CITADEL REINSURANCE COMPANY LIMITED

Consolidated Financial Statements
(With Independent Auditors' Report Thereon)

Years Ended December 31, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholder of
Citadel Reinsurance Company Limited

We have audited the accompanying consolidated financial statements of Citadel Reinsurance Company Limited which comprise the consolidated balance sheets as of December 31, 2012 and 2011, 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.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' 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 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 Citadel Reinsurance Company Limited as of December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG Audit Limited

Chartered Accountants
Hamilton, Bermuda
May 21, 2013

CITADEL REINSURANCE COMPANY LIMITED

Consolidated Balance Sheets

December 31, 2012 and 2011
(Expressed in United States Dollars)

	As at December 31,	
	2012	**2011**
ASSETS		
Marketable securities (Note 4)	$ 20,470,850	$ 26,982,811
Cash and cash equivalents	21,089,983	11,822,626
Restricted cash (Note 11)	432,849	515,099
Accounts receivable and accrued interest	3,531,138	2,645,991
Reinsurance balances receivable	4,777,042	1,808,879
Deposit assets (Note7)	55,144,701	50,679,234
Deferred underwriting expenses	775,312	410,518
Goodwill (Note 5)	1,643,956	1,643,956
Property, plant and equipment	215,712	209,624
Total assets	$ 108,081,543	$ 96,718,738
LIABILITIES		
Loss and loss adjustment expense reserves (Note 6)	$ 12,850,385	$ 11,097,829
Unearned premiums	7,885,629	2,965,283
Insurance and reinsurance balances payable	977,481	2,927,101
Unearned service fee	1,861,308	2,358,214
Deposit liabilities (Note 8)	55,045,678	50,679,234
Accounts payable and accruals	6,475,838	6,068,180
Total liabilities	85,096,319	76,095,841
EQUITY		
Share Capital (Note 9)	20,000,000	20,000,000
Retained earnings	3,599,242	991,181
Total shareholder's equity	23,599,242	20,991,181
Noncontrolling interest in subsidiaries	(614,018)	(368,284)
Total equity	22,985,224	20,622,897
Total liabilities and equity	$ 108,081,543	$ 96,718,738

See accompanying notes to consolidated financial statements

Signed on behalf of the Board

________________________________ Director

________________________________ Director

CITADEL REINSURANCE COMPANY LIMITED

Consolidated Statements of Operations

December 31, 2012 and 2011
(Expressed in United States Dollars)

	For the years ended December 31,	
	2012	**2011**
REVENUES		
Gross premiums written	$ 21,760,033	$ 9,116,408
Premiums ceded	(681,229)	(1,532,946)
Net premiums written	21,078,804	7,583,462
Change in net unearned premiums	(4,910,462)	(1,424,197)
Net premiums earned	16,168,342	6,159,265
Net investment income	890,641	(93,610)
Net realized and unrealized gains (losses) on investments	1,278,619	(217,518)
Other income	2,852,563	3,533,902
Total revenues	21,190,165	9,382,039
EXPENSES		
Loss and loss adjustment expenses	8,415,766	5,456,220
Acquisition costs	3,071,485	879,009
General and administrative expenses	7,339,856	5,234,119
Net foreign exchange gains	(87,666)	(210,540)
Total expenses	18,739,441	11,358,808
Income (loss) before income taxes	2,450,724	(1,976,769)
(Provision) recovery for income tax (Note 13)	(88,397)	103,030
Net income (loss)	2,362,327	(1,873,739)
(Loss) income attributable to non-controlling interest	245,734	311,989
NET INCOME (LOSS) ATTRIBUTABLE TO CITADEL	$ 2,608,061	$ (1,561,750)

See accompanying notes to consolidated financial statements

CITADEL REINSURANCE COMPANY LIMITED

Consolidated Statements of Changes in Shareholders' Equity

December 31, 2012 and 2011
(Expressed in United States Dollars)

