-up period refers to the initial amount of time an investor is contractually required to invest before having the ability to redeem.

3. **Investments** (continued)

Fund of funds that do provide for periodic redemptions may, depending on the fund of funds' governing documents, have the ability to deny or delay a redemption request, called a "gate". The fund of fund may implement this restriction because the aggregate amount of redemption requests as of a particular date exceeds a specified level, generally ranging from 20% to 35% of the fund of fund's net assets. The gate is a method for executing an orderly redemption process that allows for redemption requests to be executed in a timely manner to reduce the possibility of adversely affecting the remaining investors in the fund of fund. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash sometime after the redemption date. Certain fund of funds may be allowed to invest a portion of their assets in illiquid securities, such as private equity or convertible debt. In such cases, a common mechanism used is a side-pocket, whereby the illiquid security is assigned to a separate memorandum capital account or designated account. Typically the investor loses its redemption rights in the designated account. Only when the illiquid security is sold, or otherwise deemed liquid by the fund of fund, may investors redeem their interest in the side-pocket. As of November 30, 2016, the fair value of hedge funds held in lock ups, side-pockets or gates was \$8.1 million (2015: \$9.4 million).

The Company has ongoing due diligence processes with respect to funds in which it invests and their managers. These processes are designed to assist the Company in assessing the quality of information provided by, or on behalf of, each fund and in determining whether such information continues to be reliable or whether further review is warranted. Certain funds do not provide full transparency of their underlying holdings; however the Company obtains the audited financial statements for the fund of fund managers annually, and regularly reviews and discusses the fund performance with the fund managers to corroborate the reasonableness of the reported net asset values. While reported net asset value is the primary input to the review, when the net asset value is deemed not to be indicative of fair value, the Company may incorporate adjustments to the reported net asset value and not use the permitted practical expedient on an investment by investment basis. These adjustments may involve significant management judgment. The Company has not made any such adjustments for the year ended November 30, 2016 or 2015. Hedge fund investments measured at net asset value are not required to be disclosed within the fair value hierarchy following the Company's adoption of ASU 2015-07.

Derivative financial instruments that have quoted prices on a recognized exchange, such as futures and option contracts, are classified as Level 1. Over the counter derivative instruments such as interest rate swaps, foreign exchange forward contracts and credit default swaps, whose prices are based upon reports from counterparties of the transactions or observable market inputs, are classified as Level 2.

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets and liabilities. Reclassifications between Level 1, 2 and 3 of the fair value hierarchy are reported as transfers in and/or out as of the beginning of the quarter in which the reclassifications occur.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

3. **Investments** (continued)

The following tables summarize the levels of inputs used as at November 30, 2016 and 2015, in determining the classification of investment assets and liabilities held at fair value:

November 30, 2016 <u>Assets</u>	<u>Level 1</u> (\$'000)	<u>Level 2</u> (\$'000)	<u>Level 3</u> (\$'000)	<u>NAV</u> ¹ (\$'000)	<u>Total</u> (\$'000)
Short Term Investments	\$ 70,453	\$ 71,562	\$ 70	\$ –	\$ 142,085
Derivatives, net	–	5,416	–	–	5,416
Equity Securities	78,400	–	–	9,017	87,417
US Treasury and Government Agency	142,910	97	–	–	143,007
State and Municipal Bonds	–	12,542	–	–	12,542
Non-US Government Bonds	–	89,406	–	1,479	90,885
Supranationals	–	3,774	–	–	3,774
Corporate Bonds	–	159,266	–	11,674	170,940
Asset-Backed Securities	–	41,810	–	–	41,810
Mortgage-Backed Securities	–	67,459	–	377	67,836
Total Investments in Marketable Securities and Derivatives	\$ 291,763	\$ 451,332	\$ 70	22,547	\$ 765,712
Other Investments measured at net asset value ¹					\$ 85,203
November 30, 2016 <u>Liabilities</u>	<u>Level 1</u> (\$'000)	<u>Level 2</u> (\$'000)	<u>Level 3</u> (\$'000)	<u>NAV</u> ¹ (\$'000)	<u>Total</u> (\$'000)
Equity Securities sold short	\$ (18,022)	\$ –	\$ –	\$ –	\$ (18,022)
November 30, 2015 <u>Assets</u>	<u>Level 1</u> (\$'000)	<u>Level 2</u> (\$'000)	<u>Level 3</u> (\$'000)	<u>NAV</u> ¹ (\$'000)	<u>Total</u> (\$'000)
Short Term Investments	\$ 62,551	\$ 44,759	\$ 732	\$ –	\$ 108,042
Derivatives, net	–	(116)	–	–	(116)
Equity Securities	106,430	–	–	17,846	124,276
US Treasury and Government Agency	80,097	95	–	–	80,192
State and Municipal Bonds	–	14,578	–	–	14,578
Non-US Government Bonds	–	104,121	–	1,410	105,531
Supranationals	–	7,709	–	–	7,709
Corporate Bonds	–	154,022	–	7,588	161,610
Asset-Backed Securities	–	37,360	–	–	37,360
Mortgage-Backed Securities	–	59,326	–	379	59,705
Total Investments in Marketable Securities and Derivatives	\$ 249,078	\$ 421,854	\$ 732	27,223	\$ 698,887
Other Investments measured at net asset value ¹					\$ 112,738

