

American Overseas Group Limited

**Consolidated Financial Statements
For the Year Ended
December 31, 2018**



INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of
American Overseas Group Limited

We have audited the accompanying consolidated financial statements of American Overseas Group Limited and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive loss, changes in equity and retained deficit, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

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

Emphasis of Matter

We draw attention to Note 18 of the financial statements which describes the risks and uncertainties of the Company's exposure to the Commonwealth of Puerto Rico. Our opinion is not modified in respect of this matter.

Other Matter

Accounting principles generally accepted in the United States of America require that the disclosure of short-duration contracts included in Note 8 be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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June 5, 2019 (August 7, 2019 as to Note 10 of the financial statements)

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED BALANCE SHEETS
December 31, 2018 and 2017

	2018	2017
Assets		
Fixed-maturity securities held as available for sale, at fair value	\$ 135,895,981	\$ 81,028,049
Equity investments available for sale, at fair value	5,730,403	6,436,614
Cash and cash equivalents	34,707,538	40,173,162
Restricted cash	6,554,204	66,534,599
Accrued investment income	661,884	256,153
Premiums receivable	78,609,917	81,264,067
Reinsurance balances receivable, net	322,337,804	340,700,321
Salvage and subrogation recoverable	332,711	1,707,921
Deferred policy acquisition costs	161,390	100,548
Intangible assets	4,800,000	4,800,000
Goodwill	33,050,000	33,050,000
Other assets	1,711,680	1,899,547
Total assets	\$ 624,553,512	\$ 657,950,981
Liabilities and Shareholders' Equity		
Liabilities:		
Losses and loss expense reserve	\$ 266,727,620	\$ 304,772,603
Unearned premiums	110,811,939	105,689,737
Ceded premium payable	94,329,970	95,195,311
Payable to general agents	1,427,572	1,478,955
Funds withheld	54,439,838	44,985,364
Accounts payable and accrued liabilities	2,524,363	3,057,300
Redeemable Series A preference shares	7,037,861	10,312,218
Derivative liabilities	266,066	341,843
Fair value adjustment	13,740,697	15,198,761
Notes payable	16,520,907	16,520,907
Non-owned interest in VIE	300,000	300,000
Interest payable	450,770	450,770
Deferred tax liability	35,175	30,975
Total liabilities	568,612,778	598,334,744
Shareholders' equity:		
Common shares	4,612,400	4,555,800
Additional paid-in capital	188,728,707	188,331,207
Accumulated other comprehensive income	236,858	1,189,495
Retained deficit	(143,690,607)	(140,513,641)
Total shareholders' equity	49,887,358	53,562,861
Non-controlling interest in preferred shares in subsidiaries	6,053,376	6,053,376
Total equity	55,940,734	59,616,237
Total liabilities and equity	\$ 624,553,512	\$ 657,950,981

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS
December 31, 2018 and 2017

	2018	2017
Net premiums earned	\$ (214,706)	\$ 1,946,640
Fee income	11,470,288	11,530,571
Net investment income	2,809,282	1,761,994
Net realized gain	7,647	154,488
Fair value adjustment	332,422	1,452,511
Net change in fair value of credit derivatives	74,673	8,237,732
Other income	531,903	591,157
Total revenues	15,011,509	25,675,093
Net losses and loss adjustment expenses	2,593,377	19,782,700
Acquisition costs	(577,181)	447,129
General and administrative expenses	13,391,996	13,771,938
Interest expense	2,190,830	2,303,693
Total expenses	17,599,022	36,305,460
Loss before income tax expense	(2,587,513)	(10,630,367)
Income tax (expense) benefit	(4,200)	13,650
Loss before non-controlling interest	\$ (2,591,713)	\$ (10,616,717)
Net loss attributable to non controlling interest		
Non-controlling interest - dividends on Class B preference shares of subsidiary	(585,253)	-
Net loss income attributable to common shareholders	\$ (3,176,966)	\$ (10,616,717)
Net loss per common share:		
Basic	\$ (69.12)	\$ (233.62)
Diluted	\$ (69.12)	\$ (233.62)
Weighted-average number of common shares outstanding:		
Basic	45,965	45,444
Diluted	45,965	45,444

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
December 31, 2018 and 2017

	2018	2017
Net loss before non-controlling interest	\$ (2,591,713)	\$ (10,616,717)
Other comprehensive gain		
Change in unrealized fair value of investments	(944,990)	1,042,997
Reclassification adjustment for net realized investment (losses) gains included in income	(7,647)	(375,498)
Reclassification adjustment for OTTI included in net income	-	221,010
Other comprehensive (loss) gain	(952,637)	888,509
Comprehensive loss	\$ (3,544,350)	\$ (9,728,208)

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF EQUITY AND RETAINED DEFICIT
December 31, 2018 and 2017

	Share capital	Noncontrolling Interest	Additional paid-in capital	Accumulated other comprehensive (loss) income	Retained deficit	Total stockholders' equity
Balance, December 31, 2016	4,454,200	6,053,376	187,281,343	300,986	(129,896,924)	68,192,981
Net loss	-	-	-	-	(10,616,717)	(10,616,717)
Share based compensation	101,600	-	1,049,864	-	-	1,151,464
Net change in unrealized gains and losses on investments	-	-	-	888,509	-	888,509
Balance, December 31, 2017	<u>4,555,800</u>	<u>6,053,376</u>	<u>188,331,207</u>	<u>1,189,495</u>	<u>(140,513,641)</u>	<u>59,616,237</u>
Net loss	-	-	-	-	(2,591,713)	(2,591,713)
Share based compensation	56,600	-	397,500	-	-	454,100
Net change in unrealized gains and losses on investments	-	-	-	(952,637)	-	(952,637)
Dividends paid on preferred shares	-	-	-	-	(585,253)	(585,253)
Balance, December 31, 2018	<u>\$ 4,612,400</u>	<u>\$ 6,053,376</u>	<u>\$ 188,728,707</u>	<u>\$ 236,858</u>	<u>\$ (143,690,607)</u>	<u>\$ 55,940,734</u>

See Accompanying Notes to the Consolidated Financial Statements

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss for the year	\$ (2,591,713)	\$ (10,616,717)
Adjustments to reconcile net (loss) to net cash used in operating activities:		
Net realized gains on sale of investments	(7,647)	(154,488)
Net unrealized gains on credit derivatives	(74,673)	(8,237,732)
Deferred tax expense	4,200	(13,650)
Interest expense	2,190,830	2,303,693
Share based compensation	454,100	1,151,464
Amortization of fair value adjustment	(332,421)	(1,452,511)
Amortization of bond discount	198,322	43,281
Changes in operating assets and liabilities:		
Accrued investment income	(405,731)	(37,040)
Premiums receivable	2,654,150	(11,845,357)
Reinsurance balance receivable, net	18,362,517	(30,349,377)
Salvage and subrogation	1,375,210	188,156
Deferred acquisition costs, net	(60,842)	57,027
Other assets	187,867	(598,763)
Changes in derivative liability	(1,104)	221,950
Unpaid losses and loss adjustment expenses	(38,044,983)	28,084,695
Unearned premiums	5,122,202	4,491,390
Ceded premium payable	(865,341)	18,016,970
Payable to general agents	(51,383)	144,533
Funds withheld	9,454,474	1,651,500
Accounts payable and accrued liabilities	(532,937)	(1,116,905)
Net cash used in operating activities	(2,964,903)	(8,067,881)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of available for sale securities	(119,340,295)	(72,085,851)
Proceeds from sales of investments	40,542,893	27,161,779
Proceeds from maturities of investments	23,492,369	45,637,073
Net cash (used in) provided by investing activities	(55,305,033)	713,002
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of long-term note payable	-	(3,005,386)
Interest paid	(2,190,830)	(2,368,796)
Payment on preferred shares	(4,400,000)	-
Dividends paid on preferred shares	(585,253)	-
Net cash used in financing activities	(7,176,083)	(5,374,182)

AMERICAN OVERSEAS GROUP LIMITED
CONSOLIDATED STATEMENTS OF CASH FLOWS
December 31, 2018 and 2017

	2018	2017
Net (decrease)/increase in cash and cash equivalents	(65,446,019)	(12,729,062)
Cash and cash equivalents - Beginning of year	106,707,761	119,436,823
Cash and cash equivalents - End of year	\$ 41,261,742	\$ 106,707,761
 Net taxes paid (refunded)	\$ -	\$ (1,018)
<i>Reconciliation of cash and restricted cash and equivalents to Balance Sheet</i>		
Cash and cash equivalents, end of year	\$ 34,707,538	\$ 40,173,162
Restricted cash and cash equivalents, end of year	6,554,204	66,534,599
Total cash and cash equivalents and restricted cash and equivalents, end of year	\$ 41,261,742	\$ 106,707,761

See Accompanying Notes to the Consolidated Financial Statements.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BACKGROUND

American Overseas Group Limited (“AOG” or the “Company”) was incorporated on January 28, 1998, under the laws of Bermuda. The Company was originally organized to operate a mono-line financial guaranty reinsurance subsidiary which was placed in voluntary run-off in 2009. After substantially reducing its financial guaranty exposure, AOG entered the property and casualty reinsurance business in 2012. On June 26, 2013 the Company’s principal shareholder at that time, Orpheus Group Ltd. (“OGL”), acquired voting control of AOG. On October 28, 2014, AOG acquired OGL for a combination of common stock and senior notes. The Company is now a major writer of non-standard auto insurance through its U.S. subsidiaries. The bulk of its earned premium and fee income are related to its property and casualty book of business. The financial guaranty book of business remains in run-off.

2. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies adopted by the Company:

(a) Basis of preparation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”). The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and the accompanying notes. Actual results could differ materially from those estimates.

(b) Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and of its subsidiaries, as well as those of Old American County Mutual Fire Insurance Company (“OACM”), a variable interest entity (“VIE”) which the Company is required to consolidate. All significant intercompany balances have been eliminated in consolidation. For further discussion of VIEs, see Note 19.

(c) Cash and cash equivalents

The Company considers all highly liquid investments, including fixed-interest and money market fund deposits, with a maturity of 90 days or less when purchased, as cash equivalents. Cash equivalents are carried at cost which approximates fair value.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(d) Investments

The Company has classified its fixed-maturity and equity investments as available-for-sale. Available-for-sale investments are carried at fair value, with unrealized appreciation or depreciation reported as a separate component of accumulated other comprehensive income. The Company's fair values of fixed-maturity investments are based on prices obtained from nationally recognized independent pricing services and represent quoted prices in active markets when available. Equity securities include investments in shares of publicly traded companies and offshore mutual funds. All investment transactions are recorded on a trade date basis. Realized gains and losses on sales of fixed-maturity investments are determined on the basis of amortized cost. Gains and losses on sale of investments are included in "net realized gains on sale of investments" when realized. The cost of securities sold is determined using the specific identification method. The Company's investment guidelines require the orderly sale of securities that do not meet investment guidelines due to a downgrade by rating agencies or other circumstances, unless otherwise authorized by management to hold.

Other-than-temporary impairments on investments

The Company reviews its investment portfolio no less than quarterly in order to determine whether an other-than-temporary impairment ("OTTI") of its fixed-maturity and equity investments classified as available-for-sale exists. An impairment is considered to be other-than-temporary if the Company (i) intends to sell the security, (ii) more likely than not will be required to sell the security before recovering its cost, or (iii) does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). A "credit loss" is recognized when the present value of cash flows expected to be collected from the fixed-maturity investment is less than the amortized cost basis of the security. If there is an intent to sell the impaired security or it is more likely than not that the Company will be required to sell the security before recovering its cost, then the entire difference between amortized cost and the security's fair value is recognized as an OTTI charge in earnings in the period. If there is no intent to sell the impaired security and it is not more likely than not that the Company will be required to sell the security before recouping its cost but there is a credit loss, then the credit loss portion of the unrealized loss is recognized in earnings with the remainder recognized in other comprehensive income.

Factors considered when assessing impairment include: (i) securities whose market values have declined by 20% or more below amortized cost for a continuous period of at least six months; (ii) credit downgrades by rating agencies; (iii) the financial condition of the issuer; (iv) whether scheduled interest payments are past due; and (v) whether the Company has an intent to sell the security.

(e) Revenue recognition

The Company recognizes financial guaranty reinsurance contract revenue over the period of the contract in proportion to the amount of insurance protection provided. The Company recognizes a liability for unearned premium revenue at the inception of a financial guaranty insurance contract equal to the present value of the premiums due or expected to be collected over the period of the contract. The Company earns property casualty insurance and reinsurance premium revenue over the terms of the related policies. Unearned premiums represent the unexpired portion of premiums written. In addition, the Company earns fee income for providing insurance capacity for its nonstandard automobile liability and physical damage insurance products produced by managing general agents or other producers and ceded to reinsurers. Fee income is the excess of the ceding commission received from the reinsurers over the commission expense paid to the managing general agents or other producers.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(f) Deferred policy acquisition costs

Deferred policy acquisition costs comprise those expenses that vary with and are primarily related to the production of business, including ceding commissions paid.

When assessing the recoverability of deferred policy acquisition costs, the Company considers the future earnings of premiums and anticipated investment income and compares this to the sum of unamortized policy acquisition costs, expected loss and loss adjustment expenses and expected maintenance costs. This comparison is completed by underwriting year and risk type. If a deficiency were calculated, the unamortized acquisition costs would be reduced by a charge to expense. Any deficiency driven by the maintenance costs that is greater than the balance of the deferred acquisition costs for the underwriting year and risk type is recorded as a premium deficiency.

(g) Losses and loss adjustment expenses

For its property/casualty insurance and reinsurance, unpaid losses and loss adjustment expenses include an amount determined from individual case estimates (“case basis loss reserves”) and an amount for losses incurred but not reported. Such liabilities are necessarily based on assumptions and estimates and while management believes the amount is adequate, the ultimate liability may be in excess of or less than the amount provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed and adjustments are reflected in the period determined.

For its financial guaranty reinsurance business, the Company establishes loss reserves based on a review of reserving practices, reported reserves, surveillance reports and other data provided by its ceding companies. In addition, the Company augments the ceding company information with its own research, analysis and modeling.

The Company recognizes a claim liability on a financial guaranty insurance contract (excluding those written in derivative form) when the Company estimates that the present value of expected net cash outflows to be paid under the insurance contract will exceed the unearned premium revenue for that contract. The present value of expected net cash outflows is discounted using a current risk free rate based on the remaining period (contractual or expected as applicable) of the insurance contract. Expected net cash outflows are probability weighted cash flows that reflect the likelihood of possible outcomes, based on all information available to the Company.

The Company updates the discount rate each reporting period and revises expected net cash outflows when increases or decreases in the likelihood of a default and potential recoveries occurs. The discount of the loss and loss expense reserve is accreted through earnings and included in losses and loss adjustment expenses. Changes to the estimate of loss and loss adjustment expenses reserve after initial recognition are recognized in “loss and loss adjustment expenses” in the Consolidated Statements of Operations in the period of the change.

The Company reviews the portfolio on a continuous basis to identify problem credits. Quarterly, the Company reviews reserves. Management establishes reserves that it believes are adequate to cover the present value of the ultimate liability for claims. The reserves are based on estimates and are substantially dependent on the surveillance activities and reserving policies of the Company’s ceding companies and may vary materially from actual results. Adjustments based on actual loss experience are recorded in the Consolidated Statements of Operations in the periods in which they become known.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(h) Derivative instruments

American Overseas Reinsurance Company Limited (“AORE”) has entered into agreements to reinsure derivative instruments, consisting primarily of credit default swaps that it intends to reinsure for the full term of the contract. While management considers these agreements to be a normal extension of its financial guaranty reinsurance business and reinsurance in substance, certain of these contracts meet the definition of a derivative under Accounting Standards Codification (“ASC”) 815 “Derivatives and hedging” (“ASC 815”). ASC 815 establishes accounting and reporting standards for derivative instruments, and requires the Company to recognize the derivative instruments on the Consolidated Balance Sheets at their fair value, under “Derivative assets or liabilities,” as applicable, with changes in fair value recognized in earnings. Changes in fair value are recorded in “Net change in fair value of credit derivatives” on the Consolidated Statements of Operations. The “Realized gains (losses) and other settlements” component of this change in fair value includes (i) net premiums earned on credit derivative policies, including current premiums receivable on assumed credit derivative policies, net of ceding commissions, and (ii) loss payments to the reinsured including losses payable upon the occurrence of a credit event. The “Unrealized gains (losses)” component of the “Net change in fair value of credit derivatives” includes all other changes in fair value, including changes in instrument specific credit spreads and reduction in fair values due to commutation of credit derivative policies.

