

Energy Insurance Mutual Limited

Audited Financial Statements

*Years ended December 31, 2016 and 2015  
with Report of Independent Auditors*

# Energy Insurance Mutual Limited

## Audited Financial Statements

Years ended December 31, 2016 and 2015

### Contents

Report of Independent Auditors.....	1 - 2
Audited Financial Statements	
Balance Sheets .....	3
Statements of Income and Comprehensive Income .....	4 - 5
Statements of Changes in Policyholders' Surplus .....	6
Statements of Cash Flows .....	7
Notes to Financial Statements.....	8 - 23

## Report of Independent Auditors

To the Audit Committee of the Board of Directors  
Energy Insurance Mutual Limited

### ***Report on the Financial Statements***

We have audited the accompanying financial statements of Energy Insurance Mutual Limited (“the Company”) which comprise the balance sheets as of December 31, 2016 and 2015 and the related statements of income and comprehensive income, changes in policyholders' surplus and cash flows for the years then ended and the related notes to the financial statements.

### ***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls 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 these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the 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 the auditor’s 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, the auditor considers internal controls relevant to the entity’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 entity’s internal controls. 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 Energy Insurance Mutual Limited at December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Johnson Lambert LLP*

Jacksonville, Florida

March 1, 2017

# Energy Insurance Mutual Limited

## Balance Sheets

*(Expressed in Thousands of U.S. Dollars)*

	As of December 31,	
	2016	2015
<u>Assets</u>		
Investments, available-for-sale	\$ 1,355,647	\$ 1,361,051
Alternative investments	164,040	150,141
Investment in subsidiaries	3,295	3,159
Total investments	1,522,982	1,514,351
Cash and cash equivalents	39,696	76,025
Reinsurance recoverables on unpaid losses	338,780	402,203
Reinsurance recoverables on paid losses	15,707	37
Prepaid reinsurance premiums	39,444	43,634
Accrued investment income	7,236	7,953
Receivables for securities sold	2,685	3,543
Premiums receivable	8,186	7,446
Deferred policy acquisition costs	1,105	1,051
Income taxes recoverable	726	1,837
Other assets	809	621
Total assets	\$ 1,977,356	\$ 2,058,701
<u>Liabilities and policyholders' surplus</u>		
Liabilities:		
Reserve for losses and loss adjustment expenses	\$ 673,877	\$ 839,222
Unearned and advance premiums	121,825	120,975
Reinsurance premiums payable and funds held for reinsurers	8,574	20,131
Net deferred tax liability	72,365	67,697
Policyholder distributions payable	25,000	20,000
Accounts payable and accrued expenses	12,588	12,210
Line of credit	16,500	-
Payables for securities purchased	10,470	5,891
Due to subsidiaries	7,790	129
Total liabilities	948,989	1,086,255
Policyholders' surplus:		
Accumulated other comprehensive income	167,068	164,930
Members' account balance	861,299	807,516
Total policyholders' surplus	1,028,367	972,446
Total liabilities and policyholders' surplus	\$ 1,977,356	\$ 2,058,701

*See accompanying notes to the financial statements.*

## Energy Insurance Mutual Limited

### Statements of Income and Comprehensive Income

*(Expressed in Thousands of U.S. Dollars)*

	Years ended December 31,	
	2016	2015
<u>Underwriting revenue</u>		
Net premiums earned		
Direct and assumed premiums earned	\$ 222,951	\$ 209,306
Ceded premiums earned	(83,124)	(72,680)
Net premiums earned	139,827	136,626
Ceding commission income	2,421	2,121
Total underwriting revenue	142,248	138,747
<u>Underwriting expenses</u>		
Net losses and loss adjustment expenses		
Gross and assumed losses and loss adjustment expenses	123,118	238,871
Ceded losses and loss adjustment expenses	(28,161)	(107,726)
Net losses and loss adjustment expenses	94,957	131,145
Policy acquisition costs	2,273	1,823
Administrative expenses	10,559	10,681
Total underwriting expenses	107,789	143,649
Income (loss) from underwriting	34,459	(4,902)
<u>Investment income</u>		
Net realized gain on investments sold	12,426	6,767
Other-than-temporary impairments	(126)	-
Net investment income	49,295	41,572
Total investment income	61,595	48,339
Income before policyholders' distribution and income taxes	96,054	43,437
Distributions to policyholders'	(25,000)	(20,000)
Income before income taxes	71,054	23,437
<u>Income tax (expense) benefit</u>		
Current income tax (expense) benefit	(13,691)	696
Deferred income tax (expense) benefit	(3,580)	2,486
Total income tax (expense) benefit	(17,271)	3,182
Net income	\$ 53,783	\$ 26,619

(continued)