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

3. **Investments** (continued)

November 30, 2015	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u> ¹	<u>Total</u>
<u>Liabilities</u>	(\$'000)	(\$'000)	(\$'000)	(\$'000)	(\$'000)
Equity Securities sold short	(24,284)	\$ —	\$ —	\$ —	\$ (24,284)

¹ Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy following the Company's adoption of ASU 2015-07. The fair value amounts presented in these tables are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statement of financial position.

The following tables present the reconciliation of the beginning and ending fair value measurements of the Company's Level 3 assets, measured at fair value using significant unobservable inputs for the year ended November 30, 2016 and 2015:

	Short Term Investments (\$'000)	Total (\$'000)
Beginning balance at December 1, 2015	\$ 732	\$ 732
Purchases and issuances	—	—
Sales and settlements	(696)	(696)
Transfers into Level 3	—	—
Transfers out of Level 3	—	—
Reclassification	—	—
Realized and unrealized gains included in net income for the year	34	34
Ending balance at November 30, 2016	\$ 70	\$ 70

	Short Term Investments (\$'000)	Corporate Bonds (\$'000)	Total (\$'000)
Beginning balance at December 1, 2014	\$ 192	\$ 623	\$ 815
Purchases and issuances	—	—	—
Sales and settlements	(74)	—	(74)
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	—	—
Reclassification	623	(623)	—
Realized and unrealized gains included in net income for the year	(9)	—	(9)
Ending balance at November 30, 2015	\$ 732	\$ —	\$ 732

The fair value measurements of the Company's Level 3 short term investments were based on unadjusted third party pricing sources.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

3. Investments (continued)

During the year ended November 30, 2016, there were no transfers in or out of Levels 1, 2 or 3.

During the year ended November 30, 2015, certain corporate investments were reclassified to short term investments due to the remaining time to maturity. There were no other transfers in or out of Levels 1, 2 or 3 during the year ended November 30, 2015.

4. Commitments and contingencies*(a) Derivative instruments*

The Company's investment guidelines permit, subject to specific approval, investment in derivative instruments such as futures and option contracts, interest rate swaps and forward foreign currency contracts. Their use is regularly monitored and they are used for yield enhancement, duration management, interest rate and foreign currency exposure management or to obtain an exposure to a particular financial market. The Company's use of derivative instruments with embedded leverage such as futures, swaps and options contracts may increase the Company's investment risk. Credit risk arises from the potential inability of counterparties to perform under the terms of the contract.

The tables below show the fair value of the Company's derivative instruments recorded in Investments in Marketable Securities and Derivatives in the Consolidated Balance Sheet as at November 30, 2016 and 2015:

	<u>Derivative Assets</u>	<u>Derivative Liabilities</u>
	2016	2016
	Fair Value	Fair Value
	(\$'000)	(\$'000)
Interest rate swaps	\$ 883	\$ 2,346
Credit default swaps	107	287
Equity swaps	165	151
Fixed income and currency options	402	388
Forward foreign currency contracts	9,197	2,338
Equity futures	209	38
Interest rate futures	1,160	1,159
Total	<u>\$ 12,123</u>	<u>\$ 6,707</u>

	<u>Derivative Assets</u>	<u>Derivative Liabilities</u>
	2015	2015
	Fair Value	Fair Value
	(\$'000)	(\$'000)
Interest rate swaps	\$ 1,080	\$ 4,375
Credit default swaps	11	49
Equity swaps	75	227
Fixed income and currency options	155	214
Forward foreign currency contracts	5,122	1,502
Equity futures	326	-
Interest rate futures	921	1,439
Total	<u>\$ 7,690</u>	<u>\$ 7,806</u>

