



**HARRINGTON RE LTD.**

**Consolidated Financial Statements and  
Independent Auditors' Report**

**For the Years Ended December 31, 2018 and 2017**

**INDEX TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Independent Auditors' Report.....	2
Consolidated Balance Sheets as of December 31, 2018 and 2017 .....	3
Consolidated Statements of Income (Loss) for the Years Ended December 31, 2018 and 2017 .....	4
Consolidated Statements of Changes in Shareholder's Equity for the Years Ended December 31, 2018 and 2017.....	5
Consolidated Statements of Cash Flows for the Years Ended December 31, 2018 and 2017.....	6
Notes to the Consolidated Financial Statements.....	7

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Harrington Re Ltd.

We have audited the accompanying consolidated financial statements of Harrington Re Ltd. (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income (loss), changes in shareholder's equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### Management's Responsibility for the Consolidated Financial Statements

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

### Auditors' Responsibility

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

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

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

### Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Harrington Re Ltd. as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Deloitte Ltd.*

April 29, 2019

**HARRINGTON RE LTD.**  
**CONSOLIDATED BALANCE SHEETS**

As of December 31, 2018 and 2017  
(U.S. dollars in thousands, except share and per share amounts)

	<b>2018</b>	<b>2017</b>
<b>Assets</b>		
Investments ( <i>Cost 2018: \$831,701; 2017: \$666,520</i> )	\$ 876,398	\$ 713,878
Cash and cash equivalents	30,680	10,333
Reinsurance balances receivable	99,394	127,853
Deferred acquisition costs	40,373	58,529
Prepaid expenses	3,782	1,901
Other assets	33,037	9,123
<b>Total assets</b>	\$ 1,083,664	\$ 921,617
<b>Liabilities</b>		
Reserve for losses and loss expenses	\$ 352,516	\$ 149,550
Unearned premiums reserve	122,869	153,204
Credit facilities loan payable	55,000	55,000
Other liabilities	13,136	20,443
<b>Total liabilities</b>	543,521	378,197
<b>Shareholder's equity</b>		
Common shares ( <i>\$1.00 par; shares authorized, issued and outstanding: 1,000,000</i> )	1,000	1,000
Contributed Surplus	532,225	531,783
Retained earnings	6,918	10,637
<b>Total shareholder's equity</b>	540,143	543,420
<b>Total liabilities and shareholder's equity</b>	\$ 1,083,664	\$ 921,617

*See Notes to the Consolidated Financial Statements*

**HARRINGTON RE LTD.**  
**CONSOLIDATED STATEMENTS OF INCOME (LOSS)**  
For the Years Ended December 31, 2018 and 2017  
(U.S. dollars in thousands)

	<b>2018</b>	<b>2017</b>
<b>Revenues</b>		
Gross premiums written	\$ 255,340	\$ 214,217
Change in unearned premiums reserve	30,335	(52,150)
Net premiums earned	285,675	162,067
Net investment income	9,827	35,432
<b>Total revenues</b>	<b>295,502</b>	<b>197,499</b>
<b>Expenses</b>		
Losses and loss expenses	223,511	120,408
Acquisition costs	66,824	57,777
General and administrative expenses	11,898	9,028
Financing costs	260	200
Foreign exchange loss (gain)	(3,272)	(146)
<b>Total expenses</b>	<b>299,221</b>	<b>187,267</b>
<b>Net income (loss)</b>	<b>\$ (3,719)</b>	<b>\$ 10,232</b>

*See Notes to the Consolidated Financial Statements*

**HARRINGTON RE LTD.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY**

For the Years Ended December 31, 2018 and 2017

(U.S. dollars in thousands)

	<b>2018</b>	<b>2017</b>
<b>Common shares</b>		
<b>Balance at beginning and end of year</b>	\$ 1,000	\$ 1,000
<b>Contributed Surplus</b>		
Balance at beginning of year	531,783	531,341
Share-based compensation expense	442	442
<b>Balance at the end of year</b>	<b>532,225</b>	<b>531,783</b>
<b>Retained earnings</b>		
Balance at beginning of year	10,637	405
Net income (loss)	(3,719)	10,232
<b>Balance at the end of year</b>	<b>6,918</b>	<b>10,637</b>
<b>Total shareholder's equity</b>	<b>\$ 540,143</b>	<b>\$ 543,420</b>

*See Notes to the Consolidated Financial Statements*

**HARRINGTON RE LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2018 and 2017  
(U.S. dollars in thousands)

	<b>2018</b>	<b>2017</b>
<b>Operating activities:</b>		
Net income (loss)	\$ (3,719)	\$ 10,232
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net realized gains and change in unrealized gains and losses on investments	(7,872)	(38,261)
Net accretion of discount on fixed maturities	(50)	(89)
Share-based compensation expense	442	442
<i>Changes in:</i>		
Reinsurance balances receivable	28,458	(48,540)
Deferred acquisition costs	18,156	(20,391)
Prepaid expenses	(1,881)	(394)
Reserve for losses and loss expenses	202,966	111,646
Unearned premiums reserve	(30,335)	52,150
Other items	(25,929)	4,099
<b>Net cash provided by operating activities</b>	<b>180,236</b>	<b>70,894</b>
<b>Investing activities:</b>		
Purchases of investments	(711,861)	(255,906)
Sales of investments	554,977	176,548
<b>Net cash used in investing activities</b>	<b>(156,884)</b>	<b>(79,358)</b>
<b>Financing activities:</b>		
Payments for redemptions from general partner of the fund	(2,798)	(412)
<b>Net cash used in financing activities</b>	<b>(2,798)</b>	<b>(412)</b>
Effect of exchange rate changes on foreign currency cash and cash equivalents	(207)	13
Net increase (decrease) in cash and cash equivalents	20,347	(8,863)
Cash and cash equivalents, beginning of year	10,333	19,196
<b>Cash and cash equivalents, end of year</b>	<b>\$ 30,680</b>	<b>\$ 10,333</b>
Interest paid	\$ 4,154	\$ 1,862

*See Notes to the Consolidated Financial Statements*

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**1. General**

Harrington Re Ltd. ("Harrington Re") was incorporated under the laws of Bermuda on March 16, 2016, and is a wholly-owned subsidiary of Harrington Reinsurance Holdings Limited (the "Parent"). The Parent was incorporated under the laws of Bermuda on March 15, 2016.

Harrington Re is licensed as a Class 4 multi-line insurer under the Insurance Act 1978, amendments thereto and Related Regulations of Bermuda (the "Insurance Act") and is licensed to underwrite general business on an insurance and reinsurance basis. Harrington Re was licensed by the Bermuda Monetary Authority (the "BMA") effective June 22, 2016, and commenced its operations subsequently. Harrington Re provides a broad range of reinsurance products on a worldwide basis.

During the second quarter of 2016, the Parent raised approximately \$542.0 million in net proceeds through the issuance of its common shares.

AXIS Capital Holdings Limited ("AXIS Capital") through a wholly-owned subsidiary, AXIS Ventures Limited, invested \$100.0 million and acquired 18.1% of the Parent's common equity. The investment was subsequently increased to 19.0% of the Parent's common equity. The Blackstone Group L.P. ("Blackstone Group"), through a wholly-owned subsidiary, together with investment entities formed for certain senior professionals and employees of the Blackstone Group, have in total acquired 9.9% of the Parent's common equity.