*See accompanying notes to the financial statements.*

## Energy Insurance Mutual Limited

### Statements of Income and Comprehensive Income (Continued)

*(Expressed in Thousands of U.S. Dollars)*

	Years ended December 31,	
	2016	2015
<u>Comprehensive income</u>		
Net income	\$ 53,783	\$ 26,619
Net unrealized gains (losses) on available-for-sale securities, net of income taxes of \$5,456 and \$(4,348), respectively	10,133	(8,074)
Less: reclassification adjustment for net gains realized in net income, net of income taxes of \$4,305 and \$2,368, respectively	(7,995)	(4,399)
Other comprehensive income (loss), net of tax	2,138	(12,473)
Comprehensive income	\$ 55,921	\$ 14,146

*See accompanying notes to the financial statements.*

## Energy Insurance Mutual Limited

### Statements of Changes in Policyholders' Surplus

*(Expressed in Thousands of U.S. Dollars)*

	<u>Accumulated Other Comprehensive Income</u>	<u>Members' Account Balance</u>	<u>Total Policyholders' Surplus</u>
Balance at January 1, 2015	\$ 177,403	\$ 780,897	\$ 958,300
Other comprehensive loss, net of tax	(12,473)	-	(12,473)
Net income	<u>-</u>	<u>26,619</u>	<u>26,619</u>
Balance at December 31, 2015	164,930	807,516	972,446
Other comprehensive income, net of tax	2,138	-	2,138
Net income	<u>-</u>	<u>53,783</u>	<u>53,783</u>
Balance at December 31, 2016	<u>\$ 167,068</u>	<u>\$ 861,299</u>	<u>\$ 1,028,367</u>

*See accompanying notes to the financial statements.*



## Energy Insurance Mutual Limited

### Statements of Cash Flows

*(Expressed in Thousands of U.S. Dollars)*

	Years ended December 31,	
	2016	2015
Net income	\$ 53,783	\$ 26,619
Cash flows from operating activities:		
Depreciation	150	179
Amortization of bond premium or discount	4,141	6,179
Net realized investment gain	(12,300)	(6,767)
Deferred income taxes	3,580	(2,486)
Changes in operating assets and liabilities:		
Reinsurance recoverables on unpaid and paid losses	47,753	(70,627)
Prepaid reinsurance premiums	4,190	(3,412)
Premiums receivable	(740)	(1,437)
Reserve for losses and loss adjustment expenses	(165,345)	126,906
Unearned and advance premiums	850	6,759
Reinsurance premiums payable and funds held for reinsurers	(11,557)	(11,360)
Accounts payable and accrued expenses	979	84
Due to subsidiaries	7,661	(3,071)
Policyholder distribution payable	5,000	-
Income taxes recoverable	1,111	(15,093)
Net cash from operations	(60,744)	52,473
Cash flows from investing activities:		
Cost of investments purchased	(548,234)	(500,504)
Proceeds from sales of investments	542,854	409,136
Proceeds from maturities of investments	18,152	28,255
Change in amount due from purchase/sale of securities	5,437	3,095
Income from alternative investments	(9,882)	(4,341)
Equity in earnings of subsidiaries	(136)	(852)
Purchases of fixed assets	(276)	(94)
Net cash from investing	7,915	(65,305)
Cash flows from financing activities:		
Draws on line of credit	46,500	13,800
Repayments on line of credit	(30,000)	(13,800)
Net cash from financing	16,500	-
Net change in cash and cash equivalents	(36,329)	(12,832)
Cash and cash equivalents, beginning of year	76,025	88,857
Cash and cash equivalents, end of year	\$ 39,696	\$ 76,025
Supplemental disclosure of cash flow information:		
Income taxes paid, net of refunds	\$ 2,877	\$ 27,050

*See accompanying notes to the financial statements.*

# Energy Insurance Mutual Limited

## Notes to Financial Statements

Years ended December 31, 2016 and 2015

### **Note A - Organization and Significant Accounting Policies**

#### *Organization*

Energy Insurance Mutual Limited (the "Company" or "EIM") was incorporated under the Companies Act of Barbados on June 13, 1986. EIM obtained a license to engage in exempt insurance business in accordance with the provisions of the Exempt Insurance Act of Barbados, 1983. On August 12, 2003, the Company applied for, and was granted a license to operate as a Qualifying Insurance Company under the Insurance Act 1992-2 of Barbados.

The Company is a mutual insurance company with membership available to any utility or member of the energy services industry that meets EIM's underwriting standards. The Company provides excess general liability, excess fiduciary liability and excess directors and officers liability policies written on a claims first made basis. In addition, to a lesser extent the Company writes property insurance for its members. All members have casualty policies in place, approximately one-third of those members have property policies as well. During 2015, the Company started providing cyber liability coverage to its members.

#### *Basis of Reporting*

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") promulgated by the Financial Accounting Standards Board Accounting Standards Codification ("ASC" or "the guidance"). Preparation of financial statements in accordance 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.

