WATFORD RE LTD.

Financial Statements

For the Year Ended
December 31, 2014

WATFORD RE LTD.

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April 30, 2015

Independent Auditor's Report

To the Board of Directors and Shareholder of
Watford Re Ltd.

We have audited the accompanying financial statements of Watford Re Ltd. which comprise the balance sheet as of December 31, 2014 and the related statements of income (loss), changes in shareholder's equity and cash flows for the year then ended.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of the 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Watford Re Ltd. at December 31, 2014, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers Ltd.

Chartered Professional Accountants

WATFORD RE LTD.

BALANCE SHEET

(U.S. dollars in thousands, except share data)

		December 31, 2014
Assets		
Investments accounted for using the fair value option	$	927,346
Cash and cash equivalents		281,679
Accrued investment income		8,537
Premiums receivable		140,859
Unpaid losses and loss adjustment expenses recoverable		2,705
Paid losses and loss adjustment expenses recoverable		726
Prepaid reinsurance premiums		9,035
Deferred acquisition costs		49,529
Receivable for securities sold		63,110
Other assets		1,405
Total Assets	$	1,484,931
Liabilities		
Reserve for losses and loss adjustment expenses	$	66,328
Unearned premiums		180,014
Reinsurance balances payable		10,225
Payable for securities purchased		80,551
Borrowings to purchase investments		52,398
Other liabilities		11,743
Total Liabilities		401,259
Shareholder's Equity		
Common shares ($1.00 par; shares authorized, issued and outstanding: 1,000,000)		1,000
Additional paid-in capital		1,113,635
Retained deficit		(30,963)
Total Shareholder's Equity		1,083,672
Total Liabilities and Shareholder's Equity	$	1,484,931

See Notes to Financial Statements

WATFORD RE LTD.
STATEMENT OF INCOME (LOSS)
(U.S. dollars in thousands)

		Year Ended December 31, 2014
Revenues		
Net premiums written	$	274,456
Change in unearned premiums		(170,979)
Net premiums earned		103,477
Net investment loss		(8,385)
Total revenues		95,092
Expenses		
Loss and loss adjustment expenses		(70,173)
Acquisition expenses		(30,116)
Operating expenses		(8,571)
Net foreign exchange loss		(2,747)
Total expenses		(111,607)
Net loss	$	(16,515)

See Notes to Financial Statements

WATFORD RE LTD.
STATEMENT OF CHANGES IN SHAREHOLDER'S EQUITY
(U.S. dollars in thousands)

		Year Ended December 31, 2014
Common Shares		
Balance at beginning of period	$	-
Common shares issued		1,000
Balance at end of period		1,000
Additional Paid-in Capital		
Balance at begining of period		-
Common shares issued, net		1,113,635
Balance at end of period		1,113,635
Retained Deficit		
Balance at begining of period		-
Net loss		(16,515)
Dividends paid to Parent		(14,448)
Balance at end of period		(30,963)
Total Shareholder's Equity	$	1,083,672

See Notes to Financial Statements

WATFORD RE LTD.

STATEMENT OF CASH FLOWS

(U.S. dollars in thousands)

		Year Ended December 31, 2014
Operating Activities		
Net loss	$	(16,515)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Net unrealized loss on investments		22,526
Net realized loss on investments		4,109
Accrued investment income		(8,537)
Premiums receivable		(142,215)
Unpaid losses and loss adjustment expenses recoverable		(2,706)
Paid losses and loss adjustment expenses recoverable		(727)
Prepaid reinsurance premiums		(9,035)
Deferred acquisition costs		(49,529)
Reserve for losses and loss adjustment expenses		67,101
Unearned premiums		180,014
Reinsurance balances payable		10,333
Other liabilities		9,238
Other items, net		1,307
Net cash provided by Operating Activities		65,364
Investing Activities		
Purchase of investments, net		(1,258,223)
Proceeds from sale/redemption of investments		320,892
Purchases of furniture, equipment and other assets		(825)
Net cash used for Investing Activities		(938,156)
Financing Activities		
Proceeds from Common shares issued		1,114,635
Dividends paid		(14,448)
Borrowings to purchase investments		55,605
Net cash provided by Financing Activities		1,155,792
Effects of exchange rate changes on foreign currency cash		(1,321)
Increase in cash		281,679
Cash and cash equivalents, beginning of year		-
Cash and cash equivalents, end of year	$	281,679

See Notes to Financial Statements

1. General

Watford Re Ltd. (the "Company") was incorporated under the laws of Bermuda on July 19, 2013 and is a wholly-owned subsidiary of Watford Holdings Ltd. (the "Parent"). The parent was incorporated under the laws of Bermuda on July 19, 2013.