Management uses, as a key input to the estimation of the fair value of our derivatives, the mark-to-market valuation information provided to us by our ceding company (“the mark”). The Company participates in credit default swaps through a reinsurance treaty with a ceding company and therefore the contract to be valued is a reinsurance contract on a derivative. This contract is not identical to the underlying credit default swaps. In particular, although the Company’s contract allows it to share in the economic results of the underlying contracts, it does not provide rights to the same information to which the ceding company has access. Under ASC 820, “Fair value measurements and disclosures” (“ASC 820”), the fair value of the Company’s contract represents the exit price that would be paid to a market participant to assume the reinsurance contract as written; that is, the amount the market participant would require to assume the Company’s potential obligations under the contract with the same contractual rights and obligations, including those which limit the information about the ceding company’s underlying contracts that are being reinsured. Given the contractual terms that exist, the Company believes that an exit market participant would look to the information that is available from the ceding company to determine the exit value of the Company’s reinsurance contract. The primary insurers underwrite each of the transactions underlying the reinsurance contract and they have access to all the underlying data related to the transactions. The ceding company uses their own internal valuation models where market prices are not available. The Company employs procedures to test the reasonableness of the mark both in process and absolute terms because we believe that an exit market participant would perform similar procedures when determining an exit price for our reinsurance contract. If it appears that the fair values generated by the ceding company’s internal models and reported to the Company are consistent with macro spread movements and general market trends, and the Company believes that the modeling and assumptions that drive the modeling are reasonable (based on the Company’s ceding company reviews and review of publicly available information), the Company will use the mark provided by the ceding company as a key input in the determination of the fair value of the reinsurance contract. There is no single accepted model for fair valuing credit default swaps and there is generally not an active market for the type of credit default swaps insured by ceding companies and reinsured by us. Therefore, due to the limited availability of quoted market prices for these derivative contracts and the inherent uncertainties in the assumptions used in models, different valuation models may produce materially different results and be materially different from actual experience. In addition, due to the complexity of fair value accounting in particular on accounting for derivatives, future amendments or interpretations of these standards may cause us to modify our accounting methodology in a manner which may have an adverse impact on our financial results.

The use of valuation information provided to us by our ceding companies remains appropriate for the reasons described above, as well as the fact that the credit default swaps we reinsure are the same as those valued by our primaries, and the Company views its hypothetical principal market to be the same as that of our primaries,

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(h) Derivative instruments (cont'd)

being the financial guaranty insurance and reinsurance market. The Company's fair value on credit derivatives is adjusted for the Company's own non-performance risk in accordance with ASC 820. Therefore there are two components to the fair value process of the Company's derivatives. The first component is the fair value assessment performed by the primary on each derivative instrument ceded to the Company. The second component is the Company's own non-performance risk adjustment that is applied to the total fair valued derivatives obtained by the primary.

(i) Fair value measurements

ASC 820 provides guidance for fair value measurement of assets and liabilities and associated disclosures about fair value measurement. Under this standard, the definition of fair value focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). ASC 820 clarifies that fair value is a market-based measurement, not an entity-specific measurement. ASC 820 establishes a fair value hierarchy of inputs in measuring fair value, with the highest level being observable inputs and the lowest being unobservable data as follows:

- Level 1 inputs – valuations based on quoted prices in active markets for identical assets or liabilities. Valuations in this level do not entail a significant degree of judgment.
- Level 2 inputs – valuations based on 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 and model derived valuations where all significant inputs are observable in active markets.
- Level 3 inputs – valuations based on significant inputs that are unobservable.

Disclosures relating to fair value measurements are included in Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives and Note 7 – Fair Value of Financial Instruments.

(j) Goodwill and intangible assets

The Company tests for impairment of goodwill and indefinite-lived intangible assets on an annual basis, or more frequently if events or changes in circumstances indicate that impairment exists.

The Company amortizes finite-lived intangible assets over the respective useful lives of the assets. If events or changes in circumstances indicate that impairment of these assets exists, the Company will test for impairment.

If, as a result of the evaluation, the Company determines that the value of the goodwill or intangible assets is impaired, then the value of the assets will be written-down through net income in the period in which the determination of the impairment is made.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(k) Assets held and liabilities related to segregated accounts

A subsidiary of the Company is licensed to maintain segregated accounts relating to third party entities. The assets related to these programs (which include cash and accounts receivable) represent funds under management as the participants retain the risk and rewards of ownership. In the case where the Company is the beneficiary of the segregated accounts, the segregated accounts have been consolidated in the accompanying financial statements.

(l) Taxation

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the difference is reversed. A valuation allowance is recorded against gross deferred tax assets if it is more likely than not that all or some portion of the benefits related to the deferred tax assets will not be realized.

(m) Share-based compensation

The Company measures and records compensation costs for all share-based payment awards based on grant-date fair value over the requisite service period. This includes consideration of expected forfeitures in determining share based-based employee compensation expenses.

(n) Treasury shares

Common shares of AOG held by the Company and its subsidiaries are accounted for similar to share cancellations with the excess of the par value reflected in additional paid in capital.

(o) Recent accounting pronouncements

Statement of cash flows

In November 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* (a consensus of the Emerging Issues Task Force), which addresses the presentation of changes in restricted cash and restricted cash equivalents in the statement of cash flows with the objective of reducing the existing diversity in practice. Under the ASU, entities are required to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one-line item on the balance sheet, the ASU requires a reconciliation be presented either on the face of the statement of cash flows or in the notes to the financial statements showing the totals in the statement of cash flows to the related captions in the balance sheet. The ASU is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. If the ASU is adopted in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The Company implemented the new presentation into the current year and restated prior year for proper beginning cash balance.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(o) Recent accounting pronouncements (cont'd)

Credit losses on financial instruments

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in this ASU are intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will use forward-looking information to better inform their credit loss estimates as a result of the ASU. While many of the loss estimation techniques applied today will still be permitted, the inputs to those techniques will change to reflect the full amount of expected credit losses. The ASU requires enhanced disclosures to help investors and other financial statement users to better understand significant estimates and judgments used in estimating credit losses, as well as credit quality and underwriting standards of an organization's portfolio.

In addition, the ASU amends the accounting for credit losses on available-for-sale securities and purchased financial assets with credit deterioration. The ASU also eliminates the concept of "other than temporary" from the impairment model for certain available-for-sale securities. Accordingly, the ASU states that an entity must use an allowance approach, must limit the allowance to an amount at which the security's fair value is less than its amortized cost basis, may not consider the length of time fair value has been less than amortized cost, and may not consider recoveries in fair value after the balance sheet date when assessing whether a credit loss exists. For purchased financial assets with credit deterioration, the ASU requires an entity's method for measuring credit losses to be consistent with its method for measuring expected losses for originated and purchased non-credit-deteriorated assets.

The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For most debt instruments, entities will be required to record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is adopted. The changes to the impairment model for available-for-sale securities and changes to purchased financial assets with credit deterioration are to be applied prospectively. For the Company, this would be as of January 1, 2020. Early adoption is permitted for fiscal years, and interim periods with those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the effect on its Consolidated Financial Statements of adopting this ASU.

Leases

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to present right-of-use assets and lease liabilities on the balance sheet. ASU 2016-02 is to be applied using a modified retrospective approach at the beginning of the earliest comparative period in the financial statements. The ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is evaluating the impact that this ASU will have on its Consolidated Financial Statements.

Targeted improvements to the accounting for long-duration contracts

In August 2018, the FASB issued ASU 2018-12, *Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts*. The amendments in this ASU:

- improve the timeliness of recognizing changes in the liability for future policy benefits and modify the rate used to discount future cash flows,
- simplify and improve the accounting for certain market-based options or guarantees associated with deposit (or account balance) contracts,
- simplify the amortization of deferred acquisition costs, and
- improve the effectiveness of the required disclosures.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

2. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

(o) Recent accounting pronouncements (cont'd)

This ASU does not impact the Company's financial guaranty insurance contracts, but may impact its accounting for certain non-financial guaranty contracts. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption of the amendments is permitted. The Company does not expect this ASU to have a material effect on its condensed consolidated financial statements.

Changes to the disclosure requirements for fair value measurement

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. This ASU removed, modified and added additional disclosure requirements on fair value measurements in Topic 820. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Certain amendments will be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments will be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company is in the process of determining what impact this ASU will have on its condensed consolidated financial statements.

3. PLEDGED ASSETS

As of December 31, 2018 and 2017, there were investments of \$2.0 million and \$1.5 million, respectively, on deposit with state insurance department regulators related to a U.S. subsidiary.

As of December 31, 2018, and 2017, the Company had restricted cash of \$6.6 million and \$67.2 million, respectively, and investments at fair value of \$56.4 million and \$22.8 million, respectively, in trust and escrow accounts for the benefit of ceding companies. Pursuant to the terms of the reinsurance agreements with ceding companies regulated in the United States, the Company is required to secure its obligations to these ceding companies in accordance with applicable state statutes governing credit for reinsurance, and may not withdraw funds from these trust accounts without the ceding companies' express permission. The trust accounts are required to hold cash and investments equivalent to unearned premiums, case-basis and incurred but not reported loss reserves, credit impairments (a non GAAP measure representing losses expected to be paid on insured credit derivative policies), and a contingency reserve calculated by the ceding companies. Management reviews these balances for reasonableness quarterly.

AOG established an irrevocable trust (the "Series A Security Trust") for the benefit of the holders of the Series A Preference Shares. As of December 31, 2018 and 2017, the asset value of the Series A Security Trust was \$2.4 million and \$2.7 million, respectively, included within investments. Butterfield Trust Company has been appointed as its trustee. The Company has been authorized to redeem Series A Shares at any time for the amount that is not in excess of the Holder's pro-rata share of the assets in the Series A Security Trust.

AORE established an irrevocable trust (the "Class B Security Trust") for the benefit of the holders of its Class B Preference Shares. As of December 31, 2018 and 2017, the asset value of the Class B Security Trust was \$2.3 million and \$2.6 million, respectively, included within investments. Butterfield Trust Company has been appointed as its trustee. AORE has been authorized to redeem Class B Shares at any time for the amount that is not in excess of the Holder's pro-rata share of the assets in the Class B Security Trust.

ORE held a Section 114 Trust in favor of OACM to support obligations from the reinsurance business assumed. As at December 31, 2018 and 2017 the assets value was \$2.7 million and \$3.5 million, respectively.

ORE held a Section 114 Trust in favor of OAIC to support obligations from the reinsurance business assumed. As at December 31, 2018 and 2017 the assets value was \$0.5 million and nil, respectively.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS

The amortized cost, gross unrealized gains, gross unrealized losses, OTTI and estimated fair value recorded in accumulated other comprehensive income of the Company's available for sale investments at December 31, 2018 and 2017, were as follows:

	Included in Accumulated Other Comprehensive Income ("AOCI")				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		Estimated Fair Value
			Related to Changes in Estimated Fair Value	OTTI Included in Other Comprehensive Income ⁽¹⁾	
2018					
US Treasuries and government agencies ⁽²⁾	\$ 62,667,350	\$ 101,672	\$ (96,584)	\$ -	\$ 62,672,438
Corporate debt securities	24,809,755	28,831	(67,899)	-	24,770,687
Mortgage-backed securities	13,515,910	62,146	(302,831)	-	13,275,225
Asset-backed securities	35,306,818	12,913	(142,100)	-	35,177,631
Total available for sale fixed-maturity investments	<u>\$ 136,299,833</u>	<u>\$ 205,562</u>	<u>\$ (609,414)</u>	<u>\$ -</u>	<u>\$ 135,895,981</u>
Equity securities available for sale	5,089,693	719,379	(78,669)	-	5,730,403
Total investment portfolio	<u><u>\$ 141,389,526</u></u>	<u><u>\$ 924,941</u></u>	<u><u>\$ (688,083)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 141,626,384</u></u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

	Included in Accumulated Other Comprehensive Income ("AOCI")				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses Related to Changes in Estimated Fair Value	OTTI Included in Other Comprehensive Income ⁽¹⁾	Estimated Fair Value
2017					
US Treasuries and government agencies ⁽²⁾	\$ 31,050,746	\$ -	\$ (106,562)	\$ -	\$ 30,944,184
Corporate debt securities	3,015,554	2,009	(14,183)	-	3,003,380
Mortgage-backed securities	33,336,356	176,887	(251,360)	-	33,261,883
Asset-backed securities	13,782,820	35,782	-	-	13,818,602
Total available for sale fixed-maturity investments	<u>\$ 81,185,476</u>	<u>\$ 214,678</u>	<u>\$ (372,105)</u>	<u>\$ -</u>	<u>\$ 81,028,049</u>
Equity securities available for sale	5,089,692	1,346,922	-	-	6,436,614
Total investment portfolio	<u><u>\$ 86,275,168</u></u>	<u><u>\$ 1,561,600</u></u>	<u><u>\$ (372,105)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 87,464,663</u></u>

⁽¹⁾ Represents the amount of OTTI losses in accumulated other comprehensive income ("AOCI"), since adoption of the accounting guidance for OTTI.

⁽²⁾ Including US Government temporary liquidity guarantee program securities.

The Company did not have an aggregate investment in a single entity, other than U.S. Treasury securities, in excess of 10% of total investments at December 31, 2018 and 2017. The Company had no material investments in securities guaranteed by third parties and had no direct investments in financial guarantors as at December 31, 2018 and 2017.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

The amortized cost and estimated fair value of fixed-maturity securities classified as available-for-sale, as of December 31, 2018 and 2017, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

	December 31, 2018		December 31, 2017	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Less than one year	\$ 34,131,815	\$ 34,083,512	\$ 18,175,944	\$ 18,160,069
One through five years	40,052,941	40,080,441	31,125,106	31,023,454
Greater than five years	13,292,348	13,279,171	4,855,746	4,858,384
Mortgage-backed securities:				
RMBS	13,515,911	13,275,226	13,245,860	13,167,540
Asset-backed securities	35,306,818	35,177,631	13,782,820	13,818,602
Total	\$ 136,299,833	\$ 135,895,981	\$ 81,185,476	\$ 81,028,049

The investments that have unrealized loss positions as of December 31, 2018 and 2017, aggregated by investment category and the length of time they have been in a continuous unrealized loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2018:						
Fixed-maturity investments:						
US Treasuries and government agencies	\$ 29,419,558	\$ (75,066)	\$ 12,526,692	\$ (21,519)	\$ 41,946,250	\$ (96,585)
Corporate debt securities	16,129,073	(42,837)	1,531,922	(25,062)	17,660,995	(67,899)
Mortgage-backed securities	3,524,551	(7,400)	7,958,216	(295,430)	11,482,767	(302,830)
Asset-backed securities	28,535,509	(122,403)	987,525	(19,697)	29,523,034	(142,100)
Total temporarily impaired securities	\$ 77,608,691	\$ (247,706)	\$ 23,004,355	\$ (361,708)	\$ 100,613,046	\$ (609,414)

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
2017:						
Fixed-maturity investments:						
US Treasuries and government agencies	\$ 23,047,462	\$ (87,948)	\$ 4,648,475	\$ (18,613)	\$ 27,695,937	\$ (106,561)
Corporate debt securities	1,104,757	(7,033)	1,195,706	(7,149)	2,300,463	(14,182)
Mortgage-backed securities	<u>3,907,870</u>	<u>(17,438)</u>	<u>9,432,260</u>	<u>(233,924)</u>	<u>13,340,130</u>	<u>(251,362)</u>
Total temporarily impaired securities	<u>\$ 28,060,089</u>	<u>\$ (112,419)</u>	<u>\$ 15,276,441</u>	<u>\$ (259,686)</u>	<u>\$ 43,336,530</u>	<u>\$ (372,105)</u>

The following table sets forth the investment ratings of the Company's available-for-sale corporate fixed income securities as at December 31, 2018 and 2017. Ratings are assigned by Standard & Poor's or AM Best in instances where Standard & Poor's do not issue a rating.