		Shareholder's Equity		
	Total equity	Retained earnings	Share capital	Non-controlling interest in subsidiaries
Balance at December 31, 2010	$ 22,496,637	$ 2,552,932	$ 20,000,000	$ (56,295)
Net loss	(1,873,739)	(1,561,750)	-	(311,989)
Balance at December 31, 2011	$ 20,622,897	$ 991,181	$ 20,000,000	$ (368,284)
Net income	2,362,327	2,608,061	-	(245,734)
Balance at December 31, 2012	$ 22,985,224	$ 3,599,242	$ 20,000,000	$ (614,018)

See accompanying notes to consolidated financial statements

CITADEL REINSURANCE COMPANY LIMITED

Consolidated Statements of Cash Flows

December 31, 2012 and 2011
(Expressed in United States Dollars)

	For the years ended December 31, 2012	2011
Cash flows provided by (used in) operating activities:		
Net income (loss)	$ 2,362,327	$ (1,873,739)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net realized and unrealized (gains) losses	(1,278,618)	217,518
Net unrealized foreign exchange (gains) losses	(78,190)	(224,865)
Depreciation expense	65,129	64,465
Changes in assets and liabilities, excluding net assets acquired:		
Accounts receivable and accrued interest	(885,147)	(673,828)
Reinsurance balances receivable	(2,968,163)	(1,441,515)
Deposit assets	(4,465,467)	(1,707,374)
Deferred underwriting expenses	(364,794)	(380,617)
Goodwill	–	(1,643,956)
Loss and loss adjustment expense reserves	1,752,556	7,915,171
Unearned premiums	4,920,346	2,561,554
Insurance and reinsurance balance s payable	(1,949,620)	2,927,101
Unearned service fee	(496,907)	(1,189,591)
Deposit liabilities	4,366,445	1,707,374
Accounts payable and accruals	407,658	799,450
Non-controlling interest	(245,734)	(311,989)
Net cash provided by (used in) operating activities	1,141,821	6,745,159
Cash flows (used in) provided by investing activities:		
Proceeds on disposal of marketable securities	18,660,007	13,623,856
Purchases of marketable securities	(10,545,799)	(20,214,826)
Purchases of fixed assets	(70,922)	(157,089)
Change in restricted cash	82,250	2,374,932
Net cash provided by (used in) investing activities	8,125,536	(4,373,127)
Increase (decrease) in cash and cash equivalents	9,267,357	2,372,032
Cash and cash equivalents - beginning of year	11,822,626	9,450,594
Cash and cash equivalents - end of year	**$** 21,089,983	$ 11,822,626

See accompanying notes to consolidated financial statements

1. NATURE OF BUSINESS

Citadel Reinsurance Company Limited (the "Company"), which underwrites insurance and reinsurance, was incorporated under the laws of Bermuda on January 4, 1984 and is registered as a Class 3A insurer under The Insurance Act 1978, amendments thereto and related regulations ("The Act"). The Company is managed and has its principal place of business in Bermuda. The Company's ultimate parent company is Sirius International Limited, a company incorporated in Bermuda.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements in accordance with generally accepted accounting principles, requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the balance sheet date. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. The Company's principal estimates relate to the development or determination of the following:

- the valuation of investments and determination of hierarchical inputs used to measure fair value of investments;
- outstanding loss and loss expenses;
- premium revenue recognition;
- acquisition accounting.

Consolidation

These financial statements include the operations of the Company and its wholly-owned subsidiaries, namely Citadel International Reinsurance Company Limited ("CIRCL"), Citadel Risk Services UK Limited (formerly Citadel Group Representatives Limited), Citadel Group Representatives, Inc, Citadel Risk Management, Inc, ("CRMI"), Citadel Risk Services, Inc. ("CRS"), American Millennium Insurance Company ("AMIC") and Green Park (US) Incorporated.