Harrington Re has engaged AXIS Reinsurance Managers Limited ("ARM" or the "Liability Manager"), a company incorporated in Bermuda and a wholly-owned subsidiary of AXIS Capital, to act as its liability manager pursuant to a services agreement dated July 1, 2016 (the "Services Agreement"). The Liability Manager manages the day-to-day underwriting activities of Harrington Re subject to the provisions of the Services Agreement and the oversight of Harrington Re's management and Board of Directors (the "Board"). See Note 13, "*Related party transactions*" for further details.

Pursuant to an investment management agreement dated July 1, 2016 (the "Investment Management Agreement") between Blackstone Harrington Partners L.P., a Cayman Islands exempted limited partnership (the "Fund") and Blackstone Multi-Asset Advisors L.L.C., a Delaware limited liability company and an affiliate of the Blackstone Group ("BMAA"), which was assigned by BMAA to Blackstone ISG-II Advisors L.L.C., a Delaware limited liability company and an affiliate of the Blackstone Group ("BISA-II" or the "Investment Manager"), as of October 1, 2017, BISA-II serves as the investment manager of the assets of Harrington Re that are invested in the Fund. Harrington Re is the sole limited partner of the Fund. The Fund seeks to achieve attractive risk-adjusted returns through a portfolio of diversified, primarily alternative, investments. See Note 13, "*Related party transactions*" for further details.

These consolidated financial statements are presented for the twelve months ended December 31, 2018 and 2017. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP") and include the accounts of Harrington Re and the accounts of Blackstone Harrington Partners L.P., a variable interest entity ("VIE") in which Harrington Re is considered to be the primary beneficiary (together referred to as the "Company", and together with the Parent, the "Group").



**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**1. General (cont.)**

The Company is the primary beneficiary of a VIE if it has a controlling financial interest in the VIE, if it has both (a) the power to direct the activities of the VIE that most significantly impact the performance of the VIE, and (b) the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE.

All inter-company accounts and transactions have been eliminated.

All amounts are reported in U.S. dollars. Tabular data are in thousands.

**2. Significant accounting policies**

*(a) Basis of Presentation*

These consolidated financial statements have been prepared in conformity with U.S. GAAP. The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes that the amounts included in the consolidated financial statements reflect its best estimates and assumptions, actual results could differ from those estimates.

*(b) Premiums and Acquisition Costs*

Premiums

Reinsurance premiums written are recorded in accordance with the terms of the underlying policies. Reinsurance premiums are recorded at the inception of the contract and are estimated based upon information received from ceding companies. For multi-year contracts where reinsurance premiums are payable in annual installments, premiums are recorded at the inception of the contract based on management's best estimate of total premiums to be received. However, premiums are normally recognized on an annual basis for multi-year contracts where the cedant has the ability to unilaterally commute or cancel coverage within the term of the policy. The remaining annual premiums are included as written at each successive anniversary date within the multi-year term. Any subsequent differences arising on reinsurance premium estimates are recorded in the period they are determined.

Reinsurance premiums are generally earned based on information received from ceding companies over the period during which we are exposed to the underlying risk, which is usually one to two years with the exception of multi-year contracts. Unearned premiums represent the portion of premiums written which is applicable to the unexpired risks under contracts in force.

Reinstatement premiums are recognized and earned at the time a loss event occurs, where the coverage limits for the remaining life of the contract are reinstated under pre-defined contract terms. The accrual of reinstatement premiums is based on our estimate of losses and loss expenses, which reflects management's judgment, as described in Note 2(c) "*Losses and Loss Expenses*" below.

Treatment of retroactive reinsurance contracts is described in Note 2(d) "*Retroactive reinsurance accounting*".

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**2. Significant accounting policies (cont.)**

Premiums receivable balances are reviewed for impairment at least quarterly and an allowance is established for amounts considered uncollectible. The need for charge-off of any amounts previously reserved as uncollectible is assessed on a quarterly basis.

Acquisition Costs

Acquisition costs vary with and are directly related to the acquisition of reinsurance contracts and consist primarily of fees and commissions paid to brokers, underwriting fees paid to our Liability Manager and premium taxes. Premiums receivable are presented net of applicable acquisition costs when contract terms provide for the right of offset.

Total acquisition costs are deferred and charged to expense as the related premium is earned. Anticipated losses and loss expenses, other costs and investment income related to these premiums are considered in assessing the recoverability of our deferred acquisition costs. If deferred amounts are estimated to be unrecoverable, they are expensed.

*(c) Losses and Loss Expenses*

Our reserve for losses and loss expenses represents an estimate of the unpaid portion of our ultimate liability for losses and loss expenses for reinsured events that have occurred at or before the balance sheet date. The balance reflects both claims that have been reported to us (“case reserves”) and claims that have been incurred but not yet reported to us (“IBNR”). These amounts are reduced for estimated amounts of salvage and subrogation recoveries.

Management reviews our reserve for losses and loss expenses on a quarterly basis. Case reserves are primarily established based on amounts reported by the ceding companies. Management estimates IBNR after reviewing detailed actuarial analyses and applying informed judgment regarding qualitative factors that may not be fully captured in the actuarial estimates. A variety of actuarial methods are utilized in this process, including the Expected Loss Ratio, Bornhuetter-Ferguson and Chain Ladder methods. The reserve estimate is highly dependent on judgment as to which method(s) are most appropriate for a particular accident year and class of business. Our historical claims data is often supplemented with industry benchmarks when applying these methodologies.

Any adjustments to our previous reserve for losses and loss expenses estimates are recognized in the period they are determined. While we believe that our reserves for losses and loss expenses are adequate, this estimate requires significant judgment and new information, events or circumstances may result in ultimate losses that are materially greater or less than provided for in the Consolidated Balance Sheets.

Treatment of retroactive reinsurance contracts is described in Note 2(d) “*Retroactive reinsurance accounting*”.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**2. Significant accounting policies (cont.)**

*(d) Retroactive reinsurance accounting*

Retroactive reinsurance reimburses a ceding company for liabilities incurred as a result of past insurable events covered by the underlying policies reinsured. Written premiums are fully earned and corresponding losses and loss expenses are recognized at inception. In the years that these type of contracts are written, significant variances may occur in gross premiums written, net premiums earned and losses and loss expenses.

Underwriting income (loss) generated in connection with retroactive reinsurance contracts is recorded in the Consolidated Balance Sheets as an Other Liability (Asset) and amortized using the interest method over the expected claims settlement period. This amortization is recognized within losses and loss expenses in the Consolidated Statements of Income (Loss). Subsequent changes in estimated or actual cash flows under such retroactive reinsurance contracts are accounted for by adjusting the previously deferred amount to the balance that would have existed had the revised estimate been available at the inception of the reinsurance transaction, with a corresponding charge or credit to income.

*(e) Investments*

The Company has elected the fair value option for its other investments in accordance with Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") 825 "*Financial Instruments*". As a result, the Company's other investments are reported at fair value with changes in fair value included in earnings in the Consolidated Statements of Income (Loss).

Investments in fixed maturities are classified as trading in accordance with ASC 320 "*Investments – Debt and Equity Securities*". Fixed maturity investments are reported at fair value in the Consolidated Balance Sheets with changes in fair value included in earnings in the Consolidated Statements of Income (Loss).

The Investment Manager values investments according to U.S. GAAP which defines fair value, establishes a framework for measuring fair value, and requires enhanced disclosures regarding fair value measurements. Fair value is the amount that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date (i.e., the exit price) under current market conditions.