	<u>Amortized Cost</u>	<u>%</u>
2018		
AAA	\$ 45,938,887	33.7%
AA	71,995,217	52.8%
A	17,814,904	13.1%
BBB and below	<u>550,825</u>	<u>0.4%</u>
	<u>\$ 136,299,833</u>	<u>100%</u>

As of December 31, 2018, 107 out of 169 fixed maturity securities were in unrealized loss positions compared to 48 out of 104 as of December 31, 2017. As at December 31, 2018, the Company's unrealized loss position for fixed maturity securities was \$0.7 million compared to \$0.4 million at December 31, 2017. Management does not believe these investments to be other than temporarily impaired, and has no intention to sell the securities. Unrealized gains and losses relating to fixed maturity investments, excluding any credit loss portion, are currently recorded in accumulated other comprehensive income in shareholders' equity as the Company generally holds these investments to maturity. The unrealized gains and losses are expected to decrease as the investment approaches maturity and the Company expects to realize a value substantially equal to amortized cost. Thirty-three of the securities have been in an unrealized loss position of \$0.4 million for 12 months or more as of December 31, 2018 and there were sixteen securities in an unrealized loss position \$0.3 million for 12 months or more as of December 31, 2017.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

4. INVESTMENTS (Cont'd)

During the years ended December 31, 2018 and 2017, the Company recognized losses on other than temporary impairments in the amount of nil and \$ 0.2 million, respectively. There was a nil and \$ 0.2 million movement in the amount of OTTI recognized in other comprehensive income during such years respectively and the closing balance of OTTI was nil and \$0.2 million, as of December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017, an immaterial amount of net unrealized gains was recorded in accumulated other comprehensive income on securities which have previously had a credit loss written off to earnings, respectively.

Proceeds from maturities and sales of investments in fixed-maturity securities available for sale during 2018 and 2017 were \$64.0 million and \$71.4 million, respectively. Gross gains of \$10,416 and nil in 2018 and 2017, respectively, and gross losses of \$2,769 and nil in 2018 and 2017, respectively, were realized on those sales. Proceeds from the sale of equities were nil and \$1.4 million in 2018 and 2017, respectively. Gross gains from those 2017 sales were \$0.4 million.

Major categories of net investment income are summarized as follows for the years ended December 31, 2018 and 2017:

	2018	2017
Interest from fixed-maturity securities	\$ 3,402,189	\$ 1,969,058
Interest from cash equivalents	272,540	372,404
Dividend Income	97,592	97,592
Amortization	49,521	25,347
Investment expense	(242,728)	(286,204)
Interest on funds held	<u>(769,832)</u>	<u>(416,203)</u>
Net Investment income	<u>\$ 2,809,282</u>	<u>\$ 1,761,994</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE

The underwriting of insured risks and the reporting of underwriting results to AORE are the responsibility of the primary insurers under the treaties. AORE does not “re-underwrite” the transactions ceded under the treaties. AORE’s business model has always been that of a reinsurer in which it leverages and relies on the operations and reporting of the primary insurers. As a result of this model, AORE is highly dependent on the operating and reporting of the ceding companies. As the result of commutations in previous years, AORE is only assuming from ceding companies owned by a common group. AORE assesses the reasonableness of the ceding companies’ reporting by i) discussing with primary insurers their earnings methodology, ii) reviewing the primaries’ publicly available information regarding their accounting policies and methodologies, iii) comparing the primary reported information to the results of AORE’s own basic model and iv) performing analytical reviews on AORE’s underwriting results.

The following tables present a roll forward of AORE’s premiums receivable on installment policies for the years ended December 31, 2018 and 2017:

(dollars in thousands)	Years ended December 31,	
	2018	2017
Premiums receivable beginning balance	\$ 5,353	\$ 6,600
Change in premiums receivable discount	61	649
Adjustments for changes in expected term of policies (including early terminations)	-	19
Other Adjustment - Commutation	-	(1,202)
Foreign exchange movement	(205)	460
Premiums received	(573)	(1,173)
Premiums receivable ending balance	\$ 4,636	\$ 5,353

As of December 31, 2018 and 2017, AORE had \$4.6 million and \$5.3 million, respectively, of premiums receivable, which represents the present value of future expected premiums on contracts where installments are collected over the term of the policy. This amount is included within “Premiums receivable” on the Consolidated Balance Sheets, net of the related ceding commissions payable as of December 31, 2018 and 2017 of \$2.0 million and \$2.4 million, respectively. As of December 31, 2018 and 2017, \$0.2 million and \$0.2 million, respectively, of paid losses (recoverable)/due to ceding companies was netted off “Premiums receivable” on the Consolidated Balance Sheets where the right of offset with a ceding company exists.

AORE experienced a number of downgrades, commencing in the middle of 2008, by both Moody’s and S&P. On May 19, 2009, Moody’s downgraded AORE to Ba3 and, at the same time, withdrew the rating at AORE’s request. On August 31, 2009, S&P downgraded AORE’s financial strength rating to BB with negative outlook and, at the same time, withdrew the rating at AORE’s request. As a result of these downgrades, since 2008 certain of the ceding companies have a right under some of our treaty agreements to increase the ceding commission charged to AORE on the U.S. statutory unearned premium balance, as well as premiums payable after the downgrade. This increase applies to all financial guaranty and derivative policies covered by the relevant treaties. The additional ceding commissions charged to AORE have been paid or accrued and deferred and are being expensed in proportion to the earning of the remaining unearned premium, except for credit derivative policies where they are expensed as incurred. As of December 31, 2018 and 2017, additional ceding commissions due on the present value of premiums receivable on installment policies are netted off the premiums receivable within “Reinsurance balances receivable, net.”

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE (Cont'd)

The accretion of premiums receivable discount is included in earned premiums in the Company's consolidated statements of operations. As of December 31, 2018 and 2017, the weighted average risk-free rate used to discount the premiums receivable was 2.06% and 2.07%, respectively. The weighted average expected period of future premiums used to estimate the premiums receivable was 10.4 and 10.1 years for December 31, 2018 and 2017 respectively. As of December 31, 2018 and 2017, the unearned premiums on these installment policies were \$7.0 million and \$6.9 million, respectively, and were included in "unearned premiums" on the Consolidated Balance Sheets.

The following table presents the future amount of undiscounted premiums expected to be collected on installment policies and the period in which those collections are expected to occur. These amounts are based on AORE's estimates as of December 31, 2018, utilizing information as reported by the ceding companies, and any changes to the underlying information on insured obligations could cause actual results to be materially different from the amounts below:

	Premiums Expected to be collected
(dollars in thousands)	
<u>Three Months Ended:</u>	
March 31, 2019	\$ 107
June 30, 2019	229
September 30, 2019	83
December 31, 2019	154
 <u>Twelve Months Ended:</u>	
December 31, 2020	551
December 31, 2021	525
December 31, 2022	506
December 31, 2023	456
 <u>Five Years Ended:</u>	
December 31, 2028	1,684
December 31, 2033	992
December 31, 2038	684
December 31, 2043	509
December 31, 2048	288
After 2048	228

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

5. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS REINSURANCE (Cont'd)

The following table presents the expected unearned premium revenue and the schedule of total expected future premium earnings revenue on upfront and installment policies. These amounts are based on the Company's estimates as of December 31, 2018, utilizing information as reported by the ceding companies, and any changes to the underlying information on insured obligations could cause actual results to be materially different from the amounts below:

	<u>Change in Unearned Premiums</u>	<u>Accretion</u>	<u>Total Expected Future Earned Premiums</u>
(dollars in thousands)			
<u>Three Months Ended:</u>			
March 31, 2019	\$ 437	\$ 1	\$ 438
June 30, 2019	428	1	429
September 30, 2019	419	1	420
December 31, 2019	410	1	411
 <u>Twelve Months Ended:</u>			
December 31, 2020	1,553	2	1,555
December 31, 2021	1,416	2	1,418
December 31, 2022	1,285	2	1,287
December 31, 2023	1,169	1	1,170
 <u>Five Years Ended:</u>			
December 31, 2028	4,348	4	4,352
December 31, 2033	2,560	1	2,561
December 31, 2038	1,417	-	1,417
December 31, 2043	820	-	820
December 31, 2048	409	-	409
After 2048	161	-	161

Accelerated premium revenue for refunded obligations for the years ended December 31, 2018 and 2017, was approximately \$0.6 million and \$2.1 million, respectively, and represents the earning of the unearned premiums associated with the unscheduled prepayment of the underlying obligations.

The estimated premiums written for the years ended December 31, 2018 and 2017, were (\$2.6) million and \$1.5 million, respectively; see Note 10 – Commutations and Other Settlements for details of commutations in the period included within these numbers. Included in premiums written in 2018 and 2017 was estimated accretion of the premiums receivable of \$0.1 million and \$0.6 million, respectively. Accretion of the ceding commissions payable of \$4.0 thousand and \$(0.1) million, respectively, was included in acquisition expenses for such years.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES

The Company is required to recognize all derivatives as either assets or liabilities in the Consolidated Balance Sheets and measure those instruments at fair value. The gain or loss on credit derivatives will change at each measurement date based on the underlying assumptions and information used in the estimate of fair value. Such fair value changes may not be indicative of ultimate claims. The credit derivative contracts AORE has reinsured require it to make payments upon the occurrence of certain defined credit events relating to an underlying obligation. Credit derivative exposures are substantially similar to financial guaranty insurance contracts and provide for credit protection against payment default, are generally held to maturity, and the unrealized gains and losses on derivative financial instruments will approach zero as the exposure approaches its maturity date, unless there is a credit impairment. Since these derivative instruments are considered a normal extension of the AORE's financial guaranty business, AORE monitors the risks associated with these policies in accordance with its normal risk management activities as discussed in Note 8 - Losses and Loss Expense Reserve.

The following table provides the components of "Net change in fair value of credit derivatives" included in the Company's Consolidated Statements of Operations related to our credit derivative policies:

	Years ended December 31,	
	2018	2017
	<hr/>	<hr/>
Change in fair value of credit derivatives:		
Credit derivative premiums earned and receivable	\$ 36,516	\$ 221,826
Expenses on credit derivatives	(8,797)	(30,150)
Losses and loss adjustment expenses ⁽¹⁾	(13,481)	(79,211)
	<hr/>	<hr/>
Realized gains and other settlements	14,238	112,465
	<hr/>	<hr/>
Unrealized gain	60,435	8,125,267
	<hr/>	<hr/>
Net change in fair value of credit derivatives	<u>\$ 74,673</u>	<u>\$ 8,237,732</u>

⁽¹⁾ See Note 10 – Commutations and Other Settlements, for details of the effect of the commutations on the above balances.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

Determining fair value

In accordance with ASC 820, fair value is defined 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. Fair value is determined based on quoted market prices, if available. Financial guarantors sell credit protection in CDS form to financial institutions in a principal-to-principal market in which transactions are highly customized and negotiated independently. A CDS contract written by a financial guarantor differs from typical CDS contracts entered into by parties that are not financial guarantors because:

- CDS contracts written by financial guarantors are neither held for trading purposes (i.e., a short-term duration contract written for the purpose of generating trading gains) nor used as hedging instruments. Instead they are written with the intent to provide protection for the stated duration of the contract, similar to the financial guarantor's intent with regard to a financial guaranty contract.
- Financial guarantors are not entitled to terminate a CDS contract they write that is "in-the-money" and realize a profit on such a position.
- The liquidity risk present in most CDS contracts sold outside the financial guaranty industry, i.e., the risk that the CDS writer would be required to make cash payments, is typically not present in a CDS contract written by a financial guarantor. Terms are designed to replicate the payment provisions of financial guaranty contracts in that (a) losses, if any, are generally paid over time, and (b) the financial guarantor is generally not required to post collateral to secure its obligation under the CDS contract (the financial guarantor may be required to post collateral on their downgrade).

As a result of these differences, we believe there have been few, if any, relevant third-party exit transactions for CDS contracts written by financial guarantors. In the absence of a principal exit market, a financial guarantor determines the fair value of a CDS contract it writes by using internally developed models, as more fully discussed below.

Fair value modeling

The Company's CDS policies are not readily tradable as there is no active market for them. Therefore, the Company views its principal market as the financial guaranty insurance and reinsurance market, whose participants would hypothetically be able to assume this business if the Company were to hypothetically transfer a policy.

The ceding company uses its own internal valuation model where market prices are not available. The primary insurers underwrite each of the transactions underlying the reinsurance contract and they have access to all the underlying data related to the transactions. In addition, they have sophisticated modeling capabilities and services (i.e. Loan Performance and Intex) that allow them to evaluate the performance of all of the underlying credits in a transaction. Given the contractual terms of the Company's reinsurance that limit its access to the terms of the underlying credit derivatives, which are highly individualized, and the underlying loan level data, the Company believes that an exit market participant would look to the information that is available from the ceding company to determine the exit value of the Company's reinsurance contract, as discussed above. Therefore, the Company, in determining the fair value of derivative instruments, uses credit derivative contract valuations from its ceding company as a key input. Management then assesses the reasonableness of the ceding company's valuations by reviewing the primaries' publicly available information regarding their mark-to-market process, including methodology and key assumptions,

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

6. FINANCIAL GUARANTY CONTRACTS ACCOUNTED FOR AS CREDIT DERIVATIVES (cont'd)

There are many other assumptions that drive the ceding company's ultimate fair value assessment namely asset recovery assumptions, correlation across asset assumptions, discount rate used, time to maturity, timing of default assumptions, and collateral posting requirements, where applicable. So while spreads are a significant driving factor in models of fair value, they are not the only variables. Changes in correlation and recovery assumptions can result in valuations moving more or less than the absolute movement of spreads. If it appears that the marks are consistent with general market trends and the Company believes that the modeling and assumptions that drive the modeling are reasonable (based on the Company's ceding company reviews and review of publicly available information), the Company will use the mark provided by the ceding company as a key input in the determination of the fair value of its reinsurance contracts on credit derivatives. These fair values are based on estimates and are sensitive to selected assumptions and changes to assumptions could lead to materially different results.

Fair values from the ceding company's models may differ from values calculated by companies outside of the financial guaranty industry because, according to the ceding company, the terms of the CDS contracts insured generally differ from other non-insured CDS contracts. Because of these terms and conditions, the fair value of the ceding company's credit derivatives may not reflect the same prices observed in an actively traded market of CDS that do not contain terms and conditions similar to those observed in the financial guaranty market. These models and the related assumptions are continuously reevaluated by the ceding company and enhanced, as appropriate, based upon improvements in modeling techniques and availability of market information.

Our credit derivative policies are classified as Level 3 in the fair value hierarchy in Note 7 since the inputs provided to us by our ceding company and our own non-performance risk adjustments are from valuation models which place reliance on at least one significant unobservable input. Consistent with the requirements of ASC 820, we believe these models use observable market data when available.

The following table presents changes in the net credit derivative liabilities balance for which fair value was measured under Level 3 for the years ended December 31, 2018 and 2017:

Fair value measurement using significant unobservable inputs (Level 3)

	Years ended December 31,	
	2018	2017
Balance, beginning of period	\$ (341,843)	\$ (8,357,625)
Total unrealized gains included in earnings ⁽¹⁾	60,435	8,125,267
Total realized gains included in earnings ⁽²⁾	14,238	112,465
Net Cash Receipts ⁽³⁾	1,104	(221,950)
Balance, end of period	\$ (266,066)	\$ (341,843)
Change in unrealized gains and losses relating to assets held at the reporting date	\$ 56,220	\$ 183,144

(1) Included within "Net change in fair value of credit derivatives".

(2) Included in "Realized gains and other settlements" within "Net change in fair value of credit derivatives".

(3) Net cash payments/ (receipts) includes all ongoing contractual cash payments inclusive of payments to commute credit derivatives (see Note 10 – Commutations and Other Settlements for details of commutations in the years ended December 31, 2018 and 2017)

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurements

The Company follows the guidance of ASC 820 for fair value measurement of financial instruments. ASC 820 establishes a hierarchy of inputs in measuring fair value, with the highest level being observable inputs and the lowest being unobservable data, with the standard requiring that the use of observable inputs is maximized (see Note 2(i) - Significant Accounting Policies – Fair Value Measurements for a description of each of the three levels).