CIRCL is a segregated account company, incorporated in Bermuda. There are five segregated cells (2011 - four) within CIRCL, one of which has been consolidated into these financial statements on the basis that the Company owns 65% of the preferred shares of the cell. The remaining 35% of the cells's income is recognised as a minority interest. To the extent the cell has a deficiency in excess of its share capital the full amount of the deficiency is consolidated into these financial statements. To the extent that the cell's retained earnings exceed its share capital the non-controlling 35% interest is accrued on the balance sheet. The Company acquired 100% of the preferred shares of a further cell in CIRCL during 2012 and the operations of the cell have been consolidated in these financial statements.

The Company and CRS jointly own 70.73% of Great Falls Holding Company ("GFH"), a company incorporated in Delaware, U.S.A. GFH has a wholly owned subsidiary, Great Falls Insurance Company ("GFI"), which is engaged in the business of writing workers compensation insurance in the State of Maine, U.S.A. The operations of GFH and GFI have been consolidated in these financial statements on the basis that the Company owns 70.73% of the issued capital. The remaining 29.27% is recognised as a non-controlling interest.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

During 2011 the Company incorporated a new wholly owned subsidiary, Citadel Risk Holdings, Inc. (“CRHI”). The Company and CRHI jointly acquired 100% of American Millennium Insurance Company (“AMIC”) which is engaged in the business of writing commercial automobile liability insurance in the States of New Jersey, Pennsylvania and Oklahoma. At the same time, CRMI acquired 100% of Old Rock and First Brokers, brokerage operations connected to AMIC. The operations of AMIC, Old Rock and First Brokers have been consolidated in these financial statements.

Premiums and Acquisition Costs

Premiums are written when received and net premiums are earned on a pro-rata basis over the term of the related policies. Written premiums comprise the premiums on contracts entered into during the accounting period and are disclosed gross of commission payable to intermediaries and exclude taxes and duties levied on premiums.

The provision for unearned premiums represents that portion of the premiums written in respect of the current and prior years, which is attributable to the unexpired term of the corresponding policy in force.

Acquisition costs are comprised of ceding commissions, brokerage, premium taxes, profit commissions and other expenses that relate directly to the writing of reinsurance contracts. Deferred acquisition costs are amortized over the underlying term of the related.

Loss and Loss Adjustment Expense Reserves

The estimated liability for losses and loss adjustment expenses is determined from reports received from the Company ceding insurance business to the Company. Management reviews this loss information and establishes loss and loss expense reserves, including a reserve for losses incurred but not reported (“IBNR”). Loss estimates were derived from sound actuarial methods based on many items including but not limited to historical account data, industry data and pertinent pricing information.

Management believes that the reserve for losses and loss expenses at December 31, 2012 is adequate to cover the ultimate net cost of losses incurred, however, such liability is necessarily based on estimates and no representation is made that the ultimate liability may not exceed such estimates. Subsequent revisions to estimated ultimate losses will be reflected in operations in the period in which they are determined.

The establishment of the provision for losses and loss adjustment expenses is based upon known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. In establishing a provision for unpaid claims and claims expenses, management considers facts currently known, the current state of laws and litigation and current estimates of reported losses and loss expenses. 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. In addition, a provision for adverse development for reported notifications and incurred but not reported claims is recorded based on the recommendations of an independent actuary using the past loss history of the Company and industry data.

Deposit assets and deposit liabilities

For all insurance/reinsurance agreements where no risk is assumed by the Company, the Company records, in the consolidated statement of earnings, the net fee or margin earned as a result of the transactions. These fees are earned in accordance with the terms of the agreements.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

The insurance/reinsurance assets and liabilities related to the agreements are recorded at their gross amounts in the balance sheet within Deposit assets and Deposit liabilities. The provision for claims reflected as part of the Deposit liabilities is discounted based upon the liability after taking account of the known duration of such liability, the rate of return on the matching assets and the future reductions in deferred underwriting expenses and the provision for unearned premiums.

Cash and Cash Equivalents

Cash and cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Marketable securities

In accordance with the Financial Instruments Topic of the FASB ASC, the Company differentiates between held-to-maturity marketable securities, which are recognised at amortized cost, and held-for-trading marketable securities, which are recognised at market value with unrealised gains and losses being reported as other income in the consolidated statement of operations.