#### *Investment in Subsidiaries*

The Company is the sponsor and 100% common stockholder of Energy Insurance Services, Inc. ("EIS"), a sponsored cell captive insurance company domiciled in South Carolina. As a sponsored captive, EIS allows EIM members, known as Mutual Business Programs ("MBP"), to insure or reinsure the risks of their sponsoring organizations, including property, general and environmental liability, asbestos, workers' compensation and retiree medical stop loss. Through Participation Agreements with the MBPs, the insurance risks underwritten by the MBPs are contractually limited to the funds available in the individual cell's account and neither EIS nor EIM has any obligation to absorb losses of the MBP's. Likewise, EIS has no right to the capital and accumulated profits of the MBP cells. EIM does not have the power to direct the activities of the MBP's which most significantly impact economic performance.

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note A - Organization and Significant Accounting Policies (Continued)**

As of December 31, 2016, EIS has assets (exclusive of assets held in MBPs) of approximately \$10.6 million, shareholder's equity of \$2.5 million and net income of approximately \$277,000. As of December 31, 2015, EIS had assets (exclusive of assets held in MBPs) of approximately \$3.4 million, shareholder's equity of \$2.3 million and a net loss of approximately \$36,000.

The Company considers EIS a variable interest entity, which is not consolidated due to the lack of obligations, rights and powers described above. EIM accounts for its investment in EIS using the equity method of accounting because EIM is not the primary beneficiary of EIS' operations.

During 2015, EIM formed Energy Captive Management, LLC ("ECM") in the State of South Carolina to provide captive management services to EIS. As of December 31, 2016, ECM has assets of approximately \$915,000, member's equity of \$747,000 and net income of \$25,000. As of December 31, 2015, ECM had assets of approximately \$1,010,000, member's equity of \$722,000 and net loss of approximately \$(166,000).

#### *Investments*

Management determines the appropriate classification of marketable fixed-maturity and equity securities at the time of purchase. The Company's policy is to hold securities for investment purposes and, as such, has reported all securities as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in a separate component of policyholders' surplus. Interest and dividends on securities classified as available-for-sale are included in net investment income. Declines in value judged to be other-than-temporary are included as realized losses in the statement of income. The cost of securities sold is based on the specific identification method.

Alternative investments include interests in shares of investment funds, limited partnership funds, and real estate funds ("the Funds"), which are considered non-marketable. Alternative investments are structured such that the Company holds interest in the Funds and not the underlying holdings of such Funds. The Company's ownership does not provide for control over the related investees, and financial risk is limited to the funded and unfunded commitment for each investment. These Funds are stated at fair value, which is from the most recently reported net asset value as reported by their investment managers or administrators. The Company has elected the fair value option with respect to the Funds, with all gains and losses associated with the Funds recorded directly to the statement of income and comprehensive income, as a component of net investment income. The use of net asset value as an estimate of the fair value for investments in certain entities that calculate the net asset value is a permitted practical expedient.

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note A - Organization and Significant Accounting Policies (Continued)**

These alternative investment funds give investors the right, subject to predetermined redemption procedures, to redeem their investments at net asset value. Since the funds are not actively traded on an exchange, the estimated fair values are subject to judgment and uncertainty.

The financial statements of the Funds are audited annually by independent auditors, although the timing for reporting the results of such audits may not coincide with the Company's financial reporting.

#### *Cash and Cash Equivalents*

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company maintains certain cash and cash equivalent balances that are not subject to FDIC insurance. Management does not believe these balances represent a significant credit risk to the Company.

#### *Losses and Loss Adjustment Expense Reserves*

The reserve for losses and loss adjustment expenses represents the estimated ultimate gross cost of all reported and unreported losses unpaid through December 31. Since the Company provides principally high level excess of loss coverage to its members, it is exposed to severe but infrequent claims. Therefore, standard actuarial methods, such as paid loss development, are inappropriate to use. Losses are determined based on an evaluation of coverage provisions, review of underlying exposures and an analysis of EIM member loss experience.

Case reserves represent the estimated future payments on reported losses. Case reserves are continually reviewed and updated; however, given the uncertainty regarding the extent of the Company's ultimate liability, a significant additional liability could develop. Supplemental reserves (e.g., IBNR) are recorded based on actuarial projections. Although considerable variability is inherent in these estimates, particularly due to the limited number of claims to date, management believes that the aggregate reserve for losses and loss adjustment expenses is adequate. These estimates are periodically reviewed and adjusted as experience develops or new information becomes known. Such adjustments are included in current operations.

#### *Premiums*

Direct and assumed premiums are recognized as revenue on a pro-rata basis over the policy term. The portion of premiums that will be earned in the future is deferred and reported as unearned premiums. The Company pays commissions on assumed business, which is initially capitalized and expensed over the life of the policy.