The following table presents the fair value measurement levels for assets and liabilities, which the Company has recorded at fair value as of December 31, 2018 and 2017. As required by ASC 820, items are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

	Fair Value Measurements at Reporting Date Using			
Balance as of December 31, <u>2018</u>	Quoted Prices in Active Markets for Identical <u>Assets (Level 1)</u>	Significant Other Observable <u>Inputs (Level 2)</u>	Significant Unobservable <u>Inputs (Level 3)</u>	
Financial Assets:				
U.S. treasuries and government agencies	\$ 62,672,438	\$ 46,180,197	\$ 16,492,241	\$ -
Corporate debt securities	24,770,687	-	24,770,686	-
Municipal securities	-	-	-	-
Mortgage-backed securities	13,275,225	-	13,275,226	-
Asset-back securities	35,177,631	-	35,177,631	-
Investments available for sale fixed maturity investments	135,895,981	46,180,197	89,715,784	-
Cash and Cash Equivalents	34,707,538	34,707,538	-	-
Restricted Cash	6,554,204	6,554,204	-	-
Financial Liabilities:				
Derivative Liabilities ⁽¹⁾	\$ 266,066	\$ -	\$ -	\$ 266,066

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (cont'd)

	Fair Value Measurements at Reporting Date Using			
	Balance as of December 31, <u>2017</u>	Quoted Prices in Active Markets for Identical <u>Assets (Level 1)</u>	Significant Other Observable <u>Inputs (Level 2)</u>	Significant Unobservable <u>Inputs (Level 3)</u>
Financial Assets:				
U.S. treasuries and government agencies	\$ 30,944,184	\$ 30,944,184	\$ -	\$ -
Corporate debt securities	3,003,380	-	3,003,380	-
Mortgage-backed securities	33,261,883	-	33,261,883	-
Asset-back securities	13,818,602	-	13,818,602	-
Investments available for sale fixed maturity investments	81,028,049	30,944,184	50,083,865	-
Cash and Cash Equivalents	40,173,162	40,173,162		
Restricted Cash	66,534,599	66,534,599		
Financial Liabilities:				
Derivative Liabilities ⁽¹⁾	\$ 341,843	\$ -	\$ -	\$ 341,843

⁽¹⁾ See Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives for further disclosure on the application of ASC 820 to the Company’s derivative liabilities.

Fixed-maturity investments

The Company’s fair values of fixed-maturity and short-term investments are based on prices obtained from nationally recognized independent pricing services. Where available, the prices are obtained from market quotations in active markets. Where there is no quoted price for an identical security, then the pricing service may use matrix pricing or model processes, such as the option adjusted spread model, to estimate the fair value of a security. The matrix pricing or model processes consist primarily of observable inputs, which may include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data. The Company receives at least one fair value price for each of its investment securities and has not adjusted any of the prices received from the pricing services. At December 31, 2018 and 2017, all the Company’s securities were valued using the independent pricing services.

There were no transfers into or out of Level 1 or 2 during the years ended December 31, 2018 and 2017.

As management is ultimately responsible for determining the fair value measurements for all securities, the Company assesses the reasonableness of the fair values received by comparing them to other pricing information readily available and management’s knowledge of the current markets. The Company also assesses the pricing methodologies and related inputs used by the pricing services to estimate fair value. Any prices that, in management’s opinion, may not be representative of fair value are challenged with the pricing service. Based on the information obtained from the above reviews, the Company evaluated the fixed-maturity securities in the investment portfolio to determine the

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

7. FAIR VALUE OF FINANCIAL INSTRUMENTS (cont'd)

appropriate fair value hierarchy level in accordance with ASC 820. Based on the Company's evaluation, each security was classified as Level 1, 2, or 3. Prices with observable market inputs were classified as Level 2, prices on money market funds and US treasuries were classified as Level 1, and valuations with no significant observable inputs were classified as Level 3 as of December 31, 2018 and 2017. The Company holds an investment in a capital trust, classified as a corporate debt security available for sale, which was valued using an analysis to comparable securities, incorporating a spread to the yields on the comparable securities to derive the fair value. Because the investment in this security was valued using significant unobservable inputs, it is classified as Level 3 in the fair value hierarchy. There were no liabilities measured at fair value on a recurring basis using unobservable measurements other than those dealt with in Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives.

Equity investments

The Company's equity investments are comprised of funds invested in a range of diversified strategies. In accordance with U.S. GAAP, the fair values of the funds are based on the unadjusted net asset value of the funds and as such, the Company has adopted NAV as a practical expedient and this is not presented in the levelling table. The Company validates these prices through agreeing net asset values to audited financial statements where available, in conjunction with regular discussion and analysis of the investment portfolio's structure.

Other fair value disclosures

Management has estimated the fair value of certain financial instruments based upon market information using appropriate valuation methodologies. Fair value estimates are not necessarily indicative of the amount the Company could realize in a current market exchange.

The Company considers carrying amounts of cash and cash equivalents, interest, other assets, accounts payable and accrued liabilities to be reasonable estimates of their fair values.

As of December 31, 2018 and 2017, the fair value of the Company's \$38.6 million and \$58.6 million, respectively redeemable Series A Preference Shares was approximately \$7.0 million and \$10.3 million, respectively. These fair value estimates are based on the present value of expected cashflows, together with the Company's best estimate of fair value of this instrument. The fair value measurement was classified as Level 3 in the fair value hierarchy.

Carrying value of all financial assets and liabilities is equivalent to fair value.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE

The Company's loss and loss expense reserve as of December 31, 2018, represented case basis loss reserves and incurred but not reported reserves, or claim liability which includes a fair value adjustment of the financial guaranty reserves. Refer to Note 2 - Significant Accounting Policies for a description of the Company's accounting policy for insurance losses.

A summary of the movement in the provision for losses and LAE for the years ended December 31, 2018 and 2017 is presented in the following table:

	2018	2017
Losses and loss expense reserve		
Balance - Beginning of year	\$ 304,772,603	\$ 276,687,908
Less: reinsurance recoverable	(216,872,054)	(196,596,105)
Net Balance - Beginning of year	<u>87,900,549</u>	<u>80,091,803</u>
Reserves transferred in through loss portfolio transfer	-	-
Incurred related to:		
Current year	1,966,036	2,857,832
Prior Years	627,341	16,924,868
Total incurred	<u>2,593,377</u>	<u>19,782,700</u>
Net losses paid related to:		
Current year	(1,070,889)	(1,965,523)
Prior Years	(15,596,600)	(10,008,431)
Total Paid	<u>(16,667,489)</u>	<u>(11,973,954)</u>
Net balance - End of year	73,826,437	87,900,549
Add: reinsurance recoverable	192,901,183	216,872,054
Balance - End of year	<u><u>\$ 266,727,620</u></u>	<u><u>\$ 304,772,603</u></u>

For the year ended December 31, 2018, the Company incurred loss and LAE of \$2.6 million. Incurred losses related to the Company's short-tailed property casualty business were \$1.1 million, driven by \$2.0 million of incurred loss on the current accident year. The financial guaranty reinsurance business generated net incurred losses of \$1.5 million in 2018 including fair value adjustments, primarily related to its reinsurance of obligations of Commonwealth of Puerto Rico (See note 18).

For the year ended December 31, 2017, the Company incurred loss and LAE of \$19.8 million. Incurred losses related to the Company's short-tailed property casualty business were \$4.0 million, driven by \$2.9 million of incurred loss on the current accident year. The financial guaranty reinsurance business generated net incurred losses of \$15.8 million in 2017 including fair value adjustments, primarily related to its reinsurance of obligations of Commonwealth of Puerto Rico (See note 18).

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

Financial guaranty

To determine the adequacy of its aggregate reserves, the Company considers the loss reserves established by its ceding companies for the exposures it has reinsured as well as the methodologies used by the ceding companies to calculate such ceded loss reserves. To further evaluate the ceded reserve amounts established by the ceding companies, the Company uses its own expected loss forecasting methodologies. Ultimately, the Company decides on an individual credit-by-credit basis whether to establish the ceding company's reserve as its own or to use its own forecast methodology to determine the reserve for such credit. As of December 31, 2018 and 2017, the Company's recorded loss and LAE reserves for financial guaranty contracts are \$19.9 million (2017: \$19.3 million) higher than the reserves reported by the primaries.

The Company uses one of two approaches to perform its own forecast of expected losses. The first approach is a statistical expected loss approach, which considers the likelihood of alternative outcomes. The statistical expected loss is a function of: (i) the net par outstanding on the credit; (ii) internally developed historical default assumptions (taking into consideration internal ratings and remaining term to maturity of an obligation); (iii) internally developed loss severities; and (iv) a discount factor. This approach is referred to by the Company as the probabilistic expected loss ("PEL") modeling approach. The loss severities and default assumptions are based on rating agency information, are specific to each bond type and are established and approved by management. For certain credit exposures, the Company's surveillance activities may provide information relevant to adjust the estimate of the statistical expected losses. As such, the default probability or loss severity for such exposures under certain probabilistic scenarios may be adjusted based on the judgment of senior management.

The second approach entails the use of more precise estimates of expected net cash outflows (future claim payments, net of potential recoveries, expected to be paid to the holder of the insured financial obligation). The Company's risk management staff considers the likelihood of alternative possible outcomes and develops alternative loss scenarios, in conjunction with a review of historical performance data of the collateral pools. In this approach, a probability-weighted expected loss estimate is developed based on assigning probabilities to multiple net claim payment scenarios and applying an appropriate discount factor. For RMBS, the Company takes into account the first loss protective features inherent in the structure of the insured exposure, collateral losses to date, current delinquency rates and loan product characteristics such as loan-to-value ratio and credit score. The first loss protection in most of the Company's RMBS transactions is provided by excess spread, overcollateralization, subordination, and in some cases mortgage pool insurance.

A loss reserve is recorded for the excess, if any, of estimated expected losses (net cash outflows) over unearned premium reserve ("UPR"). For certain policies, estimated potential recoveries exceed estimated future claim payments because all or a portion of such recoveries relate to claims previously paid. The expected net cash inflows for these policies are recorded as a recoverable asset.

The discount factor applied is based on a risk-free discount rate corresponding to the remaining expected weighted-average life of the exposure or based on multiple risk-free discount rates related to the timing of individual claims payments. The discount factors are updated for the current risk-free rates each reporting period. As of December 31, 2018, the Company used risk free rates ranging from 2.44% to 3.02% to discount reserves for loss and loss adjustment expenses. As of December 31, 2017, the Company used risk free rates ranging from 1.28% to 2.74% to discount reserves for loss and loss adjustment expenses.

The Company establishes reserves that it believes are adequate to cover the present value of ultimate liability for losses and loss adjustment expenses, net of UPR. These reserves are based on estimates and may vary materially from actual results.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

The Company also identifies problem credits through information provided by the ceding companies at least on a quarterly basis. Such information generally consists of surveillance and underwriting reports and quarterly correspondence and/or conference calls with the ceding companies' analysts. The Company supplements this input with their own research to identify and assess the status of individual credits. Research performed includes reviews of rating agency and fixed income research publications and analysis of historical performance data. Each of the ceding companies maintains a "watch list" for credits that have been identified as requiring a greater than usual level of ongoing scrutiny and/or intervention. The ceding companies notify the Company when any ceded exposure has been placed on such a watch list.

The Company maintains its own Watch List to identify those transactions requiring increased monitoring. The Company typically places a transaction on the Watch List if the ceding company places a transaction on its watch list, and the Company generally employs a mapping of each watch list category of each ceding company to the Company's own Watch List categories. The Company also surveys market segments on an as-needed basis based on market trends, and may add transactions to the Watch List as a result of such survey even if the ceding company has not added the transaction to its watch list.

As of December 31, 2018 and 2017, the Company's Watch List definitions are as follows:

- Category 1: Transactions that are investment grade and for which future losses still seem unlikely, but with a material deterioration in some aspect. Transactions may be in Category 1 where, for example, there has been a:
 - Breach of a material performance trigger or covenant
 - Material deterioration in the financial health of the issuer, servicer, collateral manager or other important party
 - Material downgrade of internal or external credit ratings from their original level
 - Material deterioration in macroeconomic factors (such as industry trends or asset values)Investment grade transactions on which liquidity claims have been paid are in this category. Active monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.
- Category 2: Below investment grade transactions showing sufficient deterioration to make future losses possible, but for which none are currently expected. Intense monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.
- Category 3: Below investment grade transactions for which future losses are expected but for which no claims (other than liquidity claims) have yet been paid. Intense monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.
- Category 4: Below investment grade transactions for which future losses are expected and on which claims (other than liquidity claims) have been paid. Intense monitoring and intervention is employed by the ceding company, with internal credit ratings reviewed at least quarterly.

The Company generally expects "future losses" on a transaction when the Company believes there is more than a 50% chance that, on a present value basis, it will pay more claims over the remaining life of that transaction than it will ultimately have reimbursed. A "liquidity claim" is a claim that the Company expects to be reimbursed within one year. (Excluded from consideration are small, immaterial losses or claims not indicative of the performance of the transaction generally.)

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

Each transaction in Category 3 or 4 of the Watch List is generally reviewed quarterly to determine whether material changes are noted by the ceding company or by the Company. If material adverse changes are identified, surveillance reports are requested from the ceding company and discussions are held to assess the deterioration and outlook for the credit.

The Company may have transactions in Categories 1 or 2 on the Watch List or transactions not on the Watch List for which the Company has established loss reserves based on its Probabilistic Expected Loss (“PEL”) modeling analysis. These transactions are typically not on the ceding primary’s watch list and are assigned reserves in the Company’s PEL modeling primarily due to low premium pricing, not due to poor transaction performance. Further surveillance and modeling may result in the Company placing these transactions on the Watch List or downgrading the assigned category. In addition, the Company may have transactions for which it projects prior claim recoveries that are not on the Watch List because they have no remaining par outstanding. Such transactions are reflected in the tables below.

The Company does not perform loss mitigation activities and instead relies on the loss mitigation efforts of the ceding companies that report the Company’s proportionate share of the expenses incurred and liability arising from such activities. The Company pays the ceding companies a ceding commission for all policies reinsured. The ceding commission represents the Company’s portion of the cost to the ceding companies to write the transaction, perform ongoing surveillance and to undertake loss mitigation activities. Ceding commissions are deferred and expensed as each policy’s exposure matures and are included as an asset in deferred policy acquisition costs and as acquisition expenses in the statement of operations. The Company reports loss expenses associated with claims as a liability in losses and loss expense reserves on the Consolidated Balance Sheets and in loss and loss adjustment expenses in the Consolidated Statements of Operations.

Categories 1 to 4 in the below table include all financial guaranty contracts on the Company’s Watch List at December 31, 2018 and 2017, whether or not they have reserves on them. The column entitled “Deals not on Watch List” includes only financial guaranty exposures for which the Company has established reserves. Policies written in credit derivative form are not included in the above tables. Due to rounding, the numbers in the below tables may not add up to the totals.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

The following table provides information about the financial guaranty policies and related loss reserves in each of the Company's Watch List categories as of December 31, 2018:

2018

(dollars in millions)	Deals not on watch List	Surveillance Categories				Total
		Category 1	Category 2	Category 3	Category 4	
Number of policies	4	5	6	1	5	21
Remaining weighted average contract period (in yrs)	24	20	12	18	13	
Insured contractual payments outstanding:						
Principal	\$ 15.2	\$ 0.8	\$ 56.3	\$ 5.6	\$ 96.1	\$ 174.0
Interest	7.1	0.2	25.6	0.6	51.2	84.7
Total	<u>\$ 22.3</u>	<u>\$ 1.0</u>	<u>\$ 81.9</u>	<u>\$ 6.2</u>	<u>\$ 147.3</u>	<u>\$ 258.7</u>
Gross claim liability	\$ 0.3	\$ -	\$ 3.5	\$ 0.8	\$ 49.6	\$ 54.2
Less:						
Gross potential recoveries	(0.3)	-	0.3	-	0.4	0.4
Discount, net	-	-	(0.9)	-	(3.8)	(4.7)
Net claim liability	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2.9</u>	<u>\$ 0.8</u>	<u>\$ 46.2</u>	<u>\$ 49.9</u>
Unearned premium revenue ⁽¹⁾	0.2	-	0.4	-	1.0	<u>\$ 1.6</u>
Premium deficiency						\$ 0.7
Net claim liability reported in the Balance Sheet related to financial guaranty						<u>\$ 49.0</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

The following table provides information about the financial guaranty policies and related loss reserves in each of the Company's Watch List categories as of December 31, 2017:

2017

(dollars in millions)	Deals not on watch List	Surveillance Categories				Total
		Category 1	Category 2	Category 3	Category 4	
Number of policies	19	6	19	4	37	85
Remaining weighted average contract period (in yrs)	23	19	13	19	15	
Insured contractual payments outstanding:						
Principal	\$ 20.8	\$ 64.1	\$ 77.5	\$ 7.8	\$ 122.6	\$ 292.8
Interest	11.3	30.8	37.1	1.2	64.3	144.7
Total	<u>\$ 32.1</u>	<u>\$ 94.9</u>	<u>\$ 114.6</u>	<u>\$ 9.0</u>	<u>\$ 186.9</u>	<u>\$ 437.5</u>
Gross claim liability	\$ 0.6	\$ 0.1	\$ 3.9	\$ 1.3	\$ 58.7	\$ 64.6
Less:						
Gross potential recoveries	(0.9)	-	(0.8)	(0.1)	-	(1.8)
Discount, net	-	-	(0.7)	-	(3.3)	(4.0)
Net claim liability	<u>\$ (0.3)</u>	<u>\$ 0.1</u>	<u>\$ 2.4</u>	<u>\$ 1.2</u>	<u>\$ 55.4</u>	<u>\$ 58.8</u>
Unearned premium revenue ⁽¹⁾	0.4	0.1	0.5	-	1.3	<u>\$ 2.3</u>
Premium deficiency						\$ 1.0
Net claim liability reported in the Balance Sheet related to financial guaranty						<u>\$ 57.5</u>

⁽¹⁾ On policies with a loss reserve but excluding those policies with a recoverable as of December 31, 2018 and 2017, respectively.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

Property and casualty

The following presents information about incurred and paid claims development for the short term duration contracts as of December 31, 2018, net of reinsurance. The information about incurred and paid claims development for the 2013 to 2018 years, and the average annual percentage payout of incurred claims by age as of December 31, 2018, is presented as required supplementary information. The below tables begin at June 26, 2013. This was the date AOG became part of OGL, whose U.S. subsidiaries write short duration property and casualty business. Claims count information is not reflected in the below tables. Due to the role of the U.S subsidiaries in the non standard auto and the reinsurance business this information is not available.