The Company may sell securities it does not own in anticipation of a decline in market value of that security. Upon entering a short position, the Company records the proceeds in cash and cash equivalents and establishes an offsetting accounts payable for the securities due under the short sale agreement, which is subsequently marked to market. The Company will generally borrow the security sold short in order to make delivery to a buyer and then replace the borrowed security by purchasing it at the market price at the time of replacement. Until the security is replaced, the Company is required to pay the lender any interest or dividend earned, which is recorded as a reduction of other income to the Company. The Company realises again if the security declines in price between the date of the short sale and the date on which the Company replaces the borrowed security and the Company incurs a loss as a result of the short sale if the price of the security increases. Realized and unrealized gains and losses arising from short sales of securities are included in other income. There were no short positions open at year end, and all short positions have been covered.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired by the Company. Goodwill is recorded as an asset and is not amortized.

In accordance with the Intangibles – Goodwill and Other Topic of the FASB ASC, the Company performs, at a minimum, an annual valuation of its goodwill and intangible assets to test for impairment or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. For purposes of annual impairment evaluation, goodwill is assigned to the applicable reporting unit of the acquired entities giving rise to the goodwill. Fair value is determined using widely accepted valuation techniques, such as discounted cash flows and markets multiple models. These types of analyses contain uncertainties because they require management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. It is the Company’s policy to conduct impairment testing based on the Company’s current business strategy in light of present industry and economic conditions, as well as the Company’s future expectations. If, as a result of the assessment, the Company determines that the value of its goodwill and intangible assets are impaired, the Company will record an impairment charge in the period in which the determination is made.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign Currency Translation

Monetary assets and liabilities are translated into U.S. dollars at year-end exchange rates and non-monetary assets and liabilities at the exchange rates prevailing when the assets were acquired or liabilities incurred. Income and expenses are translated at the rate of exchange prevailing at the transaction date. Translation gains and losses are included in foreign exchange gains or losses unless the gain or loss is a result of trading foreign currency as part of the Company's overall investment strategy, in which case the income is recognized as other income.

Fair value of financial instruments

Fair values of financial instruments are disclosed in the notes to the financial statements when they differ from the carrying values. Where amounts receivable and payable are subject to normal credit terms, their carrying values are used as an approximation of their fair values.

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

Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 – Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly.

Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. These are generally company generated inputs and are not market based inputs.

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

At each valuation date, the Company uses a market approach technique to estimate the fair value of our fixed maturities portfolios, when possible. This market approach includes, but is not limited to, prices obtained from third party pricing services and broker-dealers for identical or comparable securities. The pricing services use market quotations for securities that have quoted prices in active markets. When quoted market prices are unavailable, the pricing services prepare estimates of fair value measurements using observable market inputs such as yield curves, credit risks and spreads, measures of volatility, expected cash flows including prepayment speeds, reported trades and broker/dealer quotes.

The fair values of the Company's interests in hedge fund investments are based upon the Net Asset Values of the underlying investment funds as reported by the investment managers, or their independent administrators. Depending on the Company's ability to redeem its hedge fund investments at the reported net asset value per share (or its equivalent) within a reasonable period of time, the hedge fund investment will be categorized within Level 2 or Level 3 of the fair value hierarchy.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

Taxation

The Company's subsidiaries that are based in the United States of America and the United Kingdom are subject to the tax laws of those jurisdictions and the jurisdictions in which they operate.

3. ACQUISITIONS

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

On October 20, 2011 the Company completed the acquisition of American Millennium Insurance Company. The purchase price of $4,911,005 was funded from available cash on hand. The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of the acquisition:

Assets	
Cash and cash equivalents	$ 2,749,106
Investments	6,008,154
Note receivable	470,000
Premium receivable	254,333
Reinsurance recoverable	293,508
Accrued investment income	59,804
Due from affiliate	1,976,643
Prepaid reinsurance	450,000
Other assets	270,238
Total Assets	12,531,786
Liabilities	
Loss and loss adjustment expenses	3,837,406
Unearned premium	1,137,677
Deeded reinsurance payable	3,823,749
Funds withheld	88,654
Other liabilities	377,251
Total Liabilities	9,264,737
Net assets acquired at fair value	$ 3,267,049

The acquisition resulted in goodwill of $1,643,956 included within the consolidated statement of operations.