Energy Insurance Mutual Limited  
Notes to Financial Statements (Continued)

**Note A - Organization and Significant Accounting Policies (Continued)**

*Reinsurance*

In the normal course of business, the Company seeks to reduce the loss that may arise from large claims, catastrophes or other events by reinsuring certain levels of risk in various areas of exposure with other insurance companies. Reinsurance premiums, ceding commissions, loss reimbursement and reserves related to reinsured claims are accounted for on a basis consistent with that used in accounting for the original policies or claims.

*Deferred Policy Acquisition Costs*

Commissions and other costs of acquiring insurance that are directly related to the successful acquisition of new and renewal business are deferred and amortized over the life of the policy to which they relate. These costs are deferred, net of related ceding commissions, to the extent recoverable, and are amortized over the period during which the related premiums are earned.

*Income Taxes*

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

The Company and its subsidiaries file a consolidated federal income tax return. Income taxes are allocated based on separate return calculations.

*Policyholder Distributions*

As a mutual insurer, EIM is owned by its policyholders. Policyholder distributions are released from excess surplus and are charged to income when declared by the Board of Directors. During 2016 and 2015, the Board of Directors approved the declaration of policyholder distributions in the amount of \$25 million and \$20 million, respectively.

*Subsequent Events*

The Company has evaluated subsequent events for disclosure and recognition through March 1, 2017, the date on which these financial statements were available to be issued.

Energy Insurance Mutual Limited  
Notes to Financial Statements (Continued)

**Note B - Insurance Activity**

Premium activity for 2016 and 2015 is summarized as follows *(in Thousands of U.S. Dollars)*:

<u>2016</u>	<u>Direct</u>	<u>Assumed</u>	<u>Ceded</u>	<u>Net</u>
Premiums written	\$ 217,863	\$ 4,831	\$ (87,314)	\$ 135,380
Change in unearned premiums	<u>1,570</u>	<u>(1,313)</u>	<u>4,190</u>	<u>4,447</u>
Premiums earned	<u>\$ 219,433</u>	<u>\$ 3,518</u>	<u>\$ (83,124)</u>	<u>\$ 139,827</u>
<u>2015</u>	<u>Direct</u>	<u>Assumed</u>	<u>Ceded</u>	<u>Net</u>
Premiums written	\$ 213,999	\$ 2,449	\$ (69,269)	\$ 147,179
Change in unearned premiums	<u>(7,296)</u>	<u>154</u>	<u>(3,411)</u>	<u>(10,553)</u>
Premiums earned	<u>\$ 206,703</u>	<u>\$ 2,603</u>	<u>\$ (72,680)</u>	<u>\$ 136,626</u>

Activity in the liability for losses and loss adjustment expenses is summarized as follows *(in Thousands of U.S. Dollars)*:

	<u>2016</u>	<u>2015</u>
Gross balance, beginning of year	\$ 839,222	\$ 712,316
Less: reinsurance recoverables on unpaid losses	<u>(402,203)</u>	<u>(330,856)</u>
Net balance, beginning of year	437,019	381,460
Incurred related to:		
Current year	106,091	155,727
Prior years	<u>(11,134)</u>	<u>(24,582)</u>
Total incurred	<u>94,957</u>	<u>131,145</u>
Paid related to:		
Current year	483	695
Prior years	<u>196,396</u>	<u>74,891</u>
Total paid	<u>196,879</u>	<u>75,586</u>
Net balance, end of year	335,097	437,019
Plus: reinsurance recoverables on unpaid losses	<u>338,780</u>	<u>402,203</u>
Gross balance, end of year	<u>\$ 673,877</u>	<u>\$ 839,222</u>

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note B - Insurance Activity (Continued)**

During 2016, incurred losses and loss adjustment expenses attributable to events of prior years decreased by approximately \$11.1 million. The favorable development of prior year losses relates to prior accident years exclusive of 2003, 2005 and 2015 of approximately \$39.6 million. Accident years 2003, 2005 and 2015 experienced unfavorable development totaling approximately \$28.5 million.

For the year ended December 31, 2015, incurred losses and loss adjustment expenses attributable to events of prior years decreased by approximately \$24.6 million. The favorable development relates to accident years 2009, 2011, 2012, and 2014, which decreased by approximately \$79.4 million. Remaining favorable development of approximately \$9.9 million was due to all other accident years with varying redundancies with the exception of accident years 2005 and 2013 which experienced unfavorable development of approximately \$64.7 million due to case development on six general liability claims.

The Company uses excess of loss reinsurance to protect the Company from severe losses on the directors and officers, general partner, general liability and fiduciary liability books of business. After certain deductibles or retentions have been satisfied, the maximum amount that could be recoverable under the 2016 and 2015 reinsurance treaties is \$240,000,000, with respect to general liability and \$87,000,000 with respect to directors and officers, general partner and fiduciary liability.

During 2003, the Company entered into a reinsurance arrangement with Nuclear Electric Insurance Limited ("NEIL") whereby NEIL provides excess of loss reinsurance on the directors and officers and general partner book of business for 80% of \$20,000,000 in excess of \$30,000,000.