Incurred loss and allocated loss adjustment expenses, net of reinsurance
For the Years Ended December 31,

(dollars in thousands)	(unaudited)		(unaudited)		(unaudited)		(unaudited)		Total of incurred-but-not-reported liabilities plus expected development on reported claims
Accident Year	2013	2014	2015	2016	2017	2018			
2013	\$ 34,799	\$ 38,858	\$ 38,245	\$ 38,013	\$ 38,276	\$ 38,132	\$	28	
2014	-	34,792	35,215	34,577	34,960	34,796		57	
2015	-	-	5,182	5,076	5,480	5,321		38	
2016	-	-	-	3,072	3,390	3,224		102	
2017	-	-	-	-	2,491	2,218		270	
2018	-	-	-	-	-	1,966		360	
					\$ 84,596	\$ 85,657			

Cumulative paid claims and allocated loss adjustment expenses, net of reinsurance
For the Years Ended December 31,

(dollars in thousands)	(unaudited)		(unaudited)		(unaudited)		(unaudited)	
Accident Year	2013	2014	2015	2016	2017	2018		
2013	\$ 15,872	\$ 30,676	\$ 35,199	\$ 37,208	\$ 37,919	\$ 38,137		
2014	-	21,080	28,728	32,052	33,420	33,927		
2015	-	-	3,392	4,708	5,332	5,384		
2016	-	-	-	1,980	2,794	2,952		
2017	-	-	-	-	1,810	2,571		
2018	-	-	-	-	-	1,071		
					\$ 81,275	\$ 84,042		

All outstanding liabilities before 2013, net of reinsurance	21
Liabilities for claims and claims adjustment expense, net of reinsurance	\$ 1,636

Average annual percentage payout of incurred claims by age, net of reinsurance

Years	Year 1	Year 2	Year 3	Year 4	Year 5
	58%	26%	11%	4%	2%

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

8. LOSSES AND LOSS EXPENSE RESERVE (cont'd)

**Reconciliation of the disclosure of incurred and paid claims development to the liability
for unpaid claims and claims adjustment expenses**

(dollars in thousands)	<u>2018</u>
<u>Net Outstanding Liabilities</u>	
Liabilities for unpaid claims and claim adjustment expenses, net of reinsurance	\$ 1,636
Total reinsurance recoverable on unpaid claims	192,568
Insurance lines other than short-duration	72,524
Unallocated claims adjustment expenses	-
Other	-
	<u>266,728</u>
Total gross liability for unpaid claims and claims adjustment expense	<u>\$ 266,728</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

9. OUTSTANDING FINANCIAL GUARANTY EXPOSURE

A portion of the Company's business consists of financial guaranty reinsurance, the purpose of which is to indemnify a primary financial guarantor, referred to as the "primary insurer" or "ceding company," against the portion of any loss it may sustain under financial guaranty policies it has ceded to the Company. The Company reinsures policies covering both U.S. and international exposures. The Company's portfolio as of December 31, 2018 was diversified by geographic and bond market sector, with no single obligor representing more than 6.2% of the Company's total outstanding ("OS") par insured.

The following table presents the Company's net par outstanding by credit sector and type of guaranty as of December 31, 2018 and 2017:

(dollars in millions)	2018		2017	
	Total OS Par	% of Total	Total OS Par	% of Total
US Public Finance				
General Obligation and Lease	\$ 449	30.5	\$ 696	30.0
Tax backed	149	10.1	165	7.1
Transportation	67	4.5	140	6.0
Healthcare	137	9.3	178	7.7
Utility	133	9.0	180	7.8
Higher Education	7	0.5	16	0.7
Other	31	2.1	38	1.6
Escrowed	16	1.1	188	8.1
Total US Public Finance	\$ 989	67.1%	\$ 1,601	69.0%
US Structured Finance				
Commercial ABS and CDOs	\$ -	-	\$ 5	0.2
RMBS	6	0.4	50	2.1
Total US Structured Finance	\$ 6	0.4%	\$ 55	2.3%
International				
Asset-backed	\$ 5	0.4	\$ 7	0.3
Public Finance	208	14.1	306	13.2
Investor Owned Utilities and Other	266	18.0	351	15.1
Total International	\$ 479	32.5%	\$ 664	28.7%
Total	\$ 1,474	100.0%	\$ 2,320	100.0%

Due to rounding the numbers in the above tables may not add up to the totals.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

9. OUTSTANDING FINANCIAL GUARANTY EXPOSURE (cont'd)

Net outstanding par reinsured at December 31, 2018 and 2017, by geographic location was as follows:

(dollars in millions)	2018		2017	
	OS Par	%	OS Par	%
International	\$ 479	32.5	\$ 664	28.6
Multi-state	1	0.1	48	2.1
California	117	7.9	275	11.9
New York	41	2.8	84	3.6
Illinois	57	3.9	126	5.4
Massachusetts	197	13.4	222	9.6
Puerto Rico	132	9.0	139	6.0
Other U.S. States	450	30.5	762	32.8
Total	\$ 1,474	100.0%	\$ 2,320	100.0%

The above outstanding par amounts do not include interest, which is an additional exposure to the company and could be significant. The above outstanding par amounts are also inclusive of outstanding par on credit derivative policies. See Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives for further information on the outstanding par relating to credit derivative policies.

10. COMMUTATIONS AND OTHER SETTLEMENTS

Effective January 1, 2018, the Company entered into a Commutation, Reassumption and Release Agreement with Assured Guaranty Municipal Corp. (“AGM”). This agreement provided, among other things, for the Company to pay a \$6,000,000 net commutation payment to terminate the reinsurance with respect to a certain policy previously assumed, with par in-force of \$43.5 million (the “Released Risks”). In return, each party was released from all liabilities and obligations with respect to the Released Risks. The effect of this agreement on the Company’s results of operations was an overall loss to net income at the time of termination of \$1.6 million.

The Company entered into a Commutation, Reassumption and Release Agreement, effective July 1, 2018, with Assured Guaranty (Europe) PLC. (“AGE”). This agreement provided, among other things, for the Company to pay a \$3,575,881 net commutation payment (previously stated as \$7,056,364 net commutation payment) to terminate the reinsurance with respect to a certain policy previously assumed, with par in-force of \$121.4 million (the “Released Risks”). In return, each party was released from all liabilities and obligations with respect to the Released Risks. The effect of this agreement on the Company’s results of operations was an overall loss to net income at the time of termination of \$2.4 million.

Effective July 1, 2018, the Company entered into a Commutation, Reassumption and Release Agreement with AGM. This agreement provided, among other things, for the Company to pay a \$364,834 net commutation payment to terminate the reinsurance with respect to a certain policy previously assumed, with par in-force of \$87.9 million (the “Released Risks”). In return, each party was released from all liabilities and obligations with respect to the Released Risks. The effect of this agreement on the Company’s results of operations was an overall loss to net income at the time of termination of \$0.2 million.

AORE entered into a Commutation Agreement, effective June 30, 2017, to commute the entire portfolio of financial guaranty reinsurance business it had assumed from Assured Guaranty Corporation (“AGC”), effective upon receipt of a commutation payment to AGC (the “AGC Commutation”). The aggregate outstanding par value of the reinsurance portfolio being commuted was \$402 million as of June 30, 2017, bringing total par outstanding down to \$2,345 million

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

as of June 30, 2017, a reduction of 17% from Q1 2017. The effect of this agreement on the Company's results of operations was an overall gain to net income at the time of termination of \$1.6 million.

11. SEGMENT INFORMATION

The determination of reportable segments is based on how management monitors the Company's underwriting operations. Management monitors the performance of its underwriting operations based on the markets and customers served and the type of accounts written. The Company is currently organized into three operating segments: property/casualty insurance and reinsurance, financial guaranty and corporate/other. All product lines fall within these classifications. The property/casualty segment provides insurance and reinsurance primarily related to US short-tail personal lines. The financial guaranty segment includes AORE's financial guaranty operations which are in run-off and which the Company has no plans to re-enter. During the year ended December 31, 2018, our major customers were the following primary monoline financial guaranty insurers all owned by a common group: Assured Guaranty Corp., or "Assured Guaranty", Assured Guaranty Municipal Corp. (formerly Financial Security Assurance Inc.), or "AGM", Assured Guaranty (Europe) Ltd., or "AGE" (formerly Financial Security Assurance (U.K.) Limited) and together with AGM, "FSA". As the Company does not manage its assets by segment, investment income, interest expense and total assets are not allocated to individual reportable segments.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

11. SEGMENT INFORMATION (cont'd)

The following tables provide a summary of the segment results.

(dollars in thousands)	December 31, 2018			
	Property/Casualty	Financial Guaranty	Corporate	Total
Net premiums earned	\$ 2,361	\$ (2,576)	\$ -	\$ (215)
Net change in fair value of credit derivatives	-	75	-	75
Losses and loss adjustment expenses	(1,060)	(1,533)	-	(2,593)
Acquisition expenses	(556)	1,133	-	577
Underwriting gain (loss)	745	(2,901)	-	(2,156)
Fee income	11,470	-	-	11,470
Net investment income	-	-	2,809	2,809
Other income	-	-	532	532
Net realized gain on sales of investments	-	-	8	8
Fair value adjustment	-	-	332	332
Operating expenses	(9,278)	(3,975)	(139)	(13,392)
Interest expense	-	-	(2,191)	(2,191)
Amortization expense	-	-	-	-
Other expense	-	-	-	-
Income tax	(4)	-	-	(4)
Net income (loss) before non controlling interest	\$ 2,933	\$ (6,877)	\$ 1,351	\$ (2,592)

(dollars in thousands)	December 31, 2017			
	Property/Casualty	Financial Guaranty	Corporate	Total
Net premiums earned	\$ 3,497	\$ (1,550)	\$ -	\$ 1,947
Net change in fair value of credit derivatives	-	8,238	-	8,238
Losses and loss adjustment expenses	(3,960)	(15,823)	-	(19,783)
Acquisition expenses	(430)	(17)	-	(447)
Underwriting gain (loss)	(893)	(9,152)	-	(10,045)
Fee income	11,531	-	-	11,531
Net investment income	-	-	1,762	1,762
Other income	-	-	591	591
Net realized gain on sales of investments	-	-	154	154
Fair value adjustment	-	-	1,453	1,453
Operating expenses	(9,593)	(3,532)	(648)	(13,773)
Interest expense	-	-	(2,304)	(2,304)
Amortization expense	-	-	-	-
Other expense	-	-	-	-
Income tax	14	-	-	14
Net income (loss) before non controlling interest	\$ 1,060	\$ (12,684)	\$ 1,008	\$ (10,617)

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

12. COMMITMENTS AND CONTINGENCIES

The insurance and reinsurance subsidiaries of the Company are involved in various claims and legal actions arising in the ordinary course of business. Some claims allege breach of good faith and fair dealing; however, those entities are vigorously defending their position, and in the opinion of management, the ultimate outcome of these matters will not have a material adverse effect on the Company's financial position, results of operations or cashflows.

Future minimum lease payments as of December 31, 2018 are as follows:

2019	\$	298,655
2020	\$	302,922
2021	\$	307,188
2022	\$	311,455
2023	\$	315,721
Thereafter	\$	1,305,549

13. REDEEMABLE SERIES A PREFERENCE SHARES

On December 14, 2006, AOG issued 75,000 Series A Preference Shares at \$1,000 per share for total consideration of \$75.0 million. The Series A Preference Shares have a par value of \$0.10 per share and a redemption value of \$1,000 per share. Until December 15, 2016, the Series A Preference Shares bear a non-cumulative, non mandatory dividend rate of 7.50%, which is payable semi-annually on June 15 and December 15 each year upon declaration by the Board of Directors. After December 15, 2016, if the Series A Preference Shares have not been redeemed or repurchased, they bear a non-cumulative, non-mandatory dividend rate of Three-Month LIBOR (as defined in the Series A Certificate of Designations) plus 3.557%, which is payable quarterly on the 15th day of March, June, September and December of each year, beginning on March 15, 2017, upon declaration by the Board of Directors. Unless previously redeemed, the Series A Preference Shares have a mandatory redemption date of December 15, 2066. AOG can redeem the Series A Preference Shares at any time from December 15, 2016 with no penalty to AOG.

On May 12, 2009, the Board determined to suspend payment of dividends on the Series A Preference Shares; therefore, during the years ended December 31, 2018 and 2017, there were no dividends declared or paid. The payment of preference share dividends is classified as interest expense. On March 10, 2010, AOG completed a tender offer for the Series A Preference Shares, pursuant to which 15,300 shares, or 20.40% of the 75,000 shares previously outstanding were validly tendered. The Company accepted for purchase all such Series A Preference Shares that were validly tendered as of the applicable expiration date and paid \$3.8 million for all such Series A Preference Shares realizing a gain of \$11.5 million. On August 8, 2016, American Overseas Group commenced a tender offer for any and all of its outstanding Series A Non-Cumulative Preference Shares for cash at a price not to exceed \$200 for each \$1,000 principal liquidation amount of the Series A Shares validly tendered and accepted by the Company. In order to be purchased in the tender offer, Series A Shares were to be tendered on or before September 2, 2016, and accepted by the Company. Of the 59,700 outstanding shares, 1,100 shares were tendered for a redemption value of \$220,000.

On January 23, 2018, AOG accepted for purchase \$20 million Series A Preference Shares that were validly tendered as of the applicable expiration date and paid \$4.4 million for all such Series A Preference Shares realizing a gain of \$15.6 million. After expiration of the tender, 38,600 Series A Non-Cumulative Preference Shares remain outstanding as of December 31, 2018.

The Company is not permitted under the terms of the Series A Preference Shares to pay common share dividends or repurchase common shares unless full dividends for the latest completed dividend period on all Series A Preference Shares have been paid. The Company has no plans to liquidate, pay common share dividends or to repurchase any of its common shares.

See Note 3 for discussion of the establishment of an irrevocable trust for the benefit of holders of the Series A Preference Shares.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

14. NONCONTROLLING INTEREST

On December 23, 2003, AORE entered into a \$50.0 million soft capital facility whereby it was granted the right to exercise perpetual put options in respect of its Class B Preference Shares against the counterparty to the option agreement, in return for which it paid the counterparty a floating put option fee through February 17, 2009. The counterparty was a trust established by an investment bank. The trust was created as a vehicle for providing capital support to AORE by allowing it to obtain, at its discretion and subject to the terms of the option agreement, access to new capital through the exercise of a put option and the subsequent purchase by the trust of AORE's Class B Preference Shares. On February 17, 2009, AORE exercised the put option in the soft capital facility and issued 500.01 Class B Preference Shares to the trust in exchange for \$50,001,000 of proceeds. On March 16, 2009, AORE elected to pay a fixed rate dividend on the Class B Preference Shares, as a result of which the Class B Preference Shares were distributed to the holders of the trust's securities. As a result of the fixed rate election, if declared by the board, dividends are payable on the Class B Preference Shares every 90 days at a rate of 6.276%. The Class B Preference Shares give investors the rights of a preferred equity investor in AORE. Such rights are subordinate to insurance claims, as well as the general unsecured creditors of AORE. The Class B Preference Shares are not rated by S&P since AORE requested the withdrawal of its ratings during 2009 and have not been rated by Moody's. AORE has the option to redeem the Class B Preference Shares, subject to certain specified terms and conditions.

Following the settlement of previous repurchases, 373.01 shares of Class B Preference Shares remained outstanding at December 31, 2018 and 2017. The remaining value of the Class B Preference Shares of \$6.1 million is included as a "Noncontrolling Interest" in the Company's Consolidated Balance Sheets as of December 31, 2018 and 2017.