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

4. Commitments and contingencies (continued)*(a) Derivative instruments (continued)*

The tables below show the net gains and losses on the Company's derivative instruments recorded in the net gains (losses) on investments in the Consolidated Statement of Operations during the years ended November 30, 2016 and 2015:

	2016		
	Net realized gains and (losses) (\$'000)	Change in unrealized gains and (losses) (\$'000)	Net gains and (losses) (\$'000)
Interest rate swaps	\$ (209)	\$ 1,832	\$ 1,623
Credit default swaps	–	(142)	(142)
Equity swaps	(15)	166	151
Fixed income and currency options	872	73	945
Forward foreign currency contracts	(1,583)	3,239	1,656
Equity futures	719	(155)	564
Interest rate futures	(2,220)	519	(1,701)
Total	\$ (2,436)	\$ 5,532	\$ 3,096

	2015		
	Net realized gains and (losses) (\$'000)	Change in unrealized gains and (losses) (\$'000)	Net gains and (losses) (\$'000)
Interest rate swaps	\$ 244	\$ 528	\$ 772
Credit default swaps	–	(24)	(24)
Equity swaps	61	(440)	(379)
Fixed income and currency options	1,855	118	1,973
Forward foreign currency contracts	21,706	(69)	21,637
Equity futures	(191)	301	110
Interest rate futures	(875)	912	37
Total	\$ 22,800	\$ 1,326	\$ 24,126

(i) Foreign currency exposure management

A forward foreign currency contract is a commitment to purchase or sell a foreign currency at a future date, at a negotiated rate. The unrealized gain or loss on open forward contracts represents the Company's net equity therein and is calculated as the difference between the contract date rate and the applicable forward rate at the reporting date as reported in published sources, applied to the face amount of the contract. The unrealized gain or loss at the reporting date is included in investments in marketable securities and derivatives in the Consolidated Balance Sheet. The Company utilizes forward foreign currency contracts to manage the impact of fluctuations in foreign currencies on the value of its foreign currency denominated investments.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

4. Commitments and contingencies (continued)*(a) Derivative instruments (continued)**(i) Foreign currency exposure management (continued)*

Forward foreign currency contracts expose the Company to credit, market and liquidity risks. The Company is exposed to market risk to the extent that adverse changes occur in the exchange rate of the underlying foreign currency. This market risk is in excess of the amounts recognized in the Consolidated Balance Sheet. Liquidity risk represents the possibility that the Company may not be able to rapidly adjust the size of its forward positions in times of high volatility and financial stress at a reasonable price. The Company's investment guidelines only permit the use of counterparties carrying a credit rating of A3 or higher by the major rating agencies.

At November 30, 2016 and 2015, the Company had the following open forward foreign currency contracts:

<u>Currency</u>	<u>2016</u>		<u>2015</u>	
	<u>Notional Receivable</u> (\$'000)	<u>Notional Payable</u> (\$'000)	<u>Notional Receivable</u> (\$'000)	<u>Notional Payable</u> (\$'000)
AUD	\$ 6,177	\$ (14,074)	\$ 7,455	\$ (13,853)
BRL	1,294	(6,573)	1,734	(4,186)
CAD	10,730	(19,093)	10,395	(22,486)
CNH	1,533	(1,546)	1,570	(2,611)
CNY	–	(6,820)	1,629	(1,679)
DKK	453	(20,410)	–	(8,606)
EUR	25,935	(69,177)	46,164	(118,366)
GBP	19,288	(38,527)	15,906	(40,507)
INR	2,309	(457)	5,571	(2,158)
JPY	2,604	(35,304)	8,316	(22,937)
KRW	488	(5,142)	2,054	(6,715)
MXN	4,206	(4,640)	2,454	(9,966)
NZD	1,590	(2,575)	3,021	(5,425)
PLN	1,785	(5,101)	1,296	(792)
SEK	5,623	(1,425)	1,796	(1,157)
SGD	2,144	(6,738)	1,105	(1,832)
TRY	1,051	(1,162)	735	(1,265)
TWD	2,467	(5,145)	989	(1,899)
USD	243,250	(83,235)	269,240	(109,850)
Other	7,016	(5,940)	4,816	(6,336)
	<u>\$ 339,943</u>	<u>\$ (333,084)</u>	<u>\$ 386,246</u>	<u>\$ (382,626)</u>

At November 30, 2016, unrealized gains of \$9.2 million (2015: \$5.1 million) and unrealized losses of \$2.3 million (2015: \$1.5 million) on forward foreign currency contracts are included in investments in marketable securities and derivatives in the Consolidated Balance Sheet.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