The property book of business is primarily reinsured by NEIL. In addition, the Company also has an arrangement with NEIL whereby its non-nuclear property book of business is fronted by EIM.

During 2009, EIM entered into a Reinsurance Treaty Trust Account Agreement ("Trust") with NEIL to collateralize the losses and loss adjustment expenses due to EIM under reinsurance agreements. EIM has been listed as the beneficiary of the Trust. As of December 31, 2016 and 2015, the total fair value of the assets held in the Trust were \$901,682,000 and \$1,097,368,000, which collateralized \$72,378,000 and \$85,858,000 in reinsurance recoverables on losses and loss adjustment expenses, respectively.

During 2016 and 2015, EIM entered into a reinsurance agreement with Oil Casualty Insurance Limited ("OCIL") whereby OCIL provides coverage for 60% of \$25,000,000 in excess of \$75,000,000 for all general liability policies issued during the year. During 2016, OCIL secured its obligations through a trust arrangement. As of December 31, 2016, the total fair value of the assets held in the trust were \$52,081,000 and collateralized \$68,977,000 in reinsurance recoverables on losses and loss adjustment expenses.

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note B - Insurance Activity (Continued)**

During 2015, OCIL secured its obligations through funds held and trust arrangements. As of December 31, 2015, the total amount of the funds held account was approximately \$13,291,000 and the total fair value of the assets held in the trust were \$30,055,000. Together, the funds held and trust collateralized \$46,024,000 in reinsurance recoverables on losses and loss adjustment expenses.

The Company writes directly and assumes certain members' cyber liability risk. A portion of this business is ceded to NEIL.

Reinsurance ceded contracts do not relieve the Company from its obligations to policyholders. The Company remains liable to its policyholders for the portion reinsured to the extent that the reinsurer does not meet the obligations assumed under the reinsurance agreement. The reinsurance recoverable on paid and unpaid losses is substantially due from NEIL, OCIL and various Lloyds of London syndicates, comprising 21%, 20%, and 19%, respectively, of the balance at December 31, 2016 and 21%, 11%, and 22%, respectively, at December 31, 2015. The remaining balance is comprised of amounts due from various reinsurers, each not exceeding 12% of the total for 2016 and 2015.

Management periodically reviews the financial condition of its existing reinsurers and concludes as to whether any allowance for uncollectible reinsurance is required. At December 31, 2016 and 2015, no such allowances were deemed necessary.

#### **Note C - Investments**

As of December 31, 2016, the cost, gross unrealized gains, gross unrealized losses, other-than-temporarily impaired and fair value of marketable fixed-maturity and equity securities are summarized as follows *(in Thousands of U.S. Dollars)*:

<u>2016</u>	<u>Cost or Amortized Cost</u>	<u>Other-than- temporarily Impaired</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
U.S. Treasury & agencies	\$ 79,066	\$ -	\$ 336	\$ (384)	\$ 79,018
U.S. state and municipal obligations	488,654	-	18,796	(698)	506,752
Corporate debt securities	103,682	-	1,819	(976)	104,525
Mortgage-backed securities	248,551	(10,927)	3,690	(2,413)	238,901
Foreign government debt	3,234	-	23	(50)	3,207
Domestic equities	99,795	(1,347)	193,737	(787)	291,398
Foreign equities	<u>88,553</u>	<u>(202)</u>	<u>54,326</u>	<u>(10,831)</u>	<u>131,846</u>
Total investments	<u>\$ 1,111,535</u>	<u>\$ (12,476)</u>	<u>\$ 272,727</u>	<u>\$ (16,139)</u>	<u>\$ 1,355,647</u>



## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note C - Investments (Continued)**

As of December 31, 2015, the cost, gross unrealized gains, gross unrealized losses, other-than-temporarily impaired and fair value of marketable fixed-maturity and equity securities are summarized as follows *(in Thousands of U.S Dollars)*:

<u>2015</u>	Cost or Amortized Cost	Other-than- temporarily Impaired	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury & agencies	\$ 35,357	\$ -	\$ 91	\$ (1,273)	\$ 34,175
U.S. state and municipal obligations	452,532	-	28,784	(205)	481,111
Corporate debt securities	141,496	-	2,056	(2,396)	141,156
Mortgage-backed securities	333,480	(11,194)	4,993	(2,395)	324,884
Domestic equities	103,064	(1,347)	177,615	(831)	278,501
Foreign equities	54,136	(211)	54,077	(6,778)	101,224
Total investments	<u>\$ 1,120,065</u>	<u>\$ (12,752)</u>	<u>\$ 267,616</u>	<u>\$ (13,878)</u>	<u>\$ 1,361,051</u>

The Company's investment guidelines require that no more than 5% of all debt securities may have a below investment-grade bond rating by at least one nationally recognized credit rating agency or the equivalent to the extent possible to determine.