4. MARKETABLE SECURITES

The total carrying value of held-for-trading securities and held-to-maturity securities as at December 31, 2012 was $20,570,676 (2011 - $25,788,992).

Held for trading	2012 Fair value	2011 Fair value
Hedge fund	$ –	$ 2,874,590
Ordinary shares	4,044,675	3,679,617
Preferred Shares	2,590,001	2,614,021
Treasury funds	786,425	209,474
	$ 7,421,100	$ 9,377,702

The amortized cost, gross unrealized gains and losses and estimated fair value of held-to-maturity securities as of December 31, 2012 and 2011, are as follows:

	2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair Value
Preferred shares	5,690,438	769,869	84,799	6,375,508
Floating notes	1,819,537	5,257	805,154	1,019,640
Corporate bonds	5,539,775	220,380	5,727	5,754,428
	13,049,749	995,507	895,680	13,149,576

	2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair Value
Preferred shares	10,900,992	261,651	1,137,047	10,025,596
Floating notes	1,814,469	5,492	331,886	1,488,075
Corporate bonds	4,889,648	107,093	99,151	4,897,589
	17,605,109	374,236	1,568,084	16,411,260

4. MARKETABLE SECURITES (continued)

The following table represents the fair value hierarchy for the Company's investments measured at fair value as at December 31, 2012:

	2012			
	Level 1	Level 2	Level 3	Total
Ordinary Shares	4,044,675	–	–	4,044,675
Preferred Shares	8,965,509	–	–	8,965,509
Floating notes	–	1,019,640	–	1,019,640
Corporate Bonds	–	5,754,428	–	5,754,428
Treasury funds	786,425	–	–	786,425
	13,763,968	6,806,708	–	20,570,676

The following table represents the fair value hierarchy for the Company's investments measured at fair value as at December 31, 2011:

	2011			
	Level 1	Level 2	Level 3	Total
Hedge Funds	–	2,874,590	–	2,874,590
Ordinary Shares	3,679,617	–	–	3,679,617
Preferred Shares	12,639,647	–	–	12,639,647
Floating notes	–	1,488,075	–	1,488,075
Corporate Bonds	–	4,897,589	–	4,897,589
Treasury funds	209,474	–	–	209,474
	16,528,738	9,260,254	–	25,788,992

The Company did not impair its investment in the held to maturity portfolio in 2012 or 2011. The Company considers impairment as other than temporary if evidence indicating that an investment's cost is recoverable within a reasonable period of time is outweighed by evidence to the contrary. The Company also considers its ability and intent to hold an investment until such recovery of the security's fair value. Recognition of impairment losses for declines in the value of securities attributable to issuer-specific events are based upon all relevant facts and circumstances for each investment. Factors considered by management include, but are not limited to, the impact of issuer-specific events, dividend flow, industry-specific events, current and expected future market and economic conditions, the nature of the investment, the severity and duration of the impairment and the volatility of the security's market price.

The amortized cost and estimated fair value amounts for preferred shares and corporate bonds held at December 31, 2012 and December 31, 2011 are shown by contractual maturity. Actual maturity may differ from contractual maturity because certain borrowers have the right to call or prepay certain obligations with or without call or prepayment penalties.