The Company is licensed as a Class 4 multi-line insurer under the Insurance Act 1978 of Bermuda, as amended, and related regulations (the "Insurance Act") and is licensed to underwrite general business on an insurance and reinsurance basis. The Company primarily underwrites reinsurance on exposures worldwide. The Company commenced operations in the first quarter of 2014 and these financial statements are presented from January 1, 2014 to December 31, 2014.

In the first quarter of 2014, the Parent raised approximately $1.1 billion of capital consisting of $907.3 million in common equity ($895.6 million net of issuance costs) and $226.6 million in preference equity ($219.2 million net of issuance costs and discount). Through its wholly-owned subsidiary, Arch Reinsurance Ltd., Arch Capital Group Ltd. ("ACGL") invested $100.0 million and acquired approximately 11% of the Parent's common equity and a warrant to purchase an additional 1.0 million common shares the Parent.

The Company has engaged Arch Underwriters Ltd. ("AUL" or the "Reinsurance Manager"), a company incorporated in Bermuda and a wholly-owned subsidiary of ACGL, to act as the reinsurance manager pursuant to the Services Agreement, as amended, dated March 24, 2014 (the "Services Agreement"). The Reinsurance Manager manages the day-to-day underwriting activities of the Company, subject to the provisions of the Service Agreement and the oversight of the Board of Directors (the "Board"). See Note 10, "Transactions with Related Parties," for further details.

The Company has engaged Highbridge Principal Strategies, LLC, ("Highbridge" or the "Investment Manager"), a subsidiary of JPMorgan Chase & Co., as investment manager of the assets in the Company's investment account pursuant to an Investment Agreement, amended and restated, dated March 24, 2014 (the "Investment Management Agreement"). The Investment Manager will invest the Company's assets in select opportunities across its credit platform subject to the terms of the Investment Management Agreement and the oversight of the Board. The aim is to build a portfolio consisting primarily of non-investment grade credit securities, including senior secured loans and high yield bonds. See Note 10, "Transactions with Related Parties," for further details.

2. Significant Accounting Policies

(a) Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

(b) Premium Revenues and Related Expenses

Reinsurance premiums written are recorded based on the type of contracts the Company writes. Premiums on the Company's excess of loss and pro rata reinsurance contracts are estimated when the business is underwritten. For excess of loss contracts, premiums are recorded as written, on the inception date, based on the terms of the contract. Estimates of premiums written under pro rata contracts are recorded in the period in which the underlying risks are expected to incept and are based on information provided by the brokers and the ceding companies. For multi-year reinsurance treaties which are payable in annual installments, premium recognition depends on whether the contract is non-cancellable. If either party retains the ability to cancel or commute coverage prior to expiration, only the initial annual installment is included as premiums written at policy inception. The remaining annual installments would then be included as premiums written at each successive anniversary date within the multi-year term. If, on the other hand, the contract is non-cancellable, the full multi-year premiums would be recognized as written at policy inception.

Reinsurance premiums written and assumed include amounts reported by brokers and ceding companies, supplemented by the Company's own estimates of premiums where reports have not been received. The determination of premium estimates requires a review of the ceding companies, familiarity with each market, the timing of the reported information, an analysis and understanding of the characteristics of each line of business, and management's judgment of the impact of various factors, including premium or loss trends, on the volume of business written and ceded to the Company. On an ongoing basis, the Company reviews the amounts reported by these third parties for reasonableness based on their experience and knowledge of the subject class of business, taking into account AUL's historical experience with the brokers or ceding companies. In addition, reinsurance contracts under which the Company assumes business generally contain specific provisions which allow the Company to perform audits of the ceding company to ensure compliance with the terms and conditions of the contract, including accurate and timely reporting of information. Based on a review of all available information, management establishes premium estimates where reports have not been received. Premium estimates are updated when new information is received and differences between such estimates and actual amounts are recorded in the period in which estimates are changed or the actual amounts are determined. Adjustments to premium estimates could be material and such adjustments could directly and significantly impact earnings favorably or unfavorably in the period they are determined because the estimated premium may be fully or substantially earned.

Reinstatement premiums are recognized at the time a loss event occurs, where coverage limits for the remaining life of the contract are reinstated under pre-defined contract terms. Reinstatement premiums, if obligatory, are fully earned when recognized. The accrual of reinstatement premiums is based on an estimate of losses and loss adjustment expenses, which reflects management's judgment.