The Company's investment objective for equities is to emulate the returns of the S&P 900 and the MSCI EAFE index for its domestic and international equity portfolios, respectively.

The cost and estimated fair value of fixed-maturity securities at December 31, 2016, by contractual maturity, are summarized below *(in Thousands of U.S. Dollars)*. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have been aged by their respective maturity dates.

	Cost or Amortized Cost	Fair Value
Maturity:		
In 2017	\$ 29,059	\$ 29,152
In 2018-2021	147,786	148,979
In 2022-2026	200,327	202,702
Due after 2026	546,015	551,570
Total fixed-maturity securities	<u>\$ 923,187</u>	<u>\$ 932,403</u>

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note C - Investments (Continued)**

Gross gains of approximately \$26,187,000 and \$13,174,000 and gross losses of (\$13,761,000) and (\$6,407,000), during 2016 and 2015 respectively, were realized on sales.

The Company regularly reviews its fixed-maturity and equity securities portfolios to evaluate the necessity of recording impairment losses for other-than-temporary declines in the fair value. In evaluating potential impairment, management considers, among other criteria: (i) the current fair value compared to amortized cost or cost, as appropriate; (ii) the length of time the security's fair value has been below amortized cost or cost; (iii) specific credit issues related to the issuer such as changes in credit rating, reduction or elimination of dividends or non-payment of scheduled interest payments; (iv) management's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in value to cost; (v) specific cash flow estimations for certain mortgage-backed securities; and (vi) current economic conditions.

Impaired securities are assessed when the decline in fair value is below the amortized cost basis for a specified duration. OTTI losses are recorded in the statement of income and comprehensive income as net realized losses on investments, and result in a permanent reduction of the cost basis of the underlying investment. The determination of OTTI is a subjective process, and different judgments and assumptions could affect the timing of loss realization. For the year ended December 31, 2016, the Company determined that one fixed-maturity security of approximately \$126,000 was other-than-temporarily impaired. For the year ended December 31, 2015, the Company determined that no investments were other-than-temporarily impaired.

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### Note C - Investments (Continued)

The following tables show gross unrealized losses and fair values of investments, aggregated by investment category, and the length of time that individual investments have been in a continuous unrealized loss position, at December 31 (*in Thousands of U.S. Dollars*):

	Less than one year		One year or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>2016</u>						
U.S. Treasury & agencies	\$ 42,092	\$ (384)	\$ -	\$ -	\$ 42,092	\$ (384)
U.S. state and municipal obligations	67,600	(694)	182	(4)	67,782	(698)
Corporate debt securities	42,838	(933)	1,455	(43)	44,293	(976)
Mortgage-backed securities	126,227	(1,737)	31,381	(676)	157,608	(2,413)
Foreign government debt	1,463	(50)	-	-	1,463	(50)
Domestic equities	5,746	(577)	49	(210)	5,795	(787)
Foreign equities	24,182	(2,198)	91,896	(8,633)	116,078	(10,831)
Total temporarily impaired securities	\$ 310,148	\$ (6,573)	\$ 124,963	\$ (9,566)	\$ 435,111	\$ (16,139)
	Less than one year		One year or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<u>2015</u>						
U.S. Treasury & Agencies	\$ 31,947	\$ (1,273)	\$ -	\$ -	\$ 31,947	\$ (1,273)
U.S. state and municipal obligations	19,237	(67)	2,936	(138)	22,173	(205)
Corporate debt securities	64,202	(2,321)	3,738	(75)	67,940	(2,396)
Mortgage-backed securities	160,753	(1,502)	35,959	(893)	196,712	(2,395)
Domestic equities	7,806	(680)	963	(151)	8,769	(831)
Foreign equities	77,783	(5,279)	23,441	(1,499)	101,224	(6,778)
Total temporarily impaired securities	\$ 361,728	\$ (11,122)	\$ 67,037	\$ (2,756)	\$ 428,765	\$ (13,878)

As of December 31, 2016, the Company had 568 fixed-maturity securities with unrealized losses. This included five with aggregate unrealized losses of \$88,600, which were 20% or greater than the cost. As of December 31, 2015, the Company had 470 fixed-maturity securities with unrealized losses. This included nine with aggregate unrealized losses of \$831,000, which were 20% or greater than the cost.

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### Note C - Investments (Continued)

The Company has evaluated these fixed-maturity securities and believes the unrealized losses are due primarily to temporary market and sector-related factors rather than to issuer specific-factors. Management does not intend to sell, and it is more likely than not that the Company will not be required to sell the securities before recovery. The Company does not consider these securities to be other-than-temporarily impaired.