4. MARKETABLE SECURITES (continued)

The maturity distribution for fixed maturities held as of December 31, 2012 was:

	Amortized cost	Estimated fair value
Due within one year	$ 491,243	$ 706,195
Due after one year through five years	208,103	227,018
Due after five years	10,530,867	11,196,723
	$ 11,230,213	$ 12,129,936

The maturity distribution for fixed maturities held as of December 31, 2011 was:

	Amortized cost	Estimated fair value
Due within one year	$ 1,164,126	$ 1,222,252
Due after one year through five years	1,685,888	1,726,817
Due after five years	12,940,625	12,041,518
	$ 15,790,639	$ 14,990,587

Excluded from the above table are floating rate note securities with a fair value of $1,389,232 as of December 31, 2012 (2011 - $1,814,469). The interest rates are reset quarterly, based on a margin over the Australian 90 day bank bill benchmark rate. Most of these securities have passed early redemption dates and can be redeemed at any time by the issuer of the securities. In such cases, this would be taken as the maturity date.

5. GOODWILL

During the year ended December 31, 2011, the Company recorded $1,643,956 of goodwill on the determination of the final purchase price of the acquisition of American Millennium Insurance Company. The Company has determined no impairment of this goodwill exists as of December 31, 2012.

6. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The following table represents the activity in the loss and loss adjustment expenses as for the years ended December 31, 2012 and 2011:

	2012	2011
Loss and loss adjustment expense reserves beginning of year	$ 11,097,829	$ 6,530,573
Loss and loss expenses incurred related to losses occurring in:		
Current year	8,921,004	2,799,047
Prior year	(118,103)	5,105,777
Total loss and loss expenses	8,802,901	7,904,824
Losses and loss expenses paid related to losses occurring in:		
Current year	2,527,909	835,400
Prior year	4,522,436	2,502,168
Total loss and loss expenses paid	7,050,345	3,337,568
Loss and loss adjustment expense reserves	$ 12,850,385	$ 11,097,829

Management believes that the assumptions used establishing its provision for loss and loss adjustment expenses represent a realistic and appropriate basis for estimating those reserves as of December 31, 2012 and 2011. However, these assumptions are subject to change and the Company continually reviews and adjusts its reserve estimates taking into account all currently known information and updated assumptions related to unknown information. While management believes it has made a reasonable estimate of loss expenses occurring up to the balance sheet date, the ultimate costs of claims incurred could exceed the Company's reserves and have a materially adverse effect on its future results of operations and financial condition.

The prior year development during 2012 and 2011 was driven by underwriting of retroactive policies for which all losses incurred and paid are reported as prior year development.

7. DEPOSIT ASSETS

Deposit assets represent cash, fixed deposits, accrued interest and marketable securities held to meet the Company's future obligations on non risk transfer business.

	2012		2011	
	Carrying value	Fair value	Carrying value	Fair value
Cash	$ 2,387,369	$ 2,387,369	$ 910,128	$ 910,128
Accrued interest	248,926	248,926	300,247	300,247
Marketable securities	9,205,713	9,205,713	8,878,543	8,878,543
Fixed deposits	43,302,693	43,885,536	40,590,316	41,519,218
	$ 55,144,701	$ 55,727,544	$ 50,679,234	$ 51,608,136

7. DEPOSIT ASSETS (continued)

The total deposit asset balance of $55,144,701 (2011 - $50,679,234) comprises amounts due within one year (current) and amounts due after one year through 5 years (deferred) as follows:

	2012	2011
Current balances	$ 50,226,602	$ 46,129,746
Deferred balances	4,918,099	4,549,488
	$ 55,144,701	$ 50,679,234

The estimated fair value at December 31, 2012 of $55,727,544 (2011 - $51,608,136) represents management's best estimate using all available information to the report date.

8. DEPOSIT LIABILITIES

Deposit liabilities represent loss reserves due to insureds and letter of credit fees due to banks on the Company's non risk transfer business. The total balance of $55,045,678 (2011 - $50,679,234) comprises amounts due in less than one year (current) and amounts due after one year through 5 years (deferred) as follows:

	2012	2011
Current balances	$ 50,096,501	$ 46,074,937
Deferred balances	4,949,177	4,604,297
	$ 55,045,678	$ 50,679,234

Included in the deposit liability above are amounts aggregating $44,310,292 (2011 - $41,610,918) which are effectively recorded at their estimated net present value using discount rates ranging between 1.27% and 3.78% (2011 - 0.70% and 5.68%% and 5.68%) which reflect the anticipated payout patterns of the losses at their ultimate expected value.