Investment gains or losses realized on the sale of investments are determined on a first-in, first-out basis. See Note 4, "*Investments*" for further details.

*Valuation Techniques*

Described below are valuation techniques employed by the Investment Manager to determine investment valuations.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**2. Significant accounting policies (cont.)**

The Investment Manager receives market and investment specific data (“Market Data”), including quotations from market participants and pricing services that is used to determine investment fair values. The Investment Manager evaluates Market Data received from market participants and pricing services for investments that are publicly traded as well as private assets that are not traded on an exchange and may require significant judgment when determining the valuation. Investments in open ended registered investment companies and Liquid Multi-Strategy Funds (“UCITS”) are valued at the published daily quotation of their net asset value.

When selecting price sources, the Investment Manager generally prioritizes fair value price sources that are most observable for each investment. Below is a listing of the valuation techniques used by the Investment Manager to determine the fair value of the Company’s investments as of the measurement date. See Note 5, “*Fair value measurements*”, for further discussion relating to the valuation of the Company’s investments.

*Over-the-counter market prices*

Certain investments that trade on over-the-counter markets may also utilize published transaction prices when it is both readily available and representative of fair value.

*Market Participant and Pricing Service quotations*

Certain investments that trade on over-the-counter markets, where published transaction prices are not utilized are generally valued with indications of fair value from market participants and pricing services.

To determine the fair value of an investment, market participants and pricing services may consider observable market transactions for identical or similar investments, quotations by other market participants, pricing matrices or pricing relationships between investments with similar characteristics.

When evaluating quotations from a pricing service, the Investment Manager may consider the number of indications of fair value from market participants, the ability to transact at such prices based on recent trading activity, reviews of quotations and prices for similar assets, as well as other Market Data.

*Net investment income*

Net investment income in the Consolidated Statements of Income (Loss) includes the interest income generated by our cash and cash equivalents and the change in the value of investments managed in the Fund, which includes the interest and dividend income received by the Fund, realized and unrealized investment gains and losses together with amortization of market premiums and discounts and is net of investment management fees, borrowing costs relating to the credit facilities loans payable and other investment related expenses.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**2. Significant accounting policies (cont.)**

*(f) Derivative instruments*

The Company may enter into derivative instruments such as futures, options, interest rate swaps and foreign currency forward contracts as part of its overall foreign currency risk management strategy, to obtain exposure to a particular financial market or for yield enhancement. The Company measures all derivative instruments at fair value and recognizes them as either assets or liabilities in the Consolidated Balance Sheets. Subsequent changes in fair value and any realized gains or losses are recognized in the Consolidated Statements of Income (Loss).

*(g) Cash and cash equivalents*

Cash and cash equivalents include cash and investments with original maturities of three months or less.

Cash and cash equivalents are recorded at amortized cost, which approximates fair value due to the short-term, liquid nature of these securities.

*(h) Share-Based Compensation*

The Parent is authorized to issue stock options to the Company's employees. The fair value of the compensation cost relating to service-based awards is measured at the grant date and expensed on a straight-line basis over the period for which the employee is required to provide services in exchange for the award. The fair value of performance-based awards is measured at the grant date based on pre-established targets relating to certain performance based measures, with the associated expense recognized on a straight-line basis over the applicable performance and vesting period. Forfeiture benefits are estimated at the time of grant and incorporated in the determination of share-based compensation.

*(i) Foreign Exchange*

The Company's functional currency is the U.S. dollar. Revenues and expenses denominated in foreign currencies are revalued at the prevailing exchange rate at the transaction date. Monetary assets and liabilities denominated in foreign currencies are re-measured at exchange rates in effect at the balance sheet date, which may result in the recognition of foreign exchange gains or losses which are included in the determination of net income (loss).

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**2. Significant accounting policies (cont.)**

*(j) Recent Accounting Pronouncements*

*Accounting standards adopted in 2018*

*Changes to Disclosures on Fair Value Measurement*

In August 2018, the FASB issued Accounting Standards Update (“ASU”) 2018-13 “*Fair Value Measurement (Topic 820) – Disclosure Framework – Changes to the Disclosure Requirement for Fair Value Measurement*” to improve the effectiveness of fair value measurement disclosures. The amended guidance added, eliminated and modified disclosures for investments measured at fair value. The guidance is effective January 1, 2020. However, the Company has early adopted the amendments, as is permitted, for the year ended December 31, 2018. The impact of the amended guidance on the Company was the removal of the requirements to disclose (a) the valuation processes for Level 3 fair value measurements, and (b) the policy for timing of the transfers between levels. The amended guidance also modified the disclosure requirement to reconcile the opening balances to the closing balances of recurring Level 3 fair value measurements; a nonpublic entity is now only required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities.

*Recently issued accounting standards not yet adopted*

*Leases*

In February 2016, the FASB issued ASU 2016-02, “*Leases (Topic 842)*” which provided a new comprehensive model for lease accounting. Topic 842 will require a lessee to recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term.

This guidance is effective for annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact of this guidance on the Company’s results of operations, financial condition and liquidity.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**3. Reserve for losses and loss expenses**

Our reserve for losses and loss expenses comprise the following as of December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Reserve for reported losses and loss expenses	\$ 85,250	\$ 17,810
Reserve for losses incurred but not reported	267,266	131,740
<b>Reserve for losses and loss expenses</b>	<b>\$ 352,516</b>	<b>\$ 149,550</b>

The following table presents a reconciliation of our beginning and ending reserve for losses and loss expenses for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Reserve for losses and loss expenses at beginning of year	\$ 149,550	\$ 37,904
Incurred losses and loss expenses relating to losses occurring in:		
Current year	217,927	118,880
Prior years	5,584	1,528
Total incurred losses and loss expenses	<u>223,511</u>	<u>120,408</u>
Paid losses and loss expenses relating to losses occurring in:		
Current year	(17,303)	(4,573)
Prior years	(25,287)	(4,342)
Total paid losses and loss expenses	<u>(42,590)</u>	<u>(8,915)</u>
Foreign exchange movements	(9,914)	153
Change in the deferred charge asset	31,959	-
<b>Reserve for losses and loss expenses at end of year</b>	<b>\$ 352,516</b>	<b>\$ 149,550</b>

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**3. Reserve for losses and loss expenses (cont.)**

During the year, the Company entered into a retroactive reinsurance contract. The Company has recognized premiums earned of \$75.1 million in relation to this contract. The Company also recognized a reserve for losses and loss expenses of \$107.9 million and an unamortized deferred charge asset of \$32.8 million, with the net amount recognized in losses and loss expenses in the Consolidated Statements of Income (Loss). The deferred charge asset which is shown as part of Other Assets is being amortized over the expected remaining loss settlement period using the interest method, and the periodic amortization is being charged to earnings as a component of losses and loss expenses. For the year ended December 31, 2018, \$0.8 million of amortization has been charged to losses and loss expenses.

In the preceding table, the classifications of both incurred losses and loss expenses, and paid losses and loss expenses, are based on the inception date of the retroactive reinsurance contract. As such, incurred and paid losses have been classified as “current year”.

During 2018, the Company recorded net unfavorable prior year loss reserve development of \$5.6 million arising from changes to prior year losses and loss expense reserve estimates. This included \$3.0 million related to unfavorable prior year loss reserve development in its longer-tail lines, primarily in the professional lines of business and \$2.6 million related to its short-tail lines of business, primarily in the property and catastrophe lines of business.