Of the 716 equity securities with unrealized losses, 86 with unrealized losses of \$3,382,000 were 20% or greater than the cost and have been in a continuous loss position for longer than a year at December 31, 2016. Of the 1,807 equity securities with unrealized losses, 659 with unrealized losses of \$5,115,000 were 20% or greater than the cost and have been in a continuous loss position for longer than a year at December 31, 2015. The Company has evaluated these securities based on past earnings trends, analysts' reports and analysts' earnings expectations. Management does not intend to sell, and it is more likely than not that the Company will not be required to sell the securities before recovery. The Company does not consider these securities to be other-than-temporarily impaired.

The composition of net investment income is summarized below *(in Thousands of U.S. Dollars)*:

	2016	2015
Interest income	\$ 29,721	\$ 29,084
Dividend income	13,490	10,847
Income from subsidiary	71	(89)
Income from alternative investments	10,401	6,262
Other	7	(495)
Gross investment income	53,690	45,609
Investment management fees	(4,218)	(3,853)
Interest expense	(177)	(184)
Net investment income	<u>\$ 49,295</u>	<u>\$ 41,572</u>

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### **Note C - Investments (Continued)**

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in the *Fair Value Measurements and Disclosures* accounting guidance. The framework is based on the inputs used in valuation and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the fair value accounting guidance includes a hierarchy based on whether significant valuation inputs are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1** – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets. Included are those investments traded on an active exchange, such as the NASDAQ Global Select Market.
- Level 2** – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs. Included are investments in U.S. Treasury securities and obligations of U.S. government agencies, together with municipal bonds, corporate debt securities, commercial mortgage and asset-backed securities, certain residential mortgage-backed securities that are generally investment grade and certain equity securities.
- Level 3** – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement. Material assumptions and factors considered in pricing investment securities may include projected cash flows, collateral performance including delinquencies, defaults and recoveries, and any market clearing activity or liquidity circumstances in the security or similar securities that may have occurred since the prior pricing period.

Fair values are based on quoted market prices when available (Level 1). The Company receives the quoted market prices from a third party, nationally recognized pricing service ("pricing service"). When market prices are not available, the Company utilizes a pricing service to determine an estimate of fair value, which is mainly used for its fixed-maturity investments' fair value. The fair value is generally estimated using current market inputs for similar financial instruments with comparable terms and credit quality, commonly referred to as matrix pricing (Level 2). In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that management believes are relevant to the particular asset or liability. This may include discounted cash flow analysis or other income based approaches (Level 3). These valuation techniques involve some level of management estimation and judgment. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used and are reflective of the assumptions that market participants would use in valuing assets or liabilities.

## Energy Insurance Mutual Limited

### Notes to Financial Statements (Continued)

#### Note C - Investments (Continued)

The following table presents the Company's investment securities within the fair value hierarchy, and the related inputs used to measure those securities at December 31, 2016 (*in Thousands of U.S. Dollars*):

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Fixed-maturity	\$ 932,403	\$ -	\$ 932,403	\$ -
Equities	423,244	423,244	-	-
Total	<u>\$ 1,355,647</u>	<u>\$ 423,244</u>	<u>\$ 932,403</u>	<u>\$ -</u>

There were no transfers between fair value levels during 2016 and 2015.

Several of EIM's policyholders are companies represented in the S&P 900. Consequently, at December 31, 2016 and 2015, EIM holds investments with a total fair value of approximately \$46.3 and \$37.4 million, respectively, in issuers who are also policyholders.

The alternative investment funds include the following as of December 31 (*in Thousands of U.S. Dollars*):

	<u>2016</u>	<u>2015</u>	<u>Redemption</u>	<u>Redemption</u>
	<u>Fair Value</u>	<u>Fair Value</u>	<u>Frequency</u>	<u>Notice Period</u>
Catastrophe reinsurance	\$ 10,825	\$ 8,198	Quarterly	45 days
High yield bank loan	69,926	64,339	Monthly	30 days
Real estate	83,289	77,604	Quarterly	45 days
Total	<u>\$ 164,040</u>	<u>\$ 150,141</u>		

The catastrophe reinsurance class includes funds with investments primarily in portfolios of traditional reinsurance and other insurance based investment instruments that have returns tied to property and casualty catastrophe risk. In addition, this class may hold cash, treasury bills and money market funds. The investments in this class have limited redemption rights and may be suspended from time to time.

The high yield bank loan class includes funds that invest in a diversified portfolio consisting primarily of direct or indirect interests in noninvestment grade, floating rate bank loans.

The real estate class includes two real estate funds that invest primarily in industrial, retail, office and multifamily housing.

The fair values of all alternative investment fund classes have been estimated using the net asset value per share of investments. As of December 31, 2016 and 2015, the Company did not have any unfunded commitments.