Reinsurance premiums written, irrespective of the class of business, are generally earned on a pro rata basis over the term of the underlying policies or reinsurance contracts. Contracts and policies written on a "losses occurring" basis cover claims that may occur during the term of the contract or policy, which is typically 12 months. Accordingly, the premium is earned evenly over the term. Contracts which are written on a "risks attaching" basis cover claims which attach to the underlying insurance policies written during the terms of such contracts. Premiums earned on such contracts usually extend beyond the original term of the reinsurance contract, typically resulting in recognition of premiums earned over a 24-month period. Certain of the Company's reinsurance contracts include provisions that adjust premiums or acquisition expenses based upon the experience under the contracts. Premiums written and earned, as well as related acquisition expenses, are recorded based upon the projected experience under such contracts.

Acquisition expenses and other expenses related to the Company's underwriting operations that vary with, and are directly related to, the successful acquisition or renewal of business are deferred and amortized over the period in which the related premiums are earned. Acquisition expenses, net of ceding commissions received from reinsurers, consist principally of commissions and premium taxes paid to obtain the Company's business. Deferred acquisition costs, which are based on the related unearned premiums, are carried at their estimated realizable value and take into account anticipated losses and loss adjustment expenses, based on historical and current experience, and anticipated investment income. A premium deficiency occurs if the sum of anticipated losses and loss adjustment expenses, unamortized acquisition costs and anticipated investment income exceed unearned premiums. A premium deficiency is recorded by charging any unamortized acquisition costs to expense to the extent required in order to eliminate the deficiency. If the premium deficiency exceeds unamortized acquisition costs then a liability is accrued for the excess deficiency. No premium deficiency charges were recorded by the Company during 2014.

(c) Reinsurance Ceded

Reinsurance ceding commissions are recognized as income on a pro rata basis over the period of risk. The portion of such commissions that will be earned in the future is deferred and reported as a reduction to acquisition costs. The accompanying statement of income (loss) reflects premiums and losses and loss adjustment expenses and acquisition costs, net of reinsurance ceded (see Note 3). Ceded unearned premiums are reported as prepaid reinsurance premiums and estimated amounts of reinsurance recoverable on unpaid losses are reported as unpaid losses and loss adjustment expenses recoverable. Reinsurance premiums ceded and unpaid losses and loss adjustment expenses recoverable are estimated in a manner consistent with that of the original policies issued and the terms of the reinsurance contracts. If the reinsurers are unable to satisfy their obligations under the agreements, the Company would be liable for such defaulted amounts.

(d) Cash and restricted cash and cash equivalents

Cash includes cash equivalents, which are investments with original maturities of three months or less.

(e) Investments

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

The fair values of fixed maturity investments are based on quotations received from nationally recognized pricing services, or when such prices are not available, by reference to broker or underwriter bid indications. Short-term investments are comprised of securities due to mature within one year of the date of issue. Investment transactions are recorded on a trade date basis with balances pending settlement recorded separately in the balance sheet as receivable for investments sold or payable for investments purchased.

All derivative financial instruments, including embedded derivative instruments, are required to be recognized as either assets or liabilities in the balance sheet and measured at fair value, with changes in the fair value recorded as a component of net realized and unrealized investment gains (losses). The Company's investment strategy allows for the use of derivative instruments. Derivative instruments may be used to enhance investment performance, replicate investment positions or manage market exposures and duration risk that would be allowed under the Company's investment guidelines if implemented in other ways.

Net investment income includes interest and dividend income, realized and unrealized gains and losses together with amortization of market premiums and discounts and is net of investment management fees and expenses. Investment gains or losses realized on the sale of investments are determined on a first-in, first-out basis and are reflected in net income. See Note 5, "Investments Information," for further details.