During 2017, the Company recorded net unfavorable prior year loss reserve development of \$1.5 million arising from changes to prior year losses and loss expense reserve estimates, primarily related to loss reserve development in its liability lines of business.

*Loss development tables*

The Company has disaggregated its loss reserve information below by its major lines of business. The Company has presented the below development tables for all accident years shown using exchange rates as of December 31, 2018. All accident years prior to the current year have also been presented using the current year exchange rates.



**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**3. Reserve for losses and loss expenses (cont.)**

Professional

<u>Incurring Losses and Loss Expenses</u>				<u>Years Ended December 31,</u>		<u>December 31, 2018</u>	
<u>Accident Year</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>Total of IBNR Reserves Plus</u>			<u>Expected Development on</u>
	<u>(Unaudited)</u>	<u>(Unaudited)</u>		<u>Reported Losses</u>			
2016	\$ 14,342	\$ 14,767	\$ 15,772	\$			10,647
2017		40,578	41,553				30,322
2018			43,630				38,345
			<u>Total</u>	<u>\$</u>			<u>100,955</u>
<u>Cumulative Paid Losses and Loss Expenses</u>							
<u>Years Ended December 31,</u>							
<u>Accident Year</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>				
	<u>(Unaudited)</u>	<u>(Unaudited)</u>					
2016	\$ 18	\$ 879	\$ 2,391				
2017		689	4,297				
2018			1,621				
			<u>Total</u>	<u>\$</u>			<u>8,309</u>
			<b>Reserve for losses and loss expenses</b>	<b>\$</b>			<b><u>92,646</u></b>

Liability

<u>Incurring Losses and Loss Expenses</u>				<u>Years Ended December 31,</u>		<u>December 31, 2018</u>	
<u>Accident Year</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>Total of IBNR Reserves Plus</u>			<u>Expected Development on</u>
	<u>(Unaudited)</u>	<u>(Unaudited)</u>		<u>Reported Losses</u>			
2016	\$ 24,883	\$ 25,986	\$ 26,770	\$			14,416
2017		53,715	53,558				35,601
2018			50,661				42,606
			<u>Total</u>	<u>\$</u>			<u>130,989</u>
<u>Cumulative Paid Losses and Loss Expenses</u>							
<u>Years Ended December 31,</u>							
<u>Accident Year</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>				
	<u>(Unaudited)</u>	<u>(Unaudited)</u>					
2016	\$ 1,303	\$ 4,783	\$ 7,071				
2017		1,200	7,757				
2018			2,849				
			<u>Total</u>	<u>\$</u>			<u>17,677</u>
			<b>Reserve for losses and loss expenses</b>	<b>\$</b>			<b><u>113,312</u></b>

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**3. Reserve for losses and loss expenses (cont.)**

Motor

<u>Accident Year</u>	<u>Incurred Losses and Loss Expenses</u> <u>Years Ended December 31,</u>		<u>December 31, 2018</u> <u>Total of IBNR Reserves Plus</u> <u>Expected Development on Reported</u> <u>Losses</u>	
	2017 (Unaudited)	2018		
2017	\$ 3,673	\$ 4,060	\$	1,079
2018		11,843		9,555
	Total	\$ 15,903		
 <u>Cumulative Paid Losses and Loss Expenses</u> <u>Years Ended December 31,</u>				
<u>Accident Year</u>	2017 (Unaudited)	2018		
2017	\$ 3	\$ 13		
2018		1		
	Total	\$ 14		
	<b>Reserve for losses and loss expenses</b>	<b>\$ 15,889</b>		

Other

<u>Accident Year</u>	<u>Incurred Losses and Loss Expenses</u> <u>Years Ended December 31,</u>		<u>December 31, 2018</u> <u>Total of IBNR Reserves Plus</u> <u>Expected Development on Reported</u> <u>Losses</u>	
	2017 (Unaudited)	2018		
2017	\$ 20,914	\$ 23,501	\$	4,335
2018		35,796		19,434
	Total	\$ 59,297		
 <u>Cumulative Paid Losses and Loss Expenses</u> <u>Years Ended December 31,</u>				
<u>Accident Year</u>	2017 (Unaudited)	2018		
2017	\$ 2,681	\$ 13,993		
2018		11,393		
	Total	\$ 25,386		
	<b>Reserve for losses and loss expenses</b>	<b>\$ 33,911</b>		

The reporting of cumulative claims frequency is deemed to be impracticable as the information necessary to provide cumulative claims frequency for these reserve classes is not available to the Company.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**3. Reserve for losses and loss expenses (cont.)**

*Reconciliation of loss development information to the Reserve for Losses and Loss Expenses*

The following table reconciles the loss development information to the Company's reserves for losses and loss expenses as of December 31, 2018:

		<b>2018</b>
<b>Reserve for losses and loss expenses</b>		
Professional	\$	92,646
Liability		113,312
Motor		15,889
Other		33,911
<b>Total</b>		<b>255,758</b>
Foreign exchange and other <sup>(1)</sup>		(37)
Assumed reserves related to retroactive transactions <sup>(2)</sup>		96,795
<b>Total reserve for losses and loss expenses</b>	<b>\$</b>	<b>352,516</b>

<sup>(1)</sup> Non-U.S. dollar denominated loss data is converted to U.S. dollar at the rates of exchange in effect at the balance sheet date for material underlying currencies. Fluctuations in foreign currency exchange rates may cause material shifts in loss development. Reserves for losses and loss expenses disclosed in the Consolidated Balance Sheets are also revalued using the exchange rate at the balance sheet date.

<sup>(2)</sup> For retroactive insurance contracts we do not believe that analysis of losses incurred and paid by accident year of the underlying event is relevant or meaningful given that our exposure to losses incepts when the contract incepts. Further, in this instance, we believe that the classifications of reported claims and case development liabilities to have no practical analytical value.

*Historical loss duration*

The following table summarizes the historic average annual percentage payout of incurred losses by age by major line of business as of December 31, 2018:

	<b>Average Annual Percentage Payout of Incurred Losses by Age</b>		
	<b>2018</b>		
	<b>(Unaudited)</b>		
	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Professional	1.8%	7.1%	9.6%
Liability	4.2%	12.6%	8.5%
Motor	0.0%	0.3%	N/A
Other	21.6%	48.1%	N/A

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**4. Investments**

The Company's investments are comprised of fixed maturities, investments in funds, and other securities managed by BISA-II in the Fund. The Fund is a Cayman Islands exempted limited partnership that was formed on August 20, 2015 and commenced operations on July 5, 2016. Blackstone Harrington Associates L.L.C., a Delaware limited liability company (the "General Partner"), serves as the general partner of the Fund. Harrington Re is the sole limited partner of the Fund.

Pursuant to the Investment Management Agreement, the Fund is managed by the Investment Manager. The Investment Manager provides certain administrative and investment management services to the Fund, including the investigation, evaluation, selection, allocation, negotiation, structuring, commitment to, monitoring of and disposition of the Fund's investments (including allocation of the Fund's assets among investment strategies). The General Partner and the Investment Manager are affiliates of the Blackstone Group.