On July 21, 2014 AORE established an irrevocable trust (the "Class B Security Trust") for the benefit of the holders of its Class B Preference Shares. The Company deposited assets valued at \$2.050 million in the Class B Security Trust. Butterfield Trust Company has been appointed as its trustee. The Company has been authorized to redeem Class B Shares at any time for the amount that is not in excess of the Holder's pro-rata share of the assets in the Class B Security Trust.

If declared by the board, dividends are payable on the Class B Preference Shares every 90 days at a rate of 6.276%. Dividends on the Class B Preference Shares are currently non-cumulative. The terms of AORE's Class B Preference Shares restrict AORE's ability to pay dividends on its common shares unless all accrued and unpaid dividends on the Class B Preference Shares for the then current dividend period have been declared and paid or a sum sufficient for payment thereof set apart, except that AORE may to declare dividends on its common shares in such amounts as are necessary for AOG (i) to service indebtedness for borrowed money as such payments become due (or to satisfy any of its guaranty obligations made in respect of AORE or AOG) or (ii) to pay its operating expenses.

If AORE fails to pay dividends in full on the Class B Preference Shares for eighteen consecutive months then the number of members on the Board of Directors of AORE is automatically increased by two with the holders of the Class B Preference Shares having the ability to elect the two additional directors. In 2017, as a dividend had not been paid for 18 months, pursuant to the Articles of Continuance of the Company, the number of directors on the Board automatically increased by two and the holders of the Class B shares were entitled to elect directors to serve. The Company thus called a Special Meeting of the Class B shareholders for July 14, 2017. As a quorum of holders of Class B Preference Shares was not present for the meeting, no meeting was held.

There were \$0.6M and nil paid to the Class B preference shareholders in 2018 and 2017, respectively.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

15. SHARE CAPITAL

As at December 31, 2018 and 2017, authorized common share capital was \$9,000,000. As at December 31, 2018 and 2017, there were 10,000,000 authorized undesignated preference shares with a par value of \$0.10 each. Common shares and additional paid in capital are presented net of treasury shares held by the company and its subsidiaries.

The following table shows a roll forward of the issued, outstanding and unissued common shares for the years ended December 31, 2017 and 2018:

	Outstanding share capital	Outstanding Shares	Treasury Shares	Issued Shares	Unissued Shares
As at December 31, 2016	\$ 4,454,200	44,542	42	44,584	45,416
Issued restricted stock awards during the year	65,900	659	-	659	(659)
Shares issued in lieu of cash for director's fees	21,400	214	-	214	(214)
Shares issued in lieu of cash for consultant's fees	14,300	143	-	143	(143)
As at December 31, 2017	\$ 4,555,800	45,558	42	45,600	44,400
Issued restricted stock awards during the year	9,600	96	-	96	(96)
Shares issued in lieu of cash for director's fees	57,000	570	-	570	(570)
Previously awarded stock awards forfeited	(10,000)	(100)	-	(100)	100
As at December 31, 2018	\$ 4,612,400	46,124	42	46,166	43,834

16. SHARE BASED COMPENSATION

As of April 26, 2006, AOG adopted the 2006 Equity Plan (the "AOG Plan"). The number of common shares that may be issued under the AOG Plan may not exceed 4,500. In the event of certain transactions affecting the common shares of the Company, the number or type of shares subject to the AOG Plan, the number and type of shares subject to outstanding awards under the Plan, and the exercise price of awards under the AOG Plan will be adjusted in accordance with the terms of the AOG Plan. The AOG Plan authorizes the grant of share options, share appreciation rights, share awards, restricted share units, performance units, or other awards that are based on AOG's common shares. The awards granted are contingent on the achievement of service conditions during a specified period, and may be subject to a risk of forfeiture or other restrictions that will lapse upon the achievement of one or more goals relating to completion of service by the participant. Awards under the AOG Plan may accelerate and become vested upon a change in control of the Company. The AOG Plan is administered by the Board of Directors. The AOG Plan is subject to amendment or termination by the board.

As at December 31, 2018, outstanding awards under the AOG Plan consisting of 1,576 share options and 317 restricted share units had been granted to the Company's directors, officers, employees and consultants. Each of the options vest in equal annual installments over a four-year period and will expire at the earlier of the tenth anniversary of the date of grant or the expiration of the AOG Plan. The grant price is the average of the highest and lowest quoted selling price on the grant date. In 2018, there were no stock options granted. Restricted share units vest in equal annual installments over a four-year period.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION (cont'd)

Stock options

The Company has used the Black-Scholes option pricing model to estimate the fair value of stock options using the following weighted average assumptions during the period ending December 31, 2017. In 2018 there were no stock options awarded:

	<u>2017</u>
Dividend yield	0%
Expected volatility	346.00%
Risk-free interest rate	1.50%
Expected life of options (in years)	4.0
Weight-average grant-date fair value	\$ 700.00

Compensation cost is recognized on a straight-line basis over the vesting period and is net of estimated pre-vesting forfeitures of 10% for both periods. The estimated forfeiture rate is based on future forfeiture expectations. At December 31, 2018, the weighted average grant date fair value for options issued subsequent to January 1, 2006 was \$810.13. The Company expensed \$0.2 million and \$0.3 million in compensation expense related to the stock options for each of the years ended December 31, 2018 and 2017 respectively. As at December 31, 2018, there was \$0.3 million of unrecognized compensation expense related to the stock options granted subsequent to January 1, 2006, which is expected to be recognized over the weighted average remaining service period of 1.57 years. For both the twelve month periods ended December 31, 2018 and 2017, the Company recognized no compensation expense for share options with an exercise price less than the market value of the underlying common shares on the date of the grant.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION (cont'd)

The following tables summarize the stock option activity for the years ended December 31, 2018 and 2017:

Stock option activity

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value ⁽¹⁾
Year ended December 31, 2018				
Options				
Outstanding - beginning of year	1,851	\$ 817.06		
Granted	-	-		
Exercised	-	-		
Forfeited	<u>(275)</u>	-		
Outstanding - end of year	<u>1,576</u>	830.35	6.71	\$ -
Exercisable - end of year	1,044	\$ 866.03	6.20	\$ -
	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value ⁽¹⁾
Year ended December 31, 2017				
Options				
Outstanding - beginning of year	1,226	\$ 876.74		
Granted	625	700.00		
Exercised	-	-		
Forfeited	<u>-</u>	-		
Outstanding - end of year	<u>1,851</u>	817.06	7.88	\$ -
Exercisable - end of year	726	\$ 895.16	6.67	\$ -

- 1) The aggregate intrinsic value was calculated based on the market value of \$200.00 and \$263.00 as at December 31, 2018 and 2017, respectively, and is calculated as the difference between the market value and the exercise price of the underlying options.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

16. SHARE BASED COMPENSATION (cont'd)

Restricted share units

The following table summarizes the restricted share unit activity for the years ended December 31, 2018 and 2017:

Restricted Share Units

	Number of share units	Weighted average grant date fair value per share
Year ended December 31, 2018		
Restricted Share Units		
Non-vested - beginning of year	631	\$ 925.08
Granted	-	-
Vested	(183)	1,121.99
Forfeited	(131)	921.44
Non-vested - End of year	<u>317</u>	<u>\$ 812.85</u>

	Number of share units	Weighted average grant date fair value per share
Year ended December 31, 2017		
Restricted Share Units		
Non-vested - beginning of year	391	\$ 1,561.97
Granted	450	700.00
Vested	(210)	1,631.91
Forfeited	-	-
Non-vested - End of year	<u>631</u>	<u>\$ 925.08</u>

The Company expensed \$0.2 million and \$0.4 million in compensation expense related to the restricted share units for the years ended December 31, 2018 and 2017 respectively under the AOG Plan. The compensation expense for restricted share units is expensed on a prorated basis over the vesting period. At December 31, 2018, there is unrecognized compensation expense related to the non-vested restricted share units under the AOG Plan of \$0.1 million, which will be recognized over the weighted average remaining service period of 2.01 years.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

17. EARNINGS (LOSS) PER SHARE

Basic earnings per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share shows the dilutive effect of all stock options and restricted share units outstanding during the period that could potentially result in the issuance of common shares. The calculation of diluted loss per share excludes the dilutive effect of stock options and restricted share awards outstanding because it would otherwise have an anti-dilutive effect on net loss per share. The weighted average number of common and common share equivalents outstanding is calculated using the treasury stock method for all potentially dilutive securities.

As of December 31, 2018 and 2017, there were 1,576 and 1,851, respectively, of stock options excluded from the diluted earnings per share calculation because they were anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2018 and 2017:

	2018	2017
Net loss available to common shareholders	\$ (3,176,966)	\$ (10,616,717)
Basic weighted-average shares	45,965	45,444
Effect of stock options	-	-
Effect of restricted share units	-	-
Diluted weighted-average shares	45,965	45,444
Basic loss earnings per share	\$ (69.12)	\$ (233.62)
Diluted loss earnings per share	\$ (69.12)	\$ (233.62)

18. RISKS AND UNCERTAINTIES

The Company has not renewed its reinsurance treaties with any of the financial guaranty primaries or otherwise written any new financial guaranty business in 2018 or 2017. While the Company does not expect to write any new financial guaranty business, this does not reduce the Company's in-force business, unless the business matures, is terminated, is commuted, or recaptured by the primaries.

The Company continues to evaluate its financial condition and capital adequacy and may pursue a different set of strategies in the future. There can be no assurance that the strategies that have been implemented or that will be pursued in the future in connection with this evaluation will improve the Company's business, financial condition, liquidity or results of operations or will not have a material adverse effect on the Company. Management believes that the Company has sufficient capital resources and liquidity to meet its obligations for at least the next twelve months and therefore that the Company remains a "going concern."

AOG is a holding company and therefore its liquidity, both on a short-term basis (for the next twelve months) and a long-term basis (beyond the twelve months), is largely dependent upon (1) the ability of its subsidiaries to pay dividends or make other payments to AOG and (2) its ability to access debt and equity markets, which is unlikely in the near term given current market conditions and AOG's current share valuation. AOG's principal uses of liquidity are for payment of operating expenses, debt service on the senior notes payable and capital investments in its subsidiaries. As of December 31, 2018, AOG has \$1.3 million of cash and investments and believes that it will have sufficient liquidity to meet its requirements over at least the next twelve months. The subsidiaries' ability to declare and pay dividends to AOG may be influenced by a variety of factors such as adverse loss development, amount and timing of claims payments, the amounts required to be held in trust for the benefit of its ceding companies, adverse market changes, insurance regulatory changes, changes in general economic conditions beyond the next twelve months and law. The

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

Company believes that AOG's expected liquidity needs can be funded from its operating and investing cash flows for the next twelve months.

AOG's property/casualty segment generates substantial cash flows from its fee-based model. The principal uses of liquidity for those entities are the payment of operating expenses, debt service on subsidiary notes and capital investment in property/casualty subsidiaries. The property/casualty subsidiaries are highly leveraged through their reinsurance arrangements, and disputes with reinsurers could severely impact the liquidity of these subsidiaries. The property/casualty subsidiaries attempt to mitigate this exposure by holding collateral from their reinsurers. The subsidiaries held \$246.8 million of collateral compared to \$226.4 million of balances at December 31, 2017 and such amounts are included in reinsurance balances received net on the consolidated balance sheet.

At December 31, 2018, the Company had \$182.9 million of cash and investments of which \$69.7 million was held in trust for the benefit of our ceding companies, leaving \$113.22 million cash and investments available to support ongoing business. See Note 3 – Pledged Assets, for further information regarding these trust accounts. Pursuant to the terms of the treaties, losses are paid out of AORE's unrestricted cash rather than AORE's trust accounts which reduces available cash until the trust accounts are adjusted. AORE is not permitted to withdraw funds from these trust accounts without the ceding companies' express permission. The ceding companies are allowed to withdraw funds from the trust account under certain conditions as specified in the trust agreements.

Further increases in loss reserves and credit impairments would require AORE to deposit additional collateral in the applicable trust account(s) and resulting claims payments in respect of those losses and impairments would increase cash outflows and could decrease the size of AORE's investment portfolio, in turn decreasing income from investments.

The principal sources of AORE's liquidity are premiums net of acquisition expenses, scheduled investment maturities, and net investment income. The principal uses of AORE's liquidity are for the payment of operating expenses, claims, ceding commissions, and for purchases of new investments and more recently funding commutation agreements. The Company believes that AORE's expected operating liquidity needs can be funded from its operating and investing cash flows for the next twelve months. See Note 14 – Noncontrolling Interest and Note 25 – Statutory Requirements, for further information regarding AORE's ability to pay dividends.

As at December 31, 2018, the Company has reinsured \$21 million of par exposures that have been written by ceding companies as credit default contracts rather than financial guaranty insurance policies. Traditional financial guaranty insurance provides an unconditional and irrevocable guaranty of payment to the holder of a municipal finance or structured finance obligation of principal and interest on that obligation in the event of a non-payment by the issuer. In contrast, credit derivatives provide protection from the occurrence of specified credit events, which frequently include non-payment of principal and interest ("failure to pay"), but may also include other terms such as settlement of individual referenced collateral losses in excess of policy specific deductibles or subordination amounts. The credit derivatives that protect against failure to pay usually have settlement terms that require the ceding company to pay interest and principal shortfalls as they occur (referred to as "pay-as-you-go"). The Company may be deemed to have assumed reinsurance on credit derivative exposures that have other than "pay-as-you-go" terms. Although the Company considers the occurrence of such payments to be unlikely, the Company is at risk of unanticipated loss payments under insured credit derivative policies that could have an adverse effect on the Company's liquidity. Further, the ceding companies write credit derivatives that are governed by standard International Swaps and Derivatives Association ("ISDA") documentation which can include various events of default related to the primary insurer itself, such as insolvency of or a failure to pay by the primary insurer on any credit derivative with a particular counterparty, which would not typically trigger a payment obligation under traditional financial guaranty. If a credit derivative (or group of credit derivatives) is terminated upon an event of default, the primary could be required to make a mark-to-market payment(s) as determined under the ISDA documentation. While the Company does not believe that its reinsurance contracts obligate it to indemnify the primary insurers for mark-to-market payments resulting from their default under the ISDA documentation, the primary insurer or its regulator may allege that the Company is liable for its pro rata share of such payments and withdraw funds to pay such claims from the trust account for the benefit of that primary insurer.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

The underwriting of insured risks and the reporting of underwriting results to the Company are the responsibility of the primary insurers under the treaties. The Company leverages and relies on the operations and reporting of the primary insurers. As a result of this model, the Company is highly dependent on the operating and reporting of the ceding companies. The ceding companies often use complex financial models, which have been internally developed, to produce their results. The Company performs its own assessment of the reasonableness of the information provided by ceding companies (See Note 6 – Financial Guaranty Contracts Accounted for as Credit Derivatives, Note 5 - Financial Guaranty Policies Accounted for as Reinsurance and Note 8 – Losses and Loss Expense Reserve, for details of the work completed by the Company on this information). However, depending on the nature of the information provided by the ceding company, the Company may not be able to identify errors in the reported information in the period in which it is reported, which may be material, as indicated by corrections of errors in primary reported information in prior period financial statements.

Exposure to Puerto Rico

The Company has reinsured exposure to general obligation bonds of the Commonwealth of Puerto Rico and various obligations of its related authorities and public corporations aggregating \$126.2 million and \$132.4 million par outstanding as of December 31, 2018 and 2017 respectively, all of which are rated below investment grade (“BIG”). The Company believes its exposure to Puerto Rico entities represents the largest risk the Company faces for the next several years. The Company’s largest Puerto Rico exposures are to bonds issued by Puerto Rico Highway and Transportation Authority (“PRHTA”) and Municipal Finance Authority (“MFA”) in the amounts of \$91.5 million and \$30.7 million, respectively, at December 31, 2018. Beginning on January 1, 2016, a number of Puerto Rico credits have defaulted on bond payments.

Puerto Rico has experienced significant general fund budget deficits in recent years. These deficits, until recently, were covered primarily with the net proceeds of bond issuances, interim financings provided by Government Development Bank for Puerto Rico (“GDB”) and, in some cases, one-time revenue measures or expense adjustment measures. In addition to high debt levels, Puerto Rico faces a challenging economic environment.

On November 30, 2015, and December 8, 2015, Governor Garcia Padilla (“the Former Governor”) issued executive orders (“Clawback Orders”) directing the Puerto Rico Department of Treasury and the Puerto Rico Tourism Company to retain or transfer certain taxes and revenues pledged to secure the payment of bonds issued by PRHTA, Puerto Rico Infrastructure Financing Authority (“PRIFA”) and Puerto Rico Convention Center District Authority (“PRCCDA”). On January 7, 2016, Assured Guaranty Ltd. and subsidiaries (“Assured”), the entities ceding Puerto Rico exposures to the Company, sued various Puerto Rico governmental officials in the United States District Court, District of Puerto Rico asserting that this attempt to “claw back” pledged taxes and revenues is unconstitutional, and demanding declaratory and injunctive relief. The Puerto Rico credits reinsured by the Company impacted by the Clawback Orders are shown in the table “Puerto Rico Par Outstanding” below.