(f) Reserves for Losses and Loss Adjustment Expenses

The reserve for losses and loss adjustment expenses consists of estimates of unpaid reported losses and loss adjustment expenses and estimates for losses incurred but not reported. The reserve for unpaid reported losses and loss adjustment expenses, established by management based on reports from ceding companies and claims from insureds, represents the estimated ultimate cost of events or conditions that have been reported to or specifically identified by the Company. Such reserves are supplemented by management's estimates of reserves for losses incurred for which reports or claims have not been received. The Company's reserves are based on a combination of reserving methods, incorporating ceding company and industry loss development patterns. The Company selects the initial expected loss and loss adjustment expense ratios based on information derived by its

Reinsurance Manager during the initial pricing of the business, supplemented by industry data where appropriate. Such ratios consider, among other things, rate changes and changes in terms and conditions that have been observed in the market. The Company, in conjunction with data and analysis supplied by its Reinsurance Manager, reviews the reserves regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in income in the period in which they are determined. Inherent in the estimates of ultimate losses and loss adjustment expenses are expected trends in claims severity and frequency and other factors which may vary significantly as claims are settled. Accordingly, ultimate losses and loss adjustment expenses may differ materially from the amounts recorded in the accompanying financial statements. Losses and loss adjustment expenses are recorded on an undiscounted basis.

(g) Foreign Exchange

Monetary assets and liabilities, such as premiums receivable and the reserve for losses and loss adjustment expenses, denominated in foreign currencies are revalued at the exchange rate in effect at the balance sheet date with the resulting foreign exchange gains and losses included in net income. Accounts that are classified as non-monetary, such as deferred acquisition costs and the unearned premium reserves, are not revalued. In the case of foreign currency denominated fixed maturity securities, the change in exchange rates between the local currency and the Company’s functional currency at each balance sheet date is included as a component of net foreign exchange gains and losses included in the statement of net income (loss).

(h) Recent Accounting Pronouncements

A new accounting standard issued in the 2014 second quarter will change the manner in which most companies recognize revenue. The standard requires that revenue reflect the transfer of goods or services to customers based on the consideration or payment the company expects to be entitled to in exchange for those goods or services; however, the standard does not change the accounting for insurance contracts or financial instruments. The new standard also requires enhanced disclosures about revenue. This accounting guidance will be effective in the 2017 first quarter and may be applied on a full retrospective or modified retrospective approach. The Company is currently assessing the impact the implementation of this standard will have on its financial statements.

(U.S. dollars in thousands, except share data)

3. Reinsurance

Through a reinsurance agreement with Arch Reinsurance Ltd. and other, less material reinsurances, the Company cedes a portion of its premiums. The effects of reinsurance on the Company's written and earned premiums and losses and loss adjustment expenses were as follows:

	2014
Premiums written	
Assumed	$ 288,627
Ceded	(14,171)
Net	$ 274,456
Premiums earned	
Assumed	$ 108,614
Ceded	(5,137)
Net	$ 103,477
Losses and Loss Adjustment Expenses	
Assumed	$ 73,777
Ceded	(3,604)
Net	$ 70,173

The Company monitors the financial condition of its reinsurers and attempts to place coverages only with substantial, financially sound carriers. At December 31, 2014, substantially all of the Company's reinsurance recoverables on paid and unpaid losses (not including prepaid reinsurance premiums) were due from Arch Reinsurance Ltd., a Bermuda-based subsidiary of ACGL, which had a rating of "A+" from A.M. Best Company. Although the Company has not experienced any material credit losses to date, an inability of its reinsurers to meet their obligations to it over the relevant exposure periods for any reason could have a material adverse effect on its financial condition and results of operations.

(U.S. dollars in thousands, except share data)

4. Reserve for Losses and Loss Adjustment Expenses

The following table represents an analysis of losses and loss adjustment expenses and a reconciliation of the beginning and ending reserve for losses and loss adjustment expenses:

	Year Ended December 31, 2014
Gross reserve for losses and loss adjustment expenses at beginning of year	$ -
Unpaid losses and loss adjustment expenses recoverable	-
Net reserve for losses and loss adjustment expenses at beginning of year	-
Net incurred losses and loss adjustment expenses relating to losses occurring in:	
Current year	70,173
Prior years	-
Total net losses and loss adjustment expenses	70,173
Foreign exchange gains	(771)
Net paid losses and loss adjustment expenses relating to losses occurring in:	
Current year	(5,779)
Prior years	-
Total paid losses and loss adjustment expenses	(6,550)
Net reserve for losses and loss adjustment expenses at end of year	63,623
Unpaid losses and loss adjustment expenses recoverable	2,705
Reserve for losses and loss adjustment expenses at end of year	$ 66,328

5. Investment Information

The following table summarizes the fair value of the Company's securities held as at December 31, 2014, for which the fair value option was elected:

	2014
Term loan investments (par value: $678,875)	$ 661,634
Corporate bonds	228,325
Asset backed securities	24,322
Short-term investments	8,890
Non-US government and government agencies	4,175
Total	$ 927,346

Fair Value Option

The Company elected to carry all fixed maturity securities and other investments at fair value under the fair value option afforded by accounting guidance regarding the fair value option for financial assets and liabilities. Changes in fair value of investments accounted for using the fair value option are included in "Net investment income." The primary reasons for electing the fair value option were to reflect economic events in earnings on a timely basis and address simplification and cost-benefit considerations.