The Company's exposure under these contracts is limited to the value of the Deposit assets at any point in time.

9. SHARE CAPITAL

Capital stock is comprised of the following authorized, issued and fully paid shares of the par value $1 each:

	2012	2011
Common shares (20,000,000 shares in 2012 and 2011)	$ 20,000,000	$ 20,000,000

No dividends were declared or paid during 2012 (2011 - $Nil).

10. RELATED PARTY TRANSACTIONS

Included in accounts payable are advances made by affiliated companies totaling $134,996 (2011 - $135,099).

Included in accounts receivable and accrued interest are advances made to the parent company and affiliates totaling $1,682,984 (2011 - $769,744). The advances are non-interest bearing and repayable on demand.

11. LETTERS OF CREDIT

The Company has pledged cash and cash equivalents of $432,849 (2011 - $515,099) and deposits of $43,402,693 (2011 - $40,954,816) to banks as security for letters of credit totalling $44,255,564 (2011 - $41,918,305) in respect of the Company's obligations under reinsurance programs and the Company’s guarantee for a letter of credit of $100,000 (2011 - $364,500) for the benefit of members of the PMA Insurance Group.

12. CONTINGENCIES AND COMMITTMENTS

The Company is liable on reinsurance ceded to the extent that the companies to which the business is ceded do not meet their contractual obligations. In the opinion of management, no loss to the Company is expected to arise in the future as a result of reinsurance ceded. Recoveries are only due on discontinued business.

The investment portfolio is managed following prudent standards of diversification across counterparties, issuers, asset classes and geographical regions. Investment guidelines are designed to limit the holdings of a single issue and issuer, control non-US dollar currency exposure and minimize sovereign risk. At December 31, 2012, 83% (2011 - 85%) of the fixed and floating income portfolio at carrying value was rated investment grade.

The Company’s investment guidelines permit short selling, where by the Company sells borrowed securities which must, at some date, be repurchased and returned to the lender. The risk associated with this practice is that, if the market value of the securities sold short increases, the Company may realize losses upon repurchase at prices which may exceed that liability presented in the consolidated balance sheet. Further, in unusual circumstances, the Company may be unable to repurchase securities to close the short position, except at prices above those previously quoted in the market. There were no short positions open at year end, and all short positions have been covered.

13. TAXATION

The Company is incorporated in Bermuda, and under current Bermuda law, is not required 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 that in the event of such taxes being imposed the Company will be exempted from taxation until the year 2035. The Company is subject to withholding tax on investment income from foreign securities.

The Company’s subsidiaries that are based in the United States and the United Kingdom are subject to the tax laws of those jurisdictions and the jurisdictions in which they operate.

At December 31, 2012, the Company had recorded a tax provision of $88,397 (2011 - $103,030 recovery).

The Company has not recorded any interest or penalties during the years ended December 31, 2012 and 2011.

14. STATUTORY REQUIREMENTS

Under the Bermuda Insurance Act 1978 ("The Act"), the Company is required to prepare Statutory Financial Statements and to file a Statutory Financial Return. The Act also requires the Company to meet certain minimum capital and surplus requirements. To satisfy these requirements, the Company was required to maintain a minimum level of statutory capital and surplus of $1,202,909 at December 31, 2012 (2011 - $1,271,014). The Company's statutory capital and surplus was $22,423,809 at December 31, 2012 (2011 - $18,691,727).

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 December 31, 2012 the Company is required to maintain relevant assets of at least $53,158,224. At that date relevant assets are $81,576,884 and the minimum liquidity ratio is therefore met.

15. SUBSEQUENT EVENTS

Subsequent events have been evaluated through May 21, 2013 which is the date the financial statements were available to be issued.