Pursuant to a letter agreement dated as of November 2, 2016 (the "Letter Agreement") between BMAA, which was assigned by BMAA to the Investment Manager as of October 1, 2017, and the Parent, the Investment Manager provides (i) certain reporting on the Fund's investment portfolio to the Company's management and the Board and (ii) assistance and support to the Company's management in connection with the Investment Manager's management of the Fund's portfolio by providing certain supplemental reporting, data, analyses and other support (as mutually agreed) with respect to the Fund.

The Fund seeks to achieve attractive risk-adjusted returns through a portfolio of diversified, primarily alternative, investments.

The following table summarizes the fair value of the Fund's securities grouped by investment strategy held as of December 31, 2018 and 2017:

<b>Strategy</b>	<b>2018</b>	<b>2017</b>
Investment Grade <sup>(1)</sup>	\$ 100,986	\$ -
Liquid Multi-Strategy Funds <sup>(2)</sup>	141,830	328,856
Long Credit <sup>(3)</sup>	105,375	105,370
Liquid Credit Alternative <sup>(4)</sup>	191,450	180,028
Private Credit Alternative <sup>(5)</sup>	35,971	15,999
Real Estate Liquid Credit <sup>(6)</sup>	107,723	16,136
Private Equity <sup>(7)</sup>	42,902	19,041
Private Real Estate <sup>(8)</sup>	119,180	30,252
Tactical Opportunities <sup>(9)</sup>	30,981	18,196
<b>Total Invested Assets</b>	<b>876,398</b>	<b>713,878</b>
Senior Secured Facility Borrowings <sup>(10)</sup>	(55,000)	(55,000)
Other Balances <sup>(11)</sup>	12,274	(2,104)
<b>Limited Partner Net Asset Value at Year End</b>	<b>\$ 833,672</b>	<b>\$ 656,774</b>

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**4. Investments (cont.)**

- (1) Investment Grade** - This strategy focuses on capital preservation, liquidity, and current income by investing primarily in investment grade fixed income securities while maintaining minimal levels of interest rate risk.
- (2) Liquid Multi-Strategy Funds** - This strategy seeks capital appreciation by allocating its assets among a variety of discretionary sub-advisers with experience managing non-traditional or “alternative” investment strategies.
- (3) Long Credit** - The primary objective of this strategy is to protect principal and generate superior risk-adjusted returns by investing in various forms of senior secured debt obligations, including senior secured loans, senior secured floating-rate notes, and senior secured notes and bonds.
- (4) Liquid Credit Alternative** - The primary objective of this strategy is to generate superior risk-adjusted returns by investing in public and private opportunities, primarily in North America and Western Europe.
- (5) Private Credit Alternative** – This strategy primarily focuses on making privately negotiated mezzanine investments. The strategy focuses on providing capital to upper middle market companies and private equity sponsors in connection with leveraged buyouts, mergers and acquisitions, recapitalizations, growth financings and other corporate transactions.
- (6) Real Estate Liquid Credit** – This strategy focuses primarily on high yield lending on commercial real estate through new loan originations and purchases of legacy loans and securities, but may otherwise pursue a broad range of real estate related debt and non-controlling equity investments.
- (7) Private Equity** - This strategy can include investments in funds investing directly in energy, healthcare, industrial, financial services or retail / consumer and other private equity related investments.
- (8) Private Real Estate** – This strategy primarily invests in funds that invest directly in real estate, real estate investment trusts and other real estate related investments.
- (9) Tactical Opportunities** - This strategy generally includes investing in assets focused on time-sensitive or other tactical investment ideas across asset classes and geographies. This strategy can also include investing opportunistically in a broad range of private or public securities and instruments, which may be equity or debt or similar thereto.
- (10) Senior Secured Facility Borrowings** – Relates to the Fund’s borrowings under the Company’s facility described in Note 8, “*Financing arrangements*”.
- (11) Other Balances** – Includes but is not limited to management fees accruals, performance based allocation to and ownership interest of the General Partner, cash, other interest, and general and administrative expense accruals.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**4. Investments (cont.)**

There are no restrictions on the Company's ability to withdraw from the Fund, however, (i) the General Partner of the Fund may limit withdrawals as of any withdrawal date for legal, regulatory or contractual reasons, (ii) the ability to withdraw capital from Harrington Re's capital account relating to any Fund investment that is illiquid by its terms will be limited and (iii) the ability to withdraw will be subject to the limitations on withdrawals imposed pursuant to the terms of the governing agreements of the underlying investments that the Fund holds.

See also Note 8, "Financing arrangements" for restrictions on the Company's investments imposed by the terms of the Company's credit facilities.

*Net Investment Income*

The components of net investment income for the years ended December 31, 2018, and 2017, were as follows:

	<b>2018</b>	<b>2017</b>
Realized and unrealized net gains on investments	\$ 7,872	\$ 38,261
Interest income	10,970	5,147
Net expenses	(9,158)	(5,097)
Total net investment income	9,684	38,311
Amounts attributable to the General Partner of the Fund	(36)	(2,920)
Net investment income attributable to the limited partner of the Fund	9,648	35,391
Other interest income	179	41
<b>Net investment income</b>	<b>\$ 9,827</b>	<b>\$ 35,432</b>

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**5. Fair value measurements**

U.S. GAAP establishes a hierarchal disclosure framework which prioritizes and ranks the level of market price observability used in measuring financial instruments at fair value. Market price observability is affected by a number of factors, including the type of financial instrument, the characteristics specific to the financial instrument and the state of the marketplace, including the existence and transparency of transactions between market participants. Financial instruments with readily available quoted prices in active markets generally will have a higher degree of market price observability and a lesser degree of judgment used in measuring fair value.

Financial instruments measured and reported at fair value are classified and disclosed based on the observability of inputs used in the determination of fair values, as follows:

- Level 1 – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in active markets (and actively traded) that the Company has the ability to access. The Company does not adjust the quoted price for these investments.
- Level 2 – Pricing inputs and other than quoted prices in active markets (and not actively traded) which are either directly or indirectly observable as of the reporting date, and fair value is determined through the use of models or other valuation methodologies. Financial instruments which are generally included in this category include corporate bonds and bank loans where the fair value is based on observable inputs or quotations from market participants and pricing service provider with higher levels of liquid market observability than Level 3 assets or liabilities.
- Level 3 – Pricing inputs are unobservable for the financial instruments and include situations where there is little, if any, market activity for the financial instrument. Fair value is determined through the use of models or other valuation methodologies such as quotations from market participants and pricing service provider. The inputs into determination of fair value require significant management judgment of estimation. Some of the factors considered for Level 2 or Level 3 determination include number of observable quotes, and obtained standard deviation of quotes, among other things.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the determination of which category within the fair value hierarchy is appropriate for any given financial instrument is based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument.

Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**5. Fair value measurements (cont.)**

The following tables summarize the valuation of the Company's financial instruments measured at fair value on a recurring basis by the fair value hierarchy as of December 31, 2018 and 2017:

**2018**

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV as Fair Value</u>	<u>Total</u>
<b>Assets</b>					
<i>Investments</i>					
Fixed maturities	\$ -	\$ 99,088	\$ 4,802	\$ -	\$ 103,890
Bonds	-	1,485	-	-	1,485
Money market funds <sup>(1)</sup>	27,145	-	-	-	27,145
<i>Affiliated Funds</i>					
UCITS	141,830	-	-	-	141,830
Investment funds	-	-	-	629,193	629,193
<b>Total assets</b>	<b>\$ 168,975</b>	<b>\$ 100,573</b>	<b>\$ 4,802</b>	<b>\$ 629,193</b>	<b>\$ 903,543</b>
<b>Liabilities</b>					
Derivative instruments <sup>(2)</sup>	\$ -	\$ 2,438	\$ -	\$ -	\$ 2,438
<b>Total liabilities</b>	<b>\$ -</b>	<b>\$ 2,438</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 2,438</b>

**2017**

<u>Description</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV as Fair Value</u>	<u>Total</u>
<b>Assets</b>					
<i>Investments</i>					
Fixed Maturities	\$ -	\$ 102,119	\$ 3,251	\$ -	\$ 105,370
Money market funds <sup>(1)</sup>	9,978	-	-	-	9,978
<i>Affiliated Funds</i>					
UCITS	328,856	-	-	-	328,856
Investment funds	-	-	-	279,652	279,652
<b>Total assets</b>	<b>\$ 338,834</b>	<b>\$ 102,119</b>	<b>\$ 3,251</b>	<b>\$ 279,652</b>	<b>\$ 723,856</b>

<sup>(1)</sup> Money market funds are included in cash and cash equivalents.

<sup>(2)</sup> See Note 6, "Derivatives".



**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**5. Fair value measurements (cont.)**

*Significant Unobservable Inputs Used in Level 3 Measurements*

The following table discloses the valuation techniques, significant unobservable inputs, and range of values used for those significant unobservable inputs for assets recognized at fair value and classified as Level 3 under the fair value hierarchy as of December 31, 2018:

	<u>Fair value</u>	<u>Valuation technique</u>	<u>Significant unobservable inputs</u>	<u>Ranges</u>	<u>Weighted average</u>
<b>Investments</b>					
Fixed Maturities	\$ 4,802	Third Party Pricing quotes <sup>(1)</sup>	N/A	N/A	N/A
<b>Total</b>	<u>\$ 4,802</u>				

<sup>(1)</sup> Third party pricing quotes are generally determined on the basis of prices between market participants provided by reputable dealers or service providers.

N/A – Not applicable

*Fair Value of Other Financial Instruments*

The changes in fair value of investments for which the Company has used Level 3 inputs to determine fair value are presented in the following table:

	<u>Bank Loans</u>	
Purchases <sup>(1)</sup>	\$	4,680
Transfers in <sup>(2)</sup>	\$	610
Transfers out <sup>(2)</sup>	\$	(985)

<sup>(1)</sup> Includes amortization of purchase premiums and accretion of purchase discounts.

<sup>(2)</sup> Transfers occurred between Level 2 and Level 3 because of changes in observability of market data due to increase or decrease in market activity and information for these investments.

The fair value of financial instruments accounting guidance also applies to financial instruments disclosed, but not carried, at fair value, except for certain financial instruments, including insurance contracts. The fair value of the Company's other assets and liabilities, which qualify as financial instruments under ASC Topic 825, Financial Instruments, approximate the carrying amounts presented in the consolidated financial statements. As these financial instruments are not actively traded, their fair values are classified as Level 2.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**6. Derivatives**

The Company holds assets and liabilities in foreign currencies and thus is exposed to foreign currency risk. The Company may enter into foreign currency forward exchange contracts to manage the exposure to this foreign currency risk. These foreign currency forward exchange contracts are used as economic hedges and are not designated as hedging instruments for financial reporting purposes.

The following table summarizes information on the classification and amount of the fair value of derivatives within the Company's Consolidated Balance Sheets as of December 31, 2018 and 2017:

<b>Derivative Instrument</b>	<b>December 31, 2018</b>			<b>December 31, 2017</b>		
	<b>Notional Amount</b>	<b>Asset Derivative at Fair Value <sup>(1)</sup></b>	<b>Liability Derivative at Fair Value <sup>(1)</sup></b>	<b>Notional Amount</b>	<b>Asset Derivative at Fair Value <sup>(1)</sup></b>	<b>Liability Derivative at Fair Value <sup>(1)</sup></b>
Foreign currency forward contracts	\$ 78,852	\$ -	\$ 2,438	\$ -	\$ -	\$ -

<sup>(1)</sup> Asset and liability derivatives are classified within Other Assets and Other Liabilities, respectively, within the Company's Consolidated Balance Sheets.

The following table summarizes information on the classification and net impact on earnings, recognized in the Company's Consolidated Statements of Income (Loss), relating to derivative instruments during the years ended December 31, 2018 and 2017:

<b>Derivative Instrument</b>	<b>Classification of gains/ losses recognized in earnings</b>	<b>Years Ended December 31,</b>	
		<b>2018</b>	<b>2017</b>
Foreign currency forward contracts	Foreign exchange loss (gain)	\$ 6,004	\$ -

There was no balance sheet offsetting activity as of December 31, 2018 or 2017.

The Company provides collateral for the above derivative positions in the form of a reduction in the aggregate commitment available amount under its credit facility arrangement with Societe Generale S.A., New York branch (the "Bank"). See Note 8, "*Financing arrangements*" for more details.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**7. Commitments and contingencies**

*(a) Concentrations of Credit Risk*

*Credit Risk Aggregation*

The Company monitors and manages the aggregation of credit risk on a Group-wide basis allowing us to consider of exposure management strategies for individual countries, regions, sectors and any other relevant inter-dependencies. The creditworthiness of each counterparty is evaluated by the Company, taking into account credit ratings assigned by independent agencies.

Credit risk aggregation is also managed through monitoring of overlaps in underwriting, financing and investing activities.

The assets that potentially subject us to concentrations of credit risk consist principally of cash and cash equivalents, our investments portfolio and reinsurance premiums receivable balances, as described below.

Cash and Cash Equivalents

In order to mitigate concentration and operational risks related to cash and cash equivalents, we utilize only well-established highly-rated financial institutions and money-market funds.

Investments

Our investment portfolio is managed by our Investment Manager in accordance with the investment guidelines set-out in the Investment Management Agreement. The Investment Management Agreement provides for the limitation of the credit risk through specific investment portfolio diversification requirements, investment concentration limitations as well as detailed liquidity provisions. As of December 31, 2018, the Fund was in compliance with the requirements of the Investment Management Agreement.

Premiums Receivable Balances

The Company manages its credit risk in its reinsurance relationships by transacting with counterparties that it considers financially sound. For all of our reinsurance contracts we have the contractual right to offset premiums receivable with corresponding payments for losses and loss expenses. These contractual rights contribute to the mitigation of credit risk, as does our monitoring of aged receivable balances. In light of these mitigating factors, and considering that a significant portion of our premiums receivable are not currently due based on the terms of the underlying contracts, we do not utilize specific credit quality indicators to monitor our premiums receivable balance. We did not record any bad debts expense charge in the years ended December 31, 2018 or 2017.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**7. Commitments and contingencies (cont.)**

*(b) Legal Proceedings*

From time to time, as is common in the insurance industry, the Company may be subject to routine legal proceedings, including arbitrations, arising in the ordinary course of business. These legal proceedings generally relate to claims asserted by or against us in the ordinary course of reinsurance operations; estimated amounts payable under such proceedings are included in the reserve for losses and loss expenses in our Consolidated Balance Sheets. As of December 31, 2018, the Company was not party to any legal proceedings.

*(c) Employment and Other Arrangements*

As of December 31, 2018, the Company has entered into employment agreements with its executive officers. Such employment arrangements provide for compensation in the form of base salary, annual bonus, participation in the Company's employee benefit programs and the reimbursements of expenses.