On June 30, 2016, PROMESA was signed into law by the President of the United States. PROMESA establishes a seven-member federal financial oversight board (“Oversight Board”) with authority to require that balanced budgets and fiscal plans be adopted and implemented by Puerto Rico. PROMESA provides a legal framework under which the debt of the Commonwealth and its related authorities and public corporations may be voluntarily restructured, and grants the Oversight Board the sole authority to file restructuring petitions in a federal court to restructure the debt of the Commonwealth and its related authorities and public corporations if voluntary negotiations fail, provided that any such restructuring must be in accordance with an Oversight Board approved fiscal plan that respects the liens and priorities provided under Puerto Rico law. PROMESA also appears to preempt at least portions of the Moratorium Act and to stay debt-related litigation, including Assured’s litigation regarding the Clawback Orders.

Judge Laura Taylor Swain of the Southern District of New York was selected by Chief Justice John Roberts of the United States Supreme Court to preside over any legal proceedings under PROMESA. Judge Swain has selected a team of five federal judges to act as mediators for certain issues and disputes.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

In May and July 2017 the Oversight Board filed petitions under Title III of PROMESA with the Federal District Court of Puerto Rico for the Commonwealth, the Puerto Rico Sales Tax Financing Corporation (COFINA), PRHTA, and Puerto Rico Electric Power Authority (PREPA). Title III of PROMESA provides for a process analogous to a voluntary bankruptcy process under chapter 9 of the United States Bankruptcy Code (Bankruptcy Code).

The Commonwealth released fiscal plans for itself and for a number of its authorities and public corporations, and in response to notices of violation from the Oversight Board and the enactment of a significant federal disaster relief package by the U.S. Congress, Puerto Rico released one or more revised fiscal plans for the Commonwealth and a number of its authorities and public corporations. The most recent fiscal plans submitted by the Commonwealth for PRHTA and PREPA were released on April 5, 2018. The Commonwealth and the Oversight Board did not agree on final fiscal plans, and on April 18 and April 19, 2018, the Oversight Board released its own versions of fiscal plans for the PRHTA and PREPA, which it certified on April 19 or 20, 2018. The Commonwealth's most recent fiscal plan for itself was certified by the oversight Board on May 9, 2019. The current governor of Puerto Rico (Governor) has announced that he will refuse to implement certain aspects of the fiscal plans certified by the Oversight Board.

On May 23, 2018, Assured filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment declaring that (i) the Oversight Board lacked authority to develop or approve the new fiscal plan for Puerto Rico which it certified on April 19, 2018 (Revised Fiscal Plan); (ii) the Revised Fiscal Plan and the Fiscal Plan Compliance Law (Compliance Law) enacted by the Commonwealth to implement the original Commonwealth Fiscal Plan violate various sections of PROMESA; (iii) the Revised Fiscal Plan, the Compliance Law and various moratorium laws and executive orders enacted by the Commonwealth to prevent the payment of debt service (a) are unconstitutional and void because they violate the Contracts, Takings and Due Process Clauses of the U.S. Constitution and (b) are preempted by various sections of PROMESA; and (iv) no Title III plan of adjustment based on the Revised Fiscal Plan can be confirmed under PROMESA. On August 13, 2018, the court-appointed magistrate judge granted the Commonwealth's and the Oversight Board's motion to stay this adversary proceeding pending a decision by the First Circuit in an appeal by Ambac Assurance Corporation of an unrelated adversary proceeding decision, which may resolve certain similar issues.

On July 23, 2018, Assured filed an adversary complaint in the Federal District Court for Puerto Rico seeking a judgment (i) declaring the members of the Oversight Board are officers of the U.S. whose appointments were unlawful under the Appointments Clause of the U.S. Constitution; (ii) declaring void from the beginning the unlawful actions taken by the Oversight Board to date, including (x) development of the Commonwealth's Fiscal Plan, (y) development of PRHTA's Fiscal Plan, and (z) filing of the Title III cases on behalf of the Commonwealth and PRHTA; and (iii) enjoining the Oversight Board from taking any further action until the Oversight Board members have been lawfully appointed in conformity with the Appointments Clause of the U.S. Constitution. The Title III court dismissed a similar lawsuit filed by another party in the Commonwealth's Title III case in July 2018. On August 3, 2018, a stipulated judgment was entered against Assured at their request based upon the court's July decision in the other Appointments Clause lawsuit and, on the same date, Assured appealed the stipulated judgment to the First Circuit. On August 15, 2018, the court consolidated, for purposes of briefing and oral argument, Assured's appeal with the other Appointments Clause lawsuit. The First Circuit consolidated Assured's appeal with a third Appointments Clause lawsuit on September 7, 2018 and held a hearing on December 3, 2018. On February 15, 2019, the First Circuit issued its ruling on the appeal and held that members of the Oversight Board were not appointed in compliance with the Appointments Clause of the U.S. Constitution but declined to dismiss the Title III petitions citing the (i) de facto officer doctrine and (ii) negative consequences to the many innocent third parties who relied on the Oversight Board's actions to date, as well as the further delay which would result from a dismissal of the Title III petitions. The case was remanded back to the Federal District Court for Puerto Rico for the appellants' requested declaratory relief that the appointment of the board members of the Oversight Board is unconstitutional. The First Circuit delayed the effectiveness of its ruling for 90 days so as to allow the President and the Senate to validate the currently defective appointments or reconstitute the Oversight Board in accordance with the Appointments Clause. On April 23, 2019, the Oversight Board filed a petition for review of the decision by the U.S. Supreme Court and on the following day filed a motion in the First Circuit to further stay the effectiveness of the First Circuit's February 15, 2019 ruling pending final disposition by the U.S. Supreme Court. On May 6, 2019, the First Circuit denied the request to stay the effectiveness of its ruling pending final disposition by the U.S. Supreme Court and instead extended the stay of the effectiveness of its ruling to July 15, 2019.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

On January 14, 2019 the Oversight Board and the Official Committee of Unsecured Creditors filed an omnibus objection in the Title III Court to claims filed by holders of approximately \$6 billion of Commonwealth general obligation bonds issued in 2012 and 2014, asserting among other things that such bonds were issued in violation of the Puerto Rico constitutional debt service limit, such bonds are null and void, and the holders have no equitable remedy against the Commonwealth. The Company has no reinsurance exposure to any of the Commonwealth general obligation bonds issued in 2012 or thereafter.

The Company's Puerto Rico exposure is through bonds issued by PRHTA, MFA, PREPA, and general obligation ("GO").

PRHTA

As of December 31, 2018 and 2017, the Company had \$30.5 million reinsured net par outstanding of PRHTA (Transportation revenue) bonds and \$61.0 million net par of PRHTA (Highway revenue) bonds. The Company has recorded reserves of \$44.3 million as of December 31, 2018 related to this exposure. As of December 31, 2017, the recorded reserves for PRHTA exposures were \$47.5 million. PRHTA is one of the public corporations affected by the Clawback Orders.

The Transportation revenue bonds are secured by a subordinate gross pledge of gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls, plus a first lien on up to \$120 million annually of taxes on crude oil, unfinished oil and derivative products. The Highway revenue bonds are secured by a gross pledge of gasoline and gas oil and diesel oil taxes, motor vehicle license fees and certain tolls. The Clawback Orders cover Commonwealth-derived taxes that are allocated to PRHTA. The PRHTA bonds are subject to executive orders issued pursuant to the Moratorium Act.

Despite the presence of funds in relevant debt service reserve accounts that the Company believes should have been employed to fund debt service, PRHTA defaulted on the full July 1, 2017 insured debt service payment, and the Company has been making claim payments related to these bonds since that date. The Oversight Board filed a petition under Title III of PROMESA with respect to PRHTA.

On June 29, 2018, the Oversight Board certified a revised fiscal plan for PRHTA. The revised certified PRHTA fiscal plan projects very limited capacity to pay debt service over the six-year forecast period.

MFA

As of December 31, 2018 and 2017, the Company had \$30.7 million and \$36.9 million, respectively, net par outstanding of bonds issued by MFA and secured by a pledge of local property tax revenues. The Company has recorded reserves of \$1.6 million as of December 31, 2018 related to this exposure. As of December 31, 2017, the recorded reserves for MFA exposures were \$1.5 million.

The MFA is a public corporation and governmental instrumentality of the Commonwealth, created to allow the municipalities of Puerto Rico to access the capital markets so they can finance public improvement programs more effectively. The MFA bonds are payable from the MFA's revenues and any money appropriated or transferred to the MFA by the Commonwealth. Revenues are derived mainly from payments on municipal bonds purchased by the MFA from PR municipalities. The municipal bonds are primarily backed by a statutory first lien on property taxes collected, without limitation as to rate or amount, on all taxable property within the issuing municipalities. The good faith, credit and unlimited taxing power of each issuing municipality is pledged for the payment of its general obligation municipal bonds and notes. Property taxes are collected directly in a lock-box by a separate municipal agency called the Municipal Revenue Collection Center created on behalf of the Commonwealth's municipalities.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

18. RISKS AND UNCERTAINTIES (cont'd)

In addition to the property tax revenue, the bonds are supported by Commonwealth appropriations of matching equalization funds. The bondholders are also protected by a reserve fund that is funded through revenue collections up to a formula-based amount. The MFA's Enabling Act provides that the Commonwealth shall annually apportion and pay to the Agency such sum as shall be necessary to maintain the reserve account in the required amount. The payment of such sum by the Commonwealth is subject to appropriation by the Legislature of Puerto Rico, which appropriation is authorized but not legally required to be made (the "Moral Obligation Pledge"). The Moral Obligation Pledge has never been drawn upon.

PREPA

As of December 31, 2018 and 2017, the Company had \$3.5 million reinsured net par outstanding of PREPA obligations which are payable from a pledge of net revenues of the electric system. The Company has recorded reserves of \$1.0 million as of December 31, 2018 related to this exposure. As of December 31, 2017, the recorded reserves for PREPA exposures were \$1.1 million.

On December 24, 2015, PREPA, Assured, an ad hoc group of uninsured bondholders and a group of fuel-line lenders entered into a Restructuring Support Agreement (RSA) with PREPA that would, subject to certain conditions, result in, among other things, modernization of the utility and a restructuring of current debt. Upon finalization of the contemplated restructuring transaction, insured PREPA revenue bonds (with no reduction to par or stated interest rate or extension of maturity) will be supported by securitization bonds issued by a special purpose corporation and secured by a transition charge assessed on ratepayers. Legislation meeting the requirements of the original RSA was enacted on February 16, 2016, and a transition charge to be paid by PREPA rate payers for debt service on the securitization bonds as contemplated by the RSA was approved by the Puerto Rico Energy Commission on June 20, 2016.

The Oversight Board did not certify the RSA under Title VI of PROMESA as the Company believes was required by PROMESA, but rather, on July 2, 2017, commenced proceedings for PREPA under Title III of PROMESA. The Company has been making claim payments on these bonds since July 1, 2017. On August 1, 2018, the Oversight Board certified a revised fiscal plan for PREPA.

The Company's exposure to PREPA was ceded to it by Assured. On May 3, 2019, Assured entered into a restructuring support agreement (PREPA RSA) with PREPA and other stakeholders, including a group of uninsured PREPA bondholders, the Commonwealth of Puerto Rico, and the Oversight Board, that is intended to, among other things, provide a framework for the consensual resolution of the treatment of Assured's insured PREPA revenue bonds in PREPA's recovery plan. Upon consummation of the restructuring transaction, PREPA's revenue bonds will be exchanged into new securitization bonds issued by a special purpose corporation and secured by a segregated transition charge assessed on electricity bills. The closing of the restructuring transaction is subject to a number of conditions, including approval by the Title III Court of the PREPA RSA and settlement described therein, a minimum of 67% support of voting bondholders for a plan of adjustment that includes this proposed treatment of PREPA revenue bonds and confirmation of such plan by the Title III court, and execution of acceptable documentation and legal opinions. Under the PREPA RSA, Assured has the option to guarantee its allocated share of the securitization exchange bonds, which may then be offered and sold in the capital markets. Assured believes that the additive value created by attaching its guarantee to the securitization exchange bonds would materially improve its overall recovery under the transaction, as well as generate new insurance premiums; and therefore that its economic results could differ from those reflected in the PREPA RSA. Management is still assessing the impact of the bonds to the Company.

The following table shows the Company's insured exposure to general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

Puerto Rico
Par Outstanding

	As of December 31, 2018	As of December 31, 2017
	(in millions)	
PRHTA (Highway revenue)	\$ 61.0	\$ 61.0
PRHTA (Transportation revenue)	30.5	30.5
PRHTA Total - subject to potential Clawback	91.5	91.5
 MFA	 30.7	 36.9
 PREPA	 3.5	 3.5
 GO	 0.5	 0.5
 Total exposure to Puerto Rico	\$ 126.2	\$ 132.4

The following table shows the scheduled amortization of the AORE insured general obligation bonds of Puerto Rico and various obligations of its related authorities and public corporations. AORE reinsures payments of interest and principal when those amounts are scheduled to be paid and cannot be required to pay on an accelerated basis. In the event that obligors default on their obligations, the Company would only be required to pay the shortfall between the principal and interest due in any given period and the amount paid by the obligors.

**Amortization Schedule of Puerto Rico Par Outstanding
and Debt Service Outstanding
As of December 31, 2018**

	Scheduled Par Amortization	Scheduled Debt Service Amortization
	(in millions)	
2019 (January 1 - March 31)	\$ -	\$ 3.2
2019 (April 1 - June 30)	-	-
2019 (July 1 - September 30)	8.4	11.6
2019 (October 1 - December 31)	-	-
Subtotal 2019	8.4	14.8
2020	4.4	10.4
2021	3.4	9.2
2022	37.0	42.6
2023-2028	9.3	26.9
2028-2032	25.7	39.3
2033-2038	38.0	43.9
Total	\$ 126.2	\$ 187.0

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

19. VARIABLE INTEREST ENTITIES

OACM is a mutual insurance company that is owned by its policyholders; however, the Company effectively has complete control over OACM through the management contract in place between the two entities, and is therefore the primary beneficiary. The Company has determined that OACM is a variable interest entity and is included in these consolidated financial statements. The interests that OACM's policyholders have in its financial position are included as non-owned interest in VIE totaling \$0.3 million at December 31, 2018 and December 31, 2017.

Creditors have no recourse against the Company in the event of default by OACM nor does the Company have any implied or unfunded commitments to OACM. The Company's financial or other support provided to OACM is limited to its management services and original investment.

The following OACM balances have been included in the Company's consolidated financial statements at December 31, 2018 and 2017 with appropriate eliminations being made for intercompany balances:

	2018	2017
ASSETS:		
Cash	\$ 19,448,765	\$ 8,779,511
Investments	40,621,477	40,030,018
Premiums receivable	75,384,930	77,530,371
Reinsurance balances receivable	321,568,144	340,059,082
Other assets	368,357	317,474
	\$ 457,391,673	\$ 466,716,456
LIABILITIES:		
Unpaid losses and loss adjustment expenses	\$ 192,108,841	\$ 215,252,570
Unearned premium	110,066,129	104,849,493
Ceded premium payable	93,478,550	94,343,312
Payable to general agents	1,069,214	936,824
Funds withheld	54,411,291	44,857,396
Accounts payable and accrued expenses	538,184	739,267
Due to parent and affiliates	789,773	803,540
	\$ 452,461,982	\$ 461,782,402
EQUITY:		
Policyholders' surplus	\$ 300,000	\$ 300,000
Surplus debenture	4,700,000	4,700,000
Accumulated other comprehensive loss	(70,309)	(65,946)
	\$ 4,929,691	\$ 4,934,054
Total Liabilities and Equity	\$ 457,391,673	\$ 466,716,456

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

20. BUSINESS CONCENTRATION

The Company's property casualty insurance subsidiaries, OACM and Old American Indemnity Company ("OA Indemnity"), produce business through unrelated managing general agencies. In 2018, four of these managing general agencies produced approximately 55.3% of OACM's gross premium writings and 55.2% of the Company's gross written premiums plus policy fees. In 2018, one managing general agent produced approximately 100.6% of OA Indemnity's gross premium writings and less than 1% of the Company's gross written premiums plus policy fees.