4. Commitments and contingencies (continued)

(a) Derivative instruments (continued)

(ii) Duration management, interest rate management and market exposure management

Futures

A portion of the Company's portfolio is invested in bond, note, money market, equity index and interest rate futures contracts. Such futures provide the Company with participation in market movements, determined by the underlying instrument or index on which the futures contract is based, without holding the instrument itself or individual bonds or stocks in that index. This approach allows the Company more efficient and less costly access to bond and stock market exposure than would be available by the exclusive use of individual bonds and stocks. Exchange-traded bond and note futures contracts may also be used in the investment portfolios as substitutes for ownership of the physical bonds and notes.

All financial futures contracts are held on a non-leveraged basis, fully backed at all times by short term investments and cash equivalents that are posted as margin collateral.

The unrealized gain or loss on financial futures contracts is calculated as the difference between the contract's price on the trade date and the contract's closing price on the valuation date as reported by the exchange on which the futures contracts are traded.

When entering a financial futures contract, the Company is required to provide initial margin which is a deposit of either cash or securities in an amount equal to a certain percentage of the contract value. The initial margin is adjusted to reflect changes in the value of the futures contract which are marked to market on a daily basis. The Company recognizes a realized gain or loss when the contract is closed. Futures contracts expose the Company to market and liquidity risks. The Company is exposed to market risk to the extent that adverse changes occur in the market values of the underlying securities or indices. This market risk is in excess of the amount recognized in the Consolidated Balance Sheet. Liquidity risk represents the possibility that the Company may not be able to rapidly adjust the size of its futures positions in times of high volatility and financial stress at a reasonable price. Exchange-traded futures are subject, however, to a number of safeguards to ensure that obligations are met, including the use of clearing houses, the posting of margins and the daily settlement of futures profits and losses and the amount of credit risk is therefore considered low.

At November 30, 2016 and 2015 the contractual values of financial futures contracts are:

	2016		2015	
	Long (\$'000)	Short (\$'000)	Long (\$'000)	Short (\$'000)
Equity index futures contracts	\$ 5,899	\$ –	\$ 7,897	\$ –
Bond and note futures contracts	260,567	(206,842)	191,804	(205,838)

The Company had gross gains of \$1.4 million and gross losses of \$1.2 million on open futures contracts for the year ended November 30, 2016 (2015 – gross gains \$1.2 million and gross losses \$1.4 million). These gains and losses are included in the Consolidated Statement of Operations. The Company holds a margin account with its futures broker for the purposes of paying and receiving cash in connection with its futures transactions. Gains and losses are settled daily in cash in this margin account.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

4. Commitments and contingencies (continued)

(a) Derivative instruments (continued)

(ii) Duration management, interest rate management and market exposure management (continued)

Swaps and Options

In order to manage interest rate exposure, portfolio duration or capitalize on anticipated changes in interest rate volatility, the Company may engage in interest rate swap transactions, buy and sell call and put options and write call and put options if the options are secured by holdings in the underlying securities or by other means which would permit immediate satisfaction of the Company's obligation as a writer of the option contracts.

Swaps and Option contracts are marked to market daily with unrealized gains and losses recorded in the Consolidated Statement of Operations.

At November 30, 2016 and 2015 the fair value of open interest rate swap contracts is:

	2016 (\$'000)	2015 (\$'000)
Interest rate swaps, net	\$ (1,463)	\$ (3,295)

Interest rate swap agreements involve the exchange by the Company with another party of their respective commitments to pay or receive interest (e.g. an exchange of floating rate payments for fixed rate payments) with respect to a notional amount of principal. Entering into these agreements involves, to varying degrees, elements of credit and market risk in excess of the amounts recognized in the Consolidated Balance Sheet. Such risks involve the possibility that there will be no liquid market for these agreements, that the counterparty to the agreements may default on its obligation to perform, or that there may be unfavorable changes in interest rates.

At November 30, 2016 and 2015 the fair value of open fixed income and currency option contracts is:

	2016 (\$'000)	2015 (\$'000)
Options purchased	\$ 402	\$ 155
Options written (liability)	(388)	(214)

Premiums received for open written options as of November 30, 2016, amounted to \$0.5 million (2015: \$0.3 million).