*(d) Other Commitments*

Please see Note 13, “*Related party transactions*” for details on the commitments under the Services Agreement and the Investment Management Agreement.

**8. Financing arrangements**

*Credit Facilities*

On July 6, 2016, the Company entered into an aggregate credit facility arrangement with Societe Generale S.A., New York branch (the “Credit Facility”). The Credit Facility expires on July 6, 2021, but the Bank may elect to terminate it on or after July 6, 2019 by providing an irrevocable written notice to the Company not less than 365 days prior to the proposed date of termination. The aggregate commitment available under the Credit Facility was \$259.0 million as of January 1, 2018, and increased to \$400.0 million available from December 31, 2018. The purpose of the Credit Facility is to provide senior secured borrowing facilities to the Fund, to provide a revolving loan facility to the Company and to provide a secured letter of credit facility for use by the Company to support its reinsurance obligations. The Credit Facility is also used to provide collateral to support any initial amounts and variation margins payable relating to the foreign exchange forward contracts described under Note 6, “*Derivatives*”. As of December 31, 2018 the related amount due was \$4.0 million and reduced the aggregate commitment amount available under the Credit Facility as of that date. The Credit Facility is secured by the Company’s investments managed by BISA-II in the Fund and is subject to certain covenants. These covenants include certain liquidity requirements with regards to the Fund’s investments, credit limits based on the fair value of the Fund and certain restrictions on the composition of the Fund’s investment portfolio.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**8. Financing arrangements (cont.)**

As of December 31, 2018, the letters of credit outstanding under the Credit Facility totaled \$243.6 million (December 31, 2017: \$117.3 million). In addition, the Fund directly borrowed \$55.0 million under the terms of the Credit Facility. The Fund pays interest on amounts outstanding on the first business day of each month at a rate of 3-month US Dollar London Interbank Offered Rate, plus 1.80% per annum (4.54% as of December 31, 2018, and 3.16% as of December 31, 2017). The interest rate resets monthly two business days prior to the first calendar day of the month and any outstanding accrued but unpaid interest will capitalize into the principal. For the year ended December 31, 2018, the Fund incurred \$2.3 million (2017: \$1.7 million) in interest expense relating to the Credit Facility, at a weighted-average rate of 4.06% (2017: 3.02%), which is shown as part of "Net investment income" in the Consolidated Statements of Income (Loss).

The Company has deferred initial set-up costs relating to the Credit Facility of \$1.0 million and is subsequently amortizing the deferred costs over the term of the borrowing arrangements. During the year ended December 31, 2018, the total interest expense incurred by the Company including the Company's revolving loan facility interest costs, interest costs relating to the letter of credit facilities and the amortization of the initial set-up costs was \$2.5 million (2017: \$1.9 million).

**9. Shareholder's equity**

*Common Shares*

The authorized, issued and outstanding share capital of the Company as of December 31, 2018 and 2017 consisted of 1,000,000 common shares with a par value of \$1.00 per share.

**10. Share-based compensation**

Under our Board approved share-based compensation plan, the Parent grants stock options to eligible employees of the Company. On July 1, 2016, 579,725 stock options were granted to employees of the Company.

Half of the stock options were granted with service period vesting conditions only. The vesting of the other half of the stock option grants is dependent on the meeting of a requisite service period and of specified performance conditions.

All stock options granted have a vesting period of 3 years with 33% of the grants vesting annually. The annual vesting of the performance-based stock grants is based upon the achievement of the established performance criteria during the applicable performance period. All stock options expire ten years from the date of the grant. During the year ended December 31, 2018 and 2017, the Company recognized \$0.4 million as an expense relating to share-based compensation and 193,242 of the stock options vested.

**11. Retirement plans**

For purposes of providing employees with retirement benefits, the Company maintains self-directed defined contribution retirement plans. Contributions are based on the participants' eligible compensation. For the year ended December 31, 2018, the Company expensed \$0.1 million (2017: \$0.1 million) related to this retirement plan.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**12. Income taxes**

Harrington Re is incorporated under the laws of Bermuda and, under current Bermuda law, are not required to pay any taxes in Bermuda on income or capital gains. We have received an assurance from the Minister of Finance in Bermuda that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits, income, gain or appreciation on any capital asset, or any tax in the nature of estate duty or inheritance tax, such tax will not be applicable to the Company until March 31, 2035.

The Fund is an exempted limited partnership registered in the Cayman Islands, and under the current law in the Cayman Islands no income taxes are imposed on the Fund.

The Company does not consider itself to be engaged in trade or business in the United States and intends to conduct its operations in a manner that will not cause it to be treated as engaged in a trade or business in the United States and, therefore, does not expect to be required to pay U.S. federal income taxes other than the U.S. excise tax on reinsurance premiums.

The United States imposes an excise tax on insurance and reinsurance premiums paid to non-U.S. insurers or reinsurers with respect to risks located in the United States. The rate of tax, unless reduced by an applicable U.S. tax treaty, is one percent for all reinsurance premiums. The Company incurs federal excise taxes on certain of its reinsurance transactions. Such amounts are reflected as acquisition costs in the Company's Consolidated Statements of Income (Loss).

FASB guidance regarding the accounting for uncertainty in income taxes prescribes a "more likely than not" threshold for the financial statement recognition of a tax position taken or expected to be taken in a tax return, assuming the relevant tax authority has full knowledge of all relevant information. The amount recognized represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability is recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the consolidated financial statements, along with any interest and penalty (if applicable) on the excess. The Company recognizes interest and penalties relating to unrecognized tax benefits in the provision for income taxes. Changes in recognition or measurement are reflected in the period in which the change in judgement occurs.

As of December 31, 2018, the Company's total unrecognized tax benefits, including interest and penalties, were \$nil (as of December 31, 2017: \$nil).

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**13. Related party transactions**

In June 2016, AXIS Capital Holdings Limited through its wholly-owned subsidiary, AXIS Ventures Limited, invested \$100.0 million and acquired 18.1% of the Parent's common equity. The investment was subsequently increased to 19.0% of the Parent's common equity. Under the shareholders' agreement dated July 1, 2016 (the "Shareholders' Agreement") as long as the Services Agreement is in effect and AXIS Capital retains a shareholding in the Parent, AXIS Capital has the right to appoint a director to the Group's Board of Directors.

The Company has engaged AXIS Reinsurance Managers Limited ("ARM" or the "Liability Manager"), a wholly-owned subsidiary of AXIS Capital, to act as its liability manager pursuant to a long term services agreement dated July 1, 2016. The Liability Manager manages the day-to-day underwriting activities of the Company subject to the provisions of the Services Agreement and the oversight of management and Board of Directors of the Company. The Services Agreement also provides for ARM to provide certain other services to the Company, including claims handling, actuarial, risk management and information technology support as specified in the agreement. The Services Agreement has limited termination provisions and is set to initially expire on June 30, 2025, provided, however, that the term is set to automatically renew for successive three-year periods following such initial term unless the Company or the Liability Manager gives written notice of cancellation at least two years prior to the end of the then current term.

In return for its services, ARM receives fees from the Company, which include underwriting fees, an underwriting expense reimbursement fee and profit commissions, as well as a reinsurance services fee as a reimbursement for the additional services provided to the Company.