(U.S. dollars in thousands, except share data)

Net Investment Income

The components of net investment income were derived from the following sources:

	Year Ended December 31, 2014
Interest and dividends	
Term loan investments	$ 18,419
Corporate bonds	6,810
Asset backed securities	867
Short-term investments	984
Non-US government and government agencies	155
Cash and cash equivalents	66
Total interest and dividends	27,301
Net realized and unrealized investment gains (losses)	
Term loan investments	(13,018)
Corporate bonds	(15,326)
Asset backed securities	(948)
Short-term investments	4,348
Non-US government and government agencies	(1,691)
Total net realized and unrealized investment gains (losses)	(26,635)
Gross investment income	666
Less investment management fees and expenses	(9,051)
Net investment loss	$ (8,385)

Restricted Assets

The Company maintains assets in trust accounts as collateral and cash-backed letters of credit for certain ACGL entities and third party ceding companies. See Note 11, “Commitments and Contingencies—Letter of Credit and Revolving Credit Facilities,” for further details. As at December 31, 2014, the Company held $114,065 in assets used for collateral or guarantees. All the assets held were in cash and cash equivalents.

6. Fair Value

Accounting guidance regarding fair value measurements addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP and provides a common definition of fair value to be used throughout GAAP. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In addition, it establishes a three-level valuation hierarchy for the disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The level in the hierarchy within which a given fair value measurement falls is determined based on the lowest level input that is significant to the measurement (Level 1 being the highest priority and Level 3 being the lowest priority).

The levels in the hierarchy are defined as follows:

Level 1: Inputs to the valuation methodology are observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Fair Value Measurements on a Recurring Basis

Following is a description of the valuation methodologies used for securities measured at fair value, as well as the general classification of such securities pursuant to the valuation hierarchy.

The Company determines the existence of an active market based on its judgment as to whether transactions for the financial instrument occur in such market with sufficient frequency and volume to provide reliable pricing information. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. The Company uses quoted values and other data provided by nationally recognized independent pricing sources as inputs into its process for determining fair values of its fixed maturity investments. Each price source has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of “matrix pricing” in which the independent pricing source uses observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, broker-dealer quotes, reported trades and sector groupings to determine a reasonable fair value. In certain circumstances, when fair values are unavailable from these independent pricing sources, quotes are obtained directly from broker-dealers who are active in the corresponding markets. Such quotes are subject to the validation procedures noted above.

Where multiple quotes or prices were obtained, a price source hierarchy was maintained in order to determine which price source would be used (*i.e.*, a price obtained from a pricing service with more seniority in the hierarchy will be used over a less senior one in all cases). The hierarchy prioritizes pricing services based on availability and reliability and assigns the highest priority to index providers. Based on the above review, the Company will challenge any prices for a security or portfolio which are considered not to be representative of fair value.

The Company reviews its securities measured at fair value and discusses the proper classification of such investments with the Investment Manager and others. A discussion of the general classification of the Company’s financial instruments follows:

Fixed maturities. Where the Company believes that quoted market prices are not available or that the market is not active, fair values are estimated by using quoted prices of securities with similar characteristics, pricing models or matrix pricing and are generally classified as Level 2 securities. The Company determined that Level 2 securities included term loans, corporate bonds, asset backed securities, non-U.S. government and government agencies and other short-term investments. The Company determined that one global corporate bond for which there is a low level of transparency around inputs to the valuation process should be classified within Level 3 of the valuation hierarchy.

Short-term investments. Other short-term investments are classified in Level 2 of the valuation hierarchy with the exception of the derivatives which are classified as Level 1 in the valuation hierarchy. See Note 8, “Derivative Instruments”, for further details.

(U.S. dollars in thousands, except share data)

The following table presents the Company's financial assets measured at fair value by level at December 31, 2014:

		Fair Value Measurement Using:		
	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets measured at fair value:				
Investments accounted for using the Fair value option:				
Term loans	$ 661,634	$ -	$ 661,634	$ -
Corporate bonds	228,325	-	204,850	23,475
Asset backed securities	24,322	-	24,322	-
Other short-term investments	8,890	1,675	7,215	-
Non-U.S. government and government agencies	4,175	-	4,175	-
Total	$ 927,346	$ 1,675	$ 902,196	$ 23,475

When the fair value of financial assets and financial liabilities cannot be derived from active markets, the fair value is determined using a variety of valuation techniques that include the use of models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required to establish fair values. Changes in assumptions about these factors could affect the reported fair value of financial instruments and the level where the instruments are disclosed in the fair value hierarchy.