Energy Insurance Mutual Limited  
Notes to Financial Statements (Continued)

**Note D - Federal Income Taxes**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are as follows *(in Thousands of U.S. Dollars)*:

	<u>2016</u>	<u>2015</u>
Deferred tax assets:		
Unpaid losses and loss adjustment expenses	\$ 6,256	\$ 9,420
Unearned premiums	5,767	5,414
Accrued expenses	3,191	3,309
Other than temporary impairments	<u>4,453</u>	<u>4,550</u>
Total deferred tax assets	19,667	22,693
Deferred tax liabilities:		
Unrealized capital gains, net	(89,761)	(88,808)
Alternative investment income	(859)	(45)
Premium amortization	(969)	(1,244)
Other	<u>(443)</u>	<u>(293)</u>
Total deferred tax liabilities	<u>(92,032)</u>	<u>(90,390)</u>
Net deferred tax liability	<u>\$ (72,365)</u>	<u>\$ (67,697)</u>

The provision for federal income tax differs from the amount derived by applying the statutory federal tax rates to pretax income for financial reporting purposes due primarily to tax exempt investment income.

The Company is required to establish a "valuation allowance" for any portion of the deferred tax asset that management believes will not be realized. The Company has historically been a taxpayer, and in the opinion of management, will continue to be in the future. Management believes that it is more likely than not that the Company will realize the benefit of the deferred tax assets, therefore no valuation allowance has been established.

During 2003, the Company applied for, and was granted an exemption from Barbados income tax by the Minister of Finance under the Duties, Taxes and Other Payment (Exemption) Act. Federal income taxes incurred by the Company are determined in accordance with the provisions of the Internal Revenue Code.

At December 31, 2016 and 2015, the Company determined there are no material unrecognized tax benefits, and no adjustments to liabilities or operations were required.

Energy Insurance Mutual Limited  
Notes to Financial Statements (Continued)

**Note E - Related Party Transactions**

As described in Note A, the Company has two subsidiaries; EIS and ECM. During 2016 and 2015, EIM provided reinsurance to certain EIS cells. For the years ended December 31, 2016 and 2015, premiums earned included \$564,000 and \$736,000 of premium assumed from EIS, respectively. During 2015, EIM provided ECM with initial capital of \$500,000 plus contributed additional capital of \$380,000. EIS reimburses ECM for certain expenses incurred related to administration of EIS, plus a service fee.

**Note F - Commitments and Contingencies**

The Company is named as defendant in various legal actions arising in the normal course of business from claims made under insurance policies and contracts. These actions are considered by the Company in estimating the loss and loss adjustment expense reserves. The Company's management believes that the resolution of these actions will not have a material adverse effect on the Company's financial position or results of operations.

**Note G - Trust Funds and Deposits**

The Company has established a trust fund with a federally insured depository. This trust fund serves as security for policyholders and third-party claimants to satisfy requirements of being listed as an alien surplus lines insurer by the National Association of Insurance Commissioners. The Company is required to maintain a minimum amount of the lesser of \$150,000,000 or \$5,400,000 plus 30% for liabilities arising from business on or after January 1, 1998. At December 31, 2016 and 2015, the balance was in excess of \$150,000,000. In addition, the State of Florida has required the Company to deposit \$300,000 as security for the Company's policyholders and creditors. The trust funds and deposit balances have been included in the accompanying balance sheets as available-for-sale investments, including both fixed-maturity securities and equities.

**Note H - Line of Credit**

A line of credit was established during 2011 in the amount of \$50,000,000. The line of credit is used solely to fund claim payments that are subject to reinsurance recovery. As of December 31, 2016 and 2015, \$16,500,000 and \$0, respectively, was outstanding on the line of credit. During 2016 and 2015, draws on the line of credit amounted to \$46,500,00 and \$13,800,000, respectively, and subsequent repayments amounted to \$30,000,000 and \$13,800,000, respectively.



Energy Insurance Mutual Limited  
Notes to Financial Statements (Continued)

**Note I - Retiree Medical Benefits**

The Company provides employees with a Post-Retirement Medical, Dental and Vision Plan ("the Plan"). The Plan is available to retirees (upon fulfilling eligibility requirements), their spouses and dependents as a continuation of the healthcare plan available to active employees. Currently the benefits are self insured, with a third party stop-loss reinsurance arrangement. Retirees are not required to make contributions for coverage. Employees hired after December 31, 2011, are required to contribute 50% of the medical plan COBRA rate, upon fulfilling the eligibility requirements under the Plan. The Plan is unfunded.

The assumed discount rate used to determine the benefit obligation is 4.65% for 2016. The assumed healthcare cost trend rate is 6.6% for 2017, trending to 4.5% by 2037. The Company recognized a liability representing the actuarially determined accumulated post-retirement benefit obligation in the amount of \$9,118,000 and \$9,455,000 as of December 31, 2016 and 2015, respectively, which is included in accounts payable and accrued expenses.

**Note J - Margin of Solvency**

In order to meet the requirements of a Qualifying Insurance Company under the Insurance Act 1992-2 of Barbados, the Company must have contributed reserves of approximately \$12 million. The policyholders' surplus provided an excess margin of solvency of approximately \$1 billion at December 31, 2016.