In June 2016, the Blackstone Group, through its wholly-owned subsidiary, together with investment entities formed for certain senior professionals and employees of the Blackstone Group, have in total acquired 9.9% of the Parent's common equity. Pursuant to the Shareholders Agreement, as long as the Investment Management Agreement is in effect and the Blackstone Group retains a shareholding in the Parent, the Blackstone Group has the right to appoint a director to the Group's Board of Directors.

Pursuant to the Investment Management Agreement, BISA-II serves as the investment manager (the "Investment Manager") of the assets of the Company that are invested in the Fund. Harrington Re is the sole limited partner of the Fund. The Fund seeks to achieve attractive risk-adjusted returns through a portfolio of diversified, primarily alternative, investments.

Pursuant to the Investment Management Agreement, the Investment Manager provides certain administrative and investment management services to the Fund, including the investigation, evaluation, selection, allocation, negotiation, structuring, commitment to, monitoring of and disposition of investments (including allocation of the Fund's assets among investment strategies). The Investment Management Agreement has limited termination provisions and is set to initially expire on the earlier of (i) the liquidation of the Fund and (ii) June 30, 2025, provided, however, that the term is set to automatically renew for successive three-year periods following such initial term unless the Company or the Investment Manager gives written notice of cancellation at least two years prior to the end of the then current term.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**13. Related party transactions (cont.)**

Pursuant to the Letter Agreement, the Investment Manager provides (i) certain reporting on the Fund's investment portfolio to the Company's management and the Board and (ii) assistance and support to the Company's management in connection with the Investment Manager's management of the Fund's portfolio by providing certain supplemental reporting, data, analysis and other support (as mutually agreed) with respect to the Fund.

In return for its investment services, the Investment Manager receives a management fee from the Fund and the General Partner receives a performance fee from the Fund.

Certain directors and executive officers of AXIS Capital and certain management and senior professionals of the Blackstone Group own common shares of the Parent.

During the years ended December 31, 2018 and 2017, the Company exclusively wrote reinsurance business with various entities in the AXIS Capital group for property and casualty risks on a quota share basis.

The related consolidated statement of income (loss) and consolidated balance sheet account balances for these transactions, including the related ARM fees, for the years ended December 31, 2018 and 2017 were as follows:

	<b>2018</b>	<b>2017</b>
<i>Consolidated Statement of Income (Loss) items:</i>		
Gross premiums written	\$ 255,340	\$ 214,217
Net premiums earned	285,675	162,067
Losses and loss expenses	223,511	120,408
Acquisition costs	66,824	57,777
General and administrative expenses	1,428	810
<i>Consolidated Balance Sheet items:</i>		
Reinsurance balances receivable	99,394	127,853
Deferred acquisition costs	40,373	58,529
Prepaid expenses	614	775
Reserve for losses and loss expenses	352,516	149,550
Unearned premiums reserve	\$ 122,869	\$ 153,204

**14. Statutory financial information**

Harrington Re is registered as a Class 4 insurer under the Insurance Act 1978, amendments thereto and Related Regulations of Bermuda (the "Insurance Act"). Under the Insurance Act, the Company is required to annually prepare and file with the Bermuda Monetary Authority a statutory financial return which includes statutory financial statements, a capital and solvency return and audited financial statements.



**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**14. Statutory financial information (cont.)**

At the time of filing its statutory financial statements, Harrington Re is also required to deliver to the BMA a declaration of compliance, in such form and with such content as may be prescribed by the BMA, declaring whether or not Harrington Re has, with respect to the 2018 financial year (i) complied with all requirements of the minimum criteria applicable to it; (ii) complied with the minimum margin of solvency as of its financial year end; (iii) complied with the applicable enhanced capital requirements as of its financial year end; and (iv) observed any limitations, restrictions or conditions imposed upon issuance of its license, if applicable.

The Insurance Act provides that the value of the statutory assets of an insurer must exceed the value of its statutory liabilities by an amount greater than its prescribed minimum solvency margin ("MSM").

The MSM that must be maintained by Harrington Re with respect to its general business is the greater of (i) \$100 million, or (ii) 50% of net premiums written (with a credit for reinsurance ceded not exceeding 25% of gross premiums) or (iii) 15% of net loss and loss expense provisions and other insurance reserves or (iv) 25% of the ECR (as defined below) as reported at the end of the relevant year.

Harrington Re is also required to maintain available statutory economic capital and surplus at a level equal to or in excess of its enhanced capital requirement ("ECR") which is established by reference to either the Bermuda Solvency Capital Requirement ("BSCR") model or an approved internal capital model, provided that the ECR shall at all times be an amount equal to, or exceeding the margin of solvency. The BSCR model is a standardized statutory risk-based capital model developed by the BMA which is used to measure the risk associated with Harrington Re's assets, liabilities and premiums. In 2016, the BMA implemented an Economic Balance Sheet ("EBS") framework which was used as the basis to determine the ECR.

The required and available statutory economic capital and surplus as of December 31, 2018 and 2017, in the table below are based on this EBS framework:

	<u>2018</u>	<u>2017</u>
Required statutory capital and surplus	\$ 278,171	\$ 227,834
Available statutory capital and surplus	\$ 557,335	\$ 529,875

Harrington Re is required to calculate and submit the ECR to the BMA annually. Following receipt of the submission of Harrington Re's ECR, the BMA has the authority to impose additional capital requirements or capital add-ons, if it deems necessary. If an insurer fails to maintain or meet its ECR, the BMA may take various degrees of regulatory action. As of December 31, 2018, the Company was in compliance with all solvency requirements of the Insurance Act.

Harrington Re is also required under the Insurance Act to maintain a minimum liquidity ratio whereby the value of its relevant assets is not less than 75% of the amount of its relevant liabilities for general business. As of December 31, 2018, Harrington Re met the minimum liquidity ratio requirement.

**HARRINGTON RE LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(U.S. dollars in thousands, except share and per share amounts)

**14. Statutory financial information (cont.)**

Harrington Re's statutory net loss for the year ended December 31, 2018 was \$3.7 million (2017 net income: \$10.2 million). Statutory accounting differs from U.S. GAAP in the reporting of certain items such as intangible assets and prepaid expenses.

Harrington Re is prohibited from declaring or paying a dividend if it is in breach of its MSM, ECR or minimum liquidity ratio or if the declaration or payment of such dividend would cause such a breach. Where an insurer fails to meet its MSM or minimum liquidity ratio on the last day of any financial year, it will be prohibited from declaring or paying any dividends during the next financial year without the approval of the BMA.

In addition, Harrington Re is prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files (at least seven days before payment of such dividends) with the BMA an affidavit signed by at least two directors (one of whom must be a Bermuda resident director if any of the insurer's directors are resident in Bermuda) and the principal representative stating that it will continue to meet its solvency margin and minimum liquidity ratio. The maximum dividend Harrington Re could pay, without a signed affidavit, having met its relevant margins, is approximately \$135.3 million.

The Bermuda Companies Act 1981 further limits Harrington Re's ability to pay dividends and make distributions from contributed surplus to its Parent if there are reasonable grounds for believing that: (a) Harrington Re is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of Harrington Re's assets would thereby be less than the aggregate of its liabilities. Harrington Re did not pay any dividends or make any distributions to its Parent during the years ended December 31, 2018 and 2017.

**15. Subsequent events**

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date of December 31, 2018 through April 29, 2019, the date these financial statements were available to be issued, and concluded that there are no subsequent events requiring recognition or disclosure.