7. Borrowings to Purchase Investments

During 2014, the Company borrowed approximately €43.3 million ($52.4 million) from the Company's custodian bank to purchase Euro denominated securities. The Company pays interest based on 3 month LIBOR plus a margin and the borrowed amount is payable upon demand. The borrowed funds are collateralized with $54.9 million of invested assets. The foreign exchange gain or loss on revaluation on the borrowed funds is included as a component of foreign exchange gains and losses included in the statement of net income (loss).

8. Derivative Instruments

The Company's investment strategy allows for the use of derivative securities. The Company's derivative instruments are recorded on its balance sheet at fair value. The fair values of those derivatives are based on quoted market prices and are classified in Level 1 of the valuation hierarchy. Derivative assets are shown as part of other short-term investments within investments accounted for using the fair value option and the derivative liabilities are included in other liabilities on the balance sheet. All realized and unrealized contract gains and losses are reflected in "Net investment income" in the Company's statement of net income (loss). The Company utilized put options to manage specific market risks as part of its total return objective.

(U.S. dollars in thousands, except share data)

The following table summarizes information on the fair values and notional values of the Company's derivative instruments at December 31, 2014:

	Fair Value	Notional Value(1)
Put Options - Assets	$ 1,675	$ 15,006
Put Options - Liabilities	(655)	(10,778)
Net Derivatives	$ 1,020	$ 4,228

(1) The net notional amount represents the absolute value of all outstanding contacts, consisting of long and short positions.

9. Income Taxes

The Company is incorporated under the laws of Bermuda and, under current Bermuda law, is not obligated to pay any taxes in Bermuda based upon income or capital gains. The Company has received a written undertaking from the Minister of Finance in Bermuda under the Exempted Undertakings Tax Protection Act 1966 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. This undertaking does not, however, prevent the imposition of taxes on any person ordinarily resident in Bermuda or any company in respect of its ownership of real property or leasehold interests in Bermuda.

The Company will be subject to U.S. federal income tax only to the extent that it derives U.S. source income that is subject to U.S. withholding tax or income that is effectively connected with the conduct of a trade or business within the U.S. and is not exempt from U.S. tax under an applicable income tax treaty with the U.S. The Company will be subject to a withholding tax on dividends from U.S. investments and interest from certain U.S. payors (subject to reduction by any applicable income tax treaty). The Company 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 U.S. excise taxes on insurance and reinsurance premium and withholding taxes on dividends and certain other U.S. source investment income). However, because there is uncertainty as to the activities which constitute being engaged in a trade or business within the United States, there can be no assurances that the U.S. Internal Revenue Service will not contend successfully that the Company is engaged in a trade or business in the United States. If the Company were subject to U.S. income tax, the Company's shareholder's equity and earnings could be materially adversely affected.

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 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.

As of December 31, 2014, the Company's total unrecognized tax benefits, including interest and penalties, were nil.

Federal Excise Taxes

The United States also 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. For 2014, the Company incurred approximately $0.2 million of federal excise taxes. Such amounts are reflected as acquisition expenses in the Company’s statement of income (loss).

10. Transactions with Related Parties

In March 2014, Arch Reinsurance Ltd., a Bermuda-based subsidiary of ACGL, invested $100 million in the Parent and acquired approximately 11% of its common equity. AUL, a subsidiary of ACGL, acts as the Company’s reinsurance manager and Highbridge, a subsidiary of JPMorgan Chase & Co., manages the Company’s investment assets, each under separate long term services agreements. ACGL and Highbridge were granted warrants to purchase additional common equity in the Parent based on performance criteria. In recognition of the sizable ownership interest, two senior executives of ACGL were appointed to the board of directors of the Company. The Services Agreement with AUL and the Investment Management Agreement with Highbridge provide for services for an extended period of time with limited termination rights by the Company. In addition, these agreements allow for both AUL and Highbridge to participate in the favorable results of the Company in the form of performance fees.