21. GOODWILL AND INTANGIBLE ASSETS

The Company performs its impairment analysis of goodwill and indefinite-lived intangible assets annually as of December 31.

In conjunction with the acquisition of OA Indemnity in 2010, the Company recorded intangible assets of \$300,000, representing the fair value of six insurance licenses acquired. The impairment analysis for this indefinite-lived intangible asset is performed on the licenses aggregated as a single unit of accounting. The fair value is determined by comparing the fair value of insurance company licenses based on observable inputs. Based upon the results of the assessment, the Company concluded that the carrying value of this intangible asset was not impaired as of December 31, 2018.

In conjunction with the acquisition of OACM in 2012, the Company recorded intangible assets and goodwill. The impairment analysis for the indefinite-lived asset of \$4,500,000 associated with the insurance license acquired was performed on this license as a unit of accounting separate from the insurance licenses of OA Indemnity. The fair value is determined by comparing the fair value of insurance company licenses, with the underlying assumption that OACM's license continues to represent the value of multiple insurance licenses due to its unique ability to operate under multiple rate filing structures within a single state. Based on the number of active managing agencies using multiple rate filings in OACM, the Company concluded that the carrying value of this intangible asset was not impaired as of December 31, 2018.

The impairment analysis was performed on OACM as the reporting unit. The fair value was determined using a discounted cash flow analysis for the revenues and operating expenses associated with this reporting unit. The fair value was compared to the carrying value of the goodwill and intangible assets net of accumulated amortization, and the fair value exceeded the carrying value of those items. Accordingly, it was determined that the carrying value of goodwill was not impaired as of December 31, 2018.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

21. GOODWILL AND INTANGIBLE ASSETS (cont'd)

The gross and net carrying amounts of intangible assets by major category as of December 31, 2018 and 2017 are as follows:

	<u>Gross</u>	<u>Accumulated Amortization</u>	<u>Net</u>
As of December 31, 2018			
Insurance licenses	\$ 4,800,000	\$ -	\$ 4,800,000
Customer relationships	12,100,000	12,100,000	-
Internally developed software	<u>350,000</u>	<u>350,000</u>	<u>-</u>
Intangible assets	<u>\$ 17,250,000</u>	<u>\$ 12,450,000</u>	<u>\$ 4,800,000</u>
As of December 31, 2017			
Insurance licenses	\$ 4,800,000	\$ -	\$ 4,800,000
Customer relationships	12,100,000	12,100,000	-
Internally developed software	<u>350,000</u>	<u>350,000</u>	<u>-</u>
Intangible assets	<u>\$ 17,250,000</u>	<u>\$ 12,450,000</u>	<u>\$ 4,800,000</u>

Insurance licenses are not amortized because they have an indefinite life. Finite-lived intangible assets are amortized over their respective useful lives. Customer relationships are amortized to align with the expected economic benefit of the income associated with those relationships, through 2015. Internally developed software is amortized on a straight-line basis over its useful life of 3 years. The management contract will expire on January 1, 2036. Unless renewed, the Company will not own the rights to manage OACM after that date.

22. NOTES PAYABLE

Prior to the amalgamation a subsidiary of OGL had outstanding debt (the "OACC Notes") which was renegotiated in connection therewith. The subsidiary issued a Senior Secured Note in the amount of \$20 million, which was to mature on October 28, 2039 (the "2014 OACC Notes"). Interest on the 2014 OACC Notes was payable in quarterly installments at a fixed rate of 12.0% per annum

In 2015, a partial repayment of \$1.6 million of principal was made on the 2014 OACC Notes and a series of new Series A Secured Senior Notes (the "2015 OACC Notes") were issued to replace and superseded the note that had been previously issued. The notes will mature on January 1, 2040 and pay interest in quarterly installments at a fixed rate of 12.0% per annum. Principal repayments of nil were made in 2018 and 2017, respectively, on the 2015 OACC Notes. As of December 31, 2018, \$0.3 million in interest was accrued and unpaid on the \$10.5 million remaining balance of the 2015 OACC Notes.

In connection with the acquisition of OGL, AOG issued \$43.9 million of Senior Notes (the "AOG Notes") to the former shareholders of OGL that mature on October 28, 2039. Interest on the AOG notes is payable in quarterly installments at a fixed rate of 9.0% per annum. Principal repayments of nil million and \$3.0 million were made in 2018 and

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

22. NOTES PAYABLE (cont'd)

2017, respectively, on the AOG Notes. As of December 31, 2018, \$0.1 million in interest was accrued and unpaid on the remaining balance of \$6.0 million on the AOG Notes.

Directors and members of their respective families held notes payable in the aggregate principal amount of approximately \$8.6 million at December 31, 2018.

In 2018, AOG issued a \$3.0 million promissory note to AORE at a 6% interest rate. As of December 31, 2018 the remaining balance is \$1.5 million and nil in accrued interest.

23. TAXATION

The Company has received an undertaking from the Bermuda government exempting it from all local income, withholding and capital gains taxes until March 31, 2035. At the present time, no such taxes are levied in Bermuda.

In September 2014, AOG and OGL each became tax resident in the U.K., although they will both remain Bermuda-based companies. As companies that are not incorporated in the U.K., each intends to manage their affairs in such a way as to establish and maintain status as tax resident in the U.K. As U.K. tax resident companies, both AOG and OGL are required to file corporation tax returns with Her Majesty's Revenue & Customs ("HMRC"). Each is subject to U.K. corporation tax in respect of its worldwide profits (both income and capital gains), subject to any applicable exemptions. The main rate of corporation tax is 20% currently; such rate fell from 21% as of April 1, 2015. The Company does not expect that AOG's or OGL's becoming U.K. tax resident will result in any material change in the group's overall tax charge. The Company expects that the dividends received by AOG or OGL from their direct subsidiaries will be exempt from U.K. corporation tax due to the exemption in section 931D of the U.K. Corporation Tax Act 2009. In addition, any dividends paid by AOG to its shareholders should not be subject to any withholding tax in the U.K. The U.K. government implemented a new tax regime for "controlled foreign companies" ("CFC regime") effective January 1, 2013. The Company does not expect any profits of non-U.K. resident members of the group to be taxed under the CFC regime.

AORE is registered as an Exempt Insurance Company carrying on general insurance business in accordance with the provisions of the Barbados Exempt Insurance Act 1983 ("Exempt Insurance Act"). AORE, as an Exempt Insurance Company, has received an undertaking exempting it from corporate taxation for the first fifteen financial years, commencing with 2013. After the first fifteen financial years AORE will be subject to corporate tax of 2% on the first \$0.13 million of its profits and 0% on any excess. AORE is further exempt from all other direct or indirect Barbados taxes on its profits and transfers of assets and securities, withholding taxes on dividends, interest or other returns payable to its shareholders.

We believe that our non-US companies are not engaged in trade or business in the U.S. and, accordingly, we do not expect those companies to be subject to U.S. taxation; however, certain of its subsidiaries are subject to U.S. taxation. Certain of its subsidiaries file a consolidated U.S. federal income tax return.

The provision for income taxes for the years ended December 31, consisted of the following:

	2018	2017
Current tax expense	\$ -	\$ -
Deferred tax expense	4,200	(13,650)
Net income tax expense	<u>\$ 4,200</u>	<u>\$ (13,650)</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

23. TAXATION (cont'd)

The expected tax provisions in taxable jurisdictions is calculated as the sum of pretax income in those jurisdictions multiplied by the statutory tax rate of the jurisdiction by which it will be taxed. Pretax income of the Company's subsidiaries which are not U.S. domiciled but are subject to U.S. tax by election are included at the U.S. statutory tax rate of 21% for 2018 and 35% for 2017.

	2018	2017
Net (loss) income before income tax	\$ (2,587,513)	\$ (10,630,365)
Adjustment for non-taxable entities	<u>6,815,120</u>	<u>12,668,268</u>
Taxable income before income tax expense	\$ 4,227,607	\$ 2,037,903
Expected tax benefit at statutory rates in taxable jurisdictions	887,797	427,960
Increases (reductions) in taxes resulting from:		
Exclusion of profit from VIE not included in consolidated		
Valuation allowance	(661,551)	(5,721,726)
Other	<u>(222,046)</u>	<u>5,280,116</u>
Income tax (benefit)/expense	<u>\$ 4,200</u>	<u>\$ (13,650)</u>
Effective tax rate	<u>0%</u>	<u>0%</u>

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

23. TAXATION (cont'd)

Tax effects of temporary differences that give rise to significant portions of the Company's deferred tax assets and deferred tax liabilities at December 31, 2018 and 2017 were as follows:

	2018	2017
Deferred tax assets:		
Net operating loss carryforward	\$ 3,871,612	\$ 3,848,400
Unearned premium reserves	30,793	(5,110)
Discounted unpaid losses and loss adjustment expenses	12,004	19,893
Goodwill and other intangible assets	<u>-</u>	<u>-</u>
 Total deferred tax assets	 <u>3,914,409</u>	 <u>3,863,183</u>
 Deferred tax liabilities:		
Deferred acquisition costs	33,892	21,115
Intangible Assets with permanent differences	<u>2,145,675</u>	<u>1,441,475</u>
	2,179,567	1,462,590
 Deferred tax assets, net, before valuation allowance	 1,734,842	 2,400,593
Valuation allowance	<u>(1,770,017)</u>	<u>(2,431,568)</u>
 Deferred tax liabilities, net	 <u>\$ (35,175)</u>	 <u>\$ (30,975)</u>

As of December 31, 2018, the Company had net operating loss carry forwards of \$18,436,245 the expiration of which is as follows:

2032		\$ 642,809
2033		\$ 8,173,931
2034		\$ 8,257,850
2035		\$ 206,117
2036		\$ 192,701
2037		\$ 962,837

As of December 31, 2018 and 2017, the Company has no tax positions for which management believes a provision for uncertainty is necessary. The Company's U.S. federal income tax returns for all tax years are subject to examination by the Internal Revenue Service.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

24. REINSURANCE

The Company has various quota share reinsurance agreements with reinsurers. The Company remains liable to its policyholders for all of its policy obligations and the reinsuring companies are obligated to the Company to the extent of the reinsured portion of the risks. Balances are presented gross of the reinsurance agreements in the accompanying consolidated financial statements.

Due to the nature of the OACM's reinsurance programs, a concentration of credit risk exists with four reinsurers that have net balances due in excess of 5% of OACM's total receivable balances in 2018. These four reinsurers account for approximately 91% of the total net recoverable from reinsurers, and 91% for 2017. OACM reinsures substantially all of its business, and monitors the credit quality of its reinsurers to ensure that its cessions are to financially sound reinsurers. Collateral which includes funds held in trust and letters of credit are obtained both to satisfy regulatory requirements for reinsurers not authorized, and to address the Company's credit concerns related to less highly rated reinsurers. 60% of the reinsurance balances OACM ceded as of December 31, 2018 were to reinsurers rated A or better. Substantially all of the balances ceded to reinsurers rated less than A are collateralized. During 2018 and 2017, OACM obtained collateral totaling \$239.8 million and \$219.3 million respectively, to offset the overall reinsurance credit risk. If the counterparties to these reinsurance contracts completely failed to perform under these contracts, which management believes is a remote possibility, the potential loss to the Company is the amount of the uncollateralized reserves for losses and loss adjustment expenses, reinsurance recoverable, and unearned premium net of reinsurance payable, which is approximately \$86.5 million as of December 31, 2018 as compared to \$86.0 million for 2017.

With OA Indemnity's reinsurance programs, a concentration of credit risk exists with three reinsurers that have net balances due in excess of 5% of OA Indemnity's total receivable balances in 2018. These three reinsurers account for approximately 100% of the total net recoverable from reinsurers, and 100% for 2017. During 2018, OA Indemnity obtained collateral and letters of credit totaling \$6.5 million to offset the overall reinsurance credit risk. If the counterparties to these reinsurance contracts completely failed to perform under these contracts, which management believes is a remote possibility, the potential loss to the Company is the amount of the uncollateralized reserves for losses and loss adjustment expenses, reinsurance recoverable, and unearned premium net of reinsurance payable, which is approximately \$1.0 million as of December 31, 2018 as compared to \$0.8 million for 2017.

25. STATUTORY REQUIREMENTS

Each of the Company's insurance companies' ability to pay dividends depends, among other things, upon their financial condition, results of operations, cash requirements, compliance with rating agency requirements, and is also subject to restrictions contained in the insurance laws and related regulations of their state of domicile and other states. Financial statements prepared in accordance with accounting practices prescribed or permitted by local insurance regulatory authorities differ in certain respects from GAAP.

The Company's U.S. domiciled insurance companies are subject to risk-based capital standards and other minimum and capital and surplus requirements. The Company's U.S. domiciled insurance companies prepare statutory financial statements in accordance with accounting practices prescribed or permitted by the National Association of Insurance Commissioners ("NAIC") and their respective insurance departments. Prescribed statutory accounting practices are set forth in the NAIC Accounting Practices and Procedures Manual. The Company has no permitted accounting practices on a statutory basis. OA Indemnity is subject to NAIC risk based capital standards and other minimum capital and surplus requirements, including the laws of Kentucky. Kentucky laws provide that without prior approval of its domiciliary commissioner, dividends to shareholders may not be paid except out of the part of surplus funds which is derived from realized net profits. Surplus funds for the purposes of this calculation are defined as the excess of assets over liabilities, including capital stock as a liability. There are no other restrictions placed on the portion of OA Indemnity's profits that may be paid as ordinary dividends to its shareholder. As of December 31, 2018, OA Indemnity had statutory capital and surplus of \$9.6 million, which was in excess of any risk-based capital levels that would require corrective actions. As a Texas county mutual, OACM is not subject to NAIC risk based capital provisions. The minimum required capital and surplus of OACM is \$5 million as provided by Texas insurance law, which is the amount of capital and surplus of the entity as of December 31, 2018.

AMERICAN OVERSEAS GROUP LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

25. STATUTORY REQUIREMENTS (cont'd)

The Company's Barbados domiciled insurance companies are required to maintain a minimum level of solvency under the Barbados Exempt Insurance Act 1983 (the "Exempt Insurance Act"). For the purpose of compliance with the solvency criteria under the Exempt Insurance Act, assets and liabilities are calculated in accordance with US GAAP. The Barbados domiciled insurance companies also must comply with the provisions of the Barbados Companies Act regulating the payment of dividends and making of distributions from contributed surplus. A company is prohibited from declaring or paying a dividend, 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 stated capital. The excess of AORE's assets over the aggregate of its liabilities and stated capital at December 31, 2018 was \$40.0 million. The minimum required solvency margin for AORE was \$1.1 million at December 31, 2018. The excess of the Company's other Barbados domiciled insurance companies' assets over the aggregate of their liabilities and stated capital was \$3.6 million. The minimum required solvency margin for those entities was \$0.6 million.

AOG must comply with the provisions of the Bermuda Companies Act regulating the payment of dividends and making of distributions from contributed surplus. A company is prohibited from declaring or paying a dividend, or making a distribution out of contributed surplus, 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 its liabilities. The Board of Directors of AOG will evaluate any dividends in accordance with this test (and any other restrictions as discussed in Note 14 – Non-controlling interest) at the time such dividends are declared.

26. SUBSEQUENT EVENTS

Subsequent events have been evaluated through June 5, 2019, which is the date the financial statements were issued.

AORE is registered as an Exempt Insurance Company and is licensed under the Exempt Insurance Act of Barbados, 1983 CAP 308. Effective January 1, 2019 the Exempt Act will be repealed, and the Insurance Act Cap. 310 will be amended to provide for, inter alia, three (3) classes of licenses under which all insurance entities will be classified and regulated.

Insurance entities will be assigned one of two classes below depending on whether they underwrite third of related part risks and the percentage of related party risk they can underwrite.

- Class 1 category will include insurance companies which restrict the business they can underwrite to related party business. These insurance entities will be taxed at zero percent.
- Class 2 category will include insurance entities which can underwrite risks of third parties. These companies will be taxed at a rate of 2%.
- Class 3 will include insurance intermediaries, insurance management companies and insurance holding companies. These companies will be taxed at a rate of 2%.

Companies licensed as Exempt Insurance Companies prior to October 17, 2017 can exercise the option to be grandfathered under the existing regime of transition to the new regime. A company can opt to be grandfathered until June 30, 2021 but at any time may elect to transition to the new regime. While grandfathered, the rights and benefits conferred upon licensees under the previous Exempt Act are maintained.

AORE has chosen to be grandfathered under the provisions of the previous regime of the Exempt Insurance Act.

Management has determined that there are no other material subsequent events that would require disclosure in AORE's financial statements through this date.