Option contracts provide the option purchaser with the right but not the obligation to buy or sell a financial instrument at a predetermined exercise price during a defined period. The option writer is obligated to buy or sell the item underlying the contract at a set price, if the option purchaser chooses to exercise the option. As a purchaser of an option contract, the Company is subject to credit risk since the counterparty is obligated to make payments under the terms of the option contract if the Company exercises the option and the Company is only subject to market risk to the extent of the premium paid. As a writer of an option contract, the Company is not subject to credit risk but is subject to market risk, since the Company is obligated to make payments under the terms of the option contract if exercised.

4. **Commitments and contingencies** (continued)

(a) *Derivative instruments* (continued)

(ii) *Duration management, interest rate management and market exposure management* (continued)

The Company uses credit default swaps as a way to manage credit risk to an individual issuer or a basket of issuers. When the Company buys protection, the Company pays a premium to the seller of the protection for the right to receive the par value of the bond in the event of default by the issuer, thereby reducing the Company's credit risk.

(b) *Concentrations of credit risk*

The investment portfolio is managed following prudent standards of diversification across counterparties, issuers, asset classes and geographical regions. Investments are allocated over three broad asset classes which are global equity, global fixed income and hedge funds. Investment guidelines are designed to limit the holdings of a single issue and issuer, control non-US dollar currency exposure and minimize sovereign risk. Fixed maturity securities held with maturities of longer than one year generally have a minimum investment rating of B3/B- or better and at least 85% (at fair value) generally have a minimum rating of Baa3/BBB- or better with average quality for the total portfolio of A2/A. The Company utilizes the lower rating as determined by Standard & Poor's and Moody's Investors Services. If a security is not rated by Standard & Poor's or Moody's Investors Services, the equivalent implied rating is utilized. Cash equivalents must carry a rating of A1/P1.

The Company's maximum permitted fixed income investment in any one institution rated BBB-/Baa3 or higher is 10% of the market value of the global fixed income portfolio with the exception of securities which are rated AA-/Aa3 or higher and issued or guaranteed by the US Treasury, US government agencies, or the Government of Canada, Japan, Australia, the United Kingdom or EMU countries of the European Union. The maximum permitted fixed income investment in any one institution rated below BBB-/Baa3 is 5% of the market value of the global fixed income portfolio. The maximum permitted equity investment in any one company, at the time of purchase, should not exceed the greater of 5% of the market value of the global equity portfolio or 150% of its weighting in the global equity benchmark index, with the latter subject to a maximum limitation of 10% of the market value of the global equity portfolio. The Company believes that there are no significant concentrations of credit risk associated with its investments in any issuer or market.

(c) *Prime brokers*

One large investment bank (the "Prime Broker") has been appointed as the Company's Prime Broker. At November 30, 2016, under the Customer Prime Broker Account Agreement, \$20.8 million (2015: \$30.4 million) of the assets of the Company are held by the Prime Broker and each of the Prime Broker's affiliated companies are subject to a general lien and a continuing first priority perfected security interest in favor of the Prime Broker and therefore constitute collateral security for the Company's obligations and liabilities to the Prime Broker. The Prime Broker has a long term credit rating of A as issued by Standard and Poor's.

(d) *Use of short selling*

As part of the Company's overall investment strategy it allocates certain funds to long/short portfolios that are managed using a market neutral investment strategy. The market neutral investment strategy will typically hold short equity positions in the same and/or related sectors as the strategy's long positions to limit exposure to market events and to reduce the Company's investment risk within the strategy.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

4. Commitments and contingencies (continued)

(e) Restricted assets

At November 30, 2016 and 2015, the fair values of the Company's restricted assets are as follows:

	<u>2016</u> (\$'000)	<u>2015</u> (\$'000)
Assets pledged under Insurance Trusts (i)	\$ 135,744	\$ 89,651
Funds at Lloyds (ii)	<u>14,500</u>	<u>—</u>
Total Restricted Assets	<u>\$ 150,244</u>	<u>\$ 89,651</u>

The Company would classify these restricted assets within level 1 of the fair value hierarchy.

(i) Assets pledged under Insurance Trusts

Certain of the Company's invested assets were held in trust and pledged in support of its reinsurance liabilities. Such pledges are largely required by the Company's operations that are "non-admitted" under U.S. state and other jurisdiction's insurance regulations, in order for the cedant to receive statutory credit for reinsurance. As at November 30, 2016, the Company had \$135.7 million (2015: \$89.7 million) pledged specifically under Insurance Trusts, of these amounts, \$1.5 million (2015: \$8.4 million) was held in cash and cash equivalents and \$134.2 million (2015: \$81.3 million) was held in short-term US Treasury Bills.

(ii) Funds at Lloyd's

The Company provides cash capital in the form of Funds at Lloyd's for use in Lloyds business through a corporate member, OCIL Limited. OCIL Limited will participate in Lloyds business through five Syndicates commencing in the Lloyds 2017 year of account.

5. Outstanding losses and loss expenses

The reserve for outstanding losses and loss expenses is provided on the basis of current estimates made by the Company's claims personnel, independent actuarial consultants and legal advisors. Outstanding loss reserves comprise individual case reserves, reserves for adverse loss development on reported claims and IBNR reserves. The summary of changes in outstanding loss and loss expenses for 2016 and 2015 is as follows:

	<u>2016</u> (\$'000)	<u>2015</u> (\$'000)
Gross balance, beginning of year	\$ 441,055	\$ 416,046
Less: losses recoverable from reinsurers	<u>(165,567)</u>	<u>(159,823)</u>
Net balance, beginning of year	275,488	256,223
Loss and loss expenses incurred related to:		
Current year	87,302	106,318
Prior years	<u>(19,640)</u>	<u>(49,041)</u>
Total loss and loss expenses incurred	<u>67,662</u>	<u>57,277</u>

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

5. Outstanding losses and loss expenses (continued)	<u>2016</u>	<u>2015</u>
	(\$'000)	(\$'000)
Paid loss and loss expenses related to:		
Current year	(1,321)	(1,470)
Prior years	<u>(12,082)</u>	<u>(36,542)</u>
Total paid loss and loss expenses	(13,403)	(38,012)
Net balance, end of year	329,747	275,488
Plus: losses recoverable from reinsurers	<u>192,944</u>	<u>165,567</u>
Gross balance, end of year	\$ 522,691	\$ 441,055

The 2016 current year incurred losses of \$87.3 million relate to: (i) the establishment of \$24.9 million of IBNR on the Company's direct insurance book of business for the 2016 underwriting year; (ii) the establishment of IBNR totaling \$48.7 million on the Company's assumed reinsurance book of business for the 2016 year; (iii) case reserves totaling \$13.0 million on the Company's assumed reinsurance book of business for the 2016 year; and (iv) case reserves totaling \$0.7 million on the Company's direct insurance book of business for the 2016 underwriting year.

During the year ended November 30, 2016, the incurred losses for prior year claims of \$(19.6) million primarily relate to: (i) favorable development on prior year claims of \$16.1 million on the Company's direct insurance book of business; (ii) favorable development totaling \$5.6 million on the Company's assumed reinsurance book of business for prior years; and (iii) \$2.1 million of loss expenses incurred over the Company's entire book of business.

The 2015 current year incurred losses of \$106.3 million relate to: (i) the establishment of \$34.4 million of IBNR on the Company's direct insurance book of business for the 2015 underwriting year; (ii) the establishment of IBNR totaling \$39.6 million on the Company's assumed reinsurance book of business for the 2015 year; (iii) case reserves totaling \$17.3 million on the Company's assumed reinsurance book of business for the 2015 year; and (iv) case reserves totaling \$15.0 million on the Company's direct insurance book of business for the 2015 underwriting year.

During the year ended November 30, 2015, the incurred losses for prior year claims of \$(49.0) million primarily relate to: (i) favorable development on prior year claims of \$35.3 million on the Company's direct insurance book of business; (ii) favorable development totaling \$14.8 million on the Company's assumed reinsurance book of business for prior years; and (iii) \$1.1 million of loss expenses incurred over the Company's entire book of business.

The Company's reserve for losses relating to pollution liabilities has been established in accordance with generally accepted accounting principles for loss contingencies. There are significant uncertainties involved in estimating the Company's ultimate liability for pollution claims. These uncertainties include, amongst others, (i) potentially long latency periods, (ii) difficulty in establishing the commencement date of the pollution, (iii) delays in the reporting of claims, (iv) uncertainty regarding the extent of the underlying and/or other insurance coverages, which may respond before the Company and (v) the future outcome of litigation that is currently in process and the potential that exists for punitive and compensatory awards.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

5. **Outstanding losses and loss expenses** (continued)

To assist in determining this reserve, management has obtained the advice of independent actuaries who annually establish an estimate of the Company's ultimate pollution claims liabilities based on actuarially accepted modeling techniques. Because of the variability and uncertainty inherent in the pollution claim evaluation, reserving and settlement processes, the reserve established by the Company represents management's best estimate at the balance sheet date based on current information but such claims may ultimately settle for a significantly greater or lesser amount. Such adjustments to reserves could be material to the Company.

6. **Loan payable**

(a) *Deferrable subordinated debentures*

On September 15, 2004 the Company issued \$200,000,000 of Deferrable Subordinated Debentures (the "Debentures"). These debentures have a final maturity date of September 15, 2034 and can be redeemed in whole prior to September 15, 2034 at the option of the Company. The Debentures bear interest at an annual fixed rate of 8.0% payable semi-annually in arrears on March 15 and September 15. The Debentures are unconditionally guaranteed by OCICL.

During the year ended November 30, 2016, the Company repurchased and retired a portion of the Deferrable Subordinated Debentures with a par value of \$5.0 million (2015 - \$nil). During prior years, the Company had repurchased and retired a portion of the Deferrable Subordinated Debentures with a par value of \$51.6 million. At November 30, 2016, the Deferrable Subordinated Debentures outstanding total was \$143.4 million (2015 - \$148.4 million) which is included in loans payable on the Consolidated Balance Sheets.

(b) *Credit facility*

Effective July 24, 2009, the Company entered into a Credit Facility ("Credit Facility") with The Bank of New York Mellon ("BNY Mellon"). Under the terms of the agreement, the Company could borrow up to \$75 million from BNY Mellon. The Company renewed the Credit Facility on August 18, 2010 and August 16, 2011. The Credit Facility was scheduled to mature on August 16, 2014. Effective August 16, 2014, the Company entered into an Amendment to extend the Credit Facility through the period August 16, 2017. At the option of the Company, any borrowings under the agreement bear interest at a rate per annum equal to either: (1) the greater of BNY Mellon's prime commercial lending rate or 0.50% plus the federal funds rate (as published by the Federal Reserve Bank of New York); or (2) 1.35% plus LIBOR for interest periods of 1, 2 or 3 months. Under the terms of the agreement, the Company must secure the payment and performance of its obligations to BNY Mellon by pledging a portion of the investments held in OCICL's investment portfolio. At November 30, 2015, the facility had not been utilized and the fair value of the investments pledged to collateralize the Company's obligation totaled \$nil. The Credit facility was not utilized during 2016 and was terminated effective November 18, 2016.

(c) *Debt issuance costs*

At November 30, 2016, the Company recognized deferred debt issuance costs of \$2.3 million (2015: \$2.5 million) relating to the Debentures, which are offset in loans payable on the Consolidated Balance Sheets. The amount of amortization of debt issuance costs for the year of \$0.1 million (2015: \$0.1 million) is included within interest expense.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

7. **Common shares**

The Company's authorized share capital is \$2,500,000 divided into 500 common shares of par value \$5,000 each. At November 30, 2016, 56 (2015: 58) shares had been issued and fully paid.

If a shareholder's insurance policies are cancelled or terminated the Company has a contractual obligation to repurchase its common share at the par value price of \$5,000 per share.

Each shareholder has one vote for each paid up common share together with an additional vote for each \$5,000 of cumulative premium as defined in the Bye-laws, subject to a maximum of 9.5% of total voting rights. The Bye-laws provides for the distribution of dividends, as and when declared by the Company's directors, and distribution of the Company's net assets upon dissolution in the same proportion as the voting rights, excluding the 9.5% limitation.

8. **Related party transactions**

- (a) General and administrative expenses represent direct expenditures incurred by the Company and expenses which have been allocated from Oil Management Services Ltd., a company affiliated through common shareholders and which provides administrative support services to the Company.
- (b) Amounts due from and to companies affiliated through common shareholders are unsecured, interest free and repayable on demand. These balances result from transactions conducted in the normal course of business.

9. **Reinsurance**

The Company purchases reinsurance when it is available on reasonable terms and conditions. Reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company remains liable to the extent that its reinsurers do not meet their obligations under these agreements and the Company therefore regularly evaluates the financial condition of its reinsurers and monitors any concentration of credit risk. In order to reduce its credit risk, the Company seeks to do business with financially sound reinsurance companies and regularly reviews the financial strength of all reinsurers used. The current reinsurance programs have been placed with reinsurers with a financial rating of A- or better per Standard & Poor's or A.M. Best. Management perform periodic reviews of reinsurance recoverables and accordingly, provisions are made for amounts identified as potentially uncollectible.

10. **Taxation**

Under current Bermuda law, the Company is not obligated to pay any taxes in Bermuda on either income or capital gains. The Company has received an undertaking from the Minister of Finance in Bermuda pursuant to the provisions of the Exempted Undertakings Tax Protection Act 1966 (the "Act") which exempts the Company from any such taxes, at least until March 31, 2035.

For the years ended November 30, 2016 and 2015, the Company did not record any unrecognized tax benefits or expenses. The Company has not recorded any interest or penalties during the years ended November 30, 2016 and 2015.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

11. Regulation

The Company is required by its license to maintain capital and surplus greater than a minimum statutory amount determined as the greater of a percentage of outstanding losses or a given fraction of net written premiums. Beginning January 1, 2014, the minimum solvency margin is also subject to a minimum of 25% of the enhanced capital requirement (“ECR”) of the Bermuda Solvency Capital Requirement model (“BSCR”).

The following tables present the reconciliation of the Company’s U.S. GAAP shareholders’ equity to statutory capital and surplus, and the corresponding minimum capital adequacy levels as at November 30, 2016 and 2015:

	2016 (\$’000)	2015 (\$’000)
U.S. GAAP Shareholders’ Equity	\$ 539,121	\$ 537,464
Plus: Loan Payable	143,400	148,400
Less: Non-admitted assets	<u>(3,212)</u>	<u>(3,163)</u>
Statutory Capital and Surplus	<u>\$ 679,309</u>	<u>\$ 682,701</u>
Minimum required statutory capital and Surplus	<u>\$ 49,462</u>	<u>\$ 41,323</u>

Non-admitted assets for statutory purposes include prepaid assets.

The Company is also required to maintain a minimum liquidity ratio whereby the value of its relevant assets is not less than 75% of the amounts of its relevant liabilities. At November 30, 2016 the Company is required to maintain relevant assets of at least \$441.8 million. At that date relevant assets are approximately \$1,190.3 million and the minimum liquidity ratio is therefore met.

As a Class 3B insurer the Company has disclosure and regulatory compliance reporting obligations along with an enhanced capital requirement. The BSCR is a standardized statutory risk-based capital model used to measure the risk associated with the Company’s assets, liabilities and premiums. The BSCR determines an enhanced capital requirement and target capital level (defined as 120% of the ECR) for Class 3B insurers. Failure to maintain statutory capital and surplus at least equal to the target capital level could result in increased regulatory oversight by the Bermuda Monetary Authority. The eligible capital rules require the Company to allocate its capital into three defined tiers based upon qualifying criteria and stipulates the maximum and minimum amounts of eligible capital in each tier that may be used to satisfy its minimum solvency margin and its ECR. As of November 30, 2016, the Company met the capital requirements of the BSCR.

12. Segmental information

The Company operates in two segments; insurance and assumed reinsurance. The insurance business written represents property and casualty risks of its shareholders and policyholders. The shareholders and policyholders comprise companies operating primarily in the energy industry. The assumed reinsurance business written mainly represents Commercial Property and Casualty risks of ceding companies that provide such insurance primarily to energy companies.

OIL CASUALTY INSURANCE, LTD.

Notes to Consolidated Financial Statements

November 30, 2016 and 2015

12. Segmental information (continued)

The following table summarizes the underwriting results of the Company's operating segments for the year ended November 30, 2016 and 2015 as follows:

	2016		
	Insurance (\$'000)	Assumed Reinsurance (\$'000)	Total (\$'000)
Premiums Written	\$ 59,446	\$ 107,120	\$ 166,566
Premiums Earned	60,072	93,918	153,990
Net Premiums Earned	19,484	80,591	100,075
Losses and loss expenses incurred, net of reinsurance	(11,561)	(56,101)	(67,662)
Commission and brokerage fees, net	(2,586)	(17,210)	(19,796)
Net underwriting income	<u>\$ 5,337</u>	<u>\$ 7,280</u>	<u>\$ 12,617</u>
	2015		
	Insurance (\$'000)	Assumed Reinsurance (\$'000)	Total (\$'000)
Premiums Written	\$ 60,262	\$ 92,422	\$ 152,684
Premiums Earned	62,576	92,883	155,459
Net Premiums Earned	28,373	83,059	111,432
Losses and loss expenses incurred, net of reinsurance	(15,159)	(42,118)	(57,277)
Commission and brokerage fees, net	(2,226)	(16,883)	(19,109)
Net underwriting income	<u>\$ 10,988</u>	<u>\$ 24,058</u>	<u>\$ 35,046</u>

13. Comparative information

Certain balances in the 2015 financial statements have been reclassified to conform to the 2016 consolidated financial statement presentation.

14. Subsequent Events

Subsequent events have been evaluated through February 23, 2017, which is the date the financial statements were issued.