The Company entered into the Services Agreement with AUL to which AUL provides services related to the management of the reinsurance portfolio for an initial term ending December 2020. The Services Agreement perpetually renews automatically in five year increments unless either party provides written notice of cancellation at least two years prior to expiration. As part of the Services Agreement, AUL will make available to the Company, on a non-exclusive basis, the “Designated Employees”, who will serve as officers of the Company and will underwrite the reinsurance business on behalf of the Company. AUL will also provide portfolio management, Designated Employee supervision, exposure modeling, loss reserve recommendations, claims-handling, accounting and other related services as part of the Services Agreement. In return for its reinsurance services, AUL will receive fees from the Company, including an underwriting fee and profit commission, as well as reimbursement for the services of the Designated Employees. All reinsurance contracts will be bound by the Company or by the Designated Employees on behalf of the Company. During the year ended December 31, 2014, the Company incurred $1.7 million in fees to AUL for services provided.

The Company entered into the Investment Management Agreement with Highbridge, in which Highbridge manages the Company’s investment portfolio for an initial term ending in December 2020. The Investment Management Agreement perpetually renews automatically in five year increments unless either party provides written notice of cancellation at least two years prior to expiration. In return for its investment services, Highbridge will receive a management fee, a performance fee and allocated overhead expenses. During the year ended December 31, 2014, the Company incurred $8.9 million in fees to Highbridge.

Certain directors and executive officers of ACGL along with Highbridge principals and management own common and preference shares of the Parent.

(U.S. dollars in thousands, except share data)

The Company reinsured Arch Reinsurance Ltd. and other ACGL entities for property and casualty risks on a quota share basis. The related statement of income (loss) and balance sheet account balances for these transactions for the year ended December 31, 2014 were as follows:

	2014
Statement of income (loss) items:	
Gross premiums written	$ 194,564
Premiums ceded	14,117
Net premiums earned	70,638
Losses and Loss Adjustment Expenses	45,803
Net acquisition costs	22,180
Balance sheet items:	
Restricted cash and cash equivalents	98,274
Premiums receivable	89,959
Unpaid losses and loss adjustment expenses recoverable	2,705
Paid losses and loss adjustment expenses recoverable	726
Prepaid reinsurance premiums	9,026
Deferred acquisition costs	40,405
Reserve for losses and loss adjustment expenses	47,964
Unearned premiums	118,835
Reinsurance balances payable	10,225
Other liabilities	752

11. Commitments and Contingencies

Concentrations of Credit Risk

The creditworthiness of a counterparty is evaluated by the Company, taking into account credit ratings assigned by independent agencies. The credit approval process involves an assessment of factors, including, among others, the counterparty country and industry exposures. Collateral may be required, at the discretion of the Company, on certain transactions based on the creditworthiness of the counterparty.

The areas where significant concentrations of credit risk may exist include unpaid losses and loss adjustment expenses recoverable, prepaid reinsurance premiums and paid losses and loss adjustment expenses recoverable net of reinsurance balances payable (collectively, “reinsurance recoverables”), investments and cash and cash equivalent balances. The Company’s reinsurance recoverables at December 31, 2014 amounted to $2.3 million and resulted from reinsurance arrangements entered into with Arch Reinsurance Ltd., which has an “A+” credit rating from A.M. Best Company. A credit exposure exists with respect to reinsurance recoverables as they may become uncollectible. The Company manages its credit risk in its reinsurance relationships by transacting with reinsurers that it considers financially sound and, if necessary, the Company may hold collateral in the form of funds, trust accounts and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis.

In addition, the Company underwrites a significant amount of its business through brokers and a credit risk exists should any of these brokers be unable to fulfill their contractual obligations with respect to the payments of insurance and reinsurance balances owed to the Company.

(U.S. dollars in thousands, except share data)

The Company's investment portfolio is managed in accordance with investment guidelines that include standards of diversification, which limit the allowable holdings of any single issue. There were no investments in any entity in excess of 10% of the Company's shareholder's equity at December 31, 2014 other than cash and cash equivalents held in operating and investment accounts with financial institutions with credit ratings between "A" and "AA-".

Letter of Credit and Revolving Credit Facilities

On May 19, 2014, the Company entered into a $200 million letter of credit facility (the "Facility") with Lloyds Bank Plc, New York Branch. The Facility expires on May 19, 2015 and is expected to be renewed. The principal purpose of the Facility is to issue, as required, evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which the Company has entered into reinsurance arrangements to ensure that such counterparties are permitted to take credit for reinsurance obtained from the Company as required under insurance regulations in the United States. The amount of letters of credit issued is driven by, among other things, the timing and payment of catastrophe losses, loss development of existing reserves, the payment pattern of such reserves, the further expansion of the Company's business and the loss experience of such business. When issued, the letters of credit are secured by cash. In addition, the Facility also requires the maintenance of certain covenants, which the Company was in compliance with at December 31, 2014. At such date, the Company had approximately $26 million in outstanding letters of credit, which were secured by cash. This amount is considered restricted and is included in cash and cash equivalents in the Company's balance sheet.

Leases and Purchase Obligations

At December 31, 2014, the future minimum rental commitments for the Company's operating lease are as follows:

	2014
2015	$ 323
2016	323
2017	323
2018	323
2019	323
Total	$ 1,615

The lease is for the rental of office space, with an expiration date of September 2, 2023. Rental expense was $0.3 million for the year ended December 31, 2014.

Employment and Other Arrangements

At December 31, 2014, the Company has entered into employment agreements with certain of its executive officers for periods extending up to March 2017. 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.

Other Commitments

As at December 31, 2014, the Company had one unfunded commitment of $1.0 million relating to a term loan within its investment portfolio.

12. Shareholders' Equity

Common Shares

The authorized share capital of the Company consists of 1,000,000 common shares, par value of $1.00 per share, at December 31, 2014. The issued share capital of the Company consists of 1,000,000 common shares, par value of $1.00 per share at December 31, 2014.

13. Retirement Plans

For purposes of providing employees with retirement benefits, the Company maintains defined contribution retirement plans. Contributions are based on the participants' eligible compensation. For 2014, the Company expensed approximately $0.06 million related to these retirement plans.

14. Legal Proceedings

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. As of December 31, 2014, the Company was not a party to any litigation or arbitration which is expected by management to have a material adverse effect on the Company's results of operations and financial condition and liquidity.

15. Statutory Information

Under The Insurance Act 1978, as amended, and related regulations of Bermuda (the "Insurance Act"), the Company, is registered as a Class 4 insurer and is required to annually prepare and file statutory financial statements and a statutory financial return with the Bermuda Monetary Authority ("BMA"). The Insurance Act also requires the Company to maintain minimum share capital and must ensure that the value of its general business assets exceeds the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margins and enhanced capital requirement pertaining to its general business. At December 31, 2014, all such requirements were met.

The Company is also required under its Class 4 license 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, 2014, the Company met the minimum liquidity ratio requirement.

Under the Insurance Act, the Company is subject to capital requirements calculated using the Bermuda Solvency and Capital Requirement model ("BSCR model"), which is a standardized statutory risk-based capital model used to measure the risk associated with the Company's assets, liabilities and premiums. Under the BSCR model, the Company's required statutory capital and surplus is referred to as the enhanced capital requirement ("ECR"). The Company is required to calculate and submit the ECR to the BMA annually. Following receipt of the submission of the Company'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, 2014, the Company met its ECR.

Statutory accounting differs from U.S. GAAP in the reporting of certain items such as acquisition costs, deferred income taxes and prepaid expenses. The statutory capital and surplus for the Company at December 31, 2014 was $1.032 billion. The required statutory capital and surplus at December 31, 2014 was $137.2 million.

The Company may declare dividends subject to it continuing to meet its solvency and capital requirements, which includes continuing to hold statutory capital and surplus equal to or exceeding its ECR. The Company is prohibited from declaring or paying in any fiscal year dividends of more than 25% of its prior year's statutory capital and surplus unless the Company files with the BMA a signed affidavit by at least two members of the

Board of Directors attesting that a dividend would not cause the company to fail to meet its relevant margins. As of December 31, 2014, the Company could pay dividends in 2015 of approximately $257.9 million without providing an affidavit to the BMA.

The Bermuda Companies Act 1981 (the “Companies Act”) limits the Company’s ability to pay dividends and distributions to its Parent if there are reasonable grounds for believing that: (a) the Company is, or would after the payment be, unable to pay its liabilities as they become due; or (b) the realizable value of the Company’s assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts. Under the Insurance Act, the Company is restricted with respect to the payment of dividends. Based on this restriction, the Company is prohibited, without prior approval of the BMA, from reducing by 15% or more its prior year statutory capital. During 2014, the Company paid $14.4 million in dividends to the Parent based on the solvency and capital requirements in 2014.

16. Subsequent Events

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date of December 31, 2014 through April 30, 2015, the date the financial statements were available to be issued, and concluded that there are no subsequent events requiring recognition or